New York State Law Digest

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

Editor: DAVID D. SIEGEL

New York State Bar Association, One Elk Street, Albany, New York

No. 621 September 2011

TIME TO APPLY FOR DEFAULT JUDGMENT ON COUNTERCLAIM

STRICT APPLICATION OF ONE-YEAR TIME LIMIT OF CPLR 3215(C) DESTROYS COUNTERCLAIM OF DEFENDANT WHO CUT THINGS TOO CLOSE

A plaintiff entitled to take a default judgment against a defendant must apply for it within one year after the default occurs. So provides CPLR 3215(c). Failure to do it within the year results in the forfeiture of the default judgment and – perversely – a default against the defaulter, who escapes liability on the claim without even having to address its merits. (See Siegel, New York Practice 5th Ed. § 294.)

The statute speaks only in terms of the plaintiff's claim, and the defendant's defaulting on it. But what about a counterclaim by the defendant (D), to which CPLR 3011 requires a reply and CPLR 3012(a) requires the reply to be served within 20 days? Does CPLR 3215(c) and its one-year limit also apply to D's obligation to seek a default judgment against the plaintiff (P) if P fails to reply during the period allowed?

It does, holds the Second Department in *Giglio v. NTIMP, Inc.*, 86 A.D.3d 301, 926 N.Y.S.2d 546 (June 14, 2011), which then minutely examines the applicable time elements in the case, with bad news for D. It finds that D missed the year by just a few days and holds the counterclaim "abandoned" under the terminology of CPLR 3215(c). "Abandoned", "barred", "forsaken", "lost" – whatever it's called. D just ain't got it no more.

Concentrating only on this time-to-take-default issue in *Giglio* – which involved other issues as well – what are the dates involved? As finally found by the appellate division, they're these:

The service of the answer containing the counterclaim was made on P on May 2, 2007. The reply time was 20 days, but because the answer was served by mail, the 20 became 25 days under the five-day extension for mail service allowed by CPLR 2103(b)(2). That means that service of the reply was required no later than May 27, 2007, and since P served no reply, P was in default as of the day after: May 28, 2007.

When did D at last seek the default? Not until June 5, 2008, when it served its motion papers applying for a default judgment. That was more than a year later, and hence too late – a default by D for not taking a timely default against P.

This was only a tentative loss for D, however. The court could still excuse D's lateness if D could show "sufficient cause". CPLR 3215(c) says so explicitly. But what that means, holds the court, is the usual two-pronged requirement of an excuse for the lateness and a showing of a meritorious position on the merits. The court finds D to have shown neither, so the tentative loss now becomes an actual one.

In an opinion by Justice Dillon, the court sums it up that

> [W]here, as here, a party moving for a default judgment beyond one year from the date of default fails to address any reasonable excuse for its untimeliness, courts may not excuse the lateness and "shall" dismiss the claim pursuant to CPLR 3215(c).

OTHER DECISIONS

"EMPLOYEE PROTECTION PROVISIONS"

EPPs Contained in Bid Solicitations for School Transportation Contracts Are Subject to "Heightened Scrutiny" in Court Because Potentially Anticompetitive on Their Face

That's in contrast with the "rational basis review" that would ordinarily be applied by the courts in determining whether to uphold the contents of an agency's bid solicitations on a public project. Here in *L&M Bus Corp. v. New York City Dep't of Education*, 17 N.Y.3d 149, 927 N.Y.S.2d 311 (June 14, 2011), the project was the busing of public school students. Some two dozen aggrieved bus companies, in an Article 78 proceeding, contested a number of the bid requirements put out by the city's Department of Education (DOE).

On most of the requirements, the Court of Appeals finds a "rational review basis" to be the criterion, and the burden to be on the companies to show that the DOE's per-rider-per-day pricing scheme lacked that basis. The companies failed in that burden with the result that the Court upholds the DOE's inclusion of a number of provisions, such as those that gave DOE the power to periodically alter rules in a "Contractor's Manual", to delete schools without adjusting the contractors' unit prices, and to require contractors to service newly added schools at the original unit price bid. It also upheld the DOE's inclusion in the bid specification of a 2% discount for payments made within 30 days of invoicing. Under the statutory (General Municipal Law § 103[1]) mandate, that all contracts for public work be awarded to the "lowest responsible bidder", these incidents are found rational enough for the courts to defer to the DOE's decision to include them.

On one notable aspect of the bid requirements, however, the Court finds the ordinary "rational review basis" inapplicable and that a "heightened scrutiny standard" instead

kicks in. That it does with the employee protection provisions (EPPs) that the DOE included in the solicitations. And under that standard, the burden of proof shifts to the agency to show that the EPPs are designed to save the public money. DOE failed to show that.

An EPP establishes a "master seniority list" applicable to the employees of an existing contractor when the employees lose their jobs because a new contractor has stepped in, i.e., when there's been a "reassignment" of busing contracts. The EPP requires that contractors give priority in hiring to the existing employees. This provision is found to be "atypical" of such contracts, and atypicality – if we may coin a phrase – is the element that invokes the "heightened scrutiny" test. So the Court of Appeals holds in an opinion by Chief Judge Lippman.

The Court sees a parallel between EPPs and PLAs – "Project Labor Agreements". As it explained in its 1996 *New York State Chapter* decision (Digest 440), a PLA limits a contractor's powers of labor negotiation, but will be upheld if found to advance the purposes of competitive bidding – mainly to save the municipality money. Similarly here, with the EPP, but it is the DOE's burden to show how an EPP can save money.

Among the reasons that the Court finds the EPPs to be "atypical" is that the DOE

> has not pointed to any other municipality in the nation that has imposed a requirement that successor contractors retain the employees who were laid off when the previous contractor lost the bid at the same salary and benefit levels that the predecessor contractor provided.

An EPP is therefore "unique", and for that reason, says the Court, invokes the "heightened scrutiny" standard.

The Court enumerates the various ways in which EPPs, like PLAs, can have "anticompetitive consequences", notably in how they affect contractors and their economic motivations to participate in the bidding.

CONSTRUING INSURANCE EXCLUSIONS

Word "Benefit" in Homeowner's Policy Is Found Ambiguous on Subject of Exclusions and – Business as Usual! – the Insurer Loses

When there's the slightest ambiguity in an insurance policy, the policy is construed against the insurer. That's a rule of long and deep application, seen again as recently in the Court of Appeals as its 2009 *Pioneer Tower* decision (Dig 595), which cites and quotes in turn from its 1984 *Seaboard* decision (Digest 304). We now have another case for this historic pile, in which ambiguity carries the day – against the insurer. The latest is *Cragg v. Allstate Indem. Corp.*, 17 N.Y.3d 118, 926 N.Y.S.2d 867 (June 9, 2011).

Kayla, a three-year old, drowned in the pool of her grandparents, with whom Kayla and her mother lived. The father – the plaintiff (P) in this declaratory action against the

insurer (D) – lived apart. The grandparents had a homeowner's policy with D under which Kayla and her mother were clearly insureds. P, with his separate residence, was not an "insured" under the policy.

An exclusion under it – i.e., what might have qualified as an exclusion if it had not been ambiguous – said that we (the insurer)

> do not cover bodily injury to an insured person ... whenever any benefit of this coverage would accrue directly or indirectly to an insured person.

P became administrator of Kayla's estate and brought an action against the insureds to recover damages for Kayla's wrongful death (which damages P is entitled to in his own right as a wrongful death distributee) and for damages for Kayla's conscious pain and suffering (which go to Kayla's estate, which P represented). Did the insurer have to defend that action? Pointing to the exclusion clause, the insurer said no. Pointing to the ambiguity in the exclusion clause, the Court says yes, and holds that the obligation to defend is itself a "benefit" under the exclusion clause.

The clause excludes coverage whenever a "directly or indirectly" insured person enjoys a policy benefit? In an opinion by Chief Judge Lippman, the Court discusses the point, analyzes the resolutions offered by both sides, even discussing how the clause came about, and decides at last what it might as well have decided at first: that the clause is ambiguous and that the insurer must lose. So D must defend and indemnify the insureds in P's pending action against them.

As we started to read *Cragg* and its quotation of the relevant clause in the policy, the clause seemed ambiguous to us. We might even say reassuringly ambiguous, since a finding of ambiguity always shortens the search for a winner and spares the court (and us) further effort.

In the pantheon of honored precepts, a Rule Against Ambiguities should be installed, commemorating for the insurance industry what the Rule Against Perpetuities has consecrated for estates practice. And the homage of eternal uppercasing should then be mandated for both.

RELEASING EVEN FRAUD CLAIM

If P Is Aware That D Is Concealing Important Business Data, and Nevertheless Releases "All Manner" of Claims Against D, P Can't Then Argue That a Fraud Claim Survives the Release

That's the gist of what the Court of Appeals finds P to be attempting here in *Centro Empresarial Cempresa S.A. v. America Movil*, 17 N.Y.3d 269, ... N.Y.S.2d .... (June 7, 2011), involving several background complications.

There were many parties involved in this dispute involving telecommunications companies. The gist of the controversy as we perceive it is that in 1999 plaintiffs

(collectively P) got defendants, including D-1, to invest in one of the companies in an agreement that gave P a minority interest and D-1 a 60% interest. Among D-1's obligations were to "manage accounting, tax, and record-keeping" and furnish periodic financial statements to various parties, including P.

As time went by, P repeatedly asked for but didn't get these statements from D-1 and was aware that D-2, a related defendant, "falsely represented" the financial weakness of a key company involved. Instead of probing further, P agreed to sell its units at a stated price, and signed with the defendants an agreement, called a "Members Release", releasing "all manner of actions" and making no exception for fraud claims.

Since P was aware of D-1's failures to provide it the requested data, P was on notice of possible fraud when it signed the release. But in this action P now sought to plead fraud to get out from under the release.

That it can't do, rules the Court of Appeals in an opinion by Judge Ciparick. Aware that P "lacked a full picture" and that

> the relationship between the parties had become adversarial, yet [P] failed to condition the release on the truth of the information supplied by [D-1], obtain representations or warranties to that effect, or insist on viewing additional information.

A release, holds the court, may encompass even "unknown fraud claims" if the agreement is knowingly made, as the Court finds this one to be. Listing the five requirements needed to establish a fraud claim, the Court finds P unable to satisfy them, notably failing – on the facts of this case – to establish "justifiable reliance" on any of D-1's representations.

A "Master Release", executed by the parties at the same time the "Members Release" was, does explicitly exclude fraud claims. P argued that that exclusion should be read into the "Members Release" as well – the release involved here – but the Court rejects the invitation. "If anything", says the Court, contrasting the two releases, "the explicit exclusion of fraud claims from the Master Release suggests that the Members Release is not so limited".

P's argument of a fiduciary relationship with D-1 doesn't avail P either. All of these parties were big, and sophisticated, and represented by counsel, and a

> sophisticated principal is able to release its fiduciary from claims – at least where, as here, the fiduciary relationship is no longer one of unquestioning trust – so long as the principal understands that the fiduciary is acting in its own interest ....

In short, concludes the Court, quoting from its 2010 *DDJ Management* decision (Digest 608), this is yet another instance in which plaintiffs "have been so lax in protecting themselves that they cannot fairly ask for the law's protection".

We may observe that once again sophistication does a plaintiff in. P would have been better off as a simpleton in this phase of the dispute.

REPUTATION EVIDENCE

"Community" in Which Witness's Reputation for Veracity Is at Issue Can Be Witness's Own Family

When a witness's reputation for honesty is at issue, it centers around the witness's reputation in the "community". For that purpose the cases have considered as "community" such places as the witness's residence area, school, business or work community, military base, etc. But how about just among the family? That qualifies, too, holds the Court of Appeals in *People v. Fernandez*, 17 N.Y.3d 70, 926 N.Y.S.2d 390 (June 2, 2011; 5-2 decision).

Don't be put off by the fact that this was a criminal case. While most of the cases on the subject over the years have indeed been criminal, the issue can become germane in civil actions cases as well – see Barker & Alexander (West 2001), Evidence § 6:56 – which is our area of responsibility. Hence we report the case here.

The defendant (D), a boy of 17 at the time involved, was charged with sexual misconduct against a child (C), his eight-year-old niece. He lived with his parents, who considered his niece their granddaughter (and vice-versa). The misconduct complained of was alleged to have taken place in D's upstairs bedroom. The complainant was the child herself, 11 at the time of the trial when she testified and virtually the sole testifier on the incriminating allegations. She described D's acts on several occasions while she was visiting at his home. D denied the allegations, and his parents testified that they generally did not allow visiting children to go upstairs.

When D's counsel sought to have them testify as well on C's "reputation for truthfulness among the family", the court barred it "on the basis that the family was not a community for purposes of reputation testimony". The appellate division reversed that, and in an opinion by Judge Ciparick the Court of Appeals affirms the reversal and holds the testimony admissible.

The Court cites its 1980 decision in *People v. Bouton*, 50 N.Y.2d 130, 428 N.Y.S.2d 218, in which it rejected the idea that a community for this purpose is restricted to the witness's "residential neighborhood". It explained that a

> reputation may grow *wherever* [emphasis is the Court's] an individual's associations are of such quantity and quality as to permit him [or her] to be personally observed by a sufficient number of individuals to give reasonable assurance of reliability.

Here the father testified that that he knew C from birth, that his extended family consisted of 25 to 30 people, and that he often heard them talk about C. The mother testified to like effect. That, holds the Court, "more than adequately formed the basis for admitting into evidence further testimony pertaining to [C's] bad reputation for truth and veracity in the community".

The Court notes the distinction made in the area of reputational evidence between reliability, which is "whether a character witness has established a proper basis for knowing a key opposing witness' general reputation for truth and veracity" and the "credibility" of the witness – whether that witness "is worthy ... of belief or is motivated by bias". The "reliability" issue is one of law for the court; if the court decides it affirmatively and the reputation evidence goes in, the witness's credibility on the subject is then a question of fact for the jury to decide.

The dissent, written by Judge Graffeo, contests the majority's decision to count the family as a community, pointing to a number of other state courts that go the other way. The dissent thinks that "a family is too insular and self-interested a grouping to provide a reliable community". That the two potential testifiers on the complainant's reputation in this case were the defendant's parents, says the dissent, creates "a keen danger of blatant bias" and in addition a serious erosion of a child's development when she "eventually discovers that she has been labeled a liar" by her grandparents.

LIABILITY OF INTERNET SERVICE PROVIDERS

CLOSELY DIVIDED COURT UPHOLDS IMMUNITY FOR INTERNET PROVIDER DESPITE ITS ARGUABLY ACTIVE ROLE IN ENHANCING DEFAMATORY MATERIAL

Whether a website provider can be held to account, such as with tort liability, for the defamatory content of a posting it has allowed on its site is a question that has occupied and beset the courts, both federal and state, around the country. The New York Court of Appeals had only a brief involvement with the subject. That was in its 1999 *Lunney* decision (Digest 480), which we reported under the caption "So Far So Good for Internet Providers: By Analogy to Telephone Companies, They're Not Liable for the Content of Messages".

But now we're in 2011, a dozen years later, and there's been a huge growth in the use of the Internet since then, and a concomitant surge of issues generated by the loud clash between our law's devotion to free speech on the one hand and its still existent – but seemingly diminishing – protections for the defamed on the other.

The defamation laws are designed to protect individuals from false, malicious, and damaging allegations, and the web is an irresistible place for the defamer to place those allegations. It's a grand expedient whereby a defamer can reach the public. Caught in

the middle is the website provider. Can it be held liable, and cast in tort damages, for letting a defamation on?

The gist of the law as now applied by the Court of Appeals in *Shiamili v. Real Estate Group of New York, Inc.*, 17 N.Y.3d 281, ... N.Y.S.2d .... (June 14, 2011; 4-3 decision), is that it can't, as long as it essentially does no more than let the material on. But what happens if the site is "interactive" (as this one was) and itself does some rearranging, or adjustment, or editing of the material tendered to it, and in such a way as to suggest that the site itself is on the side of the alleged defamer?

What happens is that the issue explodes, and the courts divide, including the New York Court of Appeals in *Shiamili*, in which the four-judge majority, in an opinion by Judge Ciparick, still finds the website immune, while a three-judge dissent, written by Chief Judge Lippman, sees the line of protection passed. Based on the plaintiff's (P's) allegations in the complaint, which have to be taken as true for the purpose of disposing of this motion to dismiss at the threshold, the dissent would uphold P's suit.

The area involved was rentals and sales in the New York real estate market. P owned a company in business in that market. He claims that the defendants defamed him with accusations of anti-semitism and other damaging allegations, and included among the defendants not just the individuals claimed to be at fault, but also a company that operated the website, or "blog", which was aimed at the same business market. Is the website liable?

It wouldn't be if it just posted the matter tendered. But P says – and the dissent agrees – that it did much more than that. It edited the material, placed it under a heading of "weekly dose of hate", and added, among other things, a "traditional image" of Jesus Christ with P's face and captioned it "King of the Token Jews" – a reference to the defendants' claim that P kept one "token" Jew on his staff to placate Jewish landlords whose business they sought.

The Court still holds the action against the website company barred by the federal Communications Decency Act (47 U.S.C. § 230), which it finds to have been enacted in response to a New York lower court case that took a stricter view of such website tampering and sustained charges against the site. It's the publisher of the defamation who is liable for it, and the Act states that no provider of an "interactive computer service" shall be considered a publisher "of any information provided by another".

Quoting from the Fourth Circuit's 1997 decision in *Zeran v. Am. Online, Inc.*, 129 F.3d 327, which it terms a "seminal" case in this field, the Court sees the website's acts here in *Shiamili* as merely the "exercise of a publisher's traditional editorial functions – such as deciding whether to publish, withdraw, postpone or alter content". It then quotes from yet another federal case, *Blumenthal v. Drudge*, 992 F.Supp. 44 (D.D.C. 1998), which holds that the statute's immunity extends even where the service provider takes an "aggressive" part in making available content that was prepared by others.

The majority view here in *Shiamili* dismisses the image as merely "satirical". The dissent says that this amounts to a trivializing of the site editor's acts, which it sees as "endorsing the truth" of the accusations against P, and even as an effort "to instigate additional attacks" against P. The dissent says that what the website did here was help "develop" the wrongful allegations, which is conduct the dissent sees as excepted from the immunity the federal act would otherwise provide.