

ONEONONE

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

A Message from the Chair

A broad knowledge of the law is especially important in these difficult economic times. Attorneys are asked to help clients who have lost their jobs, face foreclosure of their home mortgages and cannot pay their credit card bills. Clients want to know about bankruptcy. Marriages dissolve due to economic difficulties. Same sex marriage has recently become a practice area. The practitioner has to be litigator, negotiator and hand holder. Court



calendars are clogged with foreclosures and other individual matters in unprecedented numbers. There is a new court decision affecting foreclosure almost every week. This is a time when membership in the General Practice Section enables attorneys to keep up with the rapid changes in the law.

The Section has a list serve, an e-mail forum, used by many attorneys. If you don't know how to do something, you can post a question on the forum. If you need a form, you can request one on the forum. If you want to find out how other attorneys view an issue, you can put it out to the forum. Some attorneys object to the volume of e-mails received. There are several solutions to this problem. One is that you can go to

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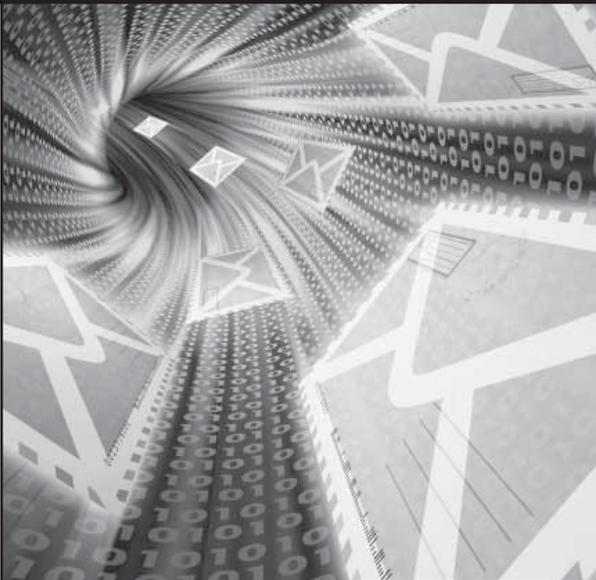
the Section's page (www.nysba.org/gp) on the NYSBA website and change the timing of delivery of messages. I use a separate e-mail for forum messages. I use Gmail for my practice e-mails and Yahoo for my forum e-mails. You can set up folders in Yahoo as in Microsoft Outlook and organize the questions and responses by area of law.

This publication keeps the practitioner informed of changes in the law. The Section has an outstanding pro-

gram prepared for the Annual Meeting CLE Program in the morning of January 25, 2011. Justice Eileen Branstetter, a Commercial Part justice in New York County, will speak on practice in the Commercial Part where all cases must now be e-filed. Renowned trial lawyer Henry Miller will speak on trial practice. David Rosen will again present a CPLR update. The Hot Tips portion of the program will expand from 5 minutes per speaker to 10 minutes per speaker.

Martin S. Kera

Request for Articles



If you have written an article you would like considered for publication, or have an idea for one, please contact the *One on One* Editor:

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Articles should be submitted in electronic document format (pdfs are NOT acceptable), along with biographical information.

www.nysba.org/OneonOne

From the Co-Editors

As the Co-Editors of *One on One*, we endeavor to provide our members and readers with a great selection of topical articles on issues affecting the varying and diverse areas of law in which our General Practice Section members practice. This issue, we are pleased to offer you the following articles, which we hope will be found very helpful and informative:



Richard Klass

Real Estate Appraising: George Lucas, a Certified Residential Appraiser, has submitted an article outlining the license requirements necessary to become a real estate appraiser. The article also delves into the background of the newly enacted Home Valuation Code of Conduct and its effect on the appraisal process, as it relates to mortgages.

Mortgage Foreclosures: This issue, we have an article relating to the mortgage foreclosure process from Bruce J. Bergman, author of the three-volume treatise *Bergman on New York Mortgage Foreclosures*, assisting banking and foreclosure counsel in deciding whether to take a payment from a defaulting borrower after the mortgage has been accelerated.

Senior Citizen Community Resources: Whether or not a senior citizen can and should go into an assisted living facility, nursing home or adult day care involves difficult decisions for the family of the loved one. In an article by George L. Roach, former Chief Attorney of the Legal Aid Society's Senior Citizen Division, the reader will discover the various choices and considerations.

Fiduciary Responsibilities: There is now a definite contrast between the former *Prudent Man Rule* and today's theory termed *Modern Portfolio Theory (MPT)*. An experienced financial professional with Summit Equities, Bruce L. Resnick discusses the duties of fiduciaries and how the modern theory of MPT relates to those duties.

Insurance Contracts: In an article by Reed Podell, the reader will learn about the ramifications of making mistakes or omissions in the application process for insurance policies. There are degrees of mistakes and omissions which can amount to material misrepresentations to the insurance company.

Mortgage Brokers: As former Provisional Counsel at the New York State Banking Department, Mordy Gross

provides an article detailing the duties of mortgage brokers. The article discusses the new requirements imposed upon mortgage brokers by Banking Law Section 590-b.



Martin Minkowitz

Collaborative Law: Law Professor and Director of the Center for Children, Families and the Law, Andrew Schepard delivers an article describing the background and development of Collaborative Law. This fairly new form of alternate dispute resolution provides many benefits to divorcing families.

Legal Malpractice and the Privity Rule: Gary E. Bashian identifies a new risk for trust and estate practitioners concerning estate planning and will drafting. In a recent decision of the New York State Court of Appeals, the Court held that the personal representative of a decedent's estate now has the right to pursue claims of legal malpractice despite the lack of privity with the attorney.

Debtor/Creditor Law: In an informative article by Richard A. Klass, an attorney concentrating on debtor/creditor issues, the newly enacted Exempt Income Protection Act (EIPA) is analyzed. The EIPA amended several statutes relating to the exemption of certain income and assets belonging to judgment debtors, especially concerning the ramifications of restraining notices and levies upon bank accounts containing exempt assets or income.

Proper Will Execution: Paul T. Shoemaker, a partner in Greenfield Stein & Senior LLP, identifies various issues and problems which come up during and after the execution of the Last Will and Testament that may create stumbling blocks for practitioners.

The General Practice Section encourages its Section members to participate on its committees and to share their knowledge with others, especially by contributing articles to an upcoming issue of *One on One*. Your contributions benefit the entire membership.

Articles should be submitted in a Word document. Please feel free to contact either Martin Minkowitz at mminkowitz@stroock.com (212-806-5600), or Richard Klass at richklass@courtstreetlaw.com (718-643-6063) to discuss ideas for articles.

Sincerely,
Martin Minkowitz
Richard Klass

Analysis of the Exempt Income Protection Act or “2009: Not the Year of the Collection Lawyer”

By Richard A. Klass

On January 1, 2009, New York State enacted new measures relating to the restraint of debtors’ bank accounts, through the enactment of the Exempt Income Protection Act (“EIPA”). Without doubt, the EIPA has wreaked havoc on the ability of creditors to collect on their debts through restraint of bank accounts.

Prior to 2009, if a debtor had 2 cents in a bank account, the bank would restrain the account and notify both the account holder/debtor and the creditor’s attorney. The restraint of the account was usually enough of an annoyance to persuade the debtor to enter into a settlement agreement so that he could free up the use of the account. Generally, the primary asset of a judgment debtor is a bank account. Since the enactment of the EIPA, with its strictures, the rate of restraint of bank accounts has severely fallen.

The EIPA materially changed the process of restraints on debtors’ bank accounts, and the steps that each party to the process must now take. The EIPA imposes new requirements on (a) the bank, to identify and analyze the source(s) of income and deposits into an account; (b) the judgment creditor’s attorney, to issue new exemption notices and forms, and appropriately address claimed exemptions by the debtor; and (c) the debtor, to timely raise any exemption claims upon restraint of an account. Since this process is “brand new” to New York law, the manners in which all of these parties, as well as the court system address the process will evolve from practice and procedure.

To begin the analysis, it is important to first see from where it came. In the past, attorneys for judgment creditors had to resolve the issue of whether to release a debtor’s restrained bank account upon the debtor’s claim that the moneys contained in the account were exempt funds. Routinely, the attorney requested that the debtor provide proof (through account statements or other documents) regarding the claim, at which point either the attorney would consent to release the account or the debtor would bring an Order to Show Cause to claim the exemption. If not voluntarily resolved between the attorney and the debtor, the debtor always had the alternative of filing a motion in the action in which the Judgment was entered, seeking to either vacate the Judgment or lift the restraint.

Part of the considerations of the Legislature in enacting the EIPA was that the threat of the continued restraint of the bank account, especially where the debtor needed immediate access to the moneys, without mean-

ingful or fair consideration of any claimed exemptions (even when the debtor “jumped through the hoops”), created a perceived presumption of uneven bargaining positions between the parties.

Another component of the process that played a part in the passing of the EIPA was the increased ease of the banking institutions to create or identify accounts containing only exempt moneys. The increased ease was due to the “direct deposit” and “electronic payment” features now common—the banking institutions are now better able to quickly determine the source of funds in an account, for the most part.

The EIPA amended or added the following sections of Article 52 of New York’s Civil Practice Law and Rules (“CPLR”):

- (a) CPLR 5205—Exemptions;
- (b) CPLR 5222—Effect of Restraint;
- (c) CPLR 5222-a—Exemption Notice and Claim Process;
- (d) CPLR 5230—Property Executions;
- (e) CPLR 5231—Income Executions; and CPLR 5232.

CPLR 5205: The new subdivisions (a) create a new exemption; (b) without limiting any other exemptions; and (c) define the term “banking institution.” Most importantly, the new exemption provides that, if “statutorily exempt payments” are made electronically or by direct deposit into a judgment debtor’s account at a banking institution, then \$2,500 is exempt from application to satisfaction of a money judgment. The time frame indicated is within 45 days prior to service of the restraining notice.

The key is that the direct deposits or electronic payments must be “*readily identifiable*” by the banking institution as statutorily exempt payments. This new language allows the bank to analyze, prior to restraint, whether the debtor’s account should be restrained from the onset—before the debtor needs to provide any other documentation to establish an exemption. Obviously, as more payment systems, businesses, and governmental agencies move towards direct deposit and electronic payments, the identification process will become even easier; the bank’s internal procedures ought to identify the source of deposits to determine whether any moneys came into the account during the 45-day period which would trigger the \$2,500 exemption.

CPLR 5222: The section which authorizes the “restraint” of debtor accounts was amended to (a) revise the notice sent to debtors, either before or with the restraining notice; (b) add an additional presumed exemption for wages; and (c) save debtor’s bank fees for unlawful restraints.

Concerning the revisions to the notice sent to debtors, a specific form must be utilized, which includes additional exemptions not found in the prior notice and more notice concerning the rights of the debtor to obtain free legal counsel or proceed in court without counsel.

As to restraints placed upon a debtor’s account, CPLR 5222 now contains two presumed exemptions, one being that mentioned in CPLR 5205 above, regarding “statutorily exempt payments.” The other new exemption is the presumption that the first \$1,740 in an account (which figure adjusts based upon the greater of the state or federal minimum hourly wage) is deemed exempt as wages, unless a court determines that those funds are unnecessary for the reasonable requirements of the debtor and his dependents. This subdivision very effectively takes out of play the restraint of most debtor bank accounts—unfortunately, most debtors live “hand-to-mouth” and bank accounts tend not to contain more than \$1,740.

The issue as to bank charges was resolved. Many times, debtors would pay bank fees of \$100-\$200 for the restraint of their accounts, whether or not the restraint was proper. Now, if the restraint is unlawful, the bank cannot charge any fees to the debtor. This seemingly applies to accounts belonging to debtors who file for bankruptcy prior to restraint, but this issue is left for future determination.

CPLR 5222-a: Perhaps the section that will cause the most stress and confusion to all involved parties, this section sets up the method for notifying debtors of exemptions and the process for lifting the restraints on accounts pursuant to those exemptions. These rules apply to a Sheriff or Support Collection Unit as well as judgment creditors.

First, the judgment creditor’s attorney must now serve (1) two copies of the restraining notice; (2) one copy of the new “exemption notice;” and (3) two copies of the new “exemption claim form.” The specifics of the notice and form are written into the statute.

Second, within two days after the bank receives the above process and notices, it must serve copies upon the debtor by mail.

Third, within twenty days of the postmarked date of the bank’s mail, the debtor must complete the “exemption claim form” (marking the appropriate claimed

exemption) and serve one copy on the judgment creditor’s attorney and one copy on the bank.

Fourth, the bank must serve a notice to the judgment creditor’s attorney that it will release all funds in the debtor’s account within eight days unless the judgment creditor interposes an objection to the exemption. Separately, the judgment creditor, upon receipt of the exemption claim form, must instruct the bank to release the account within seven days unless it is objecting to the exemption.

If the account contains commingled funds (exempt and non-exempt moneys), the accounting principle of “lowest intermediate balance” shall be applied. This will require an analysis as to whether withdrawals from the account, which will be considered to be made from non-exempt funds first, reduce the portion of non-exempt funds to a level that necessitates the release of all or a portion of the funds. Most creditors’ counsel agree that, in all likelihood, this accounting principle will result in the release of the restrained account.

The manner in which the judgment creditor’s counsel may object to a claimed exemption is by moving for an Order under CPLR 5240, and including an affirmation showing a factual basis upon which there is reasonable belief that the account contains non-exempt funds. The hearing on the motion will be noticed for seven days after service of the moving papers (* note the divergence from the notice of motion requirements under CPLR 2214). The exemption claim form is deemed prima facie evidence at the hearing, and the burden of proof will be on the creditor (which will be a heavy burden, especially if the debtor does not provide appropriate proof of the claimed exemption). Once the court issues an Order on the motion (to be done within five days of the hearing), the judgment creditor’s attorney must serve a copy of the Order on the bank and the debtor within two days thereafter.

Scary stuff! If the court determines that the creditor’s objection was asserted in bad faith, the debtor will be awarded costs, reasonable attorney’s fees, actual damages, and an amount not to exceed \$1,000.

CPLR 5230/5231/5232: These sections relate to both Property and Income Executions issued by the judgment creditor’s counsel to the Sheriff (or Marshal within New York City). The amendments to these sections mirror the changes mentioned above, and apply to levies made by the Sheriff upon debtor accounts.

State or Support Claims: The EIPA was amended, effective May 2009, to indicate that the various enacting provisions do not apply when the judgment creditor is the State of New York or its agencies or municipal corporations, or when the debt being enforced is for child support, spousal support, maintenance or alimony, pro-

vided that there is a legend at the top in 16-point bold type stating: “The judgment creditor is the State of New York or any of its agencies or municipal corporations AND/OR the debt enforced is for child support, spousal support, maintenance or alimony.”

The following forms contain the changes pursuant to the EIPA:

1. CPLR 5222 Notice to Debtor
2. Exemption Notice

3. Exemption Claim Form
4. Property Execution
5. Income Execution

Richard A. Klass, Esq., is the Co-Editor of the NYSBA General Practice Section’s *One on One*. He maintains a law firm engaged primarily in civil litigation at 16 Court Street, 29th Floor, Brooklyn Heights, New York. He may be reached at (718) COURT-ST or RichKlass@courtstreetlaw.com for any questions.

FORM 1

NOTICE TO JUDGMENT DEBTOR

Money or property belonging to you may have been taken or held in order to satisfy a judgment which has been entered against you. Read this carefully.

YOU MAY BE ABLE TO GET YOUR MONEY BACK

State and federal laws prevent certain money or property from being taken to satisfy judgments. Such money or property is said to be “exempt”. The following is a partial list of money which may be exempt:

1. Supplemental security income (SSI);
2. Social security;
3. Public assistance (welfare);
4. Spousal support, maintenance (alimony) or child support;
5. Unemployment benefits;
6. Disability benefits;
7. Worker’s compensation benefits;
8. Public or private pensions;
9. Veteran’s benefits;
10. Ninety percent of your wages or salary earned in the last sixty days;
11. Twenty-five hundred dollars of any bank account containing statutorily exempt payments that were deposited electronically or by direct deposit within the last forty-five days, including but not limited to your social security, supplemental security income, veterans benefits, public assistance, workers’ compensation, unemployment insurance, public or private pensions, railroad retirement benefits, black lung benefits or child support payments;
12. Railroad benefits; and
13. Black lung benefits.

If you think that any of your money that has been taken or held is exempt, you must act promptly because the money may be applied to the judgment. If you claim that any of your money that has been taken or held is exempt, you may contact the person sending this notice.

Also, YOU MAY CONSULT AN ATTORNEY, INCLUDING ANY FREE LEGAL SERVICES ORGANIZATIONS IF YOU QUALIFY. You can also go to court without an attorney to get your money back. Bring this notice with you when you go. You are allowed to try to prove to a judge that your money is exempt from collection under New York CPLR sections 5222(a), 5239 and 5240. If you do not have a lawyer, the clerk of the court may give you forms to help you prove your account contains exempt money that the creditor cannot collect. The law (New York Civil Practice Law and Rules, Article 4 and Sections 5239 and 5240) provides a procedure for the determination of a claim for an exemption.

**Very truly yours,
Richard A. Klass, Esq.**

FORM 2

CIVIL COURT: CITY OF NEW YORK
COUNTY OF KINGS

-----X
ABC COMPANY,

Plaintiff,

-against-

JOHN DOE,

Defendant.

-----X

Index No. 123/2010

EXEMPTION NOTICE As required by New York Law

Your bank account is restrained or “frozen.”

The attached Restraining Notice or Notice of Levy by Execution has been issued against your bank account. You are receiving this notice because a creditor has obtained a money judgment against you, and one or more of your bank accounts has been restrained to pay the judgment. A money judgment is a court’s decision that you owe money to a creditor. You should be aware that FUTURE DEPOSITS into your account(s) might also be restrained if you do not respond to this notice.

You may be able to “vacate” (remove) the judgment. If the judgment is vacated, your bank account will be released. Consult an attorney (including free legal services) or visit the Court Clerk for more information about how to do this.

Under state and federal law, certain types of funds cannot be taken from your bank account to pay a judgment. Such money is said to be “exempt.”

DOES YOUR BANK ACCOUNT CONTAIN ANY OF THE FOLLOWING TYPES OF FUNDS?

1. Social security;
2. Social security disability (SSD);
3. Supplemental security income (SSI);
4. Public assistance (welfare);
5. Income earned while receiving SSI or public assistance;
6. Veterans benefits;
7. Unemployment benefits;
8. Payments from pensions and retirement accounts;
9. Disability benefits;
10. Income earned in the last 60 days (90% of which is exempt);
11. Workers’ compensation benefits;
12. Child support;
13. Spousal support or maintenance (alimony);
14. Railroad retirement; and/or
15. Black lung benefits.

If YES, you can claim that your money is exempt and cannot be taken. To make the claim, you must (a) complete the EXEMPTION CLAIM FORM attached; (b) deliver or mail the form to the bank with the restrained or “frozen” account; and (c) deliver or mail the form to the creditor or its attorney at the address listed on the form.

You must send the forms within 20 DAYS of the postmarked date on the envelope holding this notice.

You may be able to get your account released faster if you send to the creditor or its attorney written proof that your money is exempt. Proof can include an award letter from the government, an annual statement from your pension, pay stubs, copies of checks, bank records showing the last two months of account activity, or other papers showing that the money in your bank account is exempt. If you send the creditor’s attorney proof that the money in your account is exempt, the attorney must release that money within seven days. You do not need an attorney to make an exemption using the form.

FORM 3

CIVIL COURT: CITY OF NEW YORK
COUNTY OF KINGS

-----X
ABC COMPANY,

Plaintiff,

-against-

JOHN DOE,

Defendant.

-----X

Index No. 123/2010

EXEMPTION CLAIM FORM

Name and address of judgment creditor or attorney
(To be completed by judgment creditor or attorney)

Name and address of financial institution
(To be completed by judgment creditor or attorney)

Address A

RICHARD A. KLASS, ESQ.
16 Court Street, 29th Floor
Brooklyn NY 11241

Address B

BANK
1 Court Street
Brooklyn NY 11201

Directions: To claim that some or all of the funds in your account are exempt, complete both copies of this form, and make one copy for yourself. Mail or deliver one form to **Address A** and one form to **Address B** within twenty days of the date on the envelope holding this notice.

** If you have any documents, such as an award letter, an annual statement from your pension, paystubs, copies of checks or bank records showing the last two months of account activity, include copies of the documents with this form. Your account may be released more quickly.

I state that my account contains the following type(s) of funds (check all that apply):

- | | |
|--------------------------------------------------------------|--------------------------------------------------------------------------------------|
| <input type="checkbox"/> Social security; | <input type="checkbox"/> Income earned in the last 60 days (90% of which is exempt); |
| <input type="checkbox"/> Social security disability (SSD); | <input type="checkbox"/> Wages while receiving SSI or public assistance; |
| <input type="checkbox"/> Supplemental security income (SSI); | <input type="checkbox"/> Payments from pensions and retirement accounts; |
| <input type="checkbox"/> Public assistance; | <input type="checkbox"/> Workers' compensation benefits; |
| <input type="checkbox"/> Veterans benefits; | <input type="checkbox"/> Disability benefits; |
| <input type="checkbox"/> Child support; | <input type="checkbox"/> Spousal support or maintenance (alimony); |
| <input type="checkbox"/> Unemployment insurance; | <input type="checkbox"/> Railroad retirement or black lung benefits; |
| <input type="checkbox"/> Other (describe exemption): | |

I request that any correspondence to me regarding my claim be sent to the following address:

(FILL IN YOUR COMPLETE ADDRESS)

I certify under penalty of perjury that the statement above is true to the best of my knowledge and belief.

Date: _____

SIGNATURE OF JUDGMENT DEBTOR

FORM 4

CIVIL COURT: CITY OF NEW YORK
COUNTY OF KINGS

-----X
ABC COMPANY,

Plaintiff,
- against -

JOHN DOE,

Defendant.
-----X

Index No.123/2010

EXECUTION WITH NOTICE TO GARNISHEE

TO THE SHERIFF (or MARSHAL) OF ANY COUNTY, GREETING:

WHEREAS, in an action in the Civil Court of the City of New York, County of Kings, between ABC Company, as Plaintiff, and John Doe, as Defendant, a judgment was entered on October 1, 2010, in favor of Plaintiff and against John Doe, Defendant, 123 Main Street, Brooklyn, NY 11201, in the amount of \$1,000, of which \$1,000, together with interest from October 1, 2010, remains due and unpaid;

WHEREAS, a transcript of judgment was filed with the Clerk of the County of Kings on February 3, 2009;

NOW, THEREFORE WE COMMAND YOU to satisfy the said judgment from the real and personal property of the above-named judgment debtor, and the debts due to him; and that only the property in which said judgment debtor, who is not deceased, has an interest or the debts owed to him shall be levied upon or sold hereunder; and to return this Execution to the Clerk of the above-captioned court within 60 days after issuance unless service of this Execution is made within that time or within extensions of that time made in writing by the attorney for the judgment creditor.

PURSUANT to CPLR 5205(l), \$2,500 of an account containing direct deposit or electronic payments reasonably identifiable as statutorily exempt payments, as defined in CPLR 5205(l)(2), is exempt from execution and the garnishee cannot levy upon or restrain \$2,500 in such an account.

PURSUANT to CPLR 5222(i), an execution shall not apply to an amount equal to or less than 90% of the greater of 240 times the federal minimum hourly wage prescribed in the Fair Labor Standards Act of 1938 or 240 times the state minimum hourly wage prescribed in Labor Law 652 as in effect at the time the earnings are payable, except such part as a court determines to be unnecessary for the reasonable requirements of the judgment debtor and his or her dependents.

NOTICE TO GARNISHEE

To: BANK
Address: 1 Court St., Brooklyn NY 11201

WHEREAS, it appears that you are indebted to the judgment debtor, or in possession or custody of property not capable of delivery in which the judgment debtor has an interest, including the following specified debt and/or property:

all savings, checking, and time deposit accounts; safe deposit boxes; loan security; etc.

NOW THEREFORE, you are required by CPLR Section 5232(a) forthwith to transfer to the Sheriff all personal property not capable of delivery in which the judgment debtor is known or believed to have an interest now in or hereafter coming into your possession or custody including any property specified in this notice; and to pay to the Sheriff, upon maturity, all debts now due or hereafter coming due from you to the judgment debtor; and to execute any documents necessary to effect such transfer or payment; and

TAKE NOTICE, that until such transfer or payment is made, or until the expiration of 90 days after the service of this Execution upon you, or such further time as is provided by any Order of the Court served upon you, whichever event occurs first, you are forbidden to make or suffer any sale, assignment, or transfer of, or interference with, any such property, or pay over or otherwise dispose of any such debt, to any person other than the Sheriff, except upon direction of the Sheriff or pursuant to an Order of the Court; and

TAKE FURTHER NOTICE, that at the expiration of 90 days after a levy is made by service of this Execution, or of such further time as the Court, upon motion of the judgment creditor has provided, this levy shall be void except as to property or debts which have been transferred or paid to the Sheriff, or as to which a proceeding under CPLR Sections 5225 or 5227 has been brought.

Dated: Brooklyn, New York
October 15, 2010

RICHARD A. KLASS, ESQ.
Attorney for Plaintiff
16 Court Street, 29th Floor
Brooklyn, New York 11241
718-643-6063

FORM 5

CIVIL COURT: CITY OF NEW YORK
COUNTY OF KINGS
ABC COMPANY

Index No. 123/2010

Judgment Creditor

INCOME EXECUTION

Judgment Debtor (name and last known address):

John Doe
123 Main Street
Brooklyn, NY 11201

To the Enforcement Officer,
GREETING:

A judgment was entered in the within court in favor of Judgment Creditor and the particulars are as follows:

Court of Original Entry:	Entry Date:	Original Amount:	Amount Due:	Interest from:
Civil Court, Kings County	10/16/2010	\$1,000.00	\$1,000.00	10/16/2010

The judgment was recovered against John Doe, Defendant, and transcribed with the Clerk of Kings County on October 16, 2010.

This Execution is issued against John Doe, whose last known address is: 123 Main Street, Brooklyn, NY 11201, and whose social security number is 123-45-6789, and who is receiving, or will receive wages of \$500.00 for each weekly pay period from the Employer. "Employer" herein shall include any payor of money to Judgment Debtor. The Employer's name and address is:

XYZ Warehouse, 25 Court St., Brooklyn, NY 11201

You are directed to satisfy the judgment with interest together with your fees and expenses out of all moneys now and hereafter due and owing to Judgment Debtor from the Employer pursuant to CPLR §5231.

Directions to Judgment Debtor: You are notified and commanded immediately to start paying to the Enforcement Officer serving a copy of this Income Execution on you: installments amounting to 10% (but no more than the limits set forth in I. Limitations below) of any and all salary, wages, or other income, including any and all overtime earnings, commissions, or other irregular compensation received or hereafter to be received from your Employer and to continue paying such installments until the judgment with interest and the fees and expenses of this Income Execution are fully paid and satisfied, and if you fail to do within 20 days, this Income Execution will be served upon the Employer by the Enforcement Officer.

Directions to the Employer: You are commanded to withhold and pay over to the Enforcement Officer serving a copy of this Income Execution upon you: installments amounting to 10% (but no more than the limits set forth in I. Limitations below) of any and all salary, wages, or other income, including any and all overtime earnings, commissions, or other irregular compensation now or hereafter becoming due to Judgment Debtor until the judgment with interest and the fees and expenses of this Income Execution are fully paid and satisfied.

Dated: Brooklyn, New York
October 15, 2010

RICHARD A. KLASS, ESQ.
Attorney for Plaintiff
16 Court Street, 29th Floor
Brooklyn, New York 11241
718-643-6063

IMPORTANT STATEMENT

This Income Execution directs the withholding of up to 10% of Judgment Debtor's gross income. In certain cases, however, state or federal law does not permit the withholding of that much of Judgment Debtor's gross income. The Judgment Debtor is referred to New York Civil Practice Law and Rules, Section 5231 and United States Code, Title 15, Section 1671.

I. Limitations on the amount that can be withheld:

A. An Income Execution for installments from a judgment debtor's gross income cannot exceed 10% of the judgment debtor's gross income.

B. If a judgment debtor's weekly disposable earnings are less than the greater of 30 times the current federal minimum wage (\$7.25 per hour) or \$217.50, or the New York State minimum wage (\$7.25 per hour) or \$217.50, no deduction can be made from the judgment debtor's earnings under this Income Execution.

C. A judgment debtor's weekly disposable earnings cannot be reduced below the amount arrived at by multiplying 30 times the greater of the current federal minimum wage (\$7.25 per hour) or \$217.50, or the New York State minimum wage (\$7.25 per hour) or \$217.50 under this Income Execution.

D. If deductions are being made from a judgment debtor's earnings under any orders for alimony, support, or maintenance for family members or former spouses, and those deductions equal or exceed 25% of the judgment debtor's disposable earnings, no deduction can be made from the judgment debtor's earnings under this Income Execution.

E. If deductions are being made from a judgment debtor's earnings under any orders for alimony, support, or maintenance for family members or former spouses, and those deductions are less than 25% of the judgment debtor's disposable earnings, deductions can be made from the judgment debtor's earnings under this Income Execution. However, the amount arrived at by adding the deductions from earnings made under this Execution to the deductions made from earnings under any orders for alimony, support, or maintenance for family members or former spouses cannot exceed 25% of the judgment debtor's disposable earnings.

Note: Nothing in this notice limits the proportion or amount which may be deducted under any order for alimony, support, or maintenance for family members or former spouses.

II. Explanation of limitations:

Definitions: a) Disposable earnings—Disposable earnings are that part of an individual's earnings left after deducting those amounts that are required by law to withheld (for example: taxes, social security, and unemployment insurance, but not deductions for union dues, insurance plans, etc.); b) Gross Income - Gross Income is salary, wages, or other income, including any and all overtime earnings, commissions, and income from trusts, before any deductions are made from such income.

Illustrations regarding earnings:

If disposable earnings is:

a) 30 times the greater of the federal minimum wage (\$217.50) or the New York State minimum wage (\$217.50) or less

b) more than 30 times the greater of the federal minimum wage (\$217.50) or the New York State minimum wage (\$217.50) and less than 40 times the greater of the federal minimum wage (\$290.00) or the New York State minimum wage (\$290.00)

c) 40 times the greater of the federal minimum wage (\$290.00) or New York State minimum wage (\$290.00) or more

Amount to pay or deduct from earnings under this Income Execution is:

No payment or deduction is allowed.

The lesser of: the excess over the greater of 30 times the federal minimum wage (\$217.50) or the New York State minimum wage (\$217.50) in disposable earnings, or 10% of gross earnings.

The lesser of: 25% of disposable earnings or 10% of gross the earnings.

III. Notice: You may be able to challenge this Income Execution through procedures provided in CPLR §§ 5231(i) and 5240.

If you think that the amount of your income being deducted under this Income Execution exceeds the amount permitted by state or federal law, you should act promptly because the money will be applied to the judgment. If you claim that the amount of your income being deducted under this Income Execution exceeds the amount permitted by state or federal law, you should contact your employer or other person paying your income. **YOU MAY CONSULT WITH AN ATTORNEY, INCLUDING LEGAL AID IF YOU QUALIFY.** New York law provides two procedures through which an Income Execution can be challenged.

CPLR 5231(i)—Modification: At any time, the judgment debtor may make a motion to a court for an Order modifying an Income Execution.

CPLR 5240—Modification or protective order: supervision of enforcement: At any time, Judgment Debtor may make a motion to a court for an Order denying, limiting, conditioning, regulating, extending, or modifying the use of any post-judgment enforcement procedure, including the use of Income Executions.

Return (for Sheriff's or Marshal's use only)

Fully satisfied on: _____ Unsatisfied

Partially satisfied: _____ \$ _____

Because I was unable to find the Garnishee (Employer) within my jurisdiction, I returned this Income Execution to Judgment Creditor's Attorney on: _____.

Date and time received:

Marshal, City of New York
 Sheriff, County of _____

Proof of Wills: Issues Concerning Due Execution and Interested Witnesses

By Paul T. Shoemaker

Recent judicial decisions underscore the need to have wills prepared by, and executed under the supervision of, lawyers who are experienced in such matters. It is, of course, essential to have a proper will-signing ceremony, but other dangers lurk beneath the surface, particularly problems presented by the use of interested witnesses.

This article examines cases which have dealt with issues that arise when (a) the will execution ceremony is not conducted properly, or cannot be shown to have been conducted properly, or (b) one or more of the attesting witnesses is “interested.”

Proof of Proper Execution of a Will

Section 3-2.1 of the Estates, Powers and Trusts Law (EPTL) sets forth the requirements for the due execution of a will. In order to prove the due execution of a will, it must be shown that there was substantial compliance with the following:

1. The signature of the testator was affixed by him or her (or by another person in the testator’s presence and at his or her direction) at the end of the instrument;
2. The testator declared the instrument to be his or her will;
3. Each of the witnesses signed the instrument as a witness at the testator’s request;
4. The testator signed the will in the presence of the witnesses or acknowledged to each of the witnesses that the signature appearing at the end of the instrument was his or her signature; and
5. There were at least two attesting witnesses, and they signed as witnesses within 30 days of each other.

EPTL 3-2.1.¹

Sections 1405 and 1406 of the Surrogate’s Court Procedure Act (SCPA) set forth special rules applicable to proof of due execution of a will.²

Section 1405, subdivision 1, provides that, where an attesting witness is unavailable by reason of death, absence from the state or incompetency, the court may dispense with the testimony of such attesting witness and admit the will to probate based upon the testimony of the other attesting witness.

Subdivision 3 of § 1405 provides that, where an attesting witness has forgotten the occurrence or testifies against the execution of the will, the court may still admit the will to probate if there is at least one other attesting witness whose testimony provides evidence of such facts as would be sufficient to prove the will.

In the event that all of the attesting witnesses are unavailable, the will may nevertheless be admitted to probate under subdivision 4 of § 1405 upon proof of the handwriting of the testator and of at least one attesting witness and “such other facts as would be sufficient to prove the will.”

Next, § 1406 of the SCPA provides that the attesting witnesses may submit affidavits stating such facts “as would if uncontradicted establish the genuineness of the will, the validity of its execution and that the testator at the time of execution was in all respects competent to make a will and not under any restraint.” Such affidavits must be accepted by the court as evidence of due execution **unless** an objection is made. Thus, if there is no objection, a will may be admitted to probate based on affidavits, and the live testimony of the attesting witnesses need not be taken.³

In addition, pursuant to case law, there is a presumption of due execution of a will if the execution of the will was supervised by an attorney. (The presumption, however, does not arise when the supervising attorney was a substantial beneficiary under the will.) *See, e.g., In re Kindberg.*⁴

The presence of an attestation clause (that is, a paragraph which recites compliance with the statutory requirements and which has been subscribed by the attesting witnesses) also is helpful to the proponent of a will. The presence of a complete attestation clause has been held to create a presumption of due execution.⁵

The aforementioned statutory and case law provisions give aid and comfort to the party attempting to establish the due execution of a will. On the other hand, § 3-3.2 of the EPTL can be a trap for the unwary.⁶ Section 3-3.2 provides that an attesting witness to a will to whom a beneficial disposition or appointment of property is made is a competent witness to testify concerning the execution of the will; provided, however, that the disposition or appointment made to such attesting witness will be void unless there were, at the time of execution and attestation, at least two other attesting witnesses to the will who received no beneficial disposition or appointment thereunder.

Subdivision (a) (3) of § 3-3.2 provides an exception to forfeiture for an attesting witness who would be a distributee if the will were not established. Such an attesting witness whose testimony is necessary to establish the will remains entitled to receive so much of his or her intestate share as does not exceed the value of the disposition made to him or her in the will.

Application of the Requirements of Due Execution in Recent Cases

In *In re Halpern*,⁷ the court was confronted with a will which had been executed almost 50 years earlier, on September 12, 1958. The decedent died in 2006 and the only surviving attesting witness was deposed in 2007.

The attesting witness testified that she had no memory of the events of September 12, 1958. She acknowledged her signature on the document, however, and handwriting experts authenticated the signatures of the decedent and of the attorney who had supervised the execution of the will.

The Appellate Division, relying upon the presumptions created by the fact that the will execution ceremony had been conducted under the supervision of an attorney, and that the will contained an attestation clause, affirmed the decision of Surrogate Glen, who had granted the proponents' motion for summary judgment and admitted the will to probate.

The majority found that the testimony of the attesting witness, even though it failed to show that the required formalities had taken place, was insufficient to overcome the presumptions established by the attestation clause and the fact that the will was executed under an attorney's supervision. The majority stated that the attesting witness's testimony had to be read "in context" and was properly interpreted as testimony to the effect that she could not confirm the statements made in the attestation clause because she did not remember an event which had taken place almost 50 years earlier.

The dissenting Justice, Justice McGuire, quoted the attesting witness's testimony at length, noting in particular that the attesting witness testified that there had never been an occasion when she signed any document with a lawyer and the decedent in the same room at the same time. When pressed, she stated that she was confident that no such thing had ever occurred. She also testified that no one told her that the document she was signing was anybody's will.

In addition, the dissenter attached significant weight to the fact that the attesting witness testified that she believed that she would remember if she had been asked to sign a will and that she had no recollection of any such event ever having taken place. In ad-

dition, although she acknowledged that she had signed the document, she said that she was very young (20 years old) at the time of the signing of the will, that the testator, her employer, was very controlling, and that, because of his controlling and manipulative nature, she believed she probably would have signed a document that was placed in front of her if he told her to sign it.

The dissenter did not conclude that the will should have been rejected as a matter of law based on the above testimony, but merely that summary judgment should have been denied and that the issue of the will's validity should have submitted to a finder of fact.

As noted above, under SCPA 1405(3), where the testimony of an attesting witness is "against the execution of the will," the will still may be admitted to probate upon the testimony of one of the other attesting witnesses. Here, however, there were no other surviving attesting witnesses who could provide testimony.

And, under SCPA 1405(4), if the attesting witness was simply unavailable to testify, the will could have been admitted to probate upon proof of the handwriting of the testator and of at least one of the attesting witnesses and of such other facts as would be sufficient to prove the will. In other words, if the attesting witness in the *Halpern* case had not been available to testify, the will probably would not have been cast into doubt.

The majority in *Halpern* did not address or discuss SCPA 1405, but avoided having to do so by relying on the presumptions arising from the attestation clause and the supervision of the will's execution by an attorney.

How could the problems presented in *Halpern* have been avoided? If the attesting witness had been an employee of the draftsman's law firm, then even 50 years later, the witness most likely would have testified that she was often asked to witness wills and that the lawyers in her firm who supervised the executions of wills routinely asked the appropriate questions and conducted the ceremonies in compliance with statutory requirements.

In *In re DiPasquale*,⁸ the will had not been executed under the supervision of an attorney. Accordingly, there was no presumption of compliance with the statutory requirements for the proper execution of the will.

There were affidavits of the attesting witnesses setting forth compliance with the statutory requirements, but objections had been filed by a Guardian ad Litem. As a result, the court could not accept the affidavits as conclusive proof of due execution under SCPA 1406, and the testimony of the attesting witnesses was taken.

The court observed that the witnesses did not have "failed or imperfect memories" (in which case the

application of § 1405(3) of the SCPA might have been of assistance to the proof of the will), but that their testimony affirmatively contradicted due execution of the will and showed that the necessary formalities had not taken place.

First, their testimony failed to establish that the decedent had asked them to act as witnesses. Second, the testimony failed to establish that the decedent had made it known to the witnesses that the instrument they were being asked to sign was the decedent's last will. The court therefore refused to admit the will to probate and revoked preliminary letters testamentary.

The *DiPasquale* decision vividly demonstrates the dangers of having a will executed without proper attorney supervision. In *DiPasquale*, the attesting witnesses all were accountants who had some familiarity with the formalities involved in the execution of a will. Nevertheless, the evidence established that those formalities had not in fact been fully observed.

The outcome in *DiPasquale* may be contrasted with the outcome in *In re Pilon*,⁹ where the attorney who supervised the will execution ceremony utilized secretaries employed by his firm as witnesses. Under such circumstances, the court held, it was possible and appropriate to infer that the required formalities were observed and that the testator did in fact ask the witnesses to sign as such.

In *In re Stachiw*,¹⁰ the court also refused to admit a will to probate on the grounds that it had not been properly executed. The attorney draftsman had supervised the propounded will's execution and, the court noted, a presumption of regularity that the will was properly executed therefore arose. Nevertheless, the court refused to admit the will to probate, finding that the objectants had submitted sufficient evidence to overcome that presumption.

The *Stachiw* case involved unusual circumstances because the testator was hospitalized and in "an extremely incapacitated condition." Indeed, the attorney-draftsman acknowledged in his testimony that, during the one and one-half hours he was with the decedent in his hospital room, the decedent did not say a single word.

Moreover, the attorney utilized bystanders as attesting witnesses, including a janitor who testified: "I was cleaning the bathroom and I'm on my way out mopping the floor and someone says, would you witness the signature of this gentleman is putting on the piece of paper, and I said, sure, I'll sign underneath, but that was it."¹¹

The court credited the testimony of this attesting witness that the decedent did not publish his intention that the document serve as his will or in any way declare that the instrument he was signing was his will.

The court rejected "the attorney's conclusory, self-serving assertions" that the decedent either signed the will in the presence of that witness or acknowledged his signature to the witness. The court concluded that the attorney had rushed through the execution process without giving due consideration to the decedent's condition and "without proper regard for the particular prescribed requirements of will execution."

The *Stachiw* case is unusual in that it shows that, where there is affirmative evidence to the contrary, even the supervision of a will execution by an attorney may not suffice to establish the validity of the execution of the will to the satisfaction of a court.

The Interested Witness Problem

In *Estate of Maset*,¹² the court disregarded the terms of § 3-3.2 of the EPTL in order to avoid forfeiture of a bequest to an interested witness.

In *Maset*, two of the three attesting witnesses were provided with bequests under the will. Section 3-3.2 requires forfeiture if there are not at least two witnesses to whom no disposition or appointment is made, and the determination of whether there is a disposition or appointment to an attesting witness must be made "at the time of execution and attestation." Accordingly, a straightforward application of § 3-3.2 would have required forfeiture of the bequests made to both witnesses. See, e.g., *Estate of King*.¹³

A disclaimer, or a finding of forfeiture, with respect to a bequest to one witness is not sufficient to protect a bequest to a second witness if both witnesses were beneficiaries as of the time of the execution of the will. Nevertheless, the *Maset* court ruled that one beneficiary witness (Matthew Riddick, who was not a distributee) would not forfeit his bequest because the testimony of another beneficiary witness (Alicia Maset, a daughter of the decedent) would be accepted as the testimony of a second attesting witness (in addition to the testimony of the (third) non-beneficiary witness), and the disposition to Alicia Maset would be void.

The court in *Maset* expressed sympathy towards Matthew Riddick, stating that he should "not have to forfeit, through no fault of his own, the modest monetary bequest [\$1,500] that the decedent wanted him to receive." The court further noted that Alicia Maset could still receive the share that she would have received in intestacy (EPTL 3-3.2 (a) (3)).

The court did not, however, disclose whether that outcome would have any impact on the amount Alicia Maset ultimately would receive. The will provided for her to receive the entire residuary estate. Under the court's ruling, however, she would forfeit one-half of the residuary because another daughter of the decedent also survived and, under the rules of intestate succes-

sion, the two sisters would each receive one-half of the residuary.

This raises the question of how the court decided to favor Matthew Riddick over Alicia Maset. It is true that, inasmuch as he was not a distributee, Matthew Riddick would have received nothing whatsoever if he had been required to forfeit his bequest. That, however, begs the question of how much Ms. Maset forfeited by reason of the court's disallowance of the bequest to her. If the residuary estate was worth more than \$3,000, then Alicia was impacted more severely than Matthew Riddick would have been had his bequest been deemed to have been forfeited.

While there certainly may be policy reasons why the forfeiture of a bequest to an interested witness is undesirable, those policy reasons are for the legislature to evaluate and act upon, not for the court to evaluate and act upon where the legislature has already spoken.¹⁴ Until and unless the legislature acts, decisions such as *Maset* would seem to be inappropriate.

Conclusion

It is unwise to rely on the possibility that a court will stretch the law to avoid an unintended forfeiture or to validate a will execution that was not conducted properly. The better approach clearly is for those who are intending to execute wills to retain counsel with substantial expertise in the area in order to avoid the pitfalls involved both in proving due execution of a will and in having interested parties act as witnesses to a will. Experienced counsel will follow the proper procedures and will utilize as witnesses employees of his or her law firm who have experience with such matters, thereby maximizing the likelihood that the will in question will be admitted to probate.¹⁵

The Appellate Division for the First Department had occasion in 2007 to instruct the bar as follows:

In view of the above, we find it quite clear, and it should likewise be so to the bar, that the best practice is to discourage clients from executing a will outside the attorney's office or, at the least, without the supervision of an attorney. However, if the client insists and/or the circumstances demand, the attorney should deliver a written memorandum to the client explaining the fairly straightforward formalities, in clear and simple terms, which must be observed. The client should be requested to sign and return the memorandum after the execution ceremony, acknowledging with some detail, that the instructions were followed. This

simple procedure will, to a large extent, negate the need for a proceeding such as this and abrogate the possibility that a decedent's testamentary intent will be frustrated.¹⁶

The cases discussed above demonstrate the soundness of the court's guidance and the advisability of utilizing experienced counsel in connection with the preparation and execution of a will.

Endnotes

1. EPTL § 3-2.1. Execution and attestation of wills; formal requirements
 - (a) Except for nuncupative and holographic wills authorized by 3-2.2, every will must be in writing, and executed and attested in the following manner:
 - (1) It shall be signed at the end thereof by the testator or, in the name of the testator, by another person in his presence and by his direction, subject to the following:
 - (A) The presence of any matter following the testator's signature, appearing on the will at the time of its execution, shall not invalidate such matter preceding the signature as appeared on the will at the time of its execution, except that such matter preceding the signature shall not be given effect, in the discretion of the surrogate, if it is so incomplete as not to be readily comprehensible without the aid of matter which follows the signature, or if to give effect to such matter preceding the signature would subvert the testator's general plan for the disposition and administration of his estate.
 - (B) No effect shall be given to any matter, other than the attestation clause, which follows the signature of the testator, or to any matter preceding such signature which was added subsequently to the execution of the will.
 - (C) Any person who signs the testator's name to the will, as provided in subparagraph (1), shall sign his own name and affix his residence address to the will but shall not be counted as one of the necessary attesting witnesses to the will. A will lacking the signature of the person signing the testator's name shall not be given effect; provided, however, the failure of the person signing the testator's name to affix his address shall not affect the validity of the will.
 - (2) The signature of the testator shall be affixed to the will in the presence of each of the attesting witnesses, or shall be acknowledged by the testator to each of them to have been affixed by him or by his direction. The testator may either sign in the presence of, or acknowledge his signature to each attesting witness separately.
 - (3) The testator shall, at some time during the ceremony or ceremonies of execution and attestation, declare to each of the attesting witnesses that the instrument to which his signature has been affixed is his will.
 - (4) There shall be at least two attesting witnesses, who shall, within one thirty day period, both attest the testator's signature, as affixed or acknowledged in their presence, and at the request of the testator, sign their names and affix their residence addresses at the end of the will. There shall be a rebuttable presumption that the thirty day requirement of the preceding sentence has been fulfilled. The failure of a witness to affix his address shall not affect the validity of the will.
 - (b) The procedure for the execution and attestation of wills need not be followed in the precise order set forth in paragraph (a) so long as all the requisite formalities are observed during

a period of time in which, satisfactory to the surrogate, the ceremony or ceremonies of execution and attestation continue.

2. SCPA § 1405. When court may dispense with testimony of witness

1. The death, absence from the state or incompetency of an attesting witness required to be examined as prescribed in this or the preceding section or the fact that the witness cannot with due diligence be found within the state or cannot be examined as an attesting witness by reason of his physical or mental condition may be shown by affidavit or by any competent evidence and when so shown to its satisfaction, the court may by the decree on probate or by order either in writing or entered in the minutes dispense with the testimony of such attesting witness. Where the testimony of an attesting witness has been dispensed with as provided in this section and 1 attesting witness has been examined the will may be admitted to probate upon the testimony of the attesting witness who has been examined without further or additional proof.

2. Where an attesting witness is absent from the state and it is shown that his testimony can be obtained with reasonable diligence the court may and shall upon the demand of any party require his testimony be taken by commission.

3. Where an attesting witness has forgotten the occurrence or testifies against the execution of the will and at least 1 other attesting witness has been examined, the will may be admitted to probate upon the testimony of the other witness or witnesses and such other facts as would be sufficient to prove the will.

4. If all of the attesting witnesses are dead or incompetent or unable to testify by reason of physical or mental condition or are absent from the state and their testimony has been dispensed with as provided in this section the will may nevertheless be admitted to probate upon proof of the handwriting of the testator and of at least one of the attesting witnesses and such other facts as would be sufficient to prove the will.

SCPA § 1406. Proof of will by affidavit of attesting witness out of court

1. In addition to other procedures prescribed for the proof of wills, any or all of the attesting witnesses to a will may at the request of the testator or after his death, at the request of the executor named in the will or of the proponent or the attorney for the proponent or of any person interested, make an affidavit before any officer authorized to administer oaths stating such facts as would if uncontradicted establish the genuineness of the will, the validity of its execution and that the testator at the time of execution was in all respects competent to make a will and not under any restraint. The sworn statement of a witness so taken shall be accepted by the court as though it had been taken before the court, unless:

(a) a party entitled to process in the proceeding raises objection thereto or

(b) for any other reason the court may require that the witness or witnesses be produced and examined.

2. For the purposes of making the affidavit referred to in this section, after the death of the testator, the exhibition to the witnesses of a court-certified photographic reproduction of the will shall be deemed equivalent to the exhibition to them of the original will.

3. It is advisable to have the attesting witnesses execute affidavits contemporaneously with the execution of the will. This avoids the necessity of locating the witnesses at the time of death.

4. 207 N.Y. 220, 100 N.E. 789 (1912).

5. See, e.g., *In re Clapper*, 279 A.D.2d 730, 718 N.Y. S.2d 468 (1st Dep't 2001).

6. EPTL § 3-3.2. Competence of attesting witness who is beneficiary; application to nuncupative will

(a) An attesting witness to a will to whom a beneficial disposition or appointment of property is made is a competent witness and compellable to testify respecting the execution of such will as if no such disposition or appointment has been made, subject to the following:

(1) Any such disposition or appointment made to an attesting witness is void unless there are, at the time of execution and attestation, at least two other attesting witnesses to the will who receive no beneficial disposition or appointment thereunder.

(2) Subject to subparagraph (1), any such disposition or appointment to an attesting witness is effective unless the will cannot be proved without the testimony of such witness, in which case the disposition or appointment is void.

(3) Any attesting witness whose disposition is void hereunder, who would be a distributee if the will were not established, is entitled to receive so much of his intestate share as does not exceed the value of the disposition made to him in the will, such share to be recovered as follows:

(A) In case the void disposition becomes part of the residuary disposition, from the residuary disposition only.

(B) In case the void disposition passes in intestacy, ratably from the distributees who succeed to such interest. For this purpose, the void disposition shall be distributed under 4-1.1 as though the attesting witness were not a distributee.

(b) The provisions of this section apply to witnesses to a nuncupative will authorized by 3-2.2.

7. 2010 N.Y. Slip Op. 06391 (1st Dep't 2010).

8. N.Y.L.J., Sept. 12, 2008, p. 29, col. 1 (Surr. Ct., Rockland Co.).

9. 9 A.D.3d 771, 780 N.Y.S.2d 810 (3rd Dep't 2004).

10. N.Y.L.J., Dec. 9, 2009, p. 25, col. 3 (Surr. Ct., Dutchess Co.).

11. *Id.*

12. N.Y.L.J., Dec. 1, 2009, p. 29, col. 3 (Surr. Ct., Dutchess Co.).

13. 68 Misc.2d 716, 328 N.Y.S.2d 216 (Surr. Ct., N.Y. Co. 1972).

14. Indeed, in 1998, in an article entitled *Forfeiture of Bequest by Witness to Will*, it was suggested that the legislature should reconsider the requirement that an interested witness must forfeit his or her bequest. The commentators noted that other jurisdictions do not have such a requirement and that it is not necessary for the forfeiture to be automatic. Instead, the forfeiture question could be decided by a judge or jury who could evaluate the credibility of the witness beneficiary. P. Valente & J. Palumbo, *Forfeiture of Bequest by Witness to Will*, N.Y.L.J., July 9, 1998, p. 3, col. 1.

15. There may be occasions where a prospective testator is in such a condition that he or she simply cannot properly execute a will, regardless of the efforts and skill of counsel.

16. *In re Will of Falk*, 47 A.D.3d 21, 28, 845 N.Y.S.2d 287, 292 (1st Dep't 2007), *lv. denied*, 10 N.Y.3d 702, 854 N.Y.S.2d 103 (2008).

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No Longer Working and Disabled

By Martin Minkowitz

There are a number of issues that arise when an employee has an injury or disease, filed a claim for workers' compensation benefits and leaves the work force. The employees/claimants will want to be able to continue to receive workers' compensation benefits when they stop working.

To receive continuing benefits the claimant can either be permanently totally disabled, as established by the Workers' Compensation Board, or be permanently partially disabled and the disability caused the claimant to be out of the labor market. If the *sole* cause of this claimant's loss of earnings is a voluntary withdrawal from the labor market no further payment of benefits is warranted. The question then is evaluating what caused the claimant to retire. If it is only to collect retirement benefits or some other economic or personal reason, and not related to the disability, it is the end of the right to collect workers' compensation benefits. That decision is made by the Workers' Compensation Board. It is a pure factual question, and if supported by substantial evidence, it will not be changed by an appellate court. The question does not arise in the case of a permanent total disability where it is presumed that the claimant has totally lost his or her earning capacity. Death claims likewise are generally considered in the permanently total disabled class.

So, now to focus on the permanently partially disabled people. Claimant should be making a real effort to find work within the medical restrictions even in a sedentary or light duty job. To fail to do so would be evidence of a voluntary withdrawal from the labor market.¹

Another issue is whether the claimant, who has sustained a permanent partial disability, has a "total industrial disability." A claimant who has sustained only a permanent partial disability can be classified by the Workers' Compensation Board ("WCB") as totally industrially disabled if the limitations of the disability together with life factors such as a limited educational background, work history and skills, or age cause the claimant to be incapable of gainful employment.²

This is also a question of fact for the WCB to resolve. Again, as a question of fact it is within their sole province, and will not be disturbed on appeal if it is supported in the record by substantial evidence.³

In one case where the claimant had a permanent partial disability and a limited ability to speak English, she failed to participate in free English classes which were provided by the employer and resisted job retraining. The court noted that this raised an inference that claimant was unwilling to perform other work as opposed to being unable to do so.⁴

The court therefore sustained the WCB's finding that the claimant was not totally industrially disabled, and that the decision was supported by substantial evidence. *See Kucuk v. Hickey Freeman Co., Inc.*, ___ A.D.3d ___ (2010).

To be in the classification of a totally industrial disabled person, the claimant's earning capacity must be permanently reduced to zero. If the medical history, in addition to the restrictions or limitations caused from the compensable injury, such as impaired sight, hearing or speech, illiteracy or mental condition, demonstrate the inability to work and have an earning capacity, the claimant can seek to be classified as a totally industrially disabled person.⁵

Endnotes

1. Laing v. Maryhaven Center of Hope, 39 A.D.3d 1125 (2007).
2. Wooding v. Nestle USA Inc., 75 A.D.3d 1043 (2010).
3. Sacco v. Mast ADV., 71 A.D.3d 1304 (2010).
4. *Citing Mastad v. Nashua Tape Products*, 219 A.D.2d 766 (1995).
5. New York Workers' Compensation, West New York Practice Series, Martin Minkowitz § 3.3 p. 81-2.

Martin Minkowitz (212-806-6256) is Of Counsel in the Insurance Practice Group of Stroock & Stroock & Lavan LLP. Mr. Minkowitz concentrates in insurance regulatory and litigation matters and on workers' compensation law, in which he is a nationally recognized author and expert.

BERGMAN ON MORTGAGE FORECLOSURES: Can the Mortgagee Take a Check After Acceleration?

By Bruce J. Bergman

This continues to be one of the genuinely thorny and confusing issues for mortgage holders, although another case in New York offers clarification and answers the question “yes.” But it needs some exploration.

First, let’s not confuse this issue with accepting payment after sending the breach/cure letter so typically required in residential foreclosures and in more than a few commercial cases as well. As a reminder, if a borrower responds to a breach letter by sending less than all the past due sums, the mortgagee can accept the payment because it does not cure the default.

The instance of acceleration, however, is somewhat different. Recall that acceleration is an act which occurs only *after* the breach letter has been sent and the cure period has expired. (This assumes that a breach letter is required by the mortgage documents. Absent such a clause in the mortgage, in New York there is no obligation to send a cure letter as a prerequisite to acceleration.) Once an acceleration has been declared, what the mortgagee in essence has said to the borrower is that “we require that you pay the full amount of the mortgage (which would have come due 10 or 15 or 20 or 30 years from now) and we will not accept periodic installments as we had in the past.”

After acceleration, law in New York provides that anything inconsistent with that declaration could be a waiver. So, is it inconsistent to accept some payments after acceleration (assuming those payments do not cure the default)?

Lenders have understandably been wary about taking such payments lest it give rise to a waiver. Perhaps the most practical problem is that a borrower could argue that the reason partial payments were sent (and accepted) was because an arrangement had been made with the lender to accept this and forgo foreclosure. While the lender would counter that no such understanding ever arose, courts could be sympathetic to borrowers asserting this argument and, absent clear written proof that there was never such an agreement, it could be surmised that there would be some jeopardy to the mortgage holder.

On the other hand, some lenders welcome receipt of sums of money (representing considerable amounts across a broad portfolio of loans), willing to take the occasional protest (and possible loss) when a wily borrower makes the argument.

But the legal answer to the question posed is, no, post-acceleration acceptance of a sum which doesn’t cure all arrears should not give rise to a defense to continuation of the foreclosure. [This was recited in a New York case in 1997, *CME Group Ltd. v. Cellini*, 173 Misc.2d 404, 661 N.Y.S.2d 740 (1997).] And a more recent case bolsters that position, ruling that acceptance of additional payments towards a mortgage after default and acceleration is *not* inconsistent with the mortgage holder’s insistence that the entire debt immediately be paid. [*Lavin v. Elmakiss*, 302 A.D.2d 638, 754, N.Y.S.2d 741 (3d Dept. 2003)].

So, whether a mortgagee will choose to accept post-acceleration checks is a *business* decision. As far as the law is concerned in New York, taking those checks is not a waiver.

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This article originally appeared in the Fall 2010 issue of the N.Y. Real Property Law Journal, published by the Real Property Law Section of the New York State Bar Association.

Where to Go After Homecare: Other Community Resources for Senior Citizens

By George L. Roach

A question often asked by family members caring for loved ones who are no longer able to live on their own in the community is: "What is available short of placing mom or dad in a nursing home?" The two main resources which immediately come to mind are Assisted Living Centers and Medical Model Adult Day Care Programs. Based on changing needs observed over the past thirty years, there is now a need for the type of care once provided to people in what was called a health related facility (HRF) setting. These facilities provided institutional care for people with activity of daily living skills (ADLs) that did not require placement in a skilled nursing facility (SNF) (what is thought of as traditional nursing home placement). The tremendous need for this in-between type of care, short of a nursing home, gave rise to the whole industry of providing assisted living care. There are several national chains providing assisted living care service throughout the country, including here in Suffolk County.

As with any form of long term care, the question becomes what does it cost and how do we pay for it? There are basically only three ways to pay for long term care in our society:

1. Long-term care insurance;
2. Privately from your "nest egg"; and
3. Taxpayer-funded medical care, commonly known as Medicaid.

Unfortunately, when it comes to assisted living facilities, neither Medicare nor Medicaid is available to pay for the personal care component the resident requires. Currently in Suffolk County, Medicaid will pay for the assisted living care being provided in two *pilot* programs. As these are *pilot* programs, however, the goal is to gauge the cost effectiveness of keeping people in assisted living settings versus traditional nursing home placement. The bottom line has yet to be determined.

In explaining the assisted living option to clients, I often compare the personal care component to a landlord-tenant relationship. For a specified sum of money per month, i.e., your rent, you get room and board, 24/7/365. In some places it is not a bad way to go...if you have the money. The ballpark figure for assisted living care, depending on how much you need, can range anywhere from \$2,500 to \$5,000 per month or more per individual resident. If you have good income, sufficient

liquid assets or a good long term-care insurance policy to pay the freight, this is certainly a worthwhile long-term care option.

Two problems arise with assisted living facilities. The first is when a resident's condition deteriorates to the point where placement in a traditional nursing home setting becomes necessary. This is an unfortunate situation, which requires a change of residence and the difficult adjustment, but Medicaid will pay for nursing home care.

"When...seniors are not candidates for a nursing home, the result is a rude awakening. Sadly, the situation can be characterized as a race between poverty and death to see who gets to the door first."

The second is what happens when the resident runs out of money. Addressing the second issue first, a person can be evicted from an assisted living facility for non-payment of rent. Seniors may find themselves in this situation when placed by their children, who, with the best of intentions, used their parents' money until it was gone. When such seniors are not candidates for a nursing home, the result is a rude awakening. Sadly, the situation can be characterized as a race between poverty and death to see who gets to the door first. If the patient's condition deteriorates, in all likelihood he or she will be hospitalized and nursing home placement will occur from the hospital setting. If an application for Medicaid is going to be submitted on the resident's behalf for the nursing home, the cost of the assisted living facility is a legitimate spend-down of the resident's funds. Fortunately, there is a strategy which enables assisted living residents to access Medicaid home care benefits.

The assisted living resident can transfer funds to a trusted person (no transfer penalty for community Medicaid) which can be used to pay the "room and board" cost of the assisted living facility. Excess income (above the community Medicaid level) can be deposited into a pooled income trust and also used to pay assisted living charges. An application for community Medicaid home care services can be made and some level of care will be authorized. The transferred funds

(not the income from the pooled income trust) may also be used to augment home care services which are necessary but which Medicaid will not cover.

"I rely on the old Irish proverb, 'Live everyday as if it were your last...and someday you'll be right.'"

Medical Model Adult Day Care (MMADC) is another way to keep a senior in the community. Unlike assisted living facilities, Medicaid does pay for MMADC and the beauty is that its eligibility requirements come under the Community Medicaid umbrella. That is, there are no transfer rules or penalties to become eligible for this program. Assets and resources can be freely transferred out of the applicant's name without penalty. Incomes (i.e., Social Security and pensions) are subject to the Community Medicaid income cap of \$787 per month, but with the use of the NYSARC trust applicants can get back virtually all of their Medicaid overage money to live on. Furthermore, if a spouse is involved and one spouse is in need of MMADC, the rules provide for the same spousal budgeting amounts as if the other were in a nursing home. If the income is there, the "community spouse" may be able to keep up to \$2,739 per month, the community spouse income allowance for chronic care Medicaid. It is the best of both worlds.

Elder Law attorneys with knowledge of the Medicaid law and access to a vast array of community resources available should make the best of the bad situation clients may find themselves in through no fault of their own. I often begin my advice and consultation after hearing such tales of woe with, "The silver lining in the dark cloud is as follows..." I find it helpful to the client to be able to minimize what he or she perceives to be the cruel twist of fate which no one planned. I rely on the old Irish proverb, "Live everyday as if it were your last...and someday you'll be right."

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This article originally appeared in the Fall 2010 issue of the Elder Law Attorney, published by the Elder Law Section of the New York State Bar Association.

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Real Estate Appraising: An Overview

By George Lucas

Many attorneys seek the services of an appraiser when their clients are engaged, for example, in divorce litigation, Medicaid applications, estate planning, bankruptcy cases, and, of course, home purchases and related mortgage loans. Other purposes include, but are not limited to, re-financing, PMI removal, and loan modifications. In formulating the valuation, appraisers must utilize the current sales in the marketplace where the appraisal is being performed in order to arrive at an opinion of market value. The more current the sales comparable, the more indicative it is of the market. All factors of the subject property and the sale comparables are taken into consideration by the appraiser when making a final decision about value. Some estate planning appraisals are especially challenging because they require the appraiser to perform a "forensic appraisal." A forensic appraisal is essentially an appraisal of property to determine a market value sometime in the past.

All Real Estate Appraisers are licensed by the individual states in which they practice. The minimum requirements to obtain a Certified Residential license in the State of New York are as follows:

1. 200 hours of Appraisal course work at a New York State-approved educational facility;
2. A minimum of 2,500 hours of field experience, over no less than two years and no more than five years, under the auspices of a Certified Residential Appraiser;
3. A number of specific college courses;
4. And finally, the taking (and passing) of the New York State Certified Residential Appraiser's Exam.

A Certified Residential appraiser is then granted a license to appraise any single to four-family property, without limitations on value, in any county or jurisdiction within the State of New York. With that said, a number of states allow for reciprocity, which allow certified individuals to apply for a Residential Appraiser's licenses in that jurisdiction. In order to maintain a license in good standing, an Appraiser must take at least twenty-eight hours of continuing education courses every two years prior to renewing his/her license.

The U.S. Government is currently involved in formulating heavier regulation for the industry. The Home Valuation Code of Conduct (HVCC) was the result of a joint agreement between New York Attorney General Andrew Cuomo, Freddie Mac and the Federal Housing

Finance Agency (FHFA) in March 2008. The Code, as it is sometimes known, essentially mandates a buffer be placed between the appraiser and the mortgage broker/bank to eliminate any undue influence on the appraiser in deciding on the value of a particular piece of property. The Code opened the door to a new "cottage industry," the "Appraisal Management Company" (AMC). AMCs have controlled the mortgage process ever since. They are responsible for assigning the appraiser, tracking the progress, and generally acting as a go-between in resolving any issues that may arise between appraiser and mortgage broker/bank. Finally, the AMC decides on the fees charged to homeowners and fees paid to appraisers.

The Restoring American Financial Stability Act of 2010, being heard by a House-Senate Conference Committee at the time this article was written, mandates positive changes as an addition to the HVCC, while providing regulation that practitioners and consumers alike view as more realistic. If the bill is enacted into law it will change the current appraisal climate by allowing the HVCC to expire now, instead of letting it sunset in November 2010. Also, according to OREP (The Organization of Real Estate Professionals), the new legislation will call for the Comptroller General to determine the effect that the changes to the seller-guide appraisal requirements of Fannie Mae and Freddie Mac, contained in the HVCC, will have on small business, like mortgage brokers, independent appraisers, and other small business professionals in the financial services industry.

The Comptroller General will study the effects on consumers, including the quality and the costs of appraisals; the length of time for obtaining appraisals; their impact on consumer protection; and, most importantly, maintaining appraisal independence. The Comptroller General will also look at combating appraisal inflation, mitigating acts of appraisal fraud, the structure of the appraisal industry, appraisal management companies, fee-for-service appraisers, and the regulation of appraisal management companies by the states. One hopes that the Restoring American Financial Stability Act of 2010 will positively affect the health of the economy and consumers.

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This article originally appeared in the Fall 2010 issue of the Elder Law Attorney, published by the Elder Law Section of the New York State Bar Association.

When First We Practice to Deceive: Misrepresentations, Mistakes and Omissions in the Insurance Application

By Reed Podell

Good faith and fair dealing are the bedrock of valid contracts, including insurance policies. As an inducement to issue a policy, the insurer relies upon the prospective insured's complete, accurate and truthful disclosure in its insurance application so that it can determine whether to accept the risk in consideration for a commensurate premium. In turn, the insured expects that the insurer will act in good faith when claims are presented. This is not to say that the respective parties will gladly undertake their contractually assumed duties when called upon to do so. When claims arise an insured may find that the insurer will scour not only the policy but also the insurance application in search of inaccuracies or omissions, whether intentional or not, to avoid coverage.

Insurance Law § 3105 permits insurers to void policies *ab initio* where there is a "material" misrepresentation in the insurance application.¹ The insurer's statutory right of rescission is based upon the contract law principle that a party who discovers that he has been induced to enter into a contract by fraud may elect to rescind the contract.²

An insured's misrepresentation in an insurance application is not to be confused with a breach of warranty. In contrast to a representation that an insured may make in an insurance application—a pre-contract event—a warranty is a condition precedent to coverage contained within the policy itself or is incorporated by reference into the policy.³ Except for maritime policies which are held to a higher standard, a breach of warranty will only defeat coverage if it materially increases the risk of loss, damage or injury.⁴

Materiality of a different type is at issue when determining an insurer's right to void a policy *ab initio* under Insurance Law § 3105, i.e. whether the misstatements or omissions⁵ in the insurance application are "material."⁶ "A fact is material so as to avoid *ab initio* an insurance contract if, had it been revealed, the insurer or reinsurer would either not have issued the policy or would have only issued it at a higher premium."⁷

Where there is some ambiguity as to whether a statement in an insurance application constitutes a misrepresentation, the insured is entitled to have its answers construed with the greatest liberality in its favor.⁸ But even if there is no ambiguity and it is clear that the

insured made a misrepresentation in the insurance application, this alone does not resolve whether the policy may be rescinded. Again, the misrepresentation must be "material."

Ordinarily, the materiality of a representation or omission is for the jury to determine. But where the evidence concerning the materiality is clear and substantially uncontradicted, the matter presents a question of law for the court.⁹

The insurer's burden of proof is not satisfied by conclusory self-serving affidavits of the insurer's employees that the policy would not have been issued.¹⁰ "To establish materiality of misrepresentations as a matter of law, the insurer must present documentation concerning its underwriting practices, such as underwriting manuals, bulletins or rules pertaining to similar risks, to establish that it would not have issued the same policy if the correct information had been disclosed in the application."¹¹ Additional evidence of materiality include: affidavits of underwriters stating that the carrier would not have issued a policy if the risk was accurately disclosed; copies of emails and correspondence declining coverage to similarly situated insurance applicants; and copies of disclaimer letters sent to similarly situated insureds making similar claims.¹²

The degree to which omissions rise to the level of a material misrepresentation sufficient to allow an insurer to void a policy varies depending upon the nature of the insurance and the reason for the omissions. For example, maritime insurance is subject to the doctrine of *uberrima fides* under which the parties to the insurance contract owe each other the highest degree of good faith. The doctrine requires the insured to disclose to the insurer all known circumstances materially affecting the risk to be insured. The standard for disclosure under this doctrine is an objective one. The relevant inquiry is whether a reasonable person in the insured's position would know that the particular fact is material, i.e. whether the fact is something that would have controlled the underwriter's decision to accept the risk.¹³ Reinsurance is another area that has been held to require "utmost good faith" on the part of insurance applicants who must disclose all facts materially affecting the risk of which it is aware and the reinsurer has no reason to be aware.¹⁴

Generally, though, an applicant for insurance has no duty to voluntarily disclose information material to the risk about which the underwriters never asked.¹⁵ The insurance applicant has the right to suppose that when an insurer inquires as to certain matters the insurer “considers all others to be immaterial, or that he assumes to know or waives information in regard to them.”¹⁶ Thus, if the insurer never asks and the insured makes no representation as to a particular fact then the non-disclosure of the fact will not void the policy unless the concealment is fraudulent.¹⁷ On the other hand, if the concealment of information is fraudulent then the omission may result in the policy being rescinded.¹⁸

For an insured’s non-disclosure to be fraudulent the concealment must be in bad faith with intent to mislead the insurer. The concept of “concealment” applies to insurance applications generally and is similar to the higher standard of *uberrima fides* applicable to maritime policies, with the key distinction that it also has a *mens rea* element. “Concealment is the designed and intentional withholding of any fact material to the risk which the assured in honesty and good faith ought to communicate to the underwriter.”¹⁹ If the insured knows of some fact that in good faith he knows would influence the underwriter’s decision to issue the policy, the insured is obligated to disclose that fact even if not asked.²⁰ Mistake or oversight will not suffice; the insured’s intent to deceive must be willful.²¹ But if there is no fraud, the applicant can remain silent as to many matters about which the insurer never asked.²²

To void the policy, concealment alone is not enough. The concealed fact must be “material.” Meaning, the underwriter would have refused to accept the risk and issue the same policy for the same premium if the information had been disclosed.²³ Nevertheless, though a fact may be material an insured may have no obligation to reveal it, such as where the insurer can obtain certain information from sources other than the applicant or by inspection, or where conditions are so patent that no inquiry is necessary.²⁴

If an insurer makes inquiry, an insured must provide a truthful response and has a duty to review the entire application and correct any incorrect or incomplete answers.²⁵ However, in at least one case the insurer was not permitted to rescind the policy where the insured left blank 20 questions in the application relating to the nature of its business and the insurer failed to investigate but instead accepted the application, issued the policy, and collected premiums.²⁶

Omissions or misstatements in the insurance application do not have to be intentional to result in rescission; they can be innocent.²⁷ The insured does not even have to be the one who makes the misrepresentation. Misrepresentations by those acting on behalf of

the insured, like insurance brokers, will be imputed to the insured.²⁸

Misrepresentations in an insurance application are imputed to the insured because: the signer of a contract is bound to its terms regardless of whether he or she read them; the insured has a duty to read the entire application and correct any incorrect or incomplete answers;²⁹ and misstatements in the insurance application made by the broker will be imputed to the insured because the insurance broker is generally regarded as the insured’s agent.³⁰ But even where the agent is the agent of the insurer and he knows the application contains false statements, the insurer may still avoid coverage because the insured certified the correctness of the application by signing it.³¹

Inasmuch as an applicant certifies the correctness of the application and has the duty to accurately complete it, neither the insured’s failure to read nor inability to read the application is a defense.³² Material misrepresentations made by non-English speaking insureds are not excused by their language barrier because they are expected to have someone read and explain the entire completed application to them.³³

If a policy is void *ab initio* due to the insured’s material misrepresentation, the insured cannot assert rights under the policy because the policy is treated as though it never came into existence.³⁴ And so it is no defense in an action for rescission to assert that the insurer failed to timely disclaim or prove willful misrepresentations (as may be required under certain policy terms) because such terms are in a voided, non-existent policy and coverage cannot be created where none existed.³⁵

There is, however, an exception. Since a policy that has been rendered void is treated as though it never existed, it would seem logical that no coverage would then extend to additional insureds because the additional insured is an “insured” under a non-existent policy. Alas, this is not so. When a policy is rendered void because of the named insured’s material misrepresentation in procuring it, insurers have to afford coverage to additional insureds because each additional insured must be treated as though they were issued their own policy.³⁶

Just as an insurer cannot rescind as to all insureds, it cannot rescind as to all types of insurance policies in the face of an insured’s material misrepresentation or concealment of a material fact. Automobile and workers’ compensation policies cannot be cancelled *ab initio* because governing statutes require prospective notice of cancellation.³⁷ Public policy mandates that these policies can only be cancelled prospectively because the procurement of these policies is compelled by statute and the existence of this coverage is of concern to oth-

ers beyond the insurer and insured³⁸ (though this latter rationale would seem applicable to all policies providing coverage for third party claims).

Even though these types of policies cannot be rescinded *ab initio*, this does not mean that an insurer is without recourse where it can be shown that the insured made a fraudulent misrepresentation in the insurance application (as opposed to an innocent material misrepresentation). For example, the insurer can raise as an affirmative defense the insured's fraud as a bar to recovery where the insured makes a first party claim or seeks to establish coverage in a declaratory judgment action.³⁹ Also, an insurer that becomes obligated to pay an injured third party under a fraudulently obtained policy can bring suit against its insured for damages the insurer had to pay as a result of the insured's fraud.⁴⁰ To prevail on that fraud claim the insurer must establish the insured's *mens rea*, showing that the insured acted with a willful intent to deceive and did not merely make a mistake or oversight in filling out the insurance application.⁴¹

One familiar misrepresentation in commercial general liability insurance applications is an insured's inaccurate description of its business operations. Whether inadvertent or intentional (i.e., to secure coverage for a reduced premium), insureds engaging in a high risk business activity may instead represent to insurers that they engage in a different, less-risky enterprise or be vague in their descriptions, such as describing themselves as a "general contractor" rather than a "demolition contractor."⁴²

This scenario tends not to give rise to an insurer's attempt to void a policy, however. Generally, where an insured's actual activities differ from its identified "business classification" in the policy, the issue presented to the court is whether the activity falls within the scope of coverage and/or is excluded from coverage.⁴³

Nevertheless, where the insurer seeks to void the policy because the insured may have misrepresented the nature of its business in its application, the insurer will have a duty to defend so long as there is a reasonable possibility that an underlying claim falls within the insured's identified business classification in the policy.⁴⁴ On the other hand, where claims arise from an insured's engagement in business activities that were not disclosed in the insurance application and the insurer proffers evidence that it does not write coverage for the type business that the insured actually engages in, the policy can be declared void *ab initio*.⁴⁵

Insurers' attempts to void policies *ab initio* are subject to different time frames. Before a claim is made, an insurer can rescind a policy *ab initio* by notice, i.e., without a judicial determination.⁴⁶ After a claim is asserted, the parties' positions are changed and so rescission by

notice will then only be effective prospectively. Once a claim is asserted an insurer must seek a judicial determination to accomplish a rescission *ab initio*.

The prospective cancellation and retroactive rescission of policies are expressly contemplated by the Insurance Law. For example, Section 3426 addresses commercial risk, professional liability and public entity insurance and it provides for prospective-only cancellation of policies for fraud or material misrepresentations in obtaining coverage.⁴⁷ However, a later provision of that same statute preserves an insurer's right to rescind on those same grounds.⁴⁸ This statutory scheme enables an insurer to prospectively cancel a policy after receiving a claim against a fraudulently obtained policy—thereby cutting off its exposure on any other claims that might arise during the remainder of the policy period—and then seek a judicial declaration to rescind the policy *ab initio* to avoid coverage for the claim already asserted.

It is of utmost importance that the insurer make claimants (and others interested in the outcome) parties to the declaratory judgment action for rescission, thereby ensuring that the judicial determination has collateral estoppel or *res judicata* effect upon third-parties as well as the insureds.⁴⁹ Equally important is that the insurer refunds the collected insurance premiums upon rescission.⁵⁰ If it doesn't, the insurer risks ratification.

Ratification may result and defeat even a valid claim of material misrepresentation or fraud if the insurer does not promptly act to rescind after learning of a basis to do so.⁵¹ Under contract principles, it is settled that a contracting party may not rescind "if, after knowledge of the fraud, he affirms the contract by accepting a benefit under it."⁵² Therefore, the insurer must rescind and refund premiums promptly after it learns of the material misrepresentation, otherwise the insurer will be deemed to have ratified the policy thereby affecting an estoppel and waiver of the right to rescind *ab initio*.

"When determining ratification, the key factors are whether the party silently acquiesced in the contract or rather promptly interposed his objections upon discovering the basis for the claim of rescission."⁵³ An insurer's ratification can result from its issuance of the policy, continued acceptance of premiums, or prolonged retention of premiums after learning of the facts necessary to declare the policy void.⁵⁴ Other factors to consider in determining whether an insurer's acceptance of the premium gives rise to a waiver or estoppel include:

- whether the insured was billed by the insurer or merely its general agent;
- whether the insurer had served notice of its election to rescind the policy

at the time it accepted the premium; whether the insurer's receipt of the premium was inadvertent or intentional; whether retention of the premium was permanent or temporary; and whether the premium was returned within a reasonable time after the payment came to the attention of responsible officials of the insurer.⁵⁵

Ratification is the death knell of rescission. An insurer cannot subsequently rescind once there has been a ratification of the policy no matter how misleading or fraudulent the insured was in completing the application for insurance.⁵⁶

No doubt, some insureds may be intentionally deceptive in completing an insurance application so that they can get coverage at any price or at a reduced premium. Others may simply have misunderstood or been careless in completing the insurance application, or had misplaced confidence in the insurance broker to accurately prepare it. No matter. The dishonest and well intentioned alike may find themselves equally entangled in a battle for coverage with insurers that claim the insureds' material misrepresentations misled them into issuing policies. "Oh! What a tangled web we weave when first we practise [sic] to deceive!"⁵⁷

Endnotes

1. Insurance Law 3105(b) provides: "No misrepresentation shall avoid any contract of insurance or defeat recovery thereunder unless such misrepresentation was material. No misrepresentation shall be deemed material unless knowledge by the insurer of the facts misrepresented would have led to a refusal by the insurer to make such contract."
2. *McNaught v. Equitable Life Assur. Socy. of US*, 136 A.D. 774 (2d Dep't 1910).
3. Under Ins. Law 3204, statements made by or on behalf of the insurance applicant in life, accident or health insurance, or annuity contracts are deemed representations and not warranties.
4. Ins. Law 3106; *Star City Sportswear, Inc. v. Yasuda Fire & Marine Ins. Co. of America*, 1 A.D.3d 58, 765 N.Y.S.2d 854 (1st Dep't 2003), *aff'd* 2 N.Y.3d 789, 781 N.Y.S.2d 255 (2004); *Continental Ins. Co. v. RLI Ins. Co.*, 161 A.D.2d 385, 555 N.Y.S.2d 325 (1st Dep't 1990).
5. *Vander Veer v. Continental Cas. Co.*, 34 N.Y.2d 50, 356 N.Y.S.2d 13 (1974).
6. *Process Plants Corp. v. Beneficial National Life Ins. Co.*, 53 A.D.2d 214, 385 N.Y.S.2d 308, 310 (1st Dep't 1976), *aff'd* 42 N.Y.2d 928, 397 N.Y.S.2d 1007 (1977).
7. *Feldman v. Friedman*, 241 A.D.2d 433, 434, 661 N.Y.S.2d 9, 10 (1st Dep't 1997), quoting *Christiania Gen. Ins. Corp. v. Great Am. Ins. Co.*, 979 F.2d 268 (2d Cir. 1992); *In re Pioneer Ins. Co. (Hallen)*, 298 A.D.2d 725, 749 N.Y.S.2d 295 (3d Dep't 2002).
8. *Chase v. William Penn Life Ins. Co.*, 159 A.D.2d 965, 966 (4th Dep't), *aff'd* 76 N.Y.2d 999 (1990).
9. *Sebring v. Fidelity-Phenix Fire Ins. Co. of New York*, 255 N.Y. 382, 385 (1931); *Process Plants Corp.*, 53 A.D.2d 214; *Curanovic v. New York Central Mut. Fire Ins. Co.* 307 A.D.2d 435, 437 (3d Dep't 2003).
10. *Feldman*, 241 A.D.2d 433; *Barkan v. New York Schools Ins. Reciprocal*, 65 A.D.3d 1061, 886 N.Y.S.2d 414 (2d Dep't 2009).
11. *Curanovic*, 307 A.D.2d 435; *Church of Transfiguration v. New Hampshire Ins. Co.*, 207 A.D.2d 1039, 616 N.Y.S.2d 843 (4th Dep't 1994), *lv. denied* 1994 WL 712777; *Barkan*, 65 A.D.3d 1061; *Rafi v. Rutgers Cas. Ins. Co.*, 59 A.D.3d 1057, 872 N.Y.S.2d 799 (4th Dep't 2009); *Falcon Crest Diamonds v. Dixon*, 173 Misc. 2d 450, 457, 655 N.Y.S.2d 232, 236 (Sup. Ct., N.Y. Co. 1996).
12. *Kiss Constr. NY, Inc. v. Rutgers Cas. Ins. Co.*, 61 A.D.3d 412, 414-415, 877 N.Y.S.2d 253 (1st Dep't 2009); *Varshavskaya v. Metropolitan Life Ins. Co.*, ___ A.D.3d ___, 2009 NY Slip. Op. 09215, 890 N.Y.S.2d 643 (2d Dep't 2009); *North Atlantic Life Ins. Co. v. Katz*, 163 A.D.2d 283, 557 N.Y.S.2d 150 (2d Dep't 1990).
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15. *DiDonna v. State Farm Mut. Automobile Ins. Co.*, 259 A.D.2d 727, 687 N.Y.S.2d 175 (2d Dep't 1999).
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17. *Stecker v. American Home Fire Assur. Co.*, 299 N.Y. 1, 8 (1949).
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19. *Sebring*, 255 N.Y. at 386; *Lighton v. Madison-Onondaga Mut. Fire Ins. Co.*, 106 A.D.2d 892, 483 N.Y.S.2d 515 (4th Dep't 1984).
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21. *Sebring*, 255 N.Y. at 387.
22. *Sebring*, 255 N.Y. at 386.
23. *Sebring*, 255 N.Y. at 385; *Feldman*, 241 A.D.2d 433; *In re Pioneer Ins. Co. (Hallen)*, 298 A.D.2d 725.
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32. *Axelroad*, 267 N.Y. 437; *Curanovic*, 307 A.D.2d at 437-438.
33. *Curanovic*, 307 A.D.2d at 437-438.
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36. *Lufthansa Cargo, AG v. New York Marine and General Ins. Co.*, 40 A.D.3d 444, 834 N.Y.S.2d 659 (1st Dep't 2007); *BMW Financial Services NA, Inc. v. Hassan*, 273 A.D.2d 428, 710 N.Y.S.2d 607 (2d Dep't), *lv. denied* 95 N.Y.2d 767, 717 N.Y.S.2d 547 (2000).

37. Vehicle and Traffic Law § 313; *Insurance Co. of North America v. Kaplun*, 274 A.D.2d 293, 298, 713 N.Y.S.2d 214, 217 (2d Dep't 2000); *Liberty Mut. Ins. Co. v. McClellan*, 127 A.D.2d 767, 512 N.Y.S.2d 161 (2d Dep't 1987); Workers' Compensation Law § 54(5); *Cruz v. New Millennium Const. & Restoration Corp.*, 17 A.D.3d 19, 23, 793 N.Y.S.2d 548, 551 (3d Dep't 2005).
38. *Cruz*, 17 A.D.3d 19; *Liberty Mut. Ins. Co.*, 127 A.D.2d 767; VTL § 313.
39. *Insurance Co. of North America*, 274 A.D.2d 293 [misrepresentation of vehicle ownership and residency]; *Mooney v. Nationwide Mut. Ins. Co.*, 172 A.D.2d 144, 577 N.Y.S.2d 506 (3d Dep't 1991) [misrepresentation of history of violations]; *DiDonna*, 259 A.D.2d 727 [misrepresentation of vehicle ownership and driving record]; cf. *Taradena v. Nationwide Mut. Ins. Co.*, 239 A.D.2d 876, 659 N.Y.S.2d 646 (4th Dep't 1997) [policy can be void *ab initio* and underinsured/uninsured benefits denied under an auto policy where misrepresentations were made as to vehicle ownership and identity of principal operator in insurance application].
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45. *Kiss Construction NY, Inc.*, 61 A.D.3d 412; *Morris*, 229 A.D.2d 992.
46. See e.g., Ins. Law § 3426(c)[1](C).
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48. Ins. Law § 3426(m).
49. *Cruz*, 17 A.D.3d 19.
50. *Kiss Constr. NY, Inc.*, 61 A.D.3d 412; *Federal Ins. Co. v. Kozlowski*, 18 A.D.3d 33, 39-40, 792 N.Y.S.2d 397 (1st Dep't 2005).
51. *S.E.C. v. Credit Bancorp, Ltd*, 147 F. Supp. 2d 238, 256 (S.D.N.Y. 2001).
52. *McNaught*, 136 A.D. 774.
53. *S.E.C.*, 147 F. Supp. 2d at 256; see also *Grubel v. Union Mut. Life Ins. Co.*, 54 A.D.2d 686 (2d Dep't 1976) ["Having failed to act promptly, he is deemed to have affirmed the contract and waived any action sounding in economic duress." *Id.* at 686]; *Zeldman v. Mut. Life Ins. Co. of NY*, 269 A.D. 53 (1st Dep't 1945) ["Upon receipt of knowledge...of the insured breach of condition, the insurer, if it desires so to do, must promptly exercise its election to void the policy." *Id.* at 56].
54. *Security Mut. Life Ins. Co. v. Rodriguez*, 65 A.D.3d 1, 880 N.Y.S.2d 619 (1st Dep't 2009); *Zeldman v. Mut. Life Ins. Co. of N.Y.*, 269 A.D. 53 (1st Dep't 1945) [an insurer's issuance of policy and acceptance of premiums with knowledge of insured's breach of condition gives rise to waiver or estoppel]; accord *Sirius America Ins. Co.*, 17 Misc.3d 1135(A) [policy issued and premiums collected despite omissions by insured in a patently incomplete application]; *Bible v. John Hancock Mut. Life Ins. Co. of Boston*, 256 N.Y. 458 (1931); *Burdick*, 6 Misc. 3d 1030(A), *3 (Sup. Ct., Oneida Co. 2005) [premium not refunded for at least 2½ months], citing *McNaught*, 136 A.D. 774; *Scalia v. Equitable Life Assur. Socy. of the US*, 251 A.D.2d 315 (2d Dep't 1998); and *Ellis v. Columbian Nat. Life Ins. Co.*, 270 A.D. 143 (1st Dep't 1945).
55. *Sielski v. Commercial Ins. Co. of Newark, New Jersey*, 199 A.D.2d 974, 974, 605 N.Y.S.2d 599, 600 (4th Dep't 1993), *lv. dismissed* 83 N.Y.2d 953, 615 N.Y.S.2d 877 (1994).
56. *McNaught*, 136 A.D. at 780.
57. This familiar quote is from *Marmion*, a poem written by 19th Century poet Sir Walter Scott. Canto VI, Stanza 17 reads:

*Yet Clare's sharp questions must I shun,
Must separate Constance from the nun
Oh! what a tangled web we weave
When first we practise to deceive!
A Palmer too! No wonder why
I felt rebuked beneath his eye;*

This article originally appeared in the Summer 2010 issue of the Torts, Insurance and Compensation Law Section Journal, published by the Torts, Insurance & Compensation Law Section of the New York State Bar Association.

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Mortgage Broker Duties Under New York Law— Are Brokers Fiduciaries?

By Mordy Gross

I. Introduction

The financial crisis of the past few years has been called the worst since the Great Depression.¹ Industry-wide finger pointing has ensued. A root cause of this crisis was the improvident granting of mortgages, both to people who should have not been placed in a mortgage at all, and to people who were placed in a mortgage that was not in their best interests.² Diverse incentives caused and encouraged this behavior of improperly placing borrowers. Eliminating the incentives for such behavior has become a legislative goal across the country.

One of the incentives for this bad behavior is mortgage broker compensation. Although the borrower most often pays a mortgage broker, the fee is often shifted from being paid up front to being paid at the time of the closing.³ Thus, the mortgage broker often receives his compensation directly from the bank—whether the compensation takes the form of a fee paid at the closing from the mortgage proceeds or as a direct payment from the bank. Banks often use the practice of paying a “yield spread premium” (“YSPs”), or compensation to the broker for the difference between the interest rate on a par loan and the interest rate on an above par loan.⁴ YSPs are particularly effective in allowing borrowers with little available cash or remaining loan-to-value to obtain financing. This, of course, incentivizes brokers to encourage borrowers into above par loans rather than steering their borrowers into the best loans for them, in order to maximize their own compensation.⁵

The YSP itself is not innately evil.⁶ It is a legitimate method of shifting an upfront fee paid from the borrower to his broker.⁷ However, this argument inherently must mean that the broker would otherwise work for and be paid by the borrower if the broker would otherwise look for compensation from the borrower. Thus, the problem in such fees is in the expectation of the borrower—the borrower thinks that the broker is working for him—to obtain the best loan for the borrower, when in fact the broker is working for himself (and, by proxy, the bank)—to obtain the best loan for the bank and maximize his compensation.⁸

Adding to the problem of this misunderstanding is that former regulations did not, in practice, encourage full disclosure of fees. Although the regulations *require* full disclosure, numerous ways abound to render such disclosure meaningless. In New York, the requirement under the regulation is merely that the *maximum* amount

of broker compensation be disclosed.⁹ Thus, a broker can disclose an absurd maximum that will not be exceeded, thus rendering ineffectual the goal of the regulation. Moreover, the forms promulgated by the New York State Banking Department have not encouraged meaningful disclosure by requiring a standardized format. For instance, use of the “Pre-application Disclosure and Fee Agreement for Use by New York Registered Mortgage Brokers”¹⁰ is optional. Additionally, the fact that the actual compensation is based on factors not in the borrower’s best interest need not be disclosed.

In light of this reality, legislatures across the nation have proposed laws to align borrowers’ expectations to reality. These laws require a combination of disclosure and creation of duties by the broker to the borrower.¹¹

In New York, the Governor’s Program Bill to address this issue, S. 8143,¹² enacted several changes to the relationship between a broker and a borrower in certain loans and changed the disclosure requirements for the loan transaction. Specifically, § 4 of the bill revised Banking Law § 6-l (2) regarding high-cost loans, and § 5 of the bill added a new § 6-m (2) regarding subprime loans. These subdivisions provide for disclosure of the exact broker compensation. Additionally, Section 6 of S. 8143 added a new § 590-b to the Banking Law. This section requires or establishes specific duties that run from the broker to the borrower and establishes a duty to disclose all compensation. Section 590-b allows a cause of action for actual damages and attorney’s fees by the borrower for violation of the section.¹³

Similarly, the federal government has enacted new requirements for the Good Faith Estimate¹⁴ and HUD-1¹⁵ disclosures under RESPA.¹⁶ The requirements prohibit deviation from certain terms disclosed in the Good Faith Estimate, and prohibit deviation from other terms within a tolerance level of 10%, in the absence of a new estimate. The Good Faith Estimate must conform to a template provided by the Department of Housing and Urban Development (“HUD”).

This article will examine the new requirements and duties of the Governor’s Program Bill. It will first examine the new duties under § 590-b and whether the duties impose a fiduciary duty upon the broker. It will then examine the disclosure requirements of S. 8143. Finally, it will examine the practical implications of the new sections.

II. New Section 590-b—Do the New Duties Impose a Fiduciary Relationship on Brokers?

New Section 590-b requires mortgage brokers to act in the borrower's interest; act with reasonable skill, care and diligence; act in good faith and with fair dealing; clearly disclose compensation and all other material information; and diligently work to present the borrower with a range of loan products for which the borrower likely qualifies and which are appropriate to the borrower's existing circumstances, based on information known by, or obtained in good faith by, the broker. Because these duties mirror in large part the duties that a fiduciary owes its principal, the new statute necessitates questioning whether, indeed, a mortgage broker is now a fiduciary of the borrower, with all the rights, privileges and responsibilities appertaining thereto.

A. What Is a Fiduciary Relationship and How Does It Affect Mortgage Brokers?

The first thing to keep in mind when considering fiduciary duties is the distinction between the legal definition of a fiduciary and the common conception of what a fiduciary is. In common nomenclature, a fiduciary is often limited to the realm of trusts. However, the legal use of the word fiduciary is not so limited, and arises from the contours of a relationship.¹⁷

A fiduciary relationship arises generally under two circumstances. First, the parties may, by contract, agree to the relationship, a relationship known as agency. Agency/principal relationships arise in all contexts, where the parties manifest the proper state of mind. Additionally, the relationship may be implied by law by the acts of the parties or circumstances surrounding their actions, even though no formal agency agreement is made.¹⁸ Fiduciary relationships implied by law often arise in the context of trustee and beneficiary, guardian and ward, attorney and client, and agent and principal.¹⁹ Where the circumstances show that a party, the principal, is entitled to rely upon another party, the fiduciary, a fiduciary relationship will result.²⁰

Recognizing the existence of a fiduciary relationship is important because it imposes a series of duties on the party that is a fiduciary. In brief, the fiduciary relationship imposes the following duties: duty of loyalty, duty of good faith, duty of due care and duty of disclosure.²¹ A fiduciary breaches these duties where he acts in his own interests.²²

Traditionally, a broker is distinguished from an agent in that the broker's purpose is to unite the two parties in a transaction, whereas an agent's purpose is to consummate the transaction on behalf of one of the parties. Because the primary purpose of the relationship was to unite the parties, the broker would normally not owe fiduciary duties to any one party.²³ Courts have

generally held under previous New York law that a typical mortgage broker-borrower relationship is not that of a fiduciary.²⁴ However, the nature of the agreement between the parties, the reasonable expectations of the parties, and duties imposed by statute can make what is termed a broker relationship into an agency relationship with ensuing rights and remedies.²⁵ Courts have found such a relationship where the broker took control of the application process,²⁶ or assumed a special advisory role, even though the typical relationship would be arm's-length.²⁷ Similarly, courts in other contexts have found agency or fiduciary duties where statutes or regulations impose a heightened standard of duty on the putative agent.²⁸ Therefore, arguably, a broker should not assume that a court would view his relationship with a borrower as an arm's-length transaction. It is quite likely that a fiduciary relationship will be found.

B. Parties' Expectations and Responsibilities Under the Old Law

1. Parties' Expectations in a Mortgage Broker Relationship

The finding of a fiduciary duty between the broker and the borrower, taking the average parties' expectation in a mortgage transaction, is quite likely. In the typical mortgage scenario, a borrower contacts a mortgage broker to find a mortgage. The borrower, absent clear notification otherwise, assumes that the broker is working for the borrower. Thus, the typical contract will allow the broker to be a dual agent, working for both the borrower and the lender. However, a threshold issue is whether the borrower ever really understands the legal distinction. What often results is a scenario where the borrower believes that the only interest being looked out for is the best interest of the borrower; however, the reality is that the broker is looking out for his own and the lender's interests as well—the borrower having waived his right to expect such a duty in signing the contract.²⁹ This disconnect between the expectation of the borrower and the realities of the transaction often leads to the borrower accepting a non-advantageous mortgage product.³⁰

The broker, however, expects to be treated as an independent contractor working for himself. The broker assumes that the contracts signed make this position clear and that he is not assuming any fiduciary duties. Again, whether or not the assumption made by the broker is in line with the reality of the law depends on whether the borrower is actually informed, and what duties the law imposes. However, it is clear that there is a disconnect between the borrower's expectations and the broker's expectations.

2. Common Law Fiduciary Duties of Broker-Agents

Before this article examines the new law and discusses whether it imposes a fiduciary duty, it is helpful

to discuss the common law ramifications of a finding of a fiduciary relationship or agency between the borrower and the broker.

If a mortgage broker is in the position of agent of the borrower, a fiduciary relationship exists between the agent and the principal.³¹ The agent is then bound to exercise the utmost good faith and undivided loyalty toward the principal throughout the relationship, and must act in accordance with the highest principles of morality, fidelity, loyalty, and fair dealing. The principal is entitled to rely completely upon the agent to represent him with undivided loyalty.³² Thus, where a breach of duty occurs, the agent is liable to the principal for damages caused by the breach.³³ Moreover, it is the duty of the agent to disclose to his principal all material facts that come to the agent's knowledge relating to the subject of the agency.³⁴ Lastly, an agent is prohibited from acting in any manner inconsistent with his agency. If he does so act, he can be liable for fraud.³⁵ This last duty imposes its own duty of disclosure of any conflicting interests.³⁶ This, obviously, is not in line with the expectation of the average mortgage broker.

Thus, even if the parties are *not* in a fiduciary relationship by law, the borrower certainly expects such a relationship. In light of this reality, laws have been proposed to create such duties. One such law is § 590-b.

C. New Section 590-b

Section 6 of S. 8143 added a new § 590-b to the Banking Law. Subsection (1) of § 590-b provides new requirements for brokers:

Each mortgage broker shall, in addition to the duties imposed by otherwise applicable provisions of state and federal law, with respect to any transaction, including any practice, or course of business in connection with the transaction, in which the mortgage broker solicits, processes, places or negotiates a home loan:

- (a) act in the borrower's interest;
- (b) act with reasonable skill, care and diligence;
- (c) act in good faith and with fair dealing;
- (d) not accept, give, or charge any undisclosed compensation, directly or indirectly, that inures to the benefit of the mortgage broker, whether or not characterized as an expenditure made for the borrower;
- (e) clearly disclose to the borrower, not later than three days after receipt of the loan application, all material information as specified by the superintendent that might reasonably affect the rights, interests, or ability of the borrower to

receive the borrower's intended benefit from the home loan, including total compensation that the broker would receive from any of the loan options that the lender or mortgage broker presents to the borrower; and

- (f) diligently work to present the borrower with a range of loan products for which the borrower likely qualifies and which are appropriate to the borrower's existing circumstances, based on information known by, or obtained in good faith by, the broker.

This article will examine the new duties imposed individually. Because of the scarcity of case law interpreting the statutes, parallels will have to be drawn from similar statutes in order to draw a reasonable picture of the scope of the statutory obligations. Many, if not all, of the new duties imposed have parallels in agency law. As much as prior case law and convention insist that a mortgage broker is not an agent in a fiduciary relationship with the borrower, one must consider that § 590-b changes everything—"If it looks like a duck, and quacks like a duck, we have at least to consider the possibility that we have a small aquatic bird of the family Anatidae on our hands."³⁷

1. Duty to Act in the Borrower's Interest

Section 590-b (1) (a) imposes a duty on a mortgage broker to act in the borrower's interest. Unique to New York law, this section parallels the common law duty of an agent not to act adversely to the principal's interest.³⁸ The question, of course, is whether this section codifies the common law duty of an agent to act only in the principal's interest, or if it imposes some lesser duty on a broker.

If the section is construed as codifying the common law agency duty of a mortgage broker, a unique burden would be placed on the broker-borrower relationship. Because most broker-borrower relationships are inherently in conflict with the broker-lender relationship, it is almost certain that every broker relationship would be adverse to the borrower's interest. Borrowers and lenders want different things. Simply put, the borrower wants to pay less, and the lender wants to get more. Additionally, the broker wants to maximize his compensation—an interest which often runs contrary to the interest of the borrower. Thus, a broker would be acting adversely to the borrower's interest, where, for example, the mortgage that the broker is effectuating is one in the broker's and not the borrower's interest. A breach of this common law duty normally gives rise to an action for fraud.

A subsidiary question is whether a borrower can waive this duty. Under agency law, a principal can

waive conflicts only after receiving full disclosure.³⁹ Full disclosure requires that the principal be fully informed as to every material fact.⁴⁰ Thus, if this provision parallels the agency rule, it would be waivable with such full disclosure but only if such waiver is freely given after full disclosure. However, it is worth bearing in mind that the disclosure under this section must be higher than and independent of that of subsection (e), which requires disclosure of the compensation of the broker, in order not to render that subsection a nullity. If, as seems plausible, the disclosure must parallel that which is required under agency law to disclose a conflict, a broker would be advised to make a disclosure more akin to the disclosure required of an attorney prior to accepting dual clients, which requires informed consent confirmed in writing.⁴¹ Moreover, continuing the parallel to attorney-informed consent, where the attorney himself stands to benefit from a business transaction, he must, aside from obtaining consent, advise the client in writing and give the client enough time to obtain independent legal advice.⁴² Thus, under such a standard, since a broker most often stands to benefit from the specific mortgage that the borrower chooses, the broker would have to advise the borrower to seek independent financial advice from a competent advisor.

2. Duty to Act with Reasonable Care, Skill and Diligence

Section 590-b (1) (b) imposes a duty on a mortgage broker to act “with reasonable care, skill and diligence.” Similar duties have been enacted in other states.⁴³ This duty is similar to the common law duty of an agent to perform his duties with care, competence, and diligence.⁴⁴ This duty generally requires the agent to exercise such skill as is ordinarily possessed by persons of common capacity engaged in the same business.⁴⁵ In the agency law context, courts have found such a breach where an agent failed to properly investigate and determine the availability of a promised product,⁴⁶ or to provide a product which satisfied the requested needs.⁴⁷ It would not be a far stretch for a court to determine that a mortgage broker breached this duty by not providing the borrower with the proper mortgage product.

However, the required care, skill and diligence can be set by clear benchmarks in a well-drafted contract between the agent and principal.⁴⁸ Thus, a broker can avoid liability if the contract is sufficiently clear in delineating the care, skill and diligence that the broker will use. A broker is forewarned to take care in promising or seeming to promise to obtain a certain mortgage product; such promises can set a benchmark for the broker’s services which is higher than the average and which would allow the principal to rely on such heightened promises.⁴⁹

3. Duty of Good Faith and Fair Dealing

Section 590-b (1) (c) imposes on all brokers a duty of good faith and fair dealing. This duty is not a new one; it is found in both the agency context and in the contract context. An agent has a similar duty “to be loyal to his principal and is prohibited from acting in any manner inconsistent with his agency or trust and is at all times bound to exercise the utmost good faith and loyalty in the performance of his duties.”⁵⁰ Contracts impose on the contracting parties a duty of good faith, fair dealing and cooperation.⁵¹ The question, of course, is what is considered good faith. In the context of contracts governed by the UCC, good faith is defined as “honesty in fact in the conduct or transaction concerned.”⁵² In New York, the implied covenant of good faith and fair dealing embraces a pledge that neither party will do anything having the effect of destroying or injuring the right of the other party to receive the fruits of the contract.⁵³ “Subterfuges and evasions violate the obligation of good faith in performance even though the actor believes his conduct to be justified. But the obligation goes further: bad faith may be overt or may consist of inaction, and fair dealing may require more than honesty. A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party’s performance.”⁵⁴ Under New York law, while a party to a contract is not prohibited from pursuing other contracts, and may even incidentally affect or otherwise lessen the other party’s interests, there comes a point where the actions taken by the party will so manifestly harm the other party’s interest as to constitute a breach of the duty of good faith.⁵⁵ Thus, care must be taken by the broker to insure that any deal made with the lender is not manifestly adverse to the borrower’s interest.

Since every contract includes a duty of good faith and fair dealing, one must ask why the legislature felt a need to import such a duty into the broker-borrower relationship. A reasonable explanation would be that this duty, unlike the duty of good faith in the typical contractual setting, cannot be modified, nor may its standards be set, by contractual terms.⁵⁶ Until the courts rule on the scope of this statutory duty, a broker is well advised to assume the worst—that the terms of the contract setting the standards of good faith do not govern.

4. Duty to Disclose Compensation and Other Material Information and Not Accept Undisclosed Compensation

Section 590-b (1) (d) prohibits a mortgage broker from accepting, giving, or charging “any undisclosed compensation, directly or indirectly, that inures to the

benefit of the mortgage broker, whether or not characterized as an expenditure made for the borrower.” This prohibition complements § 590-b (1) (e)’s requirement to “clearly disclose to the borrower, not later than three days after receipt of the loan application, all material information as specified by the superintendent that might reasonably affect the rights, interests, or ability of the borrower to receive the borrower’s intended benefit from the home loan, including total compensation that the broker would receive from any of the loan options that the lender or mortgage broker presents to the borrower.” A broker can avoid liability under these two sections with clear disclosure of any and all compensation that the broker will receive under each proposed loan.

Under previous New York law, the disclosure of an accurate description of broker compensation was optional, because regulations only required disclosure of the *maximum* compensation.⁵⁷ This, obviously, is not satisfactory under § 590-b; the broker must now disclose the exact compensation under each proposed mortgage option within three days. Moreover, the words “total compensation,” although undefined, will probably be construed to include any compensation inuring to the benefit of the broker from the borrower or from the bank, including YSPs.⁵⁸

This disclosure supplements the disclosure requirements under federal law. Under federal law, a mortgage broker must provide a good-faith estimate (GFE) within 3 days of the loan application or receipt of information sufficient to complete the loan application.⁵⁹ The actual amounts of the loan and fees cannot be exceeded regarding origination charges, interest rate charge and adjusted origination charge while the rate is locked, and transfer taxes. Lender-required settlement services, lender-required title services and insurance, and government recording charges cannot exceed 10% of the amount in the GFE.⁶⁰ Changes require issuance of a new GFE.⁶¹ A form and instructions are provided in Appendix C. The form sets forth the type of disclosure that would be acceptable under federal law, and because it requires brokers to report their total compensation, it would satisfy the requirements of § 590-b (1) (e).

Additionally, under federal law, if a lender violates RESPA, the lender can cure its violation by refunding the overage at settlement or within 30 days. Section 590-b does not provide such an ability to cure; however, recovery is limited under § 590-b to actual damages.⁶² Thus, if the broker or lender refunds any overage as provided under federal law, there will be no actual damages.

5. Duty to Diligently Work to Present the Borrower with a Range of Products

Section 590-b (1) (f) requires the broker to “diligently work to present the borrower with a range of loan products for which the borrower likely qualifies and which

are appropriate to the borrower’s existing circumstances, based on information known by, or obtained in good faith by, the broker.” Several states have enacted similar requirements.⁶³ Diligence is subjective, and most likely will be interpreted as it is under agency law—requiring such skill as is ordinarily possessed by persons of common capacity engaged in the same business.⁶⁴ Unlike the previous discussion of the duty of good faith and fair dealing, the benchmark here is set by the statute. As long as the broker makes a good faith effort to present “a range” of loan products for which the borrower likely qualifies, he satisfies the burden imposed by this section.

Some unanswered questions may arise as to what is considered proper presentment under the statute. Is the burden satisfied where a broker presents several products, but steers the borrower to one specific product? It would be prudent for a broker to keep records of the searches of loan options made, all communications regarding the several loan products, and the reasoning behind the recommendations in case of future problems.

In sum, the duties imposed by § 590-b parallel many of the duties of fiduciaries. Even though not stating so much in words, one must ask if the legislature intended to impose a fiduciary relationship on a broker by enacting the servitudes of such a relationship. What is clear is that § 590-b’s heightened duties are not to be lightly viewed.

III. Broker Compensation and Yield Spread Premium Disclosures

Subsections (s) and (n) of Banking Law 6-1(2) and 6-m(2), respectively, both provide new disclosure requirements for compensation for high-cost and sub-prime loans, in addition to the requirements of § 590-b. Subsection (s) provides:

No abusive yield spread premiums. In arranging a high-cost home loan, the mortgage broker shall, at the time of application, disclose the exact amount and methodology of total compensation that the broker will receive. Such amount may be paid as direct compensation from the lender, direct compensation from the borrower, or a combination of the two. The provisions of this paragraph shall not restrict the ability of a borrower to utilize a yield spread premium in order to offset any up front costs by accepting a higher interest rate. If the borrower chooses this option, any compensation from the lender which exceeds the exact amount of total compensation owed to the broker must be credited to the borrower. The superintendent shall prescribe the

form that such disclosure shall take. This provision shall not restrict a broker from accepting a lesser amount.

Subsection (n) contains substantially the same requirements for subprime loans. Similar statutes enacted in other states provide variations on the amount and time of disclosure.⁶⁵ The original draft of the bill banned all yield spread premiums.⁶⁶ Subsequent drafts changed the bill from an outright ban to “no *abusive* yield spread premiums.”⁶⁷ The legislature saw the value in such premiums but sought to ensure better disclosure. Thus, the basic requirement is fuller disclosure than what was required under previous regulations. In other words, any combination of compensation will still be allowed. It appears as though what is crucial is ensuring that the consumer receives the appropriate disclosure as prescribed by the superintendent.

The disclosure requirements of these sections are more onerous compared to the requirements under new section 590-b and federal law. Section 590-b allows three days from the application for the disclosure to take place.⁶⁸ RESPA likewise provides for three days from the application for disclosure.⁶⁹ Subsections (s) and (n) require disclosure contemporaneous with the application. Secondly, § 590-b only requires that the broker disclose the “total compensation that the broker would receive from any of the loan options that the lender or mortgage broker presents to the borrower.” A broker who discloses the total amount of compensation without disclosing his methodology at arriving at the compensation would satisfy this requirement. Likewise, under current New York regulations, there is no requirement to disclose the methodology used to arrive at a calculation.⁷⁰ Subsections (s) and (n), however, require disclosure of “the *exact amount and methodology* of total compensation that the broker will receive.” A broker thus would not satisfy his subsection (s) or (n) requirement without disclosing both the exact amount *and* the methodology of arriving at that amount. Thus, as applied to high-value loans, and subprime loans, even when not used with a yield spread premium, the broker has a greater burden in making a contemporaneous disclosure and showing how he arrived at the disclosed figures.

Under this section, as pointed out above, a broker must disclose “the exact amount” of “total compensation.” The statute defines total compensation as including both the compensation paid by the bank and by the borrower. Compensation, in this context, likely would be interpreted to include any remuneration and other benefits received in return for the broker’s arranging the mortgage.⁷¹ This, again, is consistent with § 590-b (1) (d)’s prohibition against undisclosed indirect compensation. Thus, it behooves the broker to disclose any form of compensation he may be receiving for originating the mortgage, monetary or otherwise.

Lastly, subsections (s) and (n) require that the broker credit the borrower who agrees to a yield spread premium loan any excess compensation over the amount originally agreed upon.

IV. Practical Implications of the New Sections

A. Practical Implications for Brokers

As the previous sections have made clear, full disclosure of the exact amount of broker compensation, regardless of type, is now required, at the appropriate time. Moreover, the broker now has multiple duties paralleling those of fiduciaries. A violation of a fiduciary duty may give rise to an action for fraud. Additionally, § 590-b provides for its own cause of action to enforce its sections.

Section 590-b (3) provides for a non-exclusive cause of action for actual damages caused by any broker found by a preponderance of the evidence to have violated a duty under § 590-b (1), as enumerated above.⁷² A borrower can be granted equitable relief to enforce the section, and, in a foreclosure action, may receive reasonable attorney fees. Equitable relief can include mortgage rescission, among other remedies.⁷³ While the limitation on damages provides some measure of relief to brokers, the best remedy is prevention.

Pursuant to Section 590-a (3) of the Banking Law, mortgage brokers are required to obtain surety bonds. Regulations require that the bond be made available to satisfy unpaid broker obligations in the event of insolvency or surrender of license.⁷⁴ This would include obligations under the duties imposed by § 590-b.

B. Practical Implications for Attorneys Representing Homeowners

Because § 590-b creates greater disclosure requirements, an attorney engaged to defend against a foreclosure action that does not ensure that his client was properly informed by the broker of the agreement is remiss. Whether disclosure was properly given may be of use in defending a foreclosure action. Moreover, the attorney should also bear in mind that § 590-b includes a cause of action for violations of the broker’s duties which would allow for the recovery of actual damages or for the imposition of equitable remedies.⁷⁵ Additionally, the attorney should be aware that he is entitled to reasonable attorney fees.⁷⁶

In conclusion, Section 590-b, 6-l(s) and 6-m(n) present new challenges to mortgage brokers. They require heightened disclosure, made immediately or close to the time of the proposed mortgage. They impose heightened duties arising out of what is essentially a fiduciary relationship between the borrower and broker. Finally, they allow for a cause of action for failure to properly adhere to the requirements of the statute. A broker is advised to take heed of the strictures of these sections.

Endnotes

1. See, e.g., *Business Highlights*, THE ASSOCIATED PRESS, June 17, 2009, *Anger at Fed could heat up*; Don Lee, *Calls to curb the bank are likely to intensify at Ben Bernanke's confirmation hearing*, LOS ANGELES TIMES, Dec. 3, 2009, at B1.
2. See, e.g., Bill Sponsor's Memo to S. 8143, 2007 Legis. Bill Hist. N.Y. S.B. 8143 (May 6, 2008); see also N.Y. BANKING LAW § 589 (Declaration of policy).
3. This is due to the lack of up front cash often available to homeowners and buyers. Real Estate Settlement Procedures Act Statement of Policy 2001-1, 66 Fed. Reg. 53052, 53053 (Oct. 18, 2001) (to be codified at C.F.R. pt. 3500). Borrowers may choose to pay the fees out of pocket, or to pay the origination fees, and possibly all the closing fees, by adding the amount of such fees to the principal balance of their mortgage loan. The latter approach, however, is not available to those whose loan-to-value ratio has already reached the maximum permitted by the lender. *Id.* at 53054.
4. Federal Trade Commission, *The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment*, BUREAU OF ECONOMICS STAFF REPORT, Jan. 2004, at 2-4. ("A YSP received from the lender is part of the compensation that a broker receives for originating the loan. The broker also may receive other compensation from the lender for the performance of various services, and compensation directly from the borrower in the form of borrower-paid origination charges. Congressional testimony by Olson (2002) indicates that 45 percent of broker income comes from YSPs and 55 percent from origination charges paid directly by the borrower.") ("FTC report"). See also Real Estate Settlement Procedures Act Statement of Policy 2001-1, 66 Fed. Reg. at 53054 ("Yield spread premiums permit homebuyers to pay some or all of the up front settlement costs over the life of the mortgage through a higher interest rate. Because the mortgage carries a higher interest rate, the lender is able to sell it to an investor at a higher price. In turn, the lender pays the broker an amount reflective of this price difference. The payment allows the broker to recoup the up-front costs incurred on the borrower's behalf in originating the loan. Payments from lenders to brokers based on the rates of borrowers' loans are characterized as 'indirect' fees and are referred to as yield spread premiums."). Although the legality of YSPs has been questioned under RESPA, see *Culpepper v. Inland Mortgage Corp.*, 132 F.3d 692 (11th Cir. 1998), more recent court pronouncements have upheld YSPs as authorized by HUD in 2001. See *Glover v. Standard Fed. Bank*, 283 F.3d 953 (8th Cir. 2002); *Schuetz v. Banc One Mortgage Corp.*, 292 F.3d 1004 (9th Cir. 2002).
5. Wayne Barrett, *Andrew Cuomo and Fannie and Freddie: How the youngest Housing and Urban Development secretary in history gave birth to the mortgage crisis*, THE VILLAGE VOICE, Aug. 5, 2008; Cassandra Jones Havard, "Goin' Round in Circles"...and Letting the Bad Loans Win: When Subprime Lending Fails Borrowers: The Need for Uniform Broker Regulation, 86 NEB. L. REV. 737, 754 (2008).
6. As pointed out in section III, *infra*, the legislature considered banning yield spread premiums, but ultimately rejected the ban in favor of disclosure, partially because it recognized the value in yield spread premiums.
7. FTC REP. 3. The Department of Housing and Urban Development has stated that "the yield spread premium [] can be a legitimate tool to assist the borrower. The availability of this option fosters homeownership." Real Estate Settlement Procedures Act Statement of Policy 2001-1, 66 Fed. Reg. at 53054.
8. See Siddhartha Venkatesan, *Abrogating the Holder in Due Course Doctrine in Subprime Mortgage Transactions to More Effectively Police Predatory Lending*, 7 N.Y.U. J. LEGIS. & PUB. POL'Y 177, 185 (2003) (noting that the lack of fiduciary duty encourages mortgage brokers to recommend subprime and predatory loans to borrowers). The point is not to suggest that the broker is an employee or fiduciary of the bank; rather, the broker is more incentivized by the bank's interest than the borrower's interest.
9. N.Y. COMP. CODES R. & REGS. 3 tit. § 38.3 (a) (2) (iv).
10. Promulgated by the Banking Department under Part 38.3 (a) of the General Regulations of the Banking Board. 3 N.Y.C.R.R. § 38.3 (a).
11. See Melissa LaVenia, *Developments in Banking and Financial Law: 2006-2007: The Subprime Mortgage Crisis: XII. Predatory Lending's Role in The Subprime Mortgage Crisis*, 27 REV. BANKING & FIN. L. 101, 102 (2008).
12. L. 2008, ch. 472, (eff. Aug 5, 2008).
13. N.Y. BANKING LAW § 590-b (3), (6).
14. 24 C.F.R. § 3500.7.
15. *Id.* § 3500.8.
16. 12 U.S.C. §§ 2601 *et seq.*
17. Fiduciary is defined by Merriam-Webster's Dictionary of Law as "one often in a position of authority who obligates himself or herself to act on behalf on another (as in managing money or property) and assumes a duty to act in good faith and with care, candor and loyalty in fulfilling the obligation." DICTIONARY OF LAW 193 (1996). Thus, the fact that previous proposed laws expressly called a mortgage broker a fiduciary but the enacted version of 590-b does not, is not itself proof of the kind of duties owed by the broker. The change may be mere semantics—but the duties are the same.
18. See RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006); RESTATEMENT (SECOND) OF TRUSTS § 2 cmt b (1959).
19. RESTATEMENT (SECOND) OF TRUSTS § 2 cmt b (1959).
20. 2a N.Y. JUR. 2D Agency § 20 ("The names which the parties give to the relationship is not determinative of the existence of an agency. The facts in each case must be considered in determining whether or not it is understood that the primary obligation of one party is to act for the benefit of the other.").
21. 2a N.Y. JUR. 2D Agency §§ 204-215.
22. RESTATEMENT (THIRD) OF AGENCY, § 8.01 (2006).
23. See 2a N.Y. JUR. 2D Agency § 7.
24. See, e.g., *Shovak v. Long Island Commercial Bank*, 50 A.D.3d 1118, 1120 (N.Y. App. Div. 2d Dep't 2008); *Lum v. New Century Mortgage Corp.*, 19 A.D.3d 558, 559 (N.Y. App. Div. 2d Dep't 2005); *Iannuzzi v. Wash. Mut. Bank*, No 07-CV-964 (JFB) (WDW), 2008 U.S. Dist. LEXIS 65541, at *27 (E.D.N.Y. Aug. 21, 2008); but see *Joseph v. Northwood Group, LLC*, 08 Civ. 3644 (NRB), 2009 U.S. Dist. LEXIS 64741, at *11 n.8 (S.D.N.Y. July 22, 2009) (quoting *Langer v. Haber Mortgages, Ltd.*, N.Y.L.J. p. 26 col. 4 (Sup. Ct. N.Y. County Aug. 2, 1995) as stating that "by their very nature, contracts between mortgage brokers and their clients generally create a fiduciary duty"). Other states differ. See, e.g., *Gardner v. Randall Mortgage Servs.*, No.: 2:06-cv-0612, 2009 U.S. Dist. LEXIS 105093 (D. Ohio 2009).
25. See *Iannuzzi v. Wash. Mut.*, 2008 U.S. Dist. LEXIS 65541 at *29; 12 AM. JUR. 2D BROKERS § 106; see e.g. *Weissman v. Mertz*, 128 A.D.2d 609, 610 (N.Y. App. Div. 2d Dep't 1987) (real estate "broker" is a fiduciary).
26. *E.g. Iannuzzi v. Wash. Mut. Bank*, 2008 U.S. Dist. LEXIS 65541, at *31.
27. *E.g. EBC I, Inc. v. Goldman Sachs & Co.*, 5 N.Y.3d 11, 22 (2005).
28. *E.g. R.U.P.A. § 301(1)* (imposing agency on partners); *Select Constr. Corp. v. 502 Old Country Rd. LLC*, 819 N.Y.S.2d 851 (Sup. Ct. Nassau County 2006). See also 2a N.Y. JUR. 2D Agency § 25 ("An agency is created if relations exist which will constitute an agency, regardless of whether the parties understood the exact nature of the relations.").

29. See Craig Steven Delsack, Note, *The Mortgage Contingency Clause: A Trap For The Residential Real Estate Purchaser Using A Mortgage Broker*, 17 CARDOZO L. REV. 299, 311-315 (1995) (arguing that the reality of the transaction makes most mortgage brokers into dual agents of the borrower and the bank); see also “Goin’ Round in Circles”...and Letting the Bad Loans Win: When Subprime Lending Fails Borrowers: The Need for Uniform Broker Regulation, 86 NEB. L. REV. at 752, 778 (same).
30. See Havard *supra* note 5, at 781.
31. 3 AM. JUR. 2D Agency § 204.
32. *Id.* § 205; RESTATEMENT (THIRD) OF AGENCY § 8.01 (2006).
33. 2a N.Y. JUR. 2D Agency § 217, 218; RESTATEMENT (SECOND) OF TORTS § 874 (1977).
34. 2a N.Y. JUR. 2D Agency § 225.
35. *Id.* § 228.
36. *Id.* § 228; RESTATEMENT (THIRD) OF AGENCY § 8.12 (2006).
37. DOUGLAS ADAMS, DIRK GENTLY’S HOLISTIC DETECTIVE AGENCY (1987). Alternatively, “What’s in a name? that which we call a rose, By any other name would smell as sweet.” WILLIAM SHAKESPEARE, ROMEO AND JULIET, act 2, Sc. 2.
38. A U.S. Senate bill that would impose a similar duty on mortgage brokers, 110 S. 2452, died in committee. It provided, in relevant part, “Each mortgage broker shall with respect to each home mortgage loan be deemed to have a fiduciary relationship with the borrower, and...act in the best interest of the borrower and in the utmost good faith toward the borrower, and refrain from compromising the rights or interests of the borrower in favor of the rights or interests of another, including a right or interest of the mortgage broker; and clearly disclose to the borrower... all material information that might reasonably affect the rights, interests, or ability of the borrower to receive the borrower’s intended benefit from the home mortgage loan, including total compensation that the broker would receive from any of the loan options that the broker presents to the borrower.” S. 2452, 110th Cong. § 301 (b); see also 153 CONG. REC. S15235, 15236 (2007). The language of § 590-b arguably was derived from this proposal, and thus, can be read as imposing such fiduciary duties on the mortgage broker.
39. 2a N.Y. JUR. 2D Agency § 215; 11 N.Y. JUR., 2D Brokers § 30.
40. *TPL Assocs. v. Helmsley-Spear, Inc.*, 146 A.D.2d 468, 471 (App. Div. 1st Dep’t 1989).
41. Model Rules of Prof’l Conduct, R. 1.7 (1983), 22 N.Y.C.R.R. § 1200.7 (b)(4).
42. Model Rules of Prof’l Conduct, R. 1.8 (1983), 22 N.Y.C.R.R. § 1200.8 (a).
43. *E.g.* N.C. Gen. Stat. § 53-243.10 (a) (3); Ark. Code Ann. § 23-39-510 (a) (3); 9-A Me. Rev. Stat. § 10-303-A; Ohio Rev. Code 1322.081 (A) (3); Va. Code Ann. § 6.1-422 (B) (6).
44. See Restatement (Third) of Agency § 8.08 (2006).
45. 2a N.Y. JUR. 2D Agency § 206. This is normally a fact-intensive inquiry decided by the jury. *Heinemann v. Heard*, 50 N.Y. 27, 35 (1872).
46. See, *e.g.*, *Pellegrini v. Landmark Travel Group*, 628 N.Y.S.2d 1003, 1007 (City Ct. 1995) (citing cases).
47. See *Port Clyde Foods, Inc. v. Holiday Syrups, Inc.*, 563 F.Supp. 893, 897 (S.D.N.Y. 1982) (citing cases in the insurance agent context holding that the agent breaches the duty of care where he fails to provide adequate coverage).
48. Restatement (Third) of Agency § 8.08 cmt b (2006).
49. See, *e.g.*, *Cristallina S. A. v. Christie, Manson & Woods Int’l*, 117 A.D.2d 284, 294-295 (N.Y. App. Div. 1st Dep’t 1986) (auctioneer held to higher standard because he was selected for his special skill, and he represented that he could get a specific price for the auctioned goods); see also, Restatement (Third) of Agency § 8.08 (2006). (“If an agent claims to possess special skills or knowledge, the agent has a duty to the principal to act with the care, competence, and diligence normally exercised by agents with such skills or knowledge.”); *id.* cmt c (“An agent’s level of skill or knowledge may exceed the norm for similarly situated agents. Alternatively, an agent may falsely represent that this is so. An agent’s performance should be evaluated consistently with the agent’s claimed level of skill or knowledge unless the agent establishes that the principal knew the agent’s claim to be false. The agent’s professed level of skill or knowledge becomes the standard against which the agent’s performance should be assessed.”).
50. *Sokoloff v. Harriman Estates Dev. Corp.*, 96 N.Y.2d 409, 416 (2001) (internal citations and quotations omitted).
51. 22 N.Y. JUR. 2D Contracts § 227; Restatement (Second) of Contracts § 205 (1981).
52. N.Y. U.C.C. § 1-201 (19). This has been described as a purely subjective standard that can be satisfied by someone with a pure heart but empty head. See 3 Duesenburg & King, *Bender’s Uniform Commercial Code Service: Sales & Bulk Transfers* § 4.08[3] (1997).
53. *Rooney v. Slomowitz*, 11 A.D.3d 864, 867 (N.Y. App. Div. 3d Dep’t 2004) (citing cases).
54. RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt d (1981). See also Robert S. Summers, *Good Faith in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 199-207 (1968) (describing good-faith requirements as an “excluder,” excluding bad faith more than requiring good-faith action).
55. *Van Valkenburgh, Nooger & Neville, Inc. v. Hayden Publishing Co.*, 30 N.Y.2d 34, 45-46 (1972). Thus, a publisher, while not obligated to stop publishing competing books that could lessen the royalties to the author, could be held liable for a breach of the duty of good faith if it failed to uphold its obligations to advertise the works of its original author. *Id.*; see also *American Assurance Underwriters Group, Inc. v. MetLife General Ins. Agency, Inc.*, 154 A.D.2d 206 (N.Y. App. Div. 1st Dep’t 1990) (holding that AAUG breached its covenant of good faith in contract with MetLife because it unduly influenced the employees of MetLife overseeing the enforcement of the contract).
56. In the context of the U.C.C., the parameters of what is considered good faith may be set by the contract terms. U.C.C. § 1-302 (b); N.Y. U.C.C. 1-102 (3). It is reasonable that absent such statutory authority to modify an express duty of good faith required under N.Y. U.C.C. § 1-201 (19), such duties would be unmodifiable.
57. 3 N.Y.C.R.R. § 38.3 (a) (1) (iv) requires only that the broker disclose “the specific maximum amount of such consideration to be received.”
58. See N.Y. BANKING LAW §§ 6-1 (2) (s) and 6-m (2) (n) (defining total compensation as being “paid as direct compensation from the lender, direct compensation from the borrower, or a combination of the two”).
59. 24 C.F.R. § 3500.7 (b).
60. *Id.* § 3500.7 (e).
61. *Id.* § 3500.7 (f).
62. N.Y. BANKING LAW § 590-b (4).
63. CAL. FIN. CODE § 22063 (b) (E); ME. REV. STAT. ANN. tit. 9-A § 10-303-A (1) (E); N.C. GEN. STAT. § 53-244.109 (5).
64. 2a N.Y. JUR. 2D Agency § 206. This is normally a fact-intensive inquiry decided by the jury. *Heinemann v. Heard*, 50 N.Y. 27, 35 (1872).
65. See, *e.g.*, CAL. BUS. & PROF. CODE § 10166.07 (a) (8); LA. REV. STAT. 6:1096 (f); N.H. REV. STAT. ANN. 397-A:15 (prohibiting YSPs in reverse mortgages); N.M. STAT. ANN. § 58-21-31 (requiring two-

day disclosure of YSPs and other fees); S.C. CODE ANN. § 37-23-45 (requiring detailed disclosure of YSPs before closing for high-cost loans); S.C. CODE ANN. § 37-23-75 (same for consumer loans); WASH. REV. CODE § 19.144.020 (requiring disclosure of YSPs “as a dollar amount”).

66. 2007 BILL TEXT N.Y. S.B. 8143 (May 2, 2008). The FDIC proposed the same, but the Department of HUD rejected its proposal. Real Estate Settlement Procedures Act, 73 Fed. Reg. 68204, 68225 (Nov. 17, 2008) (to be codified at C.F.R. pts. 203 & 3500).
67. 2007 BILL TEXT N.Y. S.B. 8143 (June 21, 2008).
68. N.Y. BANKING LAW § 590-b (1) (e).
69. 24 C.F.R. § 3500.7 (b).
70. 3 N.Y.C.R.R. § 38.3 (a) (1) (iv), (vii) requires only the maximum amount to be disclosed, but does not require the disclosure of the methodology.
71. BLACK’S LAW DICTIONARY 301 (8th ed. 2004) (“Remuneration and other benefits received in return for services rendered; esp., salary or wages.”).
72. See also, N.Y. Banking Law § 590-b (8) (providing that the remedies granted under § 590-b are not exclusive).
73. 13 AM. JUR. 2D *Cancellation of Instruments* § 2 (1964); *Symphony Space v. Pergola Props.*, 88 N.Y.2d 466, 485 (1996); *Rudman v. Cowles Communications, Inc.*, 30 N.Y.2d 1, 14 (1972) (rescission an equitable remedy and thus discretionary; should only be granted where damages are inadequate). It is worth noting that since an action at law would be limited in this case to actual damages and not exemplary damages, where the court decides that actual damages are inadequate, it would be forced to consider an equitable remedy instead.
74. 3 N.Y.C.R.R. § 410.14 (3) (“Such bond...shall contain substantially the following language: “In the event of the insolvency, liquidation or bankruptcy of [the broker]...the proceeds of this bond shall constitute a trust fund to be used...to pay...other obligations of the registrant.”).
75. N.Y. Banking Law § 590-b (3), (5).
76. N.Y. Banking Law § 590-b (6).

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This article originally appeared in the Summer 2010 issue of the NY Business Law Journal, published by the Business Law Section of the New York State Bar Association.

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Collaborative Law and the Uniform Collaborative Law Act

By Andrew Schepard

Groups of divorce lawyers have developed collaborative law—a new ADR process with many of the same peacemaking benefits for divorcing families as mediation. While efforts are under way to expand collaborative law into other areas and it is beginning to be utilized productively more broadly, it has its deepest roots in divorce and family law. Thousands of lawyers have been trained in collaborative law, and many parents have participated in it. Initial empirical evaluations of collaborative law indicate high levels of client satisfaction.¹ Many experienced divorce lawyers report that collaborative law increases their satisfaction with their practice because of the constructive role they play in helping clients reorganize their families—especially their relationships with their children—after divorce and separation.

“The UCLA is a milestone in the development of collaborative law, as it is a uniform statutory framework for its operation.”

This article briefly describes what collaborative law is. It then focuses on the Uniform Collaborative Law Act (UCLA) developed by the Uniform Law Commission (ULC) (formerly the National Conference of Commissioners on Uniform State Laws). The UCLA is a milestone in the development of collaborative law, as it is a uniform statutory framework for its operation. Readers interested in more detail, including citations, about collaborative law and the UCLA can consult the Act (which has an extensive Preface and Commentary) and can be found at the website of the ULC.²

A Brief Introduction to Collaborative Law

The goal of collaborative law is to encourage parties to engage in “problem-solving” rather than “positional” negotiations. As described by Roger Fisher, William Ury and Bruce Patton in their famous book, *Getting to Yes*,³ problem-solving negotiators focus on finding creative solutions to conflict that maximize benefits for all sides, while positional negotiators focus on arguing for and against positions to “win” concessions. Collaborative lawyers emphasize that no threats of litigation should be made during a collaborative law process and the need to maintain respectful dialogue. Parties disclose information voluntarily, without formal discovery requests. They voluntarily assume an obligation to correct information they supplied when

it materially changes. Parties also have the option to participate extensively in the planning for and conduct of negotiation sessions with their collaborative lawyers. Many models of collaborative law engage mental health and financial professionals in advisory and neutral roles—e.g. divorce coach, appraiser, and child’s representative. Collaborative law negotiations are confidential.

Collaborative law is thus like mediation in that it emphasizes problem solving, interest-based negotiation. It differs from mediation in that the parties are represented by lawyers and no neutral facilitates negotiations. Collaborative law is like arbitration in that the parties are represented by lawyers. It differs, however, from arbitration in that the parties in collaborative law seek to negotiate a voluntary settlement, and no third-party neutral is empowered to impose an outcome on them.

Lawyers have, of course, long engaged in problem-solving negotiations without formally labeling the process collaborative law. Lincoln’s famous advice to young lawyers in 1848 captures the longstanding tradition of lawyer collaboration:

Discourage litigation. Persuade your neighbors to compromise whenever you can. Point out to them how the nominal winner is often a real loser—in fees, expenses and waste of time. As a peacemaker, the lawyer has a superior opportunity of being a good man. There will still be business enough.⁴

The distinctively modern enhancement collaborative law makes to the tradition of lawyer professionalism and collaboration articulated by Lincoln is, however, its enforcement mechanism to ensure that problem-solving negotiations actually occur. Parties sign a written agreement (“collaborative law participation agreement”) which states that a collaborative lawyer represents a party only for the purpose of negotiations and will not represent the party in court. The parties also agree that their lawyers are disqualified from further representing parties if the collaborative law process ends without agreement (“disqualification requirement”). Finally, parties agree they mutually have the right to terminate collaborative law at any time without giving a reason.

A collaborative law participation agreement is thus a strong and enforceable mutual commitment for problem-solving negotiations. It addresses the age-old

dilemma for negotiators of deciding whether to cooperate or compete in a situation where each side does not know the other's intentions and "where the pursuit of self interest by each leads to a poor outcome for all"—the famous "prisoner's dilemma" of game theory.⁵ In collaborative law "[e]ach side knows *at the start* that the other has similarly tied its own hands by making litigation expensive. By hiring two Collaborative Law practitioners, the parties send a powerful signal to each other that they truly intend to work together to resolve their differences amicably through settlement."⁶

Collaborative law has thus far largely been practiced by lawyers in groups which draft their own model participation agreements, set their own membership qualifications and can include mental health and financial professionals. Collaborative practitioners have established their own professional association, the International Academy of Collaborative Professionals (IACP), and have worked diligently to articulate their own code of ethics within the broad framework created by the rules of professional responsibility.

There are risks for parties who choose collaborative law—especially of incurring the economic and emotional cost of employing a new lawyer. But there are also benefits for them and their children. "[I]t would be a mistake to focus solely on the risk that [collaborative law] poses for clients. Other things being equal, spouses who choose court-based divorce presumably run the greater risk of harming themselves and their children in bitter litigation or rancorous negotiations. [Collaborative law] clients presumably bind themselves by a mutual commitment to good faith negotiations in hopes of reducing the risk that they will cause such harm, just as Ulysses had his crew tie him to the mast so he would not succumb to the Sirens' call and have his ship founder."⁷

The organized bar has recognized that representation of a client in collaborative law is consistent with the Model Rules of Professional Conduct. Numerous bar association ethics committees (including the American Bar Association's) have validated collaborative law as a permissible limited purpose and scope ("unbundled") representation.⁸ They have emphasized that parties can decide for themselves whether the benefits of collaborative law outweigh the risks if they do so with informed consent.

The Uniform Law Commission and the Uniform Collaborative Law Act

The ULC has worked for uniformity of state laws since 1892. It consists of over 300 lawyer commissioners from every state. It has drafted more than 200 uniform laws on numerous subjects where uniformity is desirable and practicable. The signature product of the ULC, the Uniform Commercial Code, is a prime example of

how its work has simplified the legal life of businesses and individuals by providing rules and procedures that are consistent from state to state. The ULC has taken the same approach to alternative dispute resolution and family law developing, for example, the Uniform Mediation Act, the Uniform Arbitration Act and the Uniform Child Custody Jurisdiction and Enforcement Act.

The process of drafting a uniform act is transparent, and enlists expertise and key stakeholders. The ULC decides on a project, establishes a drafting committee of Commissioners, and designates a Reporter (usually a law professor), who produces multiple drafts for review in open meetings. Drafts are posted on the ULC website and observers from interested groups participate extensively in the drafting committee deliberations. Drafts are also reviewed by the ULC Style Committee for style and consistency. The entire ULC reviews a draft act line by line in two consecutive years. If approved, the act is then transmitted to the states for adoption and the ABA House of Delegates for approval.

The reasons that the ULC decided to undertake the drafting of the UCLA are similar to the reasons it undertakes any project—to promote the development of uniform law in an important and emerging area. A number of states have enacted statutes of varying length and complexity which recognize collaborative law,⁹ and a number of courts have taken similar action through the enactment of court rules.¹⁰ Participation agreements are crossing state lines as use of the collaborative process increases. As the use of collaborative law grows, the UCLA will provide consistency from state to state regarding enforceability of collaborative law agreements, confidentiality of communications in the process, a stay of court proceedings and the privilege against disclosure should the process not result in settlement.

Drafting the Uniform Collaborative Law Act took three years. The Drafting Committee included several Commissioners from the Committee that drafted the Uniform Mediation Act and collaborative lawyers. The Committee was advised by representatives of various ABA Sections and the ABA Commission on Domestic Violence. Many collaborative lawyers from around the country served as observers of the drafting process and contributed their expertise to the final product.

The Provisions of the Uniform Collaborative Law Act

The UCLA:

- Makes participation agreements enforceable if they meet basic requirements (e.g., are in writing and designate collaborative lawyers) (section 4);

- Creates an evidentiary privilege for communications made during the collaborative law process, similar to mediation privilege (section 17, 18 and 19);
- Codifies the disqualification requirement (section 9);
- Creates an exception to the disqualification requirement for emergency recourse to court (Section 7);
- Limits the scope of the disqualification requirement for low-income and government clients (Sections 10-11);
- Requires voluntary disclosure of information during a collaborative law process (Section 12);
- Requires collaborative lawyers to secure informed consent before parties enter into a collaborative law participation agreement including comparing collaborative law to other dispute resolution options such as mediation and arbitration (Section 14);
- Requires collaborative lawyers to screen for domestic violence and coercive behavior (Section 15);
- States clearly that collaborative law representation does not change legal ethics (Section 13).

The UCLA and the American Bar Association House of Delegates

The ULC approved the UCLA for transmission to the States in July, 2009. As of June 30, 2010 Utah has enacted it,¹¹ and it is under active consideration in a number of other states including Ohio,¹² Oklahoma,¹³ Tennessee,¹⁴ and the District of Columbia.¹⁵

The ULC presented the UCLA to the ABA House of Delegates for consideration in February 2010. After extensive comments and discussion, the ULC decided to withdraw the UCLA from House of Delegates consideration to address concerns that had been raised without compromising the Act. The ULC anticipates that the amended UCLA will be submitted for consideration to the ABA House of Delegates at its mid-year meeting in January 2011.

Subsequent to the ABA House of Delegates meeting, the Drafting Committee proposed two amendments to the UCLA which were adopted by the ULC at its summer meeting in July 2010.¹⁶ The first gives states an option of enacting the provisions of the UCLA by court rule rather than by legislation. This amendment is responsive to ABA concerns that the UCLA could be interpreted as regulation of lawyers rather than regulation of a dispute resolution process. In general terms,

the ABA favors preserving the independence of the bar by locating its regulation in the judiciary rather than the legislature. Indeed, in some states, regulation of the practice of law is a power reserved to the judiciary.¹⁷ Adoption of the UCLA by court rule would be an appropriate option for those states.

“The lawyers who practice [collaborative law] feel greater satisfaction in the profession they have chosen by helping their clients resolve their disputes productively and expeditiously.”

The second amendment to the UCLA creates another option for enacting states—to limit the scope of collaborative matters to divorce and family law matters. A number of comments at the ABA Meeting suggested that the UCLA would be more easily approved by the House of Delegates if the collaborative law process were limited to family and divorce disputes where it has gained the most acceptance and recognition. While suitable for other areas as well, collaborative law is ideally suited for divorce and family law as the parties to such disputes inevitably have continuing relationships. As stated in a leading ADR text:¹⁸

Ordinarily, when people fall into disagreement, they have the option to separate. If a couple has children, they usually cannot completely dissociate even when they divorce, however. Instead, ex-spouses remain connected in their roles as parents, often for many years. Divorced parents must find ways to share their children’s physical presence, financial responsibility, teaching, socializing, and a variety of other tasks.

Some states may, however, decide not to create subject matter limitations on matters parties and their counsel decide to submit to the collaborative law process, relying on their good judgment to decide when it would be appropriate and when it isn’t.

A Vision of the Lawyer’s Role

Not all lawyers can or will practice collaborative law. Some are more suited to the courtroom while others are more suited to the conference room. Nonetheless, collaborative law benefits the entire legal profession by providing clients with another valuable option for dispute resolution. The lawyers who practice it feel greater satisfaction in the profession they have chosen by helping their clients resolve their disputes productively and expeditiously.¹⁹ Lawyers who do not

practice collaborative law nonetheless benefit because the public has another option for responsible dispute resolution, thus creating greater public confidence in the legal system. The UCLA will provide statutory support for this evolving dispute resolution process and help our profession fulfill Lincoln's inspirational vision of the lawyer "[a]s a peacemaker."

Endnotes

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7. Ted Schneyer, *The Organized Bar and the Collaborative Law Movement: A Study in Professional Change*, 50 ARIZ. L. REV. 290, 318, n.142 (2008).
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9. See CAL. FAM. CODE § 2013 (2007); N.C. GEN. STAT. §§ 50-70 to 79 (2006); TEX. FAM. CODE §§ 6.603, 153.0072 (2006).
10. See MINN. R. GEN. PRAC. 111.05 & 304.05 (2008); SUPER. CT. CONTRA COSTA COUNTY, LOCAL RULES, RULE 12.8, (2007); L.A. COUNTY SUPERIOR COURT RULE 14.26 (2005); LRSF 11.17 (2009); SONOMA COUNTY LOCAL RULE 9.25 (2005); UTAH CODE OF JUDICIAL ADMINISTRATION, RULE 4-510 (2006); LA. CODE R. tit. IV, § 3 (2005).
11. State of Utah, H.B. 284 Substitute Uniform Collaborative Law Act available at <http://le.utah.gov/~2010/htmdoc/hbillhtm/hb0284s01.htm> (last visited May 25, 2010).
12. State of Ohio, H. B. No. 467 available at http://www.legislature.state.oh.us/bills.cfm?ID=128_HB_467 (last visited May 25, 2010).
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This article originally appeared in the Fall 2010 issue of the New York Dispute Resolution Lawyer, published by the Dispute Resolution Section of the New York State Bar Association.

Court of Appeals Rules There Is Privity Between the Estate Planner and the Client's Personal Estate Representative: But No Privity to Beneficiaries of the Estate

By Gary E. Bashian

The traditional protection from legal malpractice claims afforded Estate practitioners by the doctrine of Privity has been relaxed by a recent New York Court of Appeals decision.

In the *Estate of Saul Schneider v. Finmann*,¹ a unanimous Court of Appeals has ruled that a personal Estate representative “stands in the shoes of the decedent,” and therefore has “the capacity to maintain a malpractice claim on the Estate’s behalf.”²

As many know, New York was one of the few remaining States that continued the precept that there was no Privity between a client’s Estate and an attorney. Without this relationship of Privity, a personal Estate representative did not have the necessary standing to bring a malpractice suit against a negligent Estate planner. Now, such an action no longer requires strict attorney-client Privity as the Court has ruled that “Privity, or a relationship sufficiently approaching Privity, exists between the personal representative of an Estate and the Estate planning attorney,”³ thus imposing a duty upon the Estate planner towards the personal representative of an Estate as would exist between an attorney and live client.

This newly imposed duty between the attorney and the Estate’s personal representative establishes the threshold element necessary to bring a negligence action which was formerly denied to the personal Estate representative. Where it is found that this duty has been breached by an attorney, causation of damages is proved, and based on the actual damages that result to the Estate, the client’s Estate now has a claim for malpractice in its quiver of arrows that should send quivers of concern to all Estate planning attorneys who have acted casually because of their belief that they would be protected by the old law. Although most attorneys will explain in detail orally the Estate, gift and income tax options and issues, there will now be lawsuits against attorneys who know the laws and tax consequences, explained all of the laws and tax consequences, but did not put it in writing. Even better, a writing acknowledged by the signature of the client.

The *Schneider* case⁴ presented a situation that, until now, left a negligent Estate planning attorney immune from recourse by the former client’s Estate. Mr. Schneider was represented by Mr. Finmann and his firm from early 2000 to his passing in late 2006. Plaintiff, the

duly appointed personal representative of his Estate, alleged that based on the advice of his counsel, the decedent purchased a \$1 million life insurance policy and over the next several years he transferred the policy in, and out, of a number of limited liability partnerships of which he was the principal owner, and then subsequently transferred the policy back to himself in his own individual name. Upon Mr. Schneider’s death, this series of transactions resulted in the proceeds of the life insurance policy to be included as part of his gross taxable Estate. At the trial level, the Nassau County Supreme Court predictably granted Defendant’s summary judgment motion for plaintiff’s failure to state a cause of action pursuant to CPLR § 3211(a)(7), which was later affirmed by the Appellate Division Second Department on the same grounds.

The Appellate Division Second Department invoked the “well established rule in New York” expressed in *Spivey v. Pulley*⁵ “with respect to attorney malpractice that absent fraud, collusion, malicious acts, or other special circumstances, an attorney is not liable to third parties, not in Privity, for harm caused by professional negligence,”⁶ and did not allow the Estate to bring an action under Estates Powers and Trusts Law (EPTL) 11-3.2(b). As noted by the Appellate Division Second Department, New York Courts have strictly applied Privity in the past, and disallowed negligence claims against an Estate planner in its absence.

Upon being heard by the New York Court of Appeals, though, *Schneider* was not summarily dismissed for failure to state a cause of action. Indeed, New York’s highest Court, relying heavily on the reasoning articulated in the Texas Supreme Court case *Belt v. Oppenheimer*,⁷ determined that the personal representative of the Estate could pursue the malpractice cause of action against the allegedly negligent Estate planner. However, Estate beneficiaries and other third parties are still barred from bringing malpractice actions against Estate planners for negligent planning.

*Belt v. Oppenheimer*⁸ involved a similar suit in Texas by the personal representatives an Estate who brought an action against the attorney planners for negligently incurring “over \$1.5 million in tax liability that could have been avoided by competent Estate planning.”⁹ The *Belt* court reasoned that although damages did not occur to the Estate until after the death of the client, the negligent act occurred while the decedent was alive.

If the decedent had discovered this prior to death, he could have brought suit against the Estate planner to recover fees, and for costs to restructure the Estate in order to ameliorate the negligence. Therefore, if the injury occurs during the client's lifetime, a claim of malpractice survives the client's death and is justiciable by the personal Estate representative. Logically, the Estate is standing in the same shoes as the dead client, and is essentially the alter ego of the dead client.

Schneider seems to have adopted the Texas Supreme Court's reasoning, indicating that "the personal representative of an Estate should not be prevented from raising a negligent Estate planning against the attorney who caused harm to the Estate. The attorney planner surely knows that minimizing the tax burden of the Estate is one of the central tasks entrusted to the professional."¹⁰

Though the *Schneider* decision is far from revolutionary, and the rather narrow ruling endeavors to balance the interests of both Estate representatives and their legal counsel within the framework of the EPTL 11-3.2(b) which allows the personal representative of an Estate to maintain an action for "injury to person or property" after the testator's death, the real question is what will be the scope of liability and the dollar amount of damages that a negligent planner may be exposed to for malpractice.

While the New York Court of Appeals has specifically stated that this new application of the Privity requirement ensures that Estate planning attorneys will not be subject to "undesirable results, uncertainty, and limitless liability,"¹¹ it remains probable that if the reasoning of the *Belt* Court, cited above, were pushed to its logical extreme, it would result exactly in the "undesirable results, uncertainty, and limitless liability" that both New York's and Texas' highest Courts were specifically trying to avoid.

For example, if the personal Estate representative truly does "stand in the shoes of the decedent,"¹² then arguably he or she would be able to bring any variety of negligence claims on behalf of the Estate that are not prohibited by statute or common law. *Schneider* indicates that the basis of a malpractice action would flow from the failure to fulfill "one of the central tasks entrusted to the professional." What constitutes the essential duty of the Estate planner that, if breached, would be ruled negligence, and what method the Court will use to calculate damages, remain open issues to be determined by the Courts based on the unique and particular facts of each case.

There will, therefore, undoubtedly be many new actions throughout the Courts as personal Estate representatives bring suit where they suspect they have a cause of action due to negligent planning. Clearly, only time, and the inevitable litigation that the *Schneider* case will produce, can answer these questions.

Estate planners in New York must take great care when addressing their clients' needs as this application of Privity will have significant repercussions throughout their practices. It would behoove all attorneys to make sure their file contains enough memos and correspondence, confirmed by the client in writing, explaining the details and implications of the Estate plan as it is structured. This will be especially important where the client makes a decision to do something that will clearly, or may, result in additional taxes or other damages that that client's Estate could pursue post-death.

Endnotes

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4. *Id.*
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7. 192 S.W.3d 780 (Texas 2006).
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9. *Id.* at 782.
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Mr. Bashian gratefully acknowledges the contributions of Andrew Frisenda, an associate at Bashian & Farber, LLP, for his assistance in the composition of this article.

This article originally appeared in the Fall 2010 issue of the Trusts and Estates Law Section Newsletter, published by the Trusts and Estates Law Section of the New York State Bar Association.

Is It Possible for Fiduciaries to Rely on Modern Portfolio Theory to Diversify Today?

By Bruce L. Resnik

Introduction

For over 100 years, fiduciaries have been working with the New York state legislature to be able to diversify their portfolios and invest in different kinds of securities. Not until 1950 was it permissible for fiduciaries to invest in equities. But by 1994, the pendulum had swung so far that the Prudent Investor Act imposed a duty on fiduciaries to diversify investments. That law gave little guidance on what proper diversification was. Since then, fiduciaries have embraced Modern Portfolio Theory (“MPT”) because it seemed to establish a “scientific” basis for diversification. However, MPT did not seem to prevent significant portfolio losses in the current credit crisis. Unfortunately, the investment environment of 2010 seems to present even more challenges to diversification—cash investments do not seem to pay a return that will keep up with inflation, bonds may be subject to capital losses from increasing interest rates and issuer defaults and the growth in equities seems to have stalled in the last 10 years. In light of all this, how should a fiduciary properly diversify investments?

Discussion

In *King v. Talbot*,¹ the New York Court of Appeals adopted a form of the Prudent Man Rule which was eventually codified into the “legal list doctrine.” The statute listed the types of investments that were permissible for fiduciaries and included bank accounts, U.S. government bonds and high grade corporate bonds. Common stocks were not on the list, probably because they were deemed too speculative for fiduciaries.

However, after World War II, bond investors began to incur substantial capital losses as the general level of interest rates rose and the country experienced historically high inflation rates. Fiduciaries appealed to state legislators to allow up to 35% of a trust portfolio to be invested in what were called “non-legals,” like common stocks, and this was approved in 1950. By 1965, in the face of continuing and mounting bond losses, this percentage was increased to 50%. By 1970, after more years of high inflation and the historic stock market gains in the “go-go” years of the late 1960s, the “legal list doctrine” was repealed in its entirety and replaced by the Prudent Man Rule.²

Perhaps the biggest problem with the Prudent Man Rule, speaking strictly from an investor’s perspective, was that the performance of each investment made by a fiduciary was judged in isolation. To our eyes today, that seems patently unfair as we tend to see things more on a portfolio basis. On the whole, if a portfolio as a whole has made substantial returns over time, why penalize a fiduciary for those investments that performed poorly? That was finally remedied in 1994 when New York ad-

opted the Prudent Investor Act, which became effective on January 1, 1995. The Act provides that a fiduciary has a duty to invest and manage property in accordance with the prudent investor standard, which is essentially a standard of conduct, not of outcome or performance.³

Most importantly, that Act required that fiduciaries look at their investment portfolios as a whole. The way it did this was by imposing a general duty on fiduciaries to diversify investments.⁴ Commentators at the time pointed out that the Prudent Man Rule was “hopelessly out of step with modern investment theory.”⁵ What commentators were probably referring to was a theory dubbed Modern Portfolio Theory (MPT).

Where did this “modern” theory come from? It originated in the 1950s in a series of papers by Dr. Harry Markowitz of the University of Chicago. This new theory, which drew heavily on Dr. Markowitz’s remarkable knowledge of mathematics, attempted to quantify the concept of investment risk. Theoretically, investment risk, which was defined as the volatility of an asset’s returns in the past, could be quantified and then reduced and diversified away within a portfolio by carefully combining investments with different historical performance characteristics. This offered what looked like a “scientific” basis to obtain attractive returns while controlling risk by dividing all assets into classes and then by investing in certain asset classes, whose historical returns did not “correlate,” that is, did not produce similar returns over time. This was a groundbreaking theory because understanding, defining and quantifying investment risk was, and still is, one of the most difficult concepts for investors and fiduciaries to understand and to manage.

While, the original papers describing MPT were highly quantitative, the theory was soon simplified and popularized both for individuals and fiduciaries by asset managers, private banks and brokerage houses.

In order to demonstrate the “scientific” nature of this theory, fiduciaries were deluged with MPT concepts like the Efficient Market Theory, efficient frontiers and the Capital Asset Pricing Model, as well as MPT statistics like standard deviations, beta coefficients, Sharpe ratios, correlation coefficients, expected returns, etc. which sought to “scientifically” justify the efficacy of this approach. Indeed, a whole generation of investment analysts has now been trained in this approach, and it is nearly ubiquitous at this time.

Through the 1990s and especially the early years of this century, the MPT approach became highly institutionalized and formularized. Every conceivable desired rate of return became identified with a portfolio allocated among equity and fixed income asset classes. Equities

were generally perceived to be more volatile and hence “riskier” than fixed income investments, but they were also believed to provide higher returns over long periods of time (often referred to as the “5.00% risk premium for equities”). In short, if an investor or fiduciary desired a portfolio with a very high rate of return, all they had to do was dial up the percentage of equities in their investment portfolio.

Unfortunately, fiduciaries who thought their portfolios were safely diversified incurred substantial losses when the current credit crisis hit. Losses in equities were historically large, and there were also losses in some fixed income securities, as well as in hedge funds and other alternative investments.

Complicating things today is that the current investment environment seems to offer only more investment challenges for fiduciaries—cash investments do not pay a return that seems sufficient to keep up with inflation, bonds may be subject to capital losses both from rising interest rates and increasing issuer defaults, and the growth in equities seems to have stalled in the last 10 years.

Was Reliance on MPT Wrong?

Since it first appeared, MPT has been the subject of academic as well as “real world” criticism.

First, the most successful individual investors, like Warren Buffet and George Soros, did not seem to use the MPT approach, but, instead, seemed to concentrate on either taking big bets on the expected performance of a narrow asset class in the future, such as currency, or on buying operating companies with valuable consumer franchises and holding them for very long periods of time. Unfortunately, neither of these strategies is readily accessible to fiduciaries and, even if they were, only a few professional investors have really been successful achieving these extraordinary returns over time.

Second, asset classes, the building blocks of the portfolios developed by asset managers, private banks and brokerage houses, quickly proliferated and became splintered. For example, equities were soon categorized by the size of the market capitalization of the company issuing securities (large cap, mid-cap, small-cap), and by the arbitrary classification of an equity as either a “value stock” or a “growth stock,” or by the location of the corporate headquarters (international or U.S.). Confusingly, one asset manager’s small cap stocks were often larger than another’s; and one manager’s “value stocks” were occasionally another manager’s “growth stocks,” and so forth.

Third, and most difficult to understand, however, was that some asset classes were held out to be “non-correlating,” like alternative investments including hedge funds, private equity funds, managed future portfolios, etc. In other words, their history of returns did not closely match that of other asset classes, such as equities. Hence, according to MPT, making investments in those areas could reduce the “risk” of a portfolio. This cer-

tainly seemed to be contradictory from a common sense point of view, especially considering the short operating history of many of such investments (a history which is highly skewed by survivor bias), the high level of leverage often employed by many of these new investment vehicles to increase their returns, their frequent reliance on only one expert or investment “guru,” their high fees, the opaqueness or absence of their financial disclosures and the lack of investment liquidity, which were often associated with many of these investments.

Fourth, some MPT assumptions always seemed somewhat suspect. For example, the theory assumed that every asset’s investment returns were “normally” distributed (i.e., would resemble a bell curve), that the correlations between asset classes are fixed and unchangeable over time, that all investors have access to the same information at the same time, that all securities can be divided into parcels of any size, and most of all, that there is a perfect trade-off between risk and return. That is, if you invest in “riskier” asset classes, you will be rewarded with higher returns over time. And almost no consideration was given to the effect of taxes on investments and their historical returns.

Finally, it always seemed a little counter-intuitive to invest in an asset class for its future performance by looking solely at its historical returns. In retrospect, that seemed a little like driving a car by looking in the rear view mirror!

In spite of all these qualms, the MPT approach to diversification seemed to be successful, particularly in the period from 2002 to 2007. However, it seemed to fail decisively in the current credit crisis that followed. All asset classes seemed to become correlated—they all went down at the same time!

Was MPT Incorrect?

It is important to realize that MPT is just a theory with some very important limitations. MPT’s definition of investment risk solely as the volatility of an investment’s past returns is probably just too narrow for the real world. There are many more risks out there. Just one example of such risks would be “price risk.” Even after locating a desirable asset class to invest in, the first question to ask should be when to invest to get the investment at the best price. History shows that attractive asset classes are soon bid up in price to where attractive returns are difficult to achieve. If an investor pays too much for assets, their returns will tend to be adversely affected.

MPT was also interpreted as a reason to be neither a tactical nor strategic investor. The theory encouraged investors and fiduciaries to focus only on the historical track record of asset classes, which can be greatly skewed depending on the time period selected. It also did not seem to encourage focusing on which asset classes will show the most potential for appreciation in the future.

And think about this. In light of present market conditions, is it reasonable to assume that adding equities to a portfolio will increase the portfolio's return in any reasonable time horizon (although it will probably increase the portfolio's volatility)? The "reliable" 5.00% risk premium for investing in equities may or may not be reliable any more. As of December 31, 2009, the Standard & Poor's Index of 500 Stocks was where it was in April of 1998—over 11 years ago. Yet a first class postage stamp in 1998 cost 32 cents, and today it costs 44 cents! It is far more likely that the annual percentage growth in equities will track the percentage growth in the economy as a whole, which is likely to be less than recent historical percentages in light of the seriousness of the present economic crisis.

With the limitations of MPT exposed at this time, what strategies can fiduciaries use to diversify now and in the future?

Unfortunately, there is no easy answer to this question and no new theory for fiduciaries to rely on today to diversify in accordance with the law. But what should fiduciaries consider?

Fiduciaries are likely to be increasingly presented with portfolios that initially are drawn using MPT techniques, but which provide for "dynamic" changes of the asset allocation by an overall (or "overlay") portfolio manager. This will permit the manager more flexibility to take advantage of tactical changes in the capital markets. In addition, these portfolios will also likely include more "strategic" areas of investing to capture future returns, whether they are new industries or overseas capital markets.

To an MPT purist, this might be considered "market timing," but, even if it were, there are obvious intuitive advantages in making investments with a view to both tactical and strategic considerations.

But before embracing portfolios like this, fiduciaries should ask questions, particularly when an investment advisor points out a new area that looks attractive for investment. One such question is whether that investment class is "overpriced" or "underpriced" in the current market. It is advisable to avoid buying overpriced assets, regardless of their future prospects.

Fiduciaries should also think twice before investing in alternative investments with heavy fees and withdrawal restrictions. History has yet to prove that most of these investments are going to be successful in the long run. And for trusts as well as individuals, liquidity can be extremely important and should not be easily given up because real life can often make cash demands at the most inappropriate times.

Finally, fiduciaries should ask, if after the long hard road to get to the point where they can invest in equities, do they really need to invest in equities? Consider that the "5.00% risk premium" for equities might be an artifact of the last 50 years, and if the economy grows much slower in the future than it has in the past equi-

ties are likely to generate a much lower rate of return. At the extreme, there are some studies, especially those by Robert D. Arnott, that are easily accessible on the internet, that show that investments in bonds have even performed better over long periods of time than investments in equities.

Conclusion

Dr. Markowitz's theory will be with us for a long time and rightfully so. But like most theories, it was only a theory, and its limitations may have been glossed over by the asset managers, private banks and large brokerage companies who put together the asset classes that fit so neatly into their recommended portfolios. It should not be relied upon as the sole strategy for diversifying any portfolio today.

Unfortunately, now that fiduciaries have a duty to diversify, there appears to be no easy or scientific way to do so. To diversify today, fiduciaries will have to fall back on caution, skepticism of the equity markets and plain common sense. To paraphrase Warren Buffet, what is important today is not the return on investment, but rather the return of one's investment. We are living through difficult economic times. Fiduciaries should be cautious and more careful than ever. There are no easy formulas for diversification. Investing was never easy in the past and will probably never be easy in the future.

Endnotes

1. 40 NY 76 (1869).
2. Estates, Powers and Trusts Law (EPTL) § 11-2.2(a)(1).
3. *Id.* at § 11-2.3.
4. *Id.* at § 11-2.3(b)(3)(C).
5. McKinney's Consolidated Laws of New York Annotated, Practice Commentaries to EPTL § 11-2.3, p. 317.

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This article originally appeared in the Fall 2010 issue of the Trusts and Estates Law Section Newsletter, published by the Trusts and Estates Law Section of the New York State Bar Association.

Scenes from the General Practice Section

FALL MEETING

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Ethics Opinion 840

Distinguishing N.Y. State 786 (2005) in Light of Rule Changes

Committee on Professional Ethics of the New York State Bar Association (3/26/10)

Topic:	Lawyer paying <i>pro bono</i> client's litigation expenses.
Digest:	Under the New York Rules of Professional Conduct, a lawyer is ethically permitted to pay the litigation expenses of a <i>pro bono</i> client whether the <i>pro bono</i> client is indigent or not.
Rules:	1.8(e)(2).
Code:	DR 5-103(B).

Question

1. Is a lawyer ethically permitted to pay the litigation expenses of its *pro bono* client, an organization that provides legal services to the indigent, even though the organization itself is not indigent?

Opinion

2. A lawyer represents, on a *pro bono* basis, a non-profit organization that provides legal services to indigent people. The lawyer wishes to pay the organization's expenses in the litigation, but the organization itself is not indigent. In N.Y. State 786 (2005), decided under the former New York Code of Professional Responsibility, this Committee concluded that a lawyer was ethically prohibited from paying the litigation expenses of a *pro bono* organizational client that provided legal services to the poor unless the organization itself was indigent.¹ We now examine whether the question would be answered differently under the New York Rules of Professional Conduct that took effect on April 1, 2009 (the "Rules").² We conclude that it would.

3. At the time N.Y. State 786 was issued, DR 5-103(B)(2) of the New York Code of Professional Responsibility required that a client be *both pro bono and indigent* in order for the lawyer to be permitted to pay the client's litigation expenses. In contrast, Rule 1.8(e)(2) of the New York Rules of Professional Conduct provides that "a lawyer representing an indigent or *pro bono* client may pay court costs and expenses of litigation on behalf of the client." (Emphasis added). Therefore, under the new Rules, as long as the lawyer is representing the client on a *pro bono* basis, the lawyer may pay the *pro bono* client's court costs and expenses of litigation whether the *pro bono* client is indigent or not.

Conclusion

5. A lawyer providing *pro bono* legal representation to an organization that provides legal services to the indigent is ethically permitted to pay the organization's litigation expenses whether or not the organization is indigent.

Endnotes

1. N.Y. State 786 adopted a test for indigence of an organization relating to "objective financial wherewithal, and not one that is based on the worthiness of" the organization's cause or motivations.
2. The rule amendments addressed in this opinion pre-date the April 1, 2009 amendments (which included adoption of the ABA Model Rules format). Specifically, the rule amendments at issue here originally took effect on February 1, 2007 in conjunction with extensive amendments to the advertising and solicitation rules in the old New York Code of Professional Responsibility.

(47-09B)

Ethics Opinion 841

Committee on Professional Ethics of the New York State Bar Association (4/12/10)

- Topic:** Lawyer sending e-mails to other lawyers seeking referrals of people injured by a particular pharmaceutical product.
- Digest:** E-mails to other lawyers requesting referrals of clients are not “solicitations” regulated by Rule 7.3. However, the e-mails must comply with Rules 7.4 and 8.4(c).
- Rules:** 1.0(a); 1.5(g); 7.1; 7.3; 7.3(b); 7.4; 8.4(c).
- Comments:** Rule 7.1, cmt. 7; Rule 7.3, cmt. 1.

“Advertisement” means any public or private communication made by or on behalf of a lawyer or law firm about that lawyer or law firm’s services, the primary purpose of which is for the retention of the lawyer or law firm. *It does not include communications to existing clients or other lawyers.* [Emphasis added.]

Question

1. May a lawyer send e-mails to other lawyers asking them to refer cases to the sending lawyer involving people injured by a particular pharmaceutical product?

Facts

2. A lawyer who handles cases involving people injured by a particular pharmaceutical product proposes sending e-mails to other lawyers advising them that he is handling such cases and inviting the recipients of the e-mails to refer such cases to the lawyer.

Opinion

3. Rule 7.3 of the New York Rules of Professional Conduct (the “Rules”) establishes restrictions on solicitation by lawyers and sets forth the filing requirements for any permitted solicitation. Rule 7.3(b) defines the term “solicitation.” It states that, for purposes of Rule 7.3:

“solicitation” means any *advertisement* initiated by or on behalf of a lawyer or law firm that is directed to, or targeted at, a specific recipient or group of recipients, or their family members or legal representatives, the primary purpose of which is the retention of the lawyer or law firm, and a significant motive for which is pecuniary gain. [Emphasis added.]

4. The communication in question here contains many elements of Rule 7.3(b)—it is “by a lawyer...targeted at...a group of recipients”; the “primary purpose” of the communication is “the retention of the lawyer”; and a “significant motive” for the communication is “pecuniary gain.” But the communication lacks one crucial element of a solicitation: the communication is not an “advertisement” because it will be sent to other lawyers. Rule 1.0(a) (which defines “advertisement”) expressly excludes communications to other lawyers from the definition of “advertisement.” Specifically, Rule 1.0(a) provides:

5. Since the communication in question will be sent only to other lawyers, it is not an “advertisement.” Therefore, it is also not a “solicitation” within the meaning of Rule 7.3(b). *See* Rule 7.3, cmt. 1 (“By definition, a communication that is not an ‘advertisement’ is not a solicitation.”) A communication that is not a “solicitation” is not subject to the filing requirements (or any other requirements) of Rule 7.3. Moreover, since the communication is not an advertisement, it is also not subject to the provisions of Rule 7.1 (“Advertising”). Comment 7 to Rule 7.1 provides that communications to other lawyers are excluded from the special rules governing lawyer advertising even if their purpose is the retention of the lawyer or law firm sending them.

6. Of course, the communications must nonetheless comply with Rule 8.4(c), which prohibits a lawyer from engaging in conduct involving “dishonesty, fraud, deceit or misrepresentation,” and they must comply with Rule 7.4 (“Identification of Practice and Specialty”), which prohibits a lawyer or law firm from stating that the lawyer or law firm is a “specialist” or “specializes” in a particular field of law except in special circumstances.

7. Finally, if the attorney sending the communications intends to share a portion of the fee with a referring attorney, the sending attorney must comply with Rule 1.5(g), which regulates a division of legal fees with another lawyer not associated with the same law firm.

Conclusion

8. A lawyer may ethically send e-mails to other lawyers asking for referrals of clients who have been injured by a particular pharmaceutical product. Since a communication to other lawyers is expressly excluded from the definition of “advertisement,” the communication is not an advertisement, and is therefore also not a “solicitation.” Consequently, it is not subject to the provisions of either Rule 7.1 or Rule 7.3. However, it is subject to the provisions of Rule 7.4 and Rule 8.4(c).

(64-09)

Ethics Opinion 842

Committee on Professional Ethics of the New York State Bar Association (9/10/10)

Topic: Using an outside online storage provider to store client confidential information.

Digest: A lawyer may use an online data storage system to store and back up client confidential information provided that the lawyer takes reasonable care to ensure that confidentiality will be maintained in a manner consistent with the lawyer's obligations under Rule 1.6. In addition, the lawyer should stay abreast of technological advances to ensure that the storage system remains sufficiently advanced to protect the client's information, and should monitor the changing law of privilege to ensure that storing the information online will not cause loss or waiver of any privilege.

Rules: 1.4, 1.6(a), 1.6(c).

Question

1. May a lawyer use an online system to store a client's confidential information without violating the duty of confidentiality or any other duty? If so, what steps should the lawyer take to ensure that the information is sufficiently secure?

Opinion

2. Various companies offer online computer data storage systems that are maintained on an array of Internet servers located around the world. (The array of Internet servers that store the data is often called the "cloud.") A solo practitioner would like to use one of these online "cloud" computer data storage systems to store client confidential information. The lawyer's aim is to ensure that his clients' information will not be lost if something happens to the lawyer's own computers. The online data storage system is password-protected and the data stored in the online system is encrypted.
3. A discussion of confidential information implicates Rule 1.6 of the New York Rules of Professional Conduct (the "Rules"), the general rule governing confidentiality. Rule 1.6(a) provides as follows:

A lawyer shall not knowingly reveal confidential information... or use such information to the disadvantage of a client or for the advantage of a lawyer or a third person, unless:

(1) the client gives informed consent, as defined in Rule 1.0(j);

(2) the disclosure is impliedly authorized to advance the best interests of the client and is either reasonable under the circumstances or customary in the professional community; or

(3) the disclosure is permitted by paragraph (b).

4. The obligation to preserve client confidential information extends beyond merely prohibiting an attorney from revealing confidential information without client consent. A lawyer must also take reasonable care to affirmatively protect a client's confidential information. See N.Y. County 733 (2004) (an attorney "must diligently preserve the client's confidences, whether reduced to digital format, paper, or otherwise"). As a New Jersey ethics committee observed, even when a lawyer wants a closed client file to be destroyed, "[s]imply placing the files in the trash would not suffice. Appropriate steps must be taken to ensure that confidential and privileged information remains protected and not available to third parties." New Jersey Opinion (2006), quoting New Jersey Opinion 692 (2002).
5. In addition, Rule 1.6(c) provides that an attorney must "exercise reasonable care to prevent . . . others whose services are utilized by the lawyer from disclosing or using confidential information of a client" except to the extent disclosure is permitted by Rule 1.6(b). Accordingly, a lawyer must take reasonable affirmative steps to guard against the risk of inadvertent disclosure by others who are working under the attorney's supervision or who have been retained by the attorney to assist in providing services to the client. We note, however, that exercising "reasonable care" under Rule 1.6 does not mean that the lawyer guarantees that the information is secure from any unauthorized access.
6. To date, no New York ethics opinion has addressed the ethics of *storing* confidential information online. However, in N.Y. State 709 (1998) this Committee addressed the duty to preserve a client's confidential information when *transmitting* such information electronically. Opinion 709 concluded that lawyers may transmit confidential information by e-mail, but cautioned that "lawyers must always act reasonably in choosing to use e-mail for confidential communications." The Committee also warned that the exercise of reasonable care may differ from one case to the next. Accordingly, when a lawyer is

on notice that the confidential information being transmitted is “of such an extraordinarily sensitive nature that it is reasonable to use only a means of communication that is completely under the lawyer’s control, the lawyer must select a more secure means of communication than unencrypted Internet e-mail.” *See also* Rule 1.6, cmt. 17 (a lawyer “must take reasonable precautions” to prevent information coming into the hands of unintended recipients when transmitting information relating to the representation, but is not required to use special security measures if the means of communicating provides a reasonable expectation of privacy).

7. Ethics advisory opinions in several other states have approved the use of electronic storage of client files provided that sufficient precautions are in place. *See, e.g.*, New Jersey Opinion 701 (2006) (lawyer may use electronic filing system whereby all documents are scanned into a digitized format and entrusted to someone outside the firm provided that the lawyer exercises “reasonable care,” which includes entrusting documents to a third party with an enforceable obligation to preserve confidentiality and security, and employing available technology to guard against reasonably foreseeable attempts to infiltrate data); Arizona Opinion 05-04 (2005) (electronic storage of client files is permissible provided lawyers and law firms “take competent and reasonable steps to assure that the client’s confidences are not disclosed to third parties through theft or inadvertence”); *see also* Arizona Opinion 09-04 (2009) (lawyer may provide clients with an online file storage and retrieval system that clients may access, provided lawyer takes reasonable precautions to protect security and confidentiality and lawyer periodically reviews security measures as technology advances over time to ensure that the confidentiality of client information remains reasonably protected).
8. Because the inquiring lawyer will use the online data storage system for the purpose of preserving client information—a purpose both related to the retention and necessary to providing legal services to the client—using the online system is consistent with conduct that this Committee has deemed ethically permissible. *See* N.Y. State 473 (1977) (absent client’s objection, lawyer may provide confidential information to outside service agency for legitimate purposes relating to the representation provided that the lawyer exercises care in the selection of the agency and cautions the agency to keep the information confidential); *cf.* NY CPLR 4548 (privileged communication does not lose its privileged character solely because it is communicated by electronic

means or because “persons necessary for the delivery or facilitation of such electronic communication may have access to” its contents).

9. We conclude that a lawyer may use an online “cloud” computer data backup system to store client files provided that the lawyer takes reasonable care to ensure that the system is secure and that client confidentiality will be maintained. “Reasonable care” to protect a client’s confidential information against unauthorized disclosure may include consideration of the following steps:
 - (1) Ensuring that the online data storage provider has an enforceable obligation to preserve confidentiality and security, and that the provider will notify the lawyer if served with process requiring the production of client information;
 - (2) Investigating the online data storage provider’s security measures, policies, recoverability methods, and other procedures to determine if they are adequate under the circumstances;
 - (3) Employing available technology to guard against reasonably foreseeable attempts to infiltrate the data that is stored; and/or
 - (4) Investigating the storage provider’s ability to purge and wipe any copies of the data, and to move the data to a different host, if the lawyer becomes dissatisfied with the storage provider or for other reasons changes storage providers.
10. Technology and the security of stored data are changing rapidly. Even after taking some or all of these steps (or similar steps), therefore, the lawyer should periodically reconfirm that the provider’s security measures remain effective in light of advances in technology. If the lawyer learns information suggesting that the security measures used by the online data storage provider are insufficient to adequately protect the confidentiality of client information, or if the lawyer learns of any breach of confidentiality by the online storage provider, then the lawyer must investigate whether there has been any breach of his or her own clients’ confidential information, notify any affected clients, and discontinue use of the service unless the lawyer receives assurances that any security issues have been sufficiently remediated. *See* Rule 1.4 (mandating communication with clients); *see also* N.Y. State 820 (2008) (addressing Web-based email services).
11. Not only technology itself but also the law relating to technology and the protection of confidential communications is changing rapidly.

Lawyers using online storage systems (and electronic means of communication generally) should monitor these legal developments, especially regarding instances when using technology may waive an otherwise applicable privilege. *See, e.g., City of Ontario, Calif. v. Quon*, 130 S. Ct. 2619, 177 L.Ed.2d 216 (2010) (holding that City did not violate Fourth Amendment when it reviewed transcripts of messages sent and received by police officers on police department pagers); *Scott v. Beth Israel Medical Center*, 17 Misc. 3d 934, 847 N.Y.S.2d 436 (N.Y. Sup. 2007) (e-mails between hospital employee and his personal attorneys were not privileged because employer’s policy regarding computer use and e-mail monitoring stated that employees had no reasonable expectation of privacy in e-mails sent over the employer’s e-mail server). *But see Stengart v. Loving Care Agency, Inc.*, 201 N.J. 300, 990 A.2d 650 (2010) (despite employer’s e-mail policy stating that company had right to review and disclose all information on “the company’s media systems and services” and that e-mails were “not to be considered private or personal” to any employees, company violated employee’s attorney-client privilege by reviewing e-mails sent to employee’s personal attorney on employer’s laptop through employee’s personal, password-protected e-mail account).

12. This Committee’s prior opinions have addressed the disclosure of confidential information in metadata and the perils of practicing law over the Internet. We have noted in those opinions that the duty to “exercise reasonable care” to prevent disclosure of confidential information “may, in some circumstances, call for the lawyer to stay abreast of technological advances and the potential risks” in transmitting information electronically. N.Y. State 782 (2004), *citing* N.Y. State 709 (1998) (when conducting trademark practice over the Internet, lawyer had duty to “stay abreast of this evolving technology to assess any changes in the likelihood of interception as well as the availability of improved technologies that may re-

duce such risks at reasonable cost”); *see also* N.Y. State 820 (2008) (same in context of using e-mail service provider that scans e-mails to generate computer advertising). The same duty to stay current with the technological advances applies to a lawyer’s contemplated use of an online data storage system.

Conclusion

13. A lawyer may use an online data storage system to store and back up client confidential information provided that the lawyer takes reasonable care to ensure that confidentiality is maintained in a manner consistent with the lawyer’s obligations under Rule 1.6. A lawyer using an online storage provider should take reasonable care to protect confidential information, and should exercise reasonable care to prevent others whose services are utilized by the lawyer from disclosing or using confidential information of a client. In addition, the lawyer should stay abreast of technological advances to ensure that the storage system remains sufficiently advanced to protect the client’s information, and the lawyer should monitor the changing law of privilege to ensure that storing information in the “cloud” will not waive or jeopardize any privilege protecting the information.

(75-09)



Opinion 843

Committee on Professional Ethics of the New York State Bar Association (9/10/10)

Topic: Lawyer's access to public pages of another party's social networking site for the purpose of gathering information for client in pending litigation.

Digest: A lawyer representing a client in pending litigation may access the public pages of another party's social networking website (such as Facebook or MySpace) for the purpose of obtaining possible impeachment material for use in the litigation.

Rules: 4.1; 4.2; 4.3; 5.3(b)(1); 8.4(c)

Question

1. May a lawyer view and access the Facebook or MySpace pages of a party other than his or her client in pending litigation in order to secure information about that party for use in the lawsuit, including impeachment material, if the lawyer does not "friend" the party and instead relies on public pages posted by the party that are accessible to all members in the network?

Opinion

2. Social networking services such as Facebook and MySpace allow users to create an online profile that may be accessed by other network members. Facebook and MySpace are examples of external social networks that are available to all web users. An external social network may be generic (like MySpace and Facebook) or may be formed around a specific profession or area of interest. Users are able to upload pictures and create profiles of themselves. Users may also link with other users, which is called "friending." Typically, these social networks have privacy controls that allow users to choose who can view their profiles or contact them; both users must confirm that they wish to "friend" before they are linked and can view one another's profiles. However, some social networking sites and/or users do not require pre-approval to gain access to member profiles.
3. The question posed here has not been addressed previously by an ethics committee interpreting New York's Rules of Professional Conduct (the "Rules") or the former New York Lawyers Code of Professional Responsibility, but some guidance is available from outside New York. The Philadelphia Bar Association's Professional Guidance Committee recently analyzed the pro-

priety of "friending" an unrepresented adverse witness in a pending lawsuit to obtain potential impeachment material. See Philadelphia Bar Op. 2009-02 (March 2009). In that opinion, a lawyer asked whether she could cause a third party to access the Facebook and MySpace pages maintained by a witness to obtain information that might be useful for impeaching the witness at trial. The witness's Facebook and MySpace pages were not generally accessible to the public, but rather were accessible only with the witness's permission (*i.e.*, only when the witness allowed someone to "friend" her). The inquiring lawyer proposed to have the third party "friend" the witness to access the witness's Facebook and MySpace accounts and provide truthful information about the third party, but conceal the association with the lawyer and the real purpose behind "friending" the witness (obtaining potential impeachment material).

4. The Philadelphia Professional Guidance Committee, applying the Pennsylvania Rules of Professional Conduct, concluded that the inquiring lawyer could not ethically engage in the proposed conduct. The lawyer's intention to have a third party "friend" the unrepresented witness implicated Pennsylvania Rule 8.4(c) (which, like New York's Rule 8.4(c), prohibits a lawyer from engaging in conduct involving "dishonesty, fraud, deceit or misrepresentation"); Pennsylvania Rule 5.3(c)(1) (which, like New York's Rule 5.3(b)(1), holds a lawyer responsible for the conduct of a nonlawyer employed by the lawyer if the lawyer directs, or with knowledge ratifies, conduct that would violate the Rules if engaged in by the lawyer); and Pennsylvania Rule 4.1 (which, similar to New York's Rule 4.1, prohibits a lawyer from making a false statement of fact or law to a third person). Specifically, the Philadelphia Committee determined that the proposed "friending" by a third party would constitute deception in violation of Rules 8.4 and 4.1, and would constitute a supervisory violation under Rule 5.3 because the third party would omit a material fact (*i.e.*, that the third party would be seeking access to the witness's social networking pages solely to obtain information for the lawyer to use in the pending lawsuit).
5. Here, in contrast, the Facebook and MySpace sites the lawyer wishes to view are accessible to all members of the network. New York's Rule 8.4 would not be implicated because the law-

yer is not engaging in deception by accessing a public website that is available to anyone in the network, provided that the lawyer does not employ deception in any other way (including, for example, employing deception to become a member of the network). Obtaining information about a party available in the Facebook or MySpace profile is similar to obtaining information that is available in publicly accessible online or print media, or through a subscription research service such as Nexis or Factiva, and that is plainly permitted.¹ Accordingly, we conclude that the lawyer may ethically view and access the Facebook and MySpace profiles of a party other than the lawyer's client in litigation as long as the party's profile is available to all members in the network and the lawyer neither "friends" the other party nor directs someone else to do so.

Conclusion

6. A lawyer who represents a client in a pending litigation, and who has access to the Facebook or MySpace network used by another party in litigation, may access and review the public social network pages of that party to search for

potential impeachment material. As long as the lawyer does not "friend" the other party or direct a third person to do so, accessing the social network pages of the party will not violate Rule 8.4 (prohibiting deceptive or misleading conduct), Rule 4.1 (prohibiting false statements of fact or law), or Rule 5.3(b)(1) (imposing responsibility on lawyers for unethical conduct by nonlawyers acting at their direction).

Endnote

1. One of several key distinctions between the scenario discussed in the Philadelphia opinion and this opinion is that the Philadelphia opinion concerned an unrepresented *witness*, whereas our opinion concerns a *party*—and this party may or may not be represented by counsel in the litigation. If a lawyer attempts to "friend" a *represented* party in a pending litigation, then the lawyer's conduct is governed by Rule 4.2 (the "no-contact" rule), which prohibits a lawyer from communicating with the represented party about the subject of the representation absent prior consent from the represented party's lawyer. If the lawyer attempts to "friend" an *unrepresented* party, then the lawyer's conduct is governed by Rule 4.3, which prohibits a lawyer from stating or implying that he or she is disinterested, requires the lawyer to correct any misunderstanding as to the lawyer's role, and prohibits the lawyer from giving legal advice other than the advice to secure counsel if the other party's interests are likely to conflict with those of the lawyer's client. Our opinion does not address these scenarios.

(76-09)

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Ethics Opinion 844

Committee on Professional Ethics of the New York State Bar Association (10/8/10)

Topic: Lawyer/legislator serving as appointed counsel for indigent respondents in Family Court proceedings.

Digest: Rules 8.4(d) and 1.11(f)(2) prohibit a county legislator from accepting appointments by the Family Court to serve as attorney for the child in juvenile delinquency, PINS, neglect, or abuse proceedings.

Rules: 1.11(f)(2) and 8.4(d).

Question

1. Where a county legislature approves funding and appointments for both the office of county attorney and the office of counsel for the county department of social services, may a part-time county legislator accept appointment by the Family Court to serve as attorney for the child (formerly known as law guardian) in juvenile delinquency, PINS, neglect or abuse proceedings?¹

Opinion

2. This Committee has addressed analogous situations before. Under the authority of former DR 1-102(A)(5) (lawyer shall not “engage in conduct prejudicial to the administration of justice”) and former DR 8-101(A)(2) (lawyer who is also public official shall not “use the public position to influence, or attempt to influence, a tribunal to act in favor of the lawyer or of a client”), this Committee has determined that a lawyer/legislator may not represent criminal defendants in cases involving members of a police department or district attorney’s office over which the legislature has budget or appointment authority. N.Y. State 798 (2006); N.Y. State 692 (1997). The prohibition applies even if the legislator would abstain from all votes affecting the police budget or the district attorney’s budget. N.Y. State 702 (1998). The language of DR 1-102(A)(5) and DR 8-101(A)(2) has been incorporated without change into the New York Rules of Professional Conduct as Rules 8.4(d) and 1.11(f)(2), respectively.
3. Rules 8.4(d) and 1.11(f)(2) apply with equal force to prohibit service as attorney for the child in juvenile delinquency and PINS proceedings for three reasons: (a) the legislator’s role is the functional equivalent of a criminal defense attorney, (b) the child’s liberty is at stake, and (c) the legislator would be adverse to the county attorney’s office, whether or not the legislator actually cross-examines county-funded or county-appointed law enforcement or other personnel.

4. We recognize that neglect and abuse proceedings are somewhat different from juvenile delinquency and PINS proceedings. For example, the attorney for the child may, in a particular neglect and abuse case, take the same position as the county attorney or the county department of social services with respect to the proposed placement of a child, the proposed termination of parental rights, or other issues. Nonetheless, for two reasons, both equally important, we believe that the ethical prohibition against accepting any of these Family Court appointments should be the same.

5. First, the public may perceive that the county legislator may be receiving favored treatment from the county attorney or the county department of social services. This perception is not dissipated in situations where the legislator agrees with those offices regarding a recommended disposition of a particular neglect or abuse case. To the contrary, the perception of favored treatment may be reinforced—perhaps the public will believe that the county attorney or department of social services agrees with the legislator’s position not because it is correct but rather because the legislator holds budget or appointment authority over them and they are afraid to disagree.
6. Second, looking beyond mere perception, there is an unacceptable risk that representatives of the county attorney’s office or of the county department of social services will in fact compromise their independence and adjust their positions in a neglect or abuse proceeding to conform to the legislator’s recommendations or views as attorney for the child in a particular case. That is, there is a real risk that the county attorney’s office or the county department of social services, in deference to the county legislator’s status, will agree with the legislator either to curry favor and secure the legislator’s budget or appointment support, or to avoid antagonizing the legislator and precipitating retaliatory opposition to the budget and appointment requests that those offices must submit for legislative approval.

Conclusion

7. We answer the question in the negative. It is not ethically permissible for a county legislator to accept appointments by the Family Court to serve as attorney for the child in juvenile delinquency, PINS, or neglect and abuse proceedings.

Endnote

1. “PINS” stands for “persons in need of supervision.” (4-10)

Ethics Opinion 845

Committee on Professional Ethics of the New York State Bar Association (10/14/10)

Topic: Lawyer/real estate broker sharing her brokerage commission with lawyers who refer buyers or sellers.

Digest: A lawyer who is also a real estate broker may ethically offer to share her broker's commission with attorneys who refer buyers or sellers to her if either (a) the referring lawyer is not representing the buyer or seller in the real estate transaction, or (b) the referring lawyer is representing the buyer or seller in the real estate transaction but remits or credits the referral fee to the client and obtains the client's informed consent to the potential conflict arising from the referral fee.

Rules: 1.0(a) 1.7, 1.8(f), 8.4(a).

Facts

1. An attorney has recently decided to work as a real estate broker, but has not given up her New York law license. She desires to advertise that she will pay a percentage of her broker's commission to attorneys who refer buyers or sellers to her. In the past, she has received similar letters from other attorneys, but she is unsure if it such offers are ethically acceptable.

Question

2. May a licensed lawyer who is also a real estate broker (but is acting solely as a broker in any real estate transaction) ethically advertise that she will share her broker's commission with attorneys who refer buyers or sellers to her?

Opinion

3. The Committee assumes for purposes of this analysis that (a) the inquiring attorney is functioning solely as a real estate broker, not as a lawyer, in the real estate transactions in question, and (b) if the inquiring attorney offers any legal services in other matters, they will be distinct from the non-legal services which she renders as a real estate broker, and (c) the attorney will comply with Rule 5.7 of the New York Rules of Professional Conduct (the "Rules"), effective April 1, 2009, if it is applicable.

A. Communications to other lawyers are not "Advertisements"

4. As a preliminary matter, an advertisement that an attorney places solely in her capacity as a

real estate broker, with no intention of attracting legal business, is not an "advertisement" within the meaning of Rule 1.0(a) of the New York Rules of Professional Conduct. Rule 1.0(a) provides as follows:

"Advertisement" means any public or private communication made by or on behalf of a lawyer or law firm about that lawyer or law firm's services, the primary purpose of which is for the retention of the lawyer or law firm. It does not include communications to existing clients or other lawyers.

5. Here, since the purpose of the inquiring attorney's communications offering to share her brokerage commissions is not "the retention of the lawyer" as a lawyer, the broker's communication lacks an essential element of an "advertisement" under Rule 1.0(a). Also, the attorney proposes to direct her referral fee offer to other lawyers, and Rule 1.0(a)'s definition of "advertisement" expressly excludes "communications to...other lawyers."
- B. Referral fees to lawyers who represent the buyers or sellers in the transaction
6. The Committee's jurisdiction is limited to interpreting and applying the Rules. The Committee does not render opinions on questions of law, and thus does not opine on whether the proposed arrangement violates any statute or regulation. If the proposed arrangement violates any state or federal law or regulation, it perforce would be unethical. N.Y. State 667 (1994); N.Y. State 595 (1988); N.Y. State 576 (1986). For purposes of this opinion, however, the Committee assumes, with respect to substantive law outside the Rules of Professional Conduct, that an attorney lawfully may accept a share of a real estate brokerage commission, that a real estate broker may lawfully pay a share of her commission to a lawyer as a referral fee, and that the proposed arrangement otherwise is legal.
7. Rule 8.4(a) provides that a lawyer shall not "violate or attempt to violate the Rules of Professional Conduct, [or] knowingly assist or induce another to do so...." We therefore focus our analysis on whether another attorney's receipt of the referral fees that the inquiring attorney proposes to pay would violate the Rules of

Professional Conduct. If so, then the inquiring attorney's payment of such fees would "assist or induce another" (the receiving lawyer) to do so.

8. This Committee has often opined that a lawyer cannot act as a lawyer in the same transaction in which a lawyer acts a real estate broker because of the possible conflict between the client's interest and the lawyer's own personal interest. *See, e.g.*, N.Y. State 752 (2002); N.Y. State 493 (1978); N.Y. State 340 (1974); N.Y. State 291 (1973); N.Y. State 208 (1971). "The rationale is that the broker's interest in closing the transaction interferes with the lawyer's ability to render independent advice with respect to the transaction." N.Y. State 752 (2002). Thus, acting as both a lawyer and broker in a real estate transaction was a nonconsentable conflict under DR 5-101(A) of New York's former Code of Professional Responsibility, which prohibited a lawyer from accepting or continuing employment if the exercise of professional judgment on behalf of a client "will be or reasonably may be affected by the lawyer's own financial, business, property, or personal interests, unless a disinterested lawyer would believe that the representation of the client will not be adversely affected thereby and the client consents...."
9. The successor to DR 5-101(A) is Rule 1.7(a) (2), which prohibits representation if a reasonable lawyer would conclude that "there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests." This prohibition applies in the circumstances before us unless, per Rule 1.7(b)(1) and (b)(4), "the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client" and the client gives "informed consent, confirmed in writing."
10. In this Committee's opinion, under Rule 1.7 it remains a nonconsentable conflict for an attorney to act as both a lawyer and broker in the same transaction. That leads to the question whether a lawyer who could not act as counsel in a real estate transaction may nevertheless receive a share of the broker's commission in that transaction.
11. This Committee opined in N.Y. State 745 (2001) that a lawyer who is disqualified from a matter on nonconsentable conflict of interest grounds may not receive a referral fee for referring that matter. *Cf.*, Nassau County 89-33 (N.Y.L.J., Dec. 4, 1989, at 7, col. 1) (mortgage broker prohibited from paying a commission to an attorney, whom the broker would denominate as an "associate"

broker, if the associate broker would also represent the client in the real estate transaction).

12. Rule 8.4(a) says that a lawyer shall not "knowingly assist or induce another" to violate the Rules of Professional Conduct, so an attorney functioning as a real estate broker is prohibited from paying a referral fee or partial commission to a referring attorney if the attorney-broker knows that the referring attorney's acceptance of the payment would breach these Rules. *See, e.g.*, Nassau County 93-3 (N.Y.L.J., March 28, 1994, at 8, col. 4) (an attorney has an affirmative duty to report the misconduct of another lawyer who has undertaken to act as a lawyer and real estate broker on the same transaction).
 13. Accordingly, under Rule 8.4(a), if the inquiring lawyer/broker knows that the referring attorney will simultaneously represent the buyer or seller in the real estate transaction *and* keep a share of the real estate brokerage commission, the inquiring attorney may not share her brokerage commission with the referring attorney.
- C. Referral fees to lawyers who represent buyers or sellers in the transaction but remit or credit the referral fee to the client
14. The next question is whether a lawyer/broker may properly pay referral fees where the attorney receiving the referral fee is (or will be) acting as a lawyer for the referred brokerage client in the same real estate transaction *but* the receiving attorney agrees to remit or credit the referral fee to the client.
 15. In N.Y. State 753 (2002), we explained the rationale for the ban on an attorney serving as both a real estate broker and a lawyer in the same real estate transaction: "a lawyer should not have a personal stake in the advice rendered, and the broker who is paid if the transaction closes cannot be fully independent in advising the client as a lawyer." If the lawyer receiving the referral fee will remit or credit the full amount to the client, that will largely remove the receiving attorney's "personal stake" but it will not entirely negate the potential for conflict. Even if the lawyer remits or credits the referral fee to the client, the attorney will still have an incentive to refer real estate clients to a broker who pays a referral fee (*i.e.*, shares her commission) because the referral fee (in effect a reduced real estate brokerage commission) will enable the attorney to offer potential clients a reduced brokerage fee (or an equivalent cash payment or credit) for utilizing the attorney's services, thus attracting more business to the attorney.

16. In N.Y. State 682 (1996), we noted that our prior opinions have allowed an attorney to receive a referral fee from providers of non-legal services or products for referring clients if (a) the client consents after full disclosure, (b) the legal fee and the referral fee together do not constitute an excessive fee for legal services, and (c) the attorney remits the referral fee to the client if the client so requests. In these opinions, the referral concerned a product or service that was “fairly uniform among providers” and either was (1) “required in an objectively determinable quantity incident to the legal services performed by the attorney” (e.g., a mortgage and title insurance in connection with a real estate transaction), or (2) was “unconnected with any particular legal services” (e.g. certificates of deposit). These conflicts were consentable because “the fungible nature of the products or services and the objectively determinable amount at issue insulate the client from any ill effects from the attorney’s conflicting interest.”

17. On the other hand, N.Y. State 682 also noted two prior opinions stating that the attorney’s receipt of a referral fee or other financial interest in a transaction with the client was “absolutely forbidden” where the interests of the attorney and client were in such direct conflict that a client could not give meaningful consent to the conflict transaction. The conflict in those opinions was that the attorney’s remuneration “varied according to the quantity of the product or service...purchased by the client, which was itself based upon the attorney’s legal advice....” See N.Y. State 682 (1994) (investment advice); N.Y. State 671 (1994) (life insurance); N.Y. State 619 (1991) (life insurance). The prospect of a commission might tempt the attorney to give the client different (and inferior) legal estate planning advice due to the attorney’s financial interest. Thus, N.Y. State 682 explained and extended the analysis in N.Y. State 671 as follows:

[N]o meaningful consent is available to permit an attorney to retain life insurance referral fees. The services of an investment advisor, similar to life insurance carriers, vary substantially among different providers. Also like life insurance, the amount of the product or services required—i.e., the amount of money entrusted to the investment advisor—is not objectively determined by the transaction, presenting the potential that

the attorney might increase the referral fee by recommending that more of the client’s funds be entrusted to the advisor without appropriate regard to the client’s interests....

Accordingly, disclosure and consent would not cure the direct and substantial conflict between the client’s and lawyer’s interests inherent in accepting a referral fee from the investment advisor, even where the client is offered the choice to claim the referral fee and the attorney purports to exercise independent judgment in framing his or her initial recommendation to consult an investment advisor. Clients view recommendations of other professionals as part of their representation by their lawyers, and expect that lawyers will act as trusted fiduciaries in such matters.

18. We think the present situation—real estate brokerage—falls somewhere in between “fairly uniform” products and services like title insurance and certificates of deposit (where receiving a referral fee in connection with client work is routinely consentable as long as the referral fee is remitted to the client), on the one hand, and highly variable products and services like life insurance and investment advice (where receiving a referral fee is nonconsentable even if the referral fee is remitted to the client), on the other hand. While the quality of real estate brokerage services varies among providers, the services are “required in an objectively determinable quantity incident to the legal services performed by the attorney” because a client typically employs only one broker per transaction, commissions are relatively standard, and the size of the broker’s commission depends on the price of the home the client purchases. Moreover, although a referral fee gives the lawyer a financial incentive to refer a client to that particular broker even if the fee is passed on to the client, clients are generally aware that they have many real estate brokers to choose from, and clients are generally capable of evaluating different brokers.

19. Therefore, this Committee believes that a real estate lawyer may ethically accept a referral fee with the client’s informed consent, including a reminder that the client is free to choose a

real estate broker other than the one her lawyer recommends. (“Informed consent” is defined in Rule 1.0(j) to include the lawyer’s communication of “information adequate for the person to make an informed decision,” including “the material risks of the proposed course of conduct and reasonably available alternatives.”) As a corollary, a lawyer/broker may pay a share of her commission to a lawyer who refers a buyer or seller if the referring lawyer obtains her own client’s informed consent and remits or credits the commission to that client.

20. There is one more step. The lawyer/broker (the inquirer here) must confirm that the referring attorney will remit or credit the fee or commission to the client. This should be readily ascertainable and does not threaten privileged communications between the referring lawyer and her client. However, because of practical difficulties and the danger of intruding on the attorney-client relationship, the lawyer/broker need not confirm the referring attorney’s compliance with the disclosure and consent requirements. (This point is further explained below in the last paragraph before our conclusion.)

D. Referral fees to lawyers who do not represent the referred clients in the transaction

21. The final question is whether a lawyer/broker may properly pay referral fees to an attorney who refers clients on real estate transactions in which the referring attorney will *not* be representing the client. We are not aware of any New York ethics opinion addressing this precise issue, but several other jurisdictions have considered whether a lawyer may generally accept a referral fee from a person providing a non-legal product or service to a referred client. The results have been inconsistent. Many of the conflicting authorities were collected in Pennsylvania Opinion 2000-100, 2000 WL 567996, which concluded as follows:

[T]he Rules permit a lawyer to accept a referral fee from a service provider, provided that the lawyer is scrupulous in determining under the particular circumstances that payment of the referral fee will not impact the lawyer-client relationship or the lawyer’s exercise of independent professional judgment and that the client consents to the arrangement on the basis of full disclosure and consultation.

22. In N.Y. State 764 (2003), this Committee approved an attorney’s acceptance of an earnings credit against bank charges based upon balances held in the attorney’s IOLA account as long as the attorney made full disclosure to the client and obtained the client’s informed consent, even though the earnings credit “may well influence the attorney’s decision as to where client’s trust funds should be deposited, and that decision would have a direct and adverse financial impact upon the client if an IOLA account is chosen.” The Committee’s conclusion was based on the language of former DR 5-107(A)(2) and EC 2-21. That language is now contained, with little change, in Rule 1.8(f), which provides, in relevant part, as follows:

A lawyer shall not accept... anything of value related to the lawyer’s representation of the client, from one other than the client, unless:

- (1) the client gives informed consent;
- (2) there is no interference with the lawyer’s independent professional judgment or with the client-lawyer relationship; and
- (3) the client’s confidential information is protected as required by Rule 1.6.

23. We believe that N.Y. State 764 remains applicable under Rule 1.8(f). Thus, assuming that the requisites set forth in Rule 1.8(f) are met, a lawyer attorney may ethically accept referral fees or commissions from non-legal service providers in matters where the lawyer is not representing the client.

24. As a real estate broker, an attorney generally is not ethically obligated to affirmatively monitor the details of compliance of the attorneys from whom the lawyer/broker receives referrals. In particular, the lawyer/broker is not expected to monitor whether referring attorneys make full disclosure to, and obtain informed consent from, their clients. Ordinarily, therefore, it would not be a violation of Rule 8.4(a) for the inquiring attorney to offer and pay referral fees to attorneys for client referrals if the referring attorneys will not actually be representing the clients in the real estate transactions at issue.

25. However, an attorney cannot ignore obvious violations, *see*, Rule 1.0(k) (“knowledge may be

inferred from circumstances”), so if the inquiring attorney knows that a referring attorney has *not* obtained informed consent from that client regarding the referral to the lawyer/broker, then the lawyer/broker should (a) withhold the referral fee until the referring attorney cures the violation, or (b) refuse the referral, or (c) take other appropriate remedial steps so that she does not assist another lawyer in violating the Rules of Professional Conduct.

Conclusion

26. Because the inquiring attorney is still a licensed attorney, Rule 8.4(a) prohibits her from assisting another lawyer in conduct that would violate the Rules of Professional Conduct. Accordingly, whether the inquiring attorney may share her real estate commissions with referring attorneys depends on whether the referring lawyer would be violating the Rules by accepting the referral fee.

27. An attorney is prohibited from simultaneously representing a client in a real estate transaction and receiving a portion of the brokerage commission (*i.e.*, a referral fee) from a real estate broker to whom the attorney refers a client, unless the attorney remits or credits the referral fee to that client. An attorney functioning as a real estate broker (such as the inquiring attorney) is therefore prohibited from knowingly paying a referral fee or sharing a commission without confirming that the commission will be remitted, or equivalent credit given, to the referring attorney’s client.

28. However, an attorney functioning as a real estate broker is not prohibited from paying a referral fee or sharing her real estate commission with an attorney who refers her clients to the lawyer/broker if the referring attorney will not be representing the client in the real estate transaction at issue.

(12-10)

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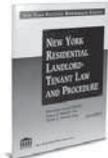
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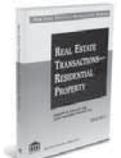
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ISSN 0733-639X ISSN 1933-8422 (online)

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