New York State Law Digest

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

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RETRIEVING DELETED ELECTRONIC DATA

FIRST DEP'T REVIEWS STEPS FOR RETRIEVAL IN CASE WHERE DISCLOSURE IS SOUGHT FROM NONPARTY

The First Department finds in *Tener v. Cremer*, ... A.D.3d ...., ... N.Y.S.2d ...., 2011 WL 4389170 (Sept. 22, 2011), its

> first opportunity to address the obligation of a nonparty to produce electronically stored information (ESI) deleted through normal business operations.

The court digs into the subject and determines that it was wrong for the lower court to deny the motion by a plaintiff (P) to punish the nonparty for contempt for disobedience of a subpoena seeking the ESI. It remands the case and requires the motion court to make several demanding inquiries before disposing of the motion. On the way, it offers an extensive treatment of the ESI subject in the context of a nonparty's claim that the information has been deleted from its computers. (In its essentials the treatment should apply to parties, too.)

The nonparty here was NYU. P claimed defamation emanating electronically from somewhere in an NYU medical center and was trying to identify the person who initiated it. NYU said that the files that would contain such data were "written over every 30 days" and that NYU lacked the "technological capability or software, if such exists" to retrieve a file more than a year old and "written over at least 12 times".

Equipped with no CPLR instructions but finding some rules on or near the point, the appellate division advises NYU that there is much that has to be done before a simple denial can cancel its obligations. It cites an affidavit from P's "forensic computer expert", for example, dismissing the "written over" argument as "deceptive". The expert said "written over" merely means that the information has been allotted to some "free space", i.e., space not yet allocated in the computer, and that the presumably destroyed data can probably be accessed by an "X-Rays Forensic" or a "Sleuth Kit".

An "X-Rays Forensic" has sometimes been identified as a species of hominid with pointed ears, a green complexion, and a handsome income. (The content of the "Sleuth Kit" is not identified in the opinion but it probably has a special compartment for money.)

Hosting such an expert, NYU – and any other similarly situated nonparty (or even party) – will be interested to know that what it was happy to report as its loss is not necessarily its loss at all: it

may happen that what was thought lost will be found, albeit in this instance more productive of chagrin than relief to the aspiring loser.

While the CPLR is silent on the matters at issue here, the court cites some federal rules by analogy and a New York Uniform Rule that it finds in point. It sees Uniform Rule 202.12(c)(3), dealing with the preliminary conference, as offering sufficient scope, at least by implication, to meet the kind of retrieval problem met here. It also cites even more specific provisions in the rules of the commercial parts of some courts, and it accents especially the so-called "Nassau Guidelines" requiring that at preliminary conferences the parties be prepared to discuss

> identification, in reasonable detail, of ESI that is or is not reasonably accessible, without undue burden or cost, the methods of storing and retrieving ESI that is not reasonably accessible, and the anticipated costs and efforts involved in retrieving such ESI.

More specifically, on the issue of expense when it's a nonparty from which ESI is sought, the court alights on CPLR 3111 and 3122(d) as requiring "the requesting party to defray" the cost.

In an opinion by Justice Moskowitz the court faults P for waiting a year before sending NYU the subpoena (which, incidentally, was accompanied by a letter advising NYU not to destroy any of the data sought and to "halt any normal business practices that would destroy that information"). What weight to give P's delay is also left to the motion court to assess on remand.

A major issue throughout will be "whether the discovery is worth the cost and effort of retrieval", says the court. Here again the Nassau Guidelines are cited as giving the court some flexibility. The present record "is insufficient to permit ... a cost/benefit analysis", so that, too, is left to the motion court.

OTHER DECISIONS

COMMON LAW INDEMNIFICATION

Before General Contractor Is Required to Indemnify Owner for Damages Paid to Injured Person at Construction Site, Showing of Actual Supervision Is Needed; Mere Showing Contractor Was Authorized to Supervise Work Doesn't Suffice

When an owner of premises bears absolute liability, as under Labor Law § 240(1), for an injury sustained by someone at a construction site on the premises, many cases hold that the owner may look to the general contractor – hired by the owner to do the whole construction project – for common law indemnification for whatever the owner is called upon to pay.

There are a host of cases on the subject, many of which we've reported in the Digest, such as the 1991 *Rocovich* case in Digest 387 construing Labor Law § 240(1) and the 1990 *Mas* case in Digest 372 on the obligation to indemnify. These are among the cases cited by the Court of Appeals in its recent decision in *McCarthy v. Turner Construction, Inc.*, 17 N.Y.3d 369, 929 N.Y.S.2d 556 (June 28, 2011), along with a number of appellate division decisions on point. On the specific issue before the Court, it finds inconsistencies among the cases.

The specific issue in *McCarthy* is whether a showing that the contractor has authority to supervise the work is "alone a sufficient basis for requiring common-law indemnification". In an opinion by Judge Jones, the Court holds that it is not; citing its 1997 *Felker* decision (Digest 453), the Court says that "[l]iability for indemnification may only be imposed against those parties ... who exercise actual supervision".

In this case the Court finds that the general contractor, albeit authorized to supervise the whole project, did not; it subcontracted part of the project to X which in turn subcontracted a segment to Y. (It was Y's employee who was injured in a fall from a ladder and whose personal injury action – with various parties sued, impleaded, and cross-claimed – that generated the controversy.) It was the subcontractors who exercised the actual supervision, with the general contractor found by the Court to have no say over how they went about their work.

The Court offers a precis of its decision in the following statement towards the end of the opinion:

> Thus, if a party with contractual authority to direct and supervise the work at a job site never exercises that authority because it subcontracted its contractual duties to an entity that actually directed and supervised the work, a common-law indemnification claim will not lie against that party on the basis of its contractual authority alone.

Situations like this appear in large numbers. Under the rule as now enunciated in *McCarthy*, the parties will doubtless focus more than ever on the facts relating to supervision, with each gunsight – trained on the most solvent of those along the contractor/subcontractors line – seeking out any shred of conduct that might pass as "supervisory".

In a footnote the Court comments that "[n]o claim for contractual indemnification is before us", only a claim of common law indemnification. Hence a contract with terms direct enough is left as a possible source of indemnification in similar cases in the future.

Absent such airtight contract protection, the only way for any entity on a construction project to truly protect itself is with an insurance policy that covers all possible contingencies – or one that contains at least some wholesome ambiguity that enables the courts to resolve it against the insurer. (Resolving ambiguities against the insurer is virtually an avocation in the courts, as most recently displayed in the *Cragg* case in Digest 621 last month.)

MONITORING MENTAL HEALTH SERVICES

Motion by Mentally Ill Jail Inmates to Extend City's Obligation to Supply Post-Discharge Services Is Found Timely

An action was brought by mentally ill plaintiffs, discharged from jail after incarceration, against the defendant (collectively, New York City), for declaratory and injunctive relief to compel what the plaintiffs deemed to be constitutional and statutory obligations to provide "discharge planning" services for them, consisting of varied benefits including among other things medical treatment and housing.

The action was settled in an agreement that contained a commitment by the defendant to provide "discharge planning" for five years and called for the appointment of monitors to oversee the defendant's duties.

The agreement stated that it would terminate five years after the beginning of monitoring unless the plaintiffs could show, before the termination, that the defendant failed in its duties, in which case the plaintiffs could ask the court to extend the agreement for an additional two years. The plaintiffs did try to show that the defendant was guilty of such a failure and did seek the two-year extension. The question was whether the plaintiffs sought it prior to the termination of the five-year period, which depended in turn on when the period began.

On that narrow but decisive issue the Court of Appeals divides 4-3, the majority, in an opinion by Judge Graffeo, holding that the plaintiffs applied in time and the dissent, in an opinion by Judge Pigott, saying that they applied too late. By one vote, the plaintiffs prevail. *Brad H. v. City of New York*, 17 N.Y.3d 180, 928 N.Y.S.2d 221 (June 28, 2011).

The majority holds on all the facts that the agreement did not terminate until May 25 or 26, 2009. The plaintiffs made their application – consisting of their filing a motion for a temporary restraining order and a preliminary injunction – on May 22, 2009, which was under the wire by a few days and hence timely. On the issue of when the monitoring started, the majority holds that it could not in any event be deemed to have started prior to the implementation date.

The dissent says it could; it reads the agreement as contemplating steps prior to that date which it considers as "monitoring", including steps to prepare to carry out the required discharge planning. The dissent sees the five years as running from those steps, and concludes on that measure that the five years had expired by the time the application was made and that it was therefore too late.

COMPETITIVE BIDDING

Town Board Can't Reject Low Bidder Based on Criteria Not Stated In Bidding Proposal

We had a comparative bidding case last month, the *L&M Bus* case in Digest 621. Now we have another, *AAA Carting and Rubbish Removal, Inc. v. Town of Southeast*, 17 N.Y.3d 136, 927 N.Y.S.2d 618 (June 9, 2011; 5-2 decision).

The bidding here in *AAA* was for the town's trash collection. The bid set forth the criteria and three of the bidders – each with a different bid – met the criteria. Instead of awarding the contract to the lowest bidder (L), however, the town board awarded it to the second lowest bidder (S) based – the Court of Appeals finds – "on criteria not contained in the bidding proposal". So doing was barred by § 103 of the General Municipal Law and by § 122 of the Town Law, the Court holds, and was arbitrary and capricious. L's Article 78 petition setting aside the award is therefore granted.

Both statutes specify that all public works projects must be awarded to the "lowest responsible bidder". The bid proposal in this case listed the requirements to be met by the bidders. Three bids came in that met the requirements: L's, the lowest and S's, the second lowest. (The third, from the holder of the previous contract, was the highest and hence out of the running.)

After the bids were in and the town board was reviewing them, it decided to consider additional "qualitative factors" not listed in the bid request, such as S's conducting monthly training meetings and safety inspections and "regular alcohol and drug screening of its employees". L protested that such things were not in the bid request and that it "could have provided information regarding these criteria had it been requested to do so".

The Court agrees with L. Finding the added "qualitative" factors to be "subjective" – and not contained in the bid request – it says it was improper for the board to consider them and concludes that

> [a] contract subject to the competitive bidding statutes must be awarded to the lowest responsible bidder who fulfills the specifications contained in the proposal. In this case, it was [L].

In an opinion by Judge Ciparick, the Court reviews the purposes of competitive bidding and explains that allowing the board to consider additional – and unspecified – criteria "effectively circumvents the open bidding process".

The Court stresses that the board was not barred from adding criteria it deemed appropriate to consider, but the proper remedy "is not to reject the lowest responsible bid, but to reject all the bids submitted and begin the process anew".
The two-judge dissent, written by Judge Pigott, protests that the conclusion really reached by the board was that L "was not a responsible bidder". It says that under the Court's holding

> contractors will be able to obtain public work simply by bidding low and vowing to comply with bid specifications. The result will be that municipalities will often be forced to accept shoddy work by unprofessional contractors the only virtue of whom is that they are cheap.

The dissent also considers it "impractical" to insist that all criteria on responsibility "be specified in the bid request".

ANOTHER CHOICE OF LAW JOURNEY

NEW YORK COLLISION BETWEEN ONTARIO BUS AND PENNSYLVANIA TRAILER GENERATES MULTIPLE PERSONAL INJURY AND WRONGFUL DEATH CLAIMS – AND ISSUES

We ordinarily try to formulate a headline that reasonably summarizes the decision we're about to digest. But as Casey Stengel once said in a different context, sometimes that's not always possible.

It's not possible in the June 30, 2011, Court of Appeals decision in *Edwards v. Erie Coach Lines Co.* (and five companion cases) reported in 17 N.Y.3d 306, 929 N.Y.S.2d 41 (5-2 decision), a massive exercise in choice of law in a situation with a number of plaintiffs on one side and a number of defendants on the other, all involved in a multi-vehicle collision producing the death of some, the serious injury of others, and an alignment of implicated jurisdictions each with its own interests to protect.

The accident took place in upstate New York when a bus and its passengers, with all Ontario contacts, struck the rear end of a shoulder-parked tractor-trailer with all Pennsylvania contacts. The case is a new classic along the line of choice of law decisions in tort cases started in 1963 with the celebrated *Babcock v. Jackson*, 12 N.Y.2d 473, 240 N.Y.S.2d 743. We've had several occasions to review *Babcock*, perhaps most extensively in our Digest 306 lead note treatment more than 25 years ago of *Schultz v. Boy Scouts of America, Inc.*, 65 N.Y.2d 189, 491 N.Y.S.2d 90 (1985). In between came the 1972 decision in *Neumeier v. Kuehner*, 31 N.Y.2d 121, 335 N.Y.S.2d 64. And later was the 1993 *Cooney* decision (Digest 400). All four cases figure in -*Edwards*.

The choice of law rule before *Babcock* was the rule of lex loci delictus, under which the law of the place of the injury governed just about all issues even in tort cases with foreign elements. That made things simple, but *Babcock*, deeming it too often unfair, abandoned it in favor of what is known today as the "interest analysis" approach. Under that standard the issues in each case with foreign elements are parsed and to each issue is applied the law of the place having – in the

court's perception – the most substantial interest in its resolution. In *Babcock*, this resulted in the application of New York's law allowing a passenger-guest to recover from a driver-host because both were New Yorkers even though the accident occurred in a place (Ontario) that had a "guest-host" statute that would have barred such a recovery.

The guest-host issue thereafter appeared so often in New York cases involving foreign law that the New York Court of Appeals afterwards took the unusual step – almost legislative in character – of formulating a three-item list with an instruction about whose law to apply to a given combination of contacts in guest-host cases. This it did in the *Neumeier* case. The Court in *Edwards* now reviews the list, which has since been used as a guidepost in cases involving other (than guest-host) issues as well. The first two *Neumeier* listings have categorical answers on specific fact patterns. When neither applies, number three kicks in, which says that the lex loci rule should once again obtain, unless there's some special reason for displacing it on the particular facts.

Edwards is an issue-by-issue and person-by-person analysis to determine the law that is to apply to each choice of law question. It's largely if not entirely an application of number three on the *Neumeier* formulation, the item that applies when the contacts don't lend themselves to the more disciplined categorization in the first two.

The Court repeats a distinction made in earlier cases between "loss-allocation" rules and "contact-regulating" rules. The latter are concerned with regulating comportment within the state's borders before any accident occurs and hence the law of the place of the occurrence applies to govern such issues as speed limits, lane minding, stop signs, turn options, etc. – the usual rules of the road. Loss-allocation rules, on the other hand, which include such things as guest-host statutes and statutory limits on damages, come into play only after the accident. These are the ones that prove most challenging in a choice of law analysis.

In an opinion by Judge Read, the majority in *Edwards* says that "the correct way to conduct a choice-of-law analysis is to consider each plaintiff vis-a-vis each defendant", as was done in the *Schultz* case. The dissent, in an opinion by Judge Ciparick, sees this as creating "additional unpredictability and lack of uniformity in litigation that arises from a single incident" and would evaluate the case instead "under a single *Neumeier* analysis", giving the law of New York in *Edwards*, as the situs of the accident, the continued role that the third *Neumeier* formulation intended situs law to retain.

Those are the tools of the inquiry. We withhold the results of their application because the discourse would preempt the whole Digest – and because we don't want to reveal what some (including the dissent) might deem their surprise endings.

CREDITOR'S ATTEMPT TO GET AT DEBTOR'S MARITAL MONEY

MARITAL PROPERTY CAN CONSIST OF MONEY OBTAINED BY FRAUD, BUT UNKNOWING SPOUSE RECEIVING SUCH FUNDS IN DIVORCE SETTLEMENT IS INSULATED IF FOUND TO HAVE GIVEN "FAIR CONSIDERATION" FOR IT

There are two questions in that, each of them certified by the Second Circuit to the New York Court of Appeals in *Commodity Futures Trading Commission v. Walsh*, 17 N.Y.3d 162, 927 N.Y.S.2d 821 (June 23, 2011; 5-2 decision).

The first involves a construction of the equitable distribution statute, § 236 of the Domestic Relations Law, and is answered yes by the Court with no dissent: fraudulently received funds can be deemed marital property. Motivated by special concerns applicable to these issues in the context of marital rights, the Court says that

> [t]o hold that the proceeds of fraud acquired by one spouse unbeknownst to the other cannot be subject to equitable distribution or conveyed through a settlement agreement as marital property would undermine one of the fundamental policies underlying the equitable distribution process, namely finality ... [and] effectively undo court orders and settlement agreements ....

The Court of course acknowledges that an entirely different situation would be presented if both spouses "participated in or were aware of the fraud" or other illegal conduct, but that's not the case here. It also stresses that it's money that's involved here, which can't be traced like a piece of "identifiable stolen property, such as a piece of artwork" (which even a good faith purchaser for value may be compelled to return to the rightful owner).

So the first question gets a quick answer: fraudulent funds can be deemed part of the marital estate.

The second and more difficult question turns on a construction of § 278 of the Debtor and Creditor Law, which bars the creditor (from whom the money was fraudulently taken) from seeking it back from a purchaser who gave "fair consideration without knowledge of the fraud". That was the key issue in *Walsh*.

The defrauder here was husband H, charged with stealing $550 million from funds he and his partner (who confessed to the theft) managed for various institutional investors. The plaintiffs are several agencies seeking to recover the money, and among those from whom they sought "disgorgement" was H's wife, W, who ended up with a good deal of the stolen money through the marital settlement she made with H (afterwards made part of a divorce decree).

A key fact is that W was innocent of any complicity in or awareness of the fraud, establishing her good faith. The open issue was whether she furnished "fair consideration" for what she got. She asked the Court to regard as "fair consideration" several things she said she gave up as her part of the equitable distribution settlement.

In an opinion by Judge Graffeo, the Court holds that several of these things may indeed be found by a court to qualify as "fair consideration" under the statute, including a "release of a claim of maintenance", an adjustment of child support obligations, and a "waiver of inheritance rights". Even "child custody or visitation concessions" can figure. Whether any of these things can be found present in this case, and the extent to which they may be found to qualify as "fair consideration" under the statute, must be determined by the federal courts on remand. Under § 272 of the Debtor and Creditor Law, the Court says that the facts and circumstances of each particular case must determine.

The two-judge dissent, written by Judge Pigott, assumes from the record that "the marital estate consists almost entirely of the proceeds of fraud" and sees W as offering as her major item of "consideration" a willingness to forego any future claim to that money. To the dissent, that's not "fair consideration"; it's just an agreement to relinquish a claim to a still greater share of the fraudulent proceeds.

An innocent recipient like W, incidentally, from whom disgorgement is sought, is called a "relief" defendant, an eccentric use of the word to say the least: among the things W got out of the settlement was (1) a $7.5 million residence, (2) $5 million in cash, (3) a distributive award of $12.5 million, and (4) a reasonable assurance that she will not soon be needing any public assistance.

One might also suggest that when even an innocent person has received so great a bonanza, a fairer alternative to letting the spouse keep everything would be to let the defrauded parties have at least part of it back. It would be hard for any court of law to work that out without specific legislative instruction, however, including some kind of formulae, and there's no such guidance available. The point did not even arise in *Commodity*.