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

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"SOPHISTICATED" ENTITIES CONTRACT RIGHTS AWAY

Two LLC Sponsors Have No "Fiduciary" Claim Against the Third Because They Signed Contract Disclaiming Reliance on the Third's Representation

The agreements in this case -- there were several -- strike us as eccentric by any standard. But agreements they were, and their collective contents are at the root of this action by two of the signers (Ps) against the third (D), interposing several claims against D. The salient one is breach of fiduciary duty.

A limited liability company was formed to lease a Manhattan building. The original investments in the LLC were $50,000 for D and $50,000 and $25,000 respectively for the plaintiffs. D later bought out the two plaintiffs' interests in the LLC for $1 million and $500,000. A handsome profit for them. About a year after that, D made a handsomer deal for himself that enabled him to assign the lease to a company for $17,500,000. That's what brought the lawsuit. Plaintiffs claim that when D bought them out he had already "surreptitiously negotiated" the bigger deal.

The circumstances of the arrival of that $17,500,000 lease would lead any observer to suspect chicanery of some kind, built at least in some measure on a charge of breach of fiduciary duty by D against the two plaintiffs. But the key thing to the Court in this case, *Pappas v. Tzolis*, 20 N.Y.3d 228, ... N.Y.S.2d .... (Nov. 27, 2012), is that the plaintiffs, when they agreed to D's buy-out, were already on such notice as would impel them to make further inquiry. "The need to use care to reach an independent assessment" of what the value of the lease would be at that point, says the Court, "should have been obvious to plaintiffs, given that [D] offered to buy [and in fact bought] their interests for 20 times what they had paid for them just a year earlier".

Breach of fiduciary duty was indeed a major part of the plaintiffs' claims, but the Court holds that they forfeited it by signing -- at the time of the buyout -- an agreement with D reciting that D "has no fiduciary duty" to plaintiffs. Both sides were "sophisticated entities", the Court finds; their relationship was not one of trust and hence the plaintiffs could not "reasonably rely on the fiduciary without making additional inquiry".

The test to be applied, holds the Court in an opinion by Judge Pigott, is

> whether, given the nature of the parties' relationship at the time of the release, the principal is aware of information about the fiduciary that would make reliance on the fiduciary unreasonable.

The Court finds the plaintiffs' purported reliance in this case unreasonable because "plaintiffs were sophisticated businessmen represented by counsel" and "at the time of the buyout, the relationship between the parties was not one of trust".

What can really stand some investigation in cases like this is the meaning of "sophisticated" and the

significance of being advised by "counsel". Isn't one being "sophisticated" enough when he sells a year-old investment for some 20 times its worth? If the law says that such an increase in value by itself puts you on notice that there may be even more that's being concealed, does it put counsel to the burden of warning about it? And in this context what kind of counsel are we talking about? Legal counsel? Financial counsel? Psychiatric counsel?

In the face of the law's misgivings about sophistication, the guileless may be licking their chops. This deserves looking into.

* * *

The Plague of "Sophistication"

Pappas is only the latest example of the crushing label of "sophistication". We've had many cases over the years in which a party's excuse for its conduct has been rejected on the basis that the party was "sophisticated". Once considered a compliment, and elsewhere perhaps still, in judicial decisions "sophisticated" has become a handy epithet indicating that whatever the party did, it should have known better. Instead of its historic flattery as an honorific, it now comes on to warn the honoree that it's about to lose its case.

Outside the courthouse a party hearing himself described as "sophisticated" might puff up with pride and pleasure. Even strut a bit. Inside, however, the word produces apprehension.

The *Pappas* case, above, is just the latest entry. It has a host of precedents.

In *Wallace* (1995, Digest 434), for example, the loss emanated from the terms of what was described as an instrument drawn "between sophisticated, counseled business people negotiating at arm's length". And in *Chemical Bank v. Meltzer* (1999, Digest 474), a bank got bamboozled after being found "a sophisticated creditor".

We can easily turn to more recent examples, such as *JMD Holding* (2005, Digest 547), where the bamboozling went to "sophisticated and well represented business people". And *EBC* (2005, Digest 549), where the shaft went to parties a dissent described as "sophisticated" and "counseled".

Then, in *Deutsche Bank* (2006, Digest 559), a "sophisticated institutional trader" was held subject to New York longarm jurisdiction after entering the state electronically. (Serves it right. You won't find an unsophisticated person sneaking into New York through the cyberspace.)

There are so many more illustrations, and in so many other contexts. In *Hoffend* (2006, Digest 562), for example, "a sophisticated commercial entity" was faulted and did not get the insurance coverage it said it bargained for. And in *Madison* (2006, Digest 566), sophisticated parties with counsel lost out on a guaranty issue in a lease dispute.

When the meek have at last inherited the earth, they're likely to find huge tracts already inhabited by the simple-minded.

Any message? Sure. If you're on the last lap of an appeal, be sure you wash off all signs of sophistication along the way. The Court has this hound dog up there -- nothin' but a hound dog -- but he can sniff out a sophisticate at 1500 yards.

OTHER DECISIONS

LABOR LAW 241(6)

Condo Does Not Have Labor Law Liability for Injuries to Repairman in Individual Unit; Co-Ops Distinguished

This is not a "scaffold" law case. That category, governed by Labor Law § 240(1), is relevant whenever a worker's injury results from the elevated nature of the work being done. It appears frequently in Court of Appeals cases and it's a big prize if the worker can get it, because it imposes absolute liability on owners and contractors for elevation-related on-the-job injuries.

Also offering absolute liability is Labor Law § 241(6), a less frequent appearer in the Court's cases but the major player in this one, *Guryev v. Tomchinsky*, 20 N.Y.3d 194, 957 N.Y.S.2d 677 (Dec. 11, 2012; 4-2 decision).

Under § 241(6), the absolute liability is imposed when a regulation prescribing specific on-the-job protections is violated. In this case the alleged violation occurred under Rule 23-1.8(a) of the Industrial Code, which requires the furnishing of eye protection when the work may endanger the eyes.

The plaintiff in this case, the employee of a company hired to renovate a unit in a condominium, was injured when a nail gun he was using "ricocheted and struck his eye". The nature of the injury satisfied the statute and regulation; the question was whether the condominium itself was an owner under it. A divided Court of Appeals, in an opinion by Judge Read, says it was not.

In the sense used under this Labor Law statute and regulation, the owner is the one who has the individual unit involved, in this case family T, who hired the contractor. (The owner was itself exempt from the Labor Law liability because the statute excludes the owners of one-family units, which the Court says an individual condo is the equivalent of.) The Court distinguishes condo boards here from co-op corporations which, it notes, "have been held to be owners potentially liable under the Labor Law" when a worker is injured while working in one of the co-op's apartments.

The dissent, written by Chief Judge Lippman, sees condominiums and cooperative corporations as equivalents in the sense used in these Labor Law provisions. It also points out that the condo's board here reserved to itself "certain prerogatives of ownership" in that any individual unit's alterations were subject to the board's approval, which could be withheld "in the Board's sole and absolute discretion"; that the board "reserved to itself plenary power to veto the unit owner's choice of contractors".

In view of the board's retention of the right to approve renovation plans, the dissent finds "[p]articularly significant" that part of the unit/condo agreement which requires that the work "shall be performed strictly in accordance with ... all applicable laws, ordinances, orders, rules, regulations and requirements". The Court labels these reserved powers "proprietary" -- aspects of ownership and hence, under the Labor Law, "non-delegable", citing its 1991 *Rocovich* decision (Digest 387).

The dissent finds the majority opinion in *Guryev* inconsistent with the worker-protective purposes behind the Labor Law statutes. As a result of the Court's holding, it laments, a construction laborer injured while working in a condominium unit

> now has no Labor Law cause of action against the unit owner by reason of the single dwelling exemption, no claim against his contractor employer by reason of the [exclusivity of the] workers' compensation [remedy], and no statutory claim against the condominium because it is not the title owner of the unit.

The majority might rejoin that the availability of workers' compensation, made the exclusive remedy as against the injured worker's employer, is enough, an argument frequently put forward. But with the Labor Law provisions, the legislature clearly aimed to offer the injured worker more. As the dissent points out, however, the worker will get no more in this case.

STATE LIABILITY

State Not Liable for Capsizing of the Ethan Allen on Lake George; No "Special Duty" Found

Twenty were killed and still others injured in the accident.

The state concededly used "outdated passenger weight criteria" in its certification of the vessel. Before the accident the weight per passenger was set at 140 pounds, which the state now increased to 174 pounds. But this case, like several similar ones the Court has handed down in recent years, falls into the "special duty" category, application of which leaves all of those suffering damages in the Ethan Allen tragedy without a remedy. *Metz v. State*, 20 N.Y.3d 175, ... N.Y.S.2d .... (Nov. 29, 2012).

There are a plethora of cases applying this narrow rule of governmental tort liability. The Court expounded on the "special duty" theory in its 2009 *McLean* decision (Digest 593). Building on still earlier cases on the subject, the Court stressed in *McLean* the requirement of a showing of "a special duty to the injured person, in contrast to a general duty owed to the public" -- language borrowed from its still earlier (1983) *Garrett* decision (Digest 280) -- before state liability could attach.

The *McLean* opinion opened with the Court's statement that once again

> we confront a case in which a failure by government to do its job has caused harm, and once again we hold that this is not one of the few cases in which such a failure subjects the government to tort liability.

Metz, which produces the same result, may as well have opened with the same statement. So might the even more recent (2011) *Valdez* decision (Digest 624), in which the Court found no "special duty" owing by a city to an assaulted victim merely because the police said it would arrest the culprit "immediately".

In the *Metz* case, the Navigation Law required a governmental certificate of inspection, including the number of passengers safely accommodatable. The claimants pointed to the state's failure to properly execute that certification duty, but so abundant are the state-favoring precedents in this realm that yet another stepped in to answer this argument specifically. That's the Court's 1983 *O'Connor* decision, which accompanied *Garrett*. *Metz* quotes *O'Connor*:

> [I]n the absence of some special relationship creating a duty to exercise care for the benefit of particular individuals, liability may not be imposed on a municipality for failure to enforce a statute or regulation.

The existing remedies for violations of safety standards are more criminal in nature -- penalties and the like -- the Court points out, and the legislature has yet to offer "a private right of action against the State". This legislative refusal is "deliberate", concludes the Court in *Metz*. In an opinion by Chief Judge Lippman, the Court laments that

> [a]lthough the law is clear, the upshot is that, regardless of any negligence on the part of the State, the victims of this disastrous wreck are essentially left without an adequate remedy.

The Court suggests that the legislature might require "marine protection and indemnity insurance", for which there are proposals pending. Had there been such here, the Court comments, the insurance "might have been able to provide [at least] a modicum of relief".

CIVIL SERVICE REINSTATEMENT

County and Town Are Both Reproached After Argument Over Who Has Initiative to Resolve Dispute Over Whether Town Is Entitled to Copy of County's Medical Report

Both the County of Westchester and the Town of Eastchester surrender some dignity after having "squabbled" for years over a medical report on the fitness of a town employee for reinstatement to his position. He'd been laid off after having been hurt on the job. He had several medical exams, two arranged by the town, which found him unfit to return to work, and one arranged by the county, which found him fit.

Under § 71 of the Civil Service Law, a certification of fitness was for the county to make, but the statute doesn't say to whom the certification must be made. "[R]ead in context", the Court finds that it's to be made to the county agency (its Department of Human Resources). The town, which had refused to reinstate the employee based on its own medical examinations, just wanted a copy of that certification, which had reached a contrary conclusion.

The whole dispute in *Lazzari v. Town of Eastchester,* 20 N.Y.3d 214, ... N.Y.S.2d .... (Nov. 27, 2012; 5-1 decision), was who had to take the initiative in securing a decision over whether the town had a right to a copy. One would think that the town's right to see it was clear enough, but the county thought otherwise. It said that the town would have to seek the copy either through a Freedom of Information Law request or an Article 78 proceeding -- litigation, in other words, because even the FOIL request was likely to be denied in the petulant posture of the county.

In an opinion by Chief Judge Lippman, the Court holds that reinstatement by the town was mandatory because the county's medical exam and certification were what counted under the statute. It faults the town for refusing the reinstatement even though not given a copy of the county MD's report. The Court apparently agrees that the county's refusal to furnish the copy was arbitrary and capricious, and that an Article 78 proceeding would have so held -- as, indeed, it finally does (at Lazzari's initiative, not the town's) -- but that the town could not refuse reinstatement while the proceedings pended. Lazzari gets reinstated, with back pay.

The Court finds "unexplained" the town's failure to use the FOIL, and says

> a bit more common sense and less stubbornness on either side could have avoided years of trouble and expense.

Judge Pigott in dissent goes further. He sides with the town, albeit without congratulations. It was the town that would have to pay for any damages caused by Lazzari after being reinstated to his job without medical justification. In the dissent's view, therefore, "submission of the certification to the Town ... was a condition precedent to the Town's reinstatement of Mr. Lazzari". The dissent describes the county's obstinacy here as "the textbook definition of arbitrary and capricious".

One looking into the whole background of this dispute between two governmental units would probably find potfuls of inflexibility and pettiness, with good faith not present even as a condiment.

EQUAL PROTECTION

After Jury Finding That D Is Sex Offender, Decision About Need for Confinement May Be Left to the Judge

The equal protection clauses of neither the federal nor New York constitutions require that the confinement issue also be left to a jury, holds the Court of Appeals in *State v. Myron P.*, 20 N.Y.3d 206, ... N.Y.S.2d .... (Nov. 20, 2012).

Two articles of the Mental Hygiene Law were involved in the case: Articles 9 and 10.

Article 9's caption is "Hospitalization of the Mentally Ill"; it concerns the mentally ill in general, and a proceeding brought under it requires that a jury hear both "the question of the mental illness and the need for retention" of the patient. (MHL § 9.35.)

The later enacted Article 10 of the MHL, captioned "Sex Offenders Requiring Civil Commitment or Supervision", is directed to sex offenders in particular and leaves the matter of confinement and supervision to the court. The respondent argued that this was an unconstitutional denial of equal protection to the sex offender group. A unanimous Court, in an opinion by Judge Pigott, rejects the argument.

The Court finds in point the language it used in its 2004 *Bower* decision (Digest 536), which said that the essence of the constitutional guarantee of equal protection is "that all persons similarly situated must be treated alike". The issue in *Myron P*. is thus whether the respective groups aimed at by these two MHL articles are alike.

As gauged by the issues involved here, concludes the Court, they are not. MHL § 10.07(f) makes available under Article 10

> two dispositional choices -- either confinement or strict and intensive supervision and treatment -- while under article 9 confinement is the only available disposition. The determination as to the level of danger an individual poses to public safety is inextricably tied to the nature of the treatment and supervision options available. This difference supports the legislature's decision that the confinement determination [of sex offenders] under article 10 is better suited for the court rather than a jury.

Therein lies the basis for a distinction between the two groups -- the mentally ill in general versus the sex offender in particular. The distinction, holds the Court, justifies the different treatment of the two in confinement decisions, and the justification negates the claim of an equal protection violation.

INTEREST ON ESCROW

Contract's Language Prescribing Bank-Rate Interest As "Sole Remedy" Bars Awarding of the Greater Statutory Interest

Among the claims that carry prejudgment interest under CPLR 5001(a) is the ubiquitous claim of damages for breach of contract. And the statutory rate of interest under CPLR 5004 is a straight 9%, a tidy sum these days, when the going rate in business and banking is a great deal lower. Hence, as long as the party against whom the claim exists is solvent and able to pay, a claimant -- assuming the claim prevails in a litigation -- has a handsome and secure investment.

The question the Court of Appeals was called on to answer in *J. D'Addario & Co. v. Embassy Industries*, 20 N.Y.3d 113, 957 N.Y.S.2d 275 (Nov. 19, 2012; 4-2 decision), was whether the parties may substitute their own agreement for interest in displacement of the statutory rules. In an opinion by Chief Judge Lippman, a majority of the Court holds that they may, and that on the facts of *Embassy* they did.

The contract in *Embassy* was for the sale of real estate in which the plaintiff buyer (B) agreed to a sales price of $6.5 million with defendant seller S, the contract providing for a 10% down payment ($650,000) to be held in escrow by S's attorney in "an interest-bearing account" at a named bank. The down payment was made and deposited accordingly. The contract also provided in a liquidated damages clause that in the event the bargain failed, whoever a court deems entitled to the down payment agrees to the "sole remedy" of the amount of it plus bank-accrued interest.

Claiming that S was in breach of the contract for failing to attend to a groundwater problem, B refused to show at the closing date set by S. When B then sued to recover the down payment, S counterclaimed and won. The trial court awarded S the $650,000, but also awarded S the 9% statutory rate of interest. The appellate division kept the victory for S, but modified to cancel the statutory interest. The Court of Appeals agrees, holding that S is entitled to only the bank-account interest as specified in the contract.

The Court's holding is that if the language of the contract is clear enough, it "trumps" CPLR 5001(a), and

the majority finds the language in *Embassy* clear enough.

The dissent, written by Judge Graffeo, does not. The majority's position, as the dissent views it, is that allowing prejudgment interest was in effect adding to the stipulated (bank-rate) interest, an improper disregard of what interest is. The dissent says that the proper way to view interest is as compensation "for the different and distinct wrong of not paying the agreed sum when it was due", which is more consistent with the purpose of interest in the first place: a charge for the use of another's money.

The dissent agrees that "specific terms in the contract excluding prejudgment interest" can supersede the statutory rules, but it "would not infer limitations on statutory interest in generic liquidated damages provisions" like those of the present contract.

The majority notes its 2007 *Manufacturer's* decision (Digest 572), in which it held in an interpleader case that the winning claimant has no right to interest from the loser. Interpleader sounds in equity, where CPLR 5001(a) itself gives the courts broad discretion even as to whether to award interest at all. The present case, involving strictly claims at law, has no equitable analogy to help ground it, but perhaps it can be seen just as a case in which the parties have substituted one category of interest (bank-rate) for the one that would otherwise apply (the CPLR 5004 rate).

The major lesson of the 2007 *Manufacturer's* case is that those escrowing money or depositing it into court should discuss and resolve in advance any issues about interest. *Embassy* advances that lesson into an outright admonition:

> [P]arties should make it a matter of routine to decide in advance whether statutory interest is to be paid on amounts held in escrow. ... [Doing so in this case] would have prevented this litigation altogether.