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REPORTING IMPORTANT OPINIONS OF THE COURT OF APPEALS
AND IN SPECIAL SITUATIONS OF OTHER COURTS

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PLENARY ACTION VERSUS ARTICLE 78 PROCEEDING

DIVIDED COURT ALLOWS PLENARY ACTION BY MBIA INSURANCE'S POLICYHOLDERS TO CONTEST INSURANCE SUPERINTENDENT'S APPROVAL OF MBIA'S RESTRUCTURING

The defendants (Ds) were MBIA Inc. and some of its subsidiaries. Afflicted by the recent tremor in the world's financial markets, they sought a family restructuring and got it from New York's superintendent of insurance (S). Huge sums were transferred from MBIA Insurance, one of the subsidiaries, to MBIA Inc., the parent, which then transferred much of it to MBIA Illinois, another sibling, with various consequences. The consequence motivating this suit, by the policyholders of MBIA Insurance, is that they saw themselves deprived of a solvent insurer. They brought a plenary action against the whole clan under New York's Debtor and Creditor Law to set aside the transfers as made in fraud of creditors. A divided Court of Appeals upholds the suit in *ABN AMRO Bank, N.V. v. MBIA Inc.*, ... N.Y.3d ...., ... N.Y.S.2d ...., 2011 WL 2534059 (June 28, 2011; 5-2 decision).

Since the transfers were all apparently part of the plan submitted to S, and were approved, the case poses right at the outset the peculiarities of (1) an action to set aside a fraudulent transfer despite the seeming approval of the transfer by the state agency charged with oversight of the industry involved, and (2) the use of an action instead of the prescribed Article 78 proceeding to overturn an administrative determination. Defendants argued (and the dissent agreed) that the remedy sought here was reserved strictly to the Article 78 proceeding.

In an opinion by Judge Ciparick citing the broad and general jurisdiction of the supreme court, the Court answers that Article 78 in these circumstances is not preemptive; hence it rejects Ds' argument that the suit is an "impermissible collateral attack" on S's approval. (One might of course ask whether restricting relief to Article 78 is in any way a diminution of supreme court's jurisdiction, since the Article 78 proceeding is itself brought in the supreme court.)

The Court saw as a defect that S did not give notice of the administrative proceedings to policyholders and similarly interested parties, who hence had no opportunity to be heard on proposed steps that could undermine their interests.

The Court comments that S's determination was based only on the MBIA submissions. The dissent, by Judge Read, counters that S reached his determination of approval only after an extensive investigation; that he was not "simply a passive recipient" of the MBIA information. The dissent's view is that if there were any deficiencies in S's fact findings, the policyholders could show that within an Article 78 proceeding, thereby helping establish the arbitrariness needed to secure relief under that article. The majority disagree, concluding that claims of this nature cannot be "properly raised and adjudicated in an article 78 proceeding".

The plaintiffs may have had second thoughts about whether they should also have brought an Article 78 proceeding because they did bring one, but only after Ds moved to dismiss the plenary action. (The proceeding is still pending, not allowed, for whatever reason, to impede the progress of the action or this appeal.)

The format of a plenary action now being upheld, the case must proceed to the merits. The merits, of course, are all about the transfers and whether there was any consideration for them, whether there was any fraud involved, any contract breached, etc. The plaintiffs argue, for example, that there was no consideration for transfers made from MBIA Insurance, which ended up with MBIA Illinois. The defendants (and the dissent) counter that there was, in that MBIA Illinois then picked up MBIA Insurance's obligations to its policyholders, and with MBIA Illinois assets made available to back them.

None of that is actually adjudicated here, however, because, as it has so often done in the past, CPLR 3211(a)(7) alights on the scene to require no more than a finding that a prima facie case has been made out by the plaintiffs. If it has been, the Court's course is just to sustain the claims as a matter of pleading and let all else abide a trial on the merits. And that's what happens.

What lessons? On the merits, for the reasons stated, none, at least not yet. But procedurally there's at least one lesson. We may conclude that despite the disagreement between majority and dissent about whether Article 78 can effectively adjudicate the substantive objections raised by the plaintiffs, it would have done the plaintiffs no harm to bring the proceeding, if not alone, then along with the action. If the mechanics of the two devices are incompatible, as witness the unique procedure that Article 78 prescribes for the proceeding (see CPLR 7804), then the complainants' dilemma can be resolved by commencing the two devices (action and proceeding) separately, each in conformity with its applicable practice – thus placating the purists – and then moving to consolidate the two.

Such a consolidation is permissible (see Siegel, New York Practice 5th Ed. § 128), although it, too, will doubtless vex the purists. (A purist has been defined as a person who takes great pains, and gives them to you.)

With the features of both an action and proceeding now permissibly merged, there would be no difficulty in trying issues like whether the MBIA Insurance plaintiffs were denied due process or otherwise denied statutory or common law rights. Those issues would be unambiguously triable under the aegis of the action. It's arguable that the Article 78 proceeding would also suffice for that (see Siegel, id., § 569), but if all it could be allowed to do is decide whether failing to offer all parties a hearing was arbitrary, leading to nothing more than an annulment of the administrative determination but barring any more adjudication than that, then the companion plenary action, still part of the consolidated scene, could then take the stage and offer its unambiguous power to try and adjudicate all issues.

Bottom line: bringing the action and proceeding together, or bringing them separately and then getting them consolidated, still seems the best policy.

OTHER DECISIONS

CHILD NEGLECT

Proof Only of Fact Father Was Convicted as SORA Level Three Sex Offender Does Not by Itself Establish Neglect of His Children

SORA stands for Sex Offender Registration Act, a criminal statute under which the father in this case was convicted of second degree rape by having sex with a person less than 15. He was sentenced to a year in prison and, when then released on time served, returned to his home and five minor children. The county then filed this neglect petition against him.

Section 1012(f) of the Family Court Act defines a neglected child as one under 18 "whose physical, mental or emotional condition has been ... or is in imminent danger of becoming impaired" because of a parent's failure to supply "a minimum degree" of supervision or by inflicting or allowing harm or the risk of harm to the child.

At the neglect hearing, the county offered only the fact of the conviction; no other evidence, not even the evidence underlying the conviction. On that record, the Court of Appeals holds that the county failed to prove neglect. *Matter of Afton C.*, 17 N.Y.3d 1, ... N.Y.S.2d .... (May 5, 2011).

The Court has not had much occasion to consider domestic violence and neglect cases. Perhaps its major entry into the field in recent years is its 2004 *Nicholson* decision (Digest 541), in which it reviewed the proof needed to remove a child from a home because of domestic violence in it. Now, in an opinion by Judge Ciparick, the Court sees the *Nicholson* holding as indicating the deficiency of the record here in *Afton*, involving neglect.

The Court perceives two requirements for a neglect finding. First, there must be proof of actual or imminent harm to the child, and, second, a showing that the "impairment, actual or imminent, [is] a consequence of the parent's failure to exercise a minimum degree of parental care". Neither requirement was satisfied by the mere introduction of the rape conviction here, the Court explains.

It holds that the conviction does not even create a presumption pointing to neglect. It acknowledges that the father did not seek treatment for his sex problem, but holds that, even so, we

> reject any presumption that an untreated sex offender residing with his or her children is a neglectful parent ... [e]ven where, as here, the offender's crimes involve victims younger than 18.

Judge Graffeo writes a separate concurrence to stress that the defect in this case was the county's over-reliance on the rape conviction alone to prove its case. The implied suggestion is that with a little more attention to detail, a case could have been made out. She therefore doubts that the Court's holding "will have broad precedential value", but what it does is "highlight the need for an adequate evidentiary basis before a finding of neglect can be entered".

ACTION AGAINST SCHOOL BOARD MEMBER

Statute of Limitations Applicable to Member of School Board for Breach of Duty Is Six Years under CPLR 213(7)

That's all the Court of Appeals decides in *Roslyn Union Free School Dist. v. Barkan*, 16 N.Y.3d 643, ... N.Y.S.2d .... (May 3, 2011), and it affects – unhappily – a school board member who sat for only a year and was not shown to have participated in, or in any way benefitted from, any of the massive thefts going on by district officers before, during, and after her one-year service. But she was on the board during that time, and hence chargeable with breach of fiduciary duty to the school district for not probing into the goings-on. Several officials were implicated, and found guilty, in the theft of some $11 million from the school district between 1998 and 2004 and, indeed, sentenced to prison terms for their wrongs, but nothing in the present record implicated the hapless Carol Margaritis (CM), who just served on the board for a year.

This case was not investigating her liability, however. It was considering only the statute of limitations applicable to the claims against her as a board member, and the Court decides, after an extensive review of the history of the relevant statutes, that the period that applies here is not the three years of CPLR 214(4) for an injury to property, as CM argued (and which on the facts would have made the claim untimely), but rather the much more specific CPLR 213(7), which governs an action "on behalf of a corporation against a present or former director [or] ... officer" for, among other things, "damages", and supplies a six-year period. The six years governs and the claim against CM was brought within that time.

Through a process that analyzes several provisions of the General Construction Law – a process that Judge Graffeo, writing the opinion, describes as a distillation – a "corporation" is found to include a "public corporation", a "public corporation" is found to include a "municipal corporation", and a "municipal corporation" is found to include a "school district". So, the specific CPLR 213(7) and its six years controls the general CPLR 214(4) and its three years, and subjects CM to this suit.

But, again, only to make the action timely. The case remains to be heard on the merits, and one must wonder whether CM's one-year service is really going to be a basis for holding her substantively liable to the school district for any part of the stolen $11 million.

As we perused the opinion, we were expecting at any moment a reference to paragraph 11 of CPLR 3211(a), an unusually specific paragraph following the 10 very general ones in this, the CPLR's key dismissal statute. It never materialized. Paragraph 11, added in 1986, was designed to cover only one situation: that in which an uncompensated official of a not-for-profit organization is the defendant and seeks a dismissal of the action based on the absence of gross negligence or harmful intent. Coordinate legislation immunizes such officials from suit unless one or the other of the two elements is present. (See Commentary C3211:34a on McKinney's CPLR 3211.) The purpose is of course to encourage people to seek and serve in these unpaid positions on public boards. The Court does note in passing that

> [t]he filing of a lawsuit by a school district against the members of its school board is certainly a disincentive for attracting qualified candidates to perform this important civic function[,]

but leaves it at that.

The qualified immunity that premises CPLR 3211(a)(11) is apparently unavailable to the board member when sued by the school district itself. (See § 720-a of the Not-For-Profit Corporation Law.) In this case, since the school district is the suing plaintiff, we must at least assume that it considered CM's position carefully before subjecting her to suit (along with the other and presumably guiltier persons). If it didn't, it can expect trouble in enlisting others to serve.

While CPLR 3211(a)(11) is an attempted assurance to board servers on the issue of personal liability, the *Roslyn* case, in treating the statute of limitations, sends a different message: even if the board member ultimately gets off the hook in point of liability, the member will still have incurred the time, trouble, expense – and anguish – of having to defend the action on the merits.

And even acknowledging the different things the statutes work on – CPLR 3211(a)(11) on substantive liability and CPLR 213 and 214 on time limits – couldn't the protective legislative intentions clearly articulated for the substantive statute be taken by analogy to

suggest at least an indulgent choice between the two competing time periods, and to lead to the selection of the shorter one?

SALE OF "GOOD WILL"

When Principal of Firm Leaves It After Its "Good Will" Is Sold to Another Firm, to What Extent Can Principal Participate in Negotiations Between His New Firm and His Client in the Old Firm?

The firms here are all in the financial services industry. Defendant Branin was a principal in firm X, where he became the favorite of client Palmer. Firm X then sold its clients' accounts, including "good will", to the Bessemer firm, the plaintiff here, where Branin worked for a while but then left to join still another firm, Stein Roe.

The law is clear enough that Branin could not actively solicit Palmer for the new firm, but in this case Branin didn't. Palmer had become aware of Branin's change of firms from other sources and it was Palmer who contacted the new firm, Stein Roe, and set up a conference. Claiming that Branin's participation in the conference, with whatever he said at it, constituted a breach of the "good will" that Bessemer had bought, Bessemer sued Branin in a New York court. The case was then removed to the federal district court (diversity of citizenship), which found Branin's conduct a breach of the "good will" sales agreement. The Circuit ultimately got the case on appeal, decided to let this cup pass from it, and sent the issue to the New York Court of Appeals on a certified question.

The question before the New York Court of Appeals in *Bessemer Trust Co. v. Branin*, 16 N.Y.3d 549, ... N.Y.S.2d .... (April 28, 2011), was how much Branin could say at the conference – which the client had initiated – without violating the covenant that New York implies in such circumstances: the covenant "to refrain from soliciting former customers, which arises upon the sale of the 'good will' of an established business", as held by the Court in its 1981 *Mohawk* decision (Digest 256).

An important factor is that Branin never committed not to compete in the financial services field. It was thus clear enough that New York law did not bar Branin from attending the conference. The issue was how much he could say.

New York law governed, accounting for the Circuit's shifting it over. The New York Court of Appeals recites the facts at length but finds itself unable to offer anything more than general principles and remits the matter to the federal court to apply them and decide the case.

One principle recited is that the buyer of an established business, even with good will included, must be prepared for "a certain amount of attrition" – apparently meaning clients leaving of their own accord to renew with their former favorite. Another is that the favored one is free to accept the business of the former customer provided he does not "actively" solicit it.

It is equally clear that the buyer of a firm's good will "is free to negotiate an express covenant" reasonably restricting the "seller's right to compete" in the particular field. We may note here that this case would probably have been easier to decide had such a covenant been part of the sale. But it wasn't, and that poses the how-far-can-the-seller-go issue.

In an opinion by Judge Ciparick, the Court tries to offer as much guidance as possible, but the realm is so heavily fact-dependent that it can do no more than scratch out a few examples. It says, for example, that while the seller can't send the former clients "targeted mailings or make individualized telephone calls" advising of "his new business ventures", he may "advertise to the public", as long as the advertisement

> is general in nature – and not specifically aimed at the seller's former customers – [which] is permissible under New York law.

Of course the seller may not disparage the firm that bought the business, but he

> may answer the factual inquiries of a former client, so long as such responses do not go beyond the scope of the specific information sought.

It's like walking on eggs, but the ultimate walk here is to be taken by the federal courts on remand.

If one lesson of the case is for the "good will" buyer to try to secure a covenant not to compete as part of the sale, we must also note that the law is also unenthusiastic about non-competition covenants, so maybe this would amount to nothing more than a substitution of one set of eggs for another.

POLICE DISABILITY BENEFITS

Even Though Officer Collecting Benefits Lied About Being Disabled, Benefits Could Not Be Terminated Because Only Pension Fund Board Could Do That, and Didn't

Others in the police department did – i.e., the city did – stopping the benefits upon the advice of corporation counsel, but according to a reading of the record by a majority of the Court of Appeals in *Seiferheld v. Kelly*, 16 N.Y.3d 561, 925 N.Y.S.2d 1 (April 28, 2011; 6-1 decision), the trustees of the Fund, the only source that could terminate the benefits, didn't. Ergo, the officer's Article 78 proceeding to overturn the administrative determination that canceled the benefits succeeds.

Officer S, an 11-year veteran, said he fell on ice while on duty and now had constant pain in his shoulder and neck and couldn't continue police work. He was put on disability and was receiving benefits when police investigators now surveillance-taped him doing construction work, and doing it daily, including lifting siding "above his head with both arms extended for some time", and all "without apparent difficulty".

The department reported this to the Police Pension Fund, which said it would "reexamine" S. Despite the complications in the factual background of the case, and whatever proceedings took place involving the Fund and its trustees, a majority of the Court of Appeals in *Seiferheld* finds that the Fund never acted, and it was the only entity that could. In an opinion by Judge Smith, the Court affirms the appellate division, which gave a similar reading. The Court laments the result, acknowledging "the common-sense appeal" of the city's position, and expresses its "distress at the way the system has malfunctioned in this case".

Judge Pigott, the dissenting judge, does not experience this distress because he does not share the Court's reading. He agrees with the reading of the trial judge, who said that the result that S argued for here could not have been intended by the statute.

There was more. Another provision of the city's code, known as the "Safeguards" statute, permits the Fund to put the disability retiree through a periodic reexamination to see if he has improved enough for some "gainful occupation". If he has, this results in his name being placed with preferred status on a civil service list, so as to secure the next available city work opening, with adjustments of disability benefits to take cognizance of the earnings the new city employment would provide.

What happens, though, if S is placed on such a list, and is eligible thereby for city service, but is then found disqualified for it after all because of some other defect, such as in this case, where S was found to have cocaine in his body? The dilemma is that this new ineligibility might suit S just fine, "because he presumably does not want to be offered a city job; he wants to remain retired and receive his pension".

The Court praises the "thoughtful opinion" of the trial judge, which "correctly concluded that this anomaly could not have been intended by the statute's authors", and agrees that this is "a problem the text of the statute does not address", i.e., the problem of S being disqualified from the City employment that the scheme would otherwise award him because of "his own fault" (here the cocaine use).

The Court still navigates to preserving the benefits of the dishonest S, at least to this point. The trip is too unsteady for Judge Pigott, however. Agreeing with the majority that only the Fund trustees could terminate S's benefits here, he disagrees with the Court's conclusion that the trustees didn't and himself concludes from the record that in fact they did.