

ONEONONE

A publication of the General Practice Section
of the New York State Bar Association



A Message from the Chair

I am excited to report that our Section recently reached the 200 new-members mark for 2007. Apparently, we are in an “expansion” mode and the timing of our expansion couldn’t be better.



Leadership Initiative—
Our Section is assuming the leadership of the Special Committee on Solo and Small Firm Practice. This new committee will give us a leadership role in shaping our Association’s future small firm and solo initiatives.

As a small firm practitioner in Nassau County, I often wonder why preliminary conferences require personal appearances (in the matrimonial area in Nassau County, not only personal appearances of attorneys are required, but personal appearances of our clients are mandated).¹

I recently learned that even Judge Kaye’s “Commission to Examine Solo and Small Firm Practice” has had the same response to the usual preliminary conference routines. Additionally, how often have you found yourself in a courtroom waiting several hours with clients for a quick 15-minute case status conference? Our committee will be addressing these practice anomalies with a commitment to propose alternatives that will be of benefit to both solo or small firm prac-

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tioners and, ultimately, our clients. Finally, wouldn't it be beyond all expectation if we were able to pay our filing fees, obtain Index Numbers, etc., electronically? Undoubtedly, this initiative could take a great deal of effort to accomplish. A fundamental part of that effort must be the organized voices of practitioners who cope with the daily repercussions of the present systems.

Collaborative Law Presentation—No one can dispute the fact that today, almost 50 percent of all marriages end in divorce. In the past, traditional divorce processes often meant costly transitions for the parties and their families. Now, however, the Collaborative Divorce process can be utilized by individuals who are committed to endings which will promote rather than destroy the parties' most important objectives. Whether you practice in the matrimonial area or are an attorney whose counsel is sought, it is important for solo and small firm practitioners to understand the real benefits of this new process.

As a matrimonial practitioner for the past 25 years, I have practiced in the traditional divorce arenas of litigation, negotiation and mediation. Now I am pleased to report that there is an exciting new development in the field of matrimonial law which is emotionally more humane and economically more rational than the traditional approaches to divorce. This new opportunity is called Collaborative Practice.

Actually, most of the country has already been introduced to Collaborative Divorce and this new settlement approach is fast becoming the "process of choice" for informed matrimonial clients. In New York, a select group of attorneys have been trained in this non-adversarial paradigm and these attorneys are making this process available to their clients. In the Collaborative process each client retains his or her own attorney who acts as advocate and advisor. This feature of the

process insures a degree of equality between the parties. The attorneys and parties are committed to settling all divorce issues without court intervention, which is done by mutualizing the parties' goals and interests. If the parties fail to accomplish a settlement, the attorneys must withdraw from future litigation between the parties. The Collaborative process also uses divorce coaches and child advocates who assist the group in creating the most advantageous strategies to promote their clients' and children's individual interests.

In my view, the best part of this new process is that the parties can control their outcomes. Throughout my years of practice, I have seen families destroyed by their "divorce animosity." Now, it seems that when parties work in the collaborative process, their animosities are converted to constructive communications, and their constructive communications lead to acceptable solutions.

Annual Meeting Program—Our annual program will feature a solid introduction to the lawyer's role in Collaborative Practice and the benefits it offers to our clients and their families. In addition, we will also include an update on Civil Practice matters, a slightly modified Hot Tips presentation, and updates and developments in environmental issues and real estate practice.

I look forward to greeting all of you on Tuesday, January 29th. Happy New Year to all.

Harriette M. Steinberg

Endnote

1. In all fairness, we should recognize that a few judges use this appearance as an opportunity to address the parties, but this practice is not the norm.

From the Editor

This is our final edition of *One on One* for 2007. It gives me the opportunity to thank all those who have contributed so generously their time and effort to these publications.

I would encourage all our readers and members of the General Practice Section to contribute to our publications in 2008, which inures to the benefit of all of our readers, as well as giving a sense of gratification to all our authors.

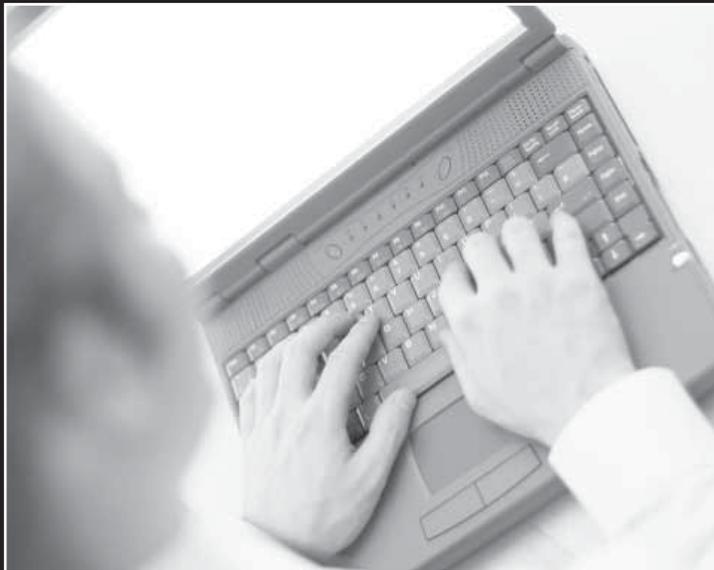


This year's final edition, in addition to our new articles, has borrowed from some of the writings during the year from our other State Bar publications, which we believe will be of interest to our members. I encourage members to let me know their thoughts and what areas we have not covered that they would have an interest in reading about and I will attempt to solicit coverage for the next edition.

Again, I take this opportunity to wish all of our readers a healthy and happy 2008 and hope that your holiday season was a wonderful one.

Martin Minkowitz

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The 21st Century Law Office: Business Continuity, Where Recovery Isn't an Option

By Jeffrey M. Alfano with Christopher P. Alfano and James L. Marciano

In the last 15 years advanced technology increased lawyer productivity and improved client services. However, while the technology that is used to practice may have changed, the ideals of the profession remain the same. In the face of substantial evolution in the profession there are still the *three basic truths*. First, billable hours are the lifeblood of any firm. Whether you are a member of 500-person firm toiling in high-rise offices on Wall Street, or you are a sole practitioner burning the midnight oil to satisfy your many clients' demands, the billable hour determines whether you can make your mortgage payments. Second, the practice of law is a knowledge-based profession. The idea that the legal profession is a knowledge-based profession goes beyond the years of schooling and testing necessary to hold oneself out as an attorney-at-law. Instead, it refers to the fact that the legal profession thrives on building and maintaining relationships with members of the community who know your competencies. Third, your success as an attorney, and in most cases your firm, is ultimately dependent on how well you serve your clients—whether your client is a multi-national corporation involved in a multi-billion dollar acquisition, or a young couple buying their first home.

The last 15 years can be considered a turning point in the practice of law. The Internet and the subsequent digital revolution changed the way lawyers and their offices looked. The view of a lawyer barely visible under a mountain of books with a secretary feverishly typing is a distant memory. It is almost impossible to envision a modern lawyer not talking to a client on a cell phone while reviewing e-mails on a BlackBerry. Clearly this is not your parents' law practice.

Document management software packages such as Abacus Law, Lexis' PC Law and Westlaw's ProLaw have changed the way law firms conduct knowledge management. Additionally, technology has revolutionized how firms capture their time and conduct their bookkeeping. Popular PC programs such as Lexis' Billing Matters and Sage's Timeslips can be found in even the smallest law firm. A firm could easily spend thousands of dollars on a state-of-the-art server housing applications that store seemingly infinite amounts of information—all of which is critical to the day-to-day business of practicing law. But in the event of a catastrophic incident, all of the benefits from technology will be for naught if proper procedures are not in place to protect this data.

Business Continuity vs. Disaster Recovery

How law firms react to an unforeseen disaster, whether it is a natural disaster such as Hurricane Katrina or the tragic events of September 11th, will often determine whether they can recover and remain profitable. This is especially true for small firms and sole practitioners. Their success or failure in the face of catastrophic events often turns on understanding the difference between disaster recovery and business continuity.

"The view of a lawyer barely visible under a mountain of books with a secretary feverishly typing is a distant memory. It is almost impossible to envision a modern lawyer not talking to a client on a cell phone while reviewing e-mails on a BlackBerry."

In the past, managers of commercial enterprises similar to law practices viewed preparation for disastrous events in terms of developing a plan to **react** to catastrophic incidents. This planning exercise is referred to as "**Disaster Recovery**." In formal terms, disaster recovery planning comprises developing a plan to get your enterprise operational in the wake of a catastrophic event.¹ Disaster recovery includes developing a plan that designates alternate physical space to relocate your operations, as well as retrieving any data or other knowledge materials that may have been destroyed or otherwise lost in the catastrophic occurrence.

Another school of thought growing out of disaster recovery planning is the concept of "**Business Continuity**." This school of thought takes a **proactive** approach to confronting unthinkable events. In the most basic terms, business continuity planning seeks to maintain mission-critical systems 100 percent of the time irrespective of any outside forces.² Business continuity plans are designed to prepare for catastrophic eventualities and allow your enterprise to operate through them without interruption.

While the disaster recovery methodology mitigates the losses felt by firms in trying times, numerous billable hours as well as communications with your clients are forced to be put on hold. In the digital world of

wi-fi and fiber optic networks, any slowdown in your enterprise can severely affect your bottom line. In the days and weeks following Hurricane Katrina, law firms with prepared disaster recovery plans waited for days and in some cases weeks to re-enter the city to retrieve the computer equipment containing their critical materials. And of course if those law offices did not survive the storm, or looters, neither did their data.³

In the 21st century digital information is critical to how lawyers practice law. Only *business continuity* planning provides practitioners the knowledge that they will be able to provide business-as-usual service to their clients. When disaster strikes, there are a host of concerns to address—such as filing insurance claims, ascertaining the safety of your workers, and locating temporary office space. Unlike many other businesses, the legal profession relies on personal relationships in order to thrive. Proprietors of small law offices typically live in the same community as their practice, side by side with their clients. During these trying times how your business reacts in serving the needs of its neighbors defines your relationship with the community. Practicing law in the face of personal disaster while guiding friends and family through it as well is trying enough; as a practitioner you have to ask yourself: Do you really want to worry about how you can access your data?

How You Back Up Your Data Matters

If your firm keeps tape, CD, DVD, or other mass storage backups of your firm's server you are already ahead of most law practices. Still, there are reasons to be concerned.

These traditional backup media are prone to failure. In the case of tape backups in particular, the mechanical parts break and the tape itself wears down. Additionally, these obsolete media leave too much room for human and system error. For example, employees forget to rotate the backup media or even perform the back up function.⁴ And of course it offers no protection against disgruntled employees who can help themselves to the data on their way out—these tapes are not secure from anyone, from your professional staff to your janitorial staff. The greatest of all the errors committed by individuals utilizing these traditional methods of system backup is that they store their backup media alongside or in the same office as the main system. This defeats the very purpose of backing up your critical data. Even in the cases where the backup media is moved offsite, it is generally stored in the legal professional's home. As is evident from the news coverage of various disasters, the worst catastrophes happen regionally.

In an attempt to remedy the shortcomings of traditional methods of data backup, numerous suppliers of

Internet backup technology have sprung up throughout cyberspace. These services allow users to upload their system's data to a secure drive at a remote site. While this method is more secure than the traditional backup media, it does not ensure *business continuity*.

First, in the event of a devastating event, a firm will need to take time to either purchase new hardware in the form of computers or hard drives. Second, the firm and its employees will need to spend valuable time uploading their stored data to their new hardware. Third, the firm will need to spend additional time reestablishing the applications necessary to run the firm. As you can see, even if your data is protected you are still using valuable time reestablishing your operation—time that would be better spent contacting clients to allay their concerns and service their needs.

The choice for law firms concerned with making the best use of their time, protecting mission-critical data, and serving their clients is to back up their servers with an online company utilizing the latest in remotely hosted server technology. Remotely hosted server technology picks up where Internet data backup leaves off. Where Internet data backup provides a “mirror” from which you can see a copy of your data in bits and bytes, remotely hosted server technology provides a “standby business.” It's like cutting over to auxiliary power—the lights may flicker for an instant, but they stay on. That's the experience you have with a remotely hosted server. With any other backup service the lights are off until the “power company” gets around to restoring it. The important difference between remotely hosted technology and ordinary Internet storage is that your firm's entire data infrastructure can be made live within 30 minutes or less, not three to five days.

A New York Attorney's Obligation to Preserve Documents

Business continuity, data preservation and document retention are intertwined in the modern practice of law. In New York attorneys are obligated under law to maintain bookkeeping records for a period of no less than seven years.⁵ In particular, the statute states:

[F]or the purposes of this subdivision, a lawyer may satisfy the requirements of maintaining copies by maintaining any of the following items: original records, photocopies, microfilm, optical imaging, and any other medium that preserves an image of the document that cannot be altered without detection.⁶

The applicable statute provides no safe harbor for those lawyers unable to meet the requirements laid out above due to catastrophe or computer failure. Instead the onus is on the individual attorney to take the necessary

steps to ensure that these documents are readily available.

The New York State Bar Association Committee on Professional Ethics interpreted this language on two occasions. First, in Opinion 680 the Committee stated “that those documents for which the Rule explicitly permits ‘copies’ to be retained may be stored in the form of computer images.”⁷ Second, in Opinion 752, the Committee broadened the scope of documents that may be stored as a computer image. Specifically, the Committee extended the use of computer imaging to cancelled checks and bank statements where the original documents are not returned to a lawyer in paper form. The Committee found that a “lawyer is not required to undertake extraordinary effort or incur extra expense to obtain these items in paper form.”⁸

As law offices move ever closer to a paperless environment the necessity for stable, secure and reliable access to data is essential.

Conclusion

Planning for the unthinkable is part of our job as lawyers. As professionals we have a duty to ourselves and our families to make the most out of the hours we spend working; we have a duty to protect our clients’ confidences; and, most importantly, we have a duty to provide reliable service to our clients. Investing in *business continuity* planning insures that attorneys are able to meet these minimum commitments. A firm should approach business continuity planning in the same way that it would approach carrying malpractice insurance—you never set out planning to use the service, but when it becomes necessary you are glad you have it.

Endnotes

1. Mike Ruetters, *Business Continuity for Global Enterprises: The Importance of Protecting and Managing Information Assets*, 27-FALL Fletcher F. World Aff. 279, 280 (2003).
2. *Id.*
3. Ernest Svenson, *Disaster Planning for Lawyers: Lessons from Katrina*, 49-MAY Advocate (Idaho) 10 (2006).
4. Joe Hartley and Wells Anderson, *Avert Disaster: Protect Your Practice With Online Backups*, 68 Tex. B.J. 910, 911 (2005).
5. N.Y. Comp. Codes R. & Regs. Tit. 22, § 1200.46(d).
6. *Id.*
7. N.Y. State Bar Assn. Comm. On Prof. Ethics, Opinion 680, (1996).
8. N.Y. State Bar Assn. Comm. On Prof. Ethics, Opinion 758, (2002).

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Large Deductibles and the Aggregate Trust Fund

By Walter B. Taylor

Over the past several months, insurance executives, carriers, brokers and employers have commented on the impact of the Workers' Compensation Law which became effective July 1, 2007. Throughout the industry, concern has focused on how the new legislation will help New York employers reduce their premium costs and increase the attractiveness of New York State as a place to do business.

This article will examine the impact of the new legislation on large deductible workers' compensation programs ("large deductible programs"), and the possible impact that the new requirements of the Aggregate Trust Fund ("Trust Fund") may have on employers in large deductible programs.

The new legislation requires that carriers deposit into the Trust Fund the present-value equivalent of awards established for permanent partial disability ("PPD") awards. If the initial deposit is insufficient to cover the award, the deposit must be increased by the carrier. However, should the deposit result in an over funding, the Trust Fund retains the over-funded portion of the deposit. Self-insureds and the New York State Insurance Fund are exempt from transfers of PPD awards to the Trust Fund.

Prior to the passage of the present Workers' Compensation Law, the predecessor Trust Fund, which was created pursuant to provisions of Section 27 of the New York Workers' Compensation Law, was authorized to oversee regular payment of benefits on death cases and certain permanent disability cases. However, in the predecessor Trust Fund, the portion of the transfers which resulted in an over funding was returned.

Employers enter large deductible programs with carriers to obtain reduced premiums in exchange for paying a portion of each claim. Like car insurance, the larger the deductible, the lower the premium. However, large deductible programs (which allow employers to self-insure a portion of each claim) are not structured like other premium programs. A deductible amount (typically as low as \$250,000 per claim) is agreed upon by both the employer and a carrier. The carrier charges a reinsurance premium (which includes its expenses) for its liability after the deductible has been met. To guarantee that the employers meet their obligations, the carriers require collateral (usually in the form of an irrevocable letter of credit) in an amount set by the carrier. This is similar to the security deposits that the Workers' Compensation Board requires (in addition to reinsurance) of self-insured groups and individual self-insureds.

However, whereas only one security deposit is established for self-insureds, employers in large deductible programs will guarantee payment twice since the carrier's transfers of PPD awards to the Trust Fund include the employer's "large deductible" portion, payment of which is guaranteed by the employer's letter of credit requirement.

"Throughout the [insurance] industry, concern has focused on how the new [workers' compensation] legislation will help New York employers reduce their premium costs and increase the attractiveness of New York State as a place to do business."

Employers self-insuring a portion of each claim through a large deductible program may have lost some of the economic advantages enjoyed by other employers who self-insured a portion of each claim as follows:

1. Employers in large deductible programs do not have the cash flow advantage of paying PPD awards over the lifetime of the claim since the employer's deductible will be included in the payment forwarded to the Trust Fund.
2. Employers lose the opportunity to invest their deductible portion which can offset the cost of each payment.
3. Employers will lose the financial advantage of self-insuring a portion of PPD awards since no portion of an over-funded award will be returned.
4. The transfer to the Trust Fund may result in the carrier requesting an increase in the collateral needed to guarantee payment on future claims.
5. Previously, reinsurance is paid after the employer's deductible payments. However, since the carrier is now required to transfer PPD awards to the Trust Fund, the time the carrier has to invest premiums is reduced, which may result in an increase in the employer's reinsurance premiums.
6. The entire PPD award (including over-funded portions) may be included in the calculation of the employers' experience modification factor.

This might result in employers in large deductible programs paying more in premiums.

Large deductible programs are not new to the marketplace. Safety National Casualty Company started writing large deductible workers' compensation programs in 1942. Many of the leading carriers provide this viable alternative for large employers seeking reduced premiums in exchange for higher deductibles.

The new legislation focused on reducing the impact of PPD awards on workers' compensation rates. Reducing lifetime benefits for PPD awards contributed to an overall 20 percent reduction in workers' compensation rates for all industry classification codes. The empha-

sis on rates, did take self-insureds into consideration. However, the transfer of PPD awards into the Trust Fund may have overlooked employers utilizing large deductible programs which in effect are also self-insurance programs. Hopefully, in future amendments, employers in large deductible programs will obtain some of the cost reductions provided other employers who self-insure a portion of each claim.

Walter B. Taylor is President of The Hamilton Wharton Group, Inc., which specializes in workers' compensation and manages a health care safety group in the State Fund.



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Consent to Settle Third-Party Actions

By Martin Minkowitz

When a workers' compensation claimant intends to settle his third-party action (negligence case), against a third party who caused the accident resulting in the injuries for which the workers' compensation benefits are being paid, the self-insured employer or workers' compensation carrier must consent. The claimant who is the plaintiff in the third-party action must obtain the written consent of the one paying the workers' compensation benefits, (the carrier or self-insured employer), or obtain an order on notice from the court which is approving the settlement. To fail to obtain the consent, or a court order, results in a statutory right given to the employer or carrier to stop paying workers' compensation benefits forever. This is based on the theory that the employer, or its carrier, are prejudiced because they were entitled to bring the third-party action¹ in order to recover the benefit payments made to the claimant under the Workers' Compensation Law.

If a case is settled for less than its real value, or is otherwise discontinued by the claimant without the consent of the person paying the benefits, that person can allege prejudice against their right to recover from the one who ultimately caused the injury. If the claimant discontinues an action with prejudice, that is obviously as final to the third-party action as a settlement with a release of the third-party defendant.

If a claimant who is pursuing the third-party action fails to properly proceed in that action, that omission or error may also be prejudicial to the workers' compensation payor. Therefore, if, for example, a plaintiff does not submit to an independent medical examination or does not permit discovery that is requested by the defendant, or fails to file opposition papers to a

motion for summary judgment, that plaintiff has acted in such a manner as may be determined prejudicial to the workers' compensation payor's rights. Clearly, if the defendant is successful because of the plaintiff's actions, or lack of action, and defeats the third-party claim, it could be construed as the equivalent of a voluntary discontinuance of the third-party action, which would be prejudicial to the workers' compensation payor. The payor's consent would have been required and without it, the plaintiff as a claimant in a workers' compensation case may lose all future rights to benefits under the Workers' Compensation Law.²

Plaintiff's counsel, in the third-party action, therefore, must be alert and understand the Workers' Compensation Law provisions because the detriment to the plaintiff can be very serious and can result in liability to the lawyer, if he or she fails to understand the importance or significance of the consent. It is no excuse that the attorney does not practice workers' compensation law, or was not retained to handle the workers' compensation case. While attempts to obtain a court order after the settlement, *nunc pro tunc*, have been attempted, most, although not all, have been unsuccessful.

Endnotes

1. WCL § 29.
2. See *Pier 1 Imports, Inc.* WCB Panel Decision 2007.

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Amendment to New York City Administrative Code Prohibits Discrimination on the Basis of Domestic Partnership Status

By Joan M. Gilbride and Yael J. Wepman

Over the past decade, recognition of domestic partnership status and the advancement of rights for domestic partners have gradually developed in the United States. On October 3, 2005, New York City's Mayor Michael Bloomberg signed into law the Local Civil Rights Restoration Act of 2005 amending the New York City Administrative Code to add "partnership status" to the list of protected classes under New York City's Human Rights Law.

The amendment defines "partnership status" to mean the status of being in a domestic partnership under the New York City Administrative Code. The Administrative Code defines a domestic partnership to exist when two people share "a close and committed personal relationship" and "live together and have been living together on a continuous basis." While domestic partners must generally register their partnerships with the New York City Clerk, the Administrative Code makes it clear that the City will recognize a marriage, domestic partnership or civil union lawfully entered into under the laws of another state.

As a result of this amendment, employers in New York City who have four or more employees are required to provide their employees' domestic partners with the same privileges that they provide to their employees' spouses.

Based upon the language of the amendment, it would appear that a New York City employer is legally obligated to amend its benefit plans to include "domestic partners." Although the amendment does affect employers' obligations under New York City Law, the amendment does not affect an employer's obligations under the federal Employee Retirement Income Security Act of 1974 ("ERISA"), which regulates private sector employee welfare and pension benefit plans, because ERISA preempts state laws related to most employee benefit plans.

ERISA protects married employees and their children; it does not protect the rights of employees with domestic partners. For instance, employers who choose to limit ERISA benefits to traditional opposite-sex spouses may do so, even in jurisdictions such as Massachusetts and Vermont, which recognize same-sex marriages or civil unions. To date, there have been no reported cases in which a private-sector employer was found to have a legal obligation to offer ERISA benefits to an employee's domestic partner.

Equality protections in the United States for sexual minorities range from the right of individual gays and lesbians to equal employment opportunities to same-sex couples' equal right to have their partnerships recognized legally. Approximately 60 cities in the United States have same-sex partnership registries, including New York, Los Angeles, San Francisco, Chicago, and Atlanta. Additional examples of equality protections for sexual minorities can be seen at the state level in California, Connecticut, Massachusetts and Vermont, which have enacted laws that extend many of the same legal rights of marriage to same-sex couples.

As more states and municipalities enact laws regarding same-sex relationships, it is important for employers and employees to keep abreast of these developments.

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The Importance of Due Diligence Investigations in Mergers and Acquisitions

By Wendy B. Davis

We are currently experiencing a merger frenzy, with businesses competing for the opportunity to acquire or merge with other businesses. This frenzy of activity is not exclusively in the multi-billion dollar transactions, like AOL and Time Warner or HCA, but also encompasses the smaller mid-market acquisitions. In this highly competitive market, it is easy to overlook the careful investigation that should preclude any acquisition decision. In a world designed by lawyers, acquiring corporations would carefully investigate all information pertaining to the business to be acquired before either party discussed the possibility of an acquisition. In the real world, many deals are struck, with signed letters of intent or term sheets, with buyers having only limited knowledge of the seller, often based on public information. In these cases, the buyer expects the lawyers, accountants, and other investigators to gather information to confirm the buyer's expectations of value and potential synergies as quickly as possible so the deal can be finalized.

Whether the investigation occurs before the preliminary handshake, or after the offering price and significant terms have already been agreed to, the buyer should use due diligence to investigate the company to be acquired before the deal is finalized and documented.¹ This investigatory process is similar regardless of whether the structure chosen is an asset purchase, stock acquisition, or merger, and the term 'seller,' is intended to indicate any target of such a transaction. Buyers who neglect this process, or who are less than diligent in their investigations, may hope to rely on the seller's representations and warranties. Courts have found such reliance to be unreasonable, and therefore denied a buyer's claim of harm as a result of a breach of those representations and warranties, where the buyer did not sufficiently investigate to discover the seller's problems.

I. The Purposes of a Due Diligence Investigation

The purposes of a due diligence investigation in an acquisition setting include:

1. To learn details that may be relevant to the drafting of the acquisition agreement, including the substance, extent, and limitations of representations and warranties and any relevant escrow or hold-back agreement for a breach of the same;
2. To evaluate the legal and financial risks of the transaction;

3. To confirm or evaluate the appropriate purchase price and the method of payment, including earn-outs;
4. To evaluate the condition of the physical plant and equipment;
5. To analyze any potential antitrust issues that may prohibit the proposed merger or acquisition; and
6. To discover liabilities or risks that may be deal-breakers.

II. The Scope of a Due Diligence Investigation

Many experienced buyers, and the attorneys who represent them, will use checklists to remind them of issues to review in their due diligence investigation. Sample checklists are available on-line, in most M&A treatises, and in the archives of law firms; however, the value of such forms is suspect. It is critical to customize any checklist to reflect the specific issues of each deal, and to think creatively rather than rely on a form. For example, one transaction was rolling along smoothly with the buyer in the final stages of a due diligence review, when a representative of the buyer did an Internet search of a key employee of the seller and learned the employee had changed his name several years ago. Although there was no evidence that the name change was for fraudulent purposes, there was sufficient suspicion that the venture capitalists financing the deal immediately backed out and the deal fell apart. Checklists should be only a starting point to your investigation. The following are some of the broad topics that should be reviewed.

A. Organizational Status

The buyer will need to confirm that the seller has filed all necessary documents of incorporation, as well as current annual reports, to ensure it is duly organized. Corporations that do business in more than one state will need to register to do business as a foreign corporation in each state in which they operate. The failure to register in each state may result in invalidity of contracts or penalties. The determination of what actions of the corporation will qualify as doing business in each state depends on the laws of each state, but owning real estate, maintaining an office, and employing local employees will require registration in most states.

The buyer will also want to confirm the identity of the officers and directors as well as their authority

to ensure that all transaction documents are properly executed and authorized. Minutes, notices, and votes of shareholder and director meetings should be reviewed to ensure appropriate approval of the intended transaction.

Any defensive measures adopted by the seller, such as shareholders' rights to purchase additional shares, or limitations on directors' terms or authority, should be investigated and evaluated for their impact on the intended transaction.

B. Contractual Obligations

The buyer should review all contractual obligations of the seller, including supplier agreements, joint venture agreements, leases, employment agreements, and financial obligations. The buyer will need to determine which contractual obligations it will assume, and whether the proposed sale to the buyer will result in a default or other consequences under any contract, based on change-in-control provisions. Exclusive dealing arrangements will need to be analyzed to disclose any conflicts with the buyer's existing contracts. Accounts payable to vendors, as well as debts owed to banks and others, should be confirmed and considered in any calculations of value of the acquisition.

C. Labor

The buyer may want to retain key employees of the seller, either temporarily to facilitate the change in control or to continue as long-term employees. Employment contracts with such employees should be reviewed to determine obligations for salary, bonuses, and benefits, and whether the sale will trigger any additional compensation, as well as covenants not to compete, should the employees decide to leave. Union contracts should also be reviewed, as well as grievance logs or complaints.

The status of any non-citizen employees should be reviewed. Visas and other immigration permits are often dependent on an employer/sponsor, and if the name or identity of the employer will be different after the merger, this may have significant consequences for the employee. If the U.S. Citizenship and Immigration Services (USCIS) determine that a visa has become invalid as the result of a merger, a key employee may be prohibited from re-entering the country. Even more damaging, if an employee whose visa has been invalidated has traveled outside the U.S. and returned without informing the USCIS of the change in status, she may be deemed to have committed entry fraud, which is a lifetime bar from ever entering the U.S.²

Criminal background checks and employment histories of the key employees, founders, and officers should be considered. An Internet search may also be revealing.

D. Insurance

Insurance contracts should be reviewed for sufficiency of coverage, conflicts with buyer's insurance agreements, and compliance by seller. Insurers should be notified of the change of ownership.

E. Tax

Tax returns for several prior years should be reviewed, and the IRS and local taxing authorities should confirm payment of all taxes owed, including payroll, excise, real estate, and income.

F. Accounting

In 2002, Congress enacted the Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002), 15 U.S.C. § 78 *et seq.* (2000). This act requires the managers of publicly owned corporations to certify that the financial statements of the corporation fairly represent the financial affairs of the corporation. As soon as the acquisition is completed, the managers of the buyer must make these representations as to the seller. The buyer must be certain that the seller, who may be a non-publicly traded corporation and therefore exempt from compliance with Sarbanes-Oxley, has used proper accounting standards in preparing accurate and complete financial statements. Many sellers are hesitant to represent such compliance to the buyer, because their accounting practices may not be as detailed or rigorous as required, and in fact this may be one reason the seller has chosen to sell rather than go through the process of an initial public offering to become publicly traded.

G. Employee Benefits

Employee benefits such as retirement and disability plans should be reviewed to determine compliance with IRS regulations. Funding of such benefits should be reviewed by experts. The buyer will want to know if any benefits or compensation will be triggered by the proposed sale. The impact of the transaction on any employee stock option plan (ESOP) should be evaluated.

H. Litigation

Outstanding lawsuits should be reviewed to determine potential liability that may be assumed by the buyer, as well as threatened litigation. Consider the case of Bristol-Myers acquiring Medical Engineering Corporation (MEC) in 1982. MEC manufactured silicone breast implants which had not been FDA approved. Such approval was not required, because the U.S. Food and Drug Administration (FDA) provided that implants could be sold without approval, but safety and effectiveness data could be required at some unspecified future date.³ When the FDA demanded the data in 1988, the FDA deemed the data submitted by Bristol-Myers and other implant manufacturers to be

inadequate and called for a voluntary moratorium on the sale of the implants. Even though the FDA never stated that the implants were not safe, but merely that the information relating to their safety was inadequate, a panic was caused by the announcement, resulting in a flood of lawsuits. The cases against Bristol-Myers, Dow Corning, 3M, and other manufacturers of breast implants resulted in a \$4.25 billion settlement.⁴ Predicting potential liability can be challenging. Although Bristol-Myers may have conducted an extensive due diligence review, and MEC was not lacking any required approvals, the results were devastating. A more thorough review should have revealed the potential for a future demand by the FDA for statistics, as well as MEC's lack of preparedness for such a demand.

I. Environmental Liability

Hazardous waste site assessments may be appropriate for all real estate owned or occupied by the seller. Because the contaminator may be liable for clean-up costs even after the property is sold, buyers may also need to assess properties that have been sold by the seller. Buyers may be liable for clean-up costs as operators or owners of the acquired real estate.

J. Valuation of Acquisition

Financial projections, which are the only reasonable indicator of the worth of the acquisition to the buyer, are merely an educated guess as to future performance. The buyer will need to study the market and customer base of the seller and predict the influence of the transaction on those customers. Customers of the seller should be contacted to determine any quality control issues or other product inadequacies, as well as to verify accounts receivable. Competitors should also be considered, to determine how the seller performs relative to the competition and the competitors' future predictions regarding the market.

K. Antitrust

If either the buyer or seller has a significant market share or few competitors, the Hart Scott Rodino Act, 15 U.S.C. § 18a, may require an advance notice of the merger to be sent to the Federal Trade Commission. If the industry is heavily regulated, then the regulating authority may require notification or approval, for example the Federal Communications Commission, Federal Aviation Administration, or Food and Drug Administration.

L. Foreign Regulations

Many U.S. companies are acquiring businesses in China, Brazil, and other emerging economies. Foreign laws will need to be analyzed early in the process to determine the permissibility of the transaction, and in more depth to determine any additional consequences of the transaction.

M. Intellectual Property

All patents, copyrights, trademarks and trade secrets owned by the seller will need to be identified and cataloged. The level of review will of course depend on the value assigned by the buyer to such assets. If the buyer's primary purpose in making this acquisition is to acquire a key product to enhance its product line, then the patent or copyright protecting rights in that product will become much more important. The buyer will need to ensure that the patent is owned by the seller corporation, and that the employee who invented or created the product is not claiming individual rights. Any licensing of the patent will need to be reviewed. The claims of the patent will determine exactly what rights the company has to exclude others from manufacturing or marketing similar products. If the patent was not artfully drafted in the first place, a buyer may find that his most valuable asset is worthless because competitors can reverse-engineer or work around it.

N. Document Retention

The buyer will need to learn the location of all documents, including financial and tax records, human resources records, and government compliance evidence. The buyer will need to be satisfied that the seller has retained adequate records for an appropriate period of time to meet the standards set forth in relevant federal and state regulations, as well as to comply with the buyer's internal policies.

III. Problems Encountered with Less-Than-Diligent Review

If the purchaser decides to abbreviate the due diligence process, or to consummate the deal notwithstanding a lack of information, courts are not likely to come to its rescue when problems are discovered after the closing. In a recent District of Maryland case,⁵ the court denied recovery to a buyer who alleged fraud and misrepresentation by a seller. The buyer paid \$2 million for the stock of a candy cane manufacturer, following a 21-day due diligence review. The buyer did not receive all of the information it requested in its due diligence checklist, but decided to close notwithstanding this lack. The buyer alleged reliance on projections of future income prepared by the seller. After the closing, the buyer discovered that the seller was not as valuable as the buyer had hoped, in part because numerous liabilities were not disclosed, including a failure to fully fund employees' 401Ks and unpaid unemployment taxes. The court found that the buyer could have discovered these liabilities and did not have a right to rely on income predictions made by the seller, as such were mere puffery. The buyer assessed the risk associated with the deal and made a calculated decision about the level of due diligence it wanted to conduct prior to closing the merger transaction.

Courts are not sympathetic to buyers who complete acquisitions without adequate due diligence, denying recovery to “sophisticated businessmen” who make “errors in judgment.”⁶ In a 1995 Southern District of New York case, the court denied recovery for fraud⁷ alleged by the purchaser in a \$400 million deal, where the purchaser had agreed to a due diligence period limited to 17 days, even though the seller’s key personnel made themselves unavailable for much of the 17-day period.⁸ The court found that the buyer had waived its right to terminate the agreement based on the results of its investigation, and therefore could not complain that it reasonably relied on the seller’s representations as to projected future income which did not materialize. The court did not make a determination as to recklessness, instead analyzing the buyer’s actions as lacking reasonable reliance.

Although most courts now agree that the buyer’s reckless conduct, rather than simple negligence, will preclude a buyer’s recovery for a seller’s fraudulent failure to disclose, recent decisions have denied recovery based on a finding that the buyer’s reliance on the seller’s statements or projections was not reasonable, because the buyer was given the opportunity to discover the accurate information.

Sellers should exercise caution where puffery is concerned. A District of Kansas court found that statements could amount to fraud where the statements were made by an insider and related to actual past or present facts and not merely predictions, and where such statements resulted in an increase in the market price of the security purchased.⁹ The court was considering the 1999 proposed acquisition of Sprint by WorldCom for \$129 billion. The merger eventually was blocked by the Department of Justice because of anti-trust concerns. Buyers considering an acquisition should be skeptical and tenacious in their investigations of the seller and the seller’s business. Sellers should avoid making unrealistic predictions as to future profits, and exercise caution in their promises to potential buyers. Careful drafting of the agreement, including disclaimers, representations, warranties, and remedies, will benefit both parties.

IV. Conclusion

Companies that are planning an acquisition or merger should plan to devote sufficient time and resources to discover potential problems with the seller. A failure to carefully review may result in a determination that the buyer is not reasonable in relying on the statements of the seller, and the buyer may be precluded from bringing an action against the seller if fraud is discovered after the sale is consummated.

Endnotes

1. The term “due diligence” originated in the Securities Act of 1933, 15 U.S.C. § 77k, in reference to the duties of a director to make disclosures in public offerings.
2. See Mark Ivener, *Stopped at the Border*, HR MAGAZINE, Vol. 51, No. 6, June 2006.
3. 21 U.S.C. § 360(c); see also William M. Brown, “Grandfathering Can Seriously Damage Your Wealth: Due Diligence in Mergers and Acquisitions of Medical Device Companies,” 36 Gonz. L. Rev. 315 (2000-2001).
4. William M. Brown, *supra* note 3, at 324.
5. *Sherwood Brands, Inc. v. Levie*, 2006 WL 827371 (D. Md. 2006).
6. *Manufacturers Hanover Trust Co. v. Drysdale Sec. Corp.*, 801 F.2d 13 (2d Cir. 1986); *Harsco Corp. v. Bowden*, 1995 WL 152523 at *7 (S.D.N.Y. 1995); *Silva Run Worldwide Ltd. v. Gaming Lottery Corp.*, 1998 WL 167330 (S.D.N.Y. 1998) (“Having agreed in writing that it had only relied on publicly available information . . . , and its own investigation of these companies, in deciding to participate in these offerings, plaintiff, run by sophisticated investors involved in a multimillion deal, cannot now, faced with an investment gone bad, claim that it relied on material misrepresentations and omissions as to material facts by [the seller].”).
7. Based on the antifraud provisions of the Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).
8. *Harsco*, 1995 WL 152523 at *7.
9. *In re Sprint Corporation Securities Litigation*, 232 F. Supp. 2d 1193, 1216-1217 (D. Kan. 2002).

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Sentencing Reform: A Modest Proposal for a Simplified Code

By Paul Shechtman

As has been widely reported, Governor Eliot Spitzer has established a Sentencing Commission to review New York's sentencing laws. One goal of the Commission should be simplification. As Justice William Donnino has written, "the sentencing statutes have become a labyrinth not easily traversed by even the most experienced practitioner of the criminal law." Those words were written in 1995, and the law has grown even more byzantine in recent years. (As the State's Director of Criminal Justice from 1995 to 1997, I bear responsibility for some of the growth.) This article is a modest proposal for reform.

When the Penal Law became effective in 1967, there were five classes of felonies—A through E—and all imprisonment sentences were indeterminate. There were no violent felonies (that classification was added in 1978), and the only recidivist provision was what is now the persistent felony offender provision for three-time offenders (§ 70.10). What we now have is a crazy quilt: indeterminate sentences for first non-violent, non-drug, non-sex felony offenders (§ 70.00); determinate sentences for most first violent felony offenders; stiffer determinate sentences for second felony offenders whose present offense is a violent felony and whose predicate offense is a non-violent felony (§ 70.06(6)); still stiffer determinate sentences for violent felony offenders whose predicate offense is a violent felony (§ 70.04); even stiffer, mostly determinate sentences for second child sexual assault felony offenders (§ 70.07); a separate indeterminate sentencing provision for certain violent offenders whose crimes are the product of domestic violence (§ 60.12); indeterminate sentences for second non-violent, non-drug, non-sex felony offenders (§ 70.06(3)); a separate sentencing scheme for felony drug offenders in which all sentences are determinate and their length turns on whether the offender has no prior felonies, a prior non-violent felony, or a prior violent felony (§§ 70.70 & 70.71); determinate sentences for "non-violent" sex offenders (§ 70.80); a separate sentencing scheme for hate crimes (§ 485.10); and two persistent felony offender provisions, one for three-time (or more) violent felons (§ 70.08) and one for all other persistent offenders (§ 70.10). And to add to the complexity there are exceptions to most rules: the authorized maximum sentence for a class E non-violent, non-drug felony offense for a second felony offender is an indeterminate term of 2 to 4 years' imprisonment, except if the crime is harassment of a correctional employee by an inmate in which event the maximum is 2½ to 5 years.

Where to begin if simplification is a goal? The first question one might ask is whether it makes sense to have both determinate sentences (e.g., 5 years) and indeterminate sentences (e.g., 2 to 6 years) in the same code. Indeterminate sentencing was premised on a "medical model" of sentencing, in which parole authorities were seen as better situated to determine if a defendant had been rehabilitated and therefore should be released. Our faith in rehabilitation (and in parole authorities) has waned since 1967, and with it has gone a preference for indeterminate sentencing. In 1995, determinate sentences were authorized for second felony offenders facing sentencing for violent offenses, and since then determinate sentencing has spread like Topsy. Now, only sentences for class A felonies, for non-violent, non-drug offenders and for some second child assault offenders remain indeterminate. The critical question then is this: is there a sound sentencing philosophy that would have indeterminate sentencing for grand larceny and bribery and determinate sentencing for kidnapping and drug distribution? If the answer is "no," as I suspect it is, then New York should move to a fully determinate scheme. (I will come back later to the issue of sentences for murder, terrorism, recidivist sex offenders and persistent offenders.)

The second step toward simplification begins with the realization that we now have 10 categories of felony offenses—A-I, A-II, violent B, non-violent B, violent C, non-violent C, etc. Thus, for example, Robbery in the Second Degree is a violent C, and Grand Larceny in the First Degree is a non-violent B. Ten categories is too many. A modest revision would be to reduce the number of categories to six by eliminating the violent felony classification. If Robbery in the Second Degree should be treated the same for sentencing purposes as Grand Larceny in the First Degree, then both should be denominated as Class B felonies.

Which brings me to a revised sentencing chart. For first-time felony offenders, the authorized sentences might look as follows:

First-Time Felony Offenders

	Shortest Term	Longest Term
Class A-II	5	20
Class B	3	15
Class C	1½*	10
Class D	1½*	7
Class E	1½*	4

*Probation sentences and definite sentences would be available for Class C through E felonies.

It bears note that to achieve sentences for drug offenses comparable to those under the 2004 reforms, most drug offenses would have to be reclassified as class D and E felonies. That is not a bad result. Selling drugs on a street corner is not the moral equivalent of rape and hence should not be designated a class B felony. Moreover, at present the A-II category is limited to certain drug crimes and a few sex offenses. The idea would be to elevate what are now B violent felonies to A-II status as part of the elimination of the violent felony classification. That would make the sentencing range for Robbery in the First Degree 5 to 20 years, much as it is under existing law.

For second felony offenders, the chart might look like this:

Instant Offense	Prior Offense	Shortest Term	Longest Term
Class A-II	Any class	8	25
Class B	B, C	7½	20
Class B	D, E	6	17½
Class C	A-I, A-II, B, C	5	15
Class C	D, E	3½	12
Class D	Any class	2½	7
Class E	Any class	1½	5

That leaves the question of sentences for murder, terrorism, repeat sex offenders, and persistent offenders. For those crimes (which would be A-I felonies), there is a compelling argument for indeterminate sentencing with a parole authority determining whether release from incarceration is appropriate. Taking a human life could warrant life in prison, but rehabilitation or old age may militate in favor of release. A provision that makes the punishment for murder 15 years to life to 25 years to life (and treats terrorists, repeat sex offenders, and persistent offenders presumptively the same as murderers) has much to commend it. (There would still be a sentence of life without parole for aggravated murder as defined in Penal Law § 125.27.)

Two more points: The sentence for a first violent felony offender is now a determinate term of between 2 to 7 years for a class D felony, but 2 to 8 years if the

class D felony is menacing a police officer. (That is a result of the Crimes Against Police Act of 2005.) Similarly, the sentence for a class B felony for a first felony drug offender is a determinate term of between 1 to 9 years, but 2 to 9 if the sale occurs near a school ground. These subtle differences may make for good politics, but they needlessly complicate New York's sentencing law. If a crime warrants a stiffer sentence, it should be elevated to a higher felony class. That principle is the Occam's razor of sentencing reform.

Finally, the Sentencing Commission should give consideration to eliminating the plea bargaining restrictions that have proliferated since the Penal Law was enacted. Under current law, for example, where an indictment charges a class B violent felony offense which is also an armed felony offense, a plea must be to a class C violent felony offense. These restrictions can be circumvented by negotiating a deal pre-indictment or in other creative ways. A rule requiring a prosecutor to explain on the record her reasons for agreeing to a disposition that is two or more classes below the top charge (e.g., from a class B to a class D felony) seems far preferable to one that precludes such a disposition from occurring when it is warranted.

I have no doubt that experienced practitioners can find fault in the scheme advanced above. It is put forward as a starting point for discussion and nothing more. Simplification should not be the only goal of sentencing reform, but it is surely an estimable one given the labyrinthine complexity of current law.

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The Marriage Toll: Prenuptial Agreements and the Tolling of the Statute of Limitations

By Elliott Scheinberg

Public Policy and Agreements

Albeit a slow churning process, public policy, as voiced by the legislature and the judiciary, is often a barometer that paces and marks legal evolution and forward thinking in society either by mirroring fluxes in principles, values, and mores,¹ clinging to time-honored societal tenets, or by adamantly declining to shed antiquated notions and perceptions. A collision of public policies makes for exciting decisions especially when one involves concerns over contractual enforcement between private parties.

In general, strong public policy favors individuals ordering and deciding their own interests through contractual arrangements, including prenuptial and postnuptial agreements.² The corollary to this principle is that policy interests favoring settlements are furthered only if settlements are routinely enforced rather than morphing into portals to litigation.³ The usual and most important function of a court is to maintain and enforce contracts than to enable parties thereto to escape from their obligation on the pretext of public policy, unless it clearly appears that they contravene public right or the public welfare.⁴

However, the power to contract is not unlimited. While, as a general rule, there is the utmost freedom of action in this regard, some restrictions are placed upon the right by legislation, by public policy, and by the nature of things; parties cannot make a binding contract in violation of law or of public policy.⁵ A court must balance the weight of the public policy at issue, and the extent to which enforcement of a contract possibly undermines that policy, against the public interest in seeing private agreements enforced.⁶

In *New England Mut. Life Insurance Co. v. Caruso*,⁷ the Court of Appeals emphasized the governing principle when issues implicate or touch on public policy concerns:

Generally, parties may contract as they wish and the courts will enforce their agreements without passing on the substance of them. Their promises are unenforceable only when statute or public policy dictates that the interest in freedom to contract is outweighed by an overriding interest of society. Courts refuse to enforce contracts in such cases because they wish to discourage undesirable conduct by

the parties or others and to avoid use of the judicial process to give effect to an unsavory transaction. Freedom of contract itself is deeply rooted in public policy, however, and therefore a decision to refrain from enforcing a particular agreement depends upon a balancing of the policy considerations against enforcement and those favoring the encouragement of transactions freely entered into by the parties.

Clash of Policies: Marriage v. Statute of Limitations

Not surprisingly, the Court of Appeals has observed that “notably, in matrimonial cases, public policy considerations abound.”⁸ What is, therefore, the result when public policy favoring agreements between parties clashes with a statute of limitations? Tapering this question a bit, what if the agreement is a prenuptial agreement? Assume that a party dissatisfied with a prenuptial agreement challenges the agreement at the time of divorce after the six-year statute of limitations to rescind an agreement (CPLR 213(1)) has expired (rescission is an equitable remedy with a six-year statute of limitations⁹).

There are two premises at odds. The first, although freedom of contract is deeply rooted in public policy,¹⁰ it is settled law that an agreement between two private parties, no matter how explicit, cannot change the public policy of this State,¹¹ so that parties may not enter into agreements that require or lead to the termination of a marriage.¹² The second premise is that the legislature did not toll the statute of limitations for challenging prenuptial agreements during the tenure of the marriage. The inquiry does not end here. The potential consequences arising from these suddenly dueling policies must be further refined: Can regulations governing contractual enforcement mandate an outcome, which outcome would have been unquestionably void as against public policy, had the outcome been drafted as a substantive provision of the agreement by the parties themselves? Framed differently, can compliance with a statute be enforced in a manner such that the very outcome prohibited by public policy, the breakdown of a marriage, becomes a necessary by-product of the enforcement? Does our jurisprudence sustain an act of violence against public policy indirectly, which act would have been interdicted had it been done

directly, a back door assault versus a front door assault?¹³ Distilled into different language still, does strict compliance with a statute, the statute of limitations, supersede public policy even if such enforcement will undeniably extirpate marriages, ergo, a consequence void as against public policy due to the time-honored policy that the law fosters and preserves marriages (discussed below)?¹⁴

This is precisely the dilemma confronted by a spouse who has signed a prenuptial agreement and, depending on the county of residence, may have no choice but to initiate litigation to challenge the agreement during the course of a harmonious marriage prior to the expiration of the limitations period and risk certain disintegration of the marriage, or abandon the right to challenge the agreement once the statutory period has expired. In essence, enforcement of the CPLR potentially leads to the impermissible end that a contract between parties could never have accomplished had it been their intention to do so.

In essence, may the judiciary save the day by creating a tolling feature where none exists in the statutory scheme to foster the state's strong position favoring the preservation of marriage? Or must a disgruntled spouse do combat in a judicial arena prior to the expiration of the statutory period during the height of a viable marriage or be relegated to a permanent forfeiture of her rights to challenge the agreement?

Answer: departmental schism. The First Department, standing on public policy, firmly stands on the principle that marriage tolls the limitations period because it is in contravention of public policy to foment dissension and compel litigation amongst spouses, that litigation not be required until such time that the marriage has broken down with nothing left to preserve or salvage.

The Second Department insists that absent a legislative exception to the statute, courts are not free to carve out their own brand of exceptions. Thus, in the Second Department, a spouse dissatisfied with a prenuptial agreement must initiate litigation within the six-year period from its execution, irrespective of how happily married, or forever surrender the right to contest the agreement.

The First Department: *Lieberman, Zuch*

In *Lieberman v. Lieberman*,¹⁵ a decision emanating from Supreme Court, New York County, the husband cross-moved, *inter alia*, for partial summary judgment to dismiss the wife's counterclaim seeking a judgment which rescinds and vacates in its entirety the parties' premarital agreement. The husband argued that an action for rescission of a prenuptial agreement is an

equitable remedy¹⁶ which is controlled by a six-year statute of limitations (CPLR 213(1)).

Noting settled state policy to protect marriages,¹⁷ *Lieberman* held that public policy required the tolling of the statute as between spouses. To hold otherwise, *Lieberman* reasoned, would be repugnant to public policy, which fosters the preservation of marriage because lawsuits between spouses are not favored. A contrary ruling would have compelled Mrs. Lieberman to review and challenge the premarital agreement while the parties were still living together as husband and wife in an ongoing marital relationship and before their child was even three years old. Such a requirement would encourage lawsuits between spouses, dissension, and likely destruction of marriages rather than enhance marital relationships.

Lieberman reviewed New York's traditional recognition that pre- and postmarital agreements must be viewed differently from other types of contracts in which the parties are strangers to each other; the rules appropriate to commercial agreements cannot be strictly applied to spouses. *Lieberman* observed that during the course of a continuing marital relationship, and most likely more than six years down the road, it is conceivable that the parties would change their agreement, as often happens with testamentary dispositions. A surviving spouse's challenge to a premarital agreement and right to claim under a deceased spouse's estate or to abrogate a waiver of a statutory right of election (EPTL 5-1.1) are routinely entertained by the courts whatever the length of the marriage, it being doubtful that any such claims would otherwise have matured during the deceased spouse's lifetime. It would be illogical that the "event of divorce" clause and "the event of death" clause in the very same premarital agreement should be controlled by different statutes of limitation:

In the face of such long standing and strong policy considerations, it would be anomalous to say that, irrespective of whether the marriage relationship is viable and continuing, the husband and wife must review their premarital agreement and assume adversarial positions with respect thereto within the first six years of their marriage or forever lose their right to challenge the agreement. Indeed, during the course of a continuing marital relationship, and most likely more than a mere six years down the road, it is conceivable that the parties would change their agreement, as often happens with testamentary dispositions.

It would appear that the public policy of this state demands that the six-year statute of limitations applicable to challenges to premarital agreements be tolled until the parties physically separate or until an action for divorce or separation is commenced, or upon the death of one of the parties. This is consistent with the view of a majority of the states. As set forth in 3 Lindey, supra, section 90.16, p. 90-125: “Whatever statute [of limitations] may be applicable in a particular jurisdiction, the general rule is that the statute is tolled during the parties’ marriage, as suits between spouses are not favored.” See, also, 54 C.J.S., Limitations of Actions, section 111, p. 149. Similarly, section 8 of the UPA, which has been substantially adopted in 18 states, provides: “Any statute of limitations applicable to an action asserting a claim for relief under a premarital agreement is tolled during the marriage of the parties to the agreement. However, equitable defenses limiting the time for enforcement, including laches and estoppel, are available to either party.”

Lieberman cited *Zuch v. Zuch*¹⁸ wherein the First Department rejected a six-year statute of limitations in an action for a constructive trust between spouses because such a holding “would require a spouse to take affirmative action to preserve claims to potential marital assets even before there had been any hint of marital discord” or risk being barred by the statute of limitations. *Zuch* stated that such a ruling “flies in the face of logic and would be against public policy because it would critically undermine the underlying purpose of the equitable distribution statute and the vitality of marriages generally.” The First Department could not tolerate or fathom a conclusion that would create such an intolerable result, especially as to marriages of long duration, where marital property had been acquired and placed in the name of one spouse, which would undermine the underlying purpose of the equitable distribution statute and the vitality of marriages generally. In essence, the First Department views a prenuptial agreement as a fail-safe against protracted and bitter litigation wherein the parties, in advance of their marriage, predetermine the conclusion. The First Department finds the logic defeating in compelling the parties to resort to the fail-safe at a time when nothing is going awry.

Although reversed by the Court of Appeals on other grounds, the Appellate Division, First Department,

in *Bloomfield v. Bloomfield*,¹⁹ reaffirmed the philosophical initiative and direction set forth in *Lieberman* and *Zuch*.

Second Department: No Exception to the Limitations Period

The Second Department strictly adheres to the statute and rejects an automatic tolling of the statute of limitations even during the viability of a marriage and the likely consequences of statutorily impelled litigation. *Pacchiana v. Pacchiana*²⁰ held that, absent continuing duress which tolls the six-year statute of limitations, a contract induced by duress or undue influence is voidable and the right to rescind accrues upon the execution of the contract; a cause of action to rescind the provisions of a marital agreement must be commenced within six years of the execution of the agreement.²¹ *Pacchiana* rejected the notion that an antenuptial agreement remains executory until the death of either spouse and that no cause of action to void it can accrue until then.²²

Zipes v. Zipes: Difference Between Pre- and Postnuptial Agreements

In *Zipes v. Zipes*²³ the wife counterclaimed to have two postnuptial agreements declared null and void. In holding the wife to the six-year statute of limitations, *Zipes* cleverly anchored its ruling on a “critically distinctive factor” between itself and *Lieberman*, to wit, that, even according to the wife, the *Zipes* marriage had ceased to be viable from well before the time the agreement was executed and continuing on until the time of the action. *Zipes* emphasized that the wife had been represented by counsel at each and every stage of the negotiations. The various agreements were signed precisely because this had been a troubled marriage. Accordingly, it could not be said that the statute of limitations was ever tolled in this case, and she could not hide behind the defense of the viability of the marriage:

It would be wrong to hold that the Wife is permitted to take advantage of the Husband by knowingly agreeing to a property distribution which she believed was invalid at the time she signed it, a time when she was represented by counsel . . . By signing each of the agreements, the Wife represented to the Husband that each agreement was acceptable to her. Permitting her to knowingly enter into the agreement and now, more than eight years later, claim that the agreement was invalid, would itself be unconscionable under the circumstances of this case.

Although the *Zipes* distinction is very appealing, we will see, below, that the Court of Appeals is reluctant to sound the death knell even for marriages involving stormy separations.

In *Freiman v. Freiman*,²⁴ on the night before the wedding, the parties executed a prenuptial agreement which had been negotiated by their respective attorneys. The wife contended that she felt undue pressure to execute the agreement since the plaintiff insisted on its execution prior to the wedding. She further complained that the husband never provided her with the necessary documents relating to his financial status, and contends that it was not until later that she became aware that the husband possessed in excess of \$10 million in assets and earned more than \$600,000 per year notwithstanding the fact that they filed joint tax returns across many years. She further claimed that had she known this prior to the execution of the prenuptial agreement, she would never have agreed to accept the paltry sums afforded to her under the agreement.

The Court dismissed the wife's various counterclaims to set aside the prenuptial agreement on the ground that they were barred by the six-year statute of limitations. The Court, however, distinguished between a general claim that the prenuptial agreement was unconscionable in its entirety and the claim that the spousal maintenance provisions alone are unconscionable. Overall unconscionability as to any property distribution contained in the agreement is governed by the six-year time limitation for equitable causes of action encompassed by CPLR 213(1). Unconscionability is not barred by any durational limitation when it relates to spousal maintenance provisions in the agreement because it is governed under DRL § 236B(3), to wit, that the amount and duration of maintenance must be fair at the time made and not be unconscionable at the time and entry of final judgment. Consequently, the maintenance provisions in the parties' prenuptial agreement were deemed not to be time-barred and reviewable for their conscionability at any time prior to the entry of final judgment, even if that date is well beyond six years after the execution of agreement.

Freiman noted the modern trend, expressed in Section 8 of the Uniform Premarital Agreement Act (9B ULA 379), and adopted by at least 18 states other than New York, that the statute of limitations on a spouse's cause of action challenging the validity of any aspect of an antenuptial agreement is tolled during the marriage and does not begin to run until one party physically separates from the other, or commences an action for divorce or separation, or dies.

Freiman distinguished the Court of Appeals pronouncements in *Scheuer v. Scheuer*²⁵ and *Dunning v. Dunning*,²⁶ which rejected the broad proposition that marriage tolls any statute of limitation pertaining to a

cause of action one spouse may have against the other, on the grounds that those cases were decided 25-30 years prior to the enactment of DRL § 236B(3).

In *Dubovsky v. Dubovsky*,²⁷ the wife's complaint asserted three causes of action sounding in negligence, fraud, battery and misrepresentation, seeking compensatory damages based on her having contracted HPV from her husband. The husband asserted the defense of statute of limitations. The wife contended that her action was tolled during the marriage; that absent such a "marriage toll," she would be compelled by law to seek redress for her injuries at the cost of the destruction of the marital relationship. Although the Supreme Court agreed with such reasoning as prevalent in the First Department, it was constrained to follow governing law in the Second Department, which strictly enforces the six-year limitations period.

Dubovsky found further support within the statutory scheme that neither public policy nor any relevant statute or precedent tolled the statutes of limitations as evidenced by the statutes of limitations provisions in DRL §§ 140(e), 171(3), and 210. These statutes of limitations do not express a public policy determination that a spouse's claim against his or her spouse is tolled to protect a marriage until such time as the marriage is no longer viable. Rather, the clear legislative intent underlying the enactment of the statutes of limitations in the Domestic Relations Law was to implement the long-standing public policy which disfavors the granting of matrimonial relief on grounds which have been acquiesced in by the parties for years relating to "offenses" which are presumed by law to have been pardoned.²⁸

In *Garguilio v. Garguilio*,²⁹ the Second Department held that the wife's contention that the agreement was invalid based upon the husband's fraudulent inducement was time-barred under both CPLR 213(8) and CPLR 203(g). The Appellate Division found that there was no question that the wife had ample opportunity years before to discover the husband's alleged fraud in inducing her to execute an "inequitable" agreement 17 years earlier. The court also rejected her claim that the husband waived the statute of limitations defense by not asserting it in earlier reply papers.

*In re Neidich*³⁰ involved an SCPA 1421 proceeding wherein the wife sought to assert her right of election regarding the decedent's estate, on the ground that her waiver of her right of election in the prenuptial agreement was void by reason of fraud, undue influence, and overreaching. The Appellate Division applied the various limitations periods and concluded that she was time-barred on all grounds because in the absence of continuing duress or undue influence, an action to rescind a prenuptial agreement accrues and the statute of limitations begins to run once the agreement is executed.³¹ The court also stressed the wife's inability to

explain her failure to discover the alleged fraud at the time she executed the prenuptial agreement by reading the document she signed. Finally, no marriage toll was recognized.

DeMille v. DeMille

In *DeMille v. DeMille*³² the parties entered into a prenuptial agreement on September 17, 1988. In August 2002, the plaintiff filed for divorce wherein she sought to vacate the agreement on grounds that it was procured through misrepresentation, duress, and coercion, and unconscionability. The motion court held that the wife's attack on the agreement was not time-barred. The Appellate Division reversed because a prenuptial agreement is a contract³³ and an action for rescission is governed by a six-year statute of limitations in CPLR 213(1); that absent continuing duress or undue influence, an action to rescind a prenuptial agreement accrues and the statute of limitations begins to run once the agreement is executed.

The Second Department underscored the difference between the prenupe as a sword and as a shield under the statutory scheme: citing the Practice Commentaries,³⁴ *DeMille* held that, pursuant to CPLR 203(d), once the six-year statute of limitations has expired, a defendant may attack the validity of a prenuptial agreement, but only as a defense in a counterclaim against a claim asserted by the plaintiff, never affirmatively to seek relief in the first instance. Otherwise stated, under CPLR 203(d) a defendant may assert an otherwise untimely claim which arose out of the same transactions alleged in the complaint, but only as a shield for recoupment purposes; it does not permit the defendant to obtain affirmative relief.³⁵

The Appellate Division observed that Mrs. DeMille could not have benefited from CPLR 203(d) since she as the plaintiff was seeking to affirmatively attack and set aside the prenuptial agreement because at the time she commenced her action the claims were time-barred pursuant to CPLR 213(2). Citing earlier Court of Appeals cases,³⁶ discussed below, *DeMille* further underscored its steadfast position that marriage does not toll the statute and no court has the authority to create such an exception to the statute of limitations.

Scheuer (1955) and *Dunning* (1950)

*Scheuer v. Scheuer*³⁷ and *Dunning v. Dunning*³⁸ have been cited repeatedly by the Second Department in support of the proposition that marriage does not automatically toll the statute of limitations. In *Scheuer* the wife sought to impose a constructive trust upon the marital residence which the husband purchased in his own name instead of joint names, as he had promised. The wife claimed that she had contributed 50% of the purchase price of the home. The husband continuously

promised to rectify the situation and add her name to the house but never did. After the statute of limitations expired the husband admitted that it had never been his intention to do so. The Court of Appeals declined to adopt the position that an "abuse of the confidential relation" of marriage should allow for an estoppel of the statute of limitations: "the statute of limitations is not tolled merely because the parties are husband and wife."

In *Dunning*, a case based on promissory notes, the defense of statute of limitations was never pleaded or raised in a motion to dismiss. It was, therefore, unavailable and was not considered as a determinative factor on appeal. The principle for which it is cited originates in dictum wherein the appeals court noted, "we point out that no such exception [the Statute of Limitations does not run in favor of one spouse as against the other while they are living together] is found in article 2 of the Civil Practice Act, or elsewhere in our statutes, and the creation thereof is beyond the power of any court."

Scheuer has evolved, appearing in many constructive trust cases. Except for the philosophical differences between the First and Second Departments surrounding the marriage toll, *Scheuer* has been applied consistently in both departments.³⁹ *Scheuer's* application is best summarized in *Accounting of Sakow*:⁴⁰

A constructive trustee may acquire property wrongfully thus holding it adversely to the beneficiary's interest from the date of acquisition, or he may wrongfully withhold property which he has rightfully acquired from the lawful beneficiary. In either case, the cause of action accrues when the acts occur upon which the claim of constructive trust is predicated, the wrongful withholding . . . Thus, it is irrelevant when the aggrieved party learns of the wrongful act giving rise to the action.

*Augustine v. Szwed*⁴¹ involved the timeliness of the plaintiff's action to impose a constructive trust on the proceeds of life insurance on her husband's life, which were received by the defendant after his death. *Augustine*, citing *Scheuer*, examined the applicable statute of limitations to an action for a constructive trust: "The cause of action accrues when the property in dispute is held adversely to the beneficiary's rights. If the beneficiary knows, or should know of the circumstances giving rise to the constructive trust, he will be barred if he fails to act within the statutory period as measured from that date . . . the cause of action accrues when the acts occur upon which the claim of constructive trust is predicated, the wrongful withholding":

[*Scheuer*] held that this cause of action arose on the date the deed was accepted because it was then that the promise was broken and that his ownership was adverse to his wife. Consistent with this ruling, it has been held that when parties agree that property will be acquired or held in one of their names with the understanding that it will be later transferred, the possession at the time of acquisition is not adverse and it does not become so until the promise to transfer is broken or repudiated.

Arnold v. Mayal Realty; Mack v. Mendels

In *Arnold v. Mayal Realty Co.*,⁴² cited in *DeMille*, the plaintiff sought leave to bring in an additional defendant. The Court of Appeals stated that a statute of limitations was not open to discretionary change by the courts no matter how compelling the circumstances, and when given its intended effect such a statute is one of repose, and experience has shown that “the occasional hardship is outweighed by the advantage of outlawing stale claims.”

Mack v. Mendels,⁴³ also cited in *DeMille*, stated:

The Legislature determines under what circumstances the time limited by statute for commencing an action shall be suspended. The courts construe provisions made by the Legislature creating exceptions or interruptions to the running of the time limited by statute in which an action may be begun. They may not themselves create such exceptions . . . General language in judicial opinions must be regarded as merely a gloss on the text of the statute under consideration, not as the formulation by judicial authority of a general rule.

However, *Mack* addressed the application of a statutory toll, not a toll arising in equity making the case unrelated to the entire question of the marriage toll as an equitable remedy.

Guidance may also be sought from the principle that “the choice of the applicable Statute of Limitations is properly related to the remedy rather than to the theory of liability.”⁴⁴ The general principle (is) that time limitations depend upon, and are confined to, the form of the remedy.”⁴⁵ *Johnson v. Albany & S.R. Co.*⁴⁶ elucidated the concept and facilitates the understanding of the role of a statute of limitations:

The statute of limitations [has] never paid a debt, although it [has] barred

a remedy . . . The moral obligation to pay always remains, although the remedy cannot be enforced in the courts. This moral obligation was always a good consideration for a subsequent promise to pay . . . Some distinction has been suggested, mainly upon the question of pleading, between a debt barred by the statute of limitations and the obligations of a debtor discharged under the insolvent laws; but it is, I think, nowhere held that a debt is paid because the remedy of the party to enforce it is suspended or gone. At all events, it is not too much to say that a party who claims to have paid a debt by a successful plea of the statute of limitations, and seeks an affirmative remedy on the ground of such a fortunate venture, is not to be regarded as the especial favorite of a court of equity.

The judgment could only be the more effective if it extinguished the debt or the moral obligation to pay; but by the law of this State [the statute of limitations] does not have that effect. This statute, it may be suggested, can be used as a shield, but not as an aggressive weapon, and is entirely like the statute giving the presumption of payment in respect to a sealed obligation after twenty years. It is available as a bar to an action, but ineffectual where a party seeks affirmative relief, based upon the fact of payment. Where such relief is sought, payment in fact must be shown. An insolvent’s discharge or a successful defence of the statute of limitations will not answer.

Mack, Scheuer, Dunning

Mack, Scheuer, Dunning, et al. notwithstanding, ongoing duress is an equitable consideration that extends the unimpaired right found in the statutory scheme (see, *Johnson, supra*)—enforcement of a contract by tolling the statutory period of limitations, in essence it is a non-statutory (equitable) remedy that tolls a statutorily enumerated event.

Greene v. Greene

Citing, *inter alia*, *Pacchiana, supra*, *DeMille v. DeMille*⁴⁷ concluded that “no court has the authority to create such an [marriage] exception to the statute of limitations.”⁴⁸ *Pacchiana* without analysis or discussion cites the Court of Appeals decision, *Greene v. Greene*,⁴⁹ which, aside from the coincidence of the identity of

names of the parties, is not a matrimonial action. The facts in *Greene* arose out of the plaintiff's action against her former attorneys seeking rescission of a trust agreement and an accounting for mismanagement of her fund, including self dealing.

The two primary issues in *Greene* were: (1) whether the plaintiff had stated a cause of action for rescission and (2) whether the cause of action was barred by the statute of limitations.

In 1964, when the plaintiff was a college sophomore, she received treatment for a mental illness at a hospital. She remained a patient at that facility and a related one until 1967. While in those institutions the plaintiff was approached by a family lawyer (not associated with the defendants) and at his urging signed a trust agreement, dated February 5, 1965, in which she virtually surrendered to him all management and control over her inheritance for her lifetime. Upon her release from the hospital in 1967 she retained the defendants to have the 1965 trust agreement set aside. The court concluded that the attorney who drafted the agreement and later became the trustee was chargeable with overreaching.

A few months after the decision the defendants drafted a new trust agreement for the plaintiff in 1969. This 1969 agreement designated her as a cotrustee of the fund. The other trustee was the defendant Theodore Greene, a member of the defendant firm but not related to the plaintiff. That automatically renewable agreement also compensated the attorneys very generously for the management of the fund including relieving themselves of ordinary fiduciary liability arising from investments which "are not of the type customarily made by trustees."

In 1977 the plaintiff terminated the trust and commenced the action. The plaintiff alleged that her trust funds were invested in companies which were clients of the defendant law firm or in which partners of the law firm had an interest as investors, officers or directors, without full and adequate disclosure to the plaintiff.

Finding many commonalities in *Greene* that parallel the origin of "the doctrine of continuous treatment" in medical and legal malpractice cases, the First Department held that the plaintiff's right of action did not accrue until she became aware of the alleged breach of the fiduciary relationship and terminated the trust. The Court of Appeals affirmed.

The Court of Appeals rejected the defendant-attorneys' argument to strictly impose the statute of limitations, to wit, that the cause of action be deemed to have accrued at the time the client was "induced" to sign the agreement because the plaintiff's action for rescission was based on the special rule applicable to contracts

between an attorney and his client, which does not rest on a theory of fraud or undue influence. *Greene* noted that although the doctrine of trust that reposes in the professional originated within the realm of medical malpractice cases it logically extended to other professions as well:

In a broader sense, the rule recognizes that a person seeking professional assistance has a right to repose confidence in the professional's ability and good faith, and realistically cannot be expected to question and assess the techniques employed or the manner in which the services are rendered . . . On this basis the continuous treatment rule has been held applicable to other types of professionals, including lawyers.

Greene made two critically defining statements:

- In medical malpractice cases the continuous treatment doctrine is now controlled by statute; but with respect to other types of professional dereliction, judicial authority has been left intact, and
- *The operative principle may also be applicable in other situations, including claims for equitable relief.*⁵⁰

The Court of Appeals reasoned that "a client who entrusts his assets to an attorney for professional assistance often faces the same dilemma as the client who entrusts his case to an attorney for possible litigation."

In neither instance can the client be expected, in the normal course, to oversee or supervise the attorney's handling of the matter, and thus in neither case is it realistic to say that the client's right of action accrued before he terminated the relationship with the attorney.

The parallel application is inescapable with respect to an ongoing marriage; the Court of Appeals specifically stated, "the operative principle may also be applicable in other situations, including claims for equitable relief," and rescission is an equitable remedy, and divorce and all ancillary relief is an action in equity.

Speaking of *Greene*, Prof. Vincent Alexander⁵¹ notes that "the approach taken in *Lieberman* is analogous to the judiciary's evolution of the 'continuous treatment' toll in professional malpractice cases . . . The purpose of the continuous treatment doctrine is to avoid destroying an ongoing client-professional relationship with a lawsuit. Surely the husband-wife relationship is equally deserving of a toll with respect to an agreement the very purpose of which is to prevent strife and secure

peace between the parties. See 2 Williston on Contracts § 270B, p. 160 (3rd ed. 1959).”

Subsequent developments in the law demonstrate that the recognition of a toll in this context lies within the judicial power . . . The purpose of these tolls is to avoid destruction of an ongoing client/patient relationship with a lawsuit. The marital relationship is equally deserving of preservation, and the toll adopted in *Bloomfield* serves this goal. Agreements that are designed to avoid marital strife should not become the precipitating events that lead to dissolution within the first six years of the marriage.

Hernandez v. New York City Health and Hospitals Corp.

That the Court of Appeals has declined to impose a cold absolute reading of the statute of limitations without an examination of its human consequences is evidenced in *Hernandez v. New York City Health and Hospitals Corp.*⁵² In *Hernandez*, the decedent died intestate at a New York City hospital, leaving her infant son as her sole distributee. Letters of guardianship were eventually issued to the decedent’s niece, who was granted authority to commence the wrongful death action. The plaintiff was granted leave to file a late notice of claim. The defendant moved to dismiss as time-barred. The Court of Appeals held that the statute of limitations was tolled until the appointment of the infant’s guardian.

Hernandez’ Perfect Storm of Statutes Would Have Favored a Strict Application of the Limitations Period

In a perfect storm of a “confluence” of statutes⁵³ that would have brought about a harsh result on the decedent’s child, “who [would] bear the full burden of dismissal of the claim” via a strict application of the statutes, the Court of Appeals instead found room to create an exception to the statute:

We decline to reach that unnecessarily harsh result, and instead would construe the toll of CPLR 208 to apply until the earliest moment there is a personal representative or potential personal representative who can bring the action, whether by appointment of a guardian or majority of the distributee, whichever occurs first.

This result strikes the appropriate balance among competing policy consid-

erations. On the one hand, Statutes of Limitation serve to bar stale claims, adding an element of certainty to human affairs . . . Against this important interest must be weighed the fairness of not unreasonably denying a claimant the right to assert a claim (emphasis provided).

Bloomfield: A Lost Opportunity; Not Unlikely the Court of Appeals Would Affirm the First Department

When the Court of Appeals granted leave to hear *Bloomfield* it was much anticipated that the schism between the First and Second Departments—divided sharply along philosophical lines—would be resolved. Regrettably, the appeals court passed on the opportunity. Nevertheless, we have two cases arising outside the matrimonial domain wherein the Court of Appeals not only applied a newly crafted toll, as in *Greene*, but also, in *Hernandez*, in *deus ex machina* fashion crafted a toll as indicative of its reluctance to render decisions with unduly harsh consequences, where equitable considerations were integral to the decision.

It can, therefore, not be overemphasized that if the appeals court acted in this manner with respect to these cases that it could hardly be imagined that it would decide differently if presented with the rift that separated the First and Second Departments.

Notwithstanding Its Strict Adherence to the Statute of Limitations the Second Department Recently Resolved a Contest Between Competing Public Policies in Marital Contests in a Manner That Broadened Rather than Restricted Marital Rights

Kessler v. Kessler

In *Kessler v. Kessler*,⁵⁴ the Second Department recently resolved a contest between two competing concerns: (1) resolution of marital disputes as set forth in the terms of the agreement, and (2) the leveling of financial disparity between spouses to assure that matrimonial outcomes are not predetermined based on “the weight of the wealthier litigant’s wallet.”⁵⁵ The approach was consistent with the spirit in *Greene* and *Hernandez*.

The Second Department awarded the wife counsel fees to seek property distribution notwithstanding a provision in the prenuptial agreement that could have dictated a contrary result. The court thus favored a ruling consistent with the spirit and public policy of the right to pursue equitable distribution.

Kessler underscored that the right to resolve a dispute by contract, although favored, has never been

without limitation; that the state is deeply concerned with marriage and “courts have thrown their cloak of protection about separation agreements and made it their business, when confronted, to see to it that they are arrived at fairly and equitably, in a manner so as to be free from the taint of fraud and duress, and to set aside or refuse to enforce those born of and subsisting in inequity.” Indeed, *Kessler* continued, in numerous contexts, agreements addressing matrimonial issues have been subjected to limitations and scrutiny beyond that afforded contracts in general”:

- (1) contracts may not violate any law or public policy; and
- (2) the State retains a supervisory role in matrimonial matters exercising heightened scrutiny beyond that afforded contracts in general:
 - (i) taint by fraud and duress;
 - (ii) amounts and duration of spousal maintenance “must be fair and reasonable at the time [] made, and not unconscionable at the time of entry of final judgment . . .”;
 - (iii) spouses may not contractually relieve each other of the requirement of support to the extent that either may become a public charge
 - (iv) the child support recitations and calculations subject to continuing judicial discretion;
 - (v) unenforceability of custody provisions in prenuptial agreements; and
 - (vi) relocation of children.

In light of *Greene* and *Hernandez*, it is especially difficult to understand how or why the Second Department approached this issue so liberally and by the same token adheres to a strict enforcement of the statute of limitations. Clearly, the foundation of marriage and its preservation can hardly be considered less sacred than the enforcement of the ancillary rights arising from the marital relationship.

Public Policy Favors the Preservation of Marriages

It is settled public policy that the law’s purpose is to preserve rather than to destroy the marriage institution: “strong public policy” favors the continuity of marriage which finds expression in statutes and in case

law.⁵⁶ The broad foundation in which the statutory rule is imbedded is the uncompromising determination of the state to preserve the important incidents of the marriage relationship during its continuance whatever the contrary sentiments of the parties themselves may be.⁵⁷ Current policy echoes traditional views. At no former period has it been more emphatically the dictate of sound public policy to preserve sacredness of a marriage relation, by protecting its confidence and guarding against discord and dissension.⁵⁸ In *Haymes v. Haymes*,⁵⁹ the Appellate Division stated:

. . . common sense teaches that it is consistent with the public policy of this state that couples enduring marital disharmony should be encouraged to attempt reconciliation, particularly when, as here, the marriage is one of long duration. That the courts should, when practicable, encourage the preservation of families, in all their permutations, is so painfully obvious, that the lack of appellate authority so declaring can only be explained by the failure heretofore of anyone to contest such a basic proposition.

In *Schlachet v. Schlachet*,⁶⁰ the supreme court stridently stated:

It is the public policy of our state to honor marriage and perpetuate its continuance. Statutes and judicial precedents bar any attempts, innocent or insidious, to interfere with, deprecate or destroy our government’s interest in protecting and preserving the family unit, sanctified by marital vows.

Contracts to Alter Marriage, Void

Contracts against public policy are illegal.⁶¹ Where an agreement is void because it is in violation of the prohibition against contracts to alter or dissolve the marriage, the entire agreement must fall;⁶² however, the severability doctrine applies with equal effect where the bar of the statute applies because the agreement is one to alter the marriage status.⁶³ The Court of Appeals, pointing to the state’s deep interest in the preservation of marriage, declared that every agreement between husband and wife must be viewed in the light of this continuing interest of the state.⁶⁴ This is in tandem with the principle set forth in *In re Wilson Sullivan Co.*,⁶⁵ that if a statute and the common law rule can stand together, the statute should not be so construed as to abolish the common law rule, so that the common law sentinel position of zealous guardianship of the vitality of marriages remains unimpeached.

The Legislature, Aware of Existing Common Law, Has in Recent Decades Shored Up Its Vigilance over Marriages

The Domestic Relations Law is a creature of the legislature⁶⁶ and the Court of Appeals has “recognized in numerous cases that the jurisdiction of the courts of this State in matrimonial actions is limited to such powers as are expressly conferred upon them by statute.”⁶⁷ The legislature is presumed to be aware of the decisional and statutory law in existence at the time of an enactment, and to have abrogated the common law only to the extent that the clear import of the language used in the statute requires;⁶⁸ otherwise stated, it is a general rule of statutory construction that a clear and specific legislative intent is required to override the common law.⁶⁹ It is a cardinal principle of statutory interpretation that the intention to change a long-established rule or principle is not to be imputed to the legislature in the absence of a clear manifestation.⁷⁰ Accordingly, it is a matter of law that the legislature has always remained aware of this foundational principle of public policy to protect marriages from disintegration, a policy which it has never abrogated.

The legislature is further presumed to have known the common law, and to have made its enactments with reference to the decisions of the courts.⁷¹ By way of example, in 1859, Supreme Court noted the legislature’s mindfulness of the common law in the enactment of legislation:

Precisely so, in construing the [] acts of 1848 and 1849, we are to presume that the Legislature passed them with the knowledge of the husband’s common law rights, and that these rights were not intended to be taken away any further than was necessary to secure to married women, as against their husbands, the free, sole, separate use, and enjoyment, and absolute disposition of their property. These are all the beneficial rights of property that could be conferred on them, or secured to them.⁷²

Legislative vigilance of the common law remains a key tenet of statutory construction as embodied in Statutes § 301:

a. Rule of strict construction: Generally, statutes in derogation of the common law receive a strict construction.

COMMENT

The Legislature in enacting statutes is presumed to have been acquainted with the common law, and generally, statutes in derogation or in contraven-

tion thereof, are strictly construed, to the end that the common law system be changed only so far as required by the words of the act and the mischief to be remedied.

The common law is never abrogated by implication. Statutes in contravention thereof cannot be extended by construction or by doubtful implication, to include cases or matters not fairly within the terms of the act, or within the reason as well as the words thereof. Thus, rules of the common law must be held no further abrogated than the clear import of the language used in the statute absolutely requires.

Among those statutes which have been deemed derogatory of the common law, and hence have received a strict interpretation are statutes abolishing dower; statutes permitting adoption; statutes preventing common-law marriages; statutes forbidding sales in bulk without notice; and statutes granting right to sue in forma pauperis.

Accordingly, it challenges reason that the legislature, aware of a history of judicial and legislative literature (the spousal privilege, see below) that have placed the preservation of marriage among the centerpieces of public policy, could be deemed to allow an interpretation of the statute of limitations in a manner that denudes this important public policy.

Public Policy to Foster Marriages as Evidenced through Spousal Privilege

Directly on point is the principle of spousal privilege, which is “designed to protect and strengthen the marital bond.”⁷³ This concept is anchored in public policy that comprehends that many events are said and done⁷⁴ precisely because of the marital relationship “induced by the marital relation and prompted by the affection, confidence and loyalty engendered by such relationship”⁷⁵ and that it is “the dictate of sound public policy to preserve sacredness of a marriage relation, by protecting its confidence and guarding against discord and dissension.”⁷⁶

Another court phrased it this way:

I hope the legislature will pause to inquire whether in this respect the ancient ways are not best and wisest; whether the marriage relation, which is the foundation of civilized society, is likely to be preserved in its purity,

by laws which permit the parties to be constrained, against each other, to disclose whatever transpires in its privacy; and to testify for or against each other under the temptation of gain or the fear of “implacable discord and dissension.”⁷⁷

Presumption of the Viability of a Marriage; Troubled Marriages Are Inviolable Even During “Stormy Separations”; *People v. Fediuk*

In *People v. Fediuk*,⁷⁸ a case involving testimony by the wife against the husband, the Court of Appeals emphasized that a marriage may remain viably inviolate notwithstanding its navigation through troubled waters; that not even a separation for months sounds the death knell of the marriage:

Communication between spouses is presumed to have been conducted under the mantle of confidentiality, a presumption that is not rebutted by the fact that the parties are not living together at the time of the communication, or that their marriage has deteriorated, for even in a stormy separation disclosures to a spouse may be induced by absolute confidence in the marital relationship.

People v. Oyola

In *People v. Oyola*⁷⁹ the father stood accused of having raped his daughter. The wife had the husband arrested after which time they were separated. The prosecutor called the wife to testify to a call from the husband following the arrest and separation wherein he admitted the crime. The wife testified:

“it was true what he done”; “he [said he] was sorry for what he did to his daughter, and then I told him that I couldn’t forgive him for what he had done to her” and “that he violated his rights as a father, and then he told me about this other woman that he had.”

The appeals court stated that, the physical separation aside, the objection to introduction into evidence of the aforementioned statement should have been sustained on the ground that it was a confidential communication between husband and wife induced by the marriage relation: *Oyola* ruled:

It is true that they had been living separately for a short time after appellant’s arrest, but the circumstances indicate that (if spoken at all) this statement was part of an attempted reconciliation between husband and wife.

It challenges clear thinking to invoke the sanctity of the marital relation to shield the admission of so heinous a crime as rape of one’s own child especially after the wife had the husband arrested and they were living apart—clearly, an already seriously devastated marriage—and, nevertheless, refuse to apply the same philosophy to what is tantamount to a certain destruction of the marriage via compelled litigation of a prenuptial agreement during an unchecked marriage. It tests logic.

People v. Fields

In *People v. Fields*,⁸⁰ the wife was called as a rebuttal witness to testify to a telephone call she received from her husband shortly after certain shootings in which he told her of them and, because the couple had been living apart for several months and the defendant was in fact living with another woman, he asked permission to come to her apartment to stay for a while. She also testified to seeing a revolver of the kind used in the shootings in the defendant’s possession some weeks before the shootings.

The district attorney sought to add an additional exception to the spousal privilege: that the purpose of the privilege is to preserve a normal marital relationship, and where the relationship no longer has a genuine existence no purpose remains in fostering the privilege. That once the husband was living with another woman the marital relationship had ended. Although extremely compelling the Appellate Division rejected the argument.

Fields: Courts Should Not Pass on the Viability of Marriages

Fields, citing *Oyola*, concluded that it is neither desirable nor sound for a court to preside over a determination regarding the viability of a marriage, to wit, when was it still sound, when was reconciliation a possibility, when did it become irretrievably broken as opposed to retrievably broken, etc.:

the difficulty with the situation is a pragmatic one. It calls upon the trial judge in determining whether the proposed testimony is admissible to decide whether the marriage is viable, that is, whether there is a possibility of reconciliation. And while there are decisional hints that this ground of exception might attain recognition, the invariable holding has been that the possibility of reconciliation has not been negated.

In light of the above, *Zipes*’ test as to the viability of a marriage falls.

Stare Decisis

Arguing that *Scheuer* and *Dunning* are no longer applicable because of contemporary public policy reflected in the Equitable Distribution Law, supreme court, in *Freiman*, made a valiant effort, as a lower court, to strike antiquated thinking that has neither been abandoned nor formally addressed by the high court since 1950 (even though the Court had the opportunity to revisit this question in *Bloomfield*).

A review of the principle of *stare decisis* is instructive. Speaking in the context of a personal injury case, the Court of Appeals, in *Heyert v. Orange & Rockland Utilities, Inc.*, stated: “*Stare decisis* is, to be sure, not a rule of law, but a matter of judicial policy, and does not have the same force in each kind of case, so that adherence to or deviation from that general policy may depend on the kind of case involved, especially the nature of the decision to be rendered, and the result that may follow from the overruling of a precedent.”⁸¹

In *Buckley v. City of New York*, the Court of Appeals stated while the longevity of a rule of law requires that its re-examination be given careful scrutiny and *stare decisis* is not to be cast aside lightly, longevity does not demand that its effect be given permanence. The continued vitality of a rule of law should depend heavily upon its continuing practicality and the demands of justice, rather than upon its mere tradition.⁸² In *Bing v. Thunig*,⁸³ the Court of Appeals underscored the danger of becoming immutably and irretractably bogged down in a law whose practical vitality has long expired in the realm of justice:

The rule . . . is out of tune with the life about us, at variance with modern-day needs and with concepts of justice and fair dealing. It should be discarded. To the suggestion that *stare decisis* compels us to perpetuate it until the legislature acts, a ready answer is at hand. It was intended, not to effect a “petrifying rigidity,” but to assure the justice that flows from certainty and stability. If, instead, adherence to precedent offers not justice but unfairness, not certainty but doubt and confusion, it loses its right to survive, and no principle constrains us to follow it. On the contrary, as this court [] declared, we would be abdicating “our own function, in a field peculiarly nonstatutory,” were we to insist on legislation and “refuse to reconsider an old and unsatisfactory court-made rule.”

In essence, the appeals court frowns upon a compelled mechanical perpetuation of an entrenched

unjust rule that is “out of tune with the life about us.”⁸⁴ With that in mind, it may be fairly posited that the Court of Appeals, in light of its decisions in *Greene*, *Hernandez*, *Fediuk*, and *Oyola*, might not reach the same conclusion it did over half a century ago and reintroduce the equitable remedy of the marriage toll were the issue reviewed today under broadened and pervasive contemporary thinking since the advent of equitable distribution.

The Marriage Toll as a Disability or Disabling Event Akin to Infancy and Intervening War

A parallel may be drawn between the cases in the First Department and the letter and the spirit of CPLR 208 (Infancy, Insanity)⁸⁵ and 209 (War)⁸⁶ in that each statute treats the condition set forth therein as a disabling event that tolls all legal consequences until the event has passed. A viable marriage similarly disables the disrupting event of mandatory litigation that would undoubtedly precipitate the downward spiral of the marriage. This is not a ground-shattering concept because this already exists with regard to duress, supervening equitable relief that tolls the limitation period until the termination of the duress⁸⁷ without any outer limit.

Continuity of the outside force is the fuel that drives the toll of duress. Its rationale is that certain torts occur over a stretch of time, not just at the single identifiable moment when the cause of action accrues. When a plaintiff is subject to a “continuous wrong,” the moment of accrual still determines when judicial relief is first available, but equity begins to run the limitations period from when the tortious conduct ceases. We presume that a plaintiff is unable to file suit so long as—but no longer than—she is subjected to a duress-based tort.⁸⁸ The marriage toll is, similarly, based on the continuity of the event, albeit not a tort but rather a socially desirable situation.

Limitation Periods as a Means to Avoid Stale Evidence

Leonard Florescue argues compellingly against the automatic marriage toll:⁸⁹

The other reason to apply the statute [of limitations] is one of fundamental equity. It is fair to say that the wealthy people who enter into prenuptial agreements would not have married without the agreement having been signed. Otherwise, why would they bother with the agreements? The Courts of this state have regularly held that such agreements are fully enforceable as other contracts are. These

people entered into a marriage contract in reliance on that law.

Now, take the poorer spouse. When the agreement is attacked it is not an academic exercise. He or she does not want to be put back where the parties would be without the agreement, i.e., unmarried and with no rights at all [rescission restores the parties to the original *status quo* before the agreement]. No, he or she wants all the rights of marriage without having to accept the obligations of the very document without which there would have been no marriage in the first place. Does that sound equitable to you? It doesn't to me and indeed it cries for an estoppel to be asserted. Also, why doesn't the enjoyment of the marriage itself (without the agreement, remember there is no marriage) constitute a ratification of the agreement?

In short, on first principles alone, Prenuptial Agreements should be enforced, the statute of limitations should apply (unless tolled by one of the recognized statutory tolls such as continuing duress or recent discovery of the alleged fraud) and the concern for whether these attacks are raised in complaints or answers should be put out of our minds.

The argument that the statute of limitations is intended to encourage a timely action when the relevant evidence is fresh and available rather than at a time when witnesses and documentary evidence are no longer available is sensible and a linchpin in not perpetuating claims that cannot be supported. However, although this argument can defeat the indefinite tolling occasioned by continuing duress—after all, tolling is tolling irrespective of the cause, time marches on with the same results, evidence becomes stale, witnesses become unavailable, documents are no longer extant, etc.—it is not. An application of the tolling period to a viable marriage no more violates that which already exists in governing law for continuing duress.

In *Kaufman v. Cohen*,⁹⁰ the court observed that if the relief from a breach of a fiduciary duty seeks an equitable remedy, the relevant period is six years under CPLR 213(1), as to which there is no date-of-discovery accrual rule. Clearly, such a tolling can go on indefinitely, again, with the same concerns of stale and unavailable evidence and witnesses.

Conclusion

There is absolutely no dispute that claims of any kind grounded in duplicity must be rooted out. Bench and bar are long weary of the surfeit of baseless proceedings to vacate pre- and postnuptial agreements. In *Kojovic v. Goldman*,⁹¹ the First Department expressed “its disdain for post-divorce claims of concealment.” The dissent in *Gottlieb v. Such*⁹² bemoaned “the prevalence of excessive post-divorce litigation” and the necessity “to find ways to discourage baseless post-judgment proceedings and offer instead protection against the enormous financial burden they entail.”

In light of the appeals court's own language and reasoning in the various decisions cited herein, where contrary results would have been anticipated, it may be fairly submitted that this question remains wide open and that it is not implausible that, in the legal climate of the 21st century, the thinking in *Lieberman et al.* could well prevail, thereby consigning *Scheuer* and *Dunning* to the legal archives.

Endnotes

1. The most preeminent exception to this rule is evidenced by the fact that New York State remains the only state without a true no-fault statute.
2. *Bloomfield v. Bloomfield*, 97 N.Y.2d 188, 764 N.E.2d 950, 738 N.Y.S.2d 650 (2001); *In re Estate of Greiff*, 92 N.Y.2d 341, 703 N.E.2d 752, 680 N.Y.S.2d 894 (1998); *Christian v. Christian*, 42 N.Y.2d 63, 71-72, 396 N.Y.S.2d 817, 365 N.E.2d 849 (1977); *Trump v. Trump*, 179 A.D.2d 201, 582 N.Y.S.2d 1008 (1st Dep't 1992).
3. *Total MRI Management, LLC v. Greenfield Imaging Associates Imaging, LLP* 11 Misc. 3d 1062(A), 816 N.Y.S.2d 702 (Sup. Ct., Nassau Co. 2006).
4. *Miller v. Continental Insurance Co.*, 40 N.Y.2d 675, 389 N.Y.S.2d 565, 358 N.E.2d 258 (1976) (quoting *Baltimore & Ohio Ry. Co. v. Voigt*, 176 U.S. 498 (1900); *Chase Manhattan Bank v. New Hampshire Insurance Co.*, 193 Misc. 2d 580, 749 N.Y.S.2d 632 (Sup. Ct., N.Y. Co. 2002)).
5. *Sternaman v. Metropolitan Life Ins. Co.*, 170 N.Y. 13, 62 N.E. 763 (1902).
6. *Chase Manhattan Bank v. New Hampshire Ins. Co.*, 193 Misc. 2d 580, 749 N.Y.S.2d 632 (Sup. Ct., N.Y. Co. 2002); see *New England Mut. Life Ins. Co. v. Caruso*, 73 N.Y.2d 74, 535 N.E.2d 270, 538 N.Y.S.2d 217 (1989).
7. *New England Mut. Life Insurance Co. v. Caruso*, 73 N.Y.2d 74, 535 N.E.2d 270, 538 N.Y.S.2d 217 (1989).
8. (1) Spousal maintenance: *Hirsch v. Hirsch*, 37 N.Y.2d 312 (1975); (2) custody: *Merrill Lynch, Pierce, Fenner & Smith v. Benjamin* 1 A.D.3d 39 (1st Dep't 2003); (3) child support: *Tompkins Co. Support Collection Unit ex rel. Chamberlin v. Chamberlin*, 99 N.Y.2d 328 (2003), and (4) counsel fees: *Kessler v. Kessler*, 33 A.D.3d 42, 818 N.Y.S.2d 571 (2d Dep't 2006). Prior to *Kessler* case law described counsel fees in public policy-like language even though *haec verba* were not used: *O'Shea v. O'Shea*, 689 N.Y.S.2d 8, 93 N.Y.2d 187, 711 N.E.2d 193 (1999); *Charpie v. Charpie*, 271 A.D.2d 169, 710 N.Y.S.2d 363 (1st Dep't 2000); *DeCabrera v. Cabrera-Rosete*, 524 N.Y.S.2d 176, 70 N.Y.2d 879, 518 N.E.2d 1168 (1987).

9. Vincent Alexander, McKinney's Statutes Practice Commentaries, CPLR 213; C213:1. Omnibus Statute of Limitations, Equity Actions and Declaratory Judgments, In General: "The six-year "omnibus" or "residuary" provision of CPLR 213(1) generally applies to an action seeking equitable relief or a declaratory judgment. See D. Siegel, *New York Practice* § 36 (3d ed. 1999); *Fitzgerald v. Hudson Nat. Golf Club*, 11 A.D.3d 426, 783 N.Y.S.2d 615 (2d Dep't 2004); *Van Dussen-Storto Motor Inn, Inc. v. Rochester Telephone Corp.*, 63 A.D.2d 244, 407 N.Y.S.2d 287 (4th Dep't 1978); *Greene v. Greene*, 56 N.Y.2d 86, 436 N.E.2d 496, 451 N.Y.S.2d 46 (1982).
10. *New England Mut. Life Ins. Co. v. Caruso*, 73 N.Y.2d 74, 535 N.E.2d 270, 538 N.Y.S.2d 217 (1989).
11. *Public Service Mut. Ins. Co. v. Goldfarb*, 53 N.Y.2d 392, 425 N.E.2d 810, 442 N.Y.S.2d 422, (1981); *Morris v. Snappy Car Rental, Inc.*, 189 A.D.2d 115, 595 N.Y.S.2d 577 (4th Dep't 1993).
12. *Winter v. Winter*, 191 N.Y. 462, 84 N.E. 382 (1908); *Stahl v. Stahl*, 221 N.Y.S.2d 931 (Sup. Ct., N.Y. Co. 1961); *In re Brenner's Will*, 44 N.Y.S.2d 447 (Sur. Ct., Westchester Co. 1943), *aff'd*, 268 A.D. 1001, 52 N.Y.S.2d 792 (2d Dep't 1944).
13. *Board of Educ., Hunter-Tannersville Cent. School Dist. v. McGinnis*, 100 A.D.2d 330, 475 N.Y.S.2d 512 (3d Dep't 1984) (Because public policy prevents parties from directly contracting away certain rights or responsibilities, the law will not permit them to achieve the same result indirectly).
14. *Weiman v. Weiman*, 295 N.Y. 150, 65 N.E.2d 754 (1946); *Bigaouette v. Bigaouette*, 135 N.Y.S.2d 719 (Sup. Ct., Kings Co. 1954); *Haas v. Haas*, 298 N.Y. 69, 80 N.E.2d 337 (1948).
15. *Lieberman v. Lieberman*, 154 Misc. 2d 749, 587 N.Y.S.2d 107 (Sup. Ct., N.Y. Co. 1992).
16. See endnote 9.
17. GOL § 5-311 declares void any agreement between a husband and wife which, by its terms, requires the dissolution of the marriage or provides for the procurement of grounds for divorce:

Certain agreements between husband and wife void:
 Except as provided in section two hundred thirty-six of the domestic relations law, a husband and wife cannot contract to alter or dissolve the marriage or to relieve either of his or her liability to support the other in such a manner that he or she will become incapable of self-support and therefore is likely to become a public charge. An agreement, heretofore or hereafter made between a husband and wife, shall not be considered a contract to alter or dissolve the marriage unless it contains an express provision requiring the dissolution of the marriage or provides for the procurement of grounds of divorce.
18. *Zuch v. Zuch*, 117 A.D.2d 397, 503 N.Y.S.2d 343 (1st Dep't 1986).
19. *Bloomfield v. Bloomfield*, 281 A.D.2d 301, 723 N.Y.S.2d 143 (1st Dep't), *leave to appeal granted*, 281 A.D.2d 325, 722 N.Y.S.2d 858 (1st Dep't), *rev'd*, 97 N.Y.2d 188, 764 N.E.2d 950, 738 N.Y.S.2d 650 (2001).
20. *Pacchiana v. Pacchiana*, 94 A.D.2d 721, 462 N.Y.S.2d 256 (2d Dep't 1983); see *Rubin v. Rubin*, 275 A.D.2d 404, 712 N.Y.S.2d 626 (2d Dep't 2000).
21. See *Rosenbaum v. Rosenbaum*, 271 A.D.2d 427, 706 N.Y.S.2d 890 (2d Dep't 2000), a cause of action to rescind the provisions of a marital agreement which allocates property must be commenced within six years of the execution of the agreement; *Anonymous v. Anonymous*, 233 A.D.2d 350, 650 N.Y.S.2d 589 (2d Dep't 1996) (The wife's action to rescind a prenuptial agreement 14 years after its signing on the grounds of duress and overreaching was held barred by the six-year statute of limitations (CPLR 213(1)).); *Katz v. Katz*, ___ A.D.3d ___, 830 N.Y.S.2d 268 (2d Dep't 2007).
22. *Rosenbaum v. Rosenbaum*, 271 A.D.2d 427, 706 N.Y.S.2d 890 (2d Dep't 2000).
23. *Zipes v. Zipes*, 158 Misc. 2d 368, 599 N.Y.S.2d 941 (Sup. Ct., Nassau Co. 1993).
24. *Freiman v. Freiman*, 178 Misc. 2d 764, 680 N.Y.S.2d 797 (Sup. Ct., Nassau Co. 1998).
25. *Scheuer v. Scheuer*, 308 N.Y. 447, 126 N.E.2d 555 (1955).
26. *Dunning v. Dunning*, 300 N.Y. 341, 90 N.E.2d 884 (1950).
27. *Dubovsky v. Dubovsky*, 725 N.Y.S.2d 832, 188 Misc. 2d 127 (Sup. Ct., Nassau Co. 2001).
28. *I.S. v. R.S.*, 117 A.D.2d 780, 499 N.Y.S.2d 106 (2d Dep't 1986) (Second Department held that where a wife had discovered that her husband had contracted a venereal disease more than five years prior to the commencement of the wife's divorce action, the action sounding in cruel and inhuman treatment, based upon the allegation that the husband had contracted such disease, was time-barred); *Rosenbaum v. Rosenbaum*, 271 A.D.2d 427, 706 N.Y.S.2d 890 (2d Dep't 2000) (wife moved to set aside a postnuptial agreement which provided that they would maintain their separate property and waived certain statutory inheritance rights; Appellate Division held that her counterclaim should have been dismissed because the cause of action to rescind the provisions of an agreement which allocates property must be commenced within six years of the execution of the agreement. The statute of limitations is not tolled during the marriage).
29. *Garguilio v. Garguilio*, 201 A.D.2d 617, 608 N.Y.S.2d 238 (2d Dep't 1994).
30. *In re Neidich*, 736 N.Y.S.2d 694, 290 A.D.2d 557 (2d Dep't 2002), *appeal denied*, 98 N.Y.2d 606, 774 N.E.2d 221, 746 N.Y.S.2d 456 (2002).
31. See CPLR 203[g], 213[8].
32. *DeMille v. DeMille*, 5 A.D.3d 428, 774 N.Y.S.2d 156 (2d Dep't 2004); *Iuliano v. Iuliano*, 30 A.D.3d 737, 817 N.Y.S.2d 174 (3d Dep't 2006) (The court denied the cross motion to set aside the prenuptial agreement on the ground that an action for rescission had a six-year statute of limitations and defendant's claim was time-barred. While a separate action for rescission was so governed, defendant was not time-barred from challenging the validity of the prenuptial agreement because this particular argument arose from, and directly related to, the plaintiff's claim that the agreement precluded equitable distribution of his assets. "It is axiomatic that claims and defenses that arise out of the same transaction as a claim asserted in the complaint are not barred by the [s]tatute of [l]imitations, even though an independent action by defendant might have been time-barred at the time the action was commenced. Thus, to this extent, defendant's claim survives"); see also *DeMille v. DeMille*, 5 Misc. 3d 355, 784 N.Y.S.2d 296 (Sup. Ct., Nassau Co. 2004), and *DeMille v. DeMille*, 32 A.D.3d 411, 820 N.Y.S.2d 111 (2d Dep't 2006).
33. *Bloomfield v. Bloomfield*, 97 N.Y.2d 188, 764 N.E.2d 950, 738 N.Y.S.2d 650 (2001); *Rubin v. Rubin*, 275 A.D.2d 404, 712 N.Y.S.2d 626 (2d Dep't 2000).
34. *Citing Alexander*, Practice Commentaries, McKinney's Cons. Laws of N.Y. Book 7B, C203:9.
35. *Citing Bloomfield v. Bloomfield*, 97 N.Y.2d 188, 764 N.E.2d 950, 738 N.Y.S.2d 650 (2001); and *Rosenblatt v. Ackoff-Ortega*, 300 A.D.2d 137, 752 N.Y.S.2d 621 (1st Dep't 2002).
36. *Scheuer v. Scheuer*, 308 N.Y. 447, 126 N.E.2d 555 (1955); *Dunning v. Dunning*, 300 N.Y. 341, 90 N.E.2d 884 (1950); *Arnold v. Mayal Realty Co., Inc.*, 299 N.Y. 57, 85 N.E.2d 616 (1949); and *Mack v. Mendels*, 249 N.Y. 356, 359, 164 N.E. 248 (1928).
37. *Scheuer v. Scheuer*, 308 N.Y. 447, 126 N.E.2d 555 (1955).

38. *Dunning*, 300 N.Y. 341; see *Anonymous v. Anonymous*, 71 A.D.2d 209, 422 N.Y.S.2d 89 (1st Dep't 1979) (It has always been the rule that the statute of limitations applies in a proceeding between husband and wife where title to property is contested.) (*Scheuer*, 308 N.Y. 447; *Dunning*, 300 N.Y. 341).
39. *Mazzone v. Mazzone*, 269 A.D.2d 574, 703 N.Y.S.2d 282 (2d Dep't 2000); *Soscia v. Soscia*, 35 A.D.3d 841, 829 N.Y.S.2d 543 (2d Dep't 2006); *Kaufman v. Cohen*, 307 A.D.2d 113, 760 N.Y.S.2d 157 (1st Dep't 2003); *Jakacic v. Jakacic*, 279 A.D.2d 551, 719 N.Y.S.2d 675 (2d Dep't 2001); *Fiore v. Fiore*, 247 A.D.2d 362, 668 N.Y.S.2d 662 (2d Dep't 1998).
40. *Accounting of Sakow*, 219 A.D.2d 479, 631 N.Y.S.2d 637 (1st Dep't 1995); *Sitkowski v. Petzing*, 175 A.D.2d 801, 572 N.Y.S.2d 930 (2d Dep't 1991) (the plaintiff and defendant were living together with the intention of marrying. They entered into a contract to purchase a home as tenants in common, for \$60,000 (\$20,000 in cash and a \$40,000 purchase money mortgage). Plaintiff alleged that, prior to the closing, they agreed that only the defendant's name would appear on the deed and that the defendant would at a later date transfer to the plaintiff a one-half interest in the subject property. In reliance on this promise, the plaintiff borrowed approximately \$20,000 to pay the cash component of the contract. The defendant took the property in his name and thereafter repeatedly postponed signing a deed of conveyance to her. Defendant eventually directed plaintiff to leave the premises since he was its sole owner. *Sitkowski* set the matter down for a hearing as to the factual questions: (1) when the defendant allegedly breached the agreement by an identifiable, wrongful act demonstrating his refusal to convey a one-half interest in the property to the plaintiff and (2) whether the plaintiff's claim was therefore time-barred.).
41. *Augustine v. Szwed*, 77 A.D.2d 298, 432 N.Y.S.2d 962 (4th Dep't 1980); Augustine has been cited in other cases, including the Second Department, e.g., *Maric Piping, Inc. v. Maric*, 271 A.D.2d 507, 705 N.Y.S.2d 684 (2d Dep't 2000), which involved a constructive trust between business partners.
42. *Arnold v. Mayal Realty Co.*, 299 N.Y. 57, 85 N.E.2d 616 (1949).
43. *Mack v. Mendels*, 249 N.Y. 356, 164 N.E. 248 (1928); *King v. Chmielewski*, 76 N.Y.2d 182, 556 N.E.2d 435, 556 N.Y.S.2d 996 (1990); *Chapin v. Posner*, 299 N.Y. 31, 85 N.E.2d 172 (1949).
44. *Powers Mercantile Corp. v. Feinberg*, 109 A.D.2d 117, 490 N.Y.S.2d 190 (1st Dep't 1985); *Sears, Roebuck & Co. v. Enco Associates, Inc.*, 43 N.Y.2d 389, 372 N.E.2d 555, 401 N.Y.S.2d 767 (1977).
45. *Sears, Roebuck & Co. v. Enco Associates, Inc.*, 43 N.Y.2d 389, 372 N.E.2d 555, 401 N.Y.S.2d 767 (1977).
46. *Johnson v. Albany & S.R. Co.*, 54 N.Y. 416 (1873); *Quadrozzi Concrete Corp. v. Mastroianni*, 56 A.D.2d 353, 392 N.Y.S.2d 687 (1977); see also *Abbate v. Abbate*, 82 A.D.2d 368, 441 N.Y.S.2d 506 (2d Dep't 1981), for an analysis.
47. *DeMille v. DeMille*, 5 A.D.3d 428, 774 N.Y.S.2d 156 (2d Dep't 2004).
48. *DeMille*, citing *Scheuer v. Scheuer*, 308 N.Y. 447, 126 N.E.2d 555 (1955); *Dunning v. Dunning*, 300 N.Y. 341, 90 N.E.2d 884 (1950); *Arnold v. Mayal Realty Co.*, 299 N.Y. 57, 85 N.E.2d 616 (1949); *Mack v. Mendels*, 249 N.Y. 356, 164 N.E. 248 (1928).
49. *Greene v. Greene*, 56 N.Y.2d 86, 436 N.E.2d 496, 451 N.Y.S.2d 46 (1982).
50. The history of the statute shows that the legislature's sole concern was to create a special and more restrictive statute in medical malpractice cases (see, e.g., *Simcusi v. Saeli*, 44 N.Y.2d 442, 406 N.Y.S.2d 259, 377 N.E.2d 713). It was not designed as an overall recodification or abrogation of judicial principles relating to the timeliness of all types of malpractice actions. Thus in medical malpractice cases the continuous treatment doctrine is now controlled by statute; but with respect to other types of professional dereliction, judicial authority has been left intact.
51. Practice Commentaries, McKinney's Statutes, CPLR 213, C213:1. Omnibus Statute of Limitations.
52. *Hernandez v. New York City Health and Hospitals Corp.*, 78 N.Y.2d 687, 585 N.E.2d 822, 578 N.Y.S.2d 510 (1991).
53. *Hernandez*: "the pertinent EPTL, SCPA and CPLR provisions in this case thus gives rise to an unusual—perhaps unique—problem. EPTL 5-4.1 grants the personal representative procedural authority to bring the wrongful death claim; SCPA 1001 and 707 make it impossible for anyone to assume that role until a guardian is appointed for the infant sole distributee; and CPLR 208 speaks of tolling the Statute of Limitations when the person entitled to bring the action is under a disability at the time of accrual. In that a wrongful death action accrues at the time of death, mechanical application of CPLR 208 is impossible unless the position of the infant/sole distributee under the SCPA is ignored."
54. *Kessler v. Kessler*, 33 A.D.3d 42, 818 N.Y.S.2d 571 (2d Dep't 2006).
55. *O'Shea v. O'Shea*, 689 N.Y.S.2d 8, 93 N.Y.2d 187, 711 N.E.2d 193 (1999); *Charpie v. Charpie*, 271 A.D.2d 169, 710 N.Y.S.2d 363 (1st Dep't 2000).
56. *Weiman v. Weiman*, 295 N.Y. 150, 65 N.E.2d 754 (1946); *Bigaouette v. Bigaouette*, 135 N.Y.S.2d 719 (Sup. Ct., Kings Co. 1954).
57. *Haas v. Haas*, 298 N.Y. 69, 80 N.E.2d 337 (1948).
58. *Pillow v. Bushnell* (Sup. Ct., N.Y. Co. 1849).
59. *Haymes v. Haymes*, 221 A.D.2d 73, 646 N.Y.S.2d 315 (1st Dep't 1996), *appeal after remand*, 252 A.D.2d 439, 675 N.Y.S.2d 593 (1st Dep't 1998).
60. *Schlachet v. Schlachet*, 84 Misc. 2d 782, 378 N.Y.S.2d 308 (Sup. Ct., Kings Co. 1975).
61. *Johnston v. Fargo*, 184 N.Y. 379, 77 N.E. 388 (1906); *Chase Manhattan Bank v. New Hampshire Insurance Co.*, 193 Misc. 2d 580, 749 N.Y.S.2d 632 (Sup. Ct., N.Y. Co. 2002).
62. *Winter v. Winter*, 191 N.Y. 462, 84 N.E. 382 (1908); *Stahl v. Stahl*, 221 N.Y.S.2d 931 (Sup. Ct., N.Y. Co. 1961); *In re Brenner's Will*, 44 N.Y.S.2d 447 (Sur. Ct., Westchester Co. 1943), *aff'd*, 268 A.D. 1001, 52 N.Y.S.2d 792 (2d Dep't 1944).
63. *Taft v. Taft*, 156 A.D.2d 444, 548 N.Y.S.2d 726 (2d Dep't 1989); *Morgenstern v. Morgenstern*, 27 A.D.2d 560, 276 N.Y.S.2d 66 (2d Dep't 1966); *Stahl v. Stahl*, 16 A.D.2d 467, 228 N.Y.S.2d 724 (1st Dep't 1962).
64. *Haas v. Haas*, 298 N.Y. 69, 80 N.E.2d 337 (1948).
65. *In re Wilson Sullivan Co.*, 289 N.Y. 110, 44 N.E.2d 387 (1942); *Childs v. Moses*, 265 A.D. 353, 38 N.Y.S.2d 704 (1st Dep't 1942).
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71. *People ex rel. Smith v. Hoffman*, 166 N.Y. 462, 60 N.E. 187 (1901).
72. *Vallance v. Bausch*, 17 How. Pr. 243, 8 Abb. Pr. 368, 28 Barb. 633 (N.Y. Sup. Gen. Term 1859).
73. *People v. Mills*, 1 N.Y.3d 269, 804 N.E.2d 392, 772 N.Y.S.2d 228 (2003).
74. *People v. Dudley*, 24 N.Y.2d 410, 248 N.E.2d 860, 301 N.Y.S.2d 9 (1969), the privilege covers acts not only speech; *People v. Daghita*, 299 N.Y. 194, 86 N.E.2d 172 (1949), the applicable general rule which we have applied in this state, and which has the support of the weight of authority throughout the United States, is that the term communication means more than mere oral communications or conversations between husband and wife. It includes knowledge derived from the observance of disclosive acts done in the presence or view of one spouse by the other because of the confidence existing between them by reason of the marital relation and which would not have been performed except for the confidence so existing. An act may communicate knowledge to the known observer and repose a confidence in him as clearly and unmistakably as if accompanying descriptive words were uttered.
75. *People v. Mills*, 1 N.Y.3d 269, 804 N.E.2d 392, 772 N.Y.S.2d 228 (2003); *Poppe v. Poppe*, 3 N.Y.2d 312, 315, 165 N.Y.S.2d 99, 144 N.E.2d 72 (1957), *rearg. denied*, 3 N.Y.2d 941 (1957); *People v. Dudley*, 24 N.Y.2d 410, 248 N.E.2d 860, 301 N.Y.S.2d 9 (1969); *Vanderbilt Rosner-Hickey*, 57 N.Y.2d 66, 73, 453 N.Y.S.2d 662, 439 N.E.2d 378 (1982).
76. *Pillow v. Bushnell* (Sup. Ct., N.Y. Co. 1849).
77. *White v. Stafford* (Sup. Ct., N.Y. Co. 1862).
78. *People v. Fediuk*, 66 N.Y.2d 881, 489 N.E.2d 732, 498 N.Y.S.2d 763 (1985); *People v. Daghita*, 299 N.Y. 194, 86 N.E.2d 172 (1949): Certainly, the wife's knowledge gained by observance of defendant's conduct in bringing home stolen property in the early morning hours and storing it in different parts of the house and more particularly under his bed was the result of a confidential communication on his part. It cannot be supposed that the defendant would have so conducted himself except in reliance upon the free and unrestrained privacy of the marital relation and the socially desirable confidence which exists, and should exist, between husband and wife. The record makes plain that defendant made no effort to conceal or disguise his conduct at his home from his wife. He was, in a word, confiding in her the information disclosed by his conduct. "Its nature, and the relation of the parties, forbade the thought of its being told to others, and the law stamped it with that seal of confidence which the parties in such a situation would feel no occasion to exact."
79. *People v. Oyola*, 6 N.Y.2d 259, 160 N.E.2d 494, 189 N.Y.S.2d 203 (1959).
80. *People v. Fields*, 38 A.D.2d 231, 328 N.Y.S.2d 542 (1st Dep't 1972).
81. *Heyert v. Orange & Rockland Utilities, Inc.*, 17 N.Y.2d 352, 218 N.E.2d 263, 271 N.Y.S.2d 201 (1966).
82. *Buckley v. City of New York*, 56 N.Y.2d 300, 437 N.E.2d 1088, 452 N.Y.S.2d 331 (1982).
83. *Bing v. Thunig*, 2 N.Y.2d 656, 143 N.E.2d 3, 163 N.Y.S.2d 3 (1957).
84. *Endresz v. Friedberg*, 24 N.Y.2d 478, 248 N.E.2d 901, 301 N.Y.S.2d 65 (1969).
85. CPLR 208: If a person entitled to commence an action is under a disability because of infancy or insanity at the time the cause of action accrues, and the time otherwise limited for commencing the action is three years or more and expires no later than three years after the disability ceases, or the person under the disability dies, the time within which the action must be commenced shall be extended to three years after the disability ceases or the person under the disability dies, whichever event first occurs; if the time otherwise limited is less than three years, the time shall be extended by the period of disability. The time within which the action must be commenced shall not be extended by this provision beyond ten years after the cause of action accrues, except, in any action other than for medical, dental or podiatric malpractice, where the person was under a disability due to infancy. This section shall not apply to an action to recover a penalty or forfeiture, or against a sheriff or other officer for an escape.
86. CPLR 209: (a) Cause of action accruing in foreign country. Where a cause of action, whether originally accrued in favor of a resident or non-resident of the state, accrued in a foreign country with which the United States or any of its allies were then or subsequently at war, or territory then or subsequently occupied by the government of such foreign country, the time which elapsed between the commencement of the war, or of such occupation, and the termination of hostilities with such country, or of such occupation, is not a part of the time within which the action must be commenced. This section shall neither apply to nor in any manner affect an action brought pursuant to section six hundred twenty-five of the banking law against a banking organization or against the superintendent of banks.
- (b) Right of alien. Where a person is unable to commence an action in the courts of the state because any party is an alien subject or citizen of a foreign country at war with the United States or any of its allies, whether the cause of action accrued during or prior to the war, the time which elapsed between the commencement of the war and the termination of hostilities with such country is not a part of the time within which the action must be commenced.
- (c) Non-enemy in enemy country or enemy-occupied territory. Where a person entitled to commence an action, other than a person entitled to the benefits of subdivision (b), is a resident of, or a sojourner in, a foreign country with which the United States or any of its allies are at war, or territory occupied by the government of such foreign country, the period of such residence or sojourn during which the war continues or the territory is so occupied is not a part of the time within which the action must be commenced.
87. *Baratta v. Kozlowski*, 94 A.D.2d 454, 464 N.Y.S.2d 803 (2d Dep't 1983).
88. *Overall v. Estate of Klotz*, 52 F.3d 398 (2d Cir., 1995).
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90. *Kaufman v. Cohen*, 307 A.D.2d 113, 760 N.Y.S.2d 157 (1st Dep't 2003).
91. *Kojovic v. Goldman*, 823 N.Y.S.2d 35 (1st Dep't 2006).
92. *Gottlieb v. Such*, 293 A.D.2d 267 (1st Dep't 2002).

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Drug Holdover Proceedings: An Overview From “Knew,” to “Should Have Known,” to “Strict Liability”

By Gerald Lebovits and Douglass J. Seidman

I. Introduction

New York State law gives District Attorneys’ offices, the Attorney General, neighboring tenants, and landlords two statutes to evict tenants and occupants of real property for illegal use: Real Property Actions and Proceedings Law (RPAPL) 711(5) (the “bawdy house” statute, which offers grounds to terminate a tenancy where a landlord-tenant relationship exists) and 715(1) (which provides grounds and procedure where use or occupancy is illegal). These statutes combine with Real Property Law (RPL) § 231, which does not create a separate right of action but which renders a lease void if the lessee allows the property to be used for any illegal trade, manufacture, or business,¹ and with RPAPL 721(8), which specifies who may maintain a proceeding. RPAPL 711(5) and 715 deprive tenants conducting illegal activity of their possessory interest, although not any ownership interest. They apply to residential and commercial real property. They allow the eviction of tenants and occupants who deal drugs, engage in illegal business activities, or otherwise use premises illegally.

To secure an eviction under New York law, a petitioner-landlord must prove that the tenant of record either actually knew that illegal-drug business was conducted from the premises or that a reasonable tenant would or should have known about it. That standard of proof is often called the “knew or should have known” standard.

Federal law lowers the standard for eviction for federally subsidized housing and for public housing. Under federal regulations, and so long as a lease clause allows it, a petitioner need prove only that an occupant or guest engaged in illegal drug activity at or near the premises. That standard is one of strict liability: A petitioner need prove sale or possession, not that the record tenant knew or should have known about it.

This article covers general issues associated with drug-holdover proceedings and examines the trend over time from “knew,” to “should have known,” to the latest standard: strict liability.

II. The Narcotics Eviction Program

In response to the drug problem sweeping the country, Robert Morgenthau, the District Attorney of New York County, began the Narcotics Eviction Program (NEP) in June 1988.² The NEP is a special,

fast-track summary program that lets landlords and the New York City District Attorneys’ Offices evict people who operate a business selling illegal drugs. The program’s public-policy rationale is that neighborhoods where real property is used to sell drugs soon degenerate and are overrun by criminal elements.³ The NEP allows landlords or the District Attorney (DA) to begin summary proceedings to evict those who sell drugs from residential or commercial spaces.

The DA in each county asks landlords to begin drug-eviction proceedings against tenants and occupants who allegedly use their premises to conduct illegal businesses. Cases brought by the DA’s office or by landlords at its behest are called “red back” cases because they have red-colored backings attached to the pleadings to distinguish them from other holdover proceedings.⁴ Under the NEP, law-enforcement officials work with landlords and tenants to remove drug dealers from their communities.⁵

The NEP created separate Narcotics Eviction Parts in the New York City Civil Court’s Housing Parts, one for each borough except Richmond County, to hear drug-holdover proceedings.⁶ The narcotics parts, formally called Illegal-Use Resolution and Trial Parts, hear cases in which allegations of illegal drug activity are the basis for the eviction proceeding.⁷

The Illegal-Use Parts offer several advantages. Motions in drug holdovers are heard and resolved quickly because the judges assigned to the Part are familiar with the applicable law and are sensitive to the Part’s policy imperatives. NEP cases, moreover, are given priority over other landlord-tenant cases awaiting trial. This priority allows police officers and other witnesses to come to court to testify on trial dates, and not sit around waiting to be heard. The relatively speedy resolutions of these proceedings also allow premises to be rented quickly to other residential and commercial tenants before new traffickers can move in.⁸

Another advantage to the NEP is the help that ADAs offer to landlords, judges, and, from time to time, even tenants. Although the DA’s Office has no standing if it does not bring the case itself, the DA’s Office aids the landlord’s proceeding by the daily presence of a paralegal or occasionally an ADA in the Illegal-Use Parts. The DA’s personnel assure the presence of police officers and the production of evidence, and they discuss and negotiate settlements.

Depending on the county and the case, an ADA, or a law student working with an ADA, might even try the landlord's case. When they do not try the landlord's case, an ADA will offer strategy and hand over scripts to assist a landlord's lawyer to question witnesses. Practice and case law even allow ADAs to argue orally before the court and submit motions as a friend of the court.⁹

But the DA is not a party in a drug-holdover proceeding brought by a landlord and cannot stop a landlord from settling a drug holdover.¹⁰ Landlords and tenants often agree to settle. One settlement that averts a trial is a probation agreement in which the tenant agrees permanently to exclude from the home the offending household member who was involved in the illegal drug activity. Another possible disposition is the tenants' consent to a final judgment of possession in which the petitioner agrees to stay execution of the warrant for a lengthy period of time; that can be a significant benefit because after trial courts usually grant no stay at all, unless all consent. ADAs often tell landlords not to accept these settlements. The reality is that landlords usually accede to the ADA's demands even though they do not have to. They worry that an ADA will accuse them of not proceeding diligently and in good faith, and neither tenants nor the courts can force a landlord to settle. Additionally, judges, who approve settlements through so-ordered stipulations, often rely on an ADA's recommendation not to so-order the stipulation.

Similarly, an ADA will sometimes tell a landlord to move to discontinue a drug case it had earlier told a landlord to bring. A landlord has the discretion not to comply with the ADA's suggestion. The landlord might want to continue the case if it wants to evict the tenant for other reasons—for example, to raise the rent if the tenant's apartment is rent-regulated. But a landlord will rarely exercise that discretion to go forward absent an ADA's continuing approval. Once an ADA tells a judge that a case is so weak that the tenant should not be evicted, the judge will pay close attention to the ADA's argument that the petition should be dismissed, and the landlord's case is doomed. In this regard, the presence of an ADA, who cares about the drug case and not about a landlord's ability to raise the rent, protects the integrity of the proceeding and offers some comfort to tenants.

III. Events Leading to a Drug-Holdover Proceeding

The NEP dictates that an assigned ADA review all drug-related search warrants and felony arrests to determine whether to bring a drug-eviction proceeding.¹¹ The process begins when the landlord learns that a sale of a controlled substance occurred at or is being conducted from the premises. The ADA can gather

further evidence through a search warrant or through confidential informants who might document the existence of illegal activity on the premises.

Once the ADA believes there is sufficient evidence to prove that an illegal business is being conducted on or from the premises, the DA's office begins a drug-eviction proceeding by serving a notice on the landlord. The notice asks the landlord to begin an eviction proceeding within five days against tenants using or allowing others to use the premises to sell drugs.¹² If the landlord refuses or neglects to act within a reasonable time, the DA's office has the authority to commence a proceeding against the tenants under RPAPL 715. That allows the DA's office to initiate the drug-holdover proceeding acting as the premises' owner or the landlord.¹³ The DA can recoup its reasonable legal fees from a landlord that did not begin the drug-holdover proceeding or which did not diligently prosecute it despite the DA's notice.¹⁴

The DA's notice to the landlord need not comply with the Civil Practice Law and Rules (CPLR) statutory requirements pertaining to serving pleadings.¹⁵

IV. Commencing a Drug-Holdover Proceeding

A. Pretrial Notices

The general rule is that landlords need not serve a termination notice.¹⁶ The reason is that RPL § 231(1) voids the lease if the premises are used for illegal trade or activity. Exceptions arise to the general rule. The first is that a termination notice is required as a condition precedent when the premises to be recovered are rent controlled¹⁷ or rent stabilized¹⁸ and the petitioner is a private landlord.¹⁹ The second is when federal law requires a predicate notice, such as for public housing in New York City,²⁰ which is run by the New York City Housing Authority, and for Section 8 housing.²¹ The third is for tenants of buildings owned or operated by New York City. Under RPL § 232(a), a month-to-month tenant of city-owned housing is entitled to a 30-day termination notice before an eviction proceeding may begin.²²

Because RPL § 231(1) terminates a lease automatically, a drug-holdover proceeding is technically not a holdover at all, at least not a typical one. A typical holdover arises from an expired or terminated lease. A drug holdover arises from a landlord-tenant relationship that terminates as a matter of law upon the illegal use in the subject premises. Thus, the waiver doctrine, which affects typical holdovers, is inapplicable to so-called drug holdovers. Laches is no defense, and it is irrelevant whether a landlord, after commencing a drug holdover, accepts rent, begins and even obtains a final judgment in a nonpayment proceeding, or renews a lease.²³

The termination notice must set forth the facts on which the proceeding is based. That requirement exists so that the respondent-tenant has ample notice about the proceeding and to ensure that the respondent has a fair chance to prepare a defense.²⁴ A termination notice is insufficient if it sets out only conclusory allegations.²⁵ Courts determine the adequacy of a termination notice on a case-to-case basis. A court that finds a termination notice insufficient will dismiss it under RPAPL 741(4).²⁶

A landlord need never serve a notice to cure before starting a drug-eviction proceeding. Public policy forbids a court to grant a cure to a tenant who had actual or constructive knowledge of the illegal acts or who passively acquiesced in them.²⁷ A petitioner must prevail with an eviction, therefore, even if the illegal activity ended long before trial.²⁸

B. Petition and Notice of Petition

After serving a termination notice or if no termination notice is required, a landlord then serves the tenant with a petition and notice of petition. The petition in a drug-holdover proceeding that follows an arrest usually contains law-enforcement paperwork like the search warrant (although not the affidavit underlying the warrant²⁹), police department property-clerk vouchers showing what the police allegedly seized, and laboratory reports stating whether the substance tested is an illegal drug and, if so, what kind and its weight. The failure to include documentation detailing the quantity of illegal narcotics recovered and a description of the illegal drug paraphernalia seized renders a petition facially defective and warrants dismissal of the petition.³⁰

The statute of limitations for a landlord to bring a drug holdover is one year from the date of the search and seizure of the drugs and drug paraphernalia.³¹ As opposed to a private landlord, the DA has a three-year period within which to serve and file the petition and notice of petition.³²

C. Burden of Proof

The petitioner has the burden of proof, by a preponderance of the evidence, to show that leased premises were used for illegal purposes.³³

A petitioner will not satisfy the burden of proof in a drug-eviction proceeding if the evidence shows that the tenant possessed the illegal drug for personal use. Nor will it be sufficient if the petitioner shows only that the illegal drug sale was a one-time or isolated occurrence. The petitioner must establish by a fair preponderance of the evidence that a continuing illegal business, not merely illegal activity, was conducted on or from the premises with the participation, knowledge, or at least passive acquiescence of one or more of the record tenants.³⁴

The court decides whether the tenant was involved in the illegal business, knew that the illegal business was taking place in the premises, or should have known that the illegal business existed and did not take reasonable steps to prevent it.³⁵ The standard arising from the circumstance when a tenant should have known that the illegal business existed and did not take reasonable steps to prevent it is called the “knew or should have known” standard. The courts have found that “it is sufficient if the acts and conduct complained of warrant the inference of acquiescence in an occupancy contemplating the prohibited purpose.”³⁶ A tenant who knew that the premises were being used to sell illegal drugs and did nothing about it will be evicted. If the tenant did not know about the illegal business but a reasonable person should have known about or recognized it, the ignorant tenant will be evicted.

The idea of punishing indifferent tenants was well-stated in the seminal case of *City of New York v. Goldman*, in which the court found that “[t]here comes a time when one must look and when he looks, he must see. Convenient indifference should not be confused with pardonable ignorance.”³⁷ A tenant cannot ignore that an illegal business is taking place in the subject premises. Instead, the tenant must take steps, like calling the police or having the person removed from the premises, to prevent the illegal business. Tenants who do not do so might be evicted.

D. Pretrial Issues

An array of pretrial collateral issues affect drug holdovers. First, an eviction does not constitute a multiple punishment in violation of the Double Jeopardy Clause. Thus, one can be both punished criminally after a conviction and evicted for the same conduct.³⁸ Second, neither the Fourth nor the Fifth Amendments require a stay of a Housing Part holdover proceeding to await the outcome of a related criminal trial. As to the Fourth Amendment, most courts have held that a motion to suppress evidence under *Mapp v. Ohio*³⁹ does not apply to drug-eviction holdovers.⁴⁰ As to suppressing statements under *Miranda*, a *Huntley* hearing is unavailable in a drug holdover.⁴¹ As to the Fifth Amendment, a defendant in a criminal case who is a respondent in a Housing Part holdover must choose between preserving a Fifth Amendment privilege and not testify or risk an adverse inference. That dilemma does not, however, justify staying the drug holdover to await the resolution of the criminal action.⁴²

Disclosure requests are possible but rarely granted to respondents in drug-holdover proceedings. The rule in drug holdovers is that disclosure should be denied unless the need for the information is compelling and particularized, and even then it should be granted only

when the information sought will not jeopardize the safety of informants or the police or the confidentiality of current or impending law-enforcement investigations.⁴³ As to disclosing *Rosario* and *Brady* material—respectively, written or otherwise-memorialized statements by witnesses in law enforcement’s possession and exculpatory material in law enforcement’s possession—one court has held that they are neither relevant nor appropriate because a drug holdover “is not a criminal proceeding, [and thus that] ‘there is no evidence or information which would tend to negate the guilt of the accused or mitigate the offense charge or which would tend to reduce the punishment of the accused.’”⁴⁴

V. New York’s Illegal-Use Statutes

New York’s illegal-use statutes were enacted in the Victorian Era. Their original purpose was to give law enforcement a weapon against prostitution.⁴⁵ The language of each statute is broad and can be interpreted in different ways. Over the years, the purpose of these statutes has changed in response to social realities.⁴⁶ That purpose has extended to landlord-tenant relationships, allowing both landlords and tenants to bring eviction proceedings against illegal-use tenants.

RPL § 231 sets forth the legal consequences tenants face when they use their dwellings for illegal purposes. Section 231(1) provides that when tenants maintain apartments for an illegal use, the lease or tenancy ends. The statute provides that

Whenever the lessee or occupant other than the owner of any building or premises, shall use or occupy the same, or any part thereof, for any illegal trade, manufacture or other business, the lease or agreement for the letting or occupancy of such building or premises . . . shall thereupon become void, and the landlord of such lessee or occupant may enter upon the premises so let or occupied.⁴⁷

If a landlord knows that a tenant is using the premises to conduct an illegal business, RPL § 231 provides the right to commence an eviction proceeding. By its terms, it also states at subdivisions five and seven that the Attorney General or any owner or tenant, including any tenant living “within two hundred feet of the demised real property, may commence an action or proceeding in supreme court to enjoin the continued unlawful trade, manufacture or other business in such premises.”⁴⁸

RPAPL 711(5) allows landlords to bring eviction proceedings against an illegal-use tenant when “[t]he premises, or any part thereof, are occupied as a bawdy-house, or house or place of assignation for lewd persons, or for purposes of prostitution, or any ille-

gal trade or manufacture, or other illegal business.”⁴⁹ RPAPL 715 allows the DA’s office and tenants residing within 200 feet of illegally used premises to begin eviction proceedings against illegal-use tenants if the landlord fails to do so.⁵⁰

VI. Defining Illegal Use

Neither the RPAPL nor the RPL defines “illegal,” “use,” or “illegal use.”⁵¹ Courts have created a five-factor test to determine whether a tenant is engaged in “illegal use.” “Illegal use” exists if there is (1) illegal conduct; (2) engaged in as a business; (3) more than once; (4) involving the premises to be recovered; and (5) with the participation, knowledge, or passive acquiescence of one or more of the record tenants.

A. Illegal Conduct

Legislators at first enacted the “illegal use” statutes to deal with public health, morals, and welfare. The statutes’ longstanding moral dimension has generated terms like “bawdy house,” “lewd persons,” and “vice.”⁵² These terms have led to complications in today’s jurisprudence, but they apply to illegal trade, manufacture, or business.⁵³ New York’s “illegal use” statutes are “unambiguous in proscribing ‘any illegal trade, manufacture or business’ without reference to the moral turpitude of any given conduct or the impact of such conduct on other tenants or in a neighborhood.”⁵⁴

Regardless of a business’s morality, eviction proceedings are warranted if the conduct complained of violates the Penal Law.⁵⁵ Eviction is allowed for crimes like drug trafficking, prostitution, gambling, and storing fireworks.

B. Business Use

For conduct to fall under the illegal-use statutes, the illegal use must constitute a business. RPL § 231 allows a landlord to terminate a lease only when the premises are “used . . . for any illegal trade, manufacture or other business.”⁵⁶ This narrow language forbids eviction proceedings based solely on an individual’s personal use of illegal drugs, regardless of the duration or quantity of that personal use.⁵⁷ The landlord must instead prove that the respondents knew or should have known that they or an occupant engaged in illegal “trade” or “manufacture.”⁵⁸

To distinguish a person’s personal use from business use, possession, or sale, New York courts look to several factors to determine whether the use relates to a sale, manufacture, or business. These factors include (a) quantity and packaging of the drugs;⁵⁹ (b) paraphernalia;⁶⁰ (c) loose cash; (d) customer lists; (e) weapons and ammunition;⁶¹ and (f) digital scales. This list is not exhaustive or conclusive. Courts make the determination on a case-by-case basis.

C. Continuity

The term “use” in the RPAPL and the RPL does not refer to a one-time occurrence: The “use” must occur continually on the premises.⁶² A single act does not satisfy the “use” requirement.⁶³ Yet “[c]essation of illegal activity prior to trial will not prevent the petitioner from obtaining a judgment.”⁶⁴

If a tenant conducts a casual transaction selling a negligible quantity of drugs inside an apartment, the business requirement might be met, but the continuity requirement will not be satisfied, and an eviction will not be warranted.⁶⁵ One way for the courts to ascertain whether continuity exists is to examine the quantity of the drugs and the quality of other evidence seized during the tenant’s arrest.

D. Nexus to the Premises

The RPAPL does not define “premises.” “Premises” is an elastic, inclusive term that depends on the circumstances in the individual case. One court has held that the common areas of a building, including the street in front of an apartment building, constitute the premises for the purposes of a drug-holdover eviction.⁶⁶ Most courts have required that the petitioner prove the apartment is the location of the illegal drug sale or production. The landlord must demonstrate, therefore, that the premises were used to further an illegal business.⁶⁷ A sufficient nexus must exist between the operation of the illegal business and the complained-of premises.⁶⁸

One way to prove this nexus is through an eyewitness who observes the tenant continually selling drugs from the premises. Another way is to offer testimony or video of foot traffic, which might circumstantially suggest a drug business connected to the premises if the volume of traffic is large, at odd hours, and indicates stays of short duration. Often the drugs are seized on the premises during an arrest or pursuant to a search warrant. This shows a relationship to the premises. It allows courts to infer the connection to the premises by the drugs’ location.⁶⁹

People who conduct illegal activity on the street far from their apartments and who never store illegal substances inside their apartments cannot be evicted through a drug-eviction proceeding. In that event a sufficient nexus between the illegal business and the premises cannot be established.

E. Presence of Illegal Drugs

The petitioner must prove that illegal drugs were on the premises. This is usually done by introducing at trial a police laboratory report to prove that the substances found at the premises were illegal and by offering police testimony to show a chain of custody of those substances through property-clerk voucher forms

from the time of the search warrant until the time of the police laboratory test. Most laboratory reports contain the chemist’s certification and thus are automatically admissible. Without that certification, a petitioner must lay a sufficient foundation under the business record rule, CPLR 4518(a), to show that the report was made in the ordinary course of business, that it was the ordinary course of business to make such a report, and that the report was made within a reasonable time after the testing.

F. Acquiescence

Another factor that establishes illegal use is that the tenant participated in or had actual knowledge of the illegal business. It is unnecessary for the tenant to be involved in the actual drug sales for the court to find illegal use. It is enough that the tenant turned a blind eye to the illegal business.⁷⁰ For example, it is no defense that the tenant left the apartment to an acquaintance because of a medical emergency or vacation and that the illegal activities occurred while the tenant was elsewhere, if the tenant acquiesced in the drug activity.⁷¹

Proving that the tenant had actual knowledge of the illegal business is difficult. This difficulty has led to years of case law interpreting the “knew or should have known” standard.

VII. The “Knew or Should Have Known” Standard

New York case law applies six factors to ascertain whether a tenant knew or should have known about a drug business connected to the subject premises. The factors are (1) whether the contraband and paraphernalia were in plain view; (2) the size of the premises; (3) the drug-arrest history of the named tenant or the occupant who is alleged to have committed the illegal activity; (4) whether intensive foot traffic occurred in and out of the premises; (5) the presence of contraband; and (6) the connection between the person alleged to possess the contraband and the apartment in which the alleged drug business occurs.

The “knew or should have known” standard is vague. Although the courts must take into account the NEP’s purpose, they cannot lose sight of the effect that evictions will have on indigent tenants, often with minor children, who were not involved in illegal activity. In a three-bedroom apartment where closets and locks are on each bedroom door, are parents supposed to do daily sweeps of the bedrooms to ensure that no illegal activity occurs? What about someone who rents a room to a boarder for extra money, either as a roommate or as a sublease? Should a tenant lose the home because of the roommate’s or subtenant’s activities? Yes, but only if the facts of the case show an inference of knowledge or willful blindness.⁷²

An explanation of the factors that determine whether a tenant knew about or acquiesced in the illegal activity will help navigate this fact-intensive terrain.

A. Plain View

When the police execute a search warrant and find substantial contraband around the premises in the open, evicting the tenant from the subject apartment might be reasonable.⁷³ But it is improper to hold an innocent tenant liable for the illegal-use tenant's activities if the evidence shows that the illegal-use occupant concealed the illegal business activity by hiding the narcotics in a closet, in a locked box, under a bed, or in an obscure location. A tenant reasonably unaware of the illegal business activities of another tenant or occupant who took measures to hide the illegal business cannot be evicted.⁷⁴

The size of the contraband found in the premises will affect a court's determination whether the contraband is in plain view.⁷⁵ An eviction is warranted when the contraband is so physically large that the tenant must have seen it and known what it was.⁷⁶ Tenants have a responsibility to be aware of the activities taking place in their premises in plain view, but they will not be evicted if the illegal activities were hidden from a person who reasonably had no reason to know about the activities.

B. The Premises' Size and Configuration

New York courts will consider the size and layout of the premises when determining whether the "knew or should have known" standard is satisfied. It is unreasonable to expect that a tenant would know what a third party is doing in a large apartment with several bedrooms, each with its own door with a lock.⁷⁷ In a small studio apartment, where everything is in the open, it will be easier for a landlord to prove that the other tenants knew about the illegal business conducted by the alleged illegal-use tenant or occupant.⁷⁸

In some instances a court will find that even in a large apartment, the tenant should have known that an illegal business was taking place. That might occur when the configuration of the premises requires the tenant to pass through the rooms where the contraband is located and the contraband is in plain view.⁷⁹ If the landlord or the DA can prove that a reasonable person would have seen the contraband and realized that another tenant or occupant was conducting an illegal business, an eviction will be justified.

C. History of Drug Arrests

New York courts will also consider the history of drug arrests of the alleged illegal user, roommate, subtenant, guest, or tenant when deciding whether the landlord has satisfied the "knew or should have known" standard. If the occupant has a history of drug

use, drug possession, or drug arrests of which the record tenant was or should have been aware, it is more likely that an eviction will ensue.⁸⁰

The courts are more likely to evict the other tenants as well,⁸¹ because indifference is different from ignorance.⁸² If a tenant knows that the co-tenant, guest, roommate, or subtenant has a history of selling drugs, with convictions for narcotics-related crimes, the tenant has a heightened duty to ensure that the co-tenant, guest, roommate, or subtenant is not conducting illegal business from the premises.

With regard to a drug-arrest history, the issue arises whether a landlord is precluded from using information from a tenant's sealed criminal records in a hold-over proceeding. One Housing Part judge ruled that only a superior court has the power to entertain that application.⁸³ In a recent Supreme Court decision, a judge granted a motion to vacate a prior order unsealing the record of a criminal case.⁸⁴ The court held that the DA was not authorized under Criminal Procedure Law 160.50 to unseal a criminal-case record. According to the court, seeking to provide evidence for a civil eviction proceeding does not serve a criminal investigation purpose—the only purpose the statute authorizes—and, further, that the DA did not show that justice required the unsealing action.⁸⁵

One consideration is whether the tenant of record was arrested during or right after the search warrant was executed. An arrest is proof of nothing, but a tenant not arrested will argue that the police officers' decision not to arrest means the absence of proof that the tenant was complicit in the drug crime.

More important than an arrest or the decision not to arrest is whether the tenant of record was arrested and then convicted after a trial or a plea of guilty to selling drugs or to possessing them with the intent to sell them. A person found guilty in a criminal case is collaterally estopped from arguing non-guilt in a civil case.⁸⁶ But a person arrested who was found not guilty or whose charges were dismissed or withdrawn does not benefit from that happenstance. The burden of proof in a criminal case is proof beyond a reasonable doubt. One can be found not guilty and still be evicted under the lesser preponderance standard applicable in civil cases. One can also benefit from constitutional protections afforded in criminal prosecutions but unavailable in civil cases. Moreover, the civil "knew or should have known" standard differs markedly from the individual culpability considered in criminal prosecutions. It is not a crime to know about drug activity and do nothing to stop it. One can be evicted, however, for knowing about it and not stopping it.

D. Foot Traffic Through the Premises

Another factor New York courts consider is foot traffic in and out of the premises. An eviction might be

warranted if the landlord can prove extensive foot traffic. Foot traffic—especially traffic that moves quickly, as if the premises were a drug supermarket—might suggest that an illegal business is being conducted in or from the premises and that the supposedly unaware tenant is not innocent after all.⁸⁷ The court must decide on a case-by-case basis what constitutes an abnormally high level of foot traffic. It is easier for a court to make its determination in residential premises than in commercial premises. Businesses naturally have a high level of traffic.

E. Contraband in the Tenant's Room

New York courts have ruled that an eviction is warranted when the record tenants have contraband in their bedrooms or on their person.⁸⁸ The presence of contraband in the tenant's bedroom or on the tenant's person indicates that the tenant had actual knowledge of the illegal business. With actual knowledge, there is no need to resort to the "should have known" standard.

F. The Connection between Tenant and Drug Dealer

The relationship between the tenant and the person who sells or possesses the contraband for sale is significant, as is the duration of stay in the apartment. Where the person with the contraband was in the apartment only for two weeks as a boarder before the police raid, no eviction was warranted. Similarly, the illegal activity of a former boyfriend or girlfriend of the adult child of the tenant of record who is present in the apartment only for an occasional overnight would normally carry less weight for eviction of the otherwise innocent tenant than if the same illegal activity was done by the tenant's child. In short, where the illegal activity was caused by a family member, close friend, or paramour of the tenant of record, it is more likely that the "knew or should have known" test will be met than if the cause was a person less connected to the tenant.⁸⁹

VIII. Strict Liability: The Recent Approach to Drug-related Activity

A. Public Housing Authorities

Congress enacted the United States Housing Act in 1937, effectively creating the first public housing.⁹⁰ Determining that creating sufficient and appropriate housing for poor people by private organizations and private landlords alone was impossible, Congress concluded that the federal government must intervene. The federal government decided to give local governments financial aid to encourage constructing acceptable housing for citizens of low income.⁹¹

The Housing Act was created to "alleviate present and recurring unemployment and to remedy the unsafe and unsanitary housing conditions and the acute shortage of decent, safe, and sanitary dwellings

for families of low income in rural or urban communities that are injurious to the health, safety, and morals of the citizens of the Nation."⁹² Because public housing apartments are limited, the Act gives each public housing authority the option to give preference to specific groups, like elderly or disabled persons or low-income families.⁹³ Given the limited amount of public-housing apartments relative to the huge demand and the growing problem of drug dealing in housing-authority projects across the country, the federal government has taken steps in recent years to punish drug dealers and drug dealing in public housing.

One step the federal government took was to discourage drug dealing by evicting tenants who, the theory goes, could have prevented drug crimes by being vigilant about criminality. The requirement to be vigilant has led to the lesser strict-liability approach in which proof of knowledge of criminality is not required to cause a forfeiture of the home.

Congress passed the Anti-Drug Abuse Act of 1988 to fight drug dealers, who were increasingly becoming a blight on public-housing tenants.⁹⁴ The Act gives public-housing officials the authority to include a new lease provision addressing evictions for drug related and other criminal offenses. The Act, as later amended, provides that each "public housing agency shall utilize leases which . . . provide that any criminal activity that threatens the health, safety, or right to peaceful enjoyment of the premises by other tenants or any drug-related criminal activity on or off such premises, engaged in by a public housing tenant, any member of the tenants household, or any guest or other person under the tenant's control, shall be cause for termination of the tenancy."⁹⁵

Continuing the nation's fight against drugs in public housing, a tougher stance was enacted against tenants who allow drug-related criminal activity to take place in or near their apartments. In his 1996 State of the Union Address, President Clinton announced his "One Strike" policy, asking local housing authorities and tenant associations to fight criminal gang members and drug dealers.⁹⁶ The "One Strike" policy urged public-housing authorities to adopt a tougher stance on evictions: "for residents who commit crime and peddle drugs . . . one strike and you're out."⁹⁷ After this announcement, Congress enacted the Housing Extension Act, and President Clinton issued a directive ordering the Department of Housing and Urban Development (HUD) to provide national guidelines for public-housing authorities to adopt the "One Strike Policy."⁹⁸ The intent was that the new, stricter policy would lead to "certain and swift eviction" for those who engage in drug-related criminal activity.⁹⁹

The United States Supreme Court case of *HUD v. Rucker* clarified the ambiguity about the federal strict-liability standard that had persisted since the inception

of the Drug-Abuse Act of 1988, in which the circuits were split about whether to apply a strict-liability standard. The Court found that 42 U.S.C. § 1437d(l)(6), which the Act created, “unambiguously requires lease terms that vest local public housing authorities with the discretion to evict tenants for the drug-related activity of household members and guests whether or not the tenant knew, or should have known, about the activity.”¹⁰⁰ The statute clarifies that a lease termination is warranted for any drug-related activity, not just the drug-related activity about which the tenants knew or should have known.¹⁰¹ The Court reasoned that Congress had a reasonable purpose in allowing no-fault evictions: to provide tenants of public-housing projects with “housing that is decent, safe, and free from illegal drugs.”¹⁰² The statute, however, does not require eviction. The decision to evict is left to the public housing authorities’ discretion. The authorities’ discretion is based on the “degree to which the public housing project suffers from ‘rampant drug-related or violent crime, the seriousness of the offending action, and the extent to which the leaseholder has . . . taken all reasonable steps to prevent or mitigate the offending action.’”¹⁰³

Scholars and housing advocates have written about the harm that this strict-liability statute has caused.¹⁰⁴ As one writer explained, “Although the laws and regulations are intended to reduce fear of gangs, criminals, drugs and violence in public housing, they provide another source of fear: being evicted for something the tenant did not do.”¹⁰⁵ Indeed, “holding the tenant responsible for the illegal acts of ‘other persons under her control’ when that person is an adult is a severe penalty, especially when the leaseholder could not foresee or was not aware of the person’s actions.”¹⁰⁶ Thus, although “keeping public housing free of illegal drugs is an important objective, keeping innocent tenants in their homes is at least as important.”¹⁰⁷ The strict-liability standard might maximize deterrence by putting the onus on the tenant to prevent drug activity by household members or guests. But strict liability is not always proper when a tenant has taken reasonable precautions against criminal activity. Thus, many believe that public-housing authorities should seek to evict only if the circumstances warrant this drastic measure.¹⁰⁸ Judges have also expressed the sentiment, even in non-strict-liability cases, that innocent tenants faced with the lack of affordable housing should not be evicted for a third person’s acts.¹⁰⁹

B. Section 8

The Section 8 program, called the Housing Choice Voucher Program, since 1996 grants federal subsidies for low-income tenants not in a federally subsidized public-housing authority like a New York City Housing Authority (NYCHA) development. The voucher can be tenant-based or project-based. Tenant-based programs are administered in New York by public housing agen-

cies (PHAs) like NYCHA, the Department of Housing and Community Renewal, and the Department of Housing Preservation and Development. Tenant-based programs stress tenant portability in the marketplace wherever landlords accept vouchers. Project-based programs, administered in New York by Quadel Consulting, a private company, apply to privately owned apartments, and typically to entire privately owned developments.

The issue in drug-holdover proceedings involving Housing Choice Voucher Program units, whether tenant- or project-based, is whether strict liability applies, assuming that the lease between the parties or the HUD-required lease has a clause that allows for strict liability, because strict liability may not be imposed absent a lease clause that allows for strict liability. Some commentators argue that strict liability does not apply to Housing Choice Voucher Program units.¹¹⁰ These commentators contend that it is especially unfair to allow private owners of Section 8 housing to impose strict liability; unlike NYCHA, for example, which has the discretion whether to seek to evict on strict liability, private owners do not exercise that discretion in the public interest. But New York case law from the lower courts imposes strict liability.¹¹¹ The consensus among the lower courts that the “knew or should have known” standard does not apply to Section 8 housing in New York will likely continue until an appellate court holds otherwise.

C. The Federal Standard Versus the New York Standard

New York law requires that an eviction for illegal use be founded on commercial drug-related activity, as explained above. Under New York law, the tenant need not be directly involved in the illegal activity, but the landlord must establish that the tenant knew or acquiesced in the illegal activity.¹¹² Strict liability does not apply. In New York City today, the NYCHA, which runs all public housing in the five boroughs, has chosen to proceed under either New York’s “knew or should have known” standard or the federal strict-liability standard depending on the circumstances of the case.

Until 1996, NYCHA dealt with tenants allegedly involved in illegal activity by holding an administrative termination hearing rather than by bringing a drug-holdover proceeding.¹¹³ During this period, when a DA’s Office asked NYCHA to commence a NEP proceeding under RPAPL 715(1), NYCHA would instead hold an administrative hearing.¹¹⁴ The DA would then have to litigate the drug-holdover proceeding in Civil Court if it chose to do so.¹¹⁵ The DA was not required to wait for an administrative hearing to be held before bringing a NEP case against a public-housing tenant.¹¹⁶ Some believe that an administrative hearing provides procedural and substantive protections to tenants

facing eviction.¹¹⁷ At these hearings, NYCHA would sometimes seek to settle the matter by a stipulation that allowed for the conditional continuation of the tenants' tenancies. In extreme circumstances, NYCHA would pursue termination of the tenancy. If either the tenant or NYCHA refused to settle the matter, the hearing would be conducted before an administrative law judge, called a hearing officer, who would make a determination subject to approval or rejection by the NYCHA board. If the NYCHA board makes a determination unfavorable to the tenant, the tenant has three options: "to voluntarily vacate the apartment; to challenge the determination through an Article 78 proceeding in Supreme Court; or to appear in Housing Court upon the commencement of a summary holdover proceeding against her."¹¹⁸

In 1996, in *Escalera*, NYCHA obtained a modification of the consent decree to allow proceedings based on allegations of illegal drug activity to be brought directly in the Civil Court's Housing Part without first holding an administrative hearing.¹¹⁹ In modifying the consent decree, the *Escalera* court found a dramatic increase in illegal drug trafficking and use and drug-related crime in New York's public housing.¹²⁰ This modification gave NYCHA the discretion to bring a drug-holdover proceeding in an NEP/Illegal-Use Part or, before bringing that proceeding, to hold an administrative hearing.

The *Rucker* decision gave NYCHA the discretion to pursue the federal standard of strict liability in those cases that suggest stringent enforcement. The circumstances of each case dictate the course NYCHA will pursue. Under many circumstances, applying the "knew or should have known" standard will lead to the same result that *Rucker's* strict-liability standard allows. If the circumstances do not clearly indicate that the tenant either participated in or knew about illegal conduct in their apartment, NYCHA will have discretion to hold an administrative hearing and pursue the application of the "knew or should have known" standard.

IX. Conclusion

The courts' various approaches to the problems of narcotics sales show the common law's evolution in New York. The NEP is an innovative court program intended to remedy a widely recognized social scourge. The NEP allows drug-related activity in residential units in New York City to be addressed swiftly. The mechanism of having the DA push private landlords and NYCHA to commence holdover proceedings insures that the ignorance and sometimes connivance of landlords about alleged drug activities does not bar prompt action. The DA's ability to give landlords the details of the drug arrests and paraphernalia recovered by the police in drug raids also insures that landlords will have enough evidence to present their case fairly.

The use of the DA's contacts and resources to insure that police officers appear to testify is essential to having all relevant evidence at trial, something private landlord's attorneys are hard-pressed to arrange themselves.

The mere fact of a lawsuit does not mean that a claim has merit. The landlord must sustain its burden to prove the elements of its claim. Innocent tenants who neither knew nor should have known about the drug activity of others who have occupied their apartments temporarily should not be rendered homeless. The factors to which the courts have looked to determine whether the "should have known" standard has been met in New York balances society's need to limit drug businesses and the rights of innocent tenants to maintain their homes and commercial space when they are unaware of hidden and surreptitious activity. Given the shortage of affordable housing in New York, strict liability for federally subsidized and public housing is a severe but effective remedy.

Endnotes

1. *N.Y.C. Hous. Auth. v. Pretto*, 8 Misc. 3d 708, 711, 795 N.Y.S.2d 871, 873 (Hous. Part Civ. Ct., Bronx Co. 2005) ("RPL § 231 does not create a cause of action to evict a tenant. To evict a tenant, a landlord must rely upon the provisions of RPAPL §§ 711(5) and 715(1)."); Andrew Scherer, *Residential Landlord and Tenant in New York* § 8:101, at 555 (2007).
2. Irving B. Hirsch, *Understanding Forfeiture and Related Civil Actions in Criminal Law: Padlock Proceedings; Nuisance Abatement Actions Evictions*, Practising Law Institute Litigation and Administrative Practice Course Handbook Series Criminal Law and Urban Problems, 164 PLI/Crim. 117, at 120 (1992).
3. *Kellner v. Cappellini*, 135 Misc. 2d 759, 765, 516 N.Y.S.2d 827, 831 (Hous. Part Civ. Ct., N.Y. Co. 1986).
4. George M. Heymann, Outside Counsel, *Eviction Proceedings for Alleged Illegal Drug Activities: An Overview*, N.Y.L.J., May 28, 1999, p. 1, col. 1.
5. Steven I. Kessler, *New York Criminal and Civil Forfeitures Including Narcotics Eviction Proceedings* 265 (1999).
6. *Id.* at 268 & n. 18 (citing *Martinez v. N.Y.C. Hous. Auth.*, N.Y.L.J., July 2, 1996, p. 26, col. 3 (Sup. Ct., N.Y. Co.) and *City of N.Y. v. 924 Columbus Ave. Assocs.*, N.Y.L.J., Oct. 19, 1994, p. 22, col. 3 (Sup. Ct., N.Y. Co.)).
7. Scherer, *supra* note 1, at § 8:133, at 569.
8. See Kessler, *supra* note 5, at 268.
9. See, e.g., *Rochdale Village Inc. v. Harris*, 172 Misc. 2d 758, 763, 659 N.Y.S.2d 416, 419 (Hous. Part Civ. Ct., Queens Co. 1997).
10. See Heymann, *supra* note 4 (citing cases) ("Does the court have the authority to accept and 'so order' a stipulation of settlement entered into between petitioner(s) and respondent(s) after a settlement conference, immediately prior to trial, without the consent of the District Attorney's office? The answer is yes.").
11. See Hirsch, *supra* note 2, at 123.
12. National Institute of Justice, *The Manhattan District Attorney's Narcotics Eviction Program* 5 (1995).
13. *Id.*
14. RPAPL 715(4).
15. See Hirsch, *supra* note 2, at 125.
16. E.g., *Hudsonview Co. v. Jenkins*, 169 Misc. 2d 389, 645 N.Y.S.2d 741 (Hous. Part Civ. Ct., N.Y. Co. 1996).

17. State Rent and Eviction Regulations, 9 N.Y.C.R.R. § 2204.2(a)(4), authorizes the eviction of rent-controlled tenants based on use of the premises for illegal activity, but only if a notice terminating the tenancy under 9 N.Y.C.R.R. § 2204.3(a) is served. See *Park 83rd St. Corp. v. Thomas*, N.Y.L.J., June 3, 1992, p. 23, col. 3 (Hous. Part Civ. Ct., N.Y. Co.).
18. 9 N.Y.C.R.R. § 2524.2(c)(2) (requiring service of seven-day notice to vacate on rent-stabilized tenant to proceed on ground of using premises for immoral or illegal purpose); see 9 N.Y.C.R.R. 2524.3(d) (allowing eviction of rent-stabilized tenants using or permitting use of dwelling for immoral or illegal purpose).
19. *2312-2316 Realty Corp v. Font*, 140 Misc. 2d 901, *passim*, 531 N.Y.S.2d 727, *passim* (Hous. Part Civ. Ct., Bronx Co. 1988).
20. See 24 C.F.R. Part 866; *Jackson Terrace Ass'n v. Patterson*, 155 Misc. 2d 556, 557, 589 N.Y.S.2d 141, 141 (Dis't Ct., Nassau Co. 1992), *appeal dismissed*, 159 Misc. 2d 637, 611 N.Y.S.2d 430 (App. Term, 2d Dep't 9th & 10th Jud. Dists. 1994) (mem.) (but noting in dictum, in decision rendered before federal regulations required termination notice, that termination notices are not ordinarily required for proceedings brought under RPAPL 711(5)).
21. 24 C.F.R. §§ 966.4(l)(2)(iii)(A), 966.4(l)(3)(i)(B)(2), 966.4(l)(3)(ii); *N.Y.C. Hous. Auth. v. Harvell*, 189 Misc. 2d 295, 296, 731 N.Y.S.2d 919, 920 (App. Term, 1st Dep't 2001) (per curiam).
22. Kessler, *supra* note 5, at 277–78.
23. See, e.g., *Hudsonview*, 169 Misc. 2d at *passim*, 645 N.Y.S.2d at *passim*.
24. *N.Y. Co. Dist. Attorney's Office v. McDaniels*, N.Y.L.J., May 24, 1991, p. 22, col. 4 (Hous. Part Civ. Ct., N.Y. Co.).
25. *Dowarp Realty v. Acevedo*, N.Y.L.J., Apr. 3, 1990, p. 26, col. 2 (App. Term, 1st Dep't) (per curiam).
26. *Cleo Realty Assocs. v. Stevens*, N.Y.L.J., Mar. 19, 1992, p. 26, col. 6 (Hous. Part Civ. Ct., N.Y. Co.) (“RPAPL 741(4) requires a petition ‘to state the facts upon which the special proceeding is based.’”).
27. E.g., *N.Y. Co. Dist. Attorney's Office v. Merced*, N.Y.L.J., Sept. 22, 1994, p. 29, col. 6 (Hous. Part Civ. Ct., N.Y. Co.).
28. *Broadway Central Securities Corp. v. Buchanan Restaurant Co., Inc.*, 218 App. Div. 594, 599–600, 218 N.Y.S. 539, 544 (1st Dep't 1926).
29. Depending on confidentiality issues, affidavits underlying search warrants might be obtainable in Criminal Court (if the case is a misdemeanor or unindicted felony) or Supreme Court (if the Grand Jury has voted to indict) so that a defendant can move to controvert the search warrant during a *Franks/Alfinito* hearing and thus seek suppression on Fourth Amendment grounds. See *People v. Castillo*, 80 N.Y.2d 578, 592 N.Y.S.2d 945, 607 N.E.2d 1050 (1992), *cert. denied*, 507 U.S. 1033 (1993).
30. *Cleo Realty*, N.Y.L.J., Mar. 19, 1992, p. 26, col. 6.
31. *Pretto*, 8 Misc. 3d at 713, 795 N.Y.S.2d at 875.
32. *Id.*, 795 N.Y.S.2d at 874–75.
33. *Normandy Realty v. Boyer*, 2 Misc. 3d 407, 410, 773 N.Y.S.2d 186, 189 (Hous. Part Civ. Ct., Bronx Co. 2003).
34. See Hirsch, *supra* note 2, at 125–26.
35. *Id.* at 132.
36. *City of N.Y. v. Goldman*, 78 Misc. 2d 693, 696–97, 356 N.Y.S.2d 754, 758 (Civ. Ct., N.Y. Co. 1974).
37. *Id.* at 696, 356 N.Y.S.2d at 758.
38. *City of N.Y. v. Wright*, 162 Misc. 2d 572, 573–74, 618 N.Y.S.2d 938, 938 (App. Term, 1st Dep't 1994) (per curiam) (noting in case of tenant who pleaded guilty to felony attempted possession of a controlled substance, following seizure of 35 jumbo vials of crack, drug paraphernalia, cash, and a gun, that eviction was not punishment but “was intended to protect the health, welfare and safety of the public residing in the same community as well as the tenants who reside in the same building”), *aff'd*, 222 A.D.2d 374, 636 N.Y.S.2d 33 (1st Dep't 1995) (mem.), *appeal dismissed*, 87 N.Y.2d, 644 N.Y.S.2d 146, 666 N.E.2d 1060 (1996).
39. 367 U.S. 643 (1961).
40. E.g., *Pleasant E. Assocs. v. Soto*, N.Y.L.J., Oct. 27, 1993, p. 26, col. 3 (Hous. Part Civ. Ct., N.Y. Co.) (noting that paramount justification for exclusionary rule—to deter unlawful police behavior—does not arise in drug holdovers). For a discussion of the issue, see *Ackert v. Figueroa*, N.Y.L.J., Apr. 8, 1997, p. 27, col. 1 (Hous. Part Civ. Ct., Queens Co.).
41. *N.Y.C. Hous. Auth. v. Grillasca*, 12 Misc. 3d 223, 224, 810 N.Y.S.2d 893, 895 (Hous. Part Civ. Ct., N.Y. Co. 2006) (Gerald Lebovits, J.) (citing *Miranda v. Arizona*, 384 U.S. 436 (1966), and *People v. Huntley*, 15 N.Y. 72, 255 N.Y.S. 838, 204 N.E. 179 (1965)); *contra City of N.Y. v. Prophete*, 144 Misc. 2d 391, 393, 544 N.Y.S.2d 411, 413 (Hous. Part Civ. Ct., N.Y. Co. 1989) (noting in dictum that to introduce statements, petitioner must lay foundation that statements were elicited voluntarily).
42. *54 W. 16th St. Apt. Corp. v. Dawson*, 179 Misc. 2d 264, 268, 684 N.Y.S.2d 400, 404 (Hous. Part Civ. Ct., N.Y. Co. 1998).
43. *Compare Grillasca*, 12 Misc. 3d at 226, 810 N.Y.S.2d at 896 (denying disclosure because of law-enforcement considerations), *with Wingate Hall Co. v. Betances*, N.Y.L.J., Sept. 29, 1993, p. 22, col. 6 (Hous. Part Civ. Ct., N.Y. Co.) (granting partial disclosure because respondent made compelling and particular demonstration of need for limited discovery and because petitioner did not demonstrate any risk to confidential informants).
44. *Merced*, N.Y.L.J., Sept. 22, 1994, p. 29, col. 6 (citation to Criminal Justice Standards omitted).
45. Kessler, *supra* note 5, at 265.
46. *Id.*
47. RPL § 231(1).
48. *Id.* § 231(6) & RPAPL 715(1). Rare are the cases brought by homeowners and tenants who live within 200 feet of an apartment, instead of by the landlord at the DA's prodding. See, e.g., *Kellner*, 135 Misc. 2d at 760, 516 N.Y.S.2d at 828.
49. RPAPL 711(5).
50. *Id.* 715(1); Kessler, *supra* note 5, at 264–65.
51. *Spira v. Spiratone*, 148 Misc. 2d 787, 789, 561 N.Y.S.2d 881, 883 (Hous. Part Civ. Ct., N.Y. Co. 1990).
52. See RPAPL 711(5), 715(1).
53. *Spira*, 148 Misc. 2d at 788, 561 N.Y.S.2d at 882 (finding, however, that attending church is not an illegal use).
54. *1165 Broadway Corp. v. Alawie*, N.Y.L.J., Nov. 8, 1995, p. 26, col. 3 (Hous. Part Civ. Ct., N.Y. Co.).
55. Kessler, *supra* note 5, at 263.
56. RPL § 231.
57. *Normandy Realty*, 2 Misc. 3d at 41–2, 773 N.Y.S.2d at 189–190.
58. RPAPL 711(5) & 715(1).
59. *Clifton Court, Inc. v. Williams*, N.Y.L.J., May 27, 1998, p. 28, col. 6 (App. Term, 2d Dep't 2d & 11th Jud. Dists.) (mem.) (finding that nearly 60 crack vials, a razor, and empty ziplock bags transportable in a couple of pockets does not prove that apartment was locus of drug operation); *Howard Ave. Assocs. v. Rojas*, N.Y.L.J., Apr. 5, 2002, p. 20, col. 6 (Hous. Part Civ. Ct., Kings Co.) (Gerald Lebovits, J.) (denying eviction of parents who had no knowledge that adult son had hidden marijuana for personal use sufficient to fill eight cigarettes—a violation, not a crime—and had no paraphernalia); *Kings Co. Dis't Attorney's Office v. Underwood*, 143 Misc. 2d 965, 968, 543 N.Y.S.2d 247, 250 (Hous. Part Civ. Ct., Kings Co. 1989) (holding that presence of 193 vials of crack reflected that drugs were being sold).
60. *N.Y. Co. Dis't Attorney's Office v. Geigel*, N.Y.L.J., Dec. 27, 1991, p. 24, col. 6 (Hous. Part Civ. Ct., N.Y. Co.) (noting that recovery heroin, cocaine, crack, crack vials, jars containing substances

used to dilute cocaine, glassine envelopes, cocaine grinders, cash, and scale was sufficient to evict).

61. *N.Y.C. Hous. Auth. v. Otero*, 2004 N.Y. Slip Op. 51454(U), 5 Misc. 3d 134(A), 799 N.Y.S.2d 162, 2004 WL 2683688, at *1, 2004 N.Y. Misc. LEXIS 2941, at *1 (App. Term. 1st Dep't 2004) (per curiam) (noting recovery of stun gun and "multiple rounds of ammunition").
62. *Randazzo v. Santangelo*, N.Y.L.J., Mar. 26, 1997, p. 31, col. 6 (Hous. Part Civ. Ct., Queens Co. 1997).
63. *N.Y.C. Hous. Auth. v. Boney*, N.Y.L.J., Feb. 3, 1998, p. 29, col. 5 (Hous. Part Civ. Ct., Kings Co.) (finding that single sale without other evidence of ongoing drug business is insufficient to support drug holdover).
64. Scherer, *supra* note 1, § 8:129, at 566.
65. *See 1165 Broadway Corp. v. Dayana of N.Y. Sportswear, Inc.*, 116 Misc. 2d 939, 944, 633 N.Y.S.2d 724, 727 (Civ. Ct., N.Y. Co. 1995).
66. *City of N.Y. v. Rodriguez*, 140 Misc. 2d at 467, 469–70, 531 N.Y.S.2d 192, 193-94 (Hous. Part Civ. Ct., Bronx Co.).
67. *City of N.Y. v. Omolukum*, 177 Misc. 2d 796, 801–02, 676 N.Y.S.2d 918, 922 (Hous. Part Civ. Ct., Bronx Co. 1998) (denying eviction of tenant for drug-related activities of former boyfriend, who was arrested for selling drugs once in front of building and twice in the building lobby where, although he gave his address as tenant's, she had kicked him out of apartment because of his violent behavior before arrests).
68. *See generally RRW Realty Corp. v. Flores*, N.Y.L.J., Feb. 10, 1999, p. 28, col. 3 (Hous. Part Civ. Ct., N.Y. Co) (discussing issue of nexus between alleged drug activity and three apartments in two buildings).
69. *N.Y.C. Hous. Auth. v. Manley*, N.Y.L.J., Jan. 8, 1997, p. 26, col. 2 (Hous. Part Civ. Ct., N.Y. Co.).
70. *Omolukum*, 177 Misc. 2d at 800–01, 676 N.Y.S.2d at 921.
71. *E.g., In re Syracuse Hous. Auth. v. Boule*, 265 A.D.2d 832, 832–33, 701 N.Y.S.2d 541, 541–42 (4th Dep't 1999) (men.) (allowing eviction under strict-liability standard because tenant's babysitter and another engaged in drug-related activity in or near federally subsidized premises while tenant was at work).
72. *See 88-09 Realty, LLC v. Hill*, 305 A.D.2d 409, 757 N.Y.S.2d 904 (2d Dep't 2003) (mem.); Drug Holdovers: *It's Getting Harder for Tenants to Claim Innocence*, 3 Finkelstein & Ferrara's Landlord-Tenant Practice Reporter 1 (Jan. 2002).
73. *N.Y.C. Hous. Auth. v. Eaddy*, 2005 N.Y. Slip Op. 50617(U), 7 Misc. 3d 131(A), 801 N.Y.S.2d 237, 2005 WL 954877, at *1, 2005 N.Y. Misc. LEXIS 811, at *1-2 (App. Term 1st Dep't 2005) (per curiam) (applying "knew or should have known" standard even though premises was public housing).
74. *Village Mgmt. Corp. v. Grant*, N.Y.L.J., Jan. 19, 1996, p. 25, col. 2 (App. Term, 1st Dep't 1996) (per curiam).
75. *N.Y.C. Hous. Auth. v. Barnes*, N.Y.L.J., July 25, 2005, p. 19, col. 3 (Hous. Part Civ. Ct., Kings Co.) (finding presence of 183 ziploc bags, one larger plastic bag of "green, leafy" marijuana, and two loaded handguns sufficient to evict).
76. *Farhadian v. Diaz*, N.Y.L.J., Feb. 26, 1990, p. 23, col. 4 (App. Term, 1st Dep't 1990) (per curiam) (finding that large quantities of drug paraphernalia, cash, and numerous firearms, as well as a safe that contained additional drugs and drug paraphernalia, show tenant's knowledge of illegal conduct); *Otero*, 2004 N.Y. Slip Op. 51454(U), 5 Misc. 134(A), 799 N.Y.S.2d 162, 2004 WL 2683688, *1, 2004 N.Y. Misc. LEXIS 2941, *1 (applying "knew or should have known" standard rather than *Rucker* strict-liability standard and allowing eviction where "police officers recovered a package containing 288 bags of cocaine, which was observed by the officers being thrown from a window of the subject premises . . . [and] digital scales, a speed loader, a stun gun, multiple rounds of ammunition, a metal safe, over \$6,000 in cash, and marijuana from two bedrooms"); *Dist. Attorney, Kings Co. v. Garcia*, N.Y.L.J., May 6, 1994, p. 33, col. 1 (Hous. Part Civ. Ct., Kings Co. 1994) (allowing eviction where sealing device was found, not in tenant's brother's locked bedroom, but in kitchen).
77. *Kingsley Court Assocs. v. Moreno*, L&T Index 92465/03 (Civ. Ct., N.Y. Co. 2004) (Gerald Lebovits, J.) (unpublished opinion) (denying eviction where apartment was 2,500 to 2,800 square feet with three or four bedrooms and where drugs and paraphernalia were found in bedroom of temporary guest hidden from view from elderly tenant of record).
78. *ARJS Realty Corp. v. Perez*, 2003 N.Y. Slip Op. 51220(U), 10, 2003 WL 22015784 at *3, 2003 N.Y. Misc. LEXIS 1093, at *12 (Hous. Part Civ. Ct., N.Y. Co.) (after arguing despite the case law to the contrary that the "knew or should have known" standard no longer exists under New York law, court found that if it does, tenant should have known about illegal activities committed in apartment smaller than 400 square feet).
79. *Village Mgmt., N.Y.L.J.*, Jan. 19, 1996, p. 25, col. 2; *855-79 LLC v. Salas*, 10 Misc. 3d 132(A), 814 N.Y.S.2d 560, 205 N.Y. Slip Op. 52039, at *1, 205 WL 3440804, at *1 (App. Term, 1st Dep't 2005) (per curiam) (eviction warranted for "31 decks of heroin, one bag of cocaine, three bags of marijuana, 26 marijuana cigarettes, and assorted drug paraphernalia, mainly in the single bedroom of a 'railroad' style apartment").
80. *Pizarro*, N.Y.L.J., June 24, 1993, p. 24, col. 6 (eviction warranted where apartment's co-occupant was tenant's 18-year-old grandson whom tenant knew had "many times" had glassine envelopes in his bedroom); *Garcia*, N.Y.L.J., May 6, 1994, p. 33, col. 1 (noting that tenant's "plea of guilty [to attempted possession of drugs] coupled with his prior conviction for drug possession shows he is no stranger to the drug scene. This background becomes relevant in evaluating the bona fides of Respondent's claim of no knowledge").
81. *Pizarro*, N.Y.L.J., June 24, 1993, p. 24, col. 6.
82. *Goldman*, 78 Misc. 2d at 696, 356 N.Y.S.2d at 758.
83. *M.S. Hous. Assocs. v. Williams*, 13 Misc. 2d 1233(A), 2006 WL 3228403, at *2 (Hous. Part Civ. Ct., N.Y. Co. 2006) (ruling that if court had power, it would not exercise it here because petitioner did not demonstrate that desired information could not be obtained through other means: "For example, petitioner could use other evidence such as witness[es] to the alleged drug activity and or the police involved in the criminal investigation who would be able to testify based on their recollection.").
84. *People v. Diaz*, Indictment No. 40097/05 (Sup. Ct., N.Y. Co.) (Jan. 31, 2007) (unpublished opinion). For an excellent discussion of *Diaz*, see George M. Heymann, Outside Counsel, "*Diaz*" and *Eviction Proceedings for Illegal Drug Activities*, N.Y.L.J., Mar. 7, 2007, at 4 col. 4.
85. *Accord People v. Canales*, 174 Misc. 2d 387, 64 N.Y.S.2d 228 (Sup. Ct., Bronx. Co. 1997).
86. *190 Stanton Inc. v. Santiago*, 60 Misc. 2d 224, 225, 302 N.Y.S.2d 693, 694–695 (Civ. Ct., N.Y. Co. 1969) (assuming collateral-estoppel effect of convictions but declining to evict tenant).
87. *N.Y.C. Hous. Auth. v. Andino*, LT 10468/96 (Civ. Ct., Richmond Co. 1996) (unpublished opinion).
88. *Pizarro*, N.Y.L.J., June 24, 1993, p. 24, col. 6.
89. *Eaddy*, 2005 N.Y. Slip Op. 50617(U), 7 Misc. 3d 131(A), 801 N.Y.S.2d 237, 2005 WL 954877, at *1, 2005 N.Y. Misc. LEXIS 811, at *1-2 (finding that person arrested inside apartment whom tenant described as her "significant other" was enough to evict).
90. United States Housing Act of 1937, ch. 896 § 3, 50 Stat. 888, 888–89 (codified as amended at 42 U.S.C. § 1437-1437z-7 (2000)).
91. Caroline Castle, Note, *You Call That a Strike? A Post-Rucker Examination of Eviction from Public Housing Due to Drug-Related Criminal Activity of a Third Party*, 37 Ga. L. Rev. 1435, 1447 (2003) (citing Housing Act of 1937 § 1).
92. Housing Act of 1937 § 1.

93. 42 U.S.C. § 1437d(c)(4)(A) (1994 & Supp. 2002).
94. *HUD v. Rucker*, 535 U.S. 125, 127 (2002).
95. 42 U.S.C. § 1437(d)(1)(6) (1994 ed. Supp. V). This was implemented in the code of federal regulations pursuant to 54 Fed Reg 15, 1998 (April 28, 1989).
96. President Clinton, 1996 State of the Union Address.
97. *Id.*
98. HUD Directive No. 96-16, at 1.
99. Attachment to HUD Directive No. 96-16, at 1.
100. *Rucker*, 535 U.S. at 130.
101. *Id.* at 131.
102. *Id.*
103. *Id.* at 134 (citing 42 U.S.C. § 11901(2)).
104. See, e.g., Peter J. Saghir, *Home Is Where the No-Fault Eviction Is: The Impact of the Drug War on Families in Public Housing*, 12 J.L. & Pol'y 369 (2003). Saghir argues that the *Rucker* decision upheld an unconscionable leasehold provision and put an unfair burden on public housing tenants. He argued for more holistic approaches such as instituting second-chance policies and community-based crime reduction and prevention strategies. Although Saghir concedes that the government has taken steps to protect tenants living in public housing, he found that the strict-liability policy negatively affects law-abiding innocent tenants.
105. Castle, *supra* note 91, at 1436.
106. Renai S. Rodney, *Am I My Mother's Keeper? The Case Against the Use of Juvenile Arrest Records in One-Strike Public Housing Evictions*, 98 Nw. U.L. Rev. 739, 765 (2004).
107. Castle, *supra* note 91, at 1468.
108. *Id.* at 1464.
109. See, e.g., *Lloyd Realty Corp. v. Albino*, 146 Misc. 2d 841, 846, 552 N.Y.S.2d 1008, 1011 (Hous. Part Civ. Ct., N.Y. Co. 1990).
110. Anne C. Fleming, Note, *Protecting the Innocent: The Future of Mentally Disabled Tenants in Federally Subsidized Housing after HUD v. Rucker*, 40 Harv. C.R.-C.L. L. Rev. 197, 202 (2005) ("Section 8 tenancies operate quite differently from those of public housing residents. Through portable vouchers, the Section 8 program creates subsidized housing maintained by private landlords and does not concentrate low-income subsidized tenants in one development. The program therefore should not suffer from the same problems as those that plague public housing developments. Although the regulations for Section 8 are similar to those for public housing, this key difference between the two programs should exclude Section 8 tenants from the strict liability interpretation of the federal regulations affirmed in *Rucker*." (footnote omitted)).
111. *B&L Assocs. v. Wakefield*, 6 Misc. 3d 388, 390-391, 785 N.Y.S.2d 681, 683 (Hous. Part Civ. Ct., Kings Co. 2004); *Hampton Houses, Inc. v. Smith*, N.Y.L.J., Mar. 13, p. 23, col. 2 (Hous. Part Civ. Ct., N.Y. Co.).
112. *Howard Ave.*, N.Y.L.J., Apr. 5, 2002, p. 20, col. 6.
113. *Escalera v. N.Y.C. Hous. Auth.*, 425 F.2d 853 (2d Cir. 1970). NYCHA agreed in a consent decree to provide an administrative hearing before bringing public housing tenants to court.
114. Hirsh, *supra* note 2, at 129.
115. *Id.*
116. *N.Y. Co. Dist. Attorney's Office v. Oquendo*, 147 Misc. 2d 125, 129-30, 553 N.Y.S.2d 973, 976 (Hous. Part Civ. Ct., N.Y. Co. 1990).
117. For an excellent article covering *Escalera* and *Rucker* issues in New York, see Barbara Mulé & Michael Yavinsky, *Saving One's Home: Collateral Consequences for Innocent Family Members*, 30 N.Y.U. Rev. L & Soc. Change 689 (2006).
118. *Id.* at 695.
119. *Escalera v. N.Y.C. Hous. Auth.*, 924 F. Supp. 1323 (S.D.N.Y. 1996)
120. *Id.* at 1340.

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Assisted Living in New York: Old and Broke, Where Will We Go from Here?

By Jane Bello Burke

Introduction

The Assisted Living Reform Act, Article 46-B of the Public Health Law (the “ALR Act”),¹ offers the illusion of reform, rather than an effective and affordable alternative to placement in a nursing home or hospital. Enacted in 2004, but still not implemented as of mid-2007, the statute creates a framework for the establishment of a new type of adult care facility: the “assisted living residence” or “ALR.” With “enhanced” certification, the ALR gives individuals the opportunity to age in place by allowing them to remain in the same residence as their needs for care and assistance increase.

In March 2007, the Department of Health proposed regulations to implement the ALR Act.² The proposed regulations impose extensive requirements which greatly increase the expense of operating an Enhanced ALR. The added expense will adversely affect the affordability of care and services and undermine access to the benefits of aging in place for moderate- and low-income individuals. Disturbingly, the proposed regulations do not envision any source of public funding to help pay for extended care in an Enhanced ALR.

Funding is fundamental to the success of the Enhanced ALR program. Without a source of funding, the opportunity to age in place in an Enhanced ALR will be financially out of reach for moderate- and low-income individuals. This will thwart the legislative intent to develop affordable assisted living and to ensure that the indigent have adequate access to a sufficient number of assisted living residences.³

Will New York’s low- and moderate-income residents realize the promise of aging in place in an Enhanced ALR? When their money is gone, where will they go? These and other important policy questions should be resolved before the ALR Act goes into effect, to ensure that the opportunity to age in place will be available to all.

The Existing Statutory Structure: Adult Care Facilities

Assisted living residences are adult care facilities, not nursing homes. Adult care facilities provide temporary or long-term residential care and services to adults.⁴ Their residents are individuals who do not require continual medical or nursing care, but due to physical or other limitations associated with age, physical or mental disabilities or other factors, are unable or substantially unable to live independently.⁵ Adult

care facilities provide non-health care services, such as room, board, meals and direction and some assistance with activities of daily living, such as grooming, dressing, bathing, toileting and the self-administration of medications.⁶

A “nursing home,” in contrast, provides “nursing care to sick, invalid, infirm, disabled or convalescent persons in addition to lodging and board or health-related service, or any combination of the foregoing,” as well as “nursing care and health-related service, or either of them, to persons who are not occupants of the facility.”⁷ Nursing homes care for frail, ill or disabled persons who cannot care for themselves and have many health care requirements. Adult care facilities offer an intermediate level of services, more supportive than an individual home, but less restrictive than a nursing home.

To operate as an ALR, an operator must be licensed, either as an adult home or an enriched housing program, and in addition obtain licensure as an assisted living residence.⁸ Under the Social Services Law, an adult home provides long-term residential care, room, board, housekeeping, personal care, and supervision to five or more adults.⁹ An enriched housing program provides long-term residential care to five or more adults (generally age 65 or older), in community-integrated settings resembling independent housing units, and must provide or arrange for room, board, housekeeping, personal care, and supervision.¹⁰

The regulations governing adult care facilities impose limitations on the type of residents who can live in adult homes and enriched housing programs.¹¹ Among other things, these facilities may not accept or retain a person who needs continual medical or nursing care or requires continual skilled observation of symptoms and reactions for the purpose of reporting a medical condition to the resident’s physician. They may not accept or retain a person who is chronically bedfast or chairfast, or chronically requires the physical assistance of another person to walk or to climb or descend stairs (unless assigned to a floor with ground-level egress). They also may not accept or retain a person who suffers from a communicable disease or health condition which constitutes a danger to others or who is cognitively, physically, or mentally impaired to the point that the resident’s safety or safety of others is compromised. It is a ground for involuntary transfer and termination of a resident’s admission agreement if the resident requires continual medical or skilled

nursing care that the adult care facility is not licensed to provide.¹²

When a resident's condition deteriorates to the point that he or she is no longer suitable for the adult home or enriched housing program, the facility generally must transfer the resident to an alternative setting, such as a nursing home or hospital, which can meet the increased needs. The goal of the ALR Act is to provide an alternative to transfer when the resident's needs increase beyond the point where continued retention would be appropriate.

The ALR Act: The Promise of a New Era

The ALR Act defines "assisted living" and "assisted living residence" as "an entity which provides or arranges for housing, on-site monitoring, and personal care services and/or home care services (either directly or indirectly), in a home-like setting to five or more adult residents unrelated to the assisted living provider."¹³ The operator holding an ALR license can apply for certification as an "enhanced" ALR. This certification allows the ALR to provide "aging in place" services to individuals who otherwise would not qualify, due to their deteriorating physical condition, to continued retention in the home.

With an Enhanced ALR certification, if the resident's needs increase to the point where he or she requires 24-hour skilled nursing or medical care, the ALR need not necessarily discharge the resident to a nursing home, hospital, or other facility which can meet the resident's needs. Instead, the resident may stay in the ALR, but only if the several conditions as set forth in the statute are met. These are as follows: first, the resident hires appropriate nursing, medical or hospice staff to meet the increased needs; second, the resident's physician and home health agency agree that the resident's additional needs can be met safely and appropriately at the residence; third, the residence agrees to retain the resident and to coordinate the additional care; and fourth, the resident is otherwise eligible to reside there.¹⁴ Through this arrangement—with the resident hiring the additional nursing, medical or hospice care and the operator coordinating the additional care with the other care and services provided in the ALR—the Enhanced ALR certificate allows for aging in place by permitting the facility to retain individuals who otherwise would not meet the retention standards for the adult home or enriched housing program.

The ALR Regulations: A Day Late and a Dollar Short

In March 2007, the Department of Health proposed regulations implementing the ALR Act. The proposed regulations impose extensive and expensive new requirements upon the Enhanced ALR. Perhaps most

significantly, they require the Enhanced ALR to provide "health care" services and to hire and pay for licensed nurses to provide staffing coverage in the facility.¹⁵ This must include, at a minimum, a licensed nurse (either a registered nurse or a licensed practical nurse) on duty and on-site for 16 hours a day, seven days a week. In addition, an RN must be on duty and on-site at least eight of those 16 hours, five days a week, and an RN must be on call and available for consultation on a 24/7 basis. Under the proposed regulations, the nurse staffing requirement is a prerequisite to certification as an Enhanced ALR, regardless of whether any individual resident has a specific need for skilled staffing.

Does the Department of Health have the statutory authority to require nurse staffing in the ALR? The scope of an agency's authority is limited by its role as an administrative rather than legislative body.¹⁶ An administrative agency, as a creature of the Legislature within the Executive branch, can act only to implement statutes in accordance with the Legislature's direction.¹⁷ Thus, an agency cannot create rules that the Legislature did not contemplate or authorize.

Significantly, the ALR Act does not itself require nurse staffing in an Enhanced ALR. Under the statute, the responsibility for hiring additional skilled nursing care is on the individual resident requiring such services, not on the ALR. Under the statute, the ALR's obligation, if it chooses to accept it, is to coordinate the care provided by the Enhanced ALR and other provider staff.

The ALR Act, as distinguished from the proposed regulations, does not mandate minimum staffing requirements. With respect to staffing, the statute states only that "an operator of enhanced assisted living may hire care staff directly pursuant to standards developed by the department or contract with a home care services agency which has been approved to operate pursuant to article thirty-six of this chapter."¹⁸ Nothing in the statute itself requires ALRs to hire nurses directly, much less to staff the facility with nurses on a 24/7 basis. If the Legislature had intended to require ALRs to hire skilled nursing staff as a prerequisite to obtaining "enhanced" certification, then it would have expressly so stated in the text of the statute. The fact that it did not suggests strongly that it intended no such result.

Why is this important? According to recent studies, the New York consumer pays a base rate average of from \$2,914 to \$3,423 a month for the "assisted living" level of care.¹⁹ Actual costs vary widely depending on the size of the living areas, services provided, type of help needed, and where the facility is located. The base rate includes room and board, assistance with activities of daily living, medication assistance, case management services, 24-hour monitoring, structured activities, housekeeping and laundry. It does not include

nursing care. The average cost in facilities offering such care can be considerably higher.

The mandatory nurse staffing requirement will result in increased costs across the board for assisted living, even for those individuals who have no skilled nursing needs at all. Take, for example, a 150-bed Enhanced ALR, in which only 10 residents have skilled nursing needs. The other 140 residents will subsidize the care provided to these few. For many individuals—those with moderate or negligible income and assets—the increased costs will make enhanced assisted living prohibitively expensive. Many of these individuals will be unable to avail themselves of the benefits of aging in place in an Enhanced ALR. For those that do, the increased costs will cause them to spend down and deplete their assets much more quickly. When that happens, where will they go?

After the Money Is Gone, Who Pays?

Medicare does not cover the costs of an assisted living residence. Medicare will pay for a skilled nursing facility—up to 100 days—if the individual has had a qualifying three-day hospital stay and requires skilled care, such as skilled nursing services and/or physical or other types of therapy. After day 100, the individual is responsible for paying 100% of the costs for each additional day of skilled nursing facility care. Medicare does not pay for most long-term care, including the costs of an assisted living facility.

Medicaid is the primary funding mechanism of long-term care services for low-income seniors in skilled nursing facilities. In New York, however, the Medicaid program will not cover the costs of an assisted living residence. Consequently, once a resident spends down his or her assets in the Enhanced ALR, transfer to a skilled nursing facility may be the only option. But how will this further the goal of aging in place? And what will be the effect on nursing homes? After Enhanced ALRs have cherry-picked the most affluent private-pay residents and depleted the assets of the rest, will this leave skilled nursing facilities with nothing but Medicaid to fund the cost of care?

Nationally, New York is in the minority of states that do not cover assisted living under their Medicaid programs. Under Medicaid, each state sets its own income eligibility standards within broad federal parameters, as well as the mix of services and products for which it will provide reimbursement. According to the National Center for Assisted Living, in 2006,²⁰ about a third of the states made changes to their assisted living regulations, about seven made major regulatory changes, and three began covering assisted living under Medicaid waivers. As a result of these changes, “[o]nly a handful of states now do not provide Medicaid coverage for assisted living.” New York is in that hand-

ful of states that do not provide Medicaid coverage for assisted living residences.

It need not be this way. Under the ALR Act (as distinguished from the proposed regulations), the obligation to hire nurses is on the individual resident requiring such care, not the residence. This is an important difference. Medicaid pays for medically necessary care for needy individuals who meet income and eligibility qualifications, and medically necessary nursing care is a Medicaid-covered benefit.²¹ Thus, if the resident requiring skilled nursing care were to hire the nurse directly—as the ALR Act contemplates—Medicaid could be available to qualified recipients as a potential source of funding for the medically necessary nursing services that they would need to be able to age in place. The Department’s proposed regulations, in shifting the burden to hire nurses to the facility, deprive residents in Enhanced ALRs of access to the Medicaid program as a potential source of funding when their money runs out.

To be sure, other alternatives are possible. Nationally, many states are experimenting with other ways to use Medicaid funds to pay for assisted living care under waivers to the Medicaid rules. Many have enacted Medicaid Home and Community Based Services Waivers to cover services in assisted living facilities.²² In New York, one promising alternative is the “Assisted Living Program,” or “ALP.”

Confusingly similar in name, the ALP is significantly different from the ALR in concept. The ALP is an alternative to nursing home care that enables individuals who are eligible for a nursing home to receive Medicaid-funded home care services in the less intensive and lower-cost setting of an adult home or enriched housing program. The ALP provides room, board, housekeeping and necessary services, including personal care, supervision, home health services, nursing, physical and other therapies.²³ Typically, the operator will contract with a licensed home care services agency, a long-term home health care program or a certified home health agency to provide the necessary services. According to the Department of Health, approximately 85% of ALP residents are Medicaid recipients.²⁴

ALPs serve a vitally important function. Unfortunately, the small size of the program—merely 4,200 beds statewide—limits its reach and effectiveness. As of April 1, 2007, the Legislature authorized the addition of 1,500 ALP beds to the total number available.²⁵ This is promising, but much more is needed to serve our aging population. Continued expansion of the ALP system, coupled with clear and consistent retention and transfer criteria across the continuum of care, would go far to address the need for aging in place services in New York.

Conclusion

With increasing longevity and escalating health care costs, more and more elders will run out of money before they run out of years. The ALR Act was intended to address this issue, by allowing individuals to age in place in the more cost-effective and less restrictive setting of an Enhanced ALR. Under the proposed regulations, however, the statute is unlikely to achieve these salutary goals.

Paradoxically, by placing the obligation to hire nurses on the residence, rather than the residents requiring such care, the proposed ALR regulations effectively transfer the cost of nursing care to the individuals living in the Enhanced ALR. This is because they increase the cost of living in the residence on a facility-wide basis. The result is to accelerate the spend-down process, while simultaneously depriving ALR residents of access to the Medicaid program as a potential source of funding when their private funds are depleted.

In enacting the ALR Act, the New York Legislature directed the creation of a task force on assisted living and charged it with making recommendations on ways to develop affordable assisted living. For the benefit of our health care system across the continuum of care, New York should consider and resolve the crucial issue of affordability before putting the ALR program into place.

Endnotes

1. N.Y. Pub. Health Law Art. 46-B, §§ 4650-4663.
2. N.Y. St. Reg., vol. XXIX, Issue 13, at 14-18 (Mar. 28, 2007) (available at www.dos.state.ny.us/info/register/2007/mar28/pdfs/rules.pdf).
3. L. 2004, chap. 2, § 5 (effective Feb. 23, 2005).
4. N.Y. Soc. Serv. Law § 2(21).
5. *Id.*; 18 N.Y.C.R.R. § 485.2.
6. N.Y. Soc. Serv. Law § 2(24), (25); 18 N.Y.C.R.R. § 485.2(b), (c).
7. N.Y. Pub. Health Law § 2801(2).
8. N.Y. Pub. Health Law § 4653.
9. N.Y. Soc. Serv. Law § 2(25).
10. N.Y. Soc. Serv. Law § 2(24).
11. 18 N.Y.C.R.R. §§ 487.4 (adult homes), 488.4 (enriched housing residences).
12. 18 N.Y.C.R.R. § 487.5(f)(7), (14)(i); 18 N.Y.C.R.R. § 488.5(e)(3), (e)(9).
13. N.Y. Pub. Health Law Art. 46-B, § 4651(1).
14. N.Y. Pub. Health Law Art. 46-B, § 4655(4).
15. Proposed 10 N.Y.C.R.R. § 1001.10.
16. *Boreali v. Axelrod*, 71 N.Y.2d 1, 6 (1987).
17. See N.Y. Const. Art. III, § 1.
18. N.Y. Pub. Health Law Art. 46-B, § 4655(1)(d).
19. See MetLife Market Survey of Assisted Living Costs, October 2005 (available at www.metlife.com/WPSAssets/84989326101130770986V1F2005%20Assisted%20Living%20Survey.pdf).
20. See National Center for Assisted Living, Assisted Living State Regulatory Review 2007 (March 2007).
21. N.Y. Soc. Serv. Law § 365-a(2)(a).
22. See National Center for Assisted Living, Assisted Living State Regulatory Review 2007 (March 2007).
23. N.Y. Soc. Serv. Law § 367-h; N.Y. Pub. Health Law § 3614.
24. See New York State Department of Health, www.health.state.ny.us/health_care/medicaid/program/longterm/alps.htm.
25. N.Y. Soc. Serv. Law § 461-l(h).

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The Demise of Eminent Domain

By Nadia E. Nedzel and Dr. Walter Block

I. Introduction

The primary concept of a limited government whose powers are both checked and balanced underlies the United States Constitution. A case in point is the Fifth Amendment, which limits the exercise of eminent domain in two ways: a taking must be for a “public use” and “just compensation” must be paid to the owner.¹ However, the long line of Supreme Court cases culminating in *Kelo v. City of New London*² has successfully obliterated both of those limitations. Citizens whose private property is taken by the government are not justly compensated nor are those takings limited by “public use.”

After this introduction, we critically discuss takings for the purpose of economic development. Section III is given over to difficulties with just compensation. The burden of section IV is to analyze, from an economic perspective, urban planning and the real estate hold out. In section V, we address a radical objection to our thesis: how can land be assembled for roads and highways without utilizing eminent domain? The purpose of section VI is to challenge the usual presumption that land subject to eminent domain be limited to public use: we ask, given that the government has already seized private property, whether it is a foregone conclusion that public use should be preferred to private use.

II. Economic Takings

Kelo is consistent with Supreme Court precedent; its only distinction is that the Court now fully and overtly accepts “economic development” as an appropriate “public use.”³ In retrospect, the decision that was most destructive to any rational definition of the term was undoubtedly *Berman v. Parker*.⁴ In *Berman*, the Court defined public use as anything a legislature wants it to be. “[W]hen the legislature has spoken, the public interest has been declared in terms well-nigh conclusive.”⁵ Furthermore, the term represents values “spiritual as well as physical, aesthetic as well as monetary.”⁶ *Berman* and *Kelo* both approved takings for purposes of economic development, and therein lies the problem.

The *Kelo* majority claims that promoting economic development is a traditional, long-accepted function of government.⁷ Perhaps that is true, but taking from one private party to give to another violates the fundamental social compact and is “against all reason and justice.”⁸ Furthermore, the practical problem with using eminent domain to foster economic development is that it often fails. The redevelopment project at issue

in *Berman* ultimately failed, as have several others, including the Poletown GM project in Michigan, and Cincinnati’s downtown. Poletown’s busy commercial strip was replaced with vacant and burned-out buildings when GM did not expand as planned and, instead of a Nordstrom store, downtown Cincinnati now has a municipal parking lot. Where an economic development taking does not result in further depression, it is likely that the area at issue would have improved without resorting to eminent domain.

“Kelo is consistent with Supreme Court precedent; its only distinction is that the Court now fully and overtly accepts ‘economic development’ as an appropriate ‘public use.’”

A second practical problem with the Supreme Court’s interpretation of “public use” is that it gives too much power to local, state, and national legislatures. As a result, legislatures have both the power and the incentive to use eminent domain irresponsibly and unjustifiably at the expense of working-class neighborhoods. Such was the case with Sunset Manor subdivision in Missouri, where a city council, attempting to increase its tax base with a new shopping mall, apparently manipulated studies so that it could declare the subdivision as blighted.

A third and very serious problem with economic takings—indeed any takings—is that they undermine private property rights, the bedrock of a well-functioning economy. If property rights are jeopardized, homeowners and small businesses lose incentive to invest in property. Economic incentives, based upon individual property rights, are essential for economic growth as shown by the work of economist Hernando de Soto⁹ and demonstrated by the fall of the Soviet Union.

III. [Un]Just Compensation and Serbonian Bogs

Just as the Supreme Court has destroyed any rational meaning of the term “public use,” so has it wrecked the meaning of “just compensation.” The compensation granted under current Supreme Court authority is unjust, even though the underlying theory seems plausible. The Court defines “just compensation” as requiring that the owner of condemned property be put in as good a financial position as if his property had not been taken, meaning that the owner should be

paid the “fair market value,” which is defined as “the price a willing buyer would pay a willing seller in the open market.”¹⁰

The “fair market value” method as used by courts is a fiction that makes sense only to attorneys who enjoy cavorting in Serbonian bogs, from which extrication is impossible.¹¹ It certainly does not make sense under either economics or traditional common law. To begin with, there is no willing seller in this equation, and the only willing buyer is the government. Market value, as ascertained by realtors, refers to the price an interested buyer would pay and assumes that the seller will accept a reasonable price given local market conditions.¹² In contrast, the judicial definition of “fair market value” is circular because it uses one unknown variable (fair market value) to define a second unknown variable (willing seller).

Regardless of semantics, the “fair market value” scheme is legally insufficient because it excludes all consequential damages, thus it is unable to fairly compensate owners for losses that would otherwise be included in tort damages. Thus, business owners lose business profits and goodwill, removal costs, relocation costs, litigation costs, and demoralization costs.¹³ Homeowners lose any value that could be attributed to emotional or historical attachment to the property.¹⁴ This exclusion of consequential damages from the plaintiff’s losses in eminent domain cases is unjust: the clause was not designed to protect the thing owned; rather, it was designed to protect the owner of the thing.¹⁵

IV. The Radical (but Effective) Solution: Repeal the “Takings” Clause

While excluding economic takings might temporarily rejuvenate “public use,” it does not remedy the interpretation of “just compensation.” Courts and takings-minded legislatures could still torture language to find that a proposed economic development project has a “public use.” The best solution is to return to common law by repealing the takings clause and forcing governments to justify their actions as if they were any other private party.

Governments would be forced to develop plans that would avoid taking property from one private person and giving it to another. Where they insisted on doing so, they would be forced to give compensation according to traditional tort law on conversion and would be forced to give just compensation. “The measure of damages recoverable in an action for the wrongful taking of property is ordinarily the market value of the thing converted, fixed as of the time and place of the conversion, and with interest from that date to the time of trial.”¹⁶ Normal compensatory damages would

be available for loss of goodwill and other “subjective” damages. Punitive damages might also be available for a particularly recalcitrant governmental entity whose taking the jury found particularly offensive—subject, possibly to the reasonable, proportionate limitation the Supreme Court recently placed on punitive damage awards.¹⁷

V. Urban Planning and Real Estate Hold Out

One of the most interesting of all architectural developments is the pie-with-a-missing-slice shaped building phenomenon. We have all seen these. Typically, there will be a gigantic high rise edifice, but not shaped at its base as we might expect, as an unbroken square, rectangle, or circle, or some such other regular geometrical figure. Instead, there will be a missing piece, on which is often perched an older home. The architect might bemoan the lack of artistic or intellectual integrity of such a development, but those who favor markets and private property will see a certain beauty in them; an economic aesthetic, as it were.

What is the source of such constructions? In most cases, a private developer was able to buy up all the lots on an entire city block except for one tiny parcel. When all purchase offers failed to convince the “hold out”¹⁸ to sell, the entrepreneur decided to go ahead with construction, but was limited to an irregular plot of land and hence, the structurally misshapen building. Such an event cannot be witnessed in any communist or dictatorship-run country. The central planners would simply not tolerate such uncooperativeness on the part of the hold out. Instead, it is a badge of honor for a capitalist nation, predicated upon the sanctity of private property rights.

Morally, it is easy to see that the misshapen edifice is preferable to the unblemished geometrically correct one. The former is predicated on voluntariness; no one is coerced into doing something against his will. The latter, in sharp contrast, is the result of violence or the threat of violence.¹⁹ This is ethically problematic, in that it cannot in principle be distinguished from armed robbery.²⁰

Even on the more mundane economic level there is something to be said on behalf of misshapen constructions that may emanate from hold out or opportunistic behavior. First, there is simply no way to distinguish such commercial interaction from any other normal business interaction. There are no objective criteria where it could be said that one man is an obstreperous hold out, while another refuses to sell to the developer for other reasons. All that is known in assuming the role of the disinterested economist is that A offers to purchase something from B, and the latter declines.

Second, assume *arguendo*, that there is indeed a discernable difference in the motivation underlying these supposedly two different behaviors (hold out and ordinary refusal to sell). Still, albeit paradoxically, it makes more economic sense to rely on a private property rights regime, which sometimes but not always eventuates in misshapen structures, than on a regime that allows some to ride roughshod over others with the goal of avoiding such architecture. Why? There are two and only two economic systems possible; all others are merely theme and variation on one of these two. They are, first, *laissez faire* capitalism, where each owner decides for himself how his property is to be used, and second, central planning, where the authority makes such determinations. But if we have learned anything whatsoever from the fall of the U.S.S.R. and the crumbling of the Berlin Wall, it is that central economic direction is a snare and a delusion. This applies to the Soviet style of planning as well as urban planning on which the basis of *Kelo* uncomfortably perches.

VI. Assembling Roads Without Eminent Domain

The opponent of eminent domain must squarely face the issue that without this type of legal recourse, there would be no roads or highways, or, at the very least, far less than the optimal mileage in this regard; this seems like a bigger challenge. Buildings can be constructed without expropriation. The result is likely to be only an aesthetically challenged edifice. But with thoroughfares, the result would appear to be nothing at all, in the face of the hold out.

How, then, would road assembly work in the absence of eminent domain? There are several means of accomplishing such. First, just as there is more than one way to skin a cat, there is more than one path that can be taken between any two points: for example, between Baton Rouge, Louisiana and British Columbia, Canada, to mention places where the present authors sometimes reside. One possibility is a direct route, taking in effect the hypotenuse, something that does not exist at present, not at least in the form of major highways. A second alternative is to go west from Baton Rouge on Interstate 10, and then north on Interstate 5 when we reach California. A third option is to start out in a northerly direction, along what is now Interstate 55, and then turn west tracing out roughly along the space now occupied by Interstate 90. Both these second plans call for going along the sides of a right triangle, the apex of which would be where Los Angeles and Chicago, respectively, are located.

There is almost an infinite number of other paths lying between the second and third tracings of the two right triangles,²¹ with the hypotenuse or direct route being only one of these. The point is that the firm that wishes to build a road between Louisiana and British

Columbia need not, at least initially, *purchase* any land at all. Rather, they can at a mere fraction of the cost, buy *options* to assemble land. For example, there are 100 feasible routes between the start and end points of our prospective road. Agents can be sent out in secret to purchase these options along all of them. As soon as, or, rather, when and if a hold out appears, who demands appreciably more for his parcel than would be justified by what farms or forest lands normally command in the given neighborhood, all efforts along that particular route may cease. That alone ought to suffice.

After all, while there are no private highways that have ever been put together, there are other long thin things that have: railroads. P.J. Hill built them without any eminent domain powers, whatsoever. But suppose that each and every one of these 100 routes runs into a hold out. Or, take the case where a single individual owns a long thin strip of land stretching from Chicago to Los Angeles, thus blocking our putative road at all points. The answer to this challenge²² is to tunnel under, or build a bridge over, this man's land holdings.²³ It might be a bit more expensive but, if it is far less than what the "blockader" is demanding, a reasonable presumption, it will be the most feasible option to take.

The obvious objection to this "modest proposal" is the *ad coelum* doctrine. According to this perspective, it would be illicit for our road company to tunnel under, or bridge over the holdout's land, since he owns whatever lies below him, all the way down, in a decreasing, cone shaped mass extending to the core of the earth, and, in an increasing cone shaped area as we move in an upward direction, all the way to the heavens.

But the *ad coelum* doctrine is itself open to a host of criticisms.²⁴ One is a pragmatic concern: it would make air flight impossible, as every land owner over which an airplane appears could charge the latter whatever price he wished. This would not constitute a mere single hold out which might or might not be potentially overcome. This doctrine would be the death knell of air carriers, period.

Another objection is more philosophical: why should someone who owns a square mile of the surface of the planet be entitled to control land hundreds or even thousands of miles below his acreage? He never homesteaded²⁵ as much as a square inch of any of it. To be sure, the tunnel built below him may not be so close to his holdings that it causes cave-ins of his buildings. Similarly, why should he be justified in determining what takes place 30,000 feet above his property? And, just how far above him do his supposed property rights extend? Certainly, airplanes should not be allowed to "buzz" him by flying only feet above his head. But can he literally own the air space all the way to Mars? To the next solar system? The courts have quite rightly refused to accommodate so outlandish a doctrine.

VII. Is Private Better Than Public Use?

One final but very, very radical point. Given that for better or worse, and we have argued the latter in this article, there are to be takings: should they be limited to the purpose of promoting public uses,²⁶ as most critics argue, or should they be for the private use of other people? In other words, given that courts condemn the land of private party A, should only the government be able to use this property, or, can the state properly give or sell A's property to private party B? At first blush, this is preposterous. After all, given that we do not want to forcibly take A's property away from him, limiting the use to which it may be put to "public" uses at least decreases the incidence of such occurrences. However, *given* that such an unjustified act has already taken place, and has no implications for future such practices (a heroic assumption), are there any cogent reasons for wishing to allow B to enjoy the fruits of A's labors? Absolutely. It all depends upon the stance one takes toward the government. If one sees it as an unmitigated robber gang,²⁷ then there is at least a case for preferring that A's property ends up in B's hands,²⁸ for the latter is at least relatively innocent.

VIII. Conclusion

It is time to end this legal, economic and philosophical discussion of eminent domain. Legally, this initiative is incompatible with constitutional emphasis on takings for public use and the requirement of just compensation. Economically, the notion that takings actually promote economic welfare is dubious. Philosophically, with respect to the *ad coelum* doctrine, ask whether, in this era of Big Government, given a taking has already occurred, if it will really further the public wealth to add more property to the public sector, or would it not be better to simply focus on providing compensation that is truly just?

Endnotes

1. U.S. CONST. amend. V. ("... nor shall private property be taken for public use, without just compensation.")
2. *Kelo v. City of New London*, 545 U.S. 469, 125 S. Ct. 2655 (2005).
3. *See id.*
4. *Berman v. Parker*, 348 U.S. 26 (1954).
5. *Id.* at 32.
6. *Id.* at 33.
7. *Kelo*, 125 S. Ct. at 2665.
8. *Kelo*, 125 S. Ct. at 2671 (O'Connor, J. dissenting).
9. *See* HERNANDO DE SOTO, *THE OTHER PATH: THE ECONOMIC ANSWER TO TERRORISM* (Basic Books 2000).
10. *See United States v. 564.54 Acres of Land*, 441 U.S. 506, 510, 516-517 (1979); *United States v. Miller*, 317 U.S. 369, 373 (1943); *Olson v. United States*, 292 U.S. 246, 255 (1934) (all holding that just compensation requires the owner be put in substantially the same pecuniary position as if his property had not been taken).
11. Parker B. Potter Jr., *Surveying the Serboman Bog: A Brief History of a Judicial Metaphor*, 28 TUL. MAR. L. J. 519, 521-522 (2004) (tracing the origin of the term to Milton's *Paradise Lost*).
12. BLACK'S LAW DICTIONARY 1587 (8th ed. 2004).
13. *Id.*; *see also* Michael DeBow, *Unjust Compensation: The Continuing Need for Reform*, 46 S.C. L. REV. 579 (1995).
14. *See DeBow* at 587-588.
15. RICHARD A. EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN*, 52-53 (1985).
16. *Morris v. Pearl St. Auction Co.*, 22 N.E.2d 740, 741 (Ohio Ct. App. 1939).
17. *BMW of N. Am. v. Gore*, 517 U.S. 569 (1996); *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408 (2003) (discussing the due process clause and damage awards).
18. Walter Block, *Herbie the Holdout*, *Frasier Forum*, 28-30 (Oct. 1989).
19. If there is any doubt about this, let someone attempt to "hold out" against a governmental condemnatory order and see what happens to him.
20. But is not a duly processed taking compatible with, and even based on, the Constitution? Well, yes, at least as interpreted by the Supreme Court. However, as Spooner has shown, this is not a binding document, since no one signed it, and it would be improper to interpret voting, or taxpaying, as implicit consent to the Constitution. *See* Lysander Spooner, *No Treason No. I* (1867) (Larkspur, Colorado: Rampart College 1966), available at <http://www.lysanderspooner.org/notreason.htm>; Lysander Spooner, *No Treason, No. VI, The Constitution of No Authority* (1870), available at http://www.lysanderspooner.org/bib_new.htm; Lysander Spooner, *A Letter To Congressman Thomas F. Bayard: Challenging His Right—and That of All the Other So-Called Senators and Representatives In Congress—To Exercise Any Legislative Power Whatever Over The People of the United States* (Boston, May 22, 1882), available at http://www.lysanderspooner.org/bib_new.htm.
21. This is only approximately true, given that the contours of the Rocky Mountains sharply reduce the pathways that can be taken. Some would say that the possible paths would be radically decreased due to this consideration, but they have not reckoned with the tunneling option, to be discussed below.
22. Gordon Tullock, *Comment on 'Roads, Bridges, Sunlight and Private Property,' by Walter Block and Matthew Block*, 7 J. des Economistes et des Etudes Humaines, Dec. 1996, at 589-592; *Block vs. Epstein*, *op. cit.*
23. Walter Block & Matthew Block, *Roads, Bridges, Sunlight and Private Property Rights*, 7 J. Des Economistes Et Des Etudes Humaines, June-Sept. 1996, at 351-362; available at http://141.164.133.3/faculty/Block/Blockarticles/roads1_vol7.htm.
24. Walter Block, *Roads, Bridges, Sunlight and Private Property: Reply to Gordon Tullock*, 8 J. des Economistes et des Etudes Humaines, June-Sept. 1998, at 315-326; available at http://141.164.133.3/faculty/Block/Blockarticles/roads2_vol8.htm.
25. HANS-HERMANN HOPPE, *THE ECONOMICS AND ETHICS OF PRIVATE PROPERTY: STUDIES IN POLITICAL ECONOMY AND PHILOSOPHY* (Kluwer 1993); John Locke, *An Essay Concerning the True Origin, Extent and End of Civil Government, in SOCIAL CONTRACT* 17-18 (E. Barker, ed., Oxford Univ. Press 1947); ELLEN FRANKEL PAUL, ED., *PROPERTY RIGHTS AND EMINENT DOMAIN* 71-158 (Transaction 1987) Check out this book. I cited the page numbers of the chapter that deals with what he is talking about, but I couldn't find anything specific. Call number JC 606.P388 1987; Michael S. Rozeff, *Original Appropriation and Its Critics* (September 1, 2005), <http://www.lewrockwell.com/rozeff/rozeff18.html>;

MURRAY N. ROTHBARD, *FOR A NEW LIBERTY* (Macmillan 1973); available at <http://www.mises.org/rothbard/foranewlb.pdf>.

26. Such as national defense, roads, lighthouses, courts, etc. For the argument that there is no such thing as a public good, e.g., that the doctrine of public goods is entirely fallacious, see Walter Block, *Public Goods and Externalities: The Case of Roads*, 7 J. OF LIBERTARIAN STUDIES: AN INTERDISCIPLINARY REV. 1-34 (Spring 1983), available at http://www.mises.org/journals/jls/7_1/7_1_1.pdf; Walter Block, *National Defense and the Theory of Externalities, Public Goods and Clubs*, in *THE MYTH OF NATIONAL DEFENSE: ESSAYS ON THE THEORY AND HISTORY OF SECURITY PRODUCTION* 301-334 (Hans-Hermann Hoppe, ed., Auburn: Mises Inst. 2003); ANTHONY DE JASAY, *SOCIAL CONTRACT, FREE RIDE: A STUDY OF THE PUBLIC GOODS PROBLEM* (Oxford Univ. Press 1989); Hans-Hermann Hoppe, *Fallacies of the Public Goods Theory and the Production of Security*, 9 J. LIBERTARIAN STUDIES 27-46 (Winter 1989), available at http://www.mises.org/journals/jls/9_1/9_1_2.pdf; Jeffery Hummel, *National Goods vs. Public Goods: Defense, Disarmament and Free Riders*, 4 THE REV. OF AUSTRIAN ECONOMICS, 88-122 (1990), available at http://www.mises.org/journals/rae/pdf/rae4_1_4.pdf.
27. *Spoooner, supra* note 20; MURRAY N. ROTHBARD, *THE ETHICS OF LIBERTY* 161-188, (N.Y. Univ. Press 2002) (1982).
28. We make another heroic assumption here that B is an innocent party, and not part and parcel of an illegitimate governmental undertaking.

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**NEW YORK STATE BAR ASSOCIATION
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Ethics Opinion No. 815

Committee on Professional Ethics of the New York State Bar Association

10/25/07

Topic: Practice of a New York lawyer in a foreign jurisdiction.

Digest: A New York lawyer who can lawfully engage in conduct in a foreign jurisdiction that would be the practice of law in New York, even though the lawyer is not formally admitted to practice in the foreign jurisdiction, is generally subject to the ethics rules in the foreign jurisdiction, and not all of the provisions of the New York Code, provided the lawyer principally practices in that jurisdiction and the conduct's primary effect is not in New York.

Code: DR 1-102(A)(3), DR 1-105(A), DR 1-105(B), DR 9-102, EC 1-12.

Question

1. What ethics rules govern the conduct of an attorney who is admitted to practice in New York and works principally in a foreign jurisdiction, when the lawyer, although not formally admitted to practice in a foreign jurisdiction, is permitted to engage in conduct there that would be the practice of law in New York?

Opinion

2. A lawyer admitted to practice in New York is contemplating an employment relationship with a law firm in a foreign jurisdiction. That jurisdiction permits the lawyer to undertake work that would be the practice of law if performed in New York, but the New York lawyer does not need to be nor will the lawyer be formally admitted to practice in the foreign jurisdiction. Because the New York lawyer will not be formally admitted to practice, the lawyer cannot, for example, represent clients in the courts of the foreign jurisdiction. The jurisdiction has a code of ethics for attorneys who are admitted to practice, but that code does not apply to the New York lawyer because the lawyer is not admitted to practice in the foreign jurisdiction.
3. Under DR 1-105(A), a lawyer admitted in New York is subject to the disciplinary authority of New York regardless of where the lawyer prac-

tics. In certain circumstances, however, "[i]n the exercise of the disciplinary authority of this state," the disciplinary rules of another jurisdiction will be applied. DR 1-105(B)(1) provides that in connection with a proceeding in a court to which the lawyer has been admitted, the rules of the court apply. "For any other conduct," DR 1-105(B)(2) states:

- a. If the lawyer is licensed to practice only in this state, the rules to be applied shall be the rules of this state, and
- b. If the lawyer is licensed to practice in this state and another jurisdiction, the rules to be applied shall be the rules of the admitting jurisdiction in which the lawyer principally practices; provided, however, that if particular conduct clearly has its predominant effect in another jurisdiction in which the lawyer is licensed to practice, the rules of that jurisdiction shall be applied to that conduct.

4. It is clear that DR 1-105(B)(1) applies where the New York lawyer appears in a court in a foreign jurisdiction. If the lawyer cannot appear in court, DR 1-105(B)(1) has no application. With respect to DR 1-105(B)(2)(b), it is the opinion of the Committee that "licensed to practice" includes not only formal licensing procedures like those required by the states in the United States, but also less formal procedures that authorize a lawyer to undertake activities in a foreign jurisdiction that would constitute the practice of law if they were undertaken in the United States. So long as the activities are lawful in the jurisdiction in which they are performed, it is our view that a lawyer undertaking such activities is "licensed to practice" in that jurisdiction, and that jurisdiction is an "admitting jurisdiction," for purposes of DR 1-105(B)(2)(b). If the lawyer principally practices in that jurisdiction and the particular conduct does not clearly have its predominant effect in New York, then under DR 1-105(B)(2)(b), the rules of the foreign jurisdiction apply.
5. A contrary interpretation would lead to anomalous results. It would be impractical, for example, to require a lawyer living abroad and work-

ing in a law firm there with foreign clients—and receiving funds in foreign currency—to keep funds in a New York bank account with only New York lawyers as signatories, as required by DR 9-102(B) and (E).

6. This may mean that a New York lawyer will be permitted to undertake representations that the lawyer could not undertake in New York. For example, the rules of the foreign jurisdiction may permit the lawyer to proceed against a current client in an unrelated matter, which the New York rules prohibit absent client consent. Because that is permitted by the rules of the foreign jurisdiction, however, it would not surprise clients.¹
7. Although not stated in DR 1-105, we believe that certain rules of the New York Code that apply to lawyers even when not engaged in the practice of law—such as the rule prohibiting illegal conduct that adversely reflects on a lawyer’s honesty, trustworthiness or fitness as a lawyer²—apply wherever the lawyer practices.³

Conclusion

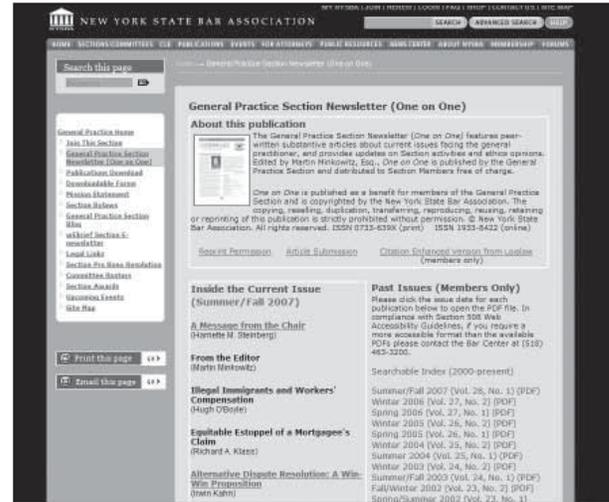
8. A New York lawyer who is permitted by the law of a foreign jurisdiction to engage in conduct in a foreign jurisdiction that would constitute the practice of law if undertaken in New York, even though the lawyer is not formally admitted to practice law, is “licensed to practice” in that jurisdiction. If the lawyer principally practices in that jurisdiction and the particular conduct does not have its predominant effect in New York, the rules of the foreign jurisdiction govern the conduct.

(12-07)

Endnotes

1. We do not address in this opinion what rules of imputation would apply in a law firm with lawyers both in New York and outside the country.
2. DR 1-102(A)(3).
3. Cf. EC 1-12 (listing rules that apply to a lawyer rendering non-legal services under DR 1-106(A)).

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Ethics Opinion No. 816

Committee on Professional Ethics of the New York State Bar Association

10/26/07

Topic: Advance payment retainer; client trust account.

Digest: A lawyer may ethically accept an advance payment retainer, place such funds in the lawyer's own account, and retain any interest earned. The lawyer may require the client to forward an advance payment retainer to pay for final fees that accrue at the end of the relationship.

Code: DR 2-106(C), DR 2-110(A), DR 9-102(A), (C).

Questions

1. May a lawyer ethically accept an advance payment retainer and place such funds in the lawyer's own account while retaining any interest earned from such amount?
2. If so, may a lawyer request the client to forward an advance payment retainer to pay for final fees that accrue at the very end of the relationship, with interim fees billed out as they are performed?

Opinion

3. Recently, we have received inquiries regarding the continued validity of our opinion in N.Y. State 570 (1985), which addressed the ethical propriety of what is commonly known as an advance payment retainer. An advance payment retainer is a sum provided by the client to the lawyer to cover payment of legal fees expected to be earned during the representation. To the extent the fees advanced are not earned during the representation, the lawyer agrees to return them to the client. This form of retainer should be distinguished from a general retainer, which is a sum paid to the lawyer for being available to the client. A general retainer is earned upon receipt.¹ The recent inquiries regarding advance payment retainers may stem from the fact that since we issued Opinion 570 in 1985, there have been several significant developments on the subject of retainer agreements and the language in DR 9-102 has been substantially amended. Therefore, it is now appropriate to revisit the principles stated in N.Y. State 570.
4. In N.Y. State 570 we concluded that fees paid to a lawyer in advance of services rendered are not

necessarily client funds and need not be deposited in a client trust account. Therefore, any interest earned on these fee advances may be retained by the lawyer. The opinion cautioned, however, that the lawyer is obliged to return any portion of the fee advance that is not earned during the representation.²

5. If the parties agree to treat advance payment of fees as the lawyer's own, the lawyer may not deposit the fee advances in a client trust account, as this would constitute impermissible commingling.³ "On the other hand, the lawyer may agree to treat advance payment of legal fees as client funds and deposit them in a client trust account; in that event any interest earned on the funds while in the client trust account must be remitted to the client."⁴
6. Since 1985, we have cited N.Y. State 570 on several occasions.⁵ N.Y. State 570 has also been cited with approval by the Appellate Division, Fourth Department and the New York City Bar ethics committee.⁶ The validity of such an advance payment retainer has also been recently recognized by the Supreme Court of Illinois.⁷
7. In Opinion 570, we noted that "it appears that the drafters of the Code of Professional Responsibility did not consider advance payments of fees to be client funds necessitating their deposit in a trust account." Although DR 9-102 has been substantially amended since 1985, the changes do not affect the reasoning of that opinion. DR 2-110(A)(3) requires a lawyer who withdraws from representing a client to "refund promptly any part of a fee paid in advance that has not been earned." As we observed in Opinion 570, this provision does not require that the advance be deposited in a client trust account until earned. This conclusion is supported by the language in DR 2-110(A), which still separately classifies fee advances and client property. DR 2-110(A)(2) requires a lawyer planning to withdraw from representing a client to "deliver[] to the client all papers and property to which the client is entitled" while DR 2-110(A)(3) separately provides for the refund of any unearned "fee paid in advance." In sum, the standards delineated in N.Y. State 570 for advance payment retainers are still valid today.

8. We note that advance payment retainer agreements, like any other fee agreement between a lawyer and client, must be “fair, reasonable, and fully known and understood by the client.”⁸ These agreements must also comply with other relevant provisions of the Code. In this respect, we construe DR 9-102 to require the lawyer to maintain complete records of any advance payment retainer received and to render appropriate account to the client regarding the retainer.⁹ Although the advance payment retainer is not client property, the client retains an interest in that portion of the retainer that is not yet earned by the lawyer. Furthermore, at the conclusion of the representation, the lawyer must promptly return any portion of the advance payment retainer that is not earned.¹⁰ Finally, it would be inappropriate for a lawyer to negotiate a non-refundable advance payment retainer with the client.¹¹
9. An advance payment retainer will obviously benefit the lawyer by helping to ensure that he or she will be paid for services rendered, at least to the extent of the advance. This form of arrangement can also benefit the client, who may wish to hire counsel to defend the client from judgment creditors. If the lawyer deposited such a retainer in a client trust account, the funds would remain the property of the client and might be subject to claims of the client’s creditors, thereby making it difficult for the client to retain counsel.¹² Therefore, it is imperative for a lawyer at the outset of the representation to discuss the advantages and disadvantages of advance payment retainers and to reach an agreement about the treatment of any such advances. These agreements should be confirmed in writing in the engagement letter where one is required.¹³
10. We also conclude that an attorney may request an advance payment retainer for final fees that accrue at the very end of the relationship, with interim fees billed out as they are performed. While such an arrangement is permissible, it must comply with the standards outlined in *Jacobson* and our prior opinions. If the advance payment retainer is intended to be payable only once specific services are performed, it must describe the services that it is intended to cover. If the services outlined in the agreement are not provided, that portion of the advance payment retainer must be promptly returned to the client.¹⁴

Conclusion

11. A lawyer may ethically accept an advance payment retainer and need not place such funds in a client trust account. If the advance payment retainer is placed in the lawyer’s account, the lawyer may retain any interest earned from such amount. A lawyer may request an advance payment retainer for final fees that accrue at the very end of the relationship.

(14-07)

Endnotes

1. See N.Y. State 570 n.1.
2. See DR 2-110(A)(3) (“A lawyer who withdraws from employment shall refund promptly any part of a fee paid in advance that has not been earned.”).
3. See DR 9-102(A) (lawyer may not commingle client funds on property with his or her own).
4. N.Y. State 570.
5. See, e.g., N.Y. State 599 (1989) (discussing nonrefundable minimum fee provisions); N.Y. State 693 (1997); N.Y. State 764 (2003).
6. See *Matter of Aquilo*, 162 A.D.2d 58, 560 N.Y.S.2d 583 (4th Dep’t 1990) (“Moneys advanced by clients for disbursements need not, unless expressly agreed, be held in trust and may be placed in a general account.”); N.Y. City 2002-2.
7. *Dowling v. Chicago Options Associates, Inc.*, ___ N.E.2d ___, 2007 WL 1288279, at *7 (Ill. May 3, 2007) (“we recognize advance payment retainers as one of three retainers available to lawyers and their clients”).
8. *Jacobson v. Sassower*, 66 N.Y.2d 991, 993, 489 N.E.2d 1283, 1284, 499 N.Y.S.2d 381, 382 (1985); see N.Y. State 599 (“the essence of the matter is clarity”).
9. DR 9-102(C)(3) requires a lawyer to “[m]aintain complete records of all funds, securities, and other properties of a client or third person coming into possession of the lawyer and render appropriate accounts to the client or third person regarding them.”
10. DR 9-102(C)(4) (requiring a lawyer to “pay or deliver to the client or third person as requested by the client or third person the funds, securities or other properties in the possession of the lawyer which the client or third person is entitled to receive”).
11. See DR 2-106(C)(2)(b) (prohibiting use of a nonrefundable fee clause in a domestic relations matter); *Matter of Cooperman*, 83 N.Y.2d 465, 633 N.E.2d 1069, 611 N.Y.S.2d 465 (1994) (holding that the payment of a nonrefundable fee for specific services, in advance and irrespective of whether professional services are actually rendered, is per se violative of public policy).
12. See, e.g., *Dowling*, ___ N.E.2d at ___, 2007 WL 1288279, at *8 (“Paying the lawyer a security retainer means the funds remain the property of the client and may therefore be subject to the claims of the client’s creditors. This could make it difficult for the client to hire legal counsel. Similarly, a criminal defendant whose property may be subject to forfeiture may wish to use an advance payment retainer to ensure that he or she has sufficient funds to secure legal representation.”).
13. See 22 NYCRR Part 1215 (engagement letters are to include, among other things, an [e]xplanation of attorney’s fees to be charged, expenses and billing practices”).
14. See DR 2-110(A)(3); DR 9-102(C)(4); N.Y. State 570.

Ethics Opinion No. 817

Committee on Professional Ethics of the New York State Bar Association

11/02/07

Topic: Lawyer's participation in residential real estate purchase and sale closing that includes a "seller's concession" and "grossed up" sale price.

Digest: Participation in residential real estate transaction that includes a "seller's concession" and "grossed up" sale price is prohibited unless the transaction is entirely lawful, the gross up is disclosed in the transaction documents and no parties are misled to their detriment.

Code: DR 1-102(A)(3), (4), (5); DR 7-102(A)(7).

Question

1. Following written agreement between buyer and seller of real estate as to terms, the purchaser requests that the agreed actual sale price be increased by 3% to cover the purchaser's anticipated closing costs, and that the seller grant purchaser a "seller's concession" in an equal amount. The buyer thereby obtains a mortgage loan based upon an increased amount, the actual purchase price plus the buyer's closing costs.
2. Seller's counsel is advised by the lender that this type of seller's concession is "done all the time" by lenders, and it is apparently authorized in the lender's underwriting manual.¹ Moreover, the lender advises seller's counsel that the practice is also acceptable to the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corp. ("Freddie Mac"), which are among the major purchasers of residential mortgage loans.
3. Seller's counsel is unaware whether the lender's underwriting guidelines, or those of Fannie Mae and Freddie Mac, discuss a price "gross up" and is concerned that there is no assurance that the "ultimate purchaser of the loan" would be aware of the selling price "gross up" used to offset the seller's concession. Moreover, counsel is concerned that the reporting of a "grossed up" selling price on the purchaser's mortgage application and the HUD-1 Settlement Statement may violate federal law, and in particular 18 U.S.C. §§ 1001, 1010, and 1012 (which criminalize fraud in certain transactions concerning the federal government).
4. Counsel asks whether participation in this transaction, as seller's attorney, will violate New York's Code of Professional Responsibility.

Opinion

5. It is clear that DR 1-102(A)(3) prohibits an attorney from engaging in "illegal" conduct; and DR 7-102(A) provides that "[i]n the representation of a client, a lawyer shall not . . . (7) counsel or assist the client in conduct the attorney knows to be illegal or fraudulent." Therefore, if the conduct at issue is unlawful or fraudulent, it is per se unethical. We do not opine on issues of law, however, so we cannot determine whether it is criminal or fraudulent.
6. This Committee does construe the Code, however. DR 1-102(A)(4) prohibits "conduct involving dishonesty . . . deceit, or misrepresentation." While we have not previously addressed the specific question raised here,² two other state ethics opinions have considered closely related questions.
7. First, in North Carolina Formal Ethics Opinion 12 (2001),³ a developer sold a lot for a certain purchase price, giving an early buyer a credit at closing. The developer, hoping to maintain the price of future sales, wanted the lawyer to obtain deed tax stamps based upon the higher price recited in the purchase agreement. The ethics committee of the North Carolina Bar, applying provisions substantially the same as the applicable New York Code provisions, determined that such conduct would be barred as involving dishonesty and misrepresentation, at least in part because the deed recordation concealed (and was intended to hide) from subsequent purchasers of nearby lots, the fact that the credit had been given.
8. Still more closely on point, in Opinion 710 (2006),⁴ the New Jersey Supreme Court Advisory Committee on Professional Ethics considered facts like those presented here. In that opinion, the practice was described as follows:

A contract for the sale of residential property has been prepared by a realtor and signed by both seller and buyer for a set purchase price with a mortgage contingency. Either during attorney review or thereafter, the lawyers for the seller and the buyer are required to amend the contract by increasing the purchase price and the mortgage contingency amount in like amounts. In

addition, the attorneys are asked to amend the contract to provide that the seller give a credit to the purchaser at closing in the same amount, calling it a “seller’s concession” or “seller’s payment of purchaser’s closing costs.” The inquirer states that the amendments are calculated to increase the size of the purchaser’s mortgage loan and “is a fraudulent practice perpetrated on the ultimate investor.”

The Committee notes that in recent years residential mortgage lending has, through the secondary market, become a major category of finance in this country. As a result of federal programs, those who originate loans may earn financing fees at the closing and then convey those loans to entities such as the Government National Mortgage Association (known as Ginnie Mae), the Federal National Mortgage Association (known as Fannie Mae) and the Federal Home Loan Mortgage Association (known as Freddie Mac). These programs, in turn, after buying the mortgages from the originators, then issue “mortgage-backed bonds” to investors, who receive the periodic payments of principal and interest from the borrowers.

This secondary market enables the originating lender to sell the loan, and to originate more loans and financing fees with the sales proceeds. In addition, the secondary market has created an investment market for low-risk mortgage-based securities, and attracts investment dollars into the residential mortgage business.

On the facts set forth in the inquiry, it appears that the sales contract as amended is submitted to the original mortgage lender, or broker, with the sale price increase and corresponding credit expressly stated, but without any assurance that assignees in the secondary market would be aware of the device employed to increase the size of the mortgage loan.

9. Based upon this description, New Jersey Op. 710 determined that the practice violated the prohibi-

tions contained in New Jersey’s Rules of Professional Conduct against counseling or assisting a client in conduct that the lawyer knows is illegal, criminal or fraudulent, and engaging in conduct involving dishonesty, fraud, deceit or misrepresentation:

By manipulating the sales price in the manner described by the inquirer, either the originating lender or the secondary investors may be deceived as to the true market price of the house. The deception is the credit to the buyer given by the seller to offset the increase in purchase price. The credit is not justified by any additional property or rights to be sold to purchaser, or by a legitimate charge against the seller on account of any actual costs assumed by it and otherwise payable by the buyer.

....

In the present inquiry, it would seem that the originating lender would have the opportunity to uncover the ruse upon a close reading of the contract and the loan application, and to protect itself before completing the transaction, but it is less clear that persons investing in the secondary market would have the same opportunity, or would have recourse against the assignor in the event a later default occurs and a loss is suffered as a result of the enhanced sales price.

The opinion concludes that a lawyer’s participation in the increase in the purchase price and offsetting credit was improper because it “involves a deceit, intending that the mortgage loan investor will rely on the misrepresentations in the contract in determining the size of the mortgage loan.” The advisory committee also said that the conduct “compromises the integrity of the underwriting of the loan because it exposes the lender and those who purchase the resulting loan to a greater risk of loss than is knowingly accepted.”

10. New Jersey Op. 710 provoked requests for clarification from the Mortgage Bankers Association of New Jersey and the North Central Jersey Association of Realtors.⁵ They asserted that New Jersey Op. 710 was based on a misunderstanding of mortgage lending practices and was leading New Jersey attorneys to refuse to work on mortgage loans containing seller’s concessions of

any kind. The mortgage bankers association said that seller's concessions made to permit financing of closing costs serve a salutary purpose because low-income and first-time buyers often do not realize at the time of contract that they will not have sufficient cash to cover the closing costs.⁶ The realtor association asked whether the opinion covered, for example, closing credits for repairs to resolve problems uncovered by the home inspection process.⁷

11. A week after the original issuance, the New Jersey committee clarified that New Jersey Op. 710 "address[ed] fictional and deceptive increases in purchase prices unrelated to the actual circumstances or costs of closing, and contrary to the expectations of the lender or the ultimate holder of the mortgage." The clarification stated that the opinion was meant to bar only those seller's concessions not premised on "a legitimate charge against the seller on account of any actual costs assumed by it and otherwise payable by the buyer," and did "not implicate a contract of sale that explicitly states that the seller shall provide the buyer with a credit against legal and legitimate costs or expenses related to the sale, which would otherwise be absorbed by the buyer, such as actual closing costs."⁸
12. The clarification thus addressed, and found permissible, some shifting of costs otherwise borne by buyers, but continued to find impermissible an increase in the purchase price and an offsetting credit to permit the buyer to finance closing costs.⁹
13. This Committee is neither a legislative nor a judicial body. Just as we cannot opine on matters of law nor can we "find facts." Thus, while we recognize the evidence that the practice of grossing up the price post-contract has become common, we find the concerns expressed in North Carolina Op. 12 and New Jersey Op. 710 of considerable weight.¹⁰
14. The issue is whether the lawyer's participation in such a transaction facilitates deception or misrepresentation. It seems obvious that there is potential deception implicit in the transactions, but we cannot determine whether or in what circumstances actual deception will occur. Thus we hold that a lawyer may not ethically participate in such a "gross up" of the actual purchase price and concomitant seller's concession unless there is neither deception nor misrepresentation at work in the transaction and its predictable consequences. At a minimum this means that the gross up (and not merely the grossed-up purchase price) must be disclosed in the transaction documents. We are persuaded that merely reporting

"a seller's concession" may imply either that the seller has agreed to reduce the purchase price he or she would otherwise have obtained or that the reported sales price is the actual price of the property, less certain costs the seller has agreed to pay. If neither of these is the case, then reporting a concession, without more, is misleading under DR 1-102.

Conclusion

15. On the facts presented here, and for the reasons above, we conclude that participation in such transactions is unethical unless there is no unlawful conduct, and there is full disclosure in the transaction documents of the substance and effect of the transaction.

(11-07)

Endnotes

1. According to the inquirer, the manual appears to approve of seller's contributions up to a maximum of 6% of the selling price (where there is a 10% deposit; if the deposit is less than 10%, the maximum seller's concession allowed is 3%). The lender has also provided seller's counsel with a redacted HUD-1 Settlement Statement from a transaction the bank recently closed, showing the grossed-up contract price on Lines 101 and 401, and the "Seller's Concession" as reductions on Lines 215 and 515.
2. In N.Y. State 545 (1982) we held that it was improper for a lawyer to execute a Real Property Transfer Report that set forth a purchase price that excluded the cost of a number of "extras." The Committee presumed that the conduct violated the Real Property Law, and was therefore barred by DR 7-102(A)(7), and did not reach the question of "dishonest . . . deceit, or misrepresentation."
3. 2001 WL 1949450.
4. 2006 WL 3891474.
5. Mary Pat Gallagher, *Ethics Ban on Seller's Concessions at Closings Limited*, 187 N.J.L.J. 1 (Jan. 1, 2007).
6. *Id.*
7. *Id.*
8. Notice to the Bar, Clarification of Advisory Committee on Professional Ethics Opinion 710 (Dec. 22, 2006).
9. While New Jersey Op. 710 was thereafter approvingly cited as supporting the imposition of civil liability and professional discipline against attorneys participating in transactions that include seller's concessions, see Dodge, *Creative Financing*, 43 Arizona Attorney 8 (June 2007), it has also been strenuously criticized in some quarters, see Schonberger, *Real Estate Attorneys Miscast as Mortgage-Market Watchdog*, 187 N.J.L.J. 1123 (March 26, 2007) ("[T]he advisory committee failed to understand that the secondary mortgage investor is not unknowingly buying risk . . . Perhaps more important is the existence, and actions, of professionals [such as appraisers] between the mortgagor and ultimate secondary market buyer.").
10. This Committee has long recognized that the lawyer's obligation under DR 1-102(A)(4) not to engage in conduct involving deception extends to deception of both clients and non-clients. See N.Y. State 626 (1992) (holding that the lawyer must provide non-client borrower with information to judge whether the lawyer's fee is or is not excessive); N.Y. State 796 ¶ 6 (2006) (noting that statements made to third parties "can become a matter of ethical concern" under DR 7-102(A)(5), which bars a lawyer from "[k]nowingly mak[ing] a false statement of law or fact").

Ethics Opinion No. 818

Committee on Professional Ethics of the New York State Bar Association

11/28/07

Topic: Conflicts of interest; persons paying for representation of another; designated underwriters' counsel.

Digest: Designated underwriters' counsel may represent the underwriters in a securities offering even though the issuer appoints and pays counsel, provided that underwriters consent after disclosure of material facts. In certain cases, with informed consent of the affected clients, designated underwriters' counsel may also represent the issuer.

Code: DR 5-101(A), 5-105(A), (B), (C), 5-107(A), (B).

Question

1. When a law firm is selected by an issuer of securities to serve as the designated counsel for the underwriters of securities to be issued by that company or other entity, may the attorney also perform legal services for the company or entity?

Opinion

2. A common practice among issuers that frequently issue investment grade securities is to designate one law firm to represent the investment banks selected to underwrite the issuer's securities offerings (a "Designated Underwriters' Counsel"). This practice is common for both corporate and municipal issuers. Frequently, the issuer will make this designation even before it has determined to undertake an offering, decided on the type of offering, or selected who the underwriters will be.¹ And, often, the selected law firm will continue in that role for a considerable period, spanning multiple offerings.
3. The appointment of a Designated Underwriters' Counsel is thought to benefit the frequent issuer, underwriters and investors. Because such counsel works consistently on offerings of the issuer's securities, it becomes particularly familiar with the issuer, and thereby better able to make judgments about the information that should be disclosed in offering documents. This familiarity may therefore improve the quality of disclosure

in offering documents, lower transaction costs and promote the efficiency of the capital markets by allowing seasoned issuers to reach the capital markets quickly, as market and other opportunities arise. The ability to reach the capital markets quickly and opportunistically is particularly important in the context of so-called "shelf" offerings.² In addition, having a single law firm as underwriters' counsel for frequent issuers rather than different firms chosen by the lead underwriter for different offerings gives the issuer the benefit of underwriter's counsel more familiar with the issuer's business and able to update its knowledge more quickly and cost effectively.

4. Although—by definition—the Designated Underwriters' Counsel represents the underwriters, the counsel's fees are paid by the issuer. Further, as noted, the Designated Underwriters' Counsel is also selected for this work by the issuer. Occasionally, an issuer who becomes familiar with a law firm as underwriter's counsel may wish to hire the firm on an unrelated matter. An issuer may also wish to select, as Designated Underwriters' Counsel, a lawyer or law firm that regularly represents the issuer or that otherwise has a personal relationship with an officer of the issuer (e.g., a family member).
5. A law firm's work for the underwriters in an offering may conflict with the interests of the issuer. For example, there may be competing interests when negotiating the underwriting agreement—the contract pursuant to which the underwriting banks agree with the issuer to underwrite the securities to be sold. Similarly, in the course of preparing for a securities offering, there may be disagreement about what is "material" for purposes of disclosure in offering documents. As the Municipal Securities Rulemaking Board has explained, "The potential for conflict of interest is inherent in the issuer's selection of the counsel whose particular responsibilities may include advocating decisions that the issuer may oppose or may perceive as not to be in its best interest."³ But while the underwriter and the issuer may be adverse to one another at certain points during the preparation of a securities offering, both have the shared goal of

completing the offering in a timely manner and complying with all applicable laws.

Analysis

6. Against this background, we examine the relevant ethical issues that Designated Underwriters' Counsel must keep in mind when representing the underwriters, both where such counsel performs no legal work for the issuer and where he or she does.
7. **Where the law firm performs no work for the issuer.** Lawyers are frequently engaged to represent a client where a third party will be responsible for payment of the lawyer's fees. One very common example is where an insurance policy protects the client in connection with a litigated matter. As we said in *N.Y. State 721*, at 3 (1999), "Despite the fact that an insurance company has retained the lawyer pursuant to its contractual duty to defend the policyholder, the client is the policyholder, not the insurance company." The obligation to exercise independent professional judgment on behalf of the client continues even when the lawyer's fee is being paid by a third person.⁴ The mere fact that a third party is paying the lawyer's fees thus does not present a disabling conflict.⁵ Nor does the prospect of repeated work, for the same or different clients—be they policyholders or underwriters. Indeed, DR 5-107(A) and (B) specifically contemplates that third parties may be obligated to pay attorneys fees.
8. The Code explicitly requires that a lawyer whose fees will be paid by a third party obtain consent of the client, after full disclosure of all relevant facts and circumstances, before accepting such compensation. Investment banks in the business of underwriting are usually well aware of the role played by Designated Underwriters' Counsel and that their selection was made, and compensation will be provided, by the issuer. Accordingly, the underwriters' consent to the issuer's selection and payment of Designated Underwriters' Counsel is usually implicit in the underwriters' agreeing to serve as an underwriter in the contemplated transaction. But Designated Underwriters' Counsel specifically needs to consider, and fully disclose to the underwriters, any material facts or circumstances—beyond the selection as Designated Underwriters' Counsel by the issuer and what that ordinarily entails—that might bear on the lawyer's ability to exercise independent professional judgment on behalf of the client (the underwriter) or otherwise interfere with the lawyer's ability to adequately represent the client.⁶ As an extreme example, such circumstances might include that a substantial percentage of the law firm's work consists of acting as Designated Underwriters' Counsel for the particular issuer whose securities the investment bank will be underwriting, or that the responsible partner is the brother of the issuer's chief financial officer or of the elected official responsible for the designation (in the case of municipal securities).
9. The Code also specifically cautions against the third party unduly interfering with the lawyer's representation of its client. Thus, the third party may not "impose conditions that would lead to inadequate representation or constrain the lawyer's independent professional judgment on behalf of the client."⁷
10. **Where the law firm performs work for the issuer.** Outside counsel to an organization or municipality obviously owes duties to the client, including the duties of zealous representation and loyalty. Where a law firm that represents an issuer is selected to serve as Designated Underwriters' Counsel, there is a potential for conflict.
11. The Code defines "differing interest" to mean "every interest of a client that will adversely affect either the judgment or the loyalty of a lawyer to a client, whether it be a conflicting, inconsistent, diverse, or other interest." Because the interests of an issuer and its underwriters may differ during the course of an offering (e.g., on what disclosures are necessary), it is possible that a law firm that currently represents both the underwriters and the issuer will be subject to "differing interests" that would preclude accepting the assignment as Designated Underwriters' Counsel or require withdrawing from it.⁸
12. In certain circumstances, however, conflicts can be waived by the clients: a lawyer can represent multiple clients with differing interests if a disinterested lawyer would believe that the lawyer can competently represent the interest of each client, and if each consents to the representation after full disclosure of the implications of the simultaneous representation and the advantages and risks involved.⁹ That analysis is fact intensive.¹⁰ For example, if all or substantially all of the lawyer's income was derived from representing the issuer, a disinterested lawyer would likely conclude that the lawyer could not competently represent the interests of the underwriters in connection with an offering.¹¹ Another example would be if a law firm were asked to

represent both the issuer and the underwriters in connection with the offering itself. This is ethically permissible in certain situations, but before undertaking the representation the firm would need to obtain informed consent from each client, and to take precautions in the event that disputes among the clients arose (such as having other counsel, for example, in-house counsel, handle those aspects of the matters).¹²

13. Where consent is available, the lawyer or law firm should, in framing the appropriate disclosure, consider the amount of work done for the issuer, the importance of that work to the law firm (financially or otherwise), and any other connections between the law firm and the issuer. For example, litigators at the law firm acting as the Designated Underwriters' Counsel may be representing the issuer in a lawsuit that will be the subject of due diligence (and, possibly, the subject of disclosure in the offering documents). In considering whether to seek consent of the issuer and underwriter in this situation, consideration should be given to whether the litigators may be called upon to reveal information to the corporate lawyers performing due diligence, and if so on what terms. The lawyer may wish to consider whether it is appropriate to advise the issuer to waive confidentiality vis-à-vis the underwriters and the effect on the privilege of doing so, or instead, for example, to set up firewalls to "screen" off the two sets of lawyers. All of this will require the informed consent of the clients, which consent will be effective only if the disinterested-lawyer test of DR 5-105 is met.

Conclusion

14. A law firm selected to serve as Designated Underwriters' Counsel by a company must carefully consider its relationship with the company selecting it, and assess whether a disinterested lawyer would conclude that the law firm can competently represent the interests of the underwriters in light of its relationship with the company, and if so, ensure that the underwriters appropriately consent to its representation of them.

Endnotes

1. Letter from Bus. Law Section of the N.Y. State Bar Ass'n to the Sec. and Exch. Comm'n (Dec. 18, 2002), available at <http://www.sec.gov/rules/proposed/s74502/gesbackman1.htm>.
2. *Id.* Under SEC Rule 415, an issuer may file a registration statement in anticipation of selling securities at a later date. With its registration statement "on the shelf," the company is able to go to market quickly when conditions are favorable.
3. MUNICIPAL SECURITIES RULEMAKING BOARD NOTICE, "Issuer Selection Of Underwriters' Counsel" (Sept. 3 1998), available at <http://www.msrb.org/MSRB1/reports/0299v191/ucounsel.htm>.
4. See, e.g., DR 5-107(B) ("Unless authorized by law, a lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal service for another to direct or regulate his or her professional judgment in rendering such legal services, or to cause the lawyer to compromise the lawyer's duty to maintain the confidences and secrets of the client under DR 4-101(B).").
5. See Nassau County 2003-2 (attorney may accept legal fees from a private school to represent students with disabilities and their parents in disputes with local school districts over the placement of students in appropriate schools even though in any given case the appropriate school may turn out to be a school other than the private school paying the attorney's fees).
6. See, e.g., DR 5-101(A) (absent informed consent, lawyer may not accept employment "if the exercise of professional judgment on behalf of the client will be or reasonably may be affected by the lawyer's own financial, business, property, or personal interests"); DR 5-105(A) (same if independent professional judgment will be or is likely to be adversely affected by other client relationships).
7. N.Y. State 721, at 4 (1999) (attorney may ethically adhere to an insurance company's numerous guidelines regarding legal research, provided that the attorney remains able to provide competent representation to his or her client).
8. DR 5-105(A), (B).
9. DR 5-101(A); DR 5-105(C).
10. See Iowa Opinion 2006-03 (law firm may, with consent, represent issuer in a bond offering where it has represented, or does represent, the underwriter in unrelated matters); N.Y. City 2001-2 (under certain circumstances, law firm may represent multiple clients on different sides of the same transaction).
11. This example is meant only for illustrative purposes and not to define an outer boundary. Specific facts and circumstances will dictate when the relationship between the lawyer, or law firm, and the issuer is such that the disinterested lawyer test would not be met.
12. See N.Y. City 2001-2; N.Y. State 807 ¶ 11 (2007) ("a single lawyer may, in unusual and very limited circumstances, undertake dual representation of both parties to a real estate transaction"). On the other hand, where accommodations cannot be made, joint representation may not be possible. See N.Y. State 753 (2002) (lawyer may not generally represent both the buyer and the lender in a real estate transaction).

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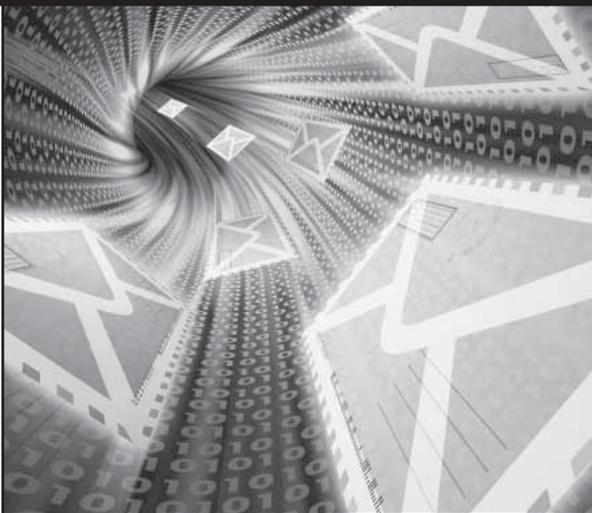
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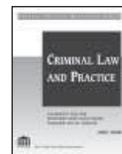


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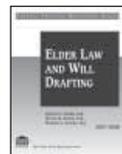


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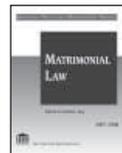


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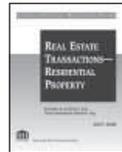


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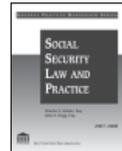


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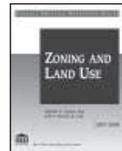
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