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ONE ON ONE

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

A Message from the Chair

The past year has been very challenging for the General Practice Section. We have remained focused on problems and concerns of general practitioners, and have strived to bring Section members activities, articles and insights relating to those issues that we deal with on a daily basis. I know that in poor economic times dropping Section membership can save a few dollars. We are aware of this and, through our efforts to keep lawyers interested, we have been successful in retaining our Section membership.

As Section Chair, I occasionally think of the things that we can all do on a macro scale to help us perform better in our day-to-day practices. A well-informed lawyer is a better advocate for his or her clients and nothing enhances good client relationships better than an ethical, knowledgeable and attentive lawyer. I cannot emphasize enough the importance of good client relations, particularly in this economy. Our clients depend on us being knowledgeable about many aspects of the law, even if they fall outside any particular area of specialty. And, that is exactly what we strive for in the General Practice Section. We have representation of your concerns on the House of Delegates. The array of articles we publish in *One on One* is designed to give us a bit of insight into those areas we are familiar with, as well as those with which we might not have famil-

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Inside

NYSBA

iarity. Through the efforts of our Section members and our Executive Committee, we will continue to strive to build the Section with the best interests of our members in the forefront of our activities. Your suggestions are always welcome. We have just had a very successful seminar given by Robert Salzman.

I am also pleased to announce that the Executive Committee has embarked on the formation of two new committees: a Litigation Committee and a Women's Issue Committee. It has come to our attention that there is a need to give attention to these two areas and we need your help to make them a reality. If you are interested in joining one of these two committees, please contact Pam McDevitt at the NYSBA. There are many other committees that will give you an opportunity to be more active with your Section. Please try to join at least one or more of our committees.

I am also happy to report that we have received an increase in response from Section members, and others, wishing to contribute to each issue of *One on One*. Member participation makes all the difference and we look to our membership to keep each issue fresh with up-to-date and current information. We can all learn from what you have to share. We encourage each of you to participate.

Our Annual Meeting of members and educational program was held on January 26, 2010 at the Hilton Hotel in New York. The sessions began at 9:00 a.m. and ended at 12:30 p.m. There was also a vote of the members at that session on important revisions to the By Laws of the Section.

In closing, I'd like to invite each of you to ask a colleague to become a member. In this case, the more the better. Visit our Section on the Web site; it is always being updated with new information on significant cases, laws and Section activities. Help us build our Section. Invite someone you know to join.

I look forward to your future participation. Thank you for your continued support. With your help we will continue to make this one of the most significant Sections of our Bar Association.

Sincerely,
Martin Minkowitz, Esq.

Catch Us on the Web at WWW.NYSBA.ORG/GP

The General Practice Section invites you to browse our Web page for information to help you manage your daily practice of law. One of our primary goals is to enhance the competence and skills of lawyers engaged in the general practice of law, to improve their ability to deliver the most efficient and highest quality legal services to their clients and to enhance the role of general practitioners and to provide a medium through which general practitioners may cooperate and assist each other in the resolution of the problems and issues of practicing law.

Visit our site at www.nysba.org/gp to find out more about: Upcoming Events; Publications and Forms; Articles and Resources; CLE and much more.

From the Editor

With this being only my second issue as Editor, I am completely overwhelmed with the response from members wishing to contribute an article to the *One on One* newsletter. Never before, in such a short period of time, have I come across such an active membership so willing to add to the featured articles presented in each issue. And I am happy to say that, to date, each issue contains more and more information from those members who truly have something valuable to offer for the benefit of the full Section membership.

In addition, I have recently attended an Executive Committee of the Section and each and every committee member was able to contribute ideas on how to enhance the value of the newsletter either with new articles, reoccurring columns and a common Q&A section. We hope to have some of these new ideas featured in our upcoming issues.

Each newsletter is only as good as the information it contains. And the information, to be relevant, needs to come from our members. For each issue to remain fresh, we constantly need to reach out to our membership for new and useful information. I am sure that each one of you comes across some new bit of information daily in your practice. Well, we want you to pass that information on to us…whether it is a suggestion on how to run your business, or a new piece of valuable legislation or precedent.

This issue contains a wealth of information. A sampling includes: *Assisting the Consumer Debtor, Part II: Defenses to Consumer Credit Claims,* part two of a three-part series by Daniel Schlanger, Esq. of Schlanger & Schlanger, LLP; *Who Is Entitled to Life Insurance Benefits and Top-Hat Benefits from an ERISA Plan Following a Divorce or a Marital Separation?* by Albert Feuer of the Law Office of Albert Feuer; *Injury Lawyers Shook Up,* by James M. Odato of the Albany *Times Union* Capitol Bureau, and *A Wholesale Review of the Vendors Endorsement: How It Works and the Priority of Coverage,* by Richard Traub of Traub, Lieberman, Straus & Shrewberry, LLP.

To keep our Section members informed on current articles and issues, we need your continued participation and support and look to each member to share his or her knowledge and experience or to reach out to others you may know who may have an article of interest for our general membership to share.

So, if you are available to participate on one of our committees or as a contributor to our newsletter, whether you are in a corporate office or a private practitioner, we want to hear from you. E-mail me at mcs@thebeaumontgroup.com, or give me a call at 718-892-0228.

I look forward to hearing from you.

With kind regards,
Maria Sclafani
***One on One* Editor**
CEO, The Beaumont Group, Inc.

Assisting the Consumer Debtor, Part II: Defenses to Consumer Credit Claims

By Daniel Schlanger

This article is the second installment of a three-part series which aims to provide the general practitioner with a basic orientation on representing consumers in collection actions. Part I focused on identifying potential counterclaims and third-party claims, particularly those arising out of state and federal consumer protection statutes, such as the Fair Debt Collection Practices Act, 15 U.S.C. §§ 1692 *et seq.*, the Truth in Lending Act, 15 U.S.C. §§ 1601 *et seq.*, and New York General Business Law § 349.

In this installment, I focus on potential defenses to consumer collection actions. I note in this regard that the New York judiciary is, in this author's experience, at something of a crossroads, with many jurists deeply concerned about the routinely sloppy and deficient pleadings churned out by the hundreds of thousands by a handful of collection firms (*Justice Disserved*, MFY Legal Services, Consumer Rights Projects), June 2008, *available at* http://www.mfy.org/Justice_Disserved.pdf.),[1] as well as the typical scarcity of admissible evidence of indebtedness. *See, e.g., MBNA Am. Bank v. Nelson*, 2007 WL 1704618. at *2 (Civ. Ct., Richmond Co.). Indeed, some judges have begun to review these pleadings more strictly even on motions for default. (The most notable of these, no doubt, is Judge Arthur M. Schack of Kings County Supreme Court, who has issued a string of widely reported, and increasingly scathing, decisions denying default judgments in foreclosure actions). Other jurists, however, are more skeptical, and may be motivated by a view, articulated or not, that the consumer is "just trying to get out of it on a technicality."

What follows is not by any means meant to be an exhaustive list of possible defenses. Rather, I merely hope to flag a few key, potentially fruitful issues. One common thread throughout many of these defenses is that their potential stems from the predominant business model for collection of distressed accounts in the United States. Typically, an account that is classified as seriously delinquent is not held by the original creditor, but rather is bundled and sold (and re-bundled and re-sold) on the secondary market. Because these accounts are handled in bulk, are purchased for pennies on the dollar, and are often litigated by assignees focused on taking defaults without proving up claims, it is common for the plaintiff in a collection action to have only a bare minimum of information and even less documentary support at the time the suit is brought. In many instances, the plaintiff cannot access additional information and documentation when challenged. This business model also "sweeps up" large numbers of accounts with significant, substantive problems relating to the underlying account, such as prior payment, or identity theft.

1. Which Statute of Limitations Applies and Has It Run?

The typical consumer collection action is for breach of contract and/or account stated. Pursuant to CPLR 213, these causes of action both have a statute of limitations of six years. As obvious as it sounds, it is critical that the practitioner check with the client regarding the last date on which he or she made a purchase or payment. The practitioner will find that in a significant minority of cases, the claim is time-barred under New York's six-year statute of limitations. The practitioner should note in this regard that statements about "date of last activity," etc. made by the debt buyer or on credit reports are not always trustworthy. In particular, these dates often reflect merely the date the account was purchased by the most recent assignee, not the date that the client made a purchase or payment.

Moreover, practitioners should inquire into the circumstances of the last payment with an eye toward New York's limitations on construing partial payment as a toll on the statute of limitations. Specifically, "[a]s to part payment, the statute will be tolled if the creditor demonstrates that it was payment of a portion of an admitted debt, made and accepted as such, *accompanied by circumstances amounting to an absolute and unqualified acknowledgment by the debtor of more being due, from which a promise may be inferred to pay the remainder," Erdheim v. Gelfman*, 303 A.D.2d 714 (2d Dep't 2003) (citations omitted) (emphasis added).

If the debt is less than six years old, the next question is whether it is subject to CPLR 202, which provides that where a cause of action accrues outside of New York, a non-resident Plaintiff is bound by the shorter of New York's limitations period and limitations period in the state where the action accrued. Accrual is determined by the "place of injury" and, where the damage alleged is economic loss, "the place of injury usually is where the plaintiff resides and sustains the economic impact of the loss." *Global Financial*

Corp. v. Triarc Corp., 93 N.Y.2d 525 (1999). Finally, "the place of residence for the purpose of CPLR 202 is traditionally the state of incorporation or the corporation's principal place of business." *Beana v. Woori Bank*, 2006 WL 2935752 at *6 (S.D.N.Y. 2006).[2]

Taken in combination with one another, these rules regarding application of CPLR 202 provide strong support for shortening the statute of limitations where, as will often be the case, the consumer collection plaintiff is incorporated and/or headquartered in states, such as Delaware, that have a three-year statute of limitations.[3]

Finally, the practitioner should keep in mind that pursuant to the UCC § 2-725, the statute of limitations for a sale of goods is four years, not six. Although this provision will not apply in the typical credit card cases, it may apply in a variety of other circumstances involving the direct sale of goods by a merchant who extends credit. Although the author is unaware of any New York authority directly on point, several courts around the country have applied the UCC's four-year statute of limitations to store cards. *Gimbel Bros., Inc. v. Cohen*, 46 Pa. D. & C.2d 747 (Ct. Com. Pl., Montgomery Co. 1969); *May Co. v. Trusnik*, 54 Ohio App.2d 71, 375 N.E.2d 72 (1977). *See also Globekirk Ltd. v. E.D. & F. Man Coffee, Ltd.*, 123 Misc. 2d 902 (New York County 1984). The courts have yet to fully grapple with the issue of how to apply this rule where the "store card" is set up through a related corporate entity rather than through the retail store that offers the card and provides the goods.[4]

2. Standing

As the Court of Appeals has famously noted, "If standing is denied, the pathway to the courthouse is blocked. The plaintiff who has standing, however, may cross the threshold and seek judicial redress." *Saratoga County Chamber of Commerce, Inc. v. Pataki*, 100 N.Y.2d 801 (2003).

The practitioner should never assume that a Plaintiff other than the original creditor can prove its standing to bring suit. Many Plaintiffs are simply unable to produce any documentation evidencing a chain of title from the original creditor to themselves. *See, e.g., Gemini Asset Recoveries, Inc./Cohen and Slamowitz, LLP v. Portoff*, 23 Misc.3d 139(A) (1st Dep't 2009). Moreover, even where documentation is provided, it is very often sorely lacking. For example, of those Plaintiffs who are able to produce some documentation on this point, a large number will produce a generic assignment that refers to a list of accounts that is not attached, such that there is no evidence that the consumer's account was actually one of those assigned. *See LVNV Funding, LLC v. Delgado*, 24 Misc.3d 1230(A) (Nassau County 2009).[5] In some cases, debt buyers that lack documentation will, when pushed on this issue, opt to dismiss their claims.

Nor is this issue merely a technical one of "making them prove it." Rather, because of the repeated, mass bundling and sale of consumer debts, failure to force a Plaintiff to prove its ownership of the debt leaves a consumer vulnerable to being sued on the same debt multiple times by different alleged "assignee." For this reason, it is important in this author's view to provide for some mechanism in any settlement (whether a hold harmless clause, a liquidated damages clause, etc.) that protects the consumer from future collection activity taken by another entity alleging an ownership interest in the debt.

3. Personal Jurisdiction

As underlined by the New York Attorney General's recent suit against no fewer than thirty-eight collection law firms regarding systemic bad service of process, and the NYAG's criminal indictment of the head of American Legal Process regarding the same issue, New York suffers from massive and widespread "sewer service" problems. *See Pfau v. Forster & Garbus, et al.*, Index No.: 2009-8236, Supreme Court, Erie Co., *Justice Disserved*, (MFY Legal Services, Consumer Rights Projects), June 2008, *available at* http://www.mfy.org/Justice_Disserved.pdf.

As a result, it is all too common that a potential client will not have been properly served and that the Affidavit of Service filed with the court is substantially false. Although this issue most frequently arises in the context of motions for vacatur/relief from judgment (the subject of the third and final installment of this series), it is also commonly arises in scenarios where the consumer gets actual notice via service made upon a relative or neighbor (or by mail only without affixation to his door). *See Saxon Mortg. Services, Inc. v. Bell*, 63 A.D.3d 1029 (2d Dep't 2009) ("actual notice alone will not sustain the service or subject a person to the court's jurisdiction when there has not been compliance with prescribed conditions of service").

Proving service at an incorrect address is hardly an arcane art: The consumer's attorney is looking to present as many convincing indices as possible of the consumer not having lived at the address where service was made (e.g., lease agreements or rent statements regarding the actual address of residence; utility bills; bank statements; etc.). Affidavits from others living at the actual or the served residence may also be useful, as are affidavits from property managers. Where service is alleged upon fictitious "persons of suitable age and discretion," affidavits obviously are crucial.

Unlike most other defenses, simply raising the defense of lack of personal jurisdiction is not sufficient to preserve it throughout the proceeding. Rather, the Defendant who has raised this defense in its Answer must make a motion to dismiss on this basis within 60 days of filing the Answer pursuant to CPLR 3211(e).

(Of course, one may also file a motion to dismiss on this basis in lieu of filing an Answer).

With regard to personal jurisdiction, the practitioner should also be aware that pursuant to CPLR 306-b, an unsuccessful attempt at service does not result in an extension of the 120-day period between filing and service absent "good cause shown or in the interest of justice." *Leader v. Maroney, Ponzini, & Spencer*, 97 N.Y.2d 96, 105 (2001). Plaintiffs who are determined by the court to have failed to serve a consumer thus have no assurance that they will be allowed to re-serve without also re-filing. The end result is that Plaintiff's claims, even if timely originally, may well be time-barred by the time the issue of service is litigated and the case re-filed. *Hafkin v. North Shore University Hospital*, 279 A.D. 2d 68 (2d Dep't 2000). (Crucially, CPLR 205(a)'s tolling provisions explicitly exclude re-filing based upon failure to serve.) It is for this reason that the collection bar routinely asks litigants (including *pro se* litigants) to waive personal jurisdiction in return for any extension of time to answer or any other routine stipulation. For the reasons just described, where there are real issues with personal jurisdiction, such a waiver implicates not only the defense of personal jurisdiction but also the defense of statute of limitations, and cannot be lightly agreed to.

4. Evidentiary Issues

Perhaps because the business model of the collection industry is based on the premise that the vast majority of claims will result in default judgment, creditors are routinely unprepared to prove up the debt. Indeed, with regard to debt buyers (as opposed to original creditors), a Plaintiff will—unless facing a counterclaim—sometimes simply dismiss when pushed for proof.

With regard to credit card collections, the creditor must prove by admissible evidence: "(1) Existence of an agreement between the defendant and the credit card issuer, (2) Issuance of the credit card at the defendant's address, (3) Use of the credit card, and (4) Retention of monthly statements and payments on the account. [Although] [e]ven without a signed application, the absence of the underlying agreement would not relieve a defendant from his obligation to pay for goods and services rendered on credit." *Worldwide Asset Purchasing, LLC v. Akrofi*, 884 N.Y.S.2d 631 (N.Y. City Ct. 2009) summarizing *Citibank v. Roberts*, 304 A.D.2d 901 (3rd Dep't 2003). If the credit card account has been assigned, the assignee must also produce competent proof of assignment. *See, e.g., Citibank (S.D.) N.A. v. Martin*, 11 Misc.3d 219, 807 N.Y.S.2d 284 (NYC Civ. Ct. 2005).

A collection action is, of course, subject to the same standards of admissibility as any other action. Of particular relevance is the standard applicable to the ubiquitous "record keeper" affiant found in most consumer creditor pleadings. These affiants will often have great difficulty alleging "personal knowledge of the operative facts" in any meaningful sense. *David Graubert, Inc. v. Bank Leumi Trust Co.*, 48 N.Y.2d 554 (1st Dep't 1979). Nor will their statements typically be "specific, with concrete particulars, and not merely conclusory." *Bickerstaff v. Vassar Oil*, 196 F.3d 435, 452 (2d Cir. 1998). Moreover, the affiant will routinely allege personal knowledge based on documents without "annex[ing] the documentary evidence to the affidavit," as required. *Watt v. Mark Irish*, 184 Misc.2d 413, 708 N.Y.S.2d 264 (Columbia 2000); *Salas v. Lake of Luzerne*, 265 A.D.2d 770 (3d Dep't 1999).

Crucially, in debt buyer cases, "the mere filing of papers received from other entities, even if they are retained in the regular course of business, is insufficient to qualify the documents as business records" (and thus subject to a hearsay exception). *Rushmore Recoveries v. Skolnick*, 15 Misc. 3d 1139(A) (Nassau Co. 2007) (citing a fairly exhaustive list of evidentiary failures common to collection pleadings), quoting *Standard Textile Co., Inc. v. National Equipment Rental, Ltd.*, 80 A.D.2d 2d 911 (2nd Dep't 1981).

Although, as seen from the citations above, these sorts of evidentiary failings are most commonly found in cases involving assignees, original creditors are by no means immune. Indeed, these same sorts of evidentiary shortcomings have featured prominently in several recent decisions denying arbitration awards sought by the purported original creditor. For example, in *MBNA Am. Bank v. Nelson*, 2007 WL 1704618 (Civ. Ct., Richmond Co. 2007), after discussing why the proffered affidavit failed, the court stated that although it appreciated "the allure that a summary process such as arbitration provides to a large commercial entity that holds hundreds of thousands, if not millions, of contracts for revolving credit,…judicial economy…should not outweigh the alleged defaulter's right to due process." *See also MBNA Am. Bank v. Straub*, 12 Misc.3d 963 (Civ. Ct., N.Y. Cty. 2006).[6]

5. Offsets and Holder-in-Due-Course Status

In reviewing potential affirmative claims in Part I of this series, the reader may have noted that the most powerful federal statutes (e.g., FDCPA, TILA, and FCRA) have markedly short statutes of limitations. Notably, however, there is no statute of limitations regarding these or any other claims where they "ar[i]se from the transactions, occurrences, or series of transactions or occurrences, upon which a claim asserted in the complaint depends" and are made as offsets (i.e., for "recoupment"). CPLR 203(d). Although offsets are, by definition, limited to no more than the amount sought by the Plaintiff, this doctrine can still, at times, be a critical tool in defending consumer claims, especially against abusive debt collectors against whom the statute of limitations has already run.

In addition, as reviewed in Part I, a debt-buyer Plaintiff will typically not be shielded from either the defenses or counterclaims as a holder in due course, *inter alia*, because such a holder must take "without notice that [the obligation] is overdue or has been dishonored…." UCC § 3-302. The practitioner must therefore interview the client regarding the entire history of the transaction, not only the client's interactions with the entity currently alleging ownership of the debt.

6. Last but Not Least: Is It Really Your Client's Debt?

In striving to determine whether or not more "exotic" defenses might apply, the practitioner should not forget to first carefully question the client as to whether he or she truly ever owed the debt. This involves asking the client to elaborate on the circumstances under which any obligation may have been incurred. Examples of substantive, non-liability may include: identity theft; unauthorized credit card use by a family member; unauthorized charges by a merchant; unauthorized charges by a credit card issuer; charges for items subsequently returned; charges for items never delivered, etc. While, as noted at the outset of this article, some jurists are skeptical of the more "procedural" defenses elaborated above, very few are immune to the defense of, "This is not my debt."

Finally, a related point. Just because the principal is owed does not mean that the balance sought by a creditor is proper. The overcharging of fees and interest is all too common. The diligent practitioner should investigate whether the interest rates, charges and fees assessed to the debtor are authorized by any alleged contract between the parties, as well as by law. On this latter point, see, e.g., NY Personal Property Law § 302(7) (the Motor Vehicle Installment Sales Act) (capping attorney's fees at no more than 15% of the amount due) and NYPPL § 413(5) (the Retail Installment Sales Act) (capping attorney's fees at 20% of the amount due, and excluding litigation costs from its list of permissible charges).

Conclusion

Plaintiffs in consumer collection actions are typically not expecting to face a significant and skilled defense. Indeed, as reviewed above, the industry's basic business model is based on herding large numbers of cases through the default judgment process without opposition from counsel familiar with the substantive, procedural and evidentiary defenses reviewed above. Although there are many, many cases in which the size of the claim and / or the relative weakness of the consumer's defenses will severely limit the consumer's (and counsel's) options, there are a large number of consumer collection claims that are feasibly and cost-effectively attacked by the solo or small firm practitioner on a variety of grounds, including those reviewed above.

Endnotes

1. MFY Legal Services's excellent report entitled examined lawsuits brought in New York City Court's by the seven biggest debt collection law firms in 2007 and reported astonishing findings: These seven collection firms filed *180,177* cases last year in New York City courts, constituting almost one-third of all the civil cases filed (excluding landlord / tenant and small claims). Notably, *consumers only appeared in 8.5% of these cases.*
2. The question of how to apply CPLR 202 where a non-resident Plaintiff alleging economic injury is headquartered in foreign state and incorporated in another is not settled, although sound policy considerations mitigate in favor of applying the shorter of the two non-New York limitations periods implicated.
3. It is unadvisable, however, to rely principally upon the Delaware choice-of-law provision found in many consumer credit agreements, as there is significant recent authority for the principle that (unlike the majority of states) New York considers the statute of limitations to be a "procedural" issue not determined by contractual choice of law provisions. *Portfolio Recovery Assoc., LLC v. King*, 55 A.D. 3d 1074 (3d Dep't 2008). The flipside, of course, is that this same line of cases holds that a creditor is not entitled to rely on a contractual choice-of-law provision to gain the benefit of another state's longer statute of limitations. *Education Resources Institute, Inc. v. Piazza*, 17 A.D. 3d 513 (2d Dep't 2005) (Plaintiff not entitled to use of Ohio's 15-year statute of limitations despite contractual Ohio choice-of-law provision).
4. The practitioner should also be aware of the Federal Communications Act, which provides a much shorter, two-year statute of limitations for actions brought by carriers. 47 U.S.C. § 415(a).
5. The problems Plaintiffs face are even more severe as applied to cases involved the bundling and sale of mortgage-backed securities. A slew of New York cases have invalidated last ditch attempts by such Plaintiffs to meeting the requirements of standing via "back dated" assignments, assignments executed without proper corporate authorization or power of attorney pursuant to RPL § 254(9), etc. *See US Bank v. Merino*, 16 Misc. 3d 209 (Sup. Ct., Suffolk Co. 2007); *US Bank v. Bernard*, 18 Misc. 3d 1130(A) (Sup. Ct., Kings Co. 2008); *US Bank v. Kosak*, 16 Misc. 3d 1133(A) (Sup. Ct., Suffolk Co. 2007); *see also Deutsche Bank Nat'l Trust Co. v. Clouden*, 851 N.Y.S.2d 57, 2007 WL 2709996, *4; *Wells Fargo Bank, N.A. v. Farmer*, 2008 WL 2309006 (Sup. Ct., Kings Co. 2008).
6. The *Nelson* court emphasized that a petitioner "must tender the actual provisions agreed to, including any and all amendments, and not simply a photocopy of general terms to which the credit issuer may currently demand [of] debtors." *Nelson* at *7. The court noted that the credit card agreement referenced by Petitioner lacked, not only a signature, but "any name, account number or other identifying statements which would connect the proffered agreement with the Respondent in this action." *Id.* The court found "these deficiencies of proof [to be] fatal." *Id.* at 8.

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The author wishes to acknowledge and thank associate David J. Fryman, J.D. (Fordham Law School, 2009) for his significant research assistance on this article.

Who Is Entitled to Life Insurance Benefits and Top-Hat Benefits from an ERISA Plan Following a Divorce or a Marital Separation?

By Albert Feuer

The extent, if any, to which a participant's spouse or former spouse is entitled to the participant's employee benefits is often an important issue in divorces and marital separations. Benefit entitlements of ERISA plans,[1] i.e., pension plans and welfare plans (which include life insurance plans), are determined by the terms of those plans.[2] ERISA plans generally need not follow state court orders.[3] On the other hand, state courts frequently issue domestic relations orders ("DROs") pertaining to such benefits. ERISA plans must follow the designation terms of those DROs which are qualified domestic relations orders ("QDROs").[4] Questions have been raised about whether life insurance plans and top-hat plans (which are pension plans maintained primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees)[5] must follow the designation terms of a DRO that "satisfies the QDRO requirements," but contradicts a designation made pursuant to the plan terms.[6]

ERISA § 206(d)(3), 29 U.S.C. § 1056(d)(3) sets forth the QDRO requirements. Subparagraph (A) requires certain pension plans to follow the designation terms of a QDRO. Subparagraph (B) requires that a QDRO be a DRO that establishes an entitlement to receive plan benefits, i.e., the DRO must direct the ERISA plan to make benefit payments. Subparagraph (B) also sets forth the requirements to be a DRO and references the additional requirements of subparagraphs (C) and (D). Subparagraph (C) sets forth the disclosure features that a QDRO must include, such as the benefit entitlement being established, the plan at issue, and the person obtaining the entitlement. Subparagraph (D) describes the benefits that a QDRO may establish.

In *Metropolitan Life v. Drainville*[7] a federal district court in Rhode Island recently explained the disclosure requirements that a DRO must satisfy in order to be a QDRO. The court held an ERISA life insurance plan (the "MetLife Plan") must treat as effective a divorce decree,[8] which required a participant to keep his first wife's children as his beneficiaries, because the court found the decree to be a QDRO. The court did not refer to any plan term that required the MetLife Plan to follow the designation terms of a DRO such as the one at issue. The dispute arose because at the time of his death, the participant had violated the terms of the decree by designating his second wife as his sole beneficiary pursuant to the plan terms.

The *Drainville* holding is incorrect because an ERISA life insurance plan must, as discussed, *infra*, disregard a DRO that violates the plan terms. Moreover, the court failed to consider the most fundamental QDRO requirement, viz., the order itself must require the ERISA plan to pay the benefits to specific persons.[9] However, the decree required the participant to name his first wife's children as beneficiaries. The first wife's children should have directed their complaint not at the life insurance plan administrator, who followed the terms of the ERISA plan, but at the participant who had breached his obligation to designate those children.

A. The *Drainville* Court's Incorrect Holding That the "QDRO Requirements" Are Applicable to Welfare Plans

The *Drainville* court presumed that the ERISA prohibition against the alienation of pension benefits, ERISA § 206(d), 1056(d) (the "Alienation Prohibition"), which contains the "QDRO requirements," is applicable to welfare plans, such as the MetLife Plan. Thus, the court concluded that the life insurance plan at issue was required to follow a DRO which satisfied the "QDRO requirements." However, the court set forth quotes from those requirements that refer only to pension plans, which make the holding questionable on its face.[10] Thus, the MetLife Plan could, and apparently did, provide that DROs were disregarded, and the participant's designee, his second wife, was entitled to his survivor benefit.

B. An Analysis of the ERISA Provisions Which Determine Whether the "QDRO Requirements" Apply to Life Insurance Plans

The applicability of the "QDRO requirements" to welfare plans, such as life insurance plans, is determined by the interaction of three ERISA provisions, which the *Drainville* court did not consider, although two cases it cited for other reasons did.[11] Their analysis was recently set forth in *Metropolitan Life Insurance Co. v. Hanson*[12] and may be found in more detail in *Metropolitan Life Ins. Co. v. Wheaton*.[13] The *Drainville* court cited *Wheaton* while discussing the disclosure parts of the "QDRO requirements."[14] The three provisions are herewith described.

First, there is a preemption of all state laws that "relate to any ERISA plan" (the "General ERISA Preemption").[15]

Second, there is an explicit QDRO exclusion from the General ERISA Preemption that cites a third section:

> (b) (7) Subsection (a) of this section shall not apply to qualified domestic relations orders (*within the meaning of section 206(d)(3)(B)(i)* of this title), qualified medical child support orders (within the meaning of section 609(a)(2)(B)(ii) of this title)….[16]

Third, there is ERISA § 206(d)(3)(B), 29 U.S.C. § 1056(d)(3)(B) (the "QDRO meaning section"):

> (B) For purposes of this paragraph–
>
> (i) the term "qualified domestic relations order'" means a domestic relations order–
>
> (I) which creates or recognizes the existence of an alternate payee's right to, or assigns to an alternate payee the right to, receive all or a portion of the benefits payable with respect to a participant *under a plan*, and
>
> (II) with respect to which the requirements of subparagraphs (C) and (D) are met, and
>
> (ii) the term "domestic relations order"' means…[17]

The *Wheaton* majority opinion, which was written by Judge Richard Posner, rested on a "literal reading" of the ERISA provisions.[18] In particular, it observed that the QDRO meaning section cited by the exclusion refers to "a plan" rather than "a pension plan." Therefore, the opinion asserted that any DRO that meets the "QDRO requirements" is not preempted, and all ERISA plans must follow the designation terms of such an order.[19]

This interpretation must be rejected because it would violate "a cardinal principle of statutory construction" set forth by the Supreme Court that "a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant."[20] If ERISA § 514(b)(7), 29 U.S.C. § 1144(b)(7), in concert with ERISA § 206(d)(3)(B), 29 U.S.C. § 1056(d)(3)(B), provided that DROs that meet the "QDRO requirements" determine benefit entitlements for all ERISA plans, they determine benefit entitlements for pension plans, as well as life insurance plans. However, that interpretation would render superfluous the provision in ERISA § 206(d)(3)(A), 29 U.S.C. § 1056(d)(3)(A) that such QDROs determine benefit entitlements for pension plans.

Congress rejected this interpretation when it enacted ERISA § 206(d)(3)(L), 29 U.S.C. § 1056(d)(3)(L). Subparagraph (d)(3)(L) was enacted together with a similar addition to the corresponding tax qualification Code Section as the part of Section 1898 of the Tax Reform Act of 1986,[21] which is entitled "Technical Corrections to the Retirement Equity Act [which introduced the 'QDRO requirements']." The two provisions were intended to "clarif[y] that the qualified domestic relations provisions do not apply to any plan to which the assignment or alienation restrictions do not apply."[22] That subparagraph limits application of paragraph (d)(3), which includes the QDRO meaning section, to pension plans subject to the Alienation Prohibition. This limitation thus clarifies that life insurance plans, which are not pension plans, and top-hat plans,[23] which are pension plans, are excluded from the QDRO requirements.

This interpretation must also be rejected because it disregards the context of the QDRO meaning section. The meaning of a QDRO, like the meaning of a qualified medical child support order, which requires health care plans to provide children with health care benefits following a divorce or marital separation ("QMSCO"),[24] may not be discerned by looking at the respective meaning sections in isolation. In both cases, the full paragraph containing the respective meaning sections must be considered.[25] Paragraph (d)(3) is part of ERISA § 206, 29 U.S.C. § 1056, which is only applicable to pension plans subject to the Alienation Prohibition. Therefore, the definition and the associated "QDRO requirements" are similarly limited. Neither applies to a health care plan,[26] to a life insurance plan, nor to a top-hat plan.

Furthermore, other parts of the QDRO definition, which are included within the "QDRO requirements" confirm that those requirements are limited to pension plans. The QDRO meaning section refers to ERISA § 206(d)(3)(D), 29 U.S.C. § 1056(d)(3)(D). That subparagraph refers to permissible forms of benefit payments. Although life insurance payments may be made in a variety of forms, health care benefits are generally payable only as lump sums. In contrast, pension plan benefits may be paid in many forms, although some plans limit the form to lump sum payments. Moreover, ERISA § 206(d)(3)(E), 29 U.S.C. § 1056(d)(3)(E) explains that the prior subparagraph (D) is not violated if the benefit payments begin before a participant has separated from service. Although health care benefits may be paid at such time, life insurance payments may never be paid before a participant has separated from service because the participant would be alive while in service. In contrast, pension payments may begin before a participant has separated from service. Similarly, both the spousal benefits described in ERISA § 206(d)(3)(F), 29 U.S.C. § 1056(d)(3)(F), and the PBGC premiums mentioned in ERISA § 206(d)(3)(J), 29 U.S.C. § 1056(d)(3)(J) refer only to pension benefits, but only those subject to the Alienation Prohibition, which excludes top-hat plans. Finally, if the "QDRO requirements" applied to all ERISA plans, the QDRO processing requirements in ERISA § 206(d)(3)(G), 29 U.S.C. § 1056(d)(3)(G), and the double payment relief provisions of ERISA §§ 206(d)(3)(H) and (I), 29 U.S.C. §§ 1056(d)(3)(H) and (I), would have not been limited to pension plans.

Judge Posner stated in *Wheaton* that it would have been "odd" for Congress to make it harder to alienate with a DRO a life insurance benefit than a pension plan benefit.[27] Judge Posner was referring to the fact that plan sponsors may permit the alienation of life insurance benefits, but they may not permit the alienation of pension benefits. However, the alienations that pension plans, unlike life insurance plans, must permit are part of a system to better protect the pension benefits of the spouses and former spouses of participants. Although it may be "odd," Congress could and did so distinguish life insurance benefits. Spouses must be given survivor benefits from pension plans but not life insurance plans.[28] Former spouses also obtained more rights with respect to pension benefits than life insurance benefits. Pension plans, but not life insurance plans, as discussed *supra*, must and may only follow the designation terms of DROs that satisfy the QDRO requirements. In contrast, sponsors of ERISA plans, other than pension plans subject to the Alienation Prohibition, such as life insurance plans or health care plans, need not but may choose to provide similar protection for spouses and former spouses of participants.

C. The *Wheaton* and the *Drainville* Courts Incorrectly Disregarded the QDRO Requirement That the Order Create a Right to Receive a Benefit

Finally, contrary to the *Wheaton* majority's emphasis on a literal reading, their holding, like all life insurance holdings that the "QDRO requirements" are applicable to life insurance plans, disregarded the fact that the DRO at issue[29] failed to satisfy the most fundamental QDRO requirement, i.e., that the order "creates or recognizes the existence of an alternate payee's right to" the payment of the benefit at issue.[30] The DRO under consideration in *Wheaton,* and the one under consideration in *Drainville*, directed the participant to make or retain a certain beneficiary designation, and in both he failed to follow those directions. In contrast, the requisite QDRO provision would be a direction to the plan that an alternate payee is entitled to be paid the survivor benefit, such as "A is entitled to the participant's survivor benefit under the X Pension Plan." ERISA would also prohibit the first wife and her children from enforcing their claim against the participant's designee, the second wife, because such enforcement would violate the core principle that the terms of an ERISA plan determine ERISA benefit entitlements.[31]

Conclusion

The *Drainville* court, like many other courts, incorrectly disregarded the limitation of the "QDRO requirements," including the requirement that ERISA plans follow the designations of such an order, to pension plans that are subject to the Alienation Prohibition. The Prohibition, as discussed, does not apply to life insurance plans or to top-hat plans. Thus, the QDRO requirements also do not apply to such plans. Therefore, the court should have directed the MetLife plan to disregard the DRO at issue, and should have held that the participant's designee pursuant to the plan terms, his second wife, was entitled to receive and keep the proceeds.

Endnotes

1. ERISA § 3(3), 29 U.S.C. § 1002(3) (2009).
2. *See generally Kennedy v. Plan Administrator of the DuPont Savings and Investment Plan*, 555 U.S. __ (2009), 129 S. Ct. 865, 2009 U.S. LEXIS 869 (January 26, 2009).
3. ERISA § 514(a), 29 U.S.C. § 1144(a). However, government plans are not subject to ERISA or this general preemption. ERISA § 4(b)(1), 29 U.S.C. § 1003(b)(1). Nor are church plans unless they elect to be subject to those requirements. ERISA § 4(b)(2), 29 U.S.C. § 1003(b)(2).
4. ERISA § 206(d)(3), 29 U.S.C. § 1056(d)(3).
5. ERISA § 201(2); 29 U.S.C. § 1051(2).
6. *See, e.g.*, Albert Feuer, *Who Is Entitled to Survivor Benefits from ERISA Plans?*, 40 J. MARSHALL L. REV. 919, 975-1003, 1025-1031 (2007), *available at* http://ssrn.com/abstract=1087504 [hereinafter Feuer, Beneficiary Article] [Oct. 23, 2009].
7. 2009 U.S. Dist. LEXIS 63613 (D.C. R.I. July 23, 2009).
8. A more extensive discussion of this decision may be found at Albert Feuer, *A Well-Reasoned but Incorrect QDRO Decision Pertaining to Life Insurance Payments from an ERISA Plan*, *available at* http://ssrn.com/abstract=1467201.[Oct. 23, 2009].
9. ERISA § 206(d)(3)(B)(i)(I), 29 U.S.C. § 1056(d)(3)(B)(i)(I).
10. *Op. cit.* at *8. The court gave an incorrect reference at note 2 for three other conditions that may preclude a DRO from being a QDRO. The correct reference is 29 U.S.C. §1056(d)(3)(D)(i)_(iii).
11. *Carland v. Metropolitan Life Ins. Co.*, 935 F.2d 1114 (10th Cir. 1991) and *Metropolitan Life Ins. Co., v. Marsh*, 119 F.3d 415 (6th Cir. 1997).
12. *2009 U.S. Dist. LEXIS 92044* (D. N.H. Oct. 1, 2009) (the DRO at issue required the participant to designate his children from his divorced first wife as the beneficiaries under an ERISA life insurance plan but his divorced third wife was his designee at the time of his death). The court cited decisions of the second, third, fourth, seventh and tenth circuits which agreed with this position but not the eleventh circuit which disagreed in *Brown v. Connecticut General Life Insurance*, 934 F.2d 1193 (11th Cir. 1991).
13. 42 F.3d 1080, 1084 (7th Cir. 1994) (the DRO at issue required the participant to designate his children from a divorced wife as the beneficiaries under an ERISA life insurance plan but his widow was his designee at the time of his death).
14. *Op. cit*. at *13.
15. ERISA § 514(a), 29 U.S.C. § 1144(a).
16. ERISA § 514(b)(7), 29 U.S.C. § 1144(b)(7) (emphasis added).

17. ERISA § 206(d)(3)(B), 29 U.S.C. § 1056(d)(3)(B) (emphasis added).

18. *See generally* Teresa S. Renaker, *Employee Welfare and Other Nonpension Benefits-9.14-Preemption Exception for QDROs and Applicability to Welfare Plans in* Dividing Pensions and Other Employee Benefits in California Divorces (CEB 2007) (an excellent review of the case law in this area), and Feuer, Beneficiary Article at 1025-1035.

19. 42 F.3d 1080, 1083-1084 (7th Cir. 1994).

20. *TRW Inc. v. Andrews,* 534 U.S. 19 at 31 (2001). The Court observed the statute contained a narrow discovery exception if a creditor misrepresents its behavior that would delay the starting time of the two-year statute of limitations of the Fair Credit Reporting Act. Thus, the Court rejected the assertion that a far broader general discovery rule could also delay the starting time because this would make the language establishing the narrow exception superfluous.

21. Section 1898(c)(4) of Pub. L. 99_514, 100 Stat. 2948 (1986).

22. S. REP. NO. 99-313 (May 29, 1986). The final bill made no change to this section other than changing the section number from 1897(c) to 1898(c). Nor was any change made in the explanation. H.R. REP. NO. 99_514, 99th Cong. 2d. Sess., reprinted in 1986 U.S.C.C.A.N. 4075, 4941.

23. ERISA § 201(2), 29 U.S.C. § 1051(2) excludes top-hat plans from Part 2 of Title I of ERISA, which includes the Alienation Prohibition.

24. ERISA § 609, 29 U.S.C. § 1169.

25. The meaning of a QDRO is determined by looking at ERISA § 206(d)(3), 29 U.S.C. 1056(d)(3), not ERISA § 206(d)(3)(B)(i), 29 U.S.C. 1056(d)(3)(B)(i) in isolation. Similarly, the meaning of a QMSCO is determined by looking at ERISA § 609(a), 29 U.S.C. § 1169(a), not ERISA § 609(a)(2)(B)(ii), 29 U.S.C. § 1169(a)(2)(B) in isolation.

26. ERISA permits children but not a participant's former spouse to use a QMSCO to obtain benefits from an ERISA health care plan. ERISA § 609(a), 29 U.S.C. § 1169(a).

27. 42 F.3d 1080, 1083-1084 (7th Cir. 1994).

28. ERISA § 205, 29 U.S.C. § 1055 applies only to pension plans.

29. See Feuer, Beneficiary Article at 1030-1031. The decrees in two circuit decisions were described incorrectly in the *Drainville* decision as including requirements about the payment of life insurance benefits or proceeds. *Op cit.* at *12. In both cases, the decree instead required the participant to make specified designations. Similarly, a decree requiring a participant maintain his former spouse and her children as the beneficiaries of an ERISA life insurance plan was conceded by all parties to be a QDRO in *Metropolitan Life Insurance Co. v. Hanson*, 2009 U.S. Dist. LEXIS 92044 (Oct. 1, 2009) at *7.

30. ERISA § 206(d)(3)(B)(i)(I), 29 U.S.C. § 1056(d)(3)(B)(i)(I).

31. Feuer, Beneficiary Article at 1030-1031. See also *Kennedy v. Plan Administrator of the DuPont Savings and Investment Plan*, 555 U.S. __ (2009), 129 S. Ct. 865, 2009 U.S. LEXIS 869 (January 26, 2009) discussed in Albert Feuer, *Did a Unanimous Supreme Court Misread ERISA, Misread the Court's Precedents, Undermine Basic ERISA Principles, and Encourage Benefits Litigation?*, 37 Comp. P. J. 247 (October 2, 2009), *available at* http://ssrn.com/abstract=1485204 (Oct. 22, 2009).

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Injury Lawyers Shook Up

By James M. Odato, Capitol Bureau, Albany Times Union

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Lawyers on injured worker cases have been biting their nails over the closed-door meetings at the Workers' Compensation Board the past four months.

They had gotten word that the board is talking about scrapping the age-old system of due process, in which lawyers for the defendant employers and attorneys for allegedly disabled workers argue before a board judge to resolve claims out of court.

As part of Executive Director Joseph Pennisi's 2015 Project, the board was preparing a dramatic overhaul for consideration by Gov. David Paterson in the next few months, the lawyers said. The New York Workers' Compensation Alliance, a group of claimants' lawyers, last week submitted Freedom of Information Law requests for all materials associated with the confidential meetings. And lawyers for defendants moved from a whisper campaign to public statements about tips they're getting about the Pennisi group's plan, asserting it's about a move to a regulator-driven system with claims paid by a sole state insurer.

"People may have received some information that was very, very upsetting and I heard it too and it was something of great concern," said Barbara Levine, president of the Injured Workers Bar. She said she has been assured by newly minted Workers' Compensation Board Chairman Robert Beloten that he won't support dumping the hearing system. Levine said:

"I was concerned…Having spoken to the chair, I am relieved. I don't think that's where this agency is heading."

Peter Walsh, an Albany lawyer who represents employers, said the "secret committee" was meeting without the chairman's knowledge but clearly was talking about removing judges, lawyers, court reporters and claims adjusters. "There'd be no due process for anyone," he said. Pennisi was unavailable, but he said in a board newsletter that everything is open for consideration: "We don't have a monopoly on knowledge and wisdom."

Board spokesman Brian Keegan said the staff discussions have been aimed at finding ways to improve the system and Paterson will get a briefing in a few weeks. "This initiative is a common, sensible, and responsible way to plan to strengthen workers' compensation in New York, with an emphasis on stakeholder involvement," Keegan said. "This is an example of how special interests can go crazy at even the rumor of progress. These lawyers need to spend less time worrying about their fees and more time earning them."

Wear white, good shoes

Gov. George Pataki once tried to get state employees to attend his annual prayer breakfasts. Paterson just wants them to walk with him—at today's West Indian Day Parade, which always gets a huge turnout in New York City.

"The Governor is inviting interested state employees to march with him. Please extend this invitation to your employees. We are asking those interested to join the governor at 10:30 a.m., at the corner of Utica Avenue and Eastern Parkway, Brooklyn. We are also asking those who march to coordinate by wearing white," says the missive to agencies from Mark Leinung, deputy director of state operations.

The invite was meant to foster a team feeling, but some state employees scratched their heads, said Barbara Zaron, president of the Organization of Management Confidential Employees.

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A Wholesale Review of the Vendors Endorsement: How It Works and the Priority of Coverage

By Richard K. Traub

What is a "vendors endorsement"? As the name suggests, it is an endorsement that can be added to general liability policies issued to product manufacturers and product distributors which typically affords coverage to vendors, i.e., those who sell the manufacturer's product to others, as additional insureds for bodily injury or property damage arising out of the manufacturer's products. Coverage under a vendors endorsement may be on a blanket basis (for all vendors) or may specify certain vendors only. These endorsements are desirable because retailers and distributors sued in products liability actions many times face liability simply because they are in the chain of distribution. While those parties likely have a contribution and / or indemnity claim against the product manufacturer, the vendors endorsement provides an alternative means of protection. In some cases, the vendors endorsement provides superior (or the only) protection—such as where the product manufacturer is a foreign corporation without assets in the United States other than its insurance policy.

The vendors endorsement does not, however, protect the vendor in all instances. Notably, there is not a great deal of case law addressing the vendors endorsement and the courts that have addressed it have taken differing approaches. The following discussion is intended to alert the reader to the issues which generally arise in connection with a vendors endorsement.

What Does "Arising Out Of" Mean?

The typical vendors endorsement grants coverage for bodily injury or property damage "arising out of the sale" of the named insured's product.[1] There is a split among jurisdictions as to whether a vendors endorsement provides coverage to a vendor for its own negligence.

Vendor's Own Negligence Is Covered

One line of cases reads the phrase "arising out of" broadly to mean "growing out of," "originating from" or "flowing from." In these cases, unless the act which caused the injury, typically negligence on part of the vendor, was specifically excluded from coverage, the courts hold the injuries or losses as covered by the vendors endorsement. *See, e.g., Sportmart, Inc. v. Daisy Manufacturing Co.*, 645 N.E.2d 360 (Ill. App. 1994) (vendor of named insured's BB gun pellets entitled to coverage under vendors endorsement where underlying injury did not relate to manufacture of pellets, but rather to vendor's sale of pellets to a minor); *Pep Boys v. CIGNA Indemnity Ins. Co. of North America*, 692 A.2d 546 (N.J. App. Div. 1997) (vendor covered for its negligence in selling Freon to a minor which led to the death of another minor from inhaling the Freon, notwithstanding the fact that there was no allegation that the Freon was defective); *Makrigiannis v. Nintendo of America, Inc.*, 815 N.E.2d 1066 (Mass. 2004) (holding that the endorsement does not limit coverage to claims for product defects and includes coverage for the vendor's own negligence); *Twin City Fire Insurance Co. v. Fireman's Fund Ins. Co.*, 386 F. Supp. 2d 1272 (S.D. Fla. 2005) (rejecting insurer's argument that the "vendor's endorsement was not intended to cover bodily injury...occasioned by the active negligence" of the vendor); *Ohio Casualty Ins. Co. v. PETsMART, Inc.*, 2003 WL 22995160 (N.D. Ill. Dec. 16, 2003).

Many of these courts state that if the insurance company did not intend to cover something, it should have specifically excluded same in its policy, noting that ambiguity is resolved in favor of the insured. One Example of this approach is found in *Pep Boys v. Cigna Indemnity Ins. Co.*, 692 A.D.2d 546 (N.J. Super. App. Div. 1997), where a 14-year-old boy purchased Freon at a Pep Boys store and died from acute Freon toxicity after inhaling the fumes. Pep Boys sought coverage from the product manufacturer's insurer based upon a vendors endorsement and the insurer denied coverage asserting Pep Boys was independently negligent because it sold Freon to a minor (in violation of New Jersey's statute) and was negligent in training its store personnel. Although the trial court agreed with the insurer, the Appellate Division reversed, noting that the vendors endorsement did not contain an exclusion for the vendor's negligence or otherwise limit coverage to claims of manufacturing or design defects or failure to warn.[2] A similar result was reached in *Sportmart, Inc. v. Daisy Manufacturing Co.*, 645 N.E.3d 360 (Ill. App. 1994) (claimant sustained partial blindness after BB gun pellets ricocheted off a light pole and insurer for pellet manufacturer was required to defend under vendors endorsement).

While the reasoning of cases like *Pep Boys* is consistent with case law addressing additional insured endorsements generally (whereby coverage is generally afforded to the additional insured for its own negligence unless specifically excluded), this view is not universally accepted when it comes to the vendors endorsement.

No Coverage for Vendor's Own Negligence Because the Vendors Endorsement Is a Cheap "Add-On"

An alternative line of cases holds that vendors endorsements only apply when the vendor is being sued in strict liability, i.e., without regard to its own fault or active negligence. One of the more frequently cited cases in this regard is *Hartford Fire Ins. Co. v. St. Paul Surplus Lines Ins. Co.*, 280 F.3d 744 (7th Cir. 2002), in which the Seventh Circuit stated the purpose of a vendors endorsement is to protect against the expense of being dragged as an additional defendant into a lawsuit "arising from a defect in a product that it distributes…[t]his assumes that the vendor's role in the distribution of the product is passive…[t]he manufacturer would be unlikely to insure against defects introduced by the vendor himself."

Judge Posner rejected the view that the vendors endorsement covers a vendor's active negligence, stating that the vendors endorsements "are cheap add-ons to products liability policies, and their cheapness makes the most sense if they're limited to the case in which the vendor, being completely passive in relation to the harm giving rise to the liability rather than the active author of the harm, would be entitled to indemnity from the manufacturer in the event that he (the vendor) was sued and held liable and made to pay damages." Thus, Judge Posner stated that the vendors endorsement is inapplicable if the vendor may be responsible for the alleged defect out of which the lawsuit arises.

New York is in accord with Judge Posner's analysis as set forth in *Hartford Fire Ins. Co. v. St. Paul Surplus Lines Ins. Co.,* and has limited coverage under the vendors endorsement to claims relating solely to the named insured's defective product. *See, e.g., Raymond Corp. v. National Union Fire. Ins. Co. of Pittsburgh, PA*, 5 N.Y.3d 157, 800 N.Y.S.2d 89 (2005) (denying coverage to vendor where accident was caused by vendor's actions rather than any defect in the product).

The Nexus Test

Most California courts which have addressed the vendors endorsement have applied a "nexus" test to determine whether the vendors endorsement affords coverage. For example, in *Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc.*, 93 Cal.Rptr.2d 364 (Cal. App. 2000), the property damage at issue was caused by a defect in the diced almonds, i.e., wood splinters, existing at the time they were sold to Shade. Shade incorporated the diced almonds (with wood splinters) into nut cluster and cereal products which it then sold. The insurer for the almond manufacturer sought to rely upon an exclusion in the vendors endorsement for "[p]roducts which, after distribution or sale by you, have been…used as…part or ingredient of any other thing or substance by or for the vendor." The court considered whether there was a nexus between the vendor's incorporation of the manufacturer's product (the almonds) into another product and the alleged property damage. The processing of the almonds into nut clusters by Shade and their subsequent incorporation as an ingredient in cereal did not, according to the court, create any new risk or introduce a distinct defect causing the third party injury. Accordingly, the court found that there was no "nexus"between the alleged injuries and the vendor's conduct and the ultimate injury and, therefore, the vendor was entitled to coverage. In other words, had there been a "nexus" between the vendor's conduct and the injury, the vendors endorsement would not have afforded coverage for the vendor.

California courts generally focus on the exclusions within the endorsement and apply the nexus test in that context. For example, in *SDR Co., Inc. v. Federal Ins. Co.,* 242 Cal.Rptr. 534 (Cal.App. 1987), the court found that the vendor was not entitled to coverage based on application of "used as a container" exclusion in the vendors endorsement (a fairly typical exclusion) where there was a nexus between the alleged injuries and the vendor's own changes in the product once it left the manufacturer. The same result was reached in *Alpha Holdings, Ltd. v. Travelers Indemnity Co.,* 2006 Cal. App. Unpub. LEXIS 6089 (where vendor incorporated insured manufacturer's product (hose) into another product (washing machine) court held that for exclusions to apply, insurer would need to show nexus between vendor's actions and the underlying action).

In *Alpha Holdings, Ltd.,* the vendor purchased inlet hoses for washing machines from the insured manufacturer and cut the hose for attachment to the washers. If the physical change to the hose caused leaks, the court reasoned, coverage would be excluded under the vendors endorsement. However, if the physical change was unrelated to the damage, the exclusion for "physical change" would not apply, and the vendor would be entitled to coverage. Thus, the court drew a distinction between mere distributors, referred to as "a nonculpable conduit," and an entity that changes the product. In the first case, the manufacturer bears responsibility for placing the defective product in the stream of commerce. In the second scenario, the insurer must determine, and quite possibly litigate, the issue of causation.

Likewise, in *Murray Ohio Mfg. Co. v. Continental Ins. Co.,* 705 F. Supp. 442 (N.D.I. 1989) (cited by the Court of Appeal of California in *Alpha Holdings, Ltd v. Travelers*), the party seeking coverage under a vendors endorsement purchased a coaster brake from the named insured manufacturer and installed the brake on a bicycle which was sold to the injured plaintiff. The insurer sought to disclaim coverage based upon an exclusion in the vendors endorsement for injury or damage arising out of products which after distribution or sale by the manufacturer have been labeled or relabeled or used as a part or ingredient or any other thing by the vendor. In rejecting this argument the court ridiculed the insurer, stating, "[o]ne wonders how many bicycle brakes [the manufacturer] or [its insurer] expected would be sold without later being attached to a bicycle. [P] [the insurer] is simply relying on Tom Waits' noted maxim, …"What the large print giveth, the small print taketh away." *Sears, Roebuck and Co. v. Reliance Insurance*, 654 F.2d at 499. Indeed *Sears, Roebuck* rejected the very argument Continental advanced here unless the installation of the brake (rather than the brake) caused the injury. 654 F.2d at 497-501. (Nullification of the coverage would contravene public policy.*)*

Other Insurance

Assuming the vendors endorsement is triggered, and further assuming that the vendor has its own insurance, the next step is to consider priority of coverage. *In Gamble Skogmo, Inc. v. Aetna Casualty & Surety Co.*, 390 N.W.2d 343, 347 (Minn. Court. App. 1986), the court held that a wholesaler was insured under both the vendors endorsement of a manufacturer's insurer and under an insurance policy that it had purchased for itself. After comparing the "other insurance" clauses of both policies, the court found that because of the particular wording of these clauses, the vendors endorsement provided primary coverage. Had the wording of the "other insurance" clauses been different, the two insurance companies each could have been partly responsible for the claim and expenses. In other words, the court held that neither the coverage afforded by the vendors endorsement nor the vendor's own insurance is, by law, primary to the other. Rather, it is the language of the "other insurance" clauses and the comparison of same that will control, using the tests set forth in the appropriate state.

In *Ebert Construction, Inc. v. Liberty Mutual Ins. Co.*, 1995 WL 756825 (Minn. App. Feb. 27, 1996), the Minnesota Court of Appeals reversed a trial court's holding that a manufacturer's policy is necessarily primary to a vendor's policy based on a total policy insuring intent analysis. Rather, the court looked to the various "other insurance" clauses in the named insured's and vendor's policies and held that the vendor's policy was primary.

In *Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc.*, 93 Cal.Rptr.2d 364 (Cal. App. 2000), a California court looked to the "other insurance" clauses in a manufacturer's policy and a retailer's policy for a priority of coverage determination, with the result being an equal share of the loss based on the policies having identical "other insurance" clauses.

It should be noted, however, that in *Shade Foods*, the vendor did not argue that the very nature of the coverage afforded under a vendor's endorsement rendered it primary to the vendor's own insurance, regardless of the competing "other insurance" clauses. Such an argument was made in *Steadfast Ins. Co. v. Eon Labs Mfg., Inc.*, 1992 WL 961791 (Del. Super. Sept. 18, 1998), where a Delaware Superior Court held that the named insured's duty to defend was triggered by a claim against the additional insured vendor, and that the insurer for the named insured could not avoid this obligation while it attempted to sort out priority of coverage.

Other Issues

Although the aforementioned discussion addresses some of the issues seen in reported decisions, in practice we are seeing additional and somewhat more complex issues. For example, in multi-party cases there are tenders up the chain of distribution under various and sometimes differing vendors endorsements. Does the insurer for the vendor at the end of the chain owe coverage to all downstream vendors? The answer to this question may depend in the first instance upon a choice of law analysis and, in the second instance by what each vendor did with respect to the product at issue.

Another issues which arises is the increasing size of judgments seen in products liability suits. In this regard, there may be multiple parties competing for the limits of a single policy which, in turn, places the insurer in a difficult position when it comes to settle. If a settlement cannot be reached on behalf of all those entitled to coverage through the vendors endorsement, the insurer may not be able to settle on behalf of any one insured and / or may have to pay its limits into the court. These situations also present issues of conflicting interests which may require appointment of separate counsel for each party where the vendors endorsement at issue imposes a duty to defend.

Endnotes

1. There are, of course, different versions of the vendors endorsement. The typical vendors endorsement is found in ISO form CG 20 15.
2. The court in *Pep Boys* pointed out, "[i]f the scriveners of these endorsements intended to limit coverage to claims involving product defects or to exclude coverage where the vendor has some independent culpability, then the endorsement should have expressed that intent."

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Non-Traditional Marriage Arrangements in a Rapidly Changing World

By Roger Thompson

Introduction

As more jurisdictions engage in deliberations on the subjects of civil unions, domestic partnerships, and same-sex marriage, it is appropriate to examine the position taken by many states along with the federal government on the topic. For purposes of simplicity, these arrangements will be referred to as non-traditional marriages.

> *"Today, only nine states (Alabama, Colorado, Kansas, Rhode Island, South Carolina, Iowa, Montana, Oklahoma, and Texas) and the District of Columbia continue to recognize common-law marriages contracted within their borders."*

From most respects, the most common form of non-traditional arrangements is the common-law marriage. These arrangements, whose origin pre-dates the establishment of these United States, are now permitted to be contracted in only a few jurisdictions. More recently, other arrangements such as civil unions and domestic partnerships have evolved, with the most recent advancement (if one may dare to refer to it as such) being same-sex marriages or gay marriages.

This article will examine each of these arrangements in turn, providing some history as to their development, and identifying those jurisdictions where such arrangements are permitted—either as a result of judicial or legislative activity. Understanding how different jurisdictions view such arrangements is one element of interest, but equally important is consideration for how another jurisdiction may view such arrangements should a couple move from a jurisdiction that permits some form of the non-traditional marriage to a jurisdiction that does not permit the forming of such arrangements. At the federal level, the "Full Faith and Credit Clause" of the federal Constitution along with the federal Defense of Marriage Act (DOMA) enacted in 1996 provides some guidance to states for purposes of recognizing such arrangements.

The article concludes with an overview as to how state workers compensation programs may interpret these relationships. There is no attempt here to imply that these arrangements are likely to have serious economic consequences for the compensation program, but rather to point out how various states may view these arrangements in cases should the issues of benefit entitlement or medical decision-making be litigated.

(1) Common-law Marriages

A common-law marriage is defined as a non-ceremonial relationship that requires "a positive mutual agreement, permanent and exclusive of all others, to enter into a marriage relationship, cohabitation sufficient to warrant a fulfillment of necessary relationship of man and wife, and an assumption of marital duties and obligations."[1] Such an arrangement is legally recognized in a number of jurisdictions as a marriage even though no legally recognized marriage ceremony is performed or civil marriage contract is entered into, nor is the marriage registered in a civil registry

Common-law marriages in the United States are an extension of the informal marriages common in Europe prior to the Reformation.[2] Apart from the wealthy or the nobility, marriages were entered into without formality whereby a couple, perhaps in the presence of family members, would agree to be married and then begin living together as husband and wife. Migration of the English to the American colonies brought the practice of common-law marriages to the United States. As the settlement of America moved westward, common-law marriages existed due to necessity. Those deciding to marry in a country then sparsely populated, and with travel conditions difficult, often found it difficult to locate clergy or officials necessary to conduct a formal marriage.

It was in 1877 that the tradition of common-law marriage was affirmed by the United States Supreme Court.[3] Today, only nine states (Alabama, Colorado, Kansas, Rhode Island, South Carolina, Iowa, Montana, Oklahoma, and Texas) and the District of Columbia continue to recognize common-law marriages contracted within their borders. In addition, five states have "grandfathered" common-law marriages allowing those established before a certain date to be recognized:

Georgia—only for common-law marriages formed before January 1, 1997.[4]

Idaho—only for common-law marriages formed before January 1, 1996.[5]

Ohio—only for common-law marriages formed before October 10, 1991.[6]

Oklahoma—only for common-law marriages formed before November 1, 1998.[7]

Pennsylvania—only for common-law marriages formed before January 1, 2005.[8]

New Hampshire recognizes common-law marriage only for purposes of probate, and **Utah** recognizes common-law marriages only if they have been validated by a court or administrative order.

Among those states that permit a common-law marriage to be contracted, the elements of a common-law marriage vary slightly from state to state. The indispensable elements are (1) cohabitation and (2) "holding out" whereby the parties demonstrate to the world that they are husband and wife through their conduct, such as the woman's assumption of the man's surname, filing a joint federal income tax return, etc. It is important to recognize that mere cohabitation cannot, by itself, rise to the level of constituting a common-law marriage.

(2) Civil Unions and Domestic Partnerships

A civil union is a legally recognized union similar to marriage for same-sex couples. Beginning with Denmark in 1989, civil unions, under one name or another, have been established by law in many developed countries so as to provide same-sex couples with the rights, benefits, and responsibilities similar (in some instances, identical) to opposite-sex marriages. In the United States, the first civil unions were offered by the state of Vermont in 2000.

Vermont—In 2000, the State Supreme Court ruled that the state must recognize same-sex couples on par with heterosexual couples, leaving to the legislature the choice of whether to legalize same-sex marriage or some other formal relationship. The legislature opted for civil unions over marriage as a compromise measure, with the law taking effect on July 1, 2000.

Connecticut—In 2005, the Connecticut legislature became the first state to legalize civil unions without an order coming from the courts. The law took effect on October 1, 2008.

New Jersey—In 2004, the New Jersey legislature made domestic partnerships available to all same-sex couples, as well as to different-sex couples aged 62 and older. Following a ruling by the New Jersey Supreme Court in *Lewis v. Harris* in 2006, the legislature legalized civil unions effective February 19, 2007. The ruling was similar to the ruling in Vermont which required the state to grant all the benefits given to heterosexual couples to homosexual couples as well.

New Hampshire—In 2007 the House and Senate passed a civil union bill designed to extend to partners in same-sex civil unions the same "rights, responsibilities and obligations" as heterosexual couples in marriages. The bill was signed into law on May 31, 2007 and the civil union law took effect on January 1, 2008.

As presently understood in the United States, a civil union is a legally recognized status almost identical to marriage, whereas a domestic partnership often connotes a lesser status that may or may not be recognized by local law. The various terms continue to evolve and the exact level of rights and responsibilities of domestic partnership depends on the particular law of a given jurisdiction. The following states recognize domestic partnerships:

California—Effective September 22, 1999, domestic partnership is available to same-sex couples and to certain opposite-sex couples in which at least one party is 62 years of age or older.[9] A domestic partnership law was adopted by the city of San Francisco in 1989. The city still offers a domestic partnership status separate from that offered by the state; city residents can apply for both.

Washington—Following a 2006 court ruling rejecting same-sex marriage, a domestic partnership bill was enacted that took effect on July 22, 2007. In 2009, the legislature fully expanded the scope of the law, bringing domestic partnerships to a level equal under state law to marriages in the state.[10]

Oregon—Following voter approval of a state constitutional amendment banning same-sex marriage in 2004, a civil union bill was changed to a domestic partnership registry giving to same-sex couples nearly all of the state level benefits associated with a marriage or civil union. The law took effect February 4, 2008.[11]

District of Columbia—The District's domestic partnership law took effect on June 11, 1992, but was not funded by Congress until 2002. Both heterosexual and homosexual couples may register, and while benefits have increased over time, the benefits are specifically enumerated and are as extensive as those of marriage.[12]

Maryland—The Maryland General Assembly passed a domestic partnership law which came into effect on July 1, 2008. The law does not establish a domestic partnership registry, so couples may be required to prove that their partnership exists by providing a sworn affidavit along with two other documents enumerated in the law (e.g., evidence of a joint mortgage, checking account, or insurance coverage, among others).

New York—With the exception of workers' compensation coverage extending to domestic partners of victims of the September 11, 2001, terrorists attacks, New York does not recognize an unmarried domestic partner as a "legal spouse."[13] Domestic partnerships are permitted in New York City for same-sex couples and opposite-sex couples in which both are above the age of 18 and are New York City residents (or at least one party to the partnership is an employee of the City of New York). The status provides three benefits: (1) the ability to remain in a "rent controlled" apartment after the domestic partner lease holder dies, (2) the ability to visit the domestic partner in a city hospital or jail and (3) the ability of city employees to obtain subsidized health insurance for their partners and to obtain the benefits of the Family Medical Leave Act.

Maine—A domestic partnership law, which provides same-sex individuals with inheritance rights over their partners' property and guardianship over their deceased partner, went into effect on July 30, 2004.[14]

Hawaii—The state offers reciprocal beneficiary registration for any adults who are prohibited by state law from marrying, including both same-sex and different-sex couples. Reciprocal beneficiaries have access to a limited number of rights and benefits on the state level, including inheritance rights, workers' compensation, the right to sue for wrongful death, health insurance and pension benefits for state employees, hospital visitation, and health care decision-making.[15]

Colorado—Beginning July 1, 2009, unmarried couples in Colorado have been able to enter a designated beneficiary agreement—similar to that found in Hawaii—which will grant them limited rights, including making funeral arrangements for each other, receiving death benefits, and inheriting property without a will. The law is valid for estate planning, property purchases, medical decisions and certain benefits such as life-insurance and retirement-plan disbursements.

(3) Same-Sex Marriages

The terms same-sex marriage or gay marriage are used to describe a legally recognized marriage between two people of the same gender. The Netherlands was the first country to allow same-sex couples to enter into legally recognized marriage in 2001. Since then, six other countries have followed suit. In the United States, although same-sex marriages are not recognized federally, several states currently permit same-sex couples to marry and two other states may permit such action by year-end.

From June 2008 until November 2008, **California** authorized same-sex marriages. At that point, California voters enacted Proposition 8, which banned same-sex marriage. A California Supreme Court decision on May 25, 2009 upheld the ban on same-sex marriages but also ruled that same-sex couples who wed before Proposition 8 was approved by the voters will remain married under state law.

On May 6, 2009, "An Act to End Discrimination in Civil Marriage and Affirm Religious Freedom," authorizing marriage between any two people rather than between one man and one woman, was passed by the **Maine** legislature and sent to the Governor for signature. In November of 2009, the law was repealed by the voters in a referendum on the issue. Supporters of the same-sex marriage bill indicated that the issue will again be brought before the voters at some future date.

The following jurisdictions in the United States issue same-sex marriage licenses that are legally identical to opposite-sex marriage licenses, based upon rulings by their respective courts of last resort:

Massachusetts—On November 18, 2003, the Massachusetts Supreme Judicial Court issued a landmark ruling holding that the state may not "deny the protections, benefits and obligations conferred by civil marriage to two individuals of the same sex who wish to marry."[16] Massachusetts was the first state to make same-sex marriages legal.

Connecticut—On October 10, 2008, the Supreme Court of Connecticut held that same-sex couples have the right to wed rather than accept a 2005 civil union law designed to give them the same rights as married couples.[17]

Iowa—On April 3, 2009, the Iowa Supreme Court upheld a lower court's ruling that a 1998 state law defining marriage as a union between a man and a woman violates the equal protection clause of the Iowa Constitution.[18]

Vermont—Along with being the first state to introduce civil unions in the United States, Vermont became the first state to recognize same-sex marriage through enactment of legislation. The law took effect September 1, 2009.

New Hampshire—With legislation effective January 1, 2010, New Hampshire became the fifth state to permit same-sex couples to marry.

Out-of-State Recognition

Article IV, Section 1 of the United States Constitution, commonly known as the Full Faith and Credit Clause, requires states to respect the "public acts, records, and judicial proceedings" of other states. The section provides, *"Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State."*

Traditionally, every state honored a marriage legally contracted in any other state. Thus, a common-law marriage validly contracted in one state where such arrangements are permitted would be recognized as valid even in those states where such marriages cannot be contracted and where they may be contrary to public policy. For example, a common-law marriage properly entered into in Oklahoma would be recognized in Wisconsin even though a common-law marriage may not be entered into in Wisconsin.

However, the introduction of civil unions involving same-sex couples, and the arrival of same-sex marriages prompted certain changes. In 1993, the Hawaii Supreme Court held that Hawaii's statute restricting legal marriage to parties of the opposite sex established a sex-based classification, which would be subject to strict scrutiny if challenged on equal protection grounds.[19] Although the court did not recognize a constitutional right to same-sex marriage, it raised the possibility that a successful equal protection challenge to the state's marriage laws could eventually lead to state-sanctioned same-sex marriages.

In response to the Hawaii decision, the United States Congress in 1996 passed the Defense of Marriage Act (DOMA),[20] which defines marriage as a union of a man and a woman for federal purposes and expressly grants states the right to refuse to recognize a same-sex marriage performed in another state. The law has two important effects:

1. No state (or other political subdivision within the United States) needs to treat a relationship between persons of the same sex as a marriage, even if the relationship is considered a marriage in another state.
2. The federal government may not treat same-sex relationships as marriages for any purpose, even if concluded or recognized by one of the states.

Serious legal issues arise from the conflict between state domestic partnership and same-sex-marriage laws, and the structure of the Defense of Marriage Act which explicitly does not extend federal law recognition to those unions. For example, though they may be considered as spouses under the laws of some states, domestic partners do not have spousal rights to Social Security benefits, to spousal benefits in the other partner's pension from a private employer (if that pension is governed by Employee Retirement Income Security Act, ERISA), and will not be treated as spouses for purposes of any federal tax law.

Many states have also passed DOMA laws, specifically barring same-sex marriages in their state. As of April 2009, 29 states have constitutional amendments explicitly barring the recognition of same-sex marriages.[21] In seventeen states the constitutional amendments go beyond defining marriage.[22] In two of the seventeen—South Dakota and Nebraska—the amendments specifically prohibit civil unions and domestic partnerships from being enacted for same-sex couples. The amendments in the other fifteen states contain broad language interpreted as prohibiting any type of spousal rights to same-sex couples. Fourteen states have laws limiting marriage to opposite-sex couples but do not explicitly ban same-sex marriage in their constitutions.[23]

As far as voluntary recognition of civil unions in other jurisdictions is concerned, California's domestic partnership law recognizes Vermont civil unions as of January 1, 2005. The New York decision in *Golden v. Paterson* upholds Governor Paterson's order that state executive branch agencies recognize same-sex marriages solemnized outside of New York, and New York City's Domestic Partnership Law, passed in 2002, also recognizes civil unions formalized in other jurisdictions. The District of Columbia Council has also voted to recognize gay marriages performed in other states.

Conclusion

What are the implications of these various non-traditional marriage arrangements for workers' compensation? Traditionally, in the majority of jurisdictions, the existence of a marriage or the demonstration of dependency has been an established criteria for purposes of (1) establishing the amount of weekly income replacement benefits in those jurisdictions where the benefit amount is calculated on the basis of spendable earnings; (2) the payment of death benefits to a surviving spouse in the case of a work-related death; or, (3) determining who may make medical decisions in the case of a seriously incapacitating injury to a worker. With the introduction of non-traditional marriage arrangements, legitimate disputes may arise as regards these stated purposes.

> *"Many states have also adopted some form of the Defense of Marriage Act, either by statute or through amendment of the state constitution, with the clear intent of not recognizing a civil union, domestic partnership, or marriage involving couples of the same sex."*

Statutes in some jurisdictions specifically authorize workers' compensation death benefits for a person cohabitating with a worker, where the persons are cohabitating as man and wife, but are not legally married.[24] In some jurisdictions, the fact of actual dependency may be sufficient in itself to entitle one to benefits despite the lack of a legal marriage.[25]

In those jurisdictions where common-law marriages continue to be recognized or where the arrangement has been entered into prior to a specific date, such arrangements will continue to be recognized in those states, as well as other states, as legitimate marriage arrangements. Workers' compensation decisions can usually be depended upon to take a liberal attitude, rather than a strict one, toward the requirements for finding such a marriage.

Federal enactment of the Defense of Marriage Act has removed the requirement that states recognize a same-sex marriage entered into in another state if their state does not permit such arrangements. Many states have also adopted some form of the Defense of Marriage Act, either by statute or through amendment of the state constitution, with the clear intent of not recognizing a civil union, domestic partnership, or marriage involving couples of the same sex. Nearly three-fifths of the states have enacted one form or another of such provision.

As stated previously, there is no indication that these non-traditional marriage arrangements will have any serious economic consequences for the workers' compensation program. The majority of jurisdictions have taken action to specifically not recognize such arrangements. It is likely that adjudicators of disputes in the workers' compensation program will adhere to the position taken in their individual jurisdiction.

Endnotes

1. Black's Law Dictionary 277 (6th ed. 1990).
2. Bowman, C. G. (1997), *A Feminist Proposal to Bring Back Common Law Marriage*, Oregon Law Review, 75, 709.
3. *Meister v. Moore* (96 U.S. 76 (1877).
4. 1996 Georgia Act 1021.
5. Idaho Code 32-201.
6. *Lyons v. Lyons*, 621 NE 2d 718 Ohio Appeals Court (1993).
7. 1998 Oklahoma Senate Bill 1076.
8. Pennsylvania Statutes, Section 1103.
9. California Family Code § 297.5.
10. Washington Rev. Code §§ 26.60.010-901.
11. Oregon Rev. Stat 11 § 106.
12. District of Columbia Code § 9-114.
13. *Valentine v. American Airlines* 17 A.D.3d 38 (NY 2005).
14. Maine Revised Statutes Annotated Title 22, § 2710.
15. Hawaii Revised Statute §§ 572C-1-7.
16. *Goodridge v. Dept. of Public Health*, 798 N.E.2d 941 (MA 2003).
17. *Kerrigan v. Commissioner of Public Health*, (SC 17716).
18. *Varnum, et al. v. Brien*, Iowa N.W.2d No. 07-1499 (IA 2009).
19. *Baehr v. Lewin*, 852 P.2d 44, (HI 1996).
20. Provisions codified at 1 U.S.C. § 7 and 28 U.S.C. § 1738C.
21. Alabama, Alaska, Arizona, Arkansas, California, Colorado, Florida, Georgia, Idaho, Kansas, Kentucky, Louisiana, Michigan, Mississippi, Missouri, Montana, Nebraska, Nevada, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia and Wisconsin.
22. Alabama, Arkansas, Georgia, Kansas, Kentucky, Louisiana, Michigan, Nebraska, North Dakota, Ohio, Oklahoma, South Carolina, South Dakota, Texas, Utah, Virginia and Wisconsin.
23. Delaware, Hawaii, Illinois, Indiana, Maine, Maryland, Minnesota, New Hampshire, North Carolina, Pennsylvania, Vermont, Washington, West Virginia and Wyoming.
24. Oregon Compensation of Williams, 653 P2d 970 (1982).
25. Michigan *West v. Barton-Malow Co.*, 230 NW2d 545 (1975).

Roger Thompson is an independent consultant.

Sole Discretion of the Board

By Martin Minkowitz

There are many issues of a workers' compensation case that are solely within the discretion of the Workers' Compensation Board ("board").

An appeal from a decision of the Workers' Compensation Board can only be made to the Appellate Division Third Department (*see* § 23 WCL). Too often appellants have raised issues on appeal from a decision of the Board, which are not reviewable by the Appellate Court. A significant number of reported decisions demonstrate that the court, in affirming the Board, has made its decision by identifying the reason it must sustain the Board's decision. For those who do not read these decisions on a regular basis, to get a clearer understanding of what kind of issues will not be reviewed on appeal, the following are a number of statements of the Appellate Division. All of these decisions were rendered in the month of October 2009. I have also included the cases cited by the court in support of the proposition.

"The Board is the sole arbiter of witness credibility (*see In re Monroe v. Town of Chester*, 42 A.D.3d 862, 864 (2007); *In re Michaels v. Ford*, 9 A.D.3d 733, 734 (2004), and its determination that claimant violated Workers' Compensation Law § 114-a will be upheld if supported by substantial evidence (*see In re Dory v. New York State Elec. & Gas Corp.*, 64 A.D.3d 848, 849 (2009); *In re Monzon v. Sam Bernardi Constr., Inc.*, 60 A.D.3d 1261, 1262-1263 (2009)." *Sharon Hammes v. Sunrise Psychiatric Clinic, Inc. et al.*, App. Div. 3rd Dep't Sept. 10, 2009.

"As claimant appeals only from the denial of his request for reconsideration and / or full Board review, the merits of the Board's underlying decision are not properly before us (*see In re Green v. Kimber Mfg., Inc.*, 59 A.D.3d 782, 783 (2009), *lv. dismissed*, 12 N.Y.3d 865 (2009), and our analysis is limited to whether the Board abused its discretion or acted arbitrarily or capriciously in denying claimant's application (*see In re Barber v. New York City Tr. Auth.*, 50 A.D.3d 1402, 1403 (2008))." *James M. Cali v. E.J. Militello Concrete, Inc.* App. Div. 3rd Dep't Sept. 10, 2009.

"We affirm. [W]hether a compensable accident occurred is a question of fact for the Board, and its determination will not be disturbed as long as it is supported by substantial evidence (*In re Neville v. Jaber*, 46 A.D.3d 1137, 1138 (2007); *accord In re Fortunato v. Opus III VII Corp.*, 56 A.D.3d 905, 906 (2008))." *Edward M. Person Jr. v. LI Maintenance AD et al.*, App. Div. 3rd Dep't Sept. 18, 2009.

"We affirm. Whether a claimant's retirement constituted a voluntary withdrawal from the labor market was a factual issue for the Board, and its determination will not be disturbed if substantial evidence in the record supports it (*see In re Hayes v. Nassau County Police Dept.*, 59 A.D.3d 831, 832 (2009); *In re Danussi v. Chateaugay A.S.A.C.T.C.*, 56 A.D.3d 856, 856 (2008))." *Bradley J. LeFever v. City of Cortland Fire*, App. Div. 3rd Dep't Sept. 15, 2009.

"Whether an employer-employee relationship exists is a factual issue for the Board, and its finding will be upheld if substantial evidence in the record supports it (*see In re Long v. Liberty Mut. Ins. Co.*, 56 A.D.3d 837, 839 (2008); *In re Jara v. SMJ Envtl., Inc.*, 55 A.D.3d 1157, 1158 (2008). In our view, these facts constitute substantial evidence supporting the Board's determination, notwithstanding the presence of evidence that could support a contrary result (*see In re Jara v. SMJ Envtl., Inc.*, 55 A.D.3d at 1158; *In re Carlson v. Akin*, 32 A.D.3d at 1132)." *Michael David Brown v. City of Rome*, App. Div. 3rd Dep't Sept. 10, 2009.

"We affirm. It is well settled that '[s]o long as the Board's determination is supported by substantial evidence it will be upheld' (*In re Gilman v. Champlain Val. Physicians Hosp.*, 23 A.D.3d 860, 861 (2005); *accord In re Dimitriadis v. One Source*, 53 A.D.3d 704, 705 (2008). Moreover, [i]t is within the Board's discretion to resolve conflicting medical opinions (*In re Pearson v. Bestcare*, 48 A.D.3d 862, 863 (2008), *lv. denied* 10 N.Y.3d 715 (2008); *accord In re Bonner v. Brownell Steel, Inc.*, 57 A.D.3d 1329, 1330 (2008)." *Cheryl P. Ancrum v. New York City Board of Education*, App. Div. 3rd Dep't Sept. 14, 2009.

"We affirm. [T]he Board is the sole and final judge of witness credibility, and it alone can evaluate the factors relevant to determining whether the testimony of a party or witness is worthy of belief (*In re McCabe v. Peconic Ambulance & Supplies*, 101 A.D.2d 679, 680 (1984); *accord In re Wilson v. Southern Tier Custom Fabricators*, 51 A.D.3d 1228, 1229 (2008)." *Lisa Chiesa v. Stillwater Central School*, App. Div. 3rd Dep't Sept. 14, 2009.

(Continued on page 31)

What Every Attorney Should Know About the New Durable Power of Attorney Form

By Anthony J. Enea

At first glance the most obvious difference between the old statutory durable general power of attorney form and the new statutory short form power of attorney (the "New Form POA" or the "New Form")[1] that became effective on September 1, 2009 is the length of the new form—it is considerably longer than the old form. Then there is the addition of the Statutory Major Gifts Rider (SMGR).[2] Beyond these obvious differences, the major distinction, in my opinion, is that the New Form poses significant execution problems, especially for seniors and small firm or sole practitioners who have difficulty obtaining witnesses for the execution of documents. In their zeal to protect the elderly from financial abuse, the drafters may have created a document that is so complicated and difficult to execute that it may end up being underutilized.[3] For example, at a recent seminar a prominent attorney suggested that he is strongly considering recommending to his clients that they execute and fund a revocable living trust, thereby avoiding the complexities of the New Form and what are likely to be the continuation of problems associated with recognition and acceptance of powers of attorney by financial institutions and banks.

I will highlight for you what I believe are some of the most important aspects / provisions of the New Form which necessitate your attention:[4]

1. The New Form must be in at least 12-point size font.

2. If more than one agent is designated, they must act together unless the principal initials the box permitting the agents to act separately.

3. If successor agents are designated, they must act together unless the principal initials the box permitting the successor agents to act separately.

4. The execution of the New Form automatically revokes any and all prior powers of attorney executed by the principal, unless otherwise stated in the "modifications" section of the New Form. Arguably, this would include any banking and financial institution powers of attorney previously executed by the principal. Certainly, other types of preexisting powers of attorney would also be revoked. Practitioners are urged to address this issue with the principal, and provide for previously executed and existing powers of attorney in the "modifications" section of the New Form.

5. Part (f), entitled "Grant of Authority," lists the specific powers—lettered "A" through "P"—that the principal may grant to the agent. The principal may either initial each of the letters corresponding to the specific power he or she wants to grant or he or she may initial the letter "P" and can then list each of the specific letters for each power to be granted.

   Letter "M" of the old form, as you may recall, contained a gifting provision. No gifting provisions are contained within letters "A" through "P" of the New Form. The sole exception is that under letter "I," entitled "Personal and Family Maintenance," the agent may continue making gifts the principal made to individuals and charities prior to the POA being signed, in an amount not to exceed $500 per recipient in any one calendar year.[5]

   Letters "A" through "O" of the New Form should not be modified in any way, shape or form. I also believe that no additional lettered matters should be added in Part (f). For an explanation of each of the powers granted a thorough reading of GOL §§ 5-1502A through 5-1502O is a must.[6]

6. Part (g) of the New Form permits the principal to state any "modifications" to the authority granted in Part (f) and otherwise modify some of the other default provisions of the New Form. However, it is important to note that any "modifications" stated in Part (g) should not be provisions which allow the agent to make gifts of the principal's assets or change the principal's interest in property. Any gifting other than the minimal gifting provided for in letter "I" must be provided for in the SMGR. For example, in Part (g), the principal could provide that the execution of the New Form does not revoke a prior banking or financial institution POA. The principal can also define the "reasonable compensation" he or she would like the agent to receive or he or she may limit the powers of a "monitor" (a newly created party under Part (i) of the New Form). Part (g) is also the section

where many elder law planning techniques can be provided for, such as entering into a personal service contract. As long as the modifications do not involve gifts of the principal's assets or changes to his or her interest in property, it appears that a variety of modifications are permissible in Part (g).

7. If the principal wishes to allow the agent to make gifts in excess of the $500 provided for in letter "I" of the powers, he or she would need to initial both Part (h) of the form and complete and execute the SMGR.

8. Part (i) of the New Form allows the agent to appoint a "monitor" who may demand accountings by the agent, including records and documents of all transactions, and also obtain documents from third parties. Caution here. If we counsel a principal to appoint one family member as agent and another family member as monitor, we may be leading our clients down a slippery slope toward family power struggles that can detrimentally impact the agent's ability to act under the New Form. It may be wise to specifically delineate the monitor's authority and the extent that he or she can seek and demand records. For example, you may wish to limit the ability to demand for records to once or twice per year. This is so especially as monitors are also permitted to commence a lawsuit against the agent(s).[7]

9. Part (j) of the New Form provides that the agent may be reimbursed for reasonable expenses incurred on the principal's behalf. If the principal wishes to allow the agent to receive "reasonable compensation," he or she must initial the box in Part (j). If the principal wishes to limit or define "reasonable compensation" he or she should do so in the modification section, Part (g).

   As you can see, the number of times the principal is required to place his or her initials has significantly increased from the old POA form. For many seniors this will be another hurdle to executing the New Form.

10. Part (l) of the form concerns the revocation and termination of the authority of the agent. Of course, the New Form POA terminates when the principal dies or becomes incapacitated if the POA is not durable.[8] The New Form is durable unless the principal states otherwise.[9] Under the new law, as in the past, delivery of a written instrument to both the agent(s) and any third party who may have relied on the POA as to the revocation of a POA is sufficient notice of revocation.[10]

11. The new POA form must be dated and signed by the principal and acknowledged by the principal before a notary public.

12. Part (n) of the New Form provides the agent with a statement of his or her legal obligations, duties and liabilities as an agent. It clearly places a significant burden and responsibility upon the agent for record keeping.

    In my opinion, the agent under the New Form POA is now in a similar fiduciary position as the trustee of a trust. Part (n) also places the attorney representing the principal in the unenviable position of having to advise the agent that there may exist a potential conflict of interest, and that he or she may wish to seek separate legal counsel before executing the New Form. If the agent does not obtain separate legal counsel, it may be wise to obtain from him or her some written acknowledgement of the waiver of the potential conflict of interest and the decision not to retain counsel.

    I believe a significant number of prospective and named agents will decide that they don't want the responsibility of being an agent, once they have read the notice provisions of the New Form and consulted with an attorney.

13. The agent must sign and have their signatures acknowledged before a notary public in Part (o) of the New Form; the New Form POA is not valid until all of the agents have signed and had their signatures acknowledged before a notary public. Multiple agents, however, do not need to sign at the same time and do not need to sign at the same time as the principal.

14. The SMGR must be executed simultaneously with the POA form by the principal. When both documents have been fully executed, they will then be read as one document.

    Gifting under the SMGR is authorized only if the principal has initialed Part (h) of the New Form POA. Clearly, the SMGR is intended to alert the principal of the gravity and importance of granting gifting powers to the agent, particularly if the agent is to have the authority to gift to him or herself. However, when one analyzes both the execution requirements of the SMGR and the legislative provisions relevant to the powers enumerated in the "modifications" section—Part (b)—of the SMGR, there are enough ambiguities and contradictions, in my opinion, to devote a full-day seminar. Nevertheless, here are highlights:

A. If the principal wishes to allow the agent to make gifts to others, not including him or herself up to the federal annual gift tax exclusion ($13,000 for 2009), he or she will need to initial the box in Part (a) of the SMGR.

B. Part (b) of the SMGR must contain any "modifications" or expansion of the gifting powers the principal wishes to give to the agent(s), and the box in Part (b) must be initialed by the principal. The Part (b) modifications relate to any expansion or modification of the power of the agent to gift beyond the annual exclusion amount ($13,000) to third parties. The powers in Part (b) *do not* include the powers to the agent to gift to him or herself (emphasis added). That authority must be provided in Part (c) of the SMGR. The gifting to third parties in Part (b) can be unlimited or gifts of a specific amount. Sample modifications of the gifting powers that can be inserted in Part (b) can be found in GOL § 5-1514(3). It does not appear that GOL § 1514(3) limits the modifications that can be made.[11] However, this seems to be another area of ambiguity.

C. Part (c) of the SMGR also has to be initialed by the principal if he or she wishes to grant the agent the authority to gift to him or herself, to the extent or limited as delineated therein.

   Thus, it appears that the boxes in Part (a), (b) and (c) of the SMGR will have to be initialed by the principal if he or she wishes to grant expanded gifting powers to the agent with respect to third parties and him or herself. The principal will also have to clearly state his or her modifications of these powers.

D. In Part (e), the SMGR must be dated and signed by the principal with his or her signature acknowledged before a notary public.

E. In Part (f), the SMGR must be witnessed by two people who are not *potential* recipients of gifts under the SMGR and the witnesses' statement must indicate that they observed the principal sign the SMGR.

F. And finally, Part (g) of the SMGR must state the name(s) and address(s) of the person or persons who prepared the SMGR.

Conclusion

This article is by no means an exhaustive review of the New Form POA and the SMGR that went into effect on September 1, 2009. More changes in the form of technical corrections are imminent, once the legislature is back in session. Hopefully, I have made the reader aware that the New Form POA and the SMGR have many complexities that must be carefully studied, understood and followed or modified depending on each client's situation. I wish you and your clients the best of luck in doing so.

Endnotes

1. 2008 N.Y. Laws ch. 644. On January 27, 2009, Governor Paterson signed into law Chapter 644 of the N.Y. Laws of 2008. *See* 2009 N.Y. Laws ch. 4. All statutory references herein are to the amendments to the N.Y. General Obligations Law §§ 1-1501, *et seq.*, and are referred to for convenience and ease of use as GOL.
2. GOL § 5-1514.
3. The author wishes to acknowledge all of the hard work and efforts of the drafters of the new form and of all the sections and committees involved. He is hopeful that the statute and form are viewed as works in progress.
4. At the time this article was written, there were at least two bills pending—A.8392 and S.5589—that propose technical corrections to the New Form with respect to the revocation or termination of the POA. While these technical corrections address some of the concerns raised in this article, it was not likely that these amendments would be enacted before the New Form became effective on September 1, 2009.
5. GOL § 5-1502I.
6. *See* GOL §§ 5-1502A–5-1502O.
7. GOL § 5-1509.
8. *See* GOL § 5-1511.
9. GOL § 5-1501A.
10. *See* GOL § 5-1511(3).
11. *See* GOL § 5-1503.

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Advance Directive News: The Reasonableness Standard

By Ellen G. Makofsky

A recent case articulated the standard for determining whether a health care agent was acting pursuant to the principal's wishes. A controversy arose when a sister of a man identified as S.S. brought an action to appoint her the health care special needs guardian and guardian *ad litem* for her brother. The sister, identified as F. H., asked for the power to allow her to keep S.S. connected to a mechanical ventilator.[1] F. H. knew that her brother previously executed a health care proxy naming his wife, R.S., as health care agent, but F.H. did not agree with the health care directions given by R.S.

> *"With passage of the health care proxy law, the legislature rejected the clear and convincing evidence standard and instead adopted a reasonableness standard."*

Legislative History and Case Law

The Court looked to the legislative history of the health care proxy to determine the appropriate standard for deciding whether the health care agent was acting according to the wishes of S.S. In 1990 when the Public Health Law was amended to provide for the health care proxy,[2] the legislative intent was to remove ambiguity from the health care decision-making process. The legislation was enacted following the Court of Appeals decision *In re O'Connor*[3] because of concern that the very stringent clear and convincing evidence standard required by the O'Connor Court was too difficult to meet. To remedy this difficulty, the health care proxy law "was enacted to fill what was believed to be a 'critical gap' in the statutory framework governing health care decisions in New York."[4] With passage of the health care proxy law, the legislature rejected the clear and convincing evidence standard and instead adopted a reasonableness standard.[5]

Almost 20 years have elapsed since the passage of the health care proxy law and there are relatively few published cases interpreting and applying Public Health Law § 29-C. What this means is that the health care proxy law does what was intended, which is to remove uncertainty in regard to an individual's health care wishes. The Court in *S.S.*, however, noted that some courts were incorrectly applying the clear and convincing evidence standard in situations where a health care proxy existed[6] and this incorrect application of the law continued the "legacy of confusion and legal uncertainty" that the health care proxy law was meant to avoid.[7]

Determining that the reasonableness standard was appropriate, the Court looked to determine S.S.'s reasonably known wishes by reviewing the written instructions included in his health care proxy and his oral declarations describing his health care wishes. At first blush, the written directive appeared to contradict the verbal statements. Once the Court determined what S.S's reasonably known health care wishes were, it then examined whether the agent was acting in good faith in implementing those reasonably known wishes.[8]

The Facts

S.S. was a man who enjoyed his life. He suffered from obesity, which eventually limited his ability to breathe. In November 2006 S.S. was brought to the emergency room with elevated carbon dioxide levels. S. S. was hospitalized and required a tracheotomy and was placed on a mechanical ventilator. S.S. was eventually weaned off the ventilator and he returned home. In a subsequent visit to his physician, Dr. A. counseled S.S. about his ongoing treatment alternatives. A discussion ensued and S.S. stated that "he did not want a mechanical ventilator or artificial nutrition."[9] According to R.S., her husband often complained about his trache and repeatedly tried to have it removed, stating, "This is no way to live."[10]

Testimony during the trial shed further light on S.S.'s wishes.

> S.S. spoke about the people he saw while he was in ICU and "rehab", dependent on tubes to live and was very animated and emphatic that he was willing to die rather than live like that. This was so, despite having already benefitted from the type of devices he was now rejecting, i.e., the NG (naso-gastric feeding) tube and

respirator during the November 2006 hospitalization.[11]

In response to S.S.'s clearly articulated wishes, Dr. A. provided S.S. with a statutory health care proxy form and suggested that he fill it out. R.S., at her husband's direction, actually filled out the form for S.S.'s signature. The health care proxy was signed in January 2009. The statutory form provides a space to write in optional instructions. When preparing health care proxies for clients, attorneys tend to be very careful to provide unambiguous instructions about health care wishes. S.S. did not have the benefit of counsel and the language used in the proxy became problematic. Although S.S. clearly stated to his doctor and to his wife that he did not want to be dependant upon a respirator or artificial nutrition, in the portion of the form allowing for optional instructions, S.S. directed his wife to write, "I wish to live."[12]

Shortly after executing the health care proxy S.S. was again admitted to the hospital and he was connected to a mechanical ventilator. It was at this point that F.H., sister of S.S, petitioned the Court. F.H. alleged that her sister-in-law, R.S., was not following the wishes of S.S. because he "wish[ed] to live" and furthermore the health care agent was motivated to remove the ventilator because she faced financial ruin if forced to continue paying for S.S's health care.[13] F.H. further alleged that R.S. was not acting in the best interest of S.S. because as health care agent "she had not agreed to the insertion of a PEG tube."[14]

F.H. is an Orthodox Jew whose religious belief was to prolong life no matter what the circumstance. S.S. was raised as an Orthodox Jew but had not been observant for decades.[15] The statement "I wish to live" was in sharp contrast to the extensive conversation S.S. had with his physician, advising Dr. A. that he wanted to live his way and on his terms, independent of machines. The written words juxtaposed with the verbal directions left the Court to "reconcile those seemingly incongruent and impossible desires to determine the principal's wishes and whether the agent…[was] acting in accordance with those health care wishes."[16]

The Court examined S.S.'s religious beliefs to be certain the decision arrived at would not substitute the sister's beliefs for those of S.S. S.S. chose his health care agent carefully. Although evidence showed he was close to his sister, he did not name her as substitute agent nor did he discuss his health care wishes with her. S.S. chose his wife as his agent because he felt she knew what he wanted and it was unlikely that she would substitute her wishes for his.

The Decision

The Court relied on the reasonableness standard to determine S.S.'s wishes. It reviewed the written instructions of the health care proxy and the substantial conversations of S.S. concerning his health care wishes. The Court reviewed the evidence submitted and found that the verbal directions given to Dr. A. and R.S. demonstrated that although S.S. "indicated his desire to live life to the fullest…he did not want to be on a respirator…he did not even want the trache, a less burdensome form of treatment."[17] The Court looked at the totality of the evidence and did not solely rely on the static written words inserted into the statutory health care proxy form. It looked at the written words in the context of S.S.'s life and lifestyle and gave great weight to his oral declarations. After analyzing the evidence presented the Court determined that S.S.'s reasonably known wishes were not to be hooked up to a mechanical ventilator or receive artificial nutrition.

"The use of the reasonableness standard to determine S.S.'s health care wishes allowed the health care proxy to do what was intended when the legislation was first envisioned."

Accordingly the Court found S.S.'s health care proxy a valid document and that R.H. was acting consistent with her husband's reasonably known wishes. As there was no proof offered by F.H. to override the health care decisions of R.S. or that the decisions were made in bad faith or that the decisions were not made in accordance with the health care proxy law, the Court decided that there was no need for a guardian of the person or property and dismissed the Petition.[18]

Conclusion

Had the Court reviewed the evidence using the clear and convincing standard set by the O'Connor Court, it is unlikely it could have arrived at the decision it did. S.S. included the statement "I wish to live" in his document and the evidence produced at trial did indicate that he was an exuberant lover of life. The statement was in sharp contrast to other evidence introduced at trial, his verbal declarations about what kind of life was acceptable to him. The statement "I wish to live" created an ambiguity which most likely would have been fatal to giving effect to S.S.'s apparent intent if the clear and convincing evidence standard were employed to determine S.S.'s wishes in regard to end-of-life decision-making.

The use of the reasonableness standard to determine S.S.'s health care wishes allowed the health care proxy to do what was intended when the legislation was first envisioned. It permitted the selected health care agent to make health care decisions based upon her broad knowledge of her husband's wishes in the context of his medical situation and prognosis.

The health care proxy is a powerful tool to assure that an individual's health care wishes are respected. The health care agent must reasonably know the principal's wishes. The S.S. case demonstrates that where some ambiguity exists it is the totality of the evidence that eventually will demonstrate a person's reasonably known wishes. The S.S. decision reinforces the importance of directing clients to fully and explicitly discuss with others their health care wishes. This is often a distasteful and difficult task for clients but as Elder Law Attorneys we need to encourage the dialogue.

> *"The S.S. decision reinforces the importance of directing clients to fully and explicitly discuss with others their health care wishes."*

Endnotes

1. *S.S. v. R.S.*, 24 Misc. 3d 567, 877 N.Y.S.2d 860 (N.Y. Sup. Ct. 2009).
2. N.Y. Pub. Health Law § 29-C (Consol. 2009).
3. *In re O'Connor*, 72 N.Y.2d 517, 531 N.E.2d 607, 534 N.Y.S.2d 886 (N.Y. 1988).
4. *S.S.*, 877 N.Y.S.2d at 863.
5. *Id.* at 863 (citing Governor Cuomo's Memorandum of Approval of the health care proxy law, "If the patient's wishes **are not reasonably known**, the agent must decide based on a judgment about the patient's best interests." Highlighting another safeguard, the Governor noted that a health care agent can decide against the provision of artificial nutrition and / or hydration only when the decision reflects the **patient's reasonably known wishes**.).
6. *Id.* at 863 (citing *In re Univ. Hosp. of the State Univ. of New York Upstate Medical Univ.*, 194 Misc. 2d 372, 754 N.Y.S.2d 153 (Sup. Ct., Onondaga Co. Nov. 12, 2002); *in ref Balich*, 2003 N.Y. Slip Op. 51080(U) (Sup. Ct., Suffolk Co. July 10, 2003); *Borenstein v. S. I. son*, 8 Misc. 3d 481 797 N.Y.S.2d 818 (Sup. Ct., Queens Co. Mar. 30, 2005).
7. *Id.* at 862.
8. *Id.* at 863.
9. *Id.* at 864.
10. *Id.*
11. *Id.*
12. *Id.* at 865 (This statement was followed with three exclamation points. R.S. testified that the exclamation points were not added at S.S.'s direction but rather were added of her own volition as it was her habit to add the emphasis of exclamation points.).
13. *Id.* at 865.
14. *Id.*
15. *Id.* at 864.
16. *Id.* at 863.
17. *Id.* at 864.
18. *Id.* at 866.

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Update on Marketable Title in New York

By Marvin N. Bagwell

"These are the times that try men's souls."

—Thomas Paine, "The Crisis,"
December 23, 1776

People employed in the title industry, at least those of us still remaining, know what Thomas Paine must have felt. With the bankruptcy of LandAmerica, the holding company of Commonwealth and Lawyer's Title, two of the largest and most prominent title underwriters, the subsequent acquisition of both by Fidelity, questions raised by the bar regarding the solvency of the other major and minor title underwriters, massive layoffs by underwriters and agents alike of many individuals who were long employed in the industry, the retirement of several of the industry's leading lights, and the paucity of new real estate transactions requiring title insurance, it is a wonder that title people even bother to get up in the morning. However, two-and-a-half centuries after the Founding Fathers endured their time in the wilderness, those of us still treading water look to another patron saint, Gloria Gaynor, for words to inspire us while we are bailing water: "I will survive!"—Hopefully.

When in survival mode, we tend to cast aside that which is secondary and would weigh us down. When one is hoarding every nickel and dime to pay the mortgage, the number of angels dancing on the head of a pin loses its relevance. But the wheels of justice move on. The courts continue to issue decisions that have relevance for the title industry. The following is an attempt to gather some of those cases in one place, so that when normalcy returns, we can once again have heated debates over commas, semicolons and how the courts could have gotten "it" that wrong. Just pretend we have selected "Potpourri" on *Jeopardy* and Alex Trebek tells us that all the correct answers begin with the letter "M." This "M" is for Marketability of title.

In 2007 and 2008, everyone in the New York title industry was so busy that few noticed that the courts issued three opinions on marketability of title, two of which involved successful bidders out-of-foreclosures sales motioning the courts to set aside their purchase contracts, and one of which involved a street widening setback line. Exceptions to title raised in title reports were at issue in these cases as well. Despite the similarities in the foreclosure cases, the courts reached diametrically opposite holdings. All three cases arose because a title company raised an exception to title over which the title company refused to insure or "omit." That fact, in and of itself, makes the cases notable.

In the first case, *R.J. Alan Co. v. Fusco*,[1] Jacob Selechnik, Jason Joseph and Louis Zazzarino were the eventual successful bidders for property foreclosed upon by R.J. Alan Co.[2] The bidders deposited $121,000 with the referee to secure their purchase. Subsequently, the bidders brought suit to set aside the contract because the title company raised three exceptions to title: (1) the adequacy of the notice of sale; (2) a gap in the time between the recording of the first and second notices of pendency; and (3) the legal sufficiency of the service of papers on all parties to the foreclosure action. The bidders argued that foregoing exceptions raised by the title company rendered title unmarketable. In the context of this analysis, the basis for the title exceptions is not all that relevant. In any event, after reviewing the allegations, the court held that the location of sale and the advertising methods used by the foreclosing party complied with the statutes, that no liens were recorded within the gap in time between the two notices of pendency (no foul, no harm), and, finally, that the bidders failed to demonstrate in what way the alleged lack of legal sufficiency impaired the marketability of title. The court held title to be marketable despite the exceptions raised by the title company in its title report. Hence, the bidders lost their attempt to void their contract of purchase. The court gave the bidders 30 days to close title or they would forfeit their deposit.[3]

> *"…it is a wonder that title people even bother to get up in the morning."*

In the second case, *NYCTL 1998-1 Trust v. Mayfield*,[4] NYCTL, a trust that held New York City tax liens ("Trust"), sold 1105 Dumont Avenue in Brooklyn at foreclosure sale to ZZ Management LLC ("ZZ").[5] ZZ bid $310,000 for the property and deposited $37,000 with the referee. ZZ then assigned its bid to Brooklyn Organization LLC ("Brooklyn"). Brooklyn ordered a title report which revealed that the deed from The City of New York (the "City") to the foreclosed borrower contained a reverter clause. The clause provided that if the borrower, the defendant Mary Mayfield, failed to renovate the property and to pay for the property's upkeep, then "at the option of the City title to the Disposition Area shall revert to and revest in the City."[6] Two title companies declined to issue a title policy free of an exception to title for the reverter. Further, the City declined the bidders' request to release the reverter from the property. Brooklyn brought suit to set aside the foreclosure sale and for the return of its deposit. The Trust argued that the terms of sale provided that the property was being sold subject to all covenants and restrictions of record and that since the reverter was a matter of public record, ZZ and Brooklyn could have discovered the reverter before they bid. In effect, the Trust's position was that the bidders were bound by the terms and conditions of their contract.[7]

The court found that "as a general rule, a purchaser…[out of] foreclosure…is entitled to…good, marketable title."[8] Ergo, Brooklyn should win. Then, the court spent a great deal of time in its opinion explaining why Brooklyn should lose. After all, Brooklyn executed the contract, and it could have discovered the right of reverter before bidding on the property. Then the court explained that, even though it lacked the power to toss the contract, even under the contract, Brooklyn should prevail because the Trust's inability to provide title insurance as specifically required by one paragraph in the contract overrode the bidder's general obligation to accept title subject to covenants and restrictions of record. Finally, the whipsawing came to an end when the court noted that courts have previously held that the City's right of reverter rendered title unmarketable.[9] Finally, the court held that because the Trust was unable to convey marketable title or to provide title insurance to insure over the reverter, the Trust was in violation of the terms of sale itself. The court vacated the foreclosure sale and directed the Trust to return the deposit to Brooklyn.[10] Whew!

The third case also involved an interest in the subject property held by the City of New York. In *Rasul v. O'Brien*,[11] Rasul entered into a contract to purchase 660 Targee Street on Staten Island from O'Brien for $285,000.[12] To bind the contract, Rasul deposited $10,000 into escrow. Rasul then ordered a title report, which revealed that a 30-foot setback line affected the property along its entire street frontage. Although the court indicated that no definitive evidence had been presented to it to show when the setback line was established, it was clear that the line had been established by New York City for purposes of possible street widening. The survey showed that if the City chose to widen the street, the new street would run through about 15 feet of the structure for its entire length. Based on this encumbrance to title, Rasul sought to cancel the contract on the grounds that the property's title was "uninsurable and unmarketable."[13] He demanded the return of his deposit. O'Brien countered that he could produce a title company willing to insure the sale and refused to return the deposit.[14]

According to the court, the general rule in cases such as this is that if the City decided to widen the street, it would compensate Rasul through a condemnation proceeding. However, Rasul said that if the premises were damaged by fire, the City might not permit him to rebuild. The court responded that he could apply for a variance. This was not the end of the story for Rasul. The court said further that "[c]ase law indicates that the restrictive use imposed by [the City Code] would not render title unmarketable unless a substantial portion of the property lies within the bed of the street and the property would be rendered useless thereby."[15] The court held that Rasul was entitled to cancel the contract and it ordered O'Brien to return Rasul's deposit:

> Under the definition of "marketable title" it is apparent that the setback line renders this title unmarketable. No reasonably intelligent person would want to purchase a home with the potential legal problems this premise has, resulting from the existence of the setback line.
> …Clearly the fact that 30 feet of a 46 foot wide lot would be lost should the City widen the street renders the property useless.[16]

Although the holdings appear to be all over the lot, all of the holdings, within the classic interpretation of the law of marketability of title, are correct.

Classical jurisprudence in New York regarding which defects render title marketable or unmarketable rests upon three often-quoted holdings. The first leg of the tripod is *Norwegian Evangelical Free Church v. Milhauser*,[17] where the sainted Justice Cardozo wrote, "The law assures to a buyer a title free from reasonable doubt, but not from every doubt."[18] A decade-and-a-half later, the First Department, in the case of *Whittier Estates v. Manhattan Savings Bank*,[19] established the second leg when it wrote, "[t]he test of [marketability] is not the hazard of possible litigation, for, as has been pointed out, 'it seems to be the inalienable right of any person to start a lawsuit'…. The test is rather the chance of successful attack."[20] Finally, at a time which most of us can still remember, the third and final leg steadied the doctrine when the court wrote in *Voorheesville Rod & Gun Club, Inc. v. E. W. Tomkins Co.*,[21]

> A marketable title is "a title free from reasonable doubt, but not from every doubt."[22] We have said that a "purchaser ought not to be compelled to take property, the possession or title of which he may be obliged to defend by litigation. He should have a title which will enable him to hold his land free from probable claim by another, and one which, if he wishes to sell, would be reasonably free from any doubt which would interfere with its market value."[23]

Read together, the foregoing three cases force any counsel contemplating an action asserting that title is unmarketable to ask her or himself two questions. Given my fact situation, once my client acquires title, will a third party bring an action to set aside my client's title? If the likely answer to this first question is "Yes," then counsel must ask, "Will the action to set aside my client's title be successful?" If the answer to the second question is "No," then title is marketable. Those of you who were quick to raise your hands in first year property class already see a problem here, but please keep reading.

In regard to the first case that we considered above, *R.J. Alan Co. v. Fusco*, it was quite obvious to the court that the exceptions to title raised by the purchasers-out-of the foreclosure action would not lead to a divesture of title.[24] The notice of sale was statutorily correct, no liens arose in the gap period between the filings of the notices of pendency, and the purchaser failed to identify any deficiency in the service of papers upon the parties sufficient for the court to opine upon whether such deficiency adversely affected marketability. Since there was no possibility that the title would be subjected to successful litigation, title was marketable. The narrative was different in the second case, *NYCTL 1998-1 Trust v. Mayfield*.[25] There, because the City had declined to release its right of reverter, it was patently obvious that had the purchaser taken title, it would be subject to litigation. Second, the litigation would have been successful because other courts had already held that a reverter in favor of the City of New York rendered title unmarketable. Hence, though it tried mightily to bind the purchaser to its contract, when that failed, the court had little choice but to find that the title indeed was unmarketable. The third case, *Rasul v. O'Brien*, follows the same pattern.[26] The court found it obvious that had he taken title, Rasul might have found himself facing litigation from the City in the form of a condemnation action or even having to file for a variance. However, it should be noted that the court in *O.W. Siebert Co. v. Kramer* reached a different conclusion by holding that a title was marketable because the five feet easement did not render "the property unusable in part or in whole."[27]

Here is the catch. There is a bit of circular reasoning, a catch-22 if you will, involved in this analysis. The courts have ruled that a title must be subject to successful litigation if the title is to be determined as being unmarketable.[28] For the tried and true questions as to title marketability, this works well. All counsel has to do is to undertake the legal research and determine whether a court, in the past, has ruled upon a particular fact situation. However, counsel does not know whether a new fact situation has led to an unmarketable title until counsel litigates the question. Which comes first, the successful litigation or the unmarketable title? Metaphorically, the court rulings in this particular area of the law leave us with a chicken or egg question.[29]

This is one area of the law where the past dictates the future. Precedence is king (or queen, if you prefer). The diligent counsel has to turn to Warren's Weed to see which issues have been and which issues have not been litigated. In the service of his or her client, counsel, facing a new and un-ruled-upon fact pattern involving marketability of title, must be prepared to become an advocate and to make arguments by analogy to the past as best as she or he can. In other words, being just a counsel is not sufficient; in this area, one must also become a lawyer with the persuasive ability, work ethic and willingness to make new law.[30]

"The title industry, like much of our world economy, undoubtedly is living through hard financial times."

Speaking of being a lawyer, there is a lesson to be gleaned from our subject cases. The bidders in these cases could have avoided a great deal of agony, legal fees and expenses, and saved precious time had they obtained a title report prior to bidding on the properties and executing a contract of sale. The defects would have become known and the purchasers would have known not to bid because of the exceptions to title. In matters and cases such as this, title insurance proves its relevance even in a down market.

The title industry, like much of our world economy, undoubtedly is living through hard financial times. But as all of the foregoing cases illustrate, real property transactions do not go ahead until exceptions raised by the title company are resolved. The wheels of commerce grind to a halt without the industry. Title will be back. If anyone asks how you know, just tell him or her that Thomas Paine and Gloria Gaynor told you so.

Endnotes

1. N.Y. L.J., Apr. 4, 2007, at 26, col. 3 (Sup. Ct. Westchester County Mar. 21, 2007).
2. *See R.J. Alan Co. v. Fusco*, N.Y. L.J., Apr. 4, 2007, at 26, col. 3 (Sup. Ct. Westchester County Mar. 21, 2007).
3. *See id.*
4. N.Y. L.J., Aug. 22, 2007, at 27, col. 1 (Sup. Ct. Kings County July 20, 2007).
5. *See* NYCTL 1998–1 *Trust v. Mayfield*, N.Y. L.J., Aug. 22, 2007, at 27, col. 1 (Sup. Ct. Kings County July 20, 2007).
6. *Id.* (quoting Deed from the City of New York to Mary Mayfield, Art. 4 (June 19, 1986)).
7. *See id.*
8. *Id.* (quoting *Jorgensen v. Endicott Trust Co.*, 100 A.D.2d 647, 648, 473 N.Y.S.2d 275, 276 (3d Dep't 1984)).
9. *See id.* (citing *Van Vliet & Place v. Gaines*, 249 N.Y. 106, 109, 162 N.E. 600, 601 (1928); *Bloom v. Kernan*, 146 A.D.2d 916, 917, 536 N.Y.S.2d 897, 898 (3d Dep't 1989); *McAndrew v. Lanphear*, 280 A.D. 6, 9, 111 N.Y.S.2d 238, 242 (4th Dep't 1952)).

10. *See id.* ("Brooklyn is entitled to an order vacating the foreclosure sale in its entirety and directing the return of the deposit.").

11. No. 24896 / 07, 2008 WL 2276004 (N.Y. Civ. Ct. Richmond County May 19, 2008).

12. *See Rasul v. O'Brien*, No. 24896 / 07, 2008 WL 2276004, at *1 (N.Y. Civ. Ct. Richmond County May 19, 2008).

13. *Id.* at *2.

14. *See id.*

15. *Id.* at *3 (quoting *O.W. Siebert Co. v. Kramer*, 107 Misc. 2d 520, 521, 435 N.Y.S.2d 476, 477 (Sup. Ct. Queens County 1980)).

16. *Id.* at *3–*4.

17. 252 N.Y. 186, 169 N.E. 134 (1929).

18. *Norwegian Evangelical Free Church v. Milhauser*, 252 N.Y. 186, 190, 169 N.E. 134, 135 (1929) (Cardozo, J.) (citing *Crocker Point Ass'n v. Gouraud*, 224 N.Y. 343, 349, 120 N.E. 737, 738 (1918)).

19. *Whittier Estates, Inc. v. Manhattan Sav. Bank*, 181 Misc. 662, 48 N.Y.S.2d 111 (Sup. Ct. App. T. 1st Dep't 1944).

20. *Id.* at 666, 48 N.Y.S.2d at 114 (quoting *Reformed Prot. Dutch Church in Garden St. v. Madison Ave. Bldg. Co.*, 214 N.Y. 268, 279, 108 N.E. 444, 447 (1915)).

21. 82 N.Y.2d 564, 626 N.E.2d 917, 606 N.Y.S.2d 132 (1993).

22. *Voorheesville Rod & Gun Club v. E.W. Tomkins Co.*, 82 N.Y.2d 564, 571, 626 N.E.2d 917, 920, 606 N.Y.S.2d 132, 135 (1993) (quoting *Regan v. Lanze*, 40 N.Y.2d 475, 482, 354 N.E.2d 818, 822, 387 N.Y.S.2d 79, 83 (1976)).

23. *Id.* (quoting *Dyker Meadow Land & Improvement Co. v. Cook*, 159 N.Y. 6, 15, 53 N.E. 690, 692 (1899)).

24. *See R.J. Alan Co. v. Fusco*, N.Y. L.J., Apr. 4, 2007, at 26, col. 3 (Sup. Ct. Westchester County Mar. 21, 2007).

25. *See* NYCTL 1998–1 *Trust v. Mayfield*, N.Y. L.J., Aug. 22, 2007, at 27, col. 1 (Sup. Ct. Kings County July 20, 2007).

26. *See Rasul*, No. 24896 / 07, 2008 WL 2276004, at *1 (N.Y. Civ. Ct. Richmond County May 19, 2008).

27. *See O.W. Siebert Co. v. Kramer*, 107 Misc. 2d 520, 522, 435 N.Y.S.2d 476, 478 (Sup. Ct. Queens County 1980).

28. *See Weiss v. Cord Helmer Realty Corp.*, 140 N.Y.S.2d 95, 98–99 (Sup. Ct. Kings County 1955).

29. *See* Marvin N. Bagwell, AXYS, L.L.C. v. Ng*: A Close Encounter of the Marketable Title Kind*, 33 N.Y. Real Prop. L.J. 3 (2005). *See generally AXYS, L.L.C. v. Ng*, N.Y. L.J., Jun. 16, 2004, at 18, col. 1 (Sup. Ct. N.Y. County).

30. By no means does this article cover the entire marketable title landscape. Entire pine forests in Maine have been decimated to produce the paper on which musings regarding marketable title have been printed. This author admittedly has contributed more than his share to the carbon footprint. *See, e.g.*, Marvin N. Bagwell, *Marketability–The Legislature (and Title Insurers, of Course) Save the Day*, N.Y. L.J., May 8, 2002, at 5; Marvin N. Bagwell, *What Is Marketability?*, N.Y. L.J., Mar. 13, 2002, at 5.

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Sole Discretion of the Board

(Continued from page 21)

"We affirm. Apportionment of a workers' compensation award is a factual issue for the Board to determine, and its decision will be upheld if supported by substantial evidence (*In re Huss v. Tops Mkts., Inc.*, 13 A.D.3d 768, 769 (2004) [citations omitted]; *see In re Mandziara v. Lowe's Home Ctrs.*, 41 A.D.3d 1020, 1020-1021 (2007)." *Shannon Ford v. Fucillo et al.*, App. Div. 3rd Dep't Sept. 16, 2009.

"The employer has since received the requested reimbursement for wages it paid to claimant and concedes that there is no present dispute as to the status of [claimant's] leave credits. Accordingly, the employer is not an 'aggrieved party' within the meaning of CPLR 5511 and lacks standing to appeal the Board's decisions (*see In re Baker v. Horace NYE Home*, 63 A.D.3d 1415 (2009); *In re Curley v. Binghamton-Johnson City Joint Sewage Bd.*, 63 A.D.3d 1387 (2009)). The mere fact that the employer views certain language in the WCLJ's proposed decision as potentially adverse or problematic does not confer standing (*see In re Baker v. Horace Nye Home*, *supra*; *Castaldi v. 39 Winfield Assoc., LLC*, 22 A.D.3d 780, 781 (2005)). Accordingly, the employer's appeals are dismissed." *Stephanie Reynolds v. Essex County et al.*, App. Div. 3rd Dep't Sept. 8, 2009.

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Arbitration Agreements and Bankruptcy—Which Law Trumps When?

By Edna Sussman, with the assistance of Osata Tonia Tongo

As reported by the Office of Administration of the U.S. Courts, in the 12-month period ending June 30, 2009, there was a 35% increase in bankruptcy filings compared to the 12-month period ending June 30, 2008. Business bankruptcy filings rose 63% while non-business filings rose 34%. Chapter 11 filings rose 91% during that period.[1] In light of these statistics and recent economic conditions, we review the principal cases that address what happens to arbitration agreements in the context of a bankruptcy proceeding. The short answer: there is no bright line.[2]

The Competing Policies

The Federal Arbitration Act (FAA) provides that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon grounds as exist at law or in equity for the revocation of any contract." [3] The Supreme Court has repeatedly stated that questions of arbitrability must be addressed with a "healthy regard for the federal policy favoring arbitration."[4] To accomplish the goals of the FAA, "the enforcement of private agreements to arbitrate and encouragement of efficient and speedy resolution," the courts must "rigorously enforce agreements to arbitrate even if the result is piecemeal litigation, at least absent a countervailing policy manifested in another federal statute."[5]

A principal purpose of the Bankruptcy Code[6] is to allow the bankruptcy court to centralize all disputes concerning all property of the debtor's estate so that the reorganization can proceed efficiently, protecting creditors and reorganizing debtors from piecemeal litigation and supporting the power of the bankruptcy court to enforce its own orders.[7]

The Second Circuit recognized the inherent tension between these statutes in commenting that there will be occasions where a dispute involving the Bankruptcy Code and the Arbitration Act presents "a conflict of near polar extremes" as "bankruptcy policy exerts an inexorable pull towards centralization while arbitration policy advocates a decentralized approach towards dispute resolution."[8]

Case Law Developments

The first significant case to deal with the tension between the FAA and the Bankruptcy Code was the Third Circuit's decision in *Zimmerman v. Continental Airlines*.[9] The court recognized that both the FAA and the Bankruptcy Reform Act represented important congressional concerns. Following a careful analysis, the court placed greater emphasis on the bankruptcy laws and stated that the intention of Congress would be better realized if the bankruptcy laws were read "to impliedly modify the Arbitration Act."[10] The court concluded that while the bankruptcy court could stay proceedings in favor of arbitration, the use of the power was to be left to the sound discretion of the bankruptcy court and established a series of considerations for the exercise of that discretion

> *"[I]n the 12-month period ending June 30, 2009…business bankruptcy filings rose 63% while non-business filings rose 34% [and] Chapter 11 filings rose 91%…"*

Subsequent to the *Zimmerman* decision, in *Shearson/American Express Inc. v. McMahon*,[11] the Supreme Court addressed the question of whether a claim brought under § 10(b) of the securities laws and under RICO must be sent to arbitration in accordance with the terms of an arbitration agreement. In its review the court established the test to be used to review challenges to an arbitration clause based on another statutory imperative. The Court held that, to overcome the federal policy favoring arbitration, the burden is on the party opposing arbitration to show that Congress intended to limit or prohibit waiver of a judicial forum for a particular claim. The Court said that this intent will be "deducible from the statute's text or legislative history…or from an inherent conflict between arbitration and the statute's underlying purpose."[12]

There is general agreement in the case law that there is no indication of a congressional intent to override the FAA in the text or legislative history of the bankruptcy laws, although as discussed below, this conclusion has been questioned by some courts. Accordingly, the third prong of the Supreme Court test—whether there is "an inherent conflict between arbitration and the statute's underlying purpose"—has been the test applied by the courts.

In the wake of the *McMahon* decision, a series of other Supreme Court decisions strongly supporting arbitration, and the 1984 amendments to the Bankruptcy Code which scaled back the jurisdiction of the bankruptcy courts,[13] the Third Circuit revisited the issue in

Hays and Co. v. Merrill Lynch Pierce Fenner & Smith Inc.[14] The court found an arbitration agreement to be a non-executory contract, which like other contracts cannot be rejected by a trustee in bankruptcy. The court held that the trustee is "bound to arbitrate all of its claims that are derived from the rights of the debtor" as of the commencement of the case, but not bound to arbitrate other claims that are not derivative but are rather statutory rights created by the bankruptcy code.[15] The court then considered whether, having found that the trustee is bound, the court had discretion to refuse to enforce the arbitration clause. Guided by the developments in the Supreme Court and in Congress, the court held that an arbitration clause should be enforced for a non-core proceeding unless "it would seriously jeopardize the objectives of the [Bankruptcy] Code."[16] Where a trustee seeks to enforce a claim inherited from the debtor in court, the court "perceived no adverse effect on the underlying purpose of the Code from enforcing arbitration."[17] The *Hays* decision has been cited often for the proposition that where a party seeks to enforce a non-core pre-petition debtor derivative contract claim, a court does not have discretion to deny enforcement of an otherwise valid arbitration clause.[18]

As courts generally begin by determining whether the proceeding is core or not non-core in deciding whether to compel arbitration or stay the bankruptcy proceeding, a brief explanation of that dichotomy is necessary. The core / non-core distinction derives from the Supreme Court decision in *Northern Pipeline Construction Company v. Marathon Pipeline Company*,[19] in which the Court struck down the provision of the 1978 Bankruptcy Act which gave broad powers to the bankruptcy courts. The Court found that the statute vested authority in Article I bankruptcy courts to decide cases that, without party consent, constitutionally could only be heard by Article III courts. To address this issue, Congress in the amendments to the Bankruptcy Code in 1984 divided claims into core and non-core, 28 U.S.C. § 157, giving bankruptcy judges authority to hear and determine "all core proceedings arising under title 11 or arising in a case under title 11." Non-core matters are only "related to" the bankruptcy proceeding. With respect to non-core matters, the bankruptcy judges can only recommend findings of fact and conclusions of law to the district court. The Bankruptcy Code provides a non-exclusive list of core proceedings.[20] As the list is not exclusive, the courts have developed additional frameworks for the core / non-core analysis.

Extensive case law and confusion over the distinction between core and non-core have followed. Indeed, the difficulties in deciding whether a matter is core or non-core have been described by one commentator as a "most difficult area of constitutional law," in which "the precedents are horribly murky, doctrinal confusion abounds, and the constitutional text is by no means clear."[21]

In *In re U.S. Lines Inc.*[22] the Second Circuit stated that whether a proceeding is core depends on whether "(1) the contract is antecedent to the reorganization petition; and (2) the degree to which the proceeding is independent of the reorganization."[23] Proceedings can be core by "virtue of their nature if either (1) the type of proceeding is unique to or uniquely affected by the bankruptcy proceedings, or (2) the proceedings directly affect a core bankruptcy function. . . ."[24] Other circuits have their own variations on the test to be applied to the core / non-core determination. A review of the cases demonstrates the difficulties the courts have with this issue as decisions by both the bankruptcy courts and the district courts are often reversed upon review.

The Fifth Circuit in *In re National Gypsum*[25] dealt with the question of how arbitration agreements in core proceedings should be handled. The court was urged to adopt a position that categorically found arbitration of core proceedings to be inherently irreconcilable with the Bankruptcy Code. The court refused, finding that doing so "conflates the inquiry" required by *McMahon* and is "too broad."[26] The court stated that not all core proceedings are premised on provisions of the code that inherently conflict with the FAA or jeopardize the objectives of the Bankruptcy Code. The court held that "non-enforcement of an otherwise applicable arbitration provision turns on the underlying nature of the proceeding, i.e. whether the proceeding derives exclusively from the provisions of the Bankruptcy Code and if so whether arbitration of the proceeding would conflict with the purposes of the Code."[27]

The Second Circuit's decision in *In re United States Lines, Inc.*[28] similarly concluded that arbitration of core proceedings does not necessarily conflict with the Bankruptcy Code. The case involved P&I insurance policies issued by several carriers that were the only source for payment of claims by thousands of employees for asbestos-related injuries. The Trust, as successor in interest to the debtor, began an adversary proceeding in bankruptcy court for a declaratory judgment on the insurance coverage. The bankruptcy court held that the proceeding was core and denied the motion to compel arbitration. The district court reversed both determinations.

The Second Circuit looked first to whether the proceeding was core or non-core as a non-core proceeding is "unlikely to present a conflict sufficient to override by implication the presumption in favor of arbitration."[29] The court held that the matter was a core proceeding. The court further held that the mere fact that a proceeding is core will not automatically give the bankruptcy court discretion to stay arbitration. On the facts before it concerning insurance coverage which the court found to be integral to the bankruptcy court's ability to preserve and equitably distribute the assets, the Second Circuit found the bankruptcy court's refusal to refer the proceeding to arbitration to be proper.[30]

In *MBNA American Bank, N.A. v. Hill,*[31] the Second Circuit reiterated its position that bankruptcy courts generally do not have discretion to refuse to compel arbitration of non-core bankruptcy matters or matters that are simply "related to" rather than "arising under" bankruptcy cases. Nor do bankruptcy courts have absolute discretion to refuse to compel arbitration of core proceedings. Rather that determination requires "a particularized inquiry into the nature of the claim and the facts of the specific bankruptcy."[32] Although finding the action before it to be a core proceeding, the court concluded that arbitration of the dispute would not jeopardize the objectives of the Bankruptcy Code and that the bankruptcy court did not have discretion to deny the motion to stay the proceeding in favor of arbitration.

"[T]here will be little certainty in some cases as to whether an arbitration agreement will be enforced in a bankruptcy."

Some years later, in *In re Mintze,*[33] the Third Circuit clarified its holding in *Hays,* stating that the decision applied equally to core and non-core proceedings and that the analysis requires a review under the *McMahon* standard for both. The analysis as to the arbitration clause thus raises both the complexity of deciding whether the proceeding is core or non-core and the complexity of deciding whether referring the proceeding to arbitration would jeopardize the objectives of the bankruptcy code.

Complicating the situation further, some courts have challenged the basic premise that the Bankruptcy Code does not itself evidence congressional intent to override the FAA. For example, in *In re White Mountain Mining Company*[34] the Fourth Circuit followed the precedents discussed above in reaching its holding. However, the court suggested, without deciding the point, that, at least with respect to core proceedings, it could be argued from the statutory text that in granting bankruptcy courts jurisdiction over "core proceedings arising under title 11" Congress "reveal[ed] a Congressional intent to choose those courts in exclusive preference to all other adjudicative bodies, including boards of arbitration, to decide core claims."[35]

In a recent decision, *In re Payton Construction Company,*[36] the court's discussion also questioned the prevailing analysis of congressional intent and urged a presumption that Congress "intended for the bankruptcy courts to be the principal and usual, if not exclusive, forum for most matters in bankruptcy."[37] The court cited the creation by Congress of bankruptcy's "centralized, collective proceeding to facilitate the expeditious and relatively inexpensive resolution of all matters relating to bankruptcy so as to make reorganization possible, enable the debtor's fresh start and maximize value and expedite recovery of creditors."[38]

Conclusion

The case-by-case approach in the case law and the difficult analysis required where the matter is not clearly core and integral to the bankruptcy have led to a lack of predictability and costly and time- consuming litigation. Indeed, the extensive litigation that can take place over the enforceability of arbitration clauses in bankruptcy can deprive the parties of the common goals of both legal regimes: efficiency, speed, and avoidance of costs.

The Supreme Court has dealt with the interplay of several statutory claims and the FAA but has not yet directly provided guidance to the courts by addressing the tension between the Bankruptcy Code and the FAA. Many commentators have urged that the Supreme Court or Congress should step in to clarify this area of the law.[39] Commentators have expressed various views as to how the question should be resolved. One commentator suggests that arbitration of core claims should be precluded by the Bankruptcy Code, argues against a *per se* rule in favor of arbitration for non-core proceedings, and urges that debtors be permitted to reject the arbitration agreement[40] pursuant to § 365 of the Bankruptcy Code.[41] Another commentator urges that the filing of a proof of claim in the bankruptcy should be deemed to be a waiver of the contractual right set forth in the arbitration clause.[42] Yet others favor a more nuanced approach that creates presumptions but allows exceptions for both core and non-core proceedings.[43]

The correct solution requires careful thought and analysis and must continue to give due deference not only to the needs of the debtor and the creditors but also to the contractual choice made by the parties to have any disputes resolved in the forum selected by the parties, a choice that can have significant impact on whether a deal is struck and on the economics of the transaction.[44]

The case-by-case analysis of the facts and of the impacts on the bankruptcy in each proceeding in which the enforceability of the arbitration clause can in good faith be debated has created a fertile field for arguments by both those who seek to enforce an arbitration agreement and those who seek to block it. Creative litigants will doubtless find many arguments to support their position.[45] Until such time as Congress or the Supreme Court steps in to simplify the task and create a more predictable litmus test, there will be little certainty in some cases as to whether an arbitration agreement will be enforced in a bankruptcy.

Endnotes

1. Administrative Office of the U.S. Courts, News Release August 13, 2009, *available at* http://www.uscourts.gov/Press_Releases/2009/BankruptcyFilingsJun2009.cfm.
2. For an overview on the subject, see 8 Norton Bankr. L. & Prac. 3d § 169:4 (2009).
3. Federal Arbitration Act, which comprises Chapter 1 of Title 9, is codified at 9 U.S.C. §§ 1-16 (2000). *See* § 2.
4. *See, e.g., Gilmer v. Interstate Johnson Lane Corp.*, 500 U.S. 20, 26 (1991).
5. *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 221 (1985).
6. 11 U.S.C. §§ 101 *et seq.*
7. *See, e.g., In re United States Lines*, 197 F. 3d 631, 640 (1999).
8. *Id.* at 640 (citations omitted).
9. 712 F.2d 55 (3d Cir. 1983).
10. *Id.* at 56.
11. 482 U.S. 220 (1987).
12. *Id.* at 227.
13. See discussion in *Hays and Co. v. Merrill Lynch Pierce Fenner & Smith Inc.*, 885 F.22d 1149, 1157 (1989) of the scope of the bankruptcy court's jurisdiction.
14. *Id.*
15. *Id.* at 1154.
16. *Id.* at 1161.
17. *Id.*
18. *See, e.g., In re Crysen/Montenay Energy Co.* 226 F.3d 160, 166 (2d Cir. 2000) ("Bankruptcy courts generally do not have discretion to decline to stay non-core proceedings in favor of arbitration"); *In re Electric Machinery Enterprises Inc.*, 479 F.3d 791 (11th Cir. 2007).
19. 458 U.S. 50 (1982).
20. *See* 28 U.S.C. § 157 (b)(A)-(O).
21. Jason C. Matson, *Running Circles Around Marathon: The Effects of Accounts Receivable as Core or Non-core Proceedings in Article III Courts*, 20 Emory Bankr. Dev. J. 451, (2004).
22. *Supra* note 7.
23. *Id.* at 637.
24. *Id.*
25. 118 F. 3d 1056 (5th Cir. 1997).
26. *Id.* at 1067.
27. *Id.*
28. *Supra* note 7.
29. *Id.* at 640.
30. However, the Second Circuit did not look to whether the claim derived exclusively from the provisions of the Bankruptcy Code as seems to be required by the *In re National Gypsum* decision. See discussion of this point in *Jurisdiction in Bankruptcy Proceedings: A Test Case for Implied Repeal of the Federal Arbitration Act*, 117 Harv. L. Rev. 2296 (2004).
31. 436 F.3d 104 (2d Cir. 2006).
32. *Id.* at 108.
33. 434 F.3d 222 (3d Cir. 2006).
34. 403 F.3d 164 (4th Cir 2005).
35. *Id.* at 168.
36. Bnkrtcy No. 07-11522-HB, Adv. No. 08-1173, 2009 WL 86968 (Bkrtcy. D. Mass., Jan 13, 2009); there is no First Circuit precedent on this issue.
37. *Id.* at 8.
38. *Id.*
39. *See, e.g.*, Mette H. Kurth, *Comment: An Unstoppable Mandate and an Immovable Policy: The Arbitration Act and the Bankruptcy Code Collide*, 43 UCLA L. Rev. 999 (1999); Matthew Dameron, *Stop the Stay: Interrupting Bankruptcy to Conduct Arbitration*, 2001 J. Disp. Resol. 337 (2001).
40. The arbitration agreement is viewed in the case law as a separate agreement from the rest of the contract. *See, e.g., Prima Paint v. Flood & Conklin*, 388 U.S. 395 (1967).
41. *Note: Jurisdiction in Bankruptcy Proceedings: A Test Case for Implied Repeal of the Federal Arbitration Act*, 117 Harv. L. Rev. 2296 (2004).
42. Michael Fielding, *Elevating Business Above the Constitution: Arbitration and Bankruptcy Proofs of Claim*, 16 Am. Bankr. Inst. L. Rev. 563 (2008).
43. Alan Resnick, *The Enforceability of Arbitration Clauses in Bankruptcy*, 15 Am. Bankr. L. Rev. 183 (2007).
44. *14 Penn Plaza LLC v. Pyett*, 129 S. Ct. 1456, 1464 (2009); *Bremen v. Zapata Off-Shore Company*, 407 U.S. 1, 14 (1972); *Roby v. Corporation Lloyd's*, 996 F.2d 1353, 1363 (2d Cir. 1993).
45. For a discussion of some of the strategies for avoiding arbitration in bankruptcy, see Michael Fielding, *How to Avoid Arbitration in Bankruptcy*, 26-6 American Bankruptcy Institute Journal 24 (July 2007).

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Soup Can or Can of Worms? Legal Issues Arising from the Warhol Estate

By Carol Heckman

Background

Andy Warhol was perhaps one of the most notorious and productive artists of our time. He has recently been dubbed the "unquestioned star of the New York contemporary art sales," with more than 43 works breaking the $1 million barrier.

Warhol died unexpectedly in 1987 following gall bladder surgery, leaving his assets in turmoil and his business affairs in disarray. His estate contained a vast array of holdings, based on his life as a collector, compulsive shopper and prolific artist. These assets included over 75,000 pieces of his own art work, his personal art collection, antique furniture and jewelry, his films, his diaries, real estate partnerships, the profitable magazine *Interview*, trademark and licensing agreements, and a stock and bond portfolio. Warhol's will provided that the bulk of his assets would go into the Andy Warhol Foundation for the Visual Arts (the Foundation).

Warhol's executor was Frederick Hughes, a close business advisor of Warhol for over 20 years. Hughes retained Edward Hayes as counsel for the estate. Hayes was a well-known criminal and civil litigator who was the model for a character in the best-selling book, *Bonfire of the Vanities*. Hayes devoted himself full-time to the Warhol estate, giving up his law practice and moving into the Factory, Warhol's art studio and office. As the years unfolded, Hughes, Hayes and The Foundation were often at odds with one another and with third parties.[1] Many of those disputes found their way into the courts, and raised important legal issues in virtually all aspects of art law. Discussed below are some of the important cases and the issues that they explore.

I. Valuation Issues

The day after Warhol's death, Hayes entered into a fee arrangement with Hughes, providing for a fee of 2.5 percent of the gross estate, which was then estimated to be worth approximately $100 million. Five weeks later, when it was learned that the estate's value was significantly higher than anticipated, Hayes reduced his compensation to 2 percent of the gross estate. A year later, the fee agreement was amended yet again to pay Hayes an executor's commission which was somewhat greater than the once adjusted fee of 2 percent.[2]

In the first four years of administering the estate, Hayes received advances of $4.85 million under the retainer agreement. These payments were approved by the Surrogate's Court at the time they were made. While this amount at first blush seems high, Hayes, at Hughes's request, agreed to devote his entire practice to the Warhol estate. This meant that Hayes was available around the clock and concerned himself exclusively with estate issues, which covered a broad spectrum of tasks. During the estate's administration, sales of Warhol's art alone totaled $32 million. Hayes also entered into contracts to sell a number of the Warhol assets, avoided a will contest by Warhol's brothers, defended claims of ownership regarding Warhol's art and real property, and represented the estate during disputes over the pension fund, income tax issues, collection of insurance for art loss by the Museum of Modern Art, customs duty claims for overseas assets, and a claim brought by Bianca Jagger in England concerning the ownership of the rights to Warhol's diaries. In addition, Hayes successfully negotiated with the Museum of Modern Art for a retrospective of Warhol's art and with Sotheby's for a series of auctions of Warhol's collectibles, a series which resulted in sales of over $25 million. Hayes's efforts were described as "pivotal" in securing Warhol's stature in the estate's assets throughout the administration of the estate.[3]

In November of 1989, Hughes appointed Archibald Gillies as President of the Foundation. Over time, significant conflicts developed among Gillies, Hughes and Hayes, leading ultimately to Hayes's termination as counsel for the estate. For example, Gillies accused Hayes of bungling several transactions, including the sale of *Interview* magazine and the licensing agreement with Schlaifer Nance (*see* section VI, *infra*). Hayes's efforts to collect the balance of his fee under the retainer agreement were opposed by the Foundation, and ultimately caused his financial ruin.

Although there was subsequent litigation as to the amount of that fee (*see* section II, *infra*), the first hurdle was to establish the estate's value. This was an obstacle in and of itself, as it has been recognized that the value of any art collection is "inherently imprecise and capable of resolution only by a Solomon-like pronouncement."[4] In this case, both the executor and the executor's attorney had an incentive to place a high value on the estate because both were to be paid a percentage of its value. The Foundation, in contrast, wanted a lower value, because it had to donate 5 percent of the estate's assets every year in order to comply with tax rules governing foundations. The Foundation settled with Hughes out of court, in an arrangement that included both cash and valuable art. The dispute with Hayes could not be settled, reportedly due to the deep hostility between Hayes and Gillies.

Six-hundred million dollars separated the parties. All agreed that the value of the art should be determined as of the date of the transfer of the art from the estate to the Foundation (February 1, 1991) and should be determined in accordance with "the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts."[5] The parties also agreed as to the precise artworks within the inventory. The inventory included 4,118 paintings, 5,103 drawings, 19,086 prints, and 66,512 photographs. The Foundation relied upon an appraisal done by Christie's Appraisals, Inc. (Christie's).[6]

The Surrogate's Court initially criticized the Christie's appraisal for its failure to contain research regarding the marketability of Warhol's art. The court noted that no one at Christie's discussed Warhol's art with contemporary art dealers, museum officials, or others to inform themselves of Warhol's position in the existing art market. The court also accused Christie's of failing to consider Warhol's importance as an artist, as well as his staying power and marketability. Perhaps the most glaring error in Christie's valuation was its failure to consider comparable sales. Christie's did consider some of its own auction sales and some of Sotheby's, but it was selective in considering these sales, and it completely ignored many sales consummated by other auction houses. The court found that such a limited focus was inadequate, considering the availability of this other sales information and that dealer, auction, and private sales should have all been considered in creating the valuation. On the other hand, experts presented by Hayes were criticized by the court for concentrating unduly on retail sales, which often inflate values.[7]

Another critical flaw in the Christie's appraisal was the presence of a fairly obvious conflict of interest. At the same time that Christie's was doing its appraisal, it was also negotiating with the Foundation regarding the auctioning of Warhol art objects. The court found that Christie's had a conflict in seeking future business from the Foundation at the same time it was retained to render an impartial appraisal of the collection.[8]

Furthermore, there was an issue regarding valuation, and whether to apply a blockage discount. As fair market value must be determined as of the date of transfer from the estate to the Foundation, it was necessary to decide whether an entire block of art could be sold immediately without depressing the market. The proper assumption, according to the court, was that the buyer would sell the artwork over the period of time that would produce maximum value, rather than from a forced or immediate sale. In most situations, however, this process would result in a discount from total unit value.[9]

The court's discussion of the discount rate included reference to cases involving two other prominent artists: David Smith (where a discount rate of 37 percent was applied) and Georgia O'Keeffe (where a limited discount of 50 percent was applied). Accordingly, the court then applied different discount rates, depending on the type of artworks. Thus, for photographs, the court applied a discount of 20 percent; for paintings, sculpture and collaborative work, 20 percent; for drawings, 50 percent, and for prints, 30 percent.

The court concluded that the total estate valuation on the transfer date was $390,979,278. Including non-art assets, the fair market value of the gross estate was $509,979,278.[10]

II. Attorney's Fees

With the value of the estate established, the next step was to set Hayes's attorney's fees. In 1995, the Surrogate's Court found that Hayes' retainer agreement was unenforceable because it contained no ceiling or limiting provision.[11] However, recognizing the value of Hayes's services as counsel for the estate, the court conducted an independent evaluation and concluded that the services were worth $7.2 million. This opinion was based in part on the view that Hayes's services were akin to those of an executor, and not merely legal in nature. The award of $7.2 million in attorney's fees was well in excess of the roughly $2.5 million that Hayes expected to receive under the initial retainer agreement, but in light of the subsequent valuation of the estate by the Surrogate's Court, the award of fees was considerably less than the sum to which he was entitled under the most recent retainer agreement.

The issues were bitterly fought. Upon appeal, the Appellate Division reduced the valuation of Hayes's services from $7.2 million to $3.5 million.[12] The court disagreed with the lower court's analogy to services of an executor, noted that Hayes was not a specialist in the relevant field and found that the fee award would result in his being compensated at an "exorbitant hourly rate."[13]

Ironically, the effect of the Appellate Division's judgment in 1996 was that Hayes then owed the estate $1.85 million from the $4.85 million that he had previously been advanced. The estate assigned this judgment to the Foundation on August 2, 1996. Within days, Hayes filed for bankruptcy.

The stage then turned to bankruptcy court litigation. The Foundation sought to assert that the debt owed by Hayes to the estate was non-dischargeable in bankruptcy, alleging that Hayes had committed "fraud or defalcation" while acting in a fiduciary capacity. The bankruptcy court held that Hayes had not acted in a fiduciary capacity within the meaning of a relevant portion of the Bankruptcy Code, and thus did not reach the question of whether his debt resulted from a defalcation. The District Court affirmed.[14]

In yet another twist in the litigation, the Second Circuit reversed.[15] After an extensive discussion of rather complex legal issues, the court agreed with the Eighth Circuit in holding that the attorney-client relationship, without more, constitutes a fiduciary relationship within § 523(a)(4) of the Bankruptcy Code.[16] The court then proceeded to find that Hayes committed a defalcation under the Code. It noted that the value of his services was irrelevant to the fees he sought, there was no cap on fees, and Hayes expected periodic payments to be made without regard to the value of past or future services. The court found this to be inconsistent with Hayes's obligation to deal fairly with the estate in establishing a fee arrangement. Instead, fees were matched to the art market. The court thus found that his conduct was sufficiently at odds with his fiduciary obligations to constitute a defalcation within the meaning of § 523(a)(4) of the Bankruptcy Code.

III. Trademark Issues

Warhol's vast collection of artwork includes numerous examples of depictions of well-known consumer goods. Perhaps his most famous are his Campbell's soup cans, which represent images of readily identifiable trademarks. Do these depictions violate either state or federal trademark law? Probably not, because Warhol did not use the trademark names to identify the source of the artwork. Without using the mark name to identify the artwork's source, Warhol did not imply that Campbell's endorsed the works.[17]

Early on, Warhol's estate and the Foundation did not shy away from initiating trademark infringement litigation. For example, in *Hughes v. Plumsters, Ltd.*,[18] the Foundation and the estate sued a company marketing a t-shirt bearing the name of Andy Warhol with the assertion that Andy Warhol, as a name, had established trademark rights. The defendant claimed that the t-shirt was a parody of Warhol's works, which would preclude any potential trademark infringement liability, even if likelihood of confusion were proven. The court in *Plumsters* held that there was a jury question regarding any likelihood of confusion as to who created the t-shirt.[19]

Hughes v. Design Look, Inc.[20] represented another aggressive attempt by the estate to assert intellectual property rights. However, the estate and the Foundation were unsuccessful in obtaining a preliminary injunction that would have prevented the defendant's production of a calendar with images created by Warhol, but which were no longer owned by the estate. The preliminary injunction application was denied because the plaintiffs did not show likelihood of success on the merits, failed to show secondary meaning, and conceded that the works were not protected by copyright or trademark.

In *Andy Warhol Enters., Inc. v. Time Inc.*,[21] the estate likewise failed to obtain a preliminary injunction against Time Inc. in a trademark infringement action for use of a section heading entitled "Interview" in its *Time* magazine. As mentioned above, *Interview* was a magazine founded by Andy Warhol, which ultimately went into his estate. *Interview* was registered by Warhol as a trademark with the U.S. Patent and Trademark Office. However, the court found that the estate had not shown any likelihood of confusion, because the *Interview* mark and the "Interview" word, as used in a heading for the magazine, did not look alike and were not used in the same fashion. The court also found that the defendant would be entitled to the fair use defense because it was not using the word "Interview" as a mark, but rather to designate a section in its magazine. Finally, the court denied the plaintiffs' claim under the New York State anti-dilution statute because the mark was not distinctive enough to support a dilution claim.

IV. Misappropriation of Images

The estate was not always the initiator of litigation. In *Dauman v. Warhol Found. for the Visual Arts*,[22] the Foundation, the estate, and the museum found themselves as defendants, again involving use of an image. The allegation of the plaintiffs, photographer Henri Dauman and Time Inc., was that the defendants unlawfully appropriated an image of Jacqueline Kennedy taken in 1963 at John F. Kennedy's funeral.[23] These images were later featured in the December 6, 1963 issue of *Life* magazine. Specifically, the plaintiffs alleged that Warhol used eight source images from newspapers and magazines, including the image from the funeral, to create silk screens which were used in turn to create the famous Warhol series on Jacqueline Kennedy. In the court's decision, a motion to dismiss the complaint was denied. The case was later settled for an undisclosed amount that a lawyer involved in the case put at "several hundred thousand dollars." The Jackie series, the basis for the litigation, continues to command top dollar in the contemporary art market, most recently selling for $15.6 million at a Christie's auction in November of 2006.

V. Insurance

The dispute over the Jacqueline Kennedy photograph also gave rise to important insurance coverage litigation in the Second Circuit. As discussed above, when Dauman and Time Inc. filed a copyright infringement suit against the Foundation and the estate for use of the photograph of Jacqueline Kennedy, both Warhol entities claimed insurance coverage. The insurance company refused coverage on the basis that it had not been given timely notice.

In 1994, the photographer wrote a letter to Warhol's estate advising that he would likely bring a lawsuit against it unless a monetary resolution could be achieved. Warhol's estate did not give notice of the threatened claim to its insurance carrier until two years later, when the actual suit was brought. The Second Circuit, following New York law and quoting Henry Wadsworth Longfellow, held that Time, Inc.'s claim was different than the photographer's claim. The photographer could not, and did not, speak for Time, Inc. when he wrote the 1994 letter regarding notice of suit. By the same token, he could not, and did not, assert a claim on behalf of Time, Inc. Accordingly, notice of Time, Inc.'s claim was timely under the policy.[24]

VI. Licensing Issues

The licensing of Warhol t-shirts was a lucrative business. In 1987, the estate entered into an exclusive licensing arrangement with Schlaifer Nance and Company, Inc. (SNC) to use and license others to use reproductions and copyrighted works of art created by Warhol, along with associated trademarks in connection with various products. SNC was the developer of the Cabbage Patch Kids program. In connection with that program, SNC had commissioned Andy Warhol to do portraits of four Cabbage Patch dolls. Early discussions had occurred prior to Warhol's death, but the final licensing agreement was dated November of 1987. This licensing agreement spawned extensive litigation.

In 1990, SNC sued the estate in federal court, alleging that the estate had breached its licensing agreement and engaged in tortious conduct. SNC also brought an arbitration claim based on a limited arbitration clause in the agreement. At the heart of the arbitration was the Foundation's 1989 agreement with the Dia Art Foundation and the Carnegie Institute to establish the "Andy Warhol Museum." The museum agreement allegedly violated rights granted to SNC under its licensing agreement, including the exclusive right to produce and sell licensed products, the right to register, own and use the trademark "Andy Warhol Museum," and the right of first refusal. In June of 1991, the arbitrators awarded $4 million to SNC, including punitive damages, finding that the estate not only breached the licensing agreement, but also conducted itself in bad faith by unreasonably rejecting products and failing to cooperate and assist in promoting the licensing program. The estate paid the arbitration award in full.

The remaining claims concerning the agreement were litigated in federal court. The court in the first reported case, *Schlaifer Nance and Co., Inc. v. Estate of Warhol*,[25] denied the estate's motion for summary judgment, finding that the claims in arbitration were in fact distinct from the claims in federal court proceedings. In 1995, the court in *Schlaifer Nance and Co., Inc. v. Estate of Warhol*,[26] denied the defendant's motion to dismiss the common law fraud claims, which comprised the only claims left remaining in the action. They accused the defendants of fraudulently inducing SNC to enter into a licensing agreement with the estate, alleging that the estate misrepresented itself as the sole owner of certain rights to Warhol's works. The claims also alleged that the estate fraudulently maintained that it would continue to have the exclusive right to transfer its rights to SNC, that those rights did not infringe upon the rights of third-parties, and that neither Warhol nor the estate had granted similar rights to anyone other than SNC.

The case went to trial in June of 1995. After seven days, the jury returned a verdict in favor of SNC, finding that all three defendants had fraudulently induced SNC to enter into a licensing agreement with the estate.[27] The jury awarded punitive damages for $1 million against all three defendants. The compensatory damage award of $63,943 was relatively modest.

The trial court, however, set aside the jury verdict. On appeal, the Second Circuit, in *Schlaifer Nance and Co., Inc. v. Estate of Warhol*,[28] affirmed the lower court's decision. The court found that there was no question that the estate misrepresented its position in assuring SNC that it controlled all rights to Warhol's works when clearly it did not. These misrepresentations included failure to disclose a prior agreement for the exclusive production of watches and the claim of art dealer Ronald Feldman to reproduction rights of certain works published in collaboration with Fotofolio.

Nevertheless, the Second Circuit found that it was unreasonable for SNC, a sophisticated licensing company, to rely on the estate's representations without verifying them. The agreement, along with the estate's actions and other circumstances, "should have raised more than one eyebrow," compelling SNC to conduct further investigation.[29] Even before Warhol's death, SNC was informed that he did not own the copyrights to all of his images. Furthermore, the sheer magnitude of the body of his works made it difficult to keep all of them out of the public domain. In addition, because Warhol spent a significant portion of his career as a commercial artist, he often sold the rights to commissioned works to his clients, thereby surrendering any copyrights that he may have otherwise owned. Where a commercial artist's work is made for hire, the rights rest with the employer or person for whom the work is prepared. SNC could not even rely on ignorance as an excuse, because it had previously hired a copyright attorney who helped explain the copyright issues.

However, the litigation did not end there. Having succeeded in overturning the jury award, the estate's lawyers launched an offensive attack on SNC. In 1998, the District Court awarded sanctions against SNC and its attorneys for prosecuting a meritless claim in bad faith.[30] The court found that it was clear from the outset that SNC and its lawyers could not prove reasonable reliance upon the estate's representations, yet they pursued fraud claims nonetheless. The Court held that SNC and its lawyers knew that the estate could not possibly own all the copyrights to all of Warhol's works because, as discussed above, many had already fallen into the public domain and the copyrights to certain others had been granted to third parties. Without conducting any due diligence or engaging in any worthwhile investigation, SNC nevertheless entered into the licensing agreement.

On appeal, this decision favoring the estate was reversed.[31] The Second Circuit found that the estate failed to show that SNC's action lacked a "colorable basis" or that SNC acted in bad faith. The court further found that the estate itself had unclean hands because it had engaged in some outrageous and deceptive conduct. Holding that the judgment as a matter of law granted against SNC's claim was a necessary but not a sufficient condition for finding a total lack of a colorable basis, the Second Circuit went on to point out the facts that supported SNC's case. These included the jury finding in favor of SNC, the opinion letter issued by the estate vouching for the *bona fides* of the estate's copyrights, and the pre-agreement evidence regarding lack of copyrights. These facts, taken together, provided a colorable basis for SNC's claim.

On the state court front, a sublicensee of SNC, Artwear, sued the estate to recover damages arising out of the estate's refusal to approve any of its products for distribution under the sublicense agreement.[32] Under the licensing agreement between the estate and SNC, the estate could not unreasonably withhold approval of a product. In contrast, under the sublicense agreement, approval could be withheld in SNC's sole discretion in conjunction with the estate. Unfortunately for Artwear, by the time the sublicense agreement was entered into, the relationship between SNC and the estate had deteriorated and none of Artwear's products were ever approved. Artwear's complaint was dismissed by the state Supreme Court and that dismissal was affirmed by the Appellate Division. The court held that Artwear was not a third-party beneficiary of the licensing agreement, that as a subcontractor it had no claim for intentional interference with contractual rights, and that it could not sue the estate for breach of the licensing agreement to which it was not a party.

VII. Authentication Issues

As the Warhol estate has proven, the value of some art pieces can be astronomical. With such a high demand for quality art, replicas, fakes and forgeries invariably find their way into the marketplace. In fact, an estimated 10 percent of all art transactions contain these unauthentic works, which undoubtedly fool many unsuspecting customers into paying far too much.

Given this, it is not surprising that unhappy purchasers look for remedies when authenticity issues arise. Relief may be found for these buyers under common law tort or contract doctrines, in addition to any state laws[33] regarding the sale of counterfeit goods. For example, a buyer may recover from the seller using a common law tort action for fraud, the proof for which varies among each state.[34] If a potential buyer wishes to rescind a contract involving an unauthentic work, he or she may do so on the grounds of misrepresentation. Another basis for recovery lies in the doctrine of mutual mistake.[35]

With the presence of so many forged works in the art market, many art experts are reluctant to give an opinion regarding a work for fear of potential litigation if they are wrong. They are also concerned about potential damage to their reputations if they provide opinions that are at odds with other experts. Perhaps the best illustration of this predicament comes from the early case of *Hahn v. Duveen*.[36] Here, an expert opined that the plaintiff's painting lacked authenticity. The plaintiff asserted that these comments caused a museum to cancel its plans to purchase the painting. Although the expert claimed that his statements were protected under a "fair comment" defense, the case ultimately settled outside of court for a sum of $60,000.

A case regarding authentication issues involving Warhol is currently pending in the U.S. District Court for the Southern District of New York.[37] In this action, Joe Simon-Whelan, the owner of an alleged Andy Warhol art piece that Simon-Whelan himself affectionately dubbed "Double Denied,"[38] is seeking $20 million in damages from the Foundation.

Simon-Whelan claims that the Foundation, the entity that authenticates true Andy Warhol works, refused to authenticate an alleged true Warhol piece in an attempt to artificially inflate the prices of the Warhol works that the Foundation itself owns and sells. Of note is the fact that "Double Denied" has a note written on one of its edges by Hughes, executor of the Warhol estate, which states: "I certify that this is an original painting by Andy Warhol completed by him in 1964." Other evidence in support of the authenticity of "Double Denied" includes letters written by Billy Name, a photographer who worked closely with Warhol. On May 26, 2009, the District Court dismissed the plaintiff's antitrust claims and Lanham Act claim, but allowed the case to proceed on all other claims. It will be interesting to see how the court rules if it finds malicious intent (due to knowledge of falsity or reckless disregard for the truth), or that the Foundation was not reviewing the proposed works with the normal duty of care expected from the art expert professional.

Another case involving similar issues is pending in state court in Brooklyn. The plaintiff, an artist and former Warhol assistant, claims to have created 320 silk screens of the artist John Chamberlain without Warhol's knowledge, 315 of which were later incorporated into Warhol-like silk screens ("315 Johns"). Chamberlain allegedly sold the works as genuine Warhols, citing a 2000 opinion by the Warhol Art Authentication Board as proof of their authenticity. In a recent decision, the court allowed the plaintiff's claim to go forward to trial, refusing to recognize the Authentication Board's decision as conclusive.[39]

Conclusion

The many issues surrounding this colorful artist's estate have been vigorously litigated in a variety of state and federal courts and in arbitration. The twists and turns in these cases provide personal drama, to be sure. In addition, the resulting precedents—still good law—provide a survey of many of the most important topics in art law.

Endnotes

1. Paul Alexander, Death and Disaster: The Rise of the Warhol Empire and the Race for Andy's Millions, 1994, Villard Books.
2. An executor's commission is fixed by statute and is calculated on a sliding scale, ranging from 2.5% to 5% for the first $5 million and 2 percent for all amounts over $5 million. N.Y. Sur. Ct. Proc. Act § 2307(1) (2008). Under this latter agreement, the value of the assets of the estate was measured as of the date of distribution, rather than the date of death.
3. *In re Estate of Warhol*, 165 Misc. 2d 726, 734, 629 N.Y.S.2d 621, 625 (Sur. Ct., N.Y. Co. 1995).
4. *In re Estate of Warhol*, 1994 N.Y. Misc. LEXIS 687 (Sur. Ct., N.Y. Co., 1994) (quoting Morris M. Messing, 48 T.C. 502, 512 (T.C. 1967)).
5. *Id.* at *2 (citing Treas. Reg. § 20.2031-1(b) (1965)).
6. *Id.* at *11.
7. *Id.* at *6–10.
8. *Id* at *11–12.
9. *Id.* at *13–14.
10. *Id.* at *31.
11. *In Re Estate of Warhol,* 629 N.Y.S.2d 621 (Sur. Ct. 1995).
12. *In re Estate of Warhol*, 224 A.D.2d 235, 637 N.Y.S.2d 708 (1st Dep't 1996).
13. *Id.* at 224 A.D. 2d at 237, 637 N.Y.S. 2d at 710.
14. *Andy Warhol Found. for the Visual Arts, Inc. v. Hayes (In re Hayes),* 1998 U.S. Dist. LEXIS 2871, at *1 (S.D.N.Y. March 11, 1998).
15. *Andy Warhol Found. for the Visual Arts, Inc. v. Hayes (In re Hayes),* 183 F.3d 162 (2d Cir. 1998).
16. *Id.* at 170 (citing *Tudor Oaks Ltd. Pshp. v. Cochrane (In re Cochrane)*, 124 F.3d 978, 984 (8th Cir. 1997)).
17. *See Lord Simon Cairns v. Franklin Mint Co.*, 107 F. Supp. 2d 1212 (C.D.CA. 2000).
18. 1989 U.S. Dist. LEXIS 16452, at *1 (N.D.CA. Aug. 28, 1989).
19. Likelihood of confusion represents the essential test in which a court determines whether a consumer may be confused as to the source of a particular product. If such confusion exists, liability for trademark infringement arises absent any attainable defense.
20. 693 F. Supp. 1500 (S.D.N.Y. 1988).
21. 700 F. Supp. 760 (S.D.N.Y. 1988).
22. 1997 U.S. Dist. LEXIS 8606, at *1 (S.D.N.Y. June 19, 1997).
23. Ironically, this same photographer who sued for the misappropriation of the Jackie picture, Henri Dauman, took portraits of Warhol in his studio for *Life* magazine and provided other source photos for Warhol's works.
24. *Warhol Found. for the Visual Arts, Inc. v. Fed. Ins. Co.,* 189 F.3d 208 (2d Cir. 1999).
25. 764 F. Supp. 43 (S.D.N.Y. 1991).
26. 1995 U.S. Dist. LEXIS 1767, at *1 (S.D.N.Y. Feb. 15, 1995).
27. *Schlaifer Nance and Co., Inc. v. Estate of Warhol,* 927 F. Supp 650, 651 (S.D.N.Y. 1996).
28. 119 F.3d 91 (2d Cir. 1997).
29. *Id.* at 99.
30. *Schlaifer Nance and Co., Inc. v. Estate of Warhol*, 7 F. Supp. 2d 364 (S.D.N.Y. 1998).
31. *Schlaifer Nance and Co., Inc. v. Estate of Warhol*, 194 F.3d 323 (2d Cir. 1999).
32. *Artwear Inc. v. Hughes*, 202 A.D.2d 76, 615 N.Y.S.2d 689 (1st Dep't 1994).
33. For example, New York law establishes that any art merchant who sells a work to a nonmerchant buyer creates an express warranty if he identifies the work with an author. N.Y. Arts & Cult. Aff. Law § 13.01 (McKinney 1984).
34. The basic elements of a common law fraud claim include a seller making a misstatement that (1) is related to a material matter of fact, (2) was made with intent to induce reliance, (3) induced justifiable reliance, and (4) resulted in damages suffered by the buyer. Restatement (Second) of Torts § 552C.
35. Under this doctrine, it must be shown that (1) the mistake was a basic assumption on which the contract was made, (2) the mistake had a material effect on the agreed-upon exchange of performance, and (3) the adversely affected party did not assume the risks of the mistake. Restatement (Second) of Contracts § 152.
36. 234 N.Y.S. 185 (Sup. Ct. 1927).
37. *Simon-Whelan v. Andy Warhol Found. for the Visual Arts, Inc.,* No. 1:07-cv-06423-LTS (S.D.N.Y. filed July 13, 2007).
38. This name refers to the fact that the Foundation twice stamped "Denied" in red ink onto the back of Simon-Whelan's piece, which consists of a Warhol self-portrait silk-screen on canvas with peach-colored background.
39. 2009 U.S. Dist. LEXIS 44242.

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Ethics Opinion 831

Committee on Professional Ethics of the New York State Bar Association

08/14/09

Topic: Disclosure of fraud on the tribunal and fraudulent conduct

Digest: Where a lawyer learns that a client, before April 1, 2009 (the effective date of the new N.Y. Rules of Professional conduct), had committed fraud on a tribunal, the lawyer's obligation to disclose the fraud is governed by DR 7-102(B)(1) of the former Code of Professional Responsibility, which generally did not permit disclosure of confidences or secrets, and not by rule 3.3 of the new Rules of Professional Conduct, which may require disclosure of confidential information necessary to remedy the fraud. Where the fraud occurred before April 1, 2009, this conclusion applies whether the lawyer learns of the fraud before or after April 1, 2009

Rules and Code: Rules 1.0(i), 1.6, 1.7(b)(4), 1.9(a), 3.3(b); Code Definitions "fraud"; DR 4-101, 7-102(B)(1)

Question

1. Where a lawyer, prior to April 1, 2009, represented a client in obtaining a conditional discharge of a misdemeanor charge, contingent on the client's not being arrested for a period of time, and then, after April 1, 2009, the lawyer learned from the client that the client had been arrested shortly before the plea, must the lawyer disclose the arrest to the prosecutor or the tribunal?

Opinion

2. The inquirer represented a defendant accused of a misdemeanor. The inquirer arranged a plea bargain under which the defendant pleaded guilty to a violation of disorderly conduct with a conditional discharge. Under the terms of the sentence of conditional discharge, the defendant avoided incarceration or probation as long as she was not arrested within the next six months. In the course of the plea, the client represented to the court and the prosecutor that she (the client) had "stayed out of trouble" since the misdemeanor arrest.

3. A short time later, but after April 1, 2009, the client told the inquirer that in fact she had been arrested the week before the plea in a different county. The inquirer asks whether he must inform the prosecutor or the court about the client's prior arrest.

4. New York adopted new Rules of Professional Conduct that became effective on April 1, 2009.[1] Both the new Rules and the former Code of Professional Responsibility have provisions addressing a lawyer's obligations where a client engages in fraudulent conduct before a tribunal. Both provisions require a lawyer to take remedial measures, but the rules differ on two significant points: First, and most clearly, the provisions differ on the critical question of whether a lawyer must disclose protected confidential information if required to remedy the fraud. Second, the definition of "fraudulent conduct" in the new rules differs from the interpretation we placed on the definition of "fraud" in the old rules with respect to whether fraudulent conduct includes misleading or deceptive conduct short of actual fraud under the applicable law.[2]

5. Under DR 7-102(B)(1) of the old Code, a lawyer who learned that a client had "perpetrated a fraud upon a person or tribunal" was required to "promptly call upon the client to rectify the same. If the client refuse[d] or [was] unable to do so," the lawyer was required to "reveal the fraud to the…tribunal, *except when the information is protected as a confidence or secret*." (Emphasis added.)[3]

6. Rule 3.3(b) of the new Rules eliminates the exception for confidences and secrets (now called simply "confidential information"). Rule 3.3(b) provides:

> A lawyer who represents a client before a tribunal and who knows that a person intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal.

7. Contrary to the Code exception for confidences and secrets, new Rule 3.3(c) expressly states that this duty applies "even if compliance requires disclosure of information otherwise protected by Rule 1.6." (Rule 1.6 defines the protections accorded to confidential information.)[4]

8. There is also a difference in the definitions of the applicable conduct that triggers this require-

ment, at least as we had interpreted it. The definition of the term "fraud" in the old Code was not a definition as such, but rather a clarification. It said:

> "Fraud" does not include conduct, although characterized as fraudulent by statute or administrative rule, which lacks an element of scienter, deceit, intent to mislead, or knowing failure to correct misrepresentations which can be reasonably expected to induce detrimental reliance by another.

9. In the absence of a Code definition of "fraud," we interpreted the term "fraud upon a tribunal" in DR 7-102(B) to refer to the term "fraud" in the law outside of the Code (except to the extent that any such law should require a mental state other than that set forth in the above definition). We said in N.Y. State 797 (2005), "Whether the client has committed fraud on the court is a legal question beyond the jurisdiction of this Committee."[5]

10. The definition of "fraud" or "fraudulent" in the new rule appears to be broader. It provides:

> "Fraud" or "fraudulent conduct" denotes conduct that is fraudulent under the substantive or procedural law of the applicable jurisdiction *or has a purpose to deceive*, provided that it does not include conduct that, although characterized as fraudulent by statute or administrative rule, lacks an element of scienter, deceit, intent to mislead, or knowing failure to correct misrepresentations that can be reasonably expected to induce detrimental reliance by another.[6]

While the new phrase "denotes conduct that is fraudulent under the substantive or procedural law of the applicable jurisdiction" codifies our interpretation of "fraud" under the Code, the inclusion of the disjunctive "or has a purpose to deceive" would appear to draw in conduct beyond conduct that constitutes "fraud" under applicable law.[7]

11. In this case, any "fraud" or "fraudulent conduct" occurred prior to April 1, 2009. In N.Y. State 829 (2009), we opined that the new rules requiring that waivers of conflicts of interest be "confirmed in writing"[8] apply only to waivers given by clients after April 1, 2009. We relied both on the language of the particular rules at issue there as well as on the general rule that, unless otherwise clearly stated, statutes are to be construed as prospective in application only.[9]

12. The application of the effective date here is less straightforward. The language of the rule does not provide much guidance. Conceivably, because the rule speaks of a lawyer who "knows" of fraudulent conduct—in the present tense—it could be interpreted to refer to anyone who has such knowledge on or after the effective date, regardless of when the fraudulent conduct occurred and regardless of when the lawyer learned of that conduct. We do not believe this interpretation is correct. The new rule is a dramatic break from the prior understanding of a lawyer's duties in the face of improper conduct by a client or witness.

13. The presumption that new rules do not apply retroactively has particular strength where a person may rely on the pre-existing rules. Where the rules have changed, a client—even a client who has engaged in fraud—should be able to rely on the advice or warnings he or she may have received, or the correct understanding he or she had, regarding the "rules of the road" that govern the lawyer-client relationship. We believe the same should apply whether the lawyer learns of the fraud before or after April 1, 2009, as long as the client's fraudulent conduct occurred prior to that date. The client has committed himself or herself when the fraud occurred.[10]

14. In this case, as noted, the fraudulent conduct in question occurred before the effective date of the new rules. We therefore apply DR 7-102(B)(2) and not Rule 3.3(b) to determine whether the lawyer has an obligation to disclose the fact that the client was arrested a week before entering a conditional discharge plea. Even if the client's false representation that he had stayed out of trouble was a "fraud on the tribunal" within the meaning of DR 7-102(B)(1)—as seems likely—it is clear that the information that the lawyer subsequently acquired was a confidence or secret. The lawyer would therefore have an obligation to disclose the information only if the information was not "protected" under DR 4-101.[11] Here, no exception to the duty of confidentiality applies, and therefore the information remains "protected" as a confidence or secret. While under DR 4-101(C)(3) (as under new Rule 1.6(b)(2)) a lawyer may disclose information necessary to prevent a future crime, the inquirer here learned of the client's misrepresentation after it occurred, when it was past wrongdoing, not a future crime.[12]

15. Some writers have questioned whether Rule 3.3 is inconsistent with the protections afforded criminal defendants under the Fifth and Sixth Amendments of the United States Constitution.[13] There is also some question whether the new requirement of Rule 3.3, a court-adopted rule, can override the statutory protection to the attorney-client privilege afforded by CPLR § 4503(a).[14] In view of the result we reach, we express no opinion on these questions.

Conclusion

16. Where a lawyer learns that, prior to April 1, 2009, a client had committed fraud on a tribunal, the lawyer's obligation to disclose the fraud is governed by DR 7-102(B)(1) of the former Code of Professional Responsibility, and not by Rule 3.3 of the new Rules of Professional Conduct. Unlike Rule 3.3, DR 7-102(B)(1) did not permit disclosure of information protected as a confidence or secret in these circumstances.

Endnotes

1. Joint Order of the Appellate Divisions, December 30, 2008.
2. See paras. 9-10 below.
3. The italicized language was added to the Code in 1976. *See* N.Y. State 454 (1976). This rule was not absolute. The exception extended only to information "protected" as a confidence or secret. We repeatedly held that information was not protected as a confidence or secret if one of the exceptions to disclosure in DR 4-101 applied. N.Y. State 797 ¶ 13 (2005); N.Y. State 781 (2004); N.Y. State 674 (1995); N.Y. State 466 (1977). In addition, the Court of Appeals stated that in certain circumstances "counsel has a duty to disclose witness perjury to the Court." *People v. Berroa*, 99 N.Y.2d 134, 142, 753 N.Y.S.2d 12, 18, 782 N.E.2d 1148, 1154 (2002) (*citing People v. DePallo*, 96 N.Y.2d 437, 729 N.Y.S.2d 649, 754 N.E.2d 751 (2001)).
4. It is unclear when the disclosure obligations under the new rule end. In past opinions, we appear to have assumed that the disclosure obligations in DR 7-102(B) where information was not "protected" as a confidence or secret ended when the proceeding in question concluded. N.Y. State 674 (discussing whether a lawyer must reveal perjury "discovered after the fact when the proceeding in which the perjury was committed (and later discovered) has not yet concluded"); N.Y. State 466 ("since the existence of the negotiable instrument is not relevant to any pending proceeding"). The New York State Bar Association proposal for the new rule, adopting the language of the ABA Model Rules, would have codified this interpretation in Rule 3.3. The proposal stated, "The duties stated in paragraphs (a) and (b) *continue to the conclusion of the proceeding* and apply even if compliance requires disclosure of information otherwise protected by Rule 1.6." New York State Bar Association Proposed Rules of Professional Conduct 160 (Feb. 1, 2008) (emphasis added) (available at www.nysba.org/proposedrulesofconduct020108. As noted in the text, Rule 3.3 as adopted by the courts omits the phrase "continue to the conclusion of the proceeding and." There is thus an argument that the courts in adopting the rule intended the obligation to continue past the end of the proceeding and, potentially, indefinitely – or at least for some reasonable period of time. The broadest version of this interpretation seems to us implausible. We believe the obligation extends for as long as the effect of the fraudulent conduct on the proceeding can be remedied, which may extend beyond the end of the proceeding – but not forever. If disclosure could not remedy the effect of the conduct on the proceeding, but could merely result in punishment of the client, we do not believe the Rule 3.3 disclosure duty applies.
5. *But see* N.Y. State 681 (1996) ("Regardless of the legal determination of the criminal effect of the client's actions, it appears that the client may be using the lawyer's services to perpetuate a fraud on the tribunal.").
6. Rule 1.0(i) (emphasis added).
7. The use of the disjunctive here was a change from the New York State Bar Association proposal. New York State Bar Association Proposed Rules of Professional Conduct, *supra* n.3, at 4 ("'Fraud' or 'fraudulent conduct' denotes conduct that is fraudulent under the substantive or procedural law of the applicable jurisdiction *and* has a purpose to deceive….") (emphasis added).
8. Rules 1.7(b)(4) and 1.9(a).
9. *Id.* ¶¶ 5, 6 & n.4 (citing *Hays v. Ward*, 179 A.D.2d 427, 429, 578 N.Y.S.2d 168, 169 (1st Dep't 1992) ("Where a statute states in clear and explicit terms, as here, that it takes effect on a certain date, it is to be construed as prospective in application."); *Murphy v. Board of Education*, 104 A.D. 796, 797, 480 N.Y.S.2d 138, 139 (2d Dep't 1984), *aff'd*, 64 N.Y.2d 856, 476 N.E.2d 651, 487 N.Y.S.2d 325 (1985)).
10. Of course, once the lawyer learns of the fraud, he or she cannot use the fraudulent testimony in argument or otherwise. That was true under DR 7-102 as it is under Rule 3.3.
11. *See* note 2 *supra*.
12. The answer might be different if the lawyer himself had made a "written or oral opinion or representation…believed by the lawyer still to be relied upon by a third person [and that] was based on materially inaccurate information or is being used to further a crime or fraud." In that circumstance, the confidence might not be protected to the extent disclosure is implicit in the lawyer's withdrawing the prior representation. DR 4-101(C)(5).
13. *See, e.g.*, Monroe H. Freedman, *Getting Honest About Client Perjury*, 21 Geo. J. L. Ethics 133, 157-163 (2008); John Wesley Hall, Jr., Professional Responsibility in Criminal Defense Practice 3d §§ 26:6, 26:21 n.8 (database updated July 2008); Joel Androphy, White Collar Crime § 20:12 (2d ed.) (database updated June 2008); 1 Criminal Practice Manual §§ 8:12, 8:23 (database updated March 2009); Formal Op. 92-2, Ethics Advisory Committee of National Association of Criminal Defense Lawyers.
14. "Unless the client waives the privilege, an attorney or his or her employee, or any person who obtains without the knowledge of the client evidence of a confidential communication made between the attorney or his or her employee and the client in the course of professional employment, shall not disclose, or be allowed to disclose such communication, nor shall the client be compelled to disclose such communication, in any action, disciplinary trial or hearing…."

(16-09)

Ethics Opinion 832

Committee on Professional Ethics of the New York State Bar Association

12/3/09

Topic: Attorney's provision of nonlegal services

Digest: Where a lawyer sells shelf corporations (a nonlegal service) to people he regards as non-clients, and provides no legal services in connection with those nonlegal services, but the lawyer's status as a lawyer is visible to the public, then absent a disclaimer or other steps, the recipients of the nonlegal services could reasonably believe there is an attorney-client relationship and thus the Rules of Professional Conduct would apply.

Rules: 5.7

Comments: Comments 1 & 3 to Rule 5.7

Question

1. A sole practitioner would like to provide what the lawyer describes as a "nonlegal service" to non-clients. The "nonlegal service" is the sale of "shelf corporations." (The term "shelf corporation" means a company that has had no recent activity or that was created to be "put on the shelf" to age. Shelf corporations are often sold to investors who want to start a company but do not want to go through the incorporation process.) Do the New York Rules of Professional Conduct (the "Rules") relating to advertising and solicitation apply to the sale of shelf corporations to non-clients?

Opinion

2. Rule 5.7 contains rules relating to nonlegal services provided by lawyers. (The Appellate Divisions adopted new Rules of Professional Conduct effective April 1, 2009.) The first two subparagraphs—Rule 5.7(a)(1) and (a)(2)—apply if an attorney is providing both legal and nonlegal services to clients. Under Rule 5.7(a)(1) if the nonlegal services are "not distinct" from the legal services provided by the lawyer to the client, then the Rules apply to both the legal and the nonlegal services. Under Rule 5.7(a)(2), if the nonlegal services and the legal services provided by the lawyer to the client are "distinct" from each other, then the Rules apply to both the legal and nonlegal services only "if the person receiving the services could reasonably believe that the nonlegal services are the subject of an attorney-client relationship."

3. Rule 5.7(a)(4) addresses whether a person receiving nonlegal services "could reasonably believe that those services are the subject of an attorney-client relationship." Specifically, the rule states that even where the legal and nonlegal services provided to the client are distinct from each other, it is "presumed that the person receiving nonlegal services believes the services to be the subject of a client-lawyer relationship *unless* the lawyer or law firm has advised the person receiving the services in writing that the services are not legal services and that the protection of a client-lawyer relationship does not exist with respect to the nonlegal services…." (Emphasis added.) However, the specified writing only serves to reverse the presumption, not to prove conclusively that the services are not legal services. As we noted in N.Y. State 755 (2002):

> We are not suggesting by this opinion that the mere statement, even in writing, to that effect is an automatic safe harbor, and DR 1-106 does not say so. The writing serves to reverse the presumption against the lawyer that would otherwise exist. It is possible that in certain circumstances, such as where the client is unsophisticated and has had a long relationship with the lawyer and where, despite the existence of a separate entity, the nonlegal services are not completely separated from the rendition of legal services, the writing would be insufficient to disabuse the client of a reasonable belief that the lawyer would be acting to protect the client.

Id. at 5; *see also* Rule 5.7, cmt. 3.

4. The lawyer's intention to sell shelf corporations only to people he regards as non-clients (and not to clients) appears to assume that he would not provide legal advice to the non-client purchasers of the corporations. That assumption may not be warranted. To test that assumption, we consider below three different ways in which the shelf corporations might be sold.

Scenario One: Lawyer Provides Legal Services

5. We first consider the possibility that the lawyer provides legal advice about shelf corporations to the purchasers, such as giving a prospective purchaser the attorney's views about (i) the legality of shelf corporations in general, (ii) the validity of a specific corporation, (iii) the advantages, rights, or benefits of shelf corporations, or (iv) the tax consequences of purchasing or owning a shelf corporation. The Rules do not define legal services, and many services do not fall neatly into the category of legal services because they may legally be undertaken by both lawyers and nonlawyers. However, "when such services are performed by a lawyer who holds himself out as a lawyer, they constitute the practice of law and the lawyer, in performing them, is governed by the Code." N.Y. State 557 (1984) at p. 2.

6. Thus, despite the fact that a nonlawyer might be entitled to provide some advice about a shelf corporation without committing the unauthorized practice of law, when a lawyer provides such advice it becomes the provision of legal services. Thus, if the lawyer provides legal advice about shelf corporations to purchasers, the lawyer would be providing legal services to them. In that situation, the Rules of Professional Conduct—including the rules regarding lawyer advertising and solicitation—would apply both to the legal advice and to the sale of the corporations. Moreover, because the lawyer would actually be rendering legal services, the disclaimer in Rule 5.7(a)(4) would not be effective.

Scenario Two: Lawyer Does Not Provide Legal Services

7. We next consider the possibility that the lawyer provides no legal advice whatsoever to the purchasers about the shelf corporations. For the assumption that the lawyer provides no legal advice to remain true, the lawyer could not answer the kinds of questions a prospective customer might ask that are likely to call for legal advice (*e.g.,* What are the tax consequences? How long may I leave the corporation on the shelf? Do I have to notify the state if I buy a shelf corporation? Is the corporation validly formed?). For example, if the shelf corporations were sold over the Internet, and the attorney was not identified anywhere on the web site as a lawyer, and any information about the corporations was provided only in writing (*e.g.,* via FAQs or links to articles), and purchasers never communicated with the lawyer directly and had no opportunity to ask for advice, then the lawyer would not be giving legal advice to purchasers. In that case the Rules would not generally apply to those sales.

8. Even where the lawyer would be generally exempt from the application of the Rules with respect to the sales, however, the exemption would not be absolute. Some Rules of Professional Conduct, such as Rule 8.4(c) (prohibiting conduct involving dishonesty, fraud, deceit, or misrepresentation), would still apply. Thus, the lawyer could not engage in dishonest, fraudulent, or deceptive conduct relating to the advertising or solicitation of the nonlegal services.

Scenario Three: Lawyer's Status as a Lawyer Is Visible to the Public

9. Finally, we consider the possibility that the attorney does not provide any legal advice to the purchaser of the shelf corporation but the attorney's status as a lawyer is visible to the public (*e.g.,* the attorney uses a law office name or letterhead, or advertises the sales on the lawyer's web site, or puts "Esq." or "J.D." after the lawyer's name). In that case there is a substantial risk that the purchaser of the shelf corporations will be misled as to whether an attorney-client relationship exists. The risk is great because the client may be confused about the nature of the attorney's role. In speaking about the need for the lawyer to avoid potential confusion between legal and nonlegal services provided to an individual, Comment 1 to Rule 5.7 notes that avoiding confusion is essential

> so that the person for whom the nonlegal services are performed understands that the services may not carry with them the legal and ethical protections that ordinarily accompany a client-lawyer relationship. The recipient of the nonlegal services may expect, for example, that the protection of client confidences and secrets, prohibitions against representation of persons with conflicting interests, and obligations of a lawyer to maintain professional independence apply to the provision of nonlegal services when that may not be the case.

10. The same concerns are relevant when the attorney sells to customers who are aware of the attorney's status as a lawyer. Even if the attorney merely identifies himself as a lawyer when selling shelf corporations but does not promise or provide legal services, the risk of confusion is great and purchasers could reasonably believe that they had an attorney-client relationship with the seller.

11. Where the attorney's status as a lawyer is visible, one way for a lawyer to avoid application of the Rules to the sale of nonlegal services would be to give the purchaser in writing the Rule 5.7(a)(4) disclaimer stating that the no legal services are being rendered and that the protection of an attorney-client relationship does not exist. We emphasize, however, that even if the lawyer provides the disclaimer specified in Rule 5.7(a)(4), it would not be effective if the lawyer actually provided legal advice or other legal services to the customer of the nonlegal business.

Conclusion

12. Where a lawyer provides legal services to a client, the Rules of Professional Conduct apply to the legal services. Where a lawyer provides nonlegal services to non-clients, the Rules generally are not applicable to the provision of the nonlegal services although some Rules of Professional Conduct would still apply. Where the attorney provides no legal services in connection with the provision of nonlegal services such as those here—the sale of shelf corporations—but the attorney's status as a lawyer is visible to the public, then absent a disclaimer or other steps, the recipients of the nonlegal services could reasonably believe there is an attorney-client relationship, and thus the Rules would apply.

28-08

Ethics Opinion 833

Committee on Professional Ethics of the New York State Bar Association

12/15/09

Topic: Clients (Prospective); Communications; Duty of Lawyer.

Digest: An attorney is not required to respond to unsolicited letters from incarcerated individuals requesting legal representation.

Rules: Rule 1.18(a); Rule 1.18(e).

Question

1. Is an attorney ethically required to respond to unsolicited letters from incarcerated individuals requesting legal representation for personal injury or other claims?

Opinion

2. No provision of the New York Rules of Professional Conduct imposes a general obligation upon an attorney to promptly answer unsolicited mail—or to answer it at all. We found that such an obligation arose under the former New York Code of Professional Responsibility only in the context of communications from an adversary or a client. *See* N.Y. State 407 (1975) ("The consistent failure of a lawyer to respond to telephone calls and correspondence from fellow *attorneys* is in violation of the Code. A lawyer is obligated to return telephone calls and inquiries from fellow members of the Bar, as well as from *clients*.") (citing former EC 7-10, EC-7-37, EC 7-38, and EC 7-39); *see also* 22 NYCRR § 1210.1(5) (Statement of Client's Rights provides that a *client* is entitled to have "telephone calls returned promptly"); N.Y. State 396 (1975) ("The consistent failure of a lawyer to respond to calls from his *clients* is in violation of [former] Canons 6 and 9") (all emphasis added).

3. We do not address whether an obligation to respond to communications from clients and other lawyers continues under the new Rules. We address here only unsolicited communications from incarcerated individuals who are neither adversaries nor clients. In New York, the only guideline of general application regarding an attorney's obligation to respond to unsolicited inquiries from persons other than adversaries or clients appears not in the Rules of Professional Conduct, which are mandatory, but rather in Standard IV of the New York State Standards of Civility, an aspirational goal not subject to enforcement through discipline. Standard IV says: "A lawyer should promptly return telephone calls and answer correspondence *reasonably* requiring a response." 22 NYCRR Part 1200, app. at IV (emphasis added).

4. Even applying that aspirational standard, however, we believe that an unsolicited letter from an incarcerated individual requesting legal representation does not, without more, reasonably require a response. We also note that a lawyer's receipt of truly unsolicited communications requesting legal representation does not create a lawyer-client relationship. *See, e.g., Knigge v. Corvese*, 2001 WL 830669, at *3-4 (S.D.N.Y. 2001) (holding that multiple voicemail messages seeking legal representation and requesting return phone calls did not result in formation of an attorney-client relationship because it was not reasonable for caller to believe that his "unilateral" decision to leave such messages could result in such a relationship).

5. Nor, under Rule 1.18 of the New York Rules of Professional Conduct, does the sender become a "prospective client" unless the lawyer subsequently "discusses" with the sender the "possibility of forming a client-lawyer relationship." Rule 1.18(a); *see also* Rule 1.18(e)(1) ("A person who…communicates information unilaterally to a lawyer, without any reasonable expectation that the lawyer is willing to discuss the possibility of forming a client-lawyer relationship…is not a prospective client within the meaning of paragraph [1.18](a)"). Thus, Rule 1.18 confirms our view that an unsolicited letter from an incarcerated individual requesting legal representation, without more, does not reasonably require a response.

6. This opinion does not address the circumstances, if any, in which an e-mail requesting legal representation or legal advice, although constituting the initial contact between a lawyer and the sender, may be deemed a response to a web site inviting public inquiry, in which case the communication could not be fairly characterized as "unsolicited." *Cf.* N.Y. City 2001-1 (absent a disclaimer warning that information sent by prospective clients will not be treated as confidential, information imparted to an attorney in good faith by a prospective client in an e-mail generated in response to an internet web site maintained by the law firm should be held in confidence even though the attorney has declined the representation).

Conclusion

7. An attorney is not ethically required to respond to unsolicited letters from incarcerated individuals requesting legal representation.

(7-09)

Ethics Opinion 834

Committee on Professional Ethics of the New York State Bar Association
(12/15/09)
Distinguishing N.Y. State 771 (2003) in light of rule changes

Topic: Use of disclaimer with client testimonials or endorsements.

Digest: Under the New York Rules of Professional Conduct, truthful client testimonials or endorsements are permitted if accompanied by the disclaimer specified in Rule 7.1(e)(3).

Rules: 7.1(a)(1), (d)(3), and (e)(3)

Question

1. Must an advertisement that contains a client testimonial or endorsement also contain the disclaimer: "Prior results do not guarantee a similar outcome"?

Opinion

2. Our opinion in N.Y. State 771 (2003) concluded that as long as an advertisement containing client testimonials was not false, deceptive or misleading, it was not necessary for the advertisement to contain the disclaimer that prior results did not guarantee a similar outcome.[1] We now examine whether this conclusion is modified in the New York Rules of Professional Conduct that took effect on April 1, 2009 (the "Rules").[2]

3. Rule 7.1(d)(3) provides that an advertisement that complies with Rule 7.1(e) may contain "testimonials or endorsements of clients…and of former clients."[3] Rule 7.1(e)(3) requires advertisements containing testimonials or endorsements of clients to include the following disclaimer: "Prior results do not guarantee a similar outcome." Therefore, under the new Rules, an advertisement that contains a client testimonial requires the prescribed disclaimer concerning results.

4. At the time we decided N.Y. State 771, the New York Code of Professional Responsibility did not have a specific Disciplinary Rule dealing with client testimonials. However, DR 2-101(A) of the Code did prohibit advertisements that were "false, deceptive or misleading," so this Committee examined client testimonials under that standard. We opined under that standard that the nature of the testimonial determined whether a disclaimer of the kind now mandated by Rule 7.1(e)(3) was required. Like DR 2-101(A) of the old Code, new Rule 7.1(a)(1) prohibits testimonials that are false, deceptive or misleading, but now Rule 7.1(e)(3) always requires the disclaimer set out in that subparagraph.

Conclusion

5. We answer the question in the affirmative. Under Rule 7.1(e)(3), an advertisement that contains a client testimonial or endorsement must also contain the disclaimer: "Prior results do not guarantee a similar outcome."

Endnotes

1. N.Y. State 771 was decided in the context of Web site advertising, but the principles enunciated in that opinion applied to all forms of attorney advertising, as does this opinion.
2. The rule amendments addressed in this opinion are based verbatim on language that took effect on February 1, 2007, when the Courts amended the Disciplinary Rules governing advertising and solicitation in the old Code of Professional Responsibility.
3. A restriction on testimonials or endorsements from current clients is contained in Rule 7.1(c)(1), which provides that an advertisement shall not "include an endorsement of, or testimonial about, a lawyer or law firm from a client with respect to a matter still pending." Rule 7.1(c)(1) was declared unconstitutional and its enforcement was permanently enjoined in *Alexander v. Cahill*, 634 F. Supp. 2d 239 (N.D.N.Y. 2007), but the defendants (disciplinary counsel in all four Departments) appealed to the Second Circuit, and the appeal was still pending when we issued this opinion. The outcome does not affect our analysis here because Rule 7.1(c) regulates only the types of testimonials and endorsements permitted, not whether they require a disclaimer.

(49-09)

Ethics Opinion 835

Committee on Professional Ethics of the New York State Bar Association
12/24/09

Topic: Multijurisdictional law practice by corporate counsel

Digest: The question of whether an out-of-state lawyer may serve as in-house counsel for a New York corporation and maintain an office in New York is not answered by the New York Rules of Professional Conduct, but rather is a question of law beyond the Committee's jurisdiction.

Rules: Rule 5.5.

Question

1. May a person who is not admitted to practice law in New York but who is admitted to practice law and is in good standing in another U.S. jurisdiction serve as general counsel for a corporation headquartered in New York and maintain an office in New York for that purpose?

Opinion

2. In New York, as elsewhere, the law generally forbids the unauthorized practice of law ("UPL"), which may include legal work performed by out-of-state lawyers as well as by non-lawyers. (The term "out-of-state lawyer" is not defined in the Rules but we use the term "out-of-state lawyer" for purposes of this opinion to mean a person who is not admitted to practice in New York but is admitted to practice and in good standing in another U.S. jurisdiction.) In New York, §§ 476-a, 478 and 484 of the Judiciary Law govern the unauthorized practice of law. Generally speaking, these provisions forbid individuals from maintaining a law practice or otherwise providing legal services in New York unless they are licensed to practice law in this state or otherwise authorized to render particular legal services in New York (for example, by admission *pro hac vice*).

3. The scope and application of these Judiciary Law provisions is a question of law that courts of New York have addressed, albeit infrequently. *See, e.g.*, *El Gemayel v. Seaman*, 72 N.Y.2d 701, 707 (1988) (finding that "in the circumstances of this case, phone calls to New York by plaintiff, an attorney licensed in a foreign jurisdiction, to advise his client of the progress of legal proceedings in that foreign jurisdiction, did not, without more, constitute the 'practice' of law in this State in violation of [Judiciary Law] § 478"); *Spivak v. Sachs*, 16 N.Y.2d 163 (1965) (holding that a California attorney engaged in the unlawful practice of law in New York by assisting an acquaintance in New York with her divorce, where the California attorney became substantially involved in the client's New York affairs—spending 14 days in New York attending meetings, reviewing drafts of a separation agreement, discussing the client's financial and custody problems, recommending a change in New York counsel and, based on his knowledge of New York and California law, rendering his opinion as to the proper jurisdiction for the divorce action and related marital and custody issues).

4. Among other things, the case law suggests that out-of-state lawyers are not engaging in the "unauthorized practice of law" in New York when they perform "incidental and innocuous" legal work in New York in the course of representing clients from their home jurisdictions. *El Gemayel v. Seaman*, 72 N.Y.2d at 707; *accord Spivak v. Sachs*, 16 N.Y.2d at 168 ("recognizing the numerous multi-State transactions and relationships of modern times, we cannot penalize every instance in which an attorney from another State comes into our State for conferences or negotiations relating to a New York client and a transaction somehow tied to New York").

5. In New York, the question of whether an out-of-state lawyer is engaged in the unauthorized practice of law in New York is exclusively a matter of law. Unlike the professional conduct rules of most other states, the New York Rules of Professional Conduct ("N.Y. Rules") that took effect on April 1, 2009 do not include provisions modeled on ABA Model Rule 5.5(b), (c) & (d). In jurisdictions in which the courts have adopted provisions comparable to Model Rule 5.5(b)-(d), the provisions have two related effects – they both judicially "authorize" out-of-state lawyers to practice law in the jurisdiction within the limits set by Rule 5.5, and they interpret the conduct authorized by Rule 5.5 as conduct that does not violate the jurisdiction's statutory and common law regulation of UPL. The rule functions as if it were a global *pro hac vice* order admitting every out-of-state lawyer to practice in the jurisdiction within the limits described in Rule 5.5. (Of course, even in states that have adopted ABA Model Rule 5.5, an out-of-state lawyer who desires to appear in court in a state where the

lawyer is not licensed to practice must still seek formal admission *pro hac vice* to that court.)

6. The New York State Bar Association has twice recommended (first in 2003, then again in 2008) that the New York courts adopt provisions similar to those in ABA Model Rule 5.5, but both times the Appellate Divisions have declined to do so. Consequently, the N.Y. Rules include no provision comparable to ABA Model Rule 5.5(d)(1), which would authorize out-of-state lawyers to work in New York as in-house corporate counsel other than in proceedings in which *pro hac vice* admission is required. Nor does New York have a court-adopted "in-house registration" rule, like that of many states, authorizing out-of-state lawyers who satisfy registration requirements to practice law in the state. See ABA Model Rule for Registration of In-House Counsel (adopted by the ABA House of Delegates in August 2008).[1]

7. The jurisdiction of this Committee is limited to answering questions about the meaning and application of the New York Rules of Professional Conduct. We do not interpret court rules or statues. The question whether an out-of-state lawyer may serve as in-house corporate counsel with an office in New York without gaining admission to the New York Bar is entirely a matter of state law governed principally by the Judiciary Law, which is statutory. It is not governed by any provision in the N.Y. Rules of Professional Conduct. Consequently, this Committee lacks jurisdiction to answer the question.

Conclusion

8. The question whether an out-of-state lawyer may serve as in-house counsel for a New York corporation and maintain an office in New York for that purpose is a question of law, and is not answered by the New York Rules of Professional Conduct. The question is therefore beyond our jurisdiction and we offer no opinion on the question. Because the question is a recurring one, however, this Committee urges the Appellate Divisions and / or the New York State Legislature to provide further guidance regarding whether and to what extent out-of-state lawyers—especially in-house lawyers who provide services solely to a corporate employer—are authorized to practice law in New York.

Endnote

1. *Available at* www.abanet.org / legaled / standards / noticeandcomment / ModelRule.DOC.

(35-09)

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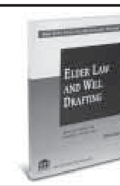

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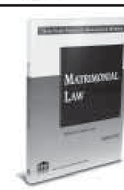

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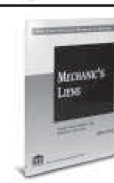

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