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ONEONONE

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

A Message from the Chair

This will be my final message after two years as the Chair of this Section. We have accomplished a lot but still have much more that we can do. We have two active committees that hold meetings at regular intervals that are well attended—Business Law chaired by Lew Tesser and Election and Government Affairs chaired by Jerry Goldfeder. These are both excellent committees where members can learn substantive law. Recently, David Hernandez, former Chair of the Puerto Rican Bar Association, joined the GP Section and agreed to become the Chair of a Diversity Subcommittee of the General Practice Section. We held a kickoff meeting on March 14th at Brooklyn Borough Hall that was very well attended. I got the chance to meet many Brooklyn members and prospective members including members that I know only from the Listserve. We hope to expand these meetings to other boroughs of New York City and the surrounding counties as well as upstate. We also hope to activate committees in real estate and trusts and estates. If anyone is interested in chairing a committee or joining a committee, please contact me. There is no charge for committee membership. You only have to be a member of this Section.

Membership has been holding steady at slightly above 2,000 members but, as always, the overall NYSBA goal is to increase membership and to try to get more members to be active in the Section. Like a professional sports team, we hope to get younger

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members. We also want more of those members to be women and of diverse background.

Computer filing is taking over in litigation and real estate. E-filing is now mandatory in Westchester and Rockland Counties, most cases in New York County and commercial cases over $75,000 in Kings County. Medical malpractice cases must be e-filed in Bronx County. The requirement to e-file should spread by the end of this year. It can be tricky and is probably a little different in each county. You should read the rules and talk to the Clerk because not everything is clear in the rules. Filing an order to show cause with a temporary restraining order is especially tricky because you have to e-file a preliminary order to show cause and then take the papers to court. In real estate, use of ACRIS is now mandatory in all counties except Richmond County. Westchester County requires use of its PREP System.

The law is under attack in a new way. Florida's "Stand Your Ground" law is front and center in the news headlines with the Trayvon Martin-George Zimmerman case. The Supreme Court will soon decide whether Obamacare is constitutional. Law graduates are suing their law schools alleging that they cannot find a job and have huge debts for student loans to pay. The claim is that the schools fraudulently represented employment statistics for recent graduates. It appears that most of these actions will be dismissed but the problem will remain. There are large numbers of recent graduates who cannot find jobs or if they find a job, cannot find another job. There is no mobility and recent graduates are often stuck in a dead end job.

Many recent graduates are opening their own practice because they have no other alternative. Membership in the Section and just reading the questions and answers on the Listserve can be a terrific learning experience for new lawyers starting their own practice. The law is still a great profession. The GP Section exists to help you grow your practice.

Finally, I want to welcome and introduce my successor, Zachary Abella, and thank you all for giving me the opportunity to serve as Chair of the General Practice Section for the past two years.

Regards,
Martin S. Kera, Esq.
Chair

From the Co-Editors

Richard Klass

As the Co-Editors of *One on One*, we endeavor to provide our members and readers with a great selection of topical articles on issues affecting the varying and diverse areas of law in which our General Practice Section members practice. This issue, we are pleased to offer you the following articles, which we hope will be found very helpful and informative:

New York's Lien Law: The authors, Joshua Stein and Colin Bumby, discuss Articles 2 and 3-A of the Lien Law, the governing statutes regarding mechanic's liens on construction projects. They analyze the two types of liens that may be asserted by vendors and general contractors against the owner of a project, including the notice of mechanic's lien recorded against real property and rights in and to "trust assets" as "trust beneficiaries." Written for the intended audience of property owners, the authors run down the requirements of a valid lien and trust claim, as well as steps that owners may take to limit and minimize potential liability.

Changes in Wages Law: In an article by Joel J. Grenwald, the managing partner of an employment and labor law firm, he writes about the new Wage Theft Prevention Act (WTPA) enacted by New York State. The WTPA substantially increases the penalties and exposure to civil liability of employers for their failure to pay minimum or overtime wages and not keeping proper records. New requirements include disclosing to employees certain information, including rate of pay, how the pay is calculated, and regular payday.

Long-Term Care Insurance: Long-term care insurance is an important part of an estate plan, states Jeffrey A. Asher, head of the Elder Care practice at Eaton & Van Winkle LLP. Considering that the fastest-growing segment of the population are people ages 85 and older, the author believes that long-term care insurance is one of the necessary components of a comprehensive elder care plan. This type of insurance may be especially important when negotiating between Medicaid eligibility and transfers of assets, where the "look back" provisions come into play.

Judges of the Court of Appeals: In an article by Spiros A. Tsimbinos, he offers our readers a brief biography of each of the seven Judges of the New York State Court of Appeals. The article lists the schools attended and prior experience of the judges, namely: Chief Judge Jonathan Lippman, Judges Carmen Beauchamp Ciparick, Victoria A. Graffeo, Susan Phillips Read, Robert S. Smith, Eugene F. Pigott, Jr. and Theodore T. Jones, Jr.

Martin Minkowitz

Interest in Wrongful Death Cases: David Schuller provides insight into the recent decision of the New York State Court of Appeals to overturn a century's worth of case precedent concerning pre-verdict interest on wrongful death awards. There has always been a dichotomy between personal injury and wrongful death cases concerning the date from which interest would be added to the verdict amount. In *Toledo v. Iglesia Ni Christo*, the court declared: "We now conclude that the proper method for calculating preverdict interest in a wrongful death action is to discount the verdict to the date of liability, i.e., the date of death, and award interest on that amount from the date of death to the date of judgment."

Insurance Law: The relationship between insurers and their insured is defined from the "metes and bounds" of the insurance contract itself, states author Alecia Walters-Hinds, a partner at Lewis, Brisbois, Bisgaard and Smith. In her article, Ms. Walters-Hinds walks the reader through the rights and obligations of both insurer and insured.

Special Needs Trusts: An article by Anthony J. Enea, the Chair-Elect of the Elder Law Section of the New York State Bar Association and Past President and founding member of the New York Chapter of the National Academy of Elder Law Attorneys (NAELA), discusses the relevancy and importance of creating a special needs trust for aging "baby boomers" with the beneficiaries in mind. He identifies needs of both aging parents and their children concerning estate planning.

Electronic Discovery: Co-Editor of *One on One*, Richard A. Klass, reports on the recent development in New York State's First Department to adopt the *Zubulake* duty to preserve electronic evidence, including e-mails and other records, in order to avoid sanctions for spoliation of evidence. Recognizing that electronic data is very valuable to litigation, the court in *VOOM HD Holdings LLC v. EchoStar Satellite LLC* declares that the duty to preserve is not only to take affirmative acts to prevent destruction of data but also to turn off automatic deletion functions of computer systems.

Articles should be submitted in a Word document. Please feel free to contact either Martin Minkowitz at mminkowitz@stroock.com (212-806-5600), or Richard Klass at richklass@courtstreetlaw.com (718-643-6063) to discuss ideas for articles.

Sincerely,
Martin Minkowitz and Richard Klass
Co-Editors

Letter to the Editors

Dear Mr. Minkowitz and Mr. Klass:

I read with great interest the recent issue of *One on One* and "Get a Bigger Bang for Your Buck in Divorce" written by Jamie D. Svenson and Paul W. Siegel.

I found that the article is especially informative but obviously written well before the publication date of the magazine. For example, under the heading "Children as Exemptions," the exemption for the 2011 tax year is stated to be $3,700.00 per person. For the 2012 tax year, which was not mentioned, the exemption is $3,800.00.

In the same section there is a statement that "most preparers utilize the E-File system when preparing returns for their clients." E-Filing is now mandatory for practically every tax preparer. It is no longer optional.

Under the heading "Childcare as a Credit," the statement is made that "only custodial parents may claim such credits and exemptions." In practice, the parent who is to claim the exemption may be negotiated. It is particularly important that a custodial parent have that exemption each year for at least one child in order to claim filing status as head of household.

Finally, under "Remedies and Options," the authors suggest that a party who wrongly files for an exemption may seek recovery in either "Small Claims or District Court so attorneys' fees do not circumvent the entire recovery."

First, there are many courts throughout New York State which also have jurisdiction to entertain suits for money damages, such as the Justice Court, Town Court, County Court, etc. Second, the word "circumvent" was confusing to me because I do not believe that attorneys' fees may "circumvent the entire recovery," but rather may "offset the entire recovery."

Substantially, the article is informative, clearly written and of significant value, especially for attorneys in general practice who do not focus their prime attention to family law matters.

Very truly yours,
Willard H. DaSilva
Past President
American Academy of Matrimonial Lawyers
New York Chapter

Introduction to the New York Lien Law for Counsel to Owners of Troubled Construction Projects

By Joshua Stein and Colin Bumby

A substantial commercial construction project (a "Project") can go wrong in many ways. One common way occurs when the general contractor (the "GC") becomes insolvent or otherwise trips and falls and cannot finish the project. When that happens, the owner of the Project (the "Owner") will find itself in an awkward corner, potentially facing claims from parties that Owner didn't even know existed.

When an Owner engages a GC under a traditional general contract, that GC agrees to build the Project for a fixed fee[1] and pay all subcontractors and material suppliers (collectively, "Vendors"[2]). At any point during the Project, however, GC may drop the ball as suggested above, or may default in other ways. In a perfect world, i.e., in an Owner's fantasyland, GC will at that point have paid all its Vendors everything due them. GC will have funded these payments from money that Owner gave GC to pay for the Project.

More likely, however, GC will not be current in paying Vendors. To the contrary, GC's problems will usually also lead to delayed Vendor payments. GC will have used funds from this Project to pay other debts or clean up similar messes on previous Projects. Or those payments may have funded home theater systems, birthday parties, and cruises in the Caribbean and elsewhere.[3]

Owner will derive cold comfort from the fact that GC remains liable to unpaid Vendors. As a practical matter, unless someone pays Vendors, they won't keep working. Although Owner could conceivably finish the Project with replacement Vendors, that process will cause huge disruptions and delays. Moreover, Owner will find some Vendors so vital that Owner cannot replace them.

In New York, Owner may also face direct claims against the Project and the real property on which it sits (together, the "Site") from unpaid Vendors, as a result of New York's "floridly complicated and impenetrably opaque"[4] Lien Law (the "Lien Law"). The Lien Law gives Vendors two possible ways to make claims against Owner or the Site, in addition to any direct contractual rights that any particular Vendor can assert.[5]

First, Lien Law Article 2 ("Article 2") allows an unpaid Vendor to file a mechanic's lien against the Site (a "Lien") and enforce that Lien.

Second, Lien Law Article 3-A ("Article 3-A") creates a separate trust fund regime to protect GCs and Vendors. Article 3-A makes Owner a statutory trustee over certain funds available for a Project. If Owner diverts assets from that trust, then Owner may incur liability to any Vendors that hold Liens or contracted directly with Owner.[6]

Owner will want to minimize its Article 2 and Article 3-A exposures if a Project goes bad, whether because of GC default or bankruptcy or otherwise. Owner will also want to: (1) complete the Project; (2) do so on time; and (3) do so on budget. As a practical matter, Owner will count itself lucky to achieve even the first goal if GC gets into trouble. But the strategies suggested here may help Owner achieve the best possible outcome under the circumstances.

As always, the legal rights, obligations, analysis, and strategy for any Project will depend on the facts and circumstances of that Project. That holds particularly true for the Lien Law. Application of the Lien Law to any set of facts usually amounts to a difficult exercise, given: (a) the opacity of the Lien Law; (b) the limited scope of cases interpreting the Lien Law; (c) the fact-intensive nature of the scant case law that does exist; and (d) the history of surprises in this area, particularly in Article 3-A.[7]

Thus, although this article seeks to offer a general roadmap, any Owner or its counsel must fully understand the facts and think through the law that applies to them, and not rely on this summary. This article offers only a rudimentary introduction to the Lien Law, and only from an Owner's point of view.

I. Owner's Obligations Under the Lien Law

This article first summarizes an Owner's exposure under Article 2, then turns to Article 3-A. It does so for three reasons, all discussed at greater length below:

1. Article 2 Lien claims have priority over Article 3-A trust claims. Article 3-A expressly blesses the use of "trust assets" to pay Liens,[8] and imposes extra liability on an Owner that applies Article 3-A trust funds to make payments that violate Article 2 priority rules for Liens.[9]

2. The Article 2 priority rules restrict an Owner much more than comparable rules under Article 3-A.

3. Owner must therefore figure out how to contend with its Article 2 obligations before it figures out how to deal with Article 3-A.

This discussion focuses primarily on Owner's Lien Law problems. For a typical Project, of course, most of the money will come from a construction lender. In some ways, a lender's issues will overlap Owner's. The Lien Law's requirements for a "building loan contract" will, however, compound a lender's headaches. This article does not cover the special concerns of a construction lender.[10]

A. Owner and Article 2

If a Vendor files a valid Lien under Article 2, Owner will need to pay that Lien or figure out how to get rid of it. If Owner doesn't, then eventually the Lien holder can foreclose its Lien and force a sale of the Site. In the meantime, so long as a Lien remains in place, Owner may find the Site unsaleable and unfinanceable. Often, Owner cannot proceed with the Project either, because Owner's lender will refuse to fund further advances.

Article 2 contains two sets of rules that Owner must understand.

First, Article 2 defines how much a Vendor can expect to successfully claim on its Lien. As against the rest of the Lien Law, these provisions are relatively comprehensible.

Second, Article 2 defines the priorities an Owner must follow if it wants to pay multiple Lien holders. These rules limit Owner's freedom to play favorites in paying Lien holders.

1. Owner's Liability to Mechanic's Lienors

In general, Owner faces exposure for the amount a Vendor claims in a Lien only to the extent that: (a) the Lien is valid; (b) the Lien holder's claim represents a reasonable estimation of the amount owed, and, (c) Owner still owes money to GC. If the Owner does not owe money to GC when a subcontractor files a Lien, but an open balance later arises, the Lien will attach only to the after-arising "Lien Fund."[11]

First, Owner is only liable to a Lien holder if the Lien is valid. To obtain a valid Lien, the claimant must: (a) follow numerous technicalities to properly file the Lien,[12] and (b) meet three substantive conditions in Lien Law Section 3. Those three substantive conditions are:

a. Vendor must fall within a certain class of persons that provide materials or services that improve property, which includes contractors, subcontractors, laborers, and material suppliers;[13]

b. Vendor must have "permanently" improved Owner's real property;[14] and

c. Owner, or its agent (who can be GC or some other Vendor) must have requested, or at least consented to, the improvement.[15]

Second, even if the Lien is valid, Owner faces exposure only to the extent of the unpaid balance due the Lien holder when it filed its Lien.[16]

Third, Vendor must have "substantially performed" its contract before it can collect what it is owed under its contract.[17] Otherwise, the Vendor can recover only in "quantum meruit." Although the measure of damages based on "substantial performance" consists of the contract price less the cost of completion, the measure of damages in "quantum meruit" consists of the fair value of its work—measured not by the contract balance, but instead by the reasonable value to Owner of Vendor's labor and materials.[18]

A court will generally hold that Vendor has "substantially performed" if Vendor can demonstrate that it "has in good faith intended to comply with the contract," and has substantially done so.[19] Thus, if Vendor's work contains slight defects or deviations from the plans, it can still collect the unpaid balance of its contract minus any damage that resulted from defects or deviations.[20] If, however, Vendor's work is somewhat significantly incomplete or defective—even, e.g., to the extent of as little as five percent of the total value of the contract—a court may decide that Vendor has not "substantially performed."[21] As in so many areas of the law, and particularly the Lien Law, much depends on the particular facts and circumstances and how a specific court decides to view them.

The doctrine of "substantial performance" applies a little differently to an "installment contract," a contract structure often seen in construction. Here, Vendor accepts payments in installments based on Vendor's completion of specified tasks. An installment contract might say, for example, that Vendor will receive a percentage of the contract based upon completion of each floor in a multifloor building. Vendor will be entitled to payment under its contract to the extent it has "substantially performed" each installment even if it has not "substantially performed" the entire contract.[22] Thus, if Vendor has substantially completed two of five floors, it will be entitled to the contract price for only those two floors. For the other three floors, Vendor will be limited to "quantum meruit"—at least until Vendor substantially completes each of those three floors.

The doctrine of "substantial performance" should not be confused with the concept of "substantial completion" in many construction contracts.[23] The American Institute of Architects ("AIA") form construction contract defines "substantial completion" as the stage in the Project when "Owner can occupy or utilize the [w]ork for its intended use."[24] Put another way, the AIA's version of "substantial completion" occurs at the point when Owner can take beneficial occupancy of the work.

A construction contract will often require Vendor to demonstrate "substantial completion" as a condition to payment, or at least as a condition to the final payment.[25] The contract may also require Vendor to obtain a certificate from the architect stating that the work has been completed in accordance with the terms and conditions of the contract, as a condition precedent to payment.[26] Where a certificate is required, a Lien will not be enforced without such certificate, unless Vendor can demonstrate that it was unreasonably withheld.[27]

As a fourth limitation under Article 2, Owner's liability to Lien holders cannot exceed the total amount Owner owes GC.[28] Each Vendor essentially steps into the shoes of GC in asserting claims against Owner (in effect becoming "subrogated" to GC's claims against Owner), and those claims cannot exceed whatever claims GC could assert against Owner.[29] As a result of this principle of subrogation, Owner owes Vendor only the lesser of:

a. Whatever GC owes Vendor when Vendor files its valid Lien, and

b. Whatever Owner owes GC when Owner receives notice of filing of that Lien.

Similarly, if Vendor has contracted out part of its contract to some other Vendor (a "Sub-Vendor," typically a subcontractor), Sub-Vendor becomes subrogated to Vendor's rights. Thus, Sub-Vendor's Lien is valid and enforceable only up to the amount, if any, still due and unpaid to Sub-Vendor from GC.[30] If no funds are due, Sub-Vendors are relegated to their trust fund rights.[31]

Where GC owes Vendor funds, Owner would then owe Sub-Vendor the lesser of:

a. Whatever Vendor owes Sub-Vendor when Sub-Vendor files its valid Lien,

b. Whatever GC owes Vendor when GC receives notice of filing of that Lien.

These "subrogation"-based limits are also subject to the requirements for "substantial performance" discussed above. If, for example, GC has not "substantially performed" under its contract, then Vendor Lien holders will see their claims capped at GC's "quantum meruit" damages, if any, instead of as described in subparagraph "b" of the two preceding formulas.[32]

2. Priorities Under Article 2

If Owner must pay one Lien holder, Owner will probably find it must pay many. If so, it will need to navigate the complicated and perilous Article 2 priority rules. These priority rules should, however, not be relied upon as written. They are nuanced, have been heavily litigated, and the Lien Law gives courts plenty of authority and latitude to fashion remedies as they see fit.[33] For context, an action to enforce a Lien takes the form of an action to foreclose a mortgage.[34] This means that the action is one in equity.[35] Against that backdrop, Owner must proceed with great care.

Article 2 priority rules do not follow the "first-to-file" priority rules that typically apply in real property law. As among Lien holders claiming from the same Project, order of filing does not matter.[36] Instead, Lien holders will be treated the same regardless of when they filed, with two important exceptions. First, if a Vendor does not file until after an earlier filed Lien has been discharged, the late filing Vendor will lose any rights to whatever Owner paid the Lien holder who filed first.[37] Second, if a Vendor does not file until after Owner has conveyed the property under a recorded deed containing the statutory covenant provided by Lien Law § 13(5), that Vendor will not be treated the same as those Vendors who filed before the conveyance.[38]

The Lien Law sets four priorities as among valid Liens in a foreclosure action under Article 2:

1. Laborers for daily and weekly wages;[39]
2. Sub-Vendors;[40]
3. Vendors that directly supplied GC;[41] and finally
4. GC and other parties with whom Owner has contracted directly.[42]

Within each priority level, multiple Lien holders have "parity," meaning they each take a pro rata share in proportion to their claims.[43] Where a single contract covers more than one building, each Vendor should have a priority claim on the part of the real property or the particular building where such Vendor's labor was performed or such Vendor's materials were used.[44]

If Owner disregards these statutory priorities and chooses to pay certain favored Vendors first, Owner should not face significant penalties. Lien Law § 56 states: "Payments voluntarily made upon any claim filed as a lien shall not impair or diminish the lien of any person except the person to whom the payment was made."[45] Implicitly, Lien Law § 56 recognizes and permits voluntary payments of any Lien. Although payments made under Lien Law § 56 to certain Vendors do not diminish the Lien of other Vendors, practically speaking, the payments work to reduce the overall Lien fund. First, most construction contracts will reduce the contract price payable to GC when Owner pays Vendors and Sub-Vendors directly. Second, GC will not be able to include the amount of the Lien Law § 56 payment to Vendor or Sub-Vendor in its Lien claim.

Because Lien Law § 56 does not expressly limit an Owner's liability, a court could conceivably frown upon[46]—and impose liability on account of—payments that an Owner makes to favored Vendors without regard to Lien priority rules. No available case considers that specific question.

B. Owner as Statutory Trustee Under Article 3-A

Above and beyond Liens arising under Article 2, Lien Law Article 3-A establishes an entirely separate legal regime. Under this system, Owner can automatically become a statutory trustee to hold certain "trust assets" for the benefit of certain Vendors known as "trust beneficiaries."[47] These "trust assets," as provided for in Article 3-A, include funds that Owner receives in connection with an improvement of real property.[48] Funds that do not originate from any of the seven sources described in Article 3-A are not "trust assets."[49] For example, Owner's own invested equity capital does not constitute a "trust asset."

Although any Owner may find Article 3 a greater nuisance than Article 2, Article 3-A is, as a substantive matter, not nearly as onerous as Article 2. Usually, Owner will not owe any Vendor more under Article 3-A than Owner owes the same Vendor under Article 2. Article 3-A also usually allows an Owner to pick and choose which Vendors to pay first, but subject to one crucial caveat. If Owner violates the very limited priority rules in Article 3-A, Owner can face severe consequences under New York Penal Law.[50] It's a crime!

1. Owner's Liability to Vendors

Owner's potential liability under Article 3-A is staggeringly broader than under Article 2. Owner will, however, rarely owe Vendors more under Article 3-A than under Article 2.

Owner *potentially* owes Vendors the entire amount of Owner's "trust assets," which consist of certain funds Owner has received or is due to receive to complete the Project. Owner's "trust assets" include its construction loan proceeds plus any availability—including future availability—under the construction loan. The "trust assets" in Owner's hands could also include other funds Owner received, or Owner's rights of action for payment of funds in connection with the Site.[51] Owner should note that if a single construction loan agreement governs the entire Project, this will create a single pool of "trust assets," even if multiple notes and mortgages exist. If multiple construction loan agreements govern different pieces of the Project, multiple pools of "trust assets" will exist.[52]

From this large pool of "trust assets" under Article 3-A, however, only a certain limited class of Vendors will actually have the right to make claims as "trust beneficiaries." Lien Law § 71(4) defines "trust beneficiaries" as Vendors that hold valid "trust claims."[53] Most Vendors will, however, rarely have valid "trust claims" against Owner. That is because, under Lien Law § 71(3)(a), for the trust where Owner acts as trustee, "trust claims" means only "claims of contractors, subcontractors, architects, engineers, surveyors, laborers and materialmen arising out of the improvement, *for which the owner is obligated.*"[54] Under New York law, Owner is "obligated" only to those Vendors that are in privity of contract with Owner[55] or that have actually obtained valid Liens on the Site.[56] In the typical case, Vendors who are "trust beneficiaries" have obtained valid Liens, so their "trust claims" simply consist of whatever they can claim under Article 2. Sub-Vendors who are not in privity of contract with Owner—hence unable to claim against "trust assets" held by Owner—may still have valid "trust claims" against the GC or other Vendors who have received "trust assets."[57]

2. Article 3-A Priority Rules

Owner can pay favored Vendors first out of the "trust assets"—even if those Vendors are not themselves "trust beneficiaries"—if Owner follows a few simple rules.

Owner can pay any Vendor claim for a cost of improvement, and can apply any "trust asset" among Vendors as Owner chooses, so long as a court has not directed Owner to make particular payments of "trust assets."[58] A court will probably direct payments only if it finds that Owner has diverted "trust assets."[59] Owner can avoid diverting "trust assets" by following two precautions.[60]

First, Owner cannot use "trust assets" for any purpose except the purpose of the trust. Virtually every payment Owner would want to make for the Project will probably meet that test, given that Lien Law § 71 defines the "purpose of the trust" as "payment of the cost of improvement."[61] Courts have occasionally found that a few Project-related payments an Owner might want to make would flunk that test, such as refunds to Owner for emergency advances, corporate administrative costs, and attorneys' fees.[62] Despite occasional exceptions like these, the "purpose of the trust" remains quite broad.

Second, Owner must keep records on the inflow and outflow of "trust assets"—failing which, a court can decide that Owner has "diverted trust assets."[63] Any diligent Owner can usually satisfy these recordkeeping requirements, though, because Owner should typically maintain most or all of the same records for its own purposes anyway.[64] Owner's failure to maintain these records could be disastrous should a "trust beneficiary" demand to examine them, especially if Owner could not reconstruct them quickly under pressure.[65]

If Owner does not follow these two simple rules in disbursing trust assets, Owner may face dire consequences. Courts have wide latitude to fashion the "appropriate" relief to protect "trust beneficiaries."[66] Courts can recover "trust assets" disbursed to third parties, require Owner to replenish the trust, limit Owner's authority over the trust, direct Owner to distribute trust assets based on a set priority scheme, and hold Owner (or certain Owner agents) liable for damages. The Lien Law even contemplates criminal liability.[67]

II. Owner's Strategies to Contend with Lien Law

Owner can and should plan a strategy early in the life of any Project—and certainly as soon as a problem erupts, although at that point it can be too late—to minimize Owner's exposure to a financially troubled GC, so Owner can come as close as possible to achieving its three goals: completing the Project, doing so on schedule, and doing so on budget. This section of the article discusses some measures that Owner and its counsel might consider taking.

A. Prepare the Battlefield

Contracts between Owner and GC must address the handling of Liens. In general, Owner should require GC to secure the discharge of Liens in fairly short order. Until Liens are discharged, Owner must be exceedingly careful before disbursing funds to GC, because payments made to a GC after Owner receives notice of a Vendor's Lien will not reduce that Lien, and Owner may end up paying twice for the same work.

B. Gather Information

Owner may not know its GC has been delinquent in paying Vendors until the moment Owner receives a Vendor's Notice of Lien.[68] With its bubble of blissful ignorance burst, Owner should promptly take all reasonable steps to collect information about its Project to (a) understand the whole picture, (b) plan Owner's strategy and (c) prepare to defend itself in court.

This information gathering should be given the highest priority. It may amount to a time-consuming ordeal. Even while Owner collects information, Owner will need to make some strategic decisions. Additional Notices of Lien will probably arrive during this process, further complicating matters.

1. Information Owner Needs

Owner will want answers to a variety of questions, including:

a. How much does Owner owe GC under the contract?

b. How much does GC owe to Vendors under their contracts?

c. What do these Vendors owe their Sub-Vendors?

d. To what extent have GC and Vendors substantially performed under their contracts?

e. Which Vendors have filed Liens?

f. Of the various GC and Vendor claims, how much covers labor?

g. How much retainage does Owner still hold, and what claims does Owner anticipate against the retainage?

2. Sources of Information

With any luck, Owner will already have maintained the records that Article 3-A requires. But those records, even when combined with information in Notices of Lien, will probably not give Owner a full picture of the Project. Owner should turn to other sources, including:

a. GC's records;

b. Vendor records;

c. A full title search of the Site, to include an examination of any unrecorded but filed documents under the Lien Law;

d. A litigation search on GC and perhaps major Vendors; and

e. Physical inspection of the Site.

GC's records probably constitute Owner's best source of information, though Owner may have difficulty obtaining them, depending on the terms of Owner's contract with GC, Owner's leverage against GC at the time, and GC's willingness to cooperate. Owners should consider retaining a forensic accounting firm to assist in unraveling the mess.

Even if the construction contract does give Owner the right to review GC's payment records, GC might just tell Owner to take a flying leap—especially given that GC knows Owner will probably soon terminate GC's contract anyway. Owner might have better luck by seeking the assistance of a cooperative Vendor. In doing so, Owner would indirectly take advantage of Article 3-A, which makes GC a statutory trustee of its own Article 3-A trust. As a result of that trust, Article 3-A allows Vendors to demand copies of GC's records. Still, even if a cooperative Vendor exists, that Vendor may need a month to obtain GC's records. Finally, if GC becomes subject to bankruptcy or similar protection, GC's records may become publicly available.

C. Complete the Project: Dealing with the Lender

For Owner to achieve its primary goal, completing the Project, Owner will typically need a source for more funds. If a Lien has been filed against the Project, this will usually constitute a default under Owner's construction loan and excuse the lender from further funding. The documents will, however, usually let Owner solve that problem by bonding the Lien.[69]

Once Owner knows a Lien has been filed, Owner will usually want to notify its construction lender—so the lender hears about the problem first from Owner rather than from a regular title continuation—and be ready to answer the lender's questions about the Lien. These questions will usually not vary much from the questions Owner will ask about the same Lien, as described above. More generally, the construction lender's agenda will largely overlap Owner's agenda, except that the lender will have some unique burdens, concerns, and risks driven by the "building loan" provisions of the Lien Law[70] and a major recent surprise from the New York Court of Appeals in interpreting a lender's risks under Article 3-A.[71] That lender-specific rat's nest lies beyond the scope of this article.

D. Bond the Project

The filing of a single Lien can function much like a drop of blood in a tank of sharks. Other Vendors will race to file their own Liens, further complicating Owner's Project and relations with its construction lender.

Owner can, in theory, prevent other Vendors from filing additional Liens against the Site by filing a bond under Lien Law § 37.[72] After Owner files such a bond, any future Liens will attach to the bond, not the Site.[73] A § 37 bond is, however, quite expensive, typically costing 1% to 2% of the bond amount. It also requires Owner to deliver substantial credit support, perhaps at least the remaining cost of the Project plus some cushion, typically very unpalatable or even impossible. Finally, such a bond gives Lien claimants tremendous leverage going forward, as it gives them security far superior to a claim against real property. Thus, Owner may not choose to file such a bond. One advantage of filing a Lien Law § 37 bond arises from the likelihood that Vendors may not pay enough attention and may still file Liens, instead of claims against the bond. If a Vendor does not re-file correctly within the time allowed for filing, it will no longer have a valid claim against the bond.[74] Although such Vendors may have a malpractice claim against the attorney who was engaged to enforce the Vendors' rights (and forgot to check whether a bond had been filed), they will no longer have a claim against Owner.

Should Owner decide to file such a bond, it should do so as soon as possible. In many cases, a bond under Lien Law § 37 does not discharge Liens that Vendors filed before Owner posted the bond, and Owner will have to file a separate bond for each Lien under Lien Law § 19.[75]

E. Assume Contracts with Vital Vendors and Consider Replacing GC

If Owner can assure access to funds to complete the Project, Owner's next challenge will be to try to stay as close to schedule as reasonably possible in finishing the Project. To do that, Owner may want to try to convince vital Vendors to stay on the job and finish their work. Otherwise, Owner risks further delays to the Project while Owner seeks new Vendors.

Owner's general contract with GC will often allow Owner to assume the contracts of any Vendors it chooses, such as the vital Vendors. Before Owner does so, it should consider three issues:

1. Owner must confirm that its general contract does allow it to pick and choose which Vendor contracts to assume. Many, probably most, general contracts follow the AIA's standard general contract, Form A201. That form gives Owner the ability to obtain the assignment of any Vendor contracts that it so chooses.[76] Owner must first, however, terminate the general contract "for cause."[77] GC's failure to properly pay Vendors constitutes sufficient cause under Form A201.[78]
2. Owner must confirm that the appropriate court allows it the flexibility to choose which contracts it assumes—even if the general contract grants this flexibility—a question outside the scope of this article. Owner should also consider its longer term business relationships with the various Sub-Vendors when deciding which contracts to assume and which to terminate.
3. Third, Owner must be sure not to inadvertently assume any contracts it did not want to assume. Owner should assume the contracts of vital Vendors only if it can do so without assuming the contracts of non-vital Vendors. If Owner can't, then it should try to negotiate new contracts with new vital Vendors. As a practical matter, Owner should try to negotiate these new contracts before it terminates its contract with GC. Otherwise, vital Vendors might stop work, in an attempt to obtain better contract terms from Owner. Owner's agreement with GC should, ideally, require GC to give Owner copies of all contracts with Vendors promptly after being executed, and should state that GC automatically assigns those contracts to Owner following a default, termination of the General Contract, and Owner's election to assume any affected contracts.

Owner should also take steps to try to limit potential recoveries by Vendors whose contracts Owner has assumed. Before assuming a contract, Owner should obtain an estoppel certificate from Vendor confirming the absence of defaults, other than payment, and establishing an agreed schedule for the payment of any balance for work already performed. In some cases, Owners have been known to condition their assumption of a contract upon Vendor's agreeing to first pursue GC for the open balance before asserting any part of that open balance against Owner. In essence, this arrangement gives Vendor a choice between (A) asserting only limited remedies against Owner but being paid to complete the Project and (B) being terminated from the Project, but retaining its Lien rights. If construction lending is involved, any filed Liens will need to be discharged, which in turn may make the first alternative more palatable.

Finally, Owner may want to stop paying the remaining (non-vital) Vendors and GC. Although this will probably precipitate litigation, Owner has techniques available to minimize the resulting liability.

F. Minimize Exposure to Non-Vital Vendors

By selectively taking over contracts with vital Vendors, Owner may increase its chances of completing the Project and doing so on schedule. As its remaining goal, Owner will want to stay as close to budget as it can. This will require finding ways to pay Lien holders less than what they claim in their Liens—but without violating Article 3-A.

1. Minimize Funds Owner Must Pay to Lien Holders

From Owner's perspective, any payments Owner pays to resolve claims of non-vital Vendors are essentially wasted, because they give Owner very little benefit. These Lien holders will have probably already finished their work—given that otherwise they could not establish "substantial performance" (or "substantial completion" under the construction contract). Thus, any further work they might perform will not deliver to Owner any additional value. Owner should keep in mind, however, that a non-vital Vendor that has demonstrated "substantial performance" or "substantial completion" will have a Lien for the value of its work and/or a claim for breach of contract. Owner must get rid of any filed Liens unless it wishes to have an unmarketable Site, an unhappy lender, and a substantial risk of foreclosure. Thus, to the extent Owner can, it should reduce the amount that it must ultimately pay Lien holders to resolve the Liens. The Lien Law does give Owner several options to mitigate the amount Owner must pay.

As a particular compelling argument, Owner can argue that a Lien holder (or a party to whom the Lien holder has become subrogated) has not substantially performed under its contract. Given the factual scenario—an insolvent GC and a largely incomplete Project—it would seem highly likely that at least some party will have not substantially performed. If Owner can successfully assert that GC or a Vendor (or several) has not substantially performed, Owner can avoid paying the full Liens.[79] Though these Lien holders will be left with a remedy of quantum meruit, they face an uphill battle to collect. Given that Project completion will probably require Owner to pay more than what it agreed to pay GC to complete the Project, Owner may be able to argue that it did not benefit from the Lien holders' work beyond what Owner has already paid.

Owner might also challenge the validity of any Liens. If Owner can successfully claim that a Lien holder does not meet one of the three substantive conditions of having a Lien (as summarized above), Owner may eliminate all payments under Article 2 to that Lien holder.

Owner might also assert that Liens were not properly filed because they violated one of the many technical requirements for filing a Lien.[80]

Before making any substantive or procedural challenge to a Lien, Owner will typically want to wait until after the deadline for filing (or re-filing) a Lien has passed—eight months from Project completion—before asserting its claim.[81] After that point, if Owner successfully challenges a Lien, the Lien holder will probably not be able to re-file.[82]

Finally, Owner can challenge whether the amounts a Vendor claims in its Lien are reasonable. Any Notice of Lien must include the Lien holder's statement of the agreed price or value of the labor performed and materials furnished when the Vendor files its Lien.[83] The Lien holder's claim must be reasonable based on the balance due. Owner can sometimes challenge the Lien amount on that basis. In addition, in the rare case where Owner can demonstrate that the Lien holder willfully exaggerated the amount of the Lien, the court can declare the Lien void and force the Lien holder to pay Owner damages, including bond premiums, and a penalty equal to the exaggerated piece of the Lien.[84] The Lien holder will also have no right to file another Lien for that claim. Unfortunately for Owner, however, Lien claimants do not often willfully exaggerate their claims, and Owner may have trouble proving willfulness,[85] which must be established in the trial of the foreclosure action.[86] The question cannot be determined on motion prior to trial.[87]

2. Avoid Article 3-A Violations

Owner should take great care not to violate Article 3-A, such as by diverting "trust assets" away from the purpose of the trust or by failing to keep proper records. As long as Owner complies with Article 3-A, it can pay its vital Vendors in whatever order it chooses and can pay any remaining "trust beneficiaries" out of any "trust assets" that remain. And, given that Vendors will in most instances be "trust beneficiaries" when they also have claims for valid Liens, Owner will often not owe these "trust beneficiaries" any more than it would have paid to satisfy their Lien claims, anyway. Although this is often the case, Owner should note that Vendors can be considered "trust beneficiaries" whether or not they have filed or had the right to file a valid Lien.[88]

Owner should also bear in mind that if it assumes contracts of vital Vendors, as this article suggests an Owner might consider doing, Owner will become "obligated" to those Vendors under Article 3-A. Thus, those Vendors will become "trust beneficiaries" with trust claims equal to the full amounts of their contracts. Owners should always consider using an intermediary to act as a replacement GC going forward, or entering into separate new contracts if possible.

III. How Owners Can Plan Ahead to Prevent Lien Problems

The discussion above focuses on steps an Owner can take after a Project goes bad. If Owner could turn back the clock, though, or wanted to try to do better next time, what more could Owner do at the outset of a Project to prevent problems? This article concludes by offering a few suggestions. Some are just reminders of "best practices" in running construction jobs. Others have not been typical in construction projects either because they are expensive or a GC will refuse to accept them. In today's markets, though—at least until the next construction boom—GCs may decide to accommodate.

First, Owner can insist on monitoring the Project by requiring GC to keep good records and give Owner regular access to those records. Owner might condition any payments to GC on proof that GC has paid Vendors. If owner can persuade GC to agree to such measures, Owner must also bear in mind the possibility of fraud. Such owners should consider engaging a forensic accounting firm to keep an eye on the chicken coop.

Second, Owner can insist on having the right—even before GC gets into visible trouble—to pay Vendors directly, or through joint checks, instead of using GC as the middleman. Again, GC will typically object to any such arrangement. And Owner should note that any such arrangement could make Vendors into Article 3-A "trust beneficiaries," because Owner could be deemed "obligated" to Vendors.[89] But if Owner's payments to Vendors are voluntary, Vendors would probably not have rights until the payment is actually made.

Third, Owner could obtain third-party assurances that GC will pay its Vendors. For example, GC could deliver to Owner a letter of credit, which Owner could draw upon if problems arose. Or Owner could require GC to deliver a payment bond, where a bonding company agrees that if GC does not pay its Vendors, then the surety will, up to the amount of the bond. Measures like these are often expensive. And if a GC's credit is strong enough so GC can arrange measures like these, then traditionally any Owner would conclude that GC's credit is also strong enough to make such measures unnecessary. Regardless of GC's credit, however, Owner should remember that GCs sometimes do play games of the types that lead to trouble. And war stories abound regarding a GC who files a Chapter 11 petition with one entity on Monday and is back in business Tuesday with a new corporate entity using the plant, equipment, and other assets of the bankrupt entity.

Finally, Owner could try to hire a more creditworthy and reliable GC. Such a GC may charge more. But Owner may find that a GC with better credit means less likelihood of trouble. Of course, particularly after the events that have rocked the real estate and financial worlds since late 2007, Owner might conclude that no one is as reliable as he or she seems. Owners may seek credit enhancement in the form of performance bonds that guarantee completion of the project, although the litigation that is needed to realize on these bonds sometimes makes their protection illusory. Other credit enhancements that are gaining acceptance in the construction industry are standby credits, which are beyond the scope of this article.[90]

In any event, Owners must recognize that New York law provides very meaningful rights and remedies for parties whose labor and materials go into a Project. The Lien Law is intended to help assure that those parties receive payment for their work. Owners must have a plan to ensure that these protected parties do not acquire the ability to derail the Project.

Endnotes

1. Owner may engage GC or, more commonly at least in New York City, a construction manager ("CM"). Under a traditional CM structure, Owner bears all financial risks of the Project, and CM enters into contracts with Vendors as Owner's agent. That mitigates many risks this article describes, but replaces them with others. A variation on a CM structure imposes obligations that are similar to conventional contracting, and is known as "Construction Manager at Risk." Even more complications arise if the Owner elects to use the "Design-Build" method of project delivery, where one entity performs both design and construction under a single contract. A CM arrangement will sometimes switch to a GC arrangement once the CM satisfies itself that very little risk remains in costing out the Project. This article considers only the implications of the GC structure for any Project. And this article limits itself to private/commercial Projects, as opposed to Projects undertaken for public agencies.
2. This article uses "Vendor" to refer to everyone—except GC—who may be owed money for a Project. Not every Vendor can always assert the Lien Law rights this article describes. The lines drawn will vary among various routes to recovery. Some

Vendors, such as architects, will deal directly with Owner, not GC. The claims of such Vendors will be similar to GC's. Other design professionals, such as engineers, and consultants, stand in a relation to the architect that is analogous to the contractor-subcontractor relationship. This article does not discuss those claims separately.

3. This would violate Lien Law Article 3-A, which prohibits a GC from using funds from one Project to pay debts of another unless GC has paid certain Vendors at the first Project. *See* N.Y. Lien Law §§ 70–79 (McKinney 2007), discussed at length below.

4. Kevin J. Connolly, *Surprises Lurk in the Lien Law*, N.Y. L.J., Aug. 8, 2010, at 9.

5. Such direct contractual rights would include, for example, any Vendor contracts that Owner has guaranteed or assumed. Vendors might have other avenues to claim a direct contractual relationship with Owner. For example, Vendor(s) and GC could enter into a so-called "liquidation agreement," which is an arrangement where GC assumes liability for Owner's actions so as to pursue Owner on behalf of Vendors. For more about these agreements, otherwise beyond this article, *see* Barry, Bette & Duke, Inc. v. New York, 240 A.D.2d 54, 56, 669 N.Y.S.2d 741, 743 (3d Dep't 1998).

6. In an extreme case, diversion of trust assets also constitutes larceny. *See* N.Y. Lien Law § 79-a(1). Other parties, such as GCs and subcontractors, can also constitute "trustees." Although this article does not exhaustively treat the trust fund obligations of these other trustees, any such trust follows the trust assets into the hands of transferees. This can sometimes produce surprises. For more on these surprises, *see* Connolly, *supra* note 4.

7. *See* Aspro Mech. Contracting, Inc. v. Fleet Bank, 1 N.Y.3d 324, 805 N.E.2d 1037 (2004), for an example of how the New York Court of Appeals sent a chill down the spines of construction lenders, as this article will briefly explain below.

8. *See generally* N.Y. Lien Law § 79 (nothing in Article 3-A prevents enforcement of a Lien under Article 2 or 3; and neither such Lien nor its satisfaction amounts to diversion of trust assets or unauthorized preference).

9. *See, e.g.*, In re Marcus Substructure Corp., 76 A.D.2d 926, 429 N.Y.S.2d 722 (2d Dep't 1980). The court considered a proposal to settle the claims of two classes of creditors—mechanics' lienors under Article 2 and Article 3-A trust beneficiaries who did not hold mechanics' Liens—by paying each creditor pro rata without regard to their class status. The court rejected this proposal, holding that "a class of mechanic's lienholders must take priority over a class of mechanic's nonlienor beneficiaries of a trust fund under [A]rticle 3-A of the Lien Law." *Id*. (collecting cases in support).

10. For more about construction loans, *see* Joshua Stein, Stein on New York Commercial Mortgage Transactions, § 5 (2006); 8 William X. Weed, Warren's Weed New York Real Property § 92.53 (5th ed. 2010) (hereinafter *Warren's Weed*).

11. *See* Brainard v. County of Kings, 155 N.Y. 538, 50 N.E. 263 (1898) (finding that if nothing is due to GC according to the contract when the Lien is filed, but some amount later becomes due under the contract, the Lien attaches to the extent of that sum).

12. *See* N.Y. Lien Law §§ 9–11. Failure to comply with these technicalities can trigger significant problems for a Lien claimant. For example, Lien Law § 9 requires Lien claimants to include certain information in their notice of Lien. If they aren't careful, these Lien claimants might, for example, forget to designate the block or blocks of real property to which the Lien will attach, which is required under Lien Law § 10. In addition, Lien Law § 11 requires Lien claimants to properly serve upon Owner their notices of Lien.

13. The statutory class includes contractors, subcontractors, laborers, materialmen (now often called material suppliers), landscape gardeners, and nurserymen. *See* N.Y. Lien Law § 3. Case law has expanded the list to include, e.g., draftsmen, engineers, surveyors, and architects. *See* 21 Laurence S. Tauber, General Practice in New York § 10.5, n. 1, 2 (Robert L. Ostertag & James D. Benson eds. 1998) (hereinafter *Ostertag & Benson*).

14. *See* N.Y. Lien Law § 2 ("improvement" includes all work on real property and any work done on such property for its permanent improvement). N.Y. Lien Law § 2 defines "improvement" quite broadly. *See Ostertag & Benson*, *supra* note 13, § 10.6. The requirement of a "permanent" improvement distinguishes between works that remain after the Project is completed, and those that are transient. Even more confusion arises because the law treats the value of temporary works as lienable if and when those works are the means by which the permanent improvement is accomplished.

15. *See* N.Y. Lien Law § 3.

16. *See id*. § 4(1).

17. *See, e.g.*, Klinik v. 66 East 80 Realty Corp., 15 Misc. 2d 911, 913-14, 185 N.Y.S.2d 1009, 1012-13 (Sup. Ct. N.Y. Cnty. 1959) (if contractor fails to fully perform under contract, contractor may still recover based on substantial performance). *See id*. for early cases discussing this issue.

18. *See* Frank v. Feiss, 266 A.D.2d 825, 826, 698 N.Y.S.2d 363, 364 (4th Dep't 1999) (absent direct evidence of the reasonable value of the work performed or materials supplied, court can infer such value from the parties' agreement); *see also* Pronti v. Smutzinger, 52 A.D.3d 1015, 1016, 861 N.Y.S.2d 148, 149 (3d Dep't 2008) (price payable under void contract may evidence reasonable value for services).

19. *See* Cassino v. Yacevich, 261 A.D. 685, 687, 27 N.Y.S.2d 95, 98 (3d Dep't 1941) (finding that a builder may recover the contract price where he has in good faith intended to comply with the contract, and has substantially complied with it); *see also* Pfeil Const. Corp. v. Moley, 14 Misc. 2d 379, 382, 179 N.Y.S.2d 443, 448 (Sup. Ct. Erie Cnty. 1958) (contract must be performed according to its terms, but trivial and innocent omissions trigger damages, not forfeiture).

20. *See* Spence v. Ham, 163 N.Y. 220, 226, 57 N.E. 412, 413 (1900) ("[t]he question of substantial performance depends somewhat on the good faith of the contractor. If [the contractor] has intended and tried to comply with the contract and has succeeded, except as to some slight things omitted by inadvertence, he will be allowed to recover the contract price, less the amount necessary to fully compensate the owner for the damages sustained by the omission." (quoting Van Clief v. Van Vechten, 130 N.Y. 571, 579, 29 N.E. 1017, 1019 (1892)).

21. *See* Carefree Building Products, Inc. v. Belina, 169 A.D.2d 956, 957, 564 N.Y.S.2d 852, 854 (3d Dep't 1991) (whether performance was substantial turns upon facts of case). The court in *Carefree* listed a number of cases discussing substantial performance based on varying degrees of deficiency: Fuchs v. Saladino, 133 A.D. 710, 715, 118 N.Y.S. 172, 176 (1st Dep't 1909) (15%); Wilson Roofing & Painting v. Jobco-Kelly Assoc., 128 A.D.2d 953, 955, 513 N.Y.S.2d 263, 265 (3d Dep't 1997) (15%); Gompert v. Healy, 149 A.D. 198, 199, 133 N.Y.S. 689, 690 (2d Dep't 1912) (25%); Mitchell v. Williams, 80 A.D. 527, 529, 80 N.Y.S. 864, 866 (1st Dep't 1903) (1/7th); Fox v. Davidson, 36 A.D. 159, 162, 55 N.Y.S. 524, 524 (1st Dep't 1899) (1/20).

22. Edward Marks, Jensen on the Mechanics' Lien Law of the State of New York § 136 (4th ed. 1963) (hereinafter *Jensen*).

23. *See* AIA Document A201, *General Conditions of the Contract for Construction*, art. 9, § 9.8.1 (2007), *available at* http://www.aia.org/contractdocs/aiab081513 (hereinafter *AIA Document A201*).

24. *Id*.

25. *See generally* Jacob & Youngs, Inc. v. Kent, 230 N.Y. 239, 129 N.E. 889 (1921) (plaintiff requested certificate of completion necessary for final payment).

26. *See AIA Document A201*, *supra* note 23, at § 9.10.1.

27. *See* Nesbit v. Braker, 104 A.D. 393, 394, 93 N.Y.S. 856, 856 (1st Dep't 1905) (absent completion certificate, plaintiff needed to show a demand and unreasonable refusal by architect); *see also* Beecher v. Schuback, 4 Misc. 54, 55, 23 N.Y.S. 604, 606 (N.Y.C. C.P. Gen. T. N.Y. Cnty. 1893) (absent evidence that architect's certificate was fraudulently or unreasonably withheld, recovery under contract was not possible).

28. *See* N.Y. Lien Law § 4(1) (limiting liability to value or agreed price of labor and materials remaining unpaid when notice of Lien filed).

29. Not every state limits Vendors' claims in this way. Absent such a limitation, even if Owner paid GC, Owner still bears the risk that GC won't pay Vendors. In these states, Owner must police GC. In New York, however, Owner has no obligation to see to GC's proper application of funds.

30. *See* Ace Contracting Co. v. Garfield & Arma Assoc., 148 Misc. 2d 475, 477, 560 N.Y.S.2d 382, 383 (Sup. Ct. N.Y. Cnty. 1990) (citing older cases to similar effect).

31. Please see Section B below for a discussion of Vendor's rights under Article 3-A.

32. *See* Electric City Concrete Co. v. Phillips, 100 A.D.2d 1, 4, 473 N.Y.S.2d 608, 610 (3d Dep't 1984) (lienors derive rights from those of GC and cannot exceed Owner's balance due GC).

33. *See* N.Y. Lien Law § 45 (court may adjust and determine equities of all parties).

34. Discussion of the fluid law of foreclosure in New York is beyond the scope of this article, but readers should be aware that the rule that contracts will be generally enforced as written, articulated in *Graf v. Hope Bldg. Corp*., has been eroded to such an extent that Justice Cardozo's ringing dissent has come to be accepted as the better rule. Justice Cardozo wrote: "however fixed the general rule and the policy of preserving it, there may be extraordinary conditions in which the enforcement of such a clause according to the letter of the covenant will be disloyal to the basic principles for which equity exists." 254 N.Y. 1, 11, 171 N.E. 884, 887 (1930) (Cardozo, J., dissenting).

35. *See* Brescia Constr. Co. v. Walart Constr. Co., 264 N.Y. 260, 265, 190 N.E. 484, 486 (1934).

36. *See* N.Y. Lien Law § 13(1) (time of filing does not set priority of Liens).

37. *See id*. § 56.

38. The mere fact that a conveyance recites the required trust fund covenant may not give it priority over Liens filed later, if no fund was actually created. *See* Monroe Sav. Bank v. First Nat'l Bank of Waterloo, 50 A.D.2d 314, 317-18, 377 N.Y.S.2d 827, 830-31 (4th Dep't 1976).

39. *See* N.Y. Lien Law § 13(1).

40. *See id*. § 56.

41. *See id.*

42. *See generally Warren's Weed*, *supra* note 10, at § 92.50[3] (referencing N.Y. Lien Law §§ 13, 56; subcontractor has priority over subcontractor with whom he contracted and also over contractor with whom he contracted).

43. *See* N.Y Lien Law § 13(1).

44. *See id.*

45. *Id.* § 56 .

46. *See generally* M.F. Hickey Co. v. Imperial Realty Co., 65 Misc. 2d 1088, 1094, 319 N.Y.S.2d 972, 979 (N.Y. Civ. Ct. N.Y. Cnty. 1970) (suggesting that if voluntary payments can defeat or diminish Lien rights of other Vendors, this seems inconsistent with N.Y. Lien Law § 56).

47. Many parties involved in a Project other than Owner can become trustees under Article 3-A. For instance, GCs and subcontractors who hire others on the Project also constitute trustees. *See also* N.Y. Lien Law § 71.

48. For a full list of Owner's trust assets, s*ee* N.Y. Lien Law §§ 70(5)(a)-(e), 71-a.

49. *See* Bristol, Litynski, Wojcik, P.C. v. Elliot, 107 Misc. 2d 1005, 436 N.Y.S.2d 190 (Sup. Ct. Albany Cnty. 1981) (funds to pay consideration expressed in the contract do not originate from any source described in N.Y Lien Law § 70(5), hence that section does not apply to the contract).

50. N.Y. Lien Law § 79-a provides: "Any trustee of a trust arising under this article, and any officer, director or agent of such trust, who applies or consents to the application of trust funds received by the trustee as money or an instrument for the payment of money for any purpose other than the purposes of that trust…is guilty of larceny and punishable as provided in the penal law…" *See also* People v. Chesler, 50 N.Y.2d 203, 205, 406. N.E.2d 455, 456, 428 N.Y.S.2d 639, 640 (1980) (discussing defenses to a charge of larceny in violation of Lien Law § 79-a).

51. *See supra* note 48 and accompanying text.

52. *See* N.Y. Lien Law § 70(2).

53. *See id*. § 70(4).

54. § 71(3)(a) (emphasis added).

55. A court may also find Owner "obligated" to a Vendor if Owner agrees to pay GC and that Vendor by joint check. *See* Sabol & Rice, Inc. v. Poughkeepsie Galleria Co., 175 A.D.2d 555, 572 N.Y.S.2d 811 (3d Dep't 1991).

56. *See* Weber v. Welch, 246 A.D.2d 782, 784, 668 N.Y.S.2d 71, 72 (3d Dep't 1998). In *Weber,* Owner argued for dismissal of the "trust claim" of a Vendor who held a valid Lien. The court rejected Owner's argument, holding that Vendor's Lien made Owner potentially obligated to Vendor. For that argument to work, however, Vendor's Lien must be valid. *But see* Innovative Drywall Inc. v. Crown Plastering Corp., 224 A.D.2d 664, 664, 638 N.Y.S2d 722, 722-23 (2d Dep't 1996) (Owner not "obligated" to a Vendor because Vendor's Lien was defective and Vendor could not show Owner had any other contractual obligation to Vendor).

57. *See* Onondaga Commercial Dry Wall Corp. v. Sylvan Glen Co., 26 A.D.2d 130, 133, 271 N.Y.S.2d 523, 525 (4th Dep't 1966) (plaintiff could not show it was beneficiary of trust assets held by Owner, but could for trust assets received by contractor).

58. N.Y. Lien Law § 74(1).

59. Fortunately for Owner, if a trust beneficiary wants to show Owner diverted trust assets, the beneficiary must prove exactly that—actual diversion of trust assets. Mere failure to pay the trust beneficiary does not suffice. *See* Ryan Ready Mixed Concrete Corp. v. Caristo, 158 N.Y.S.2d 451 (Sup. Ct. Kings Cnty. 1959)

60. Article 3-A does, however, contain a priority scheme if Owner "diverted" trust assets. *See* N.Y. Lien Law §77(8).

61. *Id*. § 71(1).

62. *See* Schwadron v. Freund, 69 Misc. 2d 342, 345, 329 N.Y.S.2d 945, 950-51 (N.Y. Sup. Ct. Rockland Cnty. 1972) ("costs of improvements" did not include corporate administrative expenses, attorneys' fees, or unrelated union benefits).

63. A court will not automatically find that Owner diverted trust assets merely because Owner cannot provide the records. Such failure does, however, constitute "presumptive evidence" of diversion, placing on Owner the burden of proving a negative. *See* N.Y. Lien Law § 75(4).

64. *See* N.Y. Lien Law § 75(2) (Owner must keep records for its trust, and allocate amounts based on any commingled bank accounts); *see id.* § 75(3) (listing records—trust assets receivable, payable, received and payments made—Owner must provide

to trust beneficiary upon demand). Owner doesn't have very much time to comply with any such demand, so should have the records ready.

65. *See generally* N.Y. Lien Law § 76 (entitling any trust beneficiary, upon request, to examine the books or records, to make copies, or to opt for a verified statement setting forth information in such books or records).

66. *See id.* § 77(3)(a).

67. *See id.* § 79-a; *see also* People v. Miller, 23 A.D.3d 699, 803 N.Y.S.2d 734 (3d Dep't 2005). In *Miller*, a GC that used "trust assets" to pay bills and expenses associated with unrelated construction projects was convicted of 32 counts of grand larceny and sentenced to concurrent prison sentences, the maximum of which was 5 to 15 years.

68. In a Notice of Lien, Vendor must allege (among other things) the work it has done, the unpaid balance for that work, and Vendor's right to a Lien. When someone says colloquially that a Vendor filed a Lien, that usually means they filed a Notice of Lien. *See generally* N.Y. Lien Law § 9 (required contents of notice of Lien).

69. *Id.* § 37(1).

70. The lender will need to make sure that any loan to pay for "costs of improvement" qualifies as a "building loan" under the Lien Law. If the lender later modifies the terms of the loan, this may require further nonintuitive measures to retain "building loan" qualification. *See generally id*. § 2(5).

71. In Aspro Mech. Contracting, Inc. v. Fleet Bank, N.A., 1 N.Y.3d 324, 330, 805 N.E.2d 1037, 1040 (2004), the New York Court of Appeals held that a mortgage lender that takes a security interest in Owner's construction contract steps into the shoes of Owner and is thus a "trustee" under Article 3-A. The construction lender can solve the problem by filing a Notice of Lending. Such a filing only protects advances made up to five days before the filing, on the date of filing or after the filing until the termination date specified in the Notice. *See* N.Y. Lien Law § 73; *see also*, 33 Robert Rubin, Sarah Biser & Catherine Kettle Brown, New York Construction Law Manual § 9.76 (2011 ed.).

72. *See* N.Y. Lien Law § 37 (upon approval of a bond, court shall discharge the property from Lien claims arising from contract described in such bond); *see also Jensen, supra* note 22, § 268.

73. N.Y. Lien Law § 37(5).

74. *Id.* § 37(5) (claimant must perfect Lien claim within statutory deadline for filing notice of Lien).

75. *Compare* In re Rockefeller Center, Inc., 238 A.D. 736, 738, 265 N.Y.S. 546, 548 (3d Dep't 1933) (§ 37 not intended to provide a method to discharge Liens filed before delivery of bond) *with* Trustees of Hanover Square Realty Investors v. Weintraub, 52 A.D.2d 600, 600-01, 382 N.Y.S.2d 110, 110 (2d Dep't 1976) (suggesting a § 37 bond also discharges previously filed Liens). *See generally* N.Y. Lien Law § 19 (discharge of a Lien for private improvement).

76. *See AIA Document A201, supra* note 23, § 14.2.2

77. *See id*. § 5.4.1. To terminate the AIA standard General Contract for cause, Owner must (a) have the architect certify that sufficient cause exists to justify such action and (b) give GC seven days' written notice. *See id*. § 14.2.2

78. *Id.* §14.2.1. Cause would also arise if GC "repeatedly refuses or fails to supply enough properly skilled workers or proper materials; fails to make payment to Subcontractors for materials or labor in accordance with the respective agreements between the Contractor and the Subcontractors; repeatedly disregards applicable laws, statutes, ordinances, codes, rules and regulations, or lawful orders of a public authority; or otherwise is guilty of substantial breach of a provision of the Contract Documents."

79. The Lien claimant bears the burden of proof on the amount and validity of its claim, thus must prove substantial performance. *See* Nesbit v. Braker, 104 A.D. 393, 394, 93 N.Y.S. 856, 857 (1st Dep't 1905) (plaintiff bore burden of proof of substantial performance).

80. *See supra* note 12 and accompanying text for more details on these technicalities.

81. *See* N.Y. Lien Law § 10 (notice of Lien may be filed at any time during progress of work, or within eight months after completion of contract).

82. The deadlines in N.Y. Lien Law § 10 differ dramatically for a Project that constitutes a "public improvement." *See id.* § 12 (deadline is 30 days after completion and acceptance of public improvement).

83. *See id.* § 9(4).

84. *See id.* §§ 39 and 39-a.

85. Walker v. Security Trust Co., 85 Misc. 2d 614, 622, 379 N.Y.S.2d 308, 316 (Sup. Ct. Monroe Cnty. 1976) ("willful" means more than just doing the act or failing to do the act, but rather an intentional and deliberate doing of the act or failing to do the act with a certain awareness).

86. *See* Durand Realty Co. Inc. v. Stolman, 197 Misc. 208, 211, 94 N.Y.S.2d 358, 361 (Sup. Ct. N.Y. Cnty. 1949), *aff'd*, 280 A.D. 758, 113 N.Y.S.2d 644 (1st Dep't 1952); *see also* Guzman v. Estate of Fluker, 226 A.D.2d 676, 678, 641 N.Y.S.2d 721, 724 (2d Dep't 1996) (citing *Durand*, willful exaggeration must be established at trial of foreclosure action).

87. *But see generally* Joe Smith Inc. v. Otis-Charles Inc., 279 A.D. 1, 5 107 N.Y.S.2d 233, 236 (4th Dep't 1951) (when appellant succeeded in having Lien discharged at commencement of trial, this terminated foreclosure action, leaving court without authority to declare Lien void for willful exaggeration).

88. N.Y. Lien Law § 71(4).

89. *See id.* § 71(3)(a) ("trust claims" can also mean any obligation of Owner incurred in connection with the improvement for a payment or expenditure defined as cost of improvement).

90. *See, e.g.*, Kevin J. Connolly, *Security for Contract Performance*, 24 John Liner Rev. 2 (Summer 2010).

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Anti-Wage Theft Laws: A Solution Creating More Problems Than It Solves?

By Joel J. Greenwald

It has always been the law that employees must be paid all wages due them, and there have always been remedies for employees when they were not: the employee could complain to the federal or state Department of Labor, and/or could bring a private lawsuit (either individually, or together with other, similarly situated workers). Without denying that some workers have been taken advantage of, and without denigrating how serious not being correctly paid is, there was no apparent epidemic of nonpayment sweeping the nation, or any particular reason to think that the existing remedies didn't work.

So if that's the case, why are "anti-wage theft" laws starting to sweep the nation?

New York State's Wage Theft Prevention Act enacted in December 2010 is one of the most talked-about "anti-wage theft" laws. The Wage Theft Prevention Act (WTPA)[1] increased the penalties and exposure to civil liability for failure to pay minimum or overtime wages, and reporting or record-keeping failures, while simultaneously increasing the record-keeping burden on employers. Under the Act, within 10 days of an employee's start date, and annually each January thereafter, employers must provide employees with written notice of:

1. The employee's rate of pay (including overtime rates, for nonexempt employees) (i.e. you have to inform employees of their classification)
2. How the employee's pay is calculated (i.e. by piece, hour, shift, day, week, salary, commission, or other)
3. Any allowances claimed by the employer as part of minimum wage (e.g. tip credit; or meal or lodging allowance) and
4. The employee's regular payday.

The notices must be provided to the employee in English as well as the employee's primary language.

In addition, each time wages are paid—so, each payday—employers must provide their employees with (a) written notice of the dates covered by that payment; (b) items 1, 2 and 3 above, and (c) the employee's gross wages, itemized deductions from gross wages, and net wages. Employers will need to be able to show this information was provided as well.

If an employer fails to provide the proper annual or start-date notice, the employee may recover $50 a week until the violation is remedied, up to $2,500 for each employee. Also, if an employer fails to provide the wage statement information, the employee may recover $100 a week until the violation is remedied, up to $2,500. In addition, an employee may recover an equal amount in liquidated damages plus collect his/her costs and attorney's fees. Thus, it is crucial for employers to be in compliance.

The records required by the Act (i.e. the above notices) must be kept for six years, and the Act contains a six-year statute of limitations, or time period during which a legal action could be brought for violations of the Act.

Thus, these requirements hit employers two ways: first, by directly increasing compliance costs; and second, by enhancing the likelihood of private lawsuits by allowing private lawsuits to redress recordkeeping violations.

The federal Department of Labor is currently proposing regulations[2] which will require extensive new disclosures by all employers to their employees. Under the proposed rules, employers will have to notify their workers of their rights under the Fair Labor Standards Act, provide information regarding hours worked and wage calculation, and even perform an explicit "classification analysis" of any workers, such as independent contractors or purported exempt employees, they intend to exclude from the coverage of the FLSA and provide that analysis to workers. Again, this type of notice requirement is meant to bring the issue of correct pay and classification to the employees. If such a regulation is passed, it will result in significantly more costs to employers to analyze both the correct classification of workers and to address the significant liability associated with workers finding they were incorrectly classified.

Other states have jumped on the bandwagon, too. For example, Maryland,[3] Illinois[4] New Mexico[5] and Washington State[6] have all passed their own anti-wage theft laws. The movement's even trickled down to the local level: Miami-Dade County[7] and the city of San Francisco[8] have passed their own ordinances, too. And this just the tip of the iceberg: wage theft laws are being considered or have been passed in jurisdictions all across the country.

While the laws vary—and generally appear to not be as tough as New York's law—what they all seem to have in common is increasing compliance burdens by increasing penalties and expanding liability while simultaneously making the government even more involved in "policing" wage issues than it has been in the past.

The problem is that to catch or deter a minority of businesses, all businesses have significant new mandates and costs imposed on them. Overall, it's reasonable to predict that the aggregate cost to business will exceed any gains—but whether these laws are good or bad, they *are*. That means that businesses must adapt to them?

What can and should an individual business do? First, it's vital to recognize that it is likely that the business is, or will soon be, affected by one or more sets of wage theft rules or laws, on the federal, state, and/or local level. Second, it's important to also recognize that these laws reflect a sea change in the nation's mood—expect that any purported wage theft will be viewed harshly by regulatory agencies and the courts.

With all that in mind, it pays be to be prudent. Consult with employment counsel about both what laws now (or shortly will) affect your business, and have counsel analyze your wage-related practices for compliance. You may also wish to review your wage-related practices from an economic as well as legal perspective. Your goal is to ensure full compliance with the law while also streamlining your processes as much as possible. If you can avoid fines and lawsuits (and bad publicity) while also using the opportunity to improve your practices, you've met the challenge posed by these new rules successfully.

DISCLAIMER: The foregoing is a summary of the laws discussed above for the purpose of providing a general overview of these laws. These materials are not meant, nor should they be construed, to provide information that is specific to any law(s). The above is not legal advice and you should consult with counsel concerning the applicability of any law to your particular situation.

Endnotes

1. Fact Sheet: http://www.labor.ny.gov/formsdocs/wp/P715.pdf.
2. http://www.dol.gov/regulations/factsheets/whd-fs-flsa-recordkeeping.htm.
3. MD Code Ann. Lab. & Empl. §§ 3-501 *et seq*, (2009).
4. 820 ILCS 115, (2010).
5. § 1 37-1-5, 50-4-32, 50-4-26, 50-4-26.1 NMSA 1978 (2009).
6. Chapter 42 of the Laws of 2010.
7. Miami–Dade Fla., Code of Miami-Dade County cha. 22 (2010).
8. San Francisco, Cal., Ordinance 101594 (2011).

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Using Long-Term Care Insurance as Part of the Elder Care Plan

By Jeffrey A. Asher

People are living longer.[1] The number of persons aged 65 and over is expected to double by the year 2030 and the fastest-growing segment of the population consists of people who are 85 and older.[2] Many experts are concerned that "aging issues" will reach a critical point as early as this year when the "baby boom" generation first starts to reach the age of retirement.[3] In this current political world, issues of health insurance, retirement, and long-term care are dominating discussions surrounding the upcoming mid-term elections. For some, aging will bring continued health, enjoyable retirement, and financial freedom. For others, aging will bring mental disability, terminal illness, and poverty. For all, aging will bring an increased complexity to life.

As Elder Care attorneys we focus on issues of long-term care, financial management, assisted living, public benefits, and whether our clients can afford their long-term care choices. The good Elder Care attorney will work closely with social workers, retirement coaches, geriatric care managers, financial planners, and others, to create a comprehensive plan for our elder clients. The following shows how long-term care insurance ("LTC insurance"), as part of a comprehensive elder care plan, will address many of the needs discussed above.

The Need for Long-Term Care and Long-Term Care Solutions

A person needs long-term care when he or she suffers from a chronic illness or condition, or has suffered a trauma, that will limit his or her ability to do certain things for himself or herself. These activities, or what we know as "activities of daily living" or ADLs, include such things as bathing, dressing, toileting, and eating. These activities may also include such things as doing household chores, preparing meals, food shopping, and/or managing his or her finances, or activities we call "instrumental activities of daily living" or IADLs. Alzheimer's disease is a good example of a common chronic illness that, depending on how far the disease has progressed, will necessitate long-term care and long-term care solutions.

For most of our clients needing long-term care solutions, we typically evaluate their financial situations, prepare for them a Health Care Proxy and/or Power of Attorney evidencing their appointments of alternate decision-makers, help them prepare a realistic and appropriate budget to pay for their long-term care needs, or help them get benefits, when necessary and appropriate, to pay for such care. For those for whom it is appropriate, we will help them prepare more long-term planning solutions, such as qualifying for Medicaid benefits.

The Costs of Long-Term Care

According to the Genworth 2010 Cost of Care survey,[4] a person aged 75 years needing long-term care should anticipate paying, on average, around $48,000 per year in home health care costs,[5] around $40,000 per year for assisted living facility costs, and around $117,000 per year for nursing home costs. According to the same survey, a person currently 55 years old and anticipating care in 20 years' time will pay, at age 75, approximately $129,000/year for home care, $104,000/year for assisted living facility, and $310,000/year for a nursing home.[6] Needless to say, this can become very expensive very quickly.

A good Elder Law attorney will also help evaluate the financial situation, prepare a realistic and appropriate budget to pay for long-term care needs, and, when appropriate, prepare more long-term planning solutions, such as qualifying for Medicaid benefits.

Medicaid Eligibility and the Transfer of Assets Planning Dilemma

There are generally two types of Medicaid coverage: Medicaid home care[7] (also referred to as community-based Medicaid), which provides home health care, some hospital coverage, doctor appointments, medications, etc. And, Medicaid nursing home care (also referred to as institutional Medicaid), which is care in a skilled nursing facility or similar institution.

To qualify for Medicaid, Medicaid recipients (whether for home care or nursing home care) may only keep a small amount of assets and income. As of the time of writing this article, a Medicaid recipient living alone may keep no more than $13,800 in non-exempt assets and have no more than $767 per month in income (both of these amounts increase depending on the number of family members who live with the Medicaid recipient), plus an unearned income credit of $20 if the applicant is over 65, blind or disabled. An individual in a nursing home or similar institution is restricted to a personal needs allowance of $50 per month. Income includes Social Security payments, distributions from IRAs and other retirement accounts, interest and dividends, etc.

Giving assets away to qualify for Medicaid is not permitted. A Medicaid applicant who does so is "penalized"—denied Medicaid benefits—for a period of time following the transfer; provided, however, that there are certain transfers which are considered "exempt transfers."

In determining the penalty period, Medicaid will "look back" at the applicant's assets over a period of 5 years. The "look back" period examines account statements, deeds, tax returns, etc., intended to discover any transfer of assets which would disqualify an applicant from Medicaid.

The Deficit Reduction Act of 2005 ("DRA"),[8] enacted on February 8, 2006, changed, among other things, the date on which the applicant's penalty begins, following a transfer of assets. Under the "old rules" of Medicaid eligibility, relating to transfers prior to February 8, 2006, the penalty period, once it is calculated on the transfer, began on the first day of the month following the transfer of assets, regardless whether a Medicaid application was made or whether the applicant was otherwise eligible for Medicaid.

Under the "new rules," however, the transfer of assets penalty period begins, not on the first day of the month following the original transfer as under the "old rules," but on the date the applicant makes his or her Medicaid application, is in an institution receiving care, and would otherwise be eligible for Medicaid but for the transfer of assets. The DRA shifted the penalty period from something that may have occurred in the past but hopefully and typically expired before the Medicaid application is made, to one not yet happening until the applicant needs Medicaid.

So, this leaves us in a bit of a planning dilemma. The good Elder Care attorney cannot advise his or her client to transfer an asset to qualify for Medicaid unless and until the client (1) enters and is in need of institutional care, (2) makes a Medicaid application to pay for such care, and (3) has no other non-exempt assets such that the client is otherwise eligible for Medicaid.

If we wait until (1) and (2) are true, and then make the transfer of assets, then our client will be penalized from Medicaid benefits beginning on the date of the transfer because (3) would have been false. On the other hand, if the client makes the transfer of assets now when any of (1), (2), and/or (3) are false, and waits until (1) and (2) become true to make (3) true, then the client had better not need Medicaid within the five years following the transfer. The best solution is that the client waits the five years from the date of the transfer to apply to Medicaid. That way, Medicaid will not pick up the transfer within the look-back period.

But, what if, as happens many times, (1) and (2) become true, but it is within five years of the transfer of assets? In that case, (3) is false since the value of the transferred property will be brought back into the client's available resources and the client will be ineligible to receive Medicaid benefits for the duration of the calculated penalty.

The Role of Long-Term Care Insurance in the Qualified Elder Care Plan

This article proposes an Elder Care plan utilizing a transfer of assets, together with a Medicaid Trust, and assumes the likelihood that Medicaid nursing home benefits may be needed within five years. For purposes of this article, and the plan discussed herein, the reader needs to assume a few things:

1. We are not dealing with a situation where the client is imminently going into a nursing home and the family is looking for emergency Medicaid planning. For those situations, there are other planning options that are the subject of other articles.
2. There are no qualified donees with which to make exempt transfers for purposes of the transfer of asset rules.
3. The client is of a certain age where the purchase of long-term care insurance is at least reasonable, if not easily affordable.

> Example: Carla Client's irrevocable income only trust ("Medicaid Trust") was funded with $600,000 on May 1, 2006, after the effective date (February 8, 2006) of the new Medicaid rules.

Under the old rules, the transfer penalty would have been calculated as follows:

$$\$600{,}000 \div \$9{,}132/\text{mo}^{9} = 65.70 \text{ months}$$
$$\approx 66 \text{ months} \div 12 \text{ months} = 5.50 \text{ years.}$$

Under the old rules, the funding of the trust on May 1, 2006 would have generated a 5 year and 6 month penalty beginning on May 1, 2006 and ending on November 1, 2011. Assuming that Carla Client would not have needed Medicaid to pay for her nursing home until at least November 2011, this would have been a great result for the client and a great plan by the attorney.

However, the new rules did away with such planning. Under the new rules, assuming the facts above and further assuming that the client goes into a nursing home and applies to Medicaid on June 1, 2010, the transfer penalty is calculated as follows:

$$\$600{,}000 \div \$10{,}285/\text{mo}^{10} = 58.34 \text{ months}$$
$$\approx 59 \text{ months} \div 12 \text{ months} = 4.91 \text{ years.}$$

The funding of the Medicaid Trust back on May 1, 2006, will generate a penalty period of 4.91 years beginning on June 1, 2010. Starting June 1, 2010, and continuing for almost 5 years, the family will have to pay privately for the nursing home services. Taking $12,000 per month as an example for the cost of Carla Client's nursing home care, the Medicaid Trust will be exhausted (assuming no growth) in 50 months or just over 4 years. In other words, the Medicaid penalty will continue for another year even after the Medicaid Trust has been exhausted.

On the other hand, if in May of 2006, Carla Client had purchased a LTC insurance policy at the same time she created and funded her Medicaid Trust, then the planning would have been complete back in May of 2006. On June 1, 2010, when Carla Client goes into a nursing home three things will happen: (1) she will file a claim with her LTC insurance provider starting her entitlement to nursing home benefits under the policy;[11] (2) Carla Client's Medicare benefits will pay entirely for the first 20 days of the nursing home's services and will require a co-pay for the next 100 days; and (3) Carla Client will make an application for Medicaid thus beginning the 4.91 year penalty period.[12]

When 4 years and 11 months have elapsed, and Carla Client is no longer subject to Medicaid's penalty period, then she will be able to stop the benefits from her LTC insurance policy and qualify for services under Medicaid. Or can she? The answer is probably not, because Medicaid will not just let you stop your outside benefits if you are entitled to them. And, if Carla Client had purchased a "lifetime benefit" policy rather than a set term policy, then there might be a few more years left in the policy during which time Medicaid, which is called the "payer of last resort," will expect the LTC insurance company to continue to pay.

But, assuming that Carla Client purchased a LTC insurance policy that was structured through the coordinated planning of the Elder Care attorney and the LTC insurance broker to provide no more than 5 or 6 years[13] in benefits, then the transition from the LTC insurance company to Medicaid would coincide with the expiration of the look-back period following the creation and funding of the Medicaid Trust in May of 2006.

Understanding LTC Insurance

In New York, LTC insurance is available in four general forms: Home Care Insurance Only, Nursing Home Insurance Only, Nursing Home and Home Care Insurance, and Long-Term Care Insurance. It is the Long-Term Care Insurance that we are discussing in the examples herein.

As the name states, Home Care Insurance only pays for home care. It is used by individuals who have absolutely no intention whatsoever to go into a nursing home. Or, have already purchased a Nursing Home Insurance Only policy and need to cover for home care services.

Similar to Home Care Insurance Only policies, Nursing Home Insurance Only pays for nursing home care. It is used by individuals who have every intention of going into a nursing home, or anticipate that their condition will necessitate them going into a nursing home. And, individuals who purchase Nursing home Insurance Only policies typically have the financial wherewithal to provide for their home care needs, but want to guard against the costs for nursing home care. Or, these individuals have already purchased a Home Care Insurance Only policy and need to cover for nursing home services.

A Nursing Home and Home Care Insurance policy provides coverage for nursing homes and home care only. This policy should be less expensive than a Long Term Care Insurance policy, but does not cover as much.

Long-Term Care Insurance is the broadest policy, and thus the most expensive. Typical Long-Term Care Insurance policies also cover adult day care facilities, assisted living facilities, and other such places.

All LTC insurance policies in New York must offer, as an option, the "inflation protection" benefit which is designed to increase the daily benefit amount over time to keep pace with inflation. Otherwise, an individual could choose to increase the benefit amounts at a future time. Under this option, the individual can increase the benefit amounts every specified number of years. However, choosing to increase the daily benefit will also increase the premiums based on the individual's attained age at the time he or she increases the benefits.

Speaking with my long-term care insurance broker, I asked the question "for those people who don't like LTC insurance, why don't they?" His answer was: cost of the premiums and "because they don't really understand it." As Elder Care attorneys we really cannot help with the cost aspect, since that is the responsibility and a function of the LTC insurance company and industry. But, we can help with the lack of understanding.

The reason why people do not understand LTC is because it is not part of an overall comprehensive elder care plan. When LTC insurance is purchased outside of a qualified planning process, people typically do not know whether to choose a "lifetime benefit" or a term benefit; they do not know how much to choose as a daily benefit, nor whether or not to take the inflation protection rider. Incorporating LTC insurance with an elder care plan gives the client a real understanding of the way in which LTC insurance works as part of the greater long-term care solution.

Now, imagine that Carla Client's brother, Charles Client, purchased his LTC insurance policy and created his Medicaid Trust also in May 2006. But, for whatever reason, Charles Client did not fund his Medicaid Trust at that time. Ten years later, in May 2016, Charles has to go into a nursing home for skilled nursing care. At the same time that Charles files his claim with the LTC insurance company he also funds his Medicaid Trust. By making his Medicaid application in May 2016, and assuming none of the current rules have changed within the last ten years, including the look-back period, then Medicaid will see the transfer of assets in May 2016 and penalize him accordingly. Since we do not know how long the penalty period will be at that time (and it may be longer than the 6 year benefit Charles Client purchased under his LTC insurance policy), it would probably be wise for Charles Client to wait out the look-back period and apply to Medicaid only after the five years have elapsed since the funding of the Medicaid Trust. By waiting until June 2021 to apply for Medicaid benefits, Charles Client can ensure that his Medicaid application will be approved since (1), (2), and (3), as discussed above, would all be true—he would already be receiving qualified institutional care, he will make a Medicaid application to pay for such care, and he will have no other non-exempt assets that would otherwise render him ineligible for Medicaid.

For those people who like and understand LTC insurance, they purchase it because they want to preserve the assets they have worked hard to accumulate, or because LTC insurance gives them independence—freedom from having to rely on children or the government to provide long-term care.

For those people, however, who do not understand LTC insurance or fail to see that the annual cost for such LTC insurance is only a fraction of the lifetime costs for long-term care, the qualified comprehensive elder care plan may help them better understand the benefits of LTC insurance. The bottom line is that when used properly as part of a comprehensive elder care plan, LTC insurance enables our client to receive qualified care in their home, the community, in an alternate living facility, or in a nursing home or other skilled nursing facility.

I am not trying to sell LTC insurance.[14] I am merely pointing out that this type of planning should be fairly obvious to us. But, is it obvious to our local LTC insurance brokers and companies? I suggest that you speak with your local LTC insurance broker and make it obvious to him or her. We surely see the need for LTC insurance as part of our Medicaid planning to cover the gap, if any, between transfer of assets/trust funding and the need for Medicaid. But, do our local LTC insurance brokers see the need for Elder Care and Medicaid planning when they sell a LTC insurance policy to their clients? This is not a primer intended to show us, the good elder care practitioner, the value of LTC insurance, but to show the financial adviser the value of our services in combination with their own for the benefit of their clients.

Endnotes

1. The average American life expectancy is about 75 for men and 80 for women. Deaths: Final Data for 2006: National Vital Statistics Reports; Vol. 57, No. 14; Hyattsville, MD; National Center for Health Statistics; 2009; Table 8, Pg. 27. Available at http://www.cdc.gov/nchs/data/nvsr/nvsr57/nvsr57_14.pdf.
2. World Population Ageing, 1950–2050, New York (NY): United Nations Publications; 2002; Pg. 23. Available at http://www.un.org/esa/population/publications/worldageing19502050/.
3. The United States Census Bureau considers a baby boomer to be someone born between 1946 and 1964. See, United States Census Bureau, "Oldest Boomers Turn 60" (2006). Available: http://www.census.gov/Press-Release/www/releases/archives/facts_for_features_special_editions/006105.html.
4. Available at http://www.genworth.com/content/products/long_term_care/long_term_care/cost_of_care.html (Genworth Study).
5. Based on 8 hours of care per day, 5 days per week.
6. Genworth Study, supra note 4. The Genworth Study webpage has a function to calculate future costs.
7. Within Medicaid community-based care there are several programs, such as: Certified Home Health Agency Services, Personal Care Services, Long-Term Home Health Care Program (a/k/a Lombardi), Medical Adult Day Care, and Managed Long-Term Care Services.
8. Pub.L. 109-171, 120 Stat. 4 (Feb. 8, 2006).
9. The 2006 Medicaid monthly regional rate for NYC. GIS 06 MA/001. Available at http://www.health.state.ny.us/ health_care/medicaid/publications/docs/gis/06ma001.pdf.
10. The 2010 Medicaid monthly regional rate for NYC. GIS 10 MA/001. Available at http://www.health.state.ny.us/ health_care/medicaid/publications/docs/gis/10ma001.pdf.
11. The commencement of Carla Client's benefits will be subject to the policy's elimination period, which is typically 90 days. The "elimination" or "waiting period" is the number of days the insured must wait before long-term care benefits will be paid under the policy. During the elimination or waiting period, the insured will have to pay privately for the care he or she receives. Shortening the elimination period will increase the cost of coverage.
12. Carla Client can apply to Medicaid either when she goes into the nursing home and have her penalty period calculated at that time, or after the look-back period expires, thus avoiding the calculation of a penalty period. The end result would be the same.
13. Different LTC insurance companies offer different benefit terms and options.
14. The client (and the reader) should consult with qualified LTC insurance broker to learn more about available LTC insurance policies and options. LTC insurance policies have certain limitations on benefits or even exclude them altogether. The client must understand the individual limitations and benefit exclusions which are contained in his or her LTC insurance policy.

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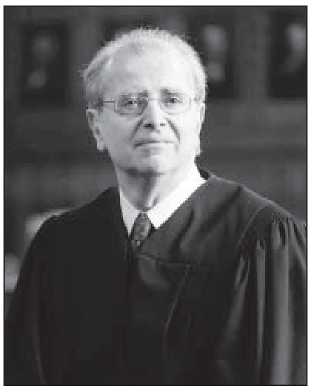
A Personal Look at the New York Court of Appeals

By Spiros A. Tsimbinos

Although the New York Court of Appeals acts as one body when it issues its decisions, it is comprised of seven distinct individuals with their own personal backgrounds, characteristics and judicial philosophies. We present, for the benefit of our readers, a brief biographical sketch of each of the Judges currently on the Court. We begin with the Chief Judge and continue with the six Associate Judges listed in the order of their seniority on the Court.

Chief Judge Jonathan Lippman



Chief Judge Lippman was appointed to the New York Court of Appeals in 2009. He moved directly from being the Presiding Justice of the Appellate Division, First Department, into the New York Court of Appeals. He was appointed by then-Governor Paterson. Judge Lippman has served for many years within the New York State court system, having held various posts including Chief Administrative Judge. While on the Court, he has attempted to achieve a greater consensus among the Judges, but in many instances he has found himself among the minority, and for the 2010-2011 term he led the Court in the number of dissents, which amounted to 28. He is basically placed within the more liberal bloc of the Court, and usually votes together with Judges Ciparick and Jones. Judge Lippman is currently 66 years of age, with his term expiring in the year 2015. He is a graduate of New York University School of Law.

Judge Carmen Beauchamp Ciparick

Judge Ciparick is the Senior Associate Judge of the Court, serving since 1994 when she was first appointed by former Governor Cuomo. She is currently 69 years of age, and her current term will end in 2012. She is a graduate of St. John's University School of Law. Judge Ciparick grew up in Washington Heights and graduated from Hunter College in 1963. Prior to her elevation to the New York Court of Appeals she served on the New York City Criminal Court and then was elected to the New York Supreme Court in 1982. Judge Ciparick is also generally considered to be a member of the liberal bloc within the Court and to be somewhat more favorable to defense concerns in criminal law cases. During the past term, she issued 19 dissenting opinions and often voted together with Chief Judge Lippman and Judge Jones.

Judge Victoria A. Graffeo

Judge Graffeo was appointed by Governor Pataki and joined the Court in 2000. Her current term ends in 2014. She is currently 59 years of age and is the youngest member of the Court. Prior to her elevation to the New York Court of Appeals, Judge Graffeo held several governmental positions, including Solicitor General and as legislative counsel. She also served in the Supreme Court in the Third Judicial District and was an Associate Justice of the Appellate Division, Third Department. Judge Graffeo was born in Rockville Centre, New York and was educated in Schenectady. She is a graduate of Albany Law School. Judge Graffeo is basically included in the more conservative bloc of the New York Court of Appeals. She often votes together with Judge Read. During the last term, Judge Graffeo dissented in 12 cases.

Judge Susan Phillips Read

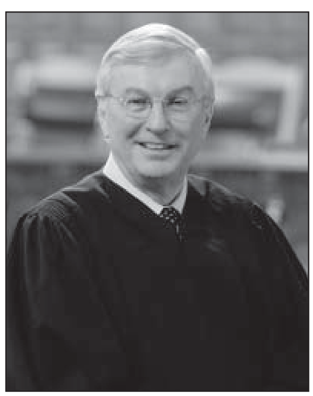
Judge Read was appointed by former Governor Pataki and joined the Court in 2003. Her current term ends in 2017. She is currently 64 years of age. Prior to her appointment to the Court of Appeals, she served as the Presiding Judge of the New York State Court of Claims, and also served as Deputy Counsel to Governor Pataki from 1995 to 1997. She was born in Ohio and attended the University of Chicago Law School. She also engaged in the private practice of law from 1988 to 1994. Judge Read currently resides with her husband in West

Sand Lake and Saratoga Springs, New York. Judge Read is also listed within the more conservative bloc of the Court and she often votes together with Judge Graffeo. During the past term, she issued 13 dissenting opinions.

Judge Robert S. Smith

Judge Smith joined the Court in 2003. He was appointed by Governor Pataki, and his term expires in 2014. He was born in New York City and grew up in Massachusetts and Connecticut. He is a graduate of Columbia Law School where he served as Editor in Chief of the *Law Review*. From 1968 to 2003, he practiced law in New York City with the firm of Paul, Weiss, Rifkind, Wharton & Garrison. He is currently 67 years of age and resides with his wife in New York City. He has three children and two grandchildren. Judge Smith moved directly from the private practice of law to the New York Court of Appeals, and had no prior judicial experience before his elevation to the Court. During his eight years of service on the Court, it has been difficult to place Judge Smith in either the liberal or conservative grouping, and he often takes an independent and contrary position from many of his colleagues. During the last term, he issued 23 dissenting opinions. He also must be considered one of the critical swing votes on the Court.

Judge Eugene F. Pigott, Jr.



Judge Pigott was appointed to the Court by former Governor Pataki, and has served on the Court since 2006. His current term expires in 2016. Judge Pigott is currently 65 years of age. He was born in Rochester, New York and practiced law in Buffalo for several years. He also previously served as Erie County Attorney. His prior judicial experience includes service on the New York State Supreme Court and as presiding Justice of the Appellate Division, Fourth Department. Judge Pigott is married, with two children, and he currently resides in Grand Island, New York. He is a graduate of Buffalo School of Law. Although Judge Pigott is also generally included within the more conservative grouping of the Court, he often pursues a more liberal and pro-defense position in criminal law matters, and is hard to pigeonhole in any one particular camp. He must be listed as one of the swing votes on the Court.

Judge Theodore T. Jones, Jr.

Judge Jones was appointed by former Governor Spitzer in 2007. His current term expires in 2015. Judge Jones was born in Brooklyn, New York and attended public schools in New York City. He is a graduate of St. John's University School of Law. After conducting a private practice for several years in Brooklyn, he was elected to the New York State Supreme Court in 1990. He eventually became the Administrative Judge for the civil term in Brooklyn, and in 2007, he began his current tenure on the New York Court of Appeals. Judge Jones is married and has two children. Judge Jones also has a distinguished military background, having served in Vietnam and having reached the rank of Captain in the United States Army. Judge Jones is placed by most observers within the liberal camp of the Court and currently appears to be one of the most pro-defense Judges with respect to criminal law decisions. During the last term, he issued 24 dissents, the second highest within the Court, many of which involve criminal law decisions. He brings to the Court a criminal law background, since he served for many years as a criminal defense attorney with the Legal Aid Society.

Conclusion

In a recent article in the *New York Law Journal* of August 18, 2011 summarizing the workings of the Court during the 2010-2011 term, Chief Judge Lippman is quoted as commenting, "It is a Court that is not predictable in any particular case. I think we often disagree but are never disagreeable with one another. It is a Court that I don't think is easy to label." Professor Vincent Bonventre, of Albany Law School, who often writes on the New York Court of Appeals, also is quoted as saying, "You have some really interesting personalities writing some very strong opinions." I hope that these brief snapshots of the seven interesting personalities who make up the New York Court of Appeals will lead to a better understanding of the Court by our readers.

This article originally appeared in the Winter 2012 issue of the New York Criminal Law Newsletter, *published by the Criminal Justice Section of the New York State Bar Association.*

Pre-verdict Interest on Wrongful Death Is Back: *Toledo v. Iglesia Ni Christo*

By David Schuller

In *Milbrandt v. A.P. Green Refractories Co.*,[1] the New York Court of Appeals, in a paradigm of judicial activism, overruled a century of precedent, as well as one of the oldest surviving statutes in the State, ruling that pre-verdict interest in a wrongful death case does not run from the date of death, but only from: (1) as to future damages, the date of the damages verdict,[2] and (2) as to past damages, the date each individual past bit of pecuniary loss would, if not for the death, have been realized by the decedent and his distributees.

EPTL 5-4.3, as recodified from its predecessor statutes going back to the nineteenth century, *creates* the statutory cause of action for wrongful death, which did not exist at common law, and provides that interest, from the date of death, shall be *added to* the award of damages.

The date-of-death statutory interest provision was long recognized as an expression of New York's public policy that where a death is caused by tort, the damages are a debt as of that date.[3]

There has, therefore, always been a dichotomy between personal injury and wrongful death causes of action. The cause of action for personal injury is a creation of the common law, and the legislature has never weighed in with a specific statutory provision of a date upon which a personal injury recovery becomes a debt due and owing. We were, therefore, left to the provisions of CPLR Article 50 to ferret out a "due and owing" date for personal injury actions. As a result, the courts floundered for decades, if not centuries, to determine when interest begins to run on a recovery for personal injury. Pre-verdict interest was out of the question, because CPLR 5001 specifies the actions in which pre-verdict interest applies, and is limited, essentially, to breach of contract and property damage actions; and personal injury does not have an embedded interest date as do death actions. It was not until *Love v. State*,[4] in 1991, that the Court of Appeals took a stand and held that interest begins to run on a personal injury award from the date that liability is established. *Love* involved a bifurcated trial, and the Court held that interest on the damages award would be awarded from the earlier date of the liability verdict. Thereafter, in *Rohring v. City of Niagara Falls*,[5] the Court expanded on that, holding that in the event liability was determined by motion rather than verdict, interest runs from the date of the order granting the motion. *Love* was based on CPLR 5002, which provides that "in any action," interest runs "from the date the verdict was rendered or the report or decision was made to the date of entry of final judgment." *Love,* in effect, bifurcated that statute, and picked the earlier date of the liability determination as the date of the verdict, report or decision.

Old timers may remember the dark days when every personal injury judgment involved litigation over whether the defendant had delayed the ultimate entry of judgment through unsuccessful motions and appeals, because the lower courts had established a mythical rule that pre-judgment interest for personal injuries would be awarded only if the defendant had caused an undue delay in entry of final judgment.[6] *Love* put an end to that exercise, holding that interest is not a penalty for dilatory tactics, but a fair payment by the defendant for the use of the plaintiff's money from the time of the liability determination to the final reckoning.

Interest on death recoveries followed a very different path. Until 1992, the EPTL provision went unquestioned, and a death recovery bore interest from the date of death. If the case took five years to come to trial, it was a "given" that five years of interest would be added to the verdict amount, and then post-verdict interest would run on that entire amount—the verdict plus the five years of pre-verdict interest—up to the entry of judgment. In fact, the same old timers remember that meritorious death cases were relatively easy to settle, because the carriers were generally willing to pay the full value of the damages in settlement just to avoid the interest; and most plaintiffs' lawyers were happy enough to settle for the principal value of the case, rather than try the case just for the interest. In extreme cases, such as where it took ten years to get to trial in the days before preliminary conferences with calendaring deadlines, the carriers would often pay more than the principal value of the case, and plaintiffs' lawyers would insist on such a premium, because once the legal interest rate was raised to nine percent in 1981, ten years of interest could almost double the value of the case.

Until the scourge of tort reform took hold in the mid-1980s, interest from the date of death was an accepted fact of life in the profession. After all, the tort reformers had never successfully challenged the EPTL provision beginning interest on the day of death, and that provision, and its successors, were widely understood as expressing New York's public policy in that regard. In fact, it was the interest provision that led to a series of distinctions between relevant pretrial developments in death cases as opposed to injury cases. For one, the subsequent remarriage of a surviving spouse is deemed inadmissible in a death case, even if the second spouse has higher earnings than the decedent, because the survivor's damages are fixed and immutable as of the date of death[7] (an exception to this immutability is the pretrial death of the surviving spouse; his/her damages are personal, whereas a fictional recovery based on life expectancy would merely provide a benefit to heirs). For another, the post-death adoption of an orphaned child is irrelevant,[8] even if the child is adopted by a wealthier family. That is all because the damages are fixed at the moment of death. By contrast, in an injury case, divorce, or death of either spouse during the pendency of the action, will limit the recovery for loss of services to the time that the marriage continued. And, of course, healing or worsening of the injury, or taking up a new income-producing career, are both relevant and determinative of the sustainable damages.

Then came the "reformers." With the enactment of CPLR Articles 50-A and 50-B, the preparation of a judgment in an injury or death case became a career for lawyers, economists, actuaries, and judgment clerks. It also put the trial judiciary into a new line of work: no longer would juries be given the "present day value" charge, which *permitted*, but did *not require*, the jury to consider the proposition that a dollar awarded today is worth more than a dollar lost tomorrow. Instead, the jury, pursuant to a companion statute, CPLR 4111(d) and (f) (now found at CPLR 4111[e]), would be instructed to award future damages *without* any reduction to present day value, and the trial judge would be charged with the task of determining the present value of each element of damages, based on (1) a discount rate for which the statute provided no benchmark, and (2) the number of future years specified in the verdict for each such element of damages. The insurers and other institutional defendants were giddy with delight, because at that time of double-digit inflation, the discount rate could decimate the present value of the award. Defense economists appeared at hearings and testified that the discount rate should be the amount that the plaintiff could earn on a money market account or long term certificate of deposit, which were then running well above ten percent. Plaintiffs' economists would argue that the double digit rates were not sustainable over the long term of the verdict, which in infants' cases, or death cases where there were infant distributees with special needs, could run over sixty years (some economists even predicted that around 2010, there would be deflation; that has practically occurred in the financial markets, which is why banks are paying almost no interest on deposits of any kind). Ultimately, reality set in: a close reading of the statute revealed that the discount did not even impact the annuity that would have to be purchased, but rather affected only the attorney's fee, usually one-third or even less in the "reformed" malpractice fee schedule, and the amount to be docketed as a lien and serve as the principal amount upon which interest *post*-verdict would be awarded. In an ironic twist, in fact, the defendants had cost themselves money by *decreasing* the attorney's fee in medical liability cases, because the discount only saved them money on the attorney's fee, leaving more of an undiscounted amount that they would have to fund for the future damage annuities!

While all of this mind-numbing activity was proceeding in the lobbies of the Legislature, two pre-Article 50-A wrongful death malpractice cases were winding their way through the courts: *Milbrandt,* and *Schmertz v. Presbyterian Hospital.* Both cases arose in the 1970s, before tort reform had done much besides destroying most vehicular negligence cases. Both had proceeded to verdict, producing a modest recovery in *Milbrandt,* and a significant recovery in *Schmertz.* By the time the cases were tried in the 1980s, the CPLR already provided for itemized verdicts in malpractice cases, and for a delineation between past and future damages, with a time period attached to each element of future damages. The only purpose served by the delineation at that time, however, was to facilitate review of the amounts awarded under the newly amended CPLR 5501, which overruled the "shocks the conscience" standard of review at common law, and substituted a "departs materially from reasonable compensation" standard, which was intended to encourage the Appellate Division, and by extension trial judges, to set aside "excessive" verdicts more readily than had been done previously. The itemized verdict rule was subsequently applied in all personal injury cases, and served as the basis for the preparation of the Article 50-A/B judgment.

In *Milbrandt,* the jury was given a "present day value" charge. In *Schmertz,* an economist testified about present value, but no present day value charge was given. Although the ultimate Court of Appeals decision states that the *Milbrandt* jury was instructed to reduce to present value, that is unlikely, because the Pattern Jury Instruction present value charge was permissive, not mandatory. Having been tried before the enactment of CPLR 4111(d), there was no instruction to award future damages without discount. Therefore, there was no means of determining whether the jury's verdicts were based on the present value as of the rendering of the verdict, or the full value of the loss as the jury believed it to be, or anything else.

In 1992, *Milbrandt* and *Schmertz* came to the Court of Appeals, consolidated, on a single point of law:

should interest be added to the verdict from the date of death? In a startling upset decision, the Court held: (1) as to future damages, interest from the date of death may be awarded only where the damages have been discounted to date-of-death present value, and since there was no way of knowing what the juries did, there was no starting point for such a calculation, and there could be no pre-verdict interest; and (2) as to past damages, it would be illogical to interpret EPTL 5-4.3 literally and award damages from the date of death, because the families did not actually lose money until each paycheck and other element of pecuniary loss had actually occurred; put another way, since the statute provides for "reasonable compensation," interest from the date of death would be inconsistent with the fundamental purpose of the law, because interest on losses that had not yet been sustained would not be compensatory (however, in order to avoid the tedious and possibly impossible task of allocating each dollar of the verdict for past damages to a specific date of loss, the trial court could use a "mid-point" fiction, and award interest on half of the pre-verdict damages). And weirdly enough, the half of the decision devoted to future damages appears first, followed by the half of the decision devoted to past damages.

The plaintiffs' bar was mystified at this judicial overruling of a century or more of precedent. The *Milbrandt* decision simply overruled the clear and unmistakable legislative intent that death damages are a debt on the date of death. The decision is fundamentally flawed by its internal inconsistency: if an item of past damage earns no interest until it has actually been sustained—basically, every payday that the decedent would have earned a paycheck had he/she lived—then why would there be any justification for an award of interest on discounted future damages, even if the jury had been instructed to discount to the date of death? If there is no interest until an item of damage would otherwise have been received by the distributees, the entire discussion of interest on post-verdict damages should have been entirely unnecessary; yet, the decision *starts* with the discussion of interest on future damages, and then closes with its complete overruling of the EPTL as to pre-verdict damages.

Some observers point to the decision's language that a verdict on a loss at a later date includes an element of damages as a rationale for the decision. However, that is not a rationale, but a rationalization. Especially in the case of past damages, the verdict *cannot* include a cent of interest in a wrongful death case. The damages for death are purely pecuniary. The jury's verdict, say, for past lost earnings cannot exceed the paychecks that the decedent would have earned up to that point. Any increase in those paychecks based on annual raises in pay is not interest; it is the principal loss of pay for each such year, already incurred prior to the date of the verdict, and therefore not in any means, manner, or stretch of imagination, interest. The jury is instructed to award such losses as have been proved with "reasonable certainty." If the verdict exceeds the evidence of principal loss, it almost automatically will be set aside and a new trial ordered unless the plaintiff were to stipulate to accept the maximum principal loss supported by the proof. Clearly, as to pre-verdict damages, *Milbrandt/Schmertz* overruled EPTL 5-4.3, without bothering to declare it unconstitutional.

Why would the Court of Appeals do such a thing? One factor was the predictably faulty reliance on the United States Court of Appeals for the Second Circuit as a reliable authority on New York substantive law. The Second Circuit had published two decisions on the subject: *Shu-Tao Lin v. McDonnell Douglas Corp.*,[9] and *Woodling v. Garrett Corp.*[10] These decisions predated New York's procedure for accepting referrals of questions of New York substantive law from federal appellate courts.[11] Both decisions have at their core the assumption that there is no point to an award of pre-verdict interest, because pre-verdict interest on an amount discounted to the accrual date will simply cancel out the discounting. That premise arises from the many years during which one of the advantages to the defense of removing a case to the federal court was that the federal courts, even in a New York diversity case, used to ignore the New York legal rate of interest, and apply the floating federal law interest rate based on market factors. Since the discount rate also is based on floating market factors, the interest and discount rates would be nearly identical, and there would be no point. The Second Circuit, however, noted in *Woodling* that it felt itself constrained to follow its earlier decision in *Lin,* about which it obviously had doubts. Ultimately, the cancel-out reasoning of *Lin* and *Woodling* was effectively overruled when the Second Circuit, in *Action S.A. v. Marc Rich & Co.*,[12] instructed the District Court to apply the New York statutory interest rate in diversity cases, and not look for excuses to ignore New York's substantive law in that regard. Therefore, this fundamental underpinning of *Lin* and *Woodling* had been *eliminated* before *Milbrandt* was even decided. To the extent that *Woodling* relies on public policy-type arguments, the decision is flawed as an attempt by a federal court to overrule a New York statute, once again, without bothering to declare it unconstitutional.

Milbrandt, *Love,* and Articles 50-A/B collided in 1994 in *Rohring*, *supra. Rohring* was a personal injury, not wrongful death, case, and was also the first major Court of Appeals decision interpreting Articles 50-A/B (at that time, the statutes were identical). *Rohring* was a bifurcated case, in that liability had been determined in the plaintiff's favor on motion, and then proceeded to a damages trial two years later. The plaintiff, relying on *Love,* sought interest from the date of the liability determination. The defendant sought to establish that *Love* did not apply to future damages in a case under

Articles 50-A/B, reasoning that under *Milbrandt,* which was not a 50-A/B case, the court's discounting to the date of the damages verdict for purposes of the structured judgment statutes implicitly meant that interest was included in the discounted future damages award, and that any award of interest would provide an interest "windfall" to the plaintiff. The Court of Appeals, *relying* on *Milbrandt,* held that the judgment should add interest from the liability award to the damages verdict, on the future damages discounted to the date of the liability determination. The Court's take on its earlier *Milbrandt* decision was that: "in a wrongful death [*Milbrandt*] case we held that future damages should be discounted to the date of liability, which by statute is the date of death, before interest is calculated on them."[13]

That sentence went relatively unnoticed for more than fifteen years. The pundits almost uniformly espoused that following *Milbrandt,* there was to be no pre-verdict interest awarded onto the verdict for future damages, period. One astute commentator, who happens to be the author of McKinney's commentaries, however, while advancing his view that *Milbrandt* barred any pre-verdict interest on future damages, and while doubting the veracity of plaintiff's lawyers who were seeking to discount the damages to the date of death and have interest awarded on them, conceded that in light of the foregoing quotation from *Rohring,* his analysis could not be considered a "roadmap" for the preparation of a judgment in a wrongful death case.[14]

Rohring was re-affirmed by the Court in *Pay v. State.*[15] *Pay* was a procedurally tortured case in which liability for injuries to an impaired infant was determined on motion for summary judgment, based on collateral estoppel, after the mother's estate was successful in establishing that the childbirth incident which killed the mother and impaired the child was caused by medical malpractice. Three years after the child's motion for summary judgment was granted, damages were awarded. The child's attorney sought to ignore both *Milbrandt* and *Rohring,* and sought three years of interest on the verdict date value of the award from the date of the liability determination to the date of the damages verdict. The Court followed its earlier *Rohring* decision, and compelled the damages to be discounted to the date of the liability determination. *Pay* actually did not do anything new, but added some nice, but unfortunately confusing, language that injury and death cases should be treated the same. The clear import of the language was that in either case, the verdict date value should be discounted to the appropriate interest accrual date. Defendants have jumped on *Pay's* language to argue that in a wrongful death case, pre-verdict interest should not run from the date of death, but from the date of the liability determination. That argument is obviously a stretch, and gained traction only in one Appellate Division case, which then itself became lost to history.[16]

One Appellate Division decision in a wrongful death case followed *Rohring* as a roadmap, and approved the award of interest, from the date of death, on the future damages discounted to the date of death, after the court had already performed the Arrticle 50-A/B discounting to the date of the damages verdict. The decision also clarified that the interest would be added to the amount to be docketed, that is, the date of verdict value, and post-verdict interest would be awarded on the total up to the entry of judgment. That case was *Krumenacker v. Gargano,*[17] which was remanded for a new trial on other issues. However, *Krumenacker* never gained much traction, and went largely uncited in subsequent lower court cases.

Desiderio v. Ochs

Desiderio v. Ochs,[18] was not about interest, but is an important link in this particular chain. *Desiderio* was a medical malpractice case brought on behalf of a neurologically impaired infant. The case proceeded to trial, and the jury awarded future damages amounting to $48,000,000, to be paid out over fifty-five years. The previously mentioned anomaly of the structured judgment statute finally materialized: since the discounting required by Article 50-A did not affect the annuity that had to be purchased, and since the payments increase by 4% per year, compounded annually, the plaintiff could receive much more over the life of the annuity than the actual damages awarded by the jury.[19] The defendant simply couldn't stand this psychologically. In the view of the defense industry, tort reform had turned out to be a potential Frankenstein monster. The defense, with amici in tow, whined all the way to the Court of Appeals that they had been robbed. Their carefully constructed monstrosity statute didn't work!

So, the defense actually argued that the Court of Appeals should truncate the award so that the plaintiff could not receive lifetime annuity payments exceeding the base amount of the verdict. The Court of Appeals majority flatly rejected the notion that the role of the courts was to make sure that the defendants received what they believed they had bargained for in their legislative agenda. The Court held that the statute would not be ignored in favor of the supposed intent of the Legislature to diminish every verdict by the application of the structuring statute, and referred the defense, and their amici, to the Legislature for any fix to the statute.

And the fix did come. Almost immediately, by Albany standards, the Legislature amended Article 50-A (but not 50-B—the malpractice defendants have their own lobbyists, separate and apart from the general defense lobbyists). They actually made Article 50-A applicable to fewer cases: wrongful death malpractice verdicts would no longer be subject to structuring at all; the minimum future damage award subject to the statute was increased from $250,000 to $500,000; pain and suffering would be paid out over a maximum of eight years rather than ten. The jury would not render a total award for future damages; instead, the jury would come to an annual damage amount, set a number of years, and set a "growth rate." The discount rate would no longer be subjected to litigation. The ten-year U.S. Treasury bond would provide the benchmark, but with an exception: for awards to be paid over more than twenty years, 2% would be added to the U.S. Treasury yield, to assure that the discount to present value would be substantial (even though the only people hurt by discounting are the attorneys; the malpractice defendants have been quite successful at discouraging filings by making malpractice litigation less profitable for lawyers). There is a trade-off: payment for permanent economic losses no longer terminate with the death of the plaintiff.[20]

Most important for our discussion, however, the Court of Appeals had refused to hold that the statute should be ignored so as to comport with supposed legislative intent or economic doctrine.

Toledo Adm. Martinez v. Iglesia Ni Christo

Joaquin Martinez, an immigrant masonry worker, was a young father of a neurologically impaired child, and his wife was expecting their second child, when he was crushed and killed by a falling concrete pillar on a construction site in 2002. Summary judgment was granted on his estate's cause of action under Labor Law section 240 in early 2006, and the damages trial ensued near the end of 2007. Following post-trial motions, the judgment was entered late in 2008. The judgment followed the dictates of *Milbrandt,* as most distinctly clarified in *Rohring, Pay,* and *Krumencacker:* interest on past damages was awarded from the mid-point between the date of death and the date of the damages verdict; and interest on future damages, discounted to the date of death utilizing the relevant Treasury Bond rate, was awarded at the statutory nine percent interest rate from the date of death to the date of the damages verdict. The interest so calculated was added to the amount of the judgment calculated pursuant to the dictates of Article 50-B. The defendant had submitted a counter-judgment, which provided no pre-verdict interest at all on the future damages, but the trial judge rejected the counter-judgment.

The parties proceeded to the Appellate Division, First Department, having stipulated that the calculations were correct, and that the appeal presented a single question of law: whether the trial court properly discounted the future wrongful death damages back to the date of death, and awarded interest thereon from the date of death to the date of judgment. The context made it quite clear that the "properly discounted" referred to the fact of discounting and awarding interest, and not whether the calculations were correct. The Appellate Division initially answered "no," and struck the award of interest on future damages.[21] The plaintiff moved to reargue, and on reargument, the Appellate Division unanimously recalled its earlier decision, and affirmed the judgment as entered.[22]

The defendant moved for, and was granted, leave to appeal to the Court of Appeals. The Defense Association of New York submitted an amicus brief, and the appeal was argued in November, 2011. In its decision, dated January 10, 2012, affirming the judgment,[23] the Court split 5-2, with the majority opinion being authored by Judge Ciparick, and the dissent by Judge Smith.

The majority opinion holds: "We now conclude that the proper method for calculating pre-verdict interest in a wrongful death action is to discount the verdict to the date of liability, i.e., the date of death, and award interest on that amount from the date of death to the date of judgment."

The majority relies on two key features in the historical treatment of EPTL 5-4.3's command that "Interest upon the principal sum recovered by the plaintiff from the date of the decedent's death shall be added to and be a part of the total sum awarded."

First: "Applying this statute and its predecessor statutes, this Court and the courts below have long held that 'prejudgment interest in a wrongful death action is part of the damages'"…"and that such interest should run from the date of death to the date of verdict."

Second: "Furthermore, it has long been the rule in New York that the damages on a wrongful death action are due on the date of the death of the plaintiff's decedent.... Future damages are thus a debt owed entirely as of the date of liability the date of death (see *Rohring,* 94 N.Y.2d at 69, 70) and such damage award properly should include pre-verdict interest calculated from the date of death."

The dissent, relying on the above referenced Second Circuit decisions predating *Action S.A.,* concludes that the discount and interest rates should be the same, and therefore cancel each other out, rendering any computation of pre-verdict interest improper. The dissent also disapproves of adding the pre-verdict interest so calculated to the amount of the award as discounted to the date of the damages verdict, because the amount already includes interest.

It is submitted that the dissent overlooks two key points of law in its analysis. First, interest and discount rates are not identical. New York's legal interest rate is nine percent. The only statutory inkling as to a discount rate, Article 50-A as amended in 2003, declines to establish a fixed discount rate, and keys the interest rate to a floating benchmark. Not even the most stalwart defense economist has argued for a fixed discount rate. Since the setting of fixed numbers is a legislative task, the courts properly decline to engage in setting them. The dissent's contention that the discount rate should equal the interest rate also confuses the issue because interest reflects the cost of borrowing money, whereas discount and growth rates determine the value of money over a time continuum. Second, the only amount available to which to add the pre-verdict interest is the amount of the award as calculated under Article 50-B; any attempt to change that would overrule *that* statute.[24]

Most interesting, however, is that the majority decision, in holding that: "the proper method for calculating pre-verdict interest in a wrongful death action is to discount the verdict to the date of liability, i.e., the date of death, and award interest on that amount from the date of death to the date of judgment," makes no distinction between past and future damages. This is, to a discerning eye, no mere accident. The majority's analysis of law relies heavily on precedent establishing that the entire liability for wrongful death damages accrues on the date of death, and there can be no logical reason to strip the *pre-verdict* damages out of that principle.

It therefore appears that the longstanding belief of many that *Milbrandt* overruled the final sentence of EPTL 5-4.3 can be laid to rest. The only legal and logical conclusion to be drawn from *Toledo* is that the entire amount of the award, after the machinations mandated by Article 50-B, should be discounted from the date of the damages verdict back to the date of death, utilizing an appropriate benchmark such as the ten- or thirty-year Treasury Bond, or a mixture thereof if there are multiple elements of damage carrying short and long payout periods; and interest on the date of death value should then be added to the judgment amount mandated by Article 50-B. Notably, the majority opinion, because of the parties' stipulation in *Toledo,* did not reach the issue whether the interest should be added to that amount, as opposed to the discounted-to-date-of-death amount. However, since Article 50-B is a legislative imperative, and since it mandates that the judgment amount is the value "at the time of the award,"[25] there is no other number to which to add the pre-verdict interest without overruling that statute. In addition, CPLR 5002 provides that pre-verdict interest is added to the amount of the verdict, so that the same result should apply to death cases not within Article 50-B, such as medical malpractice wrongful death cases, and wrongful death cases where the future damages do not exceed $250,000.

Endnotes

1. 79 NY2d 26 (1992).
2. Unless the verdict had been discounted back to the date of death, a task which no jury was ever charged with performing.
3. *Murmann v. New York, N.H. & H.R. Co.,* 233 AD 446 (2d Dept. 1931), *reversed on other grounds,* 258 NY 447 (1932).
4. 78 N.Y.2d 540 (1991).
5. 84 NY2d 60, 69 (1994).
6. The historical background is examined in both the majority and concurring opinions in the Appellate Division in *Love,* 164 AD2d 155 (4th Dept. 1990).
7. *Rodak v. Fury,* 31 AD2d 816, 817 (2d Dept. 1969); *Baker v. Sportservice Corp.,* 175 AD2d 654 (4th Dept. 1991).
8. *Alberino v. LIJ-Hillside Med. Ctr.,* 87 AD2d 217 (2d Dept. 1982).
9. 742 F2d 45 (2d Cir. 1984).
10. 813 F2d 543 (2d Cir. 1987).
11. 22 NYCRR § 500.27.
12. 951 F.2d 504, 508-09 (2d Cir. 1991).
13. *Rohring,* 84 NY2d at 69.
14. McKinney's CPLR, Commentary, Article 50-B, paragraph (g)(i).
15. 87 NY2d 1011 (1996).
16. *Shue v. Red Creek Central School Dist.,* 266 AD2d 899 (4th Dept. 1999).
17. 276 AD2d 750 (2d Dept. 2000).
18. 100NY2d 159 (2003).
19. Judge Rosenblatt's concurrence places the total payout, assuming that the child were to survive to collect it, at about $140,000,000.
20. Payment for lost earnings continues for the term set by the jury, even if the plaintiff dies before its expiration; presumably, the basis for that change is that the plaintiff's dependents should continue to receive support for the plaintiff's pre-accident work expectancy. Payment for other economic losses which the jury finds to be "permanent"—that is, essentially, medical expenses—continue for plaintiff's lifetime, even if the plaintiff outlives the jury's anticipated life expectancy.
21. 71 AD3d 404 (2010) (order recalled, 75 AD3d 436 [2010]).
22. 75 AD3d 436 (2010).
23. 2012 WL 42906.
24. See footnote 25 and accompanying text.
25. CPLR 5041(e).

The Insurer Verses Insured

By Alecia Walters-Hinds

The liability insurance policy/contract defines the metes and bounds of the relationship between the insurer and the insured. An insured's right to be accorded legal representation is a contractual right and consideration upon which his premium is in part predicated, and this right exists even if debatable theories are alleged in the pleading against the insured.[1] A contract of insurance, like any other contract, is to be construed according to the sense and meaning of the terms that the parties have used; and if such terms are clear and unambiguous, they are to be understood in their plain, ordinary and popular sense.[2]

Generally, liability insurance policies obligate the insurance company ("insurer") to defend lawsuits against the insured,[3] pay the costs of defense and indemnify the insured for judgments and settlements up to a specified limit. Under most policies, the insurer has the right to select and supervise counsel in the defense of the lawsuit, to require the cooperation of the insured[4] and to determine the settlement strategy, including whether to litigate or settle claims within their policy limits.[5] Accordingly, unless the liability policy specifies when an insurer must retain defense counsel, the insurer may retain counsel when it deems it necessary.

Although these rights exist, an insured always has the right to opt out of the benefits of insurance coverage and handle any lawsuit without interference by an insurer. Furthermore, although the insurer-appointed counsel must provide competent representation to the insured, the insured cannot force the insurer to pay for legal services that are against its interests or wishes.[6]

Assuming that an insured submits a claim to an insurer for indemnification and defense, insurers have exclusive control over settlement and defense of claims, subject to the implied duty of good faith and fair dealing.[7] The liability contract generally gives the insurer the right to control the settlement and the right to accept any settlement within policy limits without the insured's consent.[8] The insured's consent to settlement is not necessary because it was implicitly given when the insured signed the liability contract and submitted the claim for insurance coverage. Moreover, New York has *not* recognized a cause of action for breach of an insurer's implied covenant of good faith and fair dealing where it was alleged that contrary to the wishes of the insured, the insurer has settled such claim within the monetary limits of the insured's policy or it is alleged that an insurer's failure to reasonably investigate claims made against the insured resulted in increased premiums.[9] Although an insurer is not obligated to consult its insured in regard to settlement, the insurer is obliged, in most circumstances, to respond accurately to requests from its insured with reference to the progress of any settlement negotiations.[10]

Consequently, liability insurance policies obligate the insurer to defend lawsuits against the insured, pay the costs of defense and indemnify the insured for judgments and settlements up to a specified limit. However, the insured still also has rights including the right to retain its own counsel and obtain information from the insurer.

"An insured's right to be accorded legal representation is a contractual right and consideration upon which his premium is in part predicated, and this right exists even if debatable theories are alleged in the pleading against the insured."

Endnotes

1. *International Paper Co. v. Continental Cas. Co.*, 35 N.Y.2d 322, 320 N.E.2d 619, 621 (1974).
2. *Imperial Fire Ins. Co. v. Coos County*, 151 U.S. 452, 14 S.Ct. 379 (1894); *Drilling v. New York Life Ins. Co.*, 234 N.Y. 234, 137 N.E. 314 (1922).
3. The insurer's "duty to defend" entitles the insured to a full defense. The insurer's defense obligation is triggered by the existence of a "suit." This usually means the insured is served with a summons and complaint or some other document indicating a possible trigger of the liability contract. Insurance contracts often contain, as an express condition precedent to the insurer's duty to defend or indemnify the insured, a provision requiring the insured to give notice to the insurer, within a specified or reasonable time, of any accident, claim or occurrence which the insured asserts to be within the coverage of the policy. 16 Samuel Williston & Richard A. Lord, A Treatise on the Law of Contracts § 49:109 (4th ed. 2008). The claims examiner then must evaluate whether the claim warrants coverage. *See Seaboard Sur. Co. v. Gillette Co.*, 64 N.Y.2d 304, 310-311, 486 N.Y.S.2d 873, 876 (1984) ("[S]o long as the claims [contained in the complaint] may rationally be said to fall within policy coverage, whatever may later prove to be the limits of the insurer's responsibility to pay, there is no doubt that it is obligated to defend"). See also, 4 Philip L. Bruner & Patrick J. O'Connor, Jr., Construction Law § 11:20 (2008). Once the insurer selects an attorney, the insured's reasonable expectations of coverage require that the attorneys conduct themselves in the same manner as if the insureds themselves were paying the fees.

4. *See* 16 Samuel Williston & Richard A. Lord, A Treatise on the Law of Contracts § 49:106 (4th ed. 2008). However, an insured may refuse the services of an attorney selected by a carrier and may refuse to be co-client with the carrier. *See e.g., Golotrade Shipping & Travelers Indem. Co.*, 706 F. Supp. 214, 220 (S.D.N.Y 1989) (requiring the insurer to pay outside counsel to represent the insured when the insured refused in-house counsel due to a conflict of interest). *See also* ABA Comm. On Ethics and Professional Responsibility, Informal Op. 1397 (1977) ("no lawyer can continue to represent a client who does not wish to be represented").

5. *Ottaviano v Genex Coop., Inc.*, 15 A.D.3d 924, 790 N.Y.S.2d 791 (4th Dep't 2005); *M & M Elec. Inc. v. Commercial Union Ins. Co.*, 241 A.D.2d 58 61-62, 670 N.Y.S.2d 909, 911 (2d Dep't 1998); *Parker v. Agric. Ins. Co.*, 109 Misc.2d 678, 440 N.Y.S.2d 964, 967 (1981). *See also Mount Vernon Fire Ins. Co. v. J.J.C. Stucco & Carpentry Corp.*, 1997 WL 177864 4 (E.D.N.Y. 1997); *Podolsky v. Devinney,* 281 F.Supp. 488, 494 (S.D.N.Y. 1968). *See also* 16 Samuel Williston & Richard A. Lord, A Treatise on the Law of Contracts § 49:105 (4th ed. 2008).

6. *See e.g., Charter Oak Fire Ins. Co. v. Color Converting Indus. Co.*, 45 F. 3d 1170, 1175-77, 63 USLW 2501 (7th Cir. 1995) (holding that an insurer has no duty to treat an insured's key customer specially to protect the insured's business relationship). *See also, e.g., Eklund v. Safeco Ins. Co. of Am.*, 41 Colo.App. 96, 97, 579 P. 2d 1185, 1186-87 (1978) (involving insured's objection to settlement because insured was convinced that his son was not liable).

7. *Lavand v. Country-wide Ins. Co.*, 29 A.D.3d 745, 815 N.Y.S.2d 680 (2d Dep't 2006). *See also Liberty Mut. Ins. Co. v. Thalle Const. Co., Inc.*, 116 F.Supp.2d 495 (S.D.N.Y. 2000).

8. *Feliberty v. Damon*, 129 A.D.2d 207, 517 N.Y.S.2d 632 (4th Dep't 1987); *Orion Ins. Co. v. General Elec. Co.*, 129 Misc.2d 466, 471, 493 N.Y.S.2d 397 (1985).

9. *Insurance Co. of Greater New York v. Glen Haven Residential Health Care Facility,* 253 A.D.2d 378, 379, 676 N.Y.S.2d 176, 177(1st Dep't 1988). *See also Marginian v. Allstate Ins. Co.,* 18 Ohio St. 3d 345, 481 N.E.2d 600 (1985) (holding that where a contract of insurance provides that the insurer may, as it deems appropriate, settle any claim or action brought against its insured, a cause of action alleging a breach of the insurer's duty of good faith will not lie where the insurer has settled such claim within the monetary limits of the insured's policy).

10. If the insured learns of the settlement and does not wish to abide by the settlement, he has the right to opt out of the benefits of insurance coverage and handle any lawsuit without interference by an insurer. *Knobloch v. Royal Globe Ins. Co.,* 38 N.Y.2d 471, 479, 381 N.Y.S.2d 433 (1976); *Felebrity v. Damon*, 129 A.D.2d at 210.

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The NAIC and Captive Reinsurance

By Martin Minkowitz and Keira McCarthy

The National Association of Insurance Commissioners (NAIC), which meets three times a year, is the standard-setting and regulatory support organization created and governed by its members, the chief insurance regulators from the 50 states, the District of Columbia and the U.S. territories. State Insurance regulators establish standards and best practices, conduct peer review, and coordinate their state regulatory oversight. NAIC members, together with the central resources and staff support of the NAIC, form a sort of national system for state-based insurance regulation in the U.S.

The NAIC describes its goals to be to: protect the public interest; promote competitive markets; facilitate the fair and equitable treatment of insurance consumers; promote the reliability, solvency and financial solidity of insurance institutions; and support and improve state regulation of insurance.

During the past year, the National Association of Insurance Commissioners (NAIC) has focused increasingly on the use of "captive" reinsurance companies and "special purpose vehicles" by insurance companies. Captive insurance companies have traditionally been formed to facilitate programs of risk retention and risk finance, with the classic example being a pure captive that accepts risks transferred by its non-insurer parent. However, recently, some insurance companies have transferred all or a portion of the insurance risk assumed on their books to captive reinsurers or other special purpose vehicles. For example, life insurers have used captives or special purpose vehicles in the context of secured lending facilities or securitization transactions when conservative standards would otherwise require such life insurer to post reserves that would only be needed in rare situations.

On March 8, 2011, *The New York Times* reported such use of captives and special purpose vehicles in an article entitled "Seeking Business, States Loosen Insurance Rules." In particular, the article stated that insurance companies' use of captives and special purpose vehicles "has given rise to concern that a *shadow insurance industry* is emerging, with less regulation and more potential debt than policyholders know, raising the possibility that some companies will find themselves without enough money to pay future claims…much like the shadow banking system that contributed to the financial crisis" (emphasis added).

Largely in response to *The New York Times Article*, at its November 2011 Fall National Meeting, the NAIC's Financial Condition Committee formed a "Captives and Special Purpose Vehicle Use Subgroup" to review issues surrounding the use of captives and special purpose vehicles. Specifically, the Captives and Special Purpose Vehicle Use Subgroup was tasked with studying insurers' use of captives and special purpose vehicles to transfer third-party insurance risk in relation to existing state laws and regulations. However, the charge proved unclear, particularly with respect to the use of the phrase "third-party insurance risk." Consequently, a major focus of the Subgroup's discussion at the most recent NAIC National Meeting in March 2012 was the meaning of such phrase, as used in the charge.

According to some, the phrase has been mistakenly used to describe both first-party insurance, which was said to occur when only an insurer and an unaffiliated business or person are involved in the risk transfer, and third-party insurance, which was said to require a third party to the transaction. Most property/casualty practitioners recognize first-party coverage to be that under which the claimant is someone injured by the insured (e.g. property insurance) and third-party coverage to be that under which the claimant is someone injured by the insured (e.g. liability insurance). The Captives and Special Purpose Vehicle Use Subgroup determined that a more fitting phrase for its charge would be "insurance risk," defined as "a formal risk transfer, by contract known as an insurance policy, of an unaffiliated business or person to an insurer for consideration known as premium."

On March 5, 2012, the Captives and Special Purpose Vehicle Use Subgroup's charge was amended to studying insurers' use of captives and special purpose vehicles to transfer insurance risk, first-party and/or third-party risk, but not self-insurance risk, in relation to existing state laws and regulations. Despite the amendment, however, some are skeptical that the somewhat esoterically clarified charge is directly responsive to the concern raised in *The New York Times* article.

The *Times* article also indicated that states which have adopted specific laws regarding captives and special purpose vehicles "are offering a refuge from other states' insurance rules," including those requiring sufficiency of reserves. Perhaps as a consequence thereof, during its Spring meeting, the Captives and Special Purpose Vehicle Use Subgroup noted a recent trend to a greater number of states enacting specific laws regarding captives and special purpose vehicles. There appears to have been a fundamental shift from states previously enacting captive laws primarily to gain an advantage in the competition to be the domicile of insurers providing insurance to businesses. It now appears that states are enacting such laws for "defensive" purposes, to keep insurance companies and insurance business from moving to states with captive laws more hospitable to the financial needs of insurers.

With more states allowing the formation of captives and special purpose vehicles, after presenting responses from regulators to a survey regarding the role of captives or special purpose vehicles with respect to risk transfer, participants at the Spring 2012 meeting emphasized the need for the Subgroup to refocus its analysis by stepping away from the survey approach and, perhaps, adapting a more qualitative approach, concentrating on those states that have captive and special purpose vehicle laws and are active in the captive and special purpose vehicle market (e.g.: Vermont and Delaware).

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Drafting Special Needs Trusts That Are Tailored to the Needs of the Beneficiary: A Primer

By Anthony J. Enea

It has been well documented in recent years that millions of “baby boomers” are coming of age, and that their aging will have a significant impact upon our Medical and long-term care infrastructure. While this poses many challenges for Elder Law and Wills, Trusts and Estates attorneys, one consequence of the aging of baby boomers often overlooked is its impact upon the non-elderly disabled children of baby boomers.

Unfortunately, it appears that little is being done to educate the aging baby boomers as to what steps should be taken to provide for the future care and well-being of their disabled children.

Because Special Needs Trusts, a/k/a Supplemental Needs Trusts play an integral role in planning for the disabled, the following is a summary of the variations thereof and the analysis that needs to be done when considering their use to insure that each trust is tailored to the specific needs of the beneficiary.

I. Pre-Drafting Issues and Analysis

The following is a sample of some of the issues and factors that need to be assessed prior to the preparation of the SNT:

1) Obtain and review the biographical details relevant to the beneficiary of the Trust. The age of the beneficiary is an important factor to consider especially when drafting a Self Settled SNT.
2) Obtain and review the specific details as to the nature of the beneficiary’s disability and the level of need of the beneficiary of the trust. Inquire as to whether the incapacity is physical or mental. Make inquiry as to the medications, if any, the beneficiary is taking. Is the medication psychotropic? Obtain as much information as possible about the nature of the disability, and its anticipated duration.
3) Ascertain what are the functional abilities and limitations of the proposed beneficiary. For example:
   (a) Is he or she able to cook, clean and attend to his or her own personal hygiene? Can he or she handle his or her finances and live independently?;
   (b) Is he or she able to participate in decisions? If yes to what extent?;
   (c) Is he or she employed? Nature of employment? Salary? Is there a history of employment?;
   (d) What is his or her level of education? Has he or she received any special training?;
4) Review and assess the proposed beneficiaries’ present housing. What type of housing is it anticipated the beneficiary will need in the future (group home, institutional, living with family/renting an apartment)? Is the housing Federally subsidized?
5) What government benefits, if any, is the beneficiary receiving? (SSI/SSD/Medicaid Community/Institutional)? How long has the beneficiary received these benefits?
6) What are the anticipated future needs of the proposed beneficiary?
7) What are the financial resources available to the disabled person? Inheritance, family, siblings, etc. One should inquire as to whether the trust beneficiary is presently a named beneficiary or a contingent beneficiary of a Will or Trust.

An analysis of all of the above will allow the drafter of the trust to tailor some of its provisions to the specific needs and wants of the beneficiary.

It should be explained to the client that the SNT is for non-basic needs. That it is not a trust created for basic necessities, such as food and shelter, and that the purpose of the SNT is to preserve the trust funds for the disabled person without affecting his or her eligibility for government benefits such as Medicaid and SSI (Supplemental Security Income). It is also important to explain to the client the federal standard for determination that the beneficiary of the SNT is a “disabled person” as required by statute.

Under federal law, 42 U.S.C. 1382C(a)(3) a disabled person is defined as a person “unable to engage in any substantial gainful activity by reason of a medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months.” (If one is receiving Medicaid, SSI or SSD, he or she is considered “disabled.”)

II. 3 Basic Types of Supplemental Needs Trusts

A. "Third Party SNT"

A Third Party SNT is a Trust created and funded by someone other than the disabled beneficiary. It is generally created by a parent, grandparent or sibling. The source of funds used to fund a Third Party SNT is not from the disabled person. A disabled beneficiary's funds should never be used to fund a Third Party SNT. Any individual can fund this type of trust for a disabled person without affecting the beneficiary's right to receive any government benefits for which he or she is eligible.

It is important to note that a Third Party SNT can be "inter-vivos" or "testamentary." The spouse of a disabled beneficiary or the parent of a minor disabled beneficiary cannot create and fund an "inter-vivos" SNT and get the protections under §7-1.12 of EPTL for government benefits. However, the spouse or parent can fund and create a "testamentary" trust for the disabled beneficiary. All too often we tend to think of SNTs as inter vivos instruments, however, their use in testamentary documents can be of great importance.

In the seminal case of *Matter of Escher,* 94 Misc. 2d 952, aff'd, 75 A.D. 2d 531, 426 NYS 2d 1008, the Bronx County Surrogate's Court held that a testamentary trust established by parents of a disabled daughter which provided that principal was to be used only for the "necessary support and maintenance of daughter" was protected from the claim of the State for reimbursement of the amount it had paid on behalf of the daughter. The Court found that the Testator had intended principal be used for daughter during her lifetime. EPTL 7-1.12 codifies *Matter of Escher.*

It should also be noted that the funding of a Third Party SNT has Medicaid planning benefits for the Grantor of the Trust. The transfer is considered an exempt transfer. Thus, no period of ineligibility is created. See 42 U.S.C. 1382 c(a)(3).

B. "Self Settled SNT or First Party SNT"

Self Settled Trusts are authorized by the Omnibus Budget Reconciliation Act of 1993 ("OBRA93"). These are SNTs funded with a disabled beneficiary's own funds, or funds to which he or she is entitled such as a personal injury award or an inheritance. In order for the disabled beneficiary to establish and fund a Self Settled SNT, he or she must establish the following:

(a) Must be disabled (proof of SSI or SSD generally sufficient);

(b) Must be under the age of 65 (as of the date the assets are transferred to the Trust);

(c) Must be established for the benefit of the disabled beneficiary, by a parent, grandparent, guardian or court. Once established it may be funded by the disabled beneficiary. If the disabled beneficiary has no parent or grandparent, it will be necessary to obtain a Court order, pursuant to Article 81 of Mental Hygiene Law or SCPA 2101 and 202.

The transfer of disabled beneficiaries funds to the Self Settled SNT creates no look back period or ineligibility period for Medicaid nursing home benefits, so long as the disabled beneficiary is under the age of 65 at the time the gift to the Trust is made.

(d) Must have a "Payback Provision." Upon the death of the disabled beneficiary all remaining trust principal and accumulated income must be paid back to Medicaid to reimburse Medicaid for all benefits paid to the disabled beneficiary during his or her lifetime. Any funds left over may be paid to the named beneficiary of the Trust.

C. When Is a Court Order Required in Order to Create and Fund a Self Settled SNT?

If the disabled beneficiary is competent, and has a parent or grandparent willing to be the creator/grantor of the trust, a Court Order is not required. If the disabled beneficiary is mentally incapacitated, then regardless of the existence of a parent or grandparent, a Court Order is required for the creation of the trust for the assets or income of the beneficiary to be transferred to the SNT. If the disabled person is competent, and has no parent or grandparent, a Court Order is required.

Court Orders are normally obtained within an Article 81 Guardianship (can be a single transaction guardianship), or if the matter involves an inheritance, or if funds are received by a developmentally disabled or mentally retarded person then within a 17A Proceeding in the Surrogate's Court.

D. "Pooled Self Settled SNT"

A Pooled Self Settled SNT is one that must be managed by a Non-profit Association. For example, the United Jewish Appeal ("UJA") and the New York State Association of Retarded Citizens ("NYSARC") sponsor such Pooled Trusts for disabled persons.

The funds transferred to the trust are pooled in the Trust, but a separate account is established for each individual beneficiary. The beneficiary can be under or over the age of 65. However, if the beneficiary is over the age of 65 there is a penalty period for assets transferred to the Pooled Trust for Medicaid nursing home benefits. These Trusts are usually utilized where there is no family member to act as a trustee or when the beneficiary is over age 65.

Depending on the terms of the Pooled Trust, the disabled person may be able to provide how the remaining balance of his or her account is to be distributed upon his or her death; however, this would be subject to a payback to Medicaid. If the balance on death is retained by the Pooled Trust, then Medicaid is not entitled to a payback of the benefits paid.

Pooled Trusts play an important role when the disabled beneficiary has income that exceeds the monthly amount permitted by the community/home care Medicaid program. For example, if a Medicaid home care applicant has income in excess of the permitted $792.00 per month for the year 2012, he or she is allowed to contribute said excess income to a Pooled Trust. The Trust will then pay the disabled beneficiary's household expenses such as mortgage, rent and taxes from the monthly income deposited into said Trust. The Pooled Trust in many cases affords the beneficiary the financial ability to remain at home, and still be eligible for Medicaid Home Care.

III. General Drafting Considerations for SNTs

The following are some provisions to consider including in an SNT:

(a) Make specific reference to *Matter of Escher* within the body of the Trust, and that the trust is intended to comply with *Escher*.

(b) Make specific reference to EPTL 7-1.12 within the body of the Trust, and that the Trust is intended to comply with its provisions.

(c) Utilize the requisite provision that the trust corpus is to be used on behalf of the disabled individual to "supplement" and "not supplant" government benefits such as Medicaid and SSI, and that the funds are not to be used for basic needs such as food, clothing and shelter. However, despite the aforestated provision it is still important to give the Trustee the power to make distributions to meet the beneficiary's basic needs (food, clothing and shelter), even if it will diminish or impair the beneficiary's receipt of government benefits. This is commonly referred to as the "Notwithstanding Consequent Effect" provision of an SNT.

Third Party Trusts should also provide that the Trustee has the full and absolute discretion to pay out principal and income. However, the use of an ascertainable standard such as "for health, education, maintenance or support" should be avoided.

IV. Drafting Considerations for a Self Settled SNT to Be Approved by Court

When requesting that the Court approve the Self Settled SNT, the Petition to the Court seeking said approval should articulate the following:

(a) The disabled beneficiary's life expectancy and life care plans;

(b) Projected growth of funds; and

(c) Project how long the funds will last.

With respect to Court Ordered SNTs, the Courts have required different drafting requirements. (See *Matter of DiGennaro,* 202 AD 2d 259 (2d Dept 1994), *Matter of Goldblatt*, 162 AD 2d 888 and *Matter of Morales*, NYLJ 7/28/95 (Supreme Court Kings County). In Morales, the Court offered a model SNT to be used in New York City. The Department of Social Services must be notified when a Court Ordered Self Settled SNT is being requested.

In drafting an SNT it is important to be familiar with the specific disability of the beneficiary. For example, the needs of a competent physically disabled non-elderly beneficiary will be different than those of someone who is mentally incapacitated and physically disabled. The competent physically disabled beneficiary can be actively involved in the decisions concerning the drafting and implementation of a Self Settled SNT and his or her future care plan. For example, he or she can be made a member of an Advisory Committee to the Trustees.

It is also important to know what government benefits program or programs will support the beneficiary. Will it be institutional or non-institutional? This will provide the attorney draftsman an idea as to how trust assets can be used, and the specific terms to be contained in the Trust as well as for the preparation of an additional memo to Trustees about their use.

For example, a severely developmentally disabled individual residing in a group home may have more predictable needs than an individual suffering from a psychiatric illness who resides in federally subsidized housing, and receiving outpatient mental health services.

The individual suffering from a psychiatric illness who resides in the federally subsidized housing will most likely be receiving SSI, and any distributions for shelter by the Trustee of the SNT will impact the SSI coverage.

Conversely, the individual in the group home may be receiving basic community Medicaid without SSI, so the Trustee may be free to use trust funds to support a reasonable housing arrangement and provide other necessities that will enhance the beneficiary's ability to reside in the community.

It is important to consider the functional level of the beneficiary, his or her ability in an advisory capacity to participate in decisions regarding trust expenditures and management.

V. Effect of Medicaid Lien on Funding of an SNT

The U.S. Supreme Court's decision in *Arkansas HHS v. Ahlborn,* 547 US 268, 126 S. Court 1752 (2006) dramatically impacted the law on Medicaid liens and the funding of Supplemental Needs Trusts.

Under *Ahlborn*, when a Medicaid recipient receives a personal injury settlement following the payment by Medicaid of medical costs, the Medicaid lien amount is limited to the amount of proceeds meant to compensate the recipient for medical costs, and not for damages for pain and suffering, lost wages and loss of future earnings. This rule also applies to the personal injury settlement or award of a minor.

In *Ahlborn*, there was an agreement apportioning the settlement between medical costs and other damages, but the Court held the result would be the same for a Judge-allocated settlement or a jury award which establishes liability for both medical care and other kinds of damage.

Prior to *Ahlborn*, the rule in New York was that a valid Medicaid lien may be enforced against the entire amount of a personal injury settlement, award or verdict before the proceeds are transferred into a Supplemental Needs Trust. *Please see Cricchio v. Pennisi and Link v. Town of Smithtown, 9*0 NY 2d 296, 683 NE 2d 301(1997).

VI. Conclusion

The use of a properly drafted Special Needs Trust will help give the parents of a non elderly disabled child a level of comfort in knowing that they have taken a significant step in assuring the future care and well-being of their child. It is truly the cornerstone of any planning for a disabled person.

Anthony J. Enea, Esq. is a member of the firm of Enea, Scanlan & Sirignano, LLP in White Plains, New York. Mr. Enea is the Chair-Elect of the Elder Law Section and Immediate Past President and a founding member of the New York Chapter of the National Academy of Elder Law Attorneys (NAELA). He is also a member of the Council of Advanced Practitioners of NAELA. Mr. Enea is the former Editor-in-Chief of the *Elder Law Attorney*, a quarterly publication of NYSBA's Elder Law Section. Mr. Enea is a Past President of the Westchester County Bar Association and has been selected as a Super Lawyer for the fourth consecutive year and for the 2009 and 2010 was selected as a Top 25 attorney in Westchester County. Mr. Enea has also been selected for inclusion in the 2012 edition of the "Best Lawyers in America" as an elder law attorney. He is a member of the Guardianship Court Advisory Committee for the Office of Court Administration and is the former Co-Chair of the Guardianship Committee of NYSBA's Elder Law Section. Mr. Enea is Certified as an Elder Law Attorney by the National Elder Law Foundation* as accredited by the American Bar Association. He is a member of the Executive Committee of NYSBA's Trusts and Estates Law Section as a Vice-Chair of the Committee on the Elderly and Disabled. Mr. Enea is also fluent in Italian.

* The National Elder Law Foundation is not affiliated with any Governmental authority. Certification is not a requirement for the practice of Law in the State of New York and does not necessarily indicate greater competence than other attorneys experienced in this field of law.

New York's Adherence to *Zubulake v. UBS Warburg*

By Richard A. Klass

In its decision in *VOOM HD Holdings LLC v. EchoStar Satellite LLC*, 2012 NY Slip Op 658, dated January 31, 2012, the Appellate Division, First Department held that a party's duties in the electronic discovery context and the appropriate sanctions for failure to preserve electronically-stored information (ESI) should follow the federal court holding in *Zubulake v. UBS Warburg*, 217 FRD 309 [SDNY 2003] and its progeny.

In the watershed case of *Zubulake v. UBS Warburg*, the federal district court held that: "Once a party reasonably anticipates litigation, it must suspend its routine document retention/destruction policy and put in place a 'litigation hold' to ensure the preservation of relevant documents." The 'litigation hold' is not only to prevent affirmative acts but also automatic functions of computer systems. As held in *Convolve, Inc. v. Compaq Computer Corp.*, 223 FRD 162 [SDNY 2004], "In the world of electronic data, the preservation obligation is not limited simply to avoiding affirmative acts of destruction. Since computer systems generally have automatic deletion features that periodically purge electronic documents such as e-mail, it is necessary for a party facing litigation to take active steps to halt that process." The First Department opined, citing to the *Convolve* case, that it is "well settled that a party must suspend its automatic deletion function or otherwise preserve e-mails as part of a litigation hold."

In the *VOOM HD Holdings* case, the court "observed that in addition to failing to preserve electronic data upon reasonable anticipation of litigation, no steps whatsoever had been taken to prevent the purging of e-mails by employees during the four-month period after commencement of the action. EchoStar continued to permanently delete employee e-mails for up to four months after commencement of the action, relying on employees to determine which documents were relevant in response to litigation, and to preserve those e-mails by moving them to separate folders. As the court put it: 'EchoStar's purported litigation hold failed to turn off the automatic delete function and merely asked its employees—many of whom, presumably were not attorneys—to determine whether documents were potentially responsive to litigation, and to then remove each one from EchoStar's pre-set path of destruction.'"

The motion court determined that an adverse inference was warranted against EchoStar for the spoliation of electronic evidence. The court outlined the criteria for sanctions against a party seeking sanctions based on the spoliation of evidence. The moving party must demonstrate: (1) that the party with control over the evidence had an obligation to preserve it at the time it was destroyed; (2) that the records were destroyed with a "culpable state of mind;" and (3) that the destroyed evidence was relevant to the party's claim or defense such that the Trier of fact could find that the evidence would support that claim or defense. A "culpable state of mind" for purposes of spoliation sanctions includes ordinary negligence. Some of the failures which support a finding of gross negligence, when the duty to preserve electronic data has been triggered, include: (1) the failure to issue a written litigation hold, when appropriate; (2) the failure to identify all of the key players and to ensure that their electronic and other records are preserved; and (3) the failure to cease the deletion of e-mail.

The court agreed with the determination of the motion court that an adverse inference was warranted because EchoStar's spoliation of electronic evidence was the result of gross negligence at the very least. EchoStar should have reasonably anticipated litigation over the contract at issue and implement a litigation hold long before litigation had already been commenced. Such failures on the part of EchoStar entitle a finder of fact to presume the relevancy of the destroyed electronic data.

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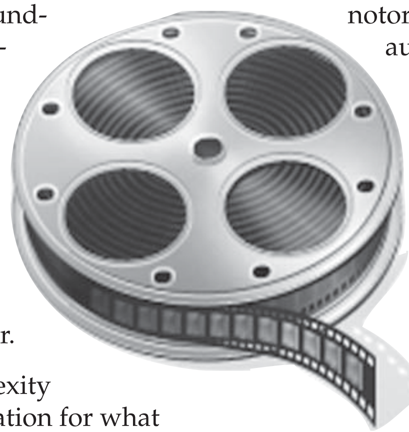
Movie Premiere

UNRAVELED—An Ambitious Man, an Immoral Plan

Director Statement by Marc H. Simon

When I was a young associate working at the law firm of Dreier LLP, my boss Marc Dreier would rib me, "Simon, you'll never be me, you'll never be me!" At the time, I thought Dreier was referencing only his grandiose life as the jet-setting owner of the seemingly super-successful law firm he had founded. But, interviewing him as the subject of my feature documentary *UNRAVELED*, just three days before he faced sentencing for swindling over 740 million dollars, I asked whether his recurring jab was meant to convey a deeper message. Dreier said he had indeed intended the subtle forewarning, but I was unconvinced by his answer.



This uncertainty, and the complexity of the man at its center, is the foundation for what I hope makes *UNRAVELED* a uniquely compelling film. While verité scenes, archival footage, and graphic animation provide both factual and dramatic support, this is Marc Dreier's story told in his own words and through his own actions. Yet, Dreier's circumstances must brand him an unreliable narrator. He is a mega-fraudster—narcissistic and brilliant—who has chosen to cooperate in creating his own documentary portrait.

The challenge of telling a documentary through the voice of only one character—without the crutch of other talking heads—is significant. Dreier's isolation is both a practical and artistic choice. As a practical matter, his victims and former colleagues recognize only harm in further sharing Marc's spotlight. As an artistic choice, I want Marc's physical and emotional separation to resonate throughout the film. Thus, *UNRAVELED* intentionally presents this fascinating man through his own transparencies and masks. The audience shall draw its own conclusions and connections. I do not expect uniformity of emotion or opinion.

When these massive financial crimes are uncovered, I think the public is deeply curious about how the perpetrators, often highly intelligent and well respected individuals in their communities, are capable of risking everything good in their lives for material or other superficial gain. I had this very unique opportunity, in spending two months with my former boss and mentor, to delve into the complexities of one of the most notorious white collar criminals in history, and audiences have been fascinated by Dreier's revelations.

The tragic irony of filming the downfall of my former mentor was never lost on me. During one of our interviews, Dreier questioned the role of the documentary filmmaker and the value that this film could serve. He proffered that the film could be analogous to the proverbial car crash—a tragedy that observers gain nothing from witnessing, yet view due to its fascinating spectacle. I hope that *UNRAVELED* persuasively refutes this characterization, as a film that prompts reflection and dialogue about ethics, values, and decision-making in the current societal landscape. I am also hopeful that it serves as a cautionary tale of the tragic consequences that result when greed and entitlement supplant moral responsibility.

Marc H. Simon is an award winning filmmaker. Mr. Simon created, wrote and produced "After Innocence," which won the special jury award at the 2005 Sundance Film Festival, before going on to receive other numerous recognitions, including its selection as a semi-finalist for Best Feature Documentary at the 78th Academy Awards. "Nursery University" marked Simon's feature directorial debut. The film, which premiered at Toronto Hot Doc Film Festival, was the top-grossing independent film during its opening theatrical weekend, and has been broadcast throughout the world. "UNRAVELED" is Simon's second straight directing effort and third as a producer. Simon is also a leading independent film attorney (this past year he has served as lead counsel for films such as "Winter's Bone," "The Kids Are All Right," and Werner Herzog's "Cave of Forgotten Dreams").

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Ethics Opinion 886

Committee on Professional Ethics of the New York State Bar Association (11/15/11)

Topic: Ancillary business organizations; conflict of interest.

Digest: A lawyer with a substantial investment in a closely held real estate brokerage firm is precluded from representing a party to a real estate transaction in which the brokerage firm is acting as broker.

Rules: 1.7, 5.7

Question

1. May an attorney with a substantial passive investment in a closely held nonlegal business entity that offers real estate brokerage, asset management and property management services represent a buyer, seller or lender in a transaction in which that nonlegal entity is serving as a broker?

Opinion

2. The inquirer seeks to establish a closely held nonlegal entity to provide brokerage, asset management and property management services to investors with a focus largely on multi-family apartment assets. The inquirer contemplates a substantial and significant investment in the nonlegal entity but does not contemplate taking an active role in the management or operation of the entity. Inquirer intends to offer legal services to clients of the entity, and particularly services in purchase, sale and lease transactions in which the affiliated nonlegal entity is serving as a broker. The inquirer's firm would be one of several law firms from which clients of the nonlegal entity would be free to choose. The legal services would be offered only after full written disclosure of the inquirer's interest in the nonlegal entity.

3. A lawyer or a law firm may provide nonlegal services, themselves or through a separate entity, to clients or other persons. New York Rules of Professional Conduct (the "Rules") 5.7; *see* N.Y. State 752 (2002), N.Y. State 753 (2002) and N.Y. State 755 (2002). Whether the nonlegal services provided by the lawyer or law firm, or a separate entity in which they have an interest, are subject to the Rules depends upon whether such services are separate and distinct from any legal services that the lawyer or law firm may provide and, if so, whether the client "could [not] reasonably believe that such nonlegal services are the subject of a client-lawyer relationship." *Id.* The client will be presumed to believe that such nonlegal services are the subject of a client-lawyer relationship unless (i) the lawyer or law firm has advised the client in writing that such services are not legal services and that the protections associated with a client-attorney relationship do not obtain or (ii) the lawyer's or law firm's interest in the separate entity providing such services is *de minimis*. *Id.*.

4. In all instances, however, the lawyer's services *qua* lawyer are subject to the Rules. In N.Y. State 752, we opined specifically that the application of the personal interest conflict rule found in DR 5-101(A), a precursor of Rule 1.7, to a lawyer seeking to serve in the dual roles of lawyer and broker, *inter alia*, survived the adoption of DR 1-106, the direct predecessor of Rule 5.7. We here reaffirm our opinion in N.Y. State 752 and hold further that, in our opinion, Rule 1.7 applies with undiminished force in circumstances where a lawyer's conflicting personal interest arises from a separate, nonlegal business or activity permitted by Rule 5.7.

5. Thus, absent informed consent, a lawyer may not provide legal representation to a person or entity if a substantial risk exists that the lawyer's personal interests arising from a permitted separate, nonlegal activity will affect the lawyer's professional judgment on behalf of that person or entity. Rule 1.7. Informed consent is dependent upon, *inter alia,* the lawyer's reasonable belief that the lawyer will be able to provide competent and diligent representation. *Id.*

6. As noted in N.Y. State 752, however, we have opined on a number of occasions over an extended period of time that, because of the strong financial interest of a lawyer who serves as a broker in the outcome of the brokerage effort, the roles of broker and lawyer in the same transaction are incompatible and not subject to consent by the client. N.Y. State 752 and Opinions cited therein. That a lawyer's or law firm's participation in a separate brokerage business is limited largely or wholly to that of investor, with little or no management or operational activity, does not alter that result. It is the personal financial interest arising from the investment that creates the personal interest conflict that is the subject of Rule 1.7.

Conclusion

7. For the reasons stated, a lawyer with a substantial passive investment in a separate, closely held nonlegal entity that offers real estate brokerage, asset management and property management services may not represent a buyer, seller or lender in a transaction in which such separate nonlegal entity is serving as a broker.

(40-10)

Ethics Opinion 887

Committee on Professional Ethics of the New York State Bar Association (11/15/11)

Topic: Non-lawyer marketers; bonus compensation to non-lawyer based on new business.

Digest: A lawyer or law firm may have a non-lawyer marketer who engages in only that advertising and solicitation in which the lawyer or law firm could engage. The lawyer or law firm may have a profit-sharing plan that pays bonus compensation to the non-lawyer marketer based on overall profits of the firm or on a percentage of the employee's base salary. However, the bonus compensation may not be based on referrals of particular matters and may not be based on the profitability of the firm or the department for which the employee markets if such profits are substantially related to the employee's marketing efforts.

Rules: Rule 1.0(a), 5.3(b), 5.4(a), 5.4(a)(3), 7.1, 7.2, 7.3(a)(1), 7.3(b), 8.4(a), 8.4(a(3)

Question

1. May a law firm hire a non-attorney marketer to market to potential corporate or union clients the firm's pre-paid legal services plans and its services as a provider of pre-paid legal services? May a law firm marketer be paid more than a salary, *e.g.,* a success fee for signing up pre-paid legal services plan sponsors?

Opinion

2. A lawyer may disseminate an advertisement[1] about the lawyer or his/her law firm and the lawyer's or law firm's services, including newspaper advertisements, letters and brochures. *See generally* Rule 7.1 of the N.Y. Rules of Professional Conduct (the "Rules") and the comments thereto.

3. The lawyer's ability to engage in in-person solicitation,[2] however, is far more limited. Rule 7.3(a)(1) of the New York Rules of Professional Conduct (the "Rules") prohibits a lawyer from engaging in solicitation "by in-person or telephone contact, or by real-time or interactive computer-accessed communication" unless the recipient is a close friend, relative, former client or existing client of the lawyer."

4. Clearly, a lawyer may hire an employee ("Marketer") to engage in advertising and solicitation activities in which lawyers themselves could ethically engage. *See* Rule 7.2, cmt [1](a lawyer may "compensate employees, agents and vendors who are engaged to provide marketing or client development services"). Thus a Marketer, like a lawyer in the firm, could develop print or web-based marketing materials and could solicit business in person or by telephone from the law firm's existing and former clients. *See* also the definitions of advertisement and solicitation, each of which includes a communication made on behalf of a lawyer or law firm.

5. A Marketer, however, is not permitted to engage in any activities that would be prohibited to the lawyer. *See* Rule 8.4(a) ("A lawyer or law firm shall not violate or attempt to violate the Rules of Professional Conduct through the acts of another"). Moreover, a lawyer is liable for compliance by his or her employees with the requirements of the Rules of Professional Conduct. *See* Rule 5.3(b) ("A lawyer shall be responsible for the conduct of a nonlawyer employed or retained by or associated with the lawyer that would be a violation of these Rules if engaged in by a lawyer [under the circumstances specified in the Rule].")

6. Consequently, if the Marketer would merely prepare written advertising materials for distribution to prospective clients or to the public, there would be no ethical issues, provided that they complied with Rule 7.1, including labeling it "attorney advertising," and the requirement for having it pre-approved by the firm. This is so even if the written materials were directly addressed to particular persons. *See Shapero v. Kentucky Bar Association*, 486 U.S. 466 (1988) (letter targeted to clients that lawyer knew could use the lawyer's services.)

7. However, the law firm could not authorize the Marketer to meet with or call prospective clients who are acquaintances of the Marketer in order to promote the firm's services, because doing so would violate Rule 7.3(a)(1) unless the prospects were close friends, clients or former clients of the law firm.

Employee Compensation Arrangements

8. Rule 5.4(a) prohibits a lawyer or law firm from sharing legal fees with a non-lawyer, with limited exceptions. A significant exception is that Rule 5.4(a)(3) permits a lawyer to "compensate a

nonlawyer employee…based in whole or in part on a profit sharing plan." Comment 1B explains:

> Paragraph (a)(3) permits limited fee sharing with a nonlawyer employee, where the employee's compensation or retirement plan is based in whole or in part on a profit-sharing arrangement. Such sharing of profits with a nonlawyer employee must be based on the total profitability of the law firm or a department within a law firm and may not be based on the fee resulting from a single case.

9. Rule 5.4 (a)(3) is a limited exception to the prohibition against a lawyer or law firm sharing legal fees with a non-lawyer. However, it does not supersede Rule 7.2, which prohibits a lawyer from compensating a person to recommend the lawyer's employment or rewarding that person for a recommendation resulting in employment.

10. In N.Y. State 733 (2000), we held that a lawyer may not pay a non-lawyer employee a percentage of fees attributable to matters referred by the employee as compensation for the referral. Although that opinion interpreted former DR 3-102(A)(3) under the Code of Professional Responsibility, the former disciplinary rule is the same as Rule 8.4(a)(3) except for punctuation, and we would reach the same result under the Rules.

11. Rule 5.4(a)(3) clearly allows a lawyer to pay a bonus to a non-lawyer employee, including an employee engaged in marketing, that is not based on referrals of particular clients or matters, but rather is based on the profitability of the entire firm or a department within the firm. Although Comment 1B interprets this prohibition as prohibiting the profit-sharing arrangement from being based on the fee resulting from a single case, it does not rule out the success of marketing efforts from being a factor in the amount of the bonus. Nevertheless, if the profits of the firm or the employee's department are directly related to the success of the employee's marketing efforts, it is difficult to see how a law firm could pay a marketing employee a bonus based on the profits of the firm or the department for which the employee engages in marketing without the bonus being considered a direct sharing of legal fees. This, of course, would depend on the size of the department and the extent to which the profits of the department are based on clients resulting from the employee's marketing efforts. Such determinations are necessarily fact-specific. Accordingly, they are not amenable to general rules. Where profits of the firm or the department are not directly correlated with the employee's marketing efforts, a bonus plan based on a percentage of the employee's salary or a percentage of the overall profits of the firm would pass muster under the Rule.

Conclusion

12. A lawyer or law firm may have a non-lawyer marketer who engages in only that advertising and solicitation in which the lawyer or law firm could engage. The lawyer or law firm may have a profit-sharing plan that pays bonus compensation to the non-lawyer marketer based on the overall profits of the firm or on a percentage of the employee's base salary. However, the bonus compensation may not be based on referrals of particular matters and may not be based on the profitability of the firm or the department for which the employee markets if such profits are substantially related to the employee's marketing efforts.

Endnotes

1. An advertisement is any public or private communication made by or on behalf of a lawyer or law firm about the lawyer or law firm's services, the primary purpose of which is for the retention of the lawyer or law firm. It does not include communications to existing clients or other lawyers. Rule 1.0(a).
2. Solicitation means any advertisement initiated by or on behalf of a lawyer or law firm that is directed to, or targeted at, a specific recipient or group of recipients, or their family members or legal representatives, the primary purpose of which is the retention of the lawyer or law firm, and a significant motive for which is pecuniary gain. It does not include a proposal or other writing prepared and delivered in response to a specific request of a prospective client. *See* Rule 7.3(b).

(9-11)

Ethics Opinion 888

Committee on Professional Ethics of the New York State Bar Association (11/15/11)

Topic: Links on a lawyer's web site to other businesses.

Digest: A lawyer may include links to other businesses on the lawyer's web site provided neither the link nor the linked material involves misrepresentation or causes confusion.

Rules: 5.8(a), 7.1, 8.4

Question

1. Under what circumstances may a lawyer's web site include links to the web sites of other businesses?

Opinion

2. The inquiring lawyer wishes to establish a law firm web site. He asks whether the web site may include links to the web sites of other businesses, particularly banks and real estate companies.

3. Whether or not a link on an attorney web site is ethically permissible depends on the purpose of the link, the nature of the site to which a link is made, and the nature of the relationship between the attorney and the owner of the web site to which the link is made.

4. A web link need not be the subject of any agreement between the law firm and the site to which the link is made. Links can be made with or without the consent of the owner of the web site to which the link is made. In fact, the owner of a web site need not even be aware that the link has been made, much less give consent for the link.

5. A law firm web site may include informational links to third party web sites. Such links are not ethically barred if the lawyer ensures that neither the inclusion of the link nor the material to which the link is made will create confusion or misrepresentation. For example, a link to an official government web site that created the impression that the law firm had some government connection would be impermissible where the implied connection does not exist. NY Rule of Professional Conduct 8.4(c). The same is true for links to private web sites if the link is likely to create confusion or misrepresentation. In some circumstances, an appropriate disclaimer would be necessary.

6. No categorical ethical bar prohibits lawyers and third parties from agreeing to link to each other's web sites, but greater care must be exercised with reciprocal links. A reciprocal link (without revenue generated for the law firm and without any financial relationship between the entities) is permitted under similar conditions as an informational link.

7. Reciprocal links that constitute advertising must comply with all the requirements of Rule 7.1, including the mandate that advertising not include false, deceptive, or misleading claims. In addition, the home pages of the web sites with the reciprocal links may need to be labeled as attorney advertising. Rule 7.1(f).

8. If the link is part of a cooperative business arrangement between the lawyer and a non-legal professional, the lawyer must comply with Rule 5.8(a). A "cooperative business arrangement" is:

    > a contractual relationship between a lawyer or law firm and a nonlegal professional or nonlegal professional service firm for the purpose of offering to the public, on a systematic and continuing basis, legal services performed by the lawyer or law firm, as well as other nonlegal professional services…

    See 22 NYCRR 1205.2. Rule 5.8(a) specifically limits the non-legal professionals with whom a lawyer may contract. *See* 22 N.Y.C.R.R. § 1205.3 (list promulgated by the Appellate Divisions of professionals with whom lawyers may contract), § 1205.5. The rules permit contractual business relationships between lawyers and five other professions (public accountancy, land surveying, social work, architecture and professional engineering) but neither realtors nor bankers. Under Rule 5.8(a), a reciprocal exclusive referral agreement may include joint advertising and sharing of office space, but may not include sharing of any legal fees.

Conclusion

9. A law firm web site can include informational links to other web sites, including those of banks and real estate companies. Neither the linked material nor the linkage itself may involve misrepresentation or create confusion. Reciprocal links are not inherently unethical. A simple reciprocal link (without revenue generated for the law firm and without any financial relationship between the entities) is permitted under similar conditions as an informational link.

(3-10)

Ethics Opinion 889

Committee on Professional Ethics of the New York State Bar Association (11/15/11)

Topic: Sharing legal fees and forming partnership with non-lawyer.

Digest: A lawyer who principally practices in a jurisdiction that allows partnership with a non-lawyer, and who is also admitted in New York, may ordinarily conduct New York litigation even if in a partnership that includes a non-lawyer who would benefit from the resulting fees; although the New York rules generally prohibit such arrangements, in this case the governing ethical provisions would be those of the other jurisdiction.

Rules: 5.4(a) & (b), 8.5(a) & (b)

Facts

1. The inquirer is a lawyer admitted to practice in both New York and the District of Columbia. The lawyer's practice is based in the District of Columbia and the majority of his revenue is derived from cases and matters within that jurisdiction.

2. The lawyer desires to form a District of Columbia partnership with a non-lawyer, a technical expert, who will assist the lawyer with prosecuting certain class action claims, at least one of which would be brought in the State of New York. For the purposes of this opinion, it is assumed that the District of Columbia permits lawyers to form a partnership with non-lawyers, and to share legal fees and profits as between them, if they comply with certain rules. *See* D.C. Opinion 322 (2004); D.C. Rule 5.4.

Questions

3. When the lawyer earns legal fees resulting from litigation commenced and prosecuted in New York, may he share those fees with his District of Columbia partnership, which would include a non-lawyer who has worked on that litigation? If the lawyer may not share the fees directly, may the firm hire the non-lawyer as an employee, to be compensated through a profit-sharing arrangement triggered by increases over the firm's current average profit?

Opinion

4. New York Rule 5.4(a) provides that, with exceptions not here pertinent, a lawyer or law firm shall not share legal fees with a non-lawyer. New York Rule 5.4(b) provides that "[a] lawyer shall not form a partnership with a nonlawyer if any of the activities of the partnership consist of the practice of law." While it is clear that the New York rules of legal ethics prohibit such a partnership and such fee sharing, the nuanced question here is whether a lawyer admitted in New York runs afoul of our ethics rules by litigating in New York as part of a partnership in the District of Columbia that is, and ethically may be, structured in the way the New York rules generally prohibit.

5. Under New York Rule 8.5(a) a New York admitted lawyer is subject to the disciplinary authority of New York regardless where the conduct occurs, but we must determine whether the ethics rules to be applied are those of New York or those of the District of Columbia. To make this determination we look to the New York choice of law rules contained in New York Rule 8.5.

6. Under New York Rule 8.5(b)(1), for "conduct in connection with a proceeding in a court before which a lawyer has been admitted to practice (either generally or for purposes of that proceeding), the rules to be applied shall be the rules of the jurisdiction in which the court sits, unless the rules of the court provide otherwise." Thus, the New York Rules of Professional Conduct apply to conduct in connection with proceedings in a New York court unless the rules of that court provide otherwise.

7. Forming a District of Columbia partnership with a non-lawyer in the District of Columbia does not become subject to New York Rule 5.4 just because the partnership may undertake some New York litigation work. As we read the inquiry, there is no suggestion that undertaking the New York litigation would substantially shift the firm's focus. We assume that the firm, even if it undertook the New York litigation, would continue to be centered on cases and revenue within the District of Columbia. Under those circumstances, we believe that formation of the partnership cannot be said to be "conduct in connection with" the New York litigation. The same is true of distributing profits, including those generated from occasional legal fees in New York, according to the general terms of the District of Columbia partnership agreement.

8. Under New York Rule 8.5(b)(2)(ii), for conduct not in connection with a proceeding in court, the rules to be applied shall be "the rules of the admitting jurisdiction in which the lawyer principally practices; provided, however, that if particular conduct clearly has its predominant effect in another jurisdiction in which the lawyer is licensed to practice, the rules of that jurisdiction shall be applied to that conduct." The inquirer principally practices in the District of Columbia. Unless the formation of the partnership or the division of compensation arising from New York litigation clearly have their predominant effect in New York, those matters are subject only to the District of Columbia ethics rules.

9. Forming the District of Columbia partnership does not clearly have its predominant effect in New York just because the partnership may undertake some New York litigation work. Under the circumstances presented, neither does it clearly have a predominant effect in New York for the partnership to distribute its fees according to the general terms of the partnership agreement, even though this may include occasional fees from New York litigation.

10. Accordingly, while the proposed distribution of legal fees may have to comply with relevant ethical rules in the District of Columbia, it is not subject to New York Rule 5.4. A contrary result, applying the New York Rules more broadly than their intended reach, could result in undue burdens for lawyers admitted in New York, but legitimately practicing in the District of Columbia through a partnership that includes a non-lawyer, who wish to participate in the occasional New York litigation matter.

11. Our conclusion as to choice of law is premised on the particular facts of the inquiry. These include that the lawyer and the law firm, now and in the foreseeable future, have their principal place of business in the District of Columbia and that the bulk of their revenue is derived from matters unrelated to the State of New York. Different facts could lead to a different result. For example, if a major portion of the revenue of the lawyer or the law firm were derived from the practice of law in the State on New York, then, depending on the particular facts, Rule 8.5 could make applicable the prohibitions of New York Rule 5.4. Certainly if the partnership were created for the very purpose of litigation in New York, establishing it in the District of Columbia would be ineffective to circumvent the New York rules on fee sharing.

12. Other jurisdictions have reached varying conclusions as to the choice of law that governs such situations. *Compare* Philadelphia Opinion 2010-7 (opining that a Pennsylvania lawyer could share fees with a non-Pennsylvania lawyer in the District of Columbia even though the DC firm had a non-lawyer partner) *with* ABA 91-360 (opining that lawyer practicing in a jurisdiction forbidding partnerships with non-lawyers would be subject to that prohibition even if a member of a DC firm), *followed in* Virginia Opinion 1584 (1994). It should be noted, however, that the ABA and Virginia opinions were based on codes without choice of law provisions similar to the current Rule 8.5 in New York.[1] We believe that the Philadelphia opinion is the more instructive precedent, and for the reasons stated above, we believe the New York choice of law rules support a similar conclusion.

13. Alternatively, we are asked to address whether the lawyer could employ the non-lawyer technical expert, with the expert receiving compensation based upon a profit-sharing model based on increases from the firm's current average profit. In N. Y. State 733 (2000), we addressed whether a lawyer may share legal fees with non-lawyer employees. Under DR 3-102 [now Rule 5.4(a)], we held that "a lawyer may compensate non-lawyer employees based on profit sharing but may not tie remuneration to the success of specific efforts by employees to solicit business for lawyers or law firms." We specifically stated that any permissible profit sharing between lawyer and non-lawyers "may not be used to circumvent the specific prohibition on fee sharing reflected in Judiciary Law §491 and DR 2-103(B)." *See also* Rule 5.4, Cmt. [1B].

14. As posed to this Committee by the inquirer, the profit-sharing with the non-lawyer employee would be based upon total profits above a significant minimum threshold. Although the non-lawyer would not be paid a percentage of fees from a given case, the non-lawyer's compensation under this profit-sharing model would correspond roughly to the amount by which his involvement increases the profit of the firm.

15. We do not reach the question whether this proposed profit-sharing model would comport with the standards that would generally apply in New York. On the facts of this inquiry, and

following the same analysis as set forth above with respect to partnership, we believe the propriety of the profit-sharing arrangements would be governed by the ethics rules of the District of Columbia. If the facts were different—for example, if New York litigation represented a significantly greater portion of the firm's caseload or revenues—then it would be necessary to consider whether the profit-sharing model would be consistent with New York ethical rules.

Conclusion

16. A lawyer who principally practices in another jurisdiction but is also admitted in New York may conduct occasional New York litigation, even if a non-lawyer would benefit from the resulting fees (either as a member of the lawyer's partnership in that other jurisdiction or as its employee compensated through a profit-sharing arrangement), if the arrangements comply with the ethics rules of that other jurisdiction.

Endnote

1. The ABA opinion was issued at a time when ABA Rule 8.5 was limited to jurisdiction of the disciplinary authority without provision for choice of law. Amendments adopted by the ABA in 1993 broadened the rules to include choice of law provisions as are found in New York Rule 8.5(b) upon which we base our conclusion. At the time of the Virginia opinion, the applicable conflicts rule, Virginia DR 1-102(B), was limited in scope.

(38-11)

Ethics Opinion 890

Committee on Professional Ethics of the New York State Bar Association (11/17/11)

Topic: Disqualification of spouses practicing in different firms from appearing on opposite sides of a litigation.

Digest: Conflicts of spouses representing clients on opposite sides of the same litigation under Rule 1.10(h) are not automatically imputed to other lawyers in the disqualified lawyers' firms, but imputation may arise in the particular circumstances of any given case. At least in civil matters, even if the conflict is imputed to other lawyers in the spouses' firms, the resulting conflict may, depending on the facts of the particular case, be waived by the client or clients with their informed consent. If substitute counsel from outside the firm is engaged, the originally retained lawyer may share confidential information with the substitute counsel as long as the affected client gives his or her informed consent or the disclosure is impliedly authorized to serve the best interests of the client under Rule 1.6.

Rules: 1.0(j), 1.6(a), 1.7(b)(1), 1.10(a) & (h)

Facts

1. The inquirer and his wife are lawyers working in a small city. The inquirer is the managing attorney of a legal services office and his wife is in private practice at a local firm. Recently, a client engaged the inquirer's wife to bring an eviction. The respondent in that proceeding sought the assistance of the inquirer's office.

Questions

2. Is the prohibition in Rule 1.10(h) that, absent a valid consent, precludes husband and wife from personally representing opposing parties in litigation imputed to other lawyers in their respective firms?

3. If the conflict is imputed, can consent cure the conflict, and, if so, is consent of one or both clients needed?

4. If the inquirer chooses to recommend that the client engage instead volunteer outside counsel, can the inquirer share with the outside counsel information derived from the legal services office's intake interview?

Opinion

5. The inquirer recognizes that he cannot personally represent the client in litigation against an adversary represented by his wife. His concern is well founded. Under the terms of Rule 1.10(h), the prohibition on lawyers representing clients in any matter where the adversary is represented by the lawyer's spouse is subject to consent by the lawyer's client "after full disclosure" and only if "the lawyer concludes that the lawyer can adequately represent the interests of the client." While worded differently, this inquiry is the same as that set forth in Rule 1.7(b)(1), the general concurrent conflict rule: whether "the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation" to the affected client or clients. Because both husband and wife are subject to the same prohibition, for both lawyers to remain on the case, both would have to conclude that they could adequately represent the interests of their clients, and both clients would have to consent. In the Committee's view, it would be a rare case in which spouses could reasonably conclude that they could adequately represent the interests of their respective clients in appearing personally as lead counsel on opposite sides of a litigation.

6. The prohibition set forth in Rule 1.10(h) is not, however, automatically imputed to other lawyers in the law offices of the husband and wife. Rule 1.10(a) provides for automatic imputation where the conflict arises under Rules 1.7, 1.8 or 1.9, but does not list conflicts arising under Rule 1.10(h). This Committee has previously observed that, under essentially identical provisions of the former New York Code of Professional Responsibility, even in cases involving criminal prosecutions, "disqualification of the district attorney's spouse in a particular case does not result in automatic disqualification of other lawyers in the spouse's firm under DR 5-105(D) [now Rule 1.10(a)]." N.Y. State 654 (1993); *accord* N.Y. State 660 (same as to lawyers in close dating relationship).

7. Nevertheless, the conflict may be imputed under the facts and circumstances of a given case, where the policies underlying the primary disqualification are also implicated by participation of other lawyers in the firm. N.Y. State

654 (1993); N.Y. State 638 (1992); N.Y. State 632 (1992). In N.Y. State 654, we enumerated certain factors that should be considered in determining whether a conflict was imputed in a given case:

> Relevant facts would include the size of the spouse's firm, the spouse's position in the firm, whether the spouse will derive direct or indirect financial or other benefit as a result of the defendant's employment of the firm, and whether the spouse played any role in the defendant's seeking representation by the firm.

In that opinion, we concluded that the conflict that prevented the spouse of a district attorney from representing a criminal defendant was imputed to the spouse's firm, and that consent of the criminal defendant would not cure the conflict. We rested heavily on the fact that the case was a criminal matter and the concern that the public might perceive favoritism in the district attorney's handling of the matter: "Since the firm of the district attorney's spouse is quite small, the public would be likely to see the potential for abuse whether the defendant were represented by the district attorney's spouse's partner or associate, or by the district attorney's spouse." N.Y. State 654.

8. This opinion, by contrast, involves a civil landlord-tenant case that does not implicate the public interests present in a criminal matter. In these circumstances, whether a colleague in the inquirer's office or a colleague in the wife's law firm, or both, could proceed with the representation in the eviction matter would depend primarily on whether, under all the facts, "there is a significant risk that the [litigating] lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own… personal interests" occasioned by that lawyer's relationship with one or the other spouse. Rule 1.7(a)(2). This is an objective test based on the particular circumstances: the lawyers involved, "acting reasonably," must "determine whether…the lawyer's judgment may be impaired or the lawyer's loyalty may be divided if the lawyer accepts or continues the representation." Rule 1.7, Cmt. [2]. The answer may depend on, among other things, whether both spouses withdraw from the affected representation or only one of them does. In the latter case in particular—where a colleague is litigating directly against one of the spouses—we believe it is quite likely, if the respective law offices are relatively small, that a significant risk of an adverse effect on the litigating lawyer's professional judgment would arise.

9. Even if there is such a significant risk, however, that conflict can be cured by consent of the affected clients as long as the lawyer involved reasonably believes that, notwithstanding that risk, he or she will in fact be able to provide competent and diligent representation to the affected client. Rule 1.7(b)(1). Any consent will often be conditioned on effective screening of the disqualified spouse from all contact with the matter.

10. Whether consent needs to be obtained from one client or both also depends on the circumstances. For example, a colleague in the inquirer's office, where the inquirer is managing attorney, might well conclude that he or she must obtain consent of the respondent in the eviction matter. Yet perhaps the colleague in the wife's firm, given facts such as the size of that office and the lawyer's role in it, might reach a different conclusion. It would always be most prudent for all the various lawyers involved to obtain consent from their clients, but whether that is *required* depends on the analysis above.

11. Information derived from the intake interview is confidential whether or not the lawyer assumes representation of the prospective client. *See* Rule 1.18(b). If the representation were taken over by a colleague in the inquirer's legal services office, the inquirer could discuss information from the intake interview with that colleague. *See* Rule 1.6 Cmt. [5] ("lawyers in a firm may, in the course of the firm's practice, disclose to each other information relating to a client of the firm, unless the client has instructed that particular information be confined to specified lawyers"). If outside counsel is retained to take over a representation, however, confidential information may be disclosed to the new lawyer only, under Rule 1.6(a)(1), with the "informed consent" of the respondent as that term is defined by Rule 1.0(j), or, under Rule 1.6(a)(2), if the disclosure is impliedly authorized to advance the best interests of the client and reasonable under the circumstances or customary in the professional community.[1] Assuming that the client is aware that the inquirer has undertaken to find replacement counsel, briefing new counsel is likely to be both reasonable and customary unless the information derived from the intake interview was adverse to the interests of the client.

Conclusion

12. Conflicts under Rule 1.10(h) are not automatically imputed to other lawyers in the disqualified lawyers' firms, but imputation may arise in the particular circumstances of any given case. Even if the conflict is imputed to other lawyers in the spouses' firms, the resulting conflict may, depending on the facts of the particular case, be waived by the client or clients with their informed consent. If substitute counsel is engaged, the originally retained lawyer may share confidential information with the substitute counsel as long as the affected client gives his or her informed consent or the disclosure is impliedly authorized under rule 1.6(a)(2).

Endnote

1. This is not a case in which the lawyer's contact with a prospective or former client is so remote as to call into question whether disclosure to serve the client's best interests could ever be reasonable or customary. To the contrary, the inquirer's involvement with the respondent is ongoing. Without trying to formulate general rules, we conclude on the present facts—where a lawyer has obtained confidential information from a prospective client and has undertaken, with permission, to hand the matter over to new counsel identified by the lawyer—that the lawyer may be impliedly authorized to disclose information to the new lawyer if doing so meets the tests set forth in Rule 1.6(a)(2).

(40-11)

Ethics Opinion 891

Committee on Professional Ethics of the New York State Bar Association (11/17/11)

Topic: Conflict of Interest; Referrals by attorney to a title abstract company or title company agent in which the attorney has a financial interest.

Digest: An attorney may refer a client to a title abstract company or title company agent in which the attorney has a financial interest in the limited case where the Company or Agent does only ministerial tasks. The attorney's personal interest conflict arising from the financial interest may preclude the attorney from representing that client in the same transaction that the title abstract company or title company agent is providing services in.

Rules: DR 1-106; 5-104(A); Rule 1.7; 1.8; 5.7

Questions

1. May an attorney refer work to a title abstract company or title company agent in which the attorney has a financial interest? (A "title abstract company" and a "title company agent" being hereinafter collectively referred to as a "title company.")
2. May an attorney represent a client in a transaction where the title company in which the attorney has a financial interest is providing services to that client?

Opinion

3. Both of the above questions were answered under the Code of Professional Responsibility by opinions of this Committee. See N.Y. State 595, 621, 738, 752, 753 and 755. The answers and reasoning set forth in those opinions are still valid under the NY Rules of Professional Conduct which replaced the Code of Professional Responsibility effective April 1, 2009.
4. N.Y. State 595 held that an attorney could refer clients to an abstract company in which the attorney has an interest and continue to represent the client in the transaction, provided that the abstract company performs only ministerial tasks. If the abstract company were to perform non-ministerial tasks (such as title insurance or recommendations for title insurance), the resulting personal interest conflicts with the attorney's duty to the client in the transaction and is a non-consentable conflict.
5. N.Y. State 621 confirmed the result in N.Y. State 595 and distinguished N.Y. State 576 which allowed an attorney to refer a client in a transaction to a title company that paid a commission to the attorney, provided that, among other things, the attorney passed the commission on to the client and where exceptions to title were not negotiable.
6. N. Y. State 738 applied the prohibition where the attorney's spouse holds a financial interest.
7. N. Y. State 752 made clear that notwithstanding the adoption of DR 1-106 the prohibitions regarding title companies remained valid.
8. N. Y. State 753 reiterated that a lawyer's interest in a title abstract company providing insurance or making an insurance recommendation could not, even with client consent, represent the buyer, seller or lender in the transaction unless the abstract company performs only ministerial tasks.
9. Rule 5.7 is substantially the same as DR 1-106 and accordingly the same reasoning applies regarding the permissibility of referrals to title companies.

Conclusion

10. An attorney may refer a client to a title company in which the attorney has a financial interest provided that the attorney may not represent the client in the transaction in which that title company will provide title services to the client unless the services are purely ministerial or if, among other things, the attorney passes the commission on to the client and where exceptions to title are not negotiable.

(27-11)

Ethics Opinion 892

Committee on Professional Ethics of the New York State Bar Association (11/28/11)

Topic: Lawyer's participation in residential real estate transaction that includes both a "seller's concession" and an equivalent "gross-up" in the sale price.

Digest: The fact that the sales price in a residential real estate transaction has been "grossed-up" must be expressly disclosed in the transaction documents containing the sales price in addition to the amount of the "seller's concession."

Rules: 8.4(c)

Facts

1. Seller's attorney presented a contract for the sale of a single family home to the mortgagee bank with provisions stating that "At the closing of title Seller shall pay $25,000.00 towards Purchasers' closing costs and points" and "Purchaser and Seller hereby and herewith acknowledge and understand that the sales price has been increased by the sum of $25,000.00 to allow and provide for the aforesaid Seller's Concession."

2. Although seller's attorney has been using substantially similar language without objection by lenders for numerous residential real estate transactions, the lender in this instance advised the seller's attorney that the "Contract states price increased due to Seller concession; increase for this reason is not allowed."

Question

3. May a lawyer ethically participate in a residential real estate transaction where the lender objects to the disclosure in the sales contract and the HUD-1 Settlement Statement showing that the amount of the sales price has been increased ("grossed-up") in an amount equivalent to the amount of the seller's concession?

Opinion

4. Rule 8.4(c) prohibits a lawyer from engaging in conduct involving misconduct. Under the facts of this inquiry the failure to disclose the increase or "gross-up" of the purchase price would constitute misrepresentation. In N.Y. State 817 (2007) this Committee opined that a lawyer's participation in a residential real estate transaction that includes a "seller's concession" and a "grossed up" or increased sales price is ethically prohibited, unless the gross-up is disclosed in the transaction documents. That opinion did not hold that a seller's concession or gross-up was improper. Rather, the opinion held a full disclosure of the gross-up in the transaction documents was necessary to avoid a misrepresentation regarding the amount of the purchase price.

5. In N.Y. State 882 (2011) we affirmed what we said in N.Y. State 817 and clarified in which documents the disclosure of the gross-up was required to be made:

> The problem is not the seller's concession in the abstract. Many seller's concessions are legitimate. The problem here is the matching "gross up" of the selling price, which effectively wipes out the seller's concession. If a buyer has to pay $6,000 in order to get a $6,000 discount, then the true selling price has not changed. Thus, a gross up, if not expressly disclosed as such, is a misrepresentation and is proscribed by Rule 8.4(c). Consequently, if a lawyer participates in a real estate transaction in which the lawyer knows (or should know) that the transaction documents containing the grossed-up sales price do not expressly disclose that the sales price was increased by the same amount as the seller's concession, the lawyer violates Rules 8.4(c). The fact that the practice may be widespread does not authorize an attorney to participate in the misrepresentation. The Rule is equally applicable to the buyer's attorney, the seller's attorney, and the lender's attorney.

N.Y. State 882 ¶ 10.

Here, because the mortgagee bank rejected the disclosure required by our ethical opinions, the attorneys for the buyer, seller and lender not only had reason to know that the documents with the deletion would contain a misrepresentation, they each had actual knowledge.[1]

6. N.Y. State 882 addressed the issue raised by the current inquiry.

> Even if the seller's concession and matching gross-up were suggested by a mortgage broker, a loan officer, or some other employee at the mortgage bank, the lawyer is not relieved from making the necessary disclosures. Disclosure may be even more important in that situation because the lender's representative—the very person who might be expected to detect a misrepresentation (the supposedly increased sales price that is fully offset by an unexplained seller's concession)—is encouraging the misrepresentation. No function other than to misrepresent the purchase price can be ascribed to a gross–up equal to an unexplained seller's concession. A lawyer may not participate in that misrepresentation no matter who suggested it.

Id. ¶ 11.

7. Under these circumstances, where the lender objects to the disclosure of the gross-up of the purchase price, none of the lawyers may ethically participate in the transaction. Their best course would be to advise the lender the "gross-up" is ethically prohibited unless disclosed in the documents that recite the purchase price and that if the lender will not agree to the disclosure, the lawyers for the buyer, seller and lender may not participate in the transaction.

Conclusion

8. A lawyer may not ethically participate in a residential real estate transaction where the lender objects to the disclosure of the fact that there has been a gross-up of the purchase price equivalent to amount of the seller's concession.

Endnote

1. Rule 1.0(k) provides as follows:

> "Knowingly," "known," "know," or "knows" denotes actual knowledge of the fact in question. A person's knowledge may be inferred from circumstances.

A lawyer "should know" a fact when it can be readily inferred from the circumstances.

(12-11)

Ethics Opinion 893

Committee on Professional Ethics of the New York State Bar Association (12/1/11)

Topic: Assistant District Attorney accepting appointment as foreclosure referee.

Digest: A full-time prosecutor may accept appointment to referee foreclosure panels, and may oversee foreclosure proceedings, provided there is no conflict.

Rules: 1.7, 1.12

Question

1. May a full-time Assistant District Attorney seek and accept appointment to a court-appointed referee foreclosure panel?

Opinion

2. New York law permits courts to appoint referees from court-appointed referee panels to exercise a number of powers in connection with a foreclosure. N.Y. Civ. Prac. L & R. § 4301. Referees compute the value of foreclosed property and sell it at public auction. N.Y. Civ. Prac. L. & R. §1351(1). The statutory fee is $50 to compute the value of the property and $500 to sell the property, although the court can authorize a higher fee for property with a sales price that exceeds $50,000. N.Y. Civ. Prac. L & R. §8003(b).

3. Applicants to be referees complete a short form that includes the applicant's education and experience, prior court appointments, and the appointment requested. The Office of Court Administration does not conduct screening of those seeking appointment, and appointment of referees is left to the discretion of individual judges. Rules of the Unified Court System, pt. 36 Appointments; NYS Office of Court Administration, Report of the Commission on Fiduciary Appointments (Dec. 2001).

4. No per se rule in the New York Rules of Professional Conduct prohibits the Assistant District Attorney from accepting an appointment to a referee panel. We caution, however, that apart from the Rules of Professional Conduct, there could be other provisions—such as in county law or the ethics rules for a particular District Attorney's office—that could prohibit an Assistant District Attorney from accepting an appointment as a referee. This committee does not opine on questions of law, regulation or agency policy.

5. Moreover, although no per se provision in the Rules of Professional Conduct prohibits the Assistant District Attorney from accepting an appointment as a referee, the rules governing conflicts of interest may prohibit an Assistant District Attorney, in particular situations, from accepting appointment to the panel generally or overseeing a particular foreclosure.

   Except as provided in paragraph (b), a lawyer shall not represent a client if a reasonable lawyer would conclude that …

   > (2) there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests.

   Rule 1.7(a); *see also* Rule 1.7(b) (setting forth an exception based on informed consent and other factors).

6. An Assistant District Attorney should avoid situations in which his or her interests in being a referee would create a conflict under Rule 1.7(a)(2). For example, given the discretion of a judge to make a referee appointment, the attorney should consider whether it is appropriate to accept a referee assignment from a judge before whom the attorney frequently appears or is currently appearing in the role of prosecutor, or to seek appointment to a panel that would routinely result in assignments from such a judge.

7. While it usually will be ethical for an attorney to accept an appointment to a referee panel, the Assistant District Attorney must also consider whether there may be a conflict under Rule 1.7(a)(2) with respect to an appointment to oversee any particular foreclosure. An attorney should not serve as a referee in a matter where one of the parties to the foreclosure is currently being prosecuted or is likely to be prosecuted by the District Attorney's office in which the Assistant District Attorney serves. The Assistant District Attorney should also consider whether it would be appropriate to serve as a referee in a proceeding in which he or she has previously participated in a criminal matter in which any party to the foreclosure was involved. Whether serving as a referee in such a situation would

constitute a conflict under Rule 1.7(a)(2) might depend on the length of time that had passed since the criminal proceeding, the extent of the Assistant District Attorney's involvement in that matter, and the extent of the party's involvement in that matter (*e.g.*, as a defendant, witness, juror, or complainant). Where the foreclosure involves law enforcement personnel with whom the Assistant District Attorney works as a prosecutor, the attorney should weigh whether these professional relationships might affect his or her professional judgment. *See* N.Y. State 544 (1982); N.Y. State 800 (1986).

8. We note also that should an Assistant District Attorney accept an appointment as a referee in a matter, he or she might thereafter be subject to various provisions of Rule 1.12, such as restrictions on subsequent employment, because a referee is an "adjudicative officer" and a "third-party neutral," which are two of the categories of lawyers covered by that Rule. *See* Rule 1.12, Cmt. [1]. The question before us is whether an Assistant District Attorney may accept appointment as a referee, not what restrictions may apply to him or her after accepting such appointment. But we urge an Assistant District Attorney in this situation to study Rule 1.12 carefully if and when he or she accepts an appointment as a referee.

Conclusion

9. A full-time prosecutor may accept appointment to a referee foreclosure panel and may oversee foreclosure proceedings, provided there is no conflict under the Rules of Professional Conduct.

(18-11)

Ethics Opinion 894

Committee on Professional Ethics of the New York State Bar Association (12/1/11)

Topic: Communication with represented party; service of process.

Digest: When authorized by statute, an attorney may personally serve process on a represented party and ask certain related questions, but may not go beyond service of process to communicate on the subject of the representation without the consent of such party's lawyer.

Rules: 1.0(l), 4.2

Facts

1. An attorney for a landlord, to commence a summary eviction proceeding, serves a petition and notice of petition. The tenant appears by counsel and challenges the service. Landlord's attorney wishes to effect new service by personally serving the notice and petition directly upon the tenant.

Question

2. May an attorney personally serve process on a party known to be represented?

Opinion

3. The New York Rules of Professional Conduct provide:

> In representing a client, a lawyer shall not communicate or cause another to communicate about the subject of the representation with a party that the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the prior consent of the other lawyer or is authorized to do so by law.

Rule 4.2(a).

4. Clearly the tenant is represented by a lawyer in the matter. The validity of the original service of process is irrelevant to this issue. *See* Rule 1.0(l) (defining "matter" to include a claim or controversy as well as a proceeding). Landlord's attorney therefore may not "communicate or cause another to communicate" with the tenant about the subject of the representation without the prior consent of the tenant's lawyer unless landlord's attorney is authorized to do so by law.

5. The purpose of Rule 4.2 is to promote the proper functioning of the legal system by protecting a person who has chosen to be represented by a lawyer in a matter against possible over-reaching by other lawyers who represent clients in the matter. *See* Rule 4.2, Cmt. [1]. Although the rule is popularly known as the "no-contact" rule, by its terms the rule prohibits contact without the opposing lawyer's consent only if (a) such contact involves communication, (b) the communication is about the subject of the representation, and (c) the communication is not authorized by law.

6. Rule 4.2 is not limited to oral communication. A letter mailed or handed to the represented tenant by the lawyer or the lawyer's agent, if it argued the landlord's position or offered a settlement of the matter, clearly would constitute a prohibited communication. Whether legal process that commences a court action also constitutes "communication about the subject of the representation" is a question we need not decide, because another clause of the Rule is sufficient to answer the inquiry.

7. Rule 4.2 allows a lawyer to communicate with an unrepresented person when "authorized to do so by law." The Real Property Actions and Proceedings Law provides for process to be personally served upon the respondent in the proceeding, without reference to whether the respondent is represented. "Service of the notice of petition and petition shall be made by personally delivering them to the respondent," or alternatively, by specified forms of mail to the respondent in addition to either delivering the papers to a person of suitable age and discretion at the property sought to be recovered, or else leaving the papers in a specified manner at the property. RPAPL § 735(1).

8. Under the Civil Practice Law and Rules, authorization to serve process and other papers is very broad and does not exclude lawyers. "Except where otherwise prescribed by law or order of court, papers may be served by any person not a party of the age of eighteen years or over." CPLR 2103. Articles 8 and 8-A of the New York General Business Law contain requirements with respect to process servers. Both specifically exempt attorneys from the definition of process servers who are required to maintain

records (which clearly would not be necessary if attorneys could not personally serve process). GBL §§ 89-t, 89-bb. Although many lawyers use professional process servers, the CPLR does not require them to do so.[1] And if it would violate the Rule for the lawyer personally to effect service, then it would be equally violative for the lawyer to "cause another," such as a process server, to do so. There is no violation in either case, because service directly upon a respondent, even if represented, is authorized by law.

9. May a lawyer, when serving process on a represented person, engage in conversation with that person? It is permissible, whether or not advisable, to discuss matters wholly unrelated to the representation. Some more related communications are common in the course of serving process. For example, the server may have occasion to ask the prospective recipient whether he or she is the person named in the papers, or to ask the recipient to sign an acknowledgement of receipt of service.

10. We doubt that asking the tenant to confirm his or her identity, or to sign an acknowledgement of receipt, would be a communication "about the subject of the representation" within the meaning of Rule 4.2. In any event, we believe that communications such as these would fall within the legal authorization for making service directly upon the respondent. The CPLR anticipates that a person serving process may have occasion to engage in some such types of communication. *See* CPLR 306 (d) & (e) (allowing proof of service by means including "a signed acknowledgment of receipt of a summons and complaint" or a "writing admitting service by the person to be served").

11. However, a statute providing for service directly upon parties (including represented ones) does not constitute a general authorization of communication with such persons during the course of service. A lawyer serving process on a represented person must be careful not to exceed the scope of the authorization in any way that would violate the no-contact rule.[2] Conversation on the subject matter of the representation, if not included within the authorization for service of process, remains prohibited.

Conclusion

12. An attorney may personally serve process on a represented party as authorized by statute. In the course of making service, the attorney may ask the represented party if he or she is the person named in the papers, and may request the represented party to sign an acknowledgement of receipt of process. The attorney may not, however, without the consent of that person's lawyer, go beyond service of process to elicit or participate in communications with that person about the subject of the representation.

Endnotes

1. In fact there can be legitimate reasons, not involving circumvention of Rule 4.2, for a lawyer personally to effect service. For example, the lawyer may wish to save the cost of a professional server or to be assured that service is timely and valid.

2. We note the approach to this issue that has been taken by another State. In Florida, the analogue to our Rule 4.2 states no exception for communications authorized by law, so there is reason for it to include an explicit but limited exception for service of process:

> In representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer. Notwithstanding the foregoing, an attorney may, without such prior consent, communicate with another's client in order to meet the requirements of any court rule, statute or contract requiring notice or service of process directly on an adverse party, in which event the communication shall be strictly restricted to that required by the court rule, statute or contract, and a copy shall be provided to the adverse party's attorney.

Fla. Rule 4-4.2(a).

(36-11)

Ethics Opinion 895

Committee on Professional Ethics of the New York State Bar Association (12/6/11)

Topic: Spousal conflicts of interest.

Digest: Absent informed consent confirmed in writing, a sole practitioner may not represent a client in a matter where the opposing party is represented by a lawyer in a five-lawyer firm in which her spouse is the senior partner. The lawyer in her spouse's firm representing the opposing party may also have a conflict, which would be imputed to all lawyers in the spouse's firm unless it can be and is cured by informed consent, confirmed in writing.

Rules: 1.0(h) & (j), 1.6(c), 1.7, 1.10(a), (d) & (h)

Question

1. A sole practitioner practices law from home in a small community, but occasionally uses the conference room and telephone lines in her spouse's law firm. The spouse's firm is a five-lawyer firm at which her spouse is the senior partner. May the sole practitioner and a lawyer from the spouse's firm (but not the spouse) serve as opposing counsel in a case in which the sole practitioner's client is a minor?

Opinion

2. On April 1, 2009, the New York Rules of Professional Conduct (the "Rules") replaced the New York Code of Professional Responsibility (the "Code") but, as we show below, there is no substantive difference in the provisions governing the answers to these inquiries.

A. Does a conflict arise from the spousal relationship?

3. The essence of the question is whether a lawyer may represent a client if the opposing counsel is an attorney in the law firm where her spouse is the senior partner.

4. To analyze conflicts arising from a spousal relationship, we start with Rule 1.10(h), which provides as follows:

> A lawyer related to another lawyer as parent, child, sibling or spouse shall not represent in any matter a client whose interests differ from those of another party to the matter who the lawyer knows is represented by the other lawyer ***unless the client consents to the representation after full disclosure and the lawyer concludes that the lawyer can adequately represent the interests of the client.*** [Emphasis added.]

5. Thus, under Rule 1.10(h), a conflict of interest arises when spouses represent opposing parties in a matter. However, the facts indicate that the sole practitioner's spouse is not representing the opposing party, but rather another lawyer in the spouse's five-lawyer firm. Therefore, Rule 1.10(h) itself does not apply.

6. However, Rule 1.10(h) is essentially a more specific version of Rule 1.7(a)(2), the general rule on concurrent conflicts arising from a lawyer's personal interests. Under Rule 1.7(a)(2), unless a lawyer complies with Rule 1.7(b), "a lawyer shall not represent a client if a reasonable lawyer would conclude that…there is a significant risk that the lawyer's professional judgment on behalf of the client will be adversely affected by the lawyer's own financial, business, property or other personal interests." Rule 1.7(b)(1) allows a client to waive a conflict of interest if the lawyer reasonably concludes that she can competently and diligently represent the client, but Rule 1.7(b)(4) adds that consent must be both "informed" and "confirmed in writing." These conditions for waiver also apply to a conflict arising under Rule 1.10(h). *See* Rule 1.10(d) ("A disqualification prescribed by this Rule may be waived by the affected client…under the conditions stated in Rule 1.7.").

B. Is the conflict imputed to other lawyers in the spouse's firm?

7. Rule 1.10(a) imputes one lawyer's conflict of interest under Rule 1.7, Rule 1.8, or Rule 1.9 to all lawyers "associated in" the same firm, but Rule 1.10(a) does not explicitly impute a disqualification arising under Rule 1.10(h). "Unlike disqualifications under most other.… Rules, disqualifications under DR 9-101(D) are not imputed to the rest of the disqualified lawyer's firm." Roy D. Simon, Simon's New York Code of Professional Responsibility Annotated 1450 (ed. 2008). (Rule 1.10(h) is identical to former DR 9-101(D).) Rule 1.10(h) applies only when the spouses personally represent opposing sides. Here, the lawyer's spouse does not person-

ally represent the opposing party—a partner in the spouse's firm does. Yet this does not end our analysis, because we must also consider whether the sole practitioner or the opposing counsel in her spouse's firm—or both – have a conflict under Rule 1.7(a)(2). If the lawyer in the spouse's firm has a conflict under Rule 1.7(a)(2), then pursuant to Rule 1.10(a) that conflict would be imputed to all other lawyers in the spouse's firm.

8. This Committee considered an issue similar to the one here in N.Y. State 654 (1993). That opinion addressed whether a district attorney could prosecute a defendant represented not by the D.A.'s spouse but by the other lawyer at the two-lawyer firm where the D.A.'s spouse worked. Despite the heightened emphasis on fairness and the appearance of fairness in criminal cases, this Committee stated that under DR 5-105(D) (predecessor to Rule 1.10(a)), "disqualification of the district attorney's spouse in a particular case does not result in automatic disqualification of other lawyers in the spouse's firm." But the Committee qualified this general statement by noting that "whether others in the firm are disqualified will turn on the particular facts and circumstances, including the basis of the primary disqualification and the underlying policies and interests to be served." The Committee listed several relevant factors for the attorney to consider, including (i) "the size of the spouse's firm," (ii) "the spouse's position in the firm," (iii) "whether the spouse will derive direct or indirect financial or other benefit as a result of the [representation]," and (iv) "whether the spouse played any role in the [client's] seeking representation by the firm."

9. Applying these factors to the district attorney's inquiry in N.Y. State 654, this Committee concluded that the spouse's entire firm was disqualified by imputation. Our determination was based largely on the size of the firm. Because the spouse was a partner in a two-partner firm, this Committee noted that "the public would be likely to see the potential for abuse whether the defendant were represented by the district attorney's spouse's partner or associate, or by the district attorney's spouse."

10. N.Y. State 654 shows that our analysis does not end simply because Rule 1.10(h) does not explicitly impute the conflict of interest to the spouse's entire firm. In accordance with Rule 1.7(a)(2), the inquiring sole practitioner here must ask whether a reasonable lawyer would conclude that there is a "significant risk" that the professional judgment of a lawyer in the inquirer's position (*i.e.,* married to the senior partner of the opposing law firm) would be "adversely affected by the [inquiring] lawyer's financial, business, property or other personal interests." As in N.Y. State 654, factors relevant to assessing the risk of an adverse effect on the inquiring lawyer's professional judgment include the size of the spouse's firm, the spouse's position in the firm, whether the spouse would share in fees earned from the representation, and the spouse's involvement in the representation of party opposing the inquirer.

11. Here, the firm at which the inquirer's spouse works has only five lawyers. The inquirer's spouse is the senior partner in the firm, and therefore would presumably share in the fees generated in the matter in which the inquirer is adverse counsel. Moreover, as the senior partner, the spouse may well have a supervisory role in the matter. Accordingly, a favorable result for the sole practitioner's client would most likely be an unfavorable result for her spouse. Thus, a conflict arises under Rule 1.7(a)(2). (If the sole practitioner's spouse was personally working on the case, then the sole practitioner and her spouse would be representing opposing parties, which would trigger Rule 1.10(h)—but the facts indicate that the spouse is not working on the case.)

12. Because there is a conflict under Rule 1.7(a)(2), the sole practitioner may represent her minor client only if she complies with Rule 1.7(b). Specifically, the sole practitioner may represent the minor client only if she reasonably believes that she can provide competent and diligent representation and her client gives informed consent, confirmed in writing. See Rule 1.7(b)(1) and (4). (Another condition, set out in Rule 1.7(b)(2), is that the representation is not prohibited by law. That condition explicitly turns on a question of law on which we have no authority to offer an opinion, but we will assume for purposes of this opinion that the condition is met because very few representations are prohibited by law.)

13. To ensure that the client's consent under Rule 1.7(b)(4) is "informed," the inquirer must adequately explain to her client "the material risks of the proposed course of conduct and reasonably available alternatives." Rule 1.0(j) (defining "informed consent"). Comment [11] to Rule 1.7 suggests some of the material risks when closely related lawyers are representing opposing clients in the same matter. Even though the inquiring lawyer and the spouse are not both representing clients in the same matter, we think

the concerns in Comment [11] apply. Comment [11] provides, in relevant part, as follows:

> When lawyers representing different clients in the same matter or in substantially related matters are closely related, there may be a significant risk that client confidences will be revealed and that the lawyer's family relationship will interfere with both loyalty and professional judgment. As a result, each client is entitled to know of the existence and implications of the relationship between the lawyers, before the lawyer agrees to undertake the representation. …

14. We assume that the lawyer in the spouse's firm who is representing the opposing party is aware of this entire situation *(i.e.,* knows that the senior partner is married to the sole practitioner). Therefore, the lawyer in the spouse's firm who is representing the opposing party has a mirror-image conflict under Rule 1.7(a)(2). Because the sole practitioner's spouse is a senior partner in that lawyer's firm, a reasonable lawyer would conclude that there is a significant risk of an adverse effect on the lawyer's professional judgment. For example, the sole practitioner's spouse may not want the lawyer opposing her to be too aggressive against the sole practitioner, or may want the sole practitioner to win a large money judgment and a corresponding large fee to add to the family coffers. Many different scenarios are possible. Thus, a conflict arises under Rule 1.7(a)(2), and Rule 1.7(b)(1) and (b)(4) require that the lawyer opposing the sole practitioner's client must take appropriate action to deal with his conflict of interest. Specifically, the lawyer in the spouse's firm may not undertake or continue to represent the opposing party here unless he reasonably believes that he can competently and diligently represent the interests of his client and, if so, the client gives informed consent, confirmed in writing.

C. May a minor consent to a conflict?

15. The requirement that the sole practitioner obtain her minor client's informed consent raises the issue of whether a minor acting alone can give informed consent. This issue has been addressed in a number of opinions. In three opinions decided under the old Code of Professional Responsibility—N.Y. State 256 (1972), N.Y. State 274 (1972), and N.Y. State 790 n.4 (2005)—this Committee determined that a minor by himself or herself could not consent to a conflict. Nothing in the Rules of Professional Conduct changes this conclusion.

16. However, those opinions did not address the ability of a *representative* of a minor (such as a parent, guardian *ad litem,* custodian, guardian, committee, trustee or court) to give the necessary consent. The ability of a minor's representative raises questions of law beyond the jurisdiction of the Committee to decide. *See, e.g*. General Obligations Law §2-102 (defining the term "minor") and §§3-101 *et seq*. (addressing the effect of status as a minor). Other provisions relating to minors are found in the Penal Law, Family Court Act, Surrogate's Court Procedure Act, Social Service Law, Estate, Powers and Trusts Law and Domestic Relations Law. The sole practitioner should examine those sources.

D. Do the shared office facilities create a conflict?

17. Independent of the spousal relationship between the lawyers, there is also a question whether the sole practitioner's occasional use of the conference room and telephone lines in her spouse's firm means that they are deemed to be in the same "firm" for purposes of the Rules. In N.Y. State 715 (1999), which addressed temporary lawyers, we said: that "lawyers who share office space but are not in the same firm have been deemed to be 'associated' in a firm for purposes of the conflicts rules and vicarious disqualification rules." *See also* Rule 1.0, cmt. [2] (stating that whether two lawyers constitute a "firm" will "depend on the specific facts," and giving some examples). If the inquirer's use of the spouse's office facilities makes the inquirer "associated in" the same "firm" as the spouse within the meaning of Rules 1.0(h) and 1.10(a), then the sole practitioner would be disqualified from representing the minor to the same extent as a partner or associate in the spouse's firm. *See* N.Y. State 437 (1976); N.Y. State 609 (1990).

18. Based upon the facts in the instant matter, however, we do not believe that the sole practitioner's occasional use of the spouse's conference room and telephones rises to the level of at which the sole practitioner is "associated in" her spouse's firm for conflicts purposes (but that could change if the office sharing relationship expands or becomes more than occasional). *See* N.Y. State 609 (1990).

19. Nevertheless, the office sharing arrangement is relevant to another aspect of conflict of interest analysis. As we have noted above, the sole practitioner has a conflict of interest under Rule 1.7(a)(2) because the opposing counsel works at

her spouse's firm, so she must obtain informed consent under Rule 1.7(b)(4) before agreeing to represent the minor client. As part of obtaining informed consent, the sole practitioner should disclose to her minor client (or the minor client's representative) the facts regarding her occasional use of the office facilities at the opposing firm. Those facts—including the risks to the client's confidential information—are part of the "information adequate for the person to make an informed decision" as to whether to retain or continue using the lawyer, and part of an adequate explanation of "the material risks of the proposed course of conduct and reasonably available alternatives," both of which are elements in the definition of "informed consent." *See* Rule 1.0(j) (defining "informed consent"). Needless to say, the sole practitioner should also take every reasonable measure to protect her client's confidences when using the conference room or telephone lines at her spouse's firm. *Cf.* Rule 1.6(c) (requiring lawyer to "exercise reasonable care" to prevent others from disclosing a client's confidential information except as permitted by Rule 1.6).

20. Since we conclude that the sole practitioner and her spouse are not part of the same "firm" based on the sole practitioner's occasion use of her spouse's office facilities, we need not decide whether the sole practitioner and her spouse's firm would have a conflict of interest under Rule 1.7(b)(3), which provides that a conflict is waivable only if "the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal."

Conclusion

21. Absent informed consent, confirmed in writing, a lawyer may not represent a client in a matter in which the opposing party is represented by a lawyer in a five-lawyer law firm where her spouse is the senior partner. The lawyer in her spouse's firm who is representing the opposing party may also have a conflict, which would be imputed to all lawyers in the spouse's firm unless it can be and is cured by informed consent, confirmed in writing.

(25-10a)

Ethics Opinion 896

Committee on Professional Ethics of the New York State Bar Association (12/12/11)

Topic: Providing lien search services to clients.

Digest: A law firm may subcontract lien search work to a third party but may not bill the client more than the costs incurred by the law firm. A law firm may provide lien search services to a client through the law firm's own employees, but if the lien search services are "not distinct" from the legal services, then the law firm must comply with the Rules of Professional Conduct regarding both the legal and nonlegal services. A law firm may provide lien searches to a client through a lien search firm affiliated with the law firm, but the law firm must comply with the Rules regarding both the legal and nonlegal services unless the law firm has advised its client in writing that the services are not legal services and lack the protection of a client-lawyer relationship. Even then, the law firm must comply with Rule 1.7 because the law firm's financial interest in providing the nonlegal services through an affiliated entity creates a conflict.

Rules: 1.5(d), 1.7(a)-(b), 1.8(a), and 5.7(a)-(b)

Background

1. This opinion concerns lien search services. Lien searches are used to determine whether a title owner's interest in property is encumbered, to what extent it is encumbered, and—in the case of multiple encumbrances—the priority of the encumbrances. For example, a mortgage lender will conduct a lien search of real property records to determine if there are outstanding senior mortgage liens, tax liens, mechanic's liens or judgment liens affecting the property. A judgment creditor will conduct a UCC lien search to determine if personal property owned by the judgment debtor has been pledged to secured creditors who will have priority in the collateral. A car dealer will conduct a lien search of the Department of Motor Vehicles to assure that his new car customer has paid off the loan on the trade-in vehicle.

2. A lien search is a ministerial function and does not constitute the practice of law. Lien searches thus may be performed by nonlawyers. Lien search companies, like title abstract companies, examine the public record to identify encumbrances affecting real and personal property and provide their search results to lenders, title insurance companies, judgment creditors, and other interested parties. Lien search companies do not sell insurance.

3. Some lawyers and law firms undertake to perform lien searches for clients through their own employees, without engaging a third party lien search firm. Other law firms contract with a third party to perform lien searches. Sometimes the third party is independent of the law firm, but other times the third party is owned by or is otherwise affiliated with the law firm. Law firms that contract for third parties to perform lien searches sometimes pay the third party and then bill the client for those services, and other times instruct the third party to bill the client directly.

Questions

4. This opinion addresses three related questions:

   A. May a law firm subcontract lien search work to an unaffiliated third party and bill the client more than the law firm pays the third party for those services?

   B. May a law firm provide lien search services to a client through the law firm's own employees and bill the client for such services?

   C. May a law firm provide lien searches to a client through a lien search company owned in whole or in part by lawyers in the law firm, and bill the client for such services?

Opinion

Question A: Providing Lien Searches Through an Independent Third Party

5. A law firm may subcontract with an independent (*i.e.*, unaffiliated) third party to perform lien searches, and may bill clients for the cost of such services. However, a law firm may not pass on the expense of a third party lien search to clients under the pretense that the law firm itself performed the services. The law firm must accurately disclose both the fact that third party provided the services and the terms under which such services were provided.

6. Further, a law firm may not charge the client more than the third party search firm's charges

unless the law firm incurs additional costs. Rule 1.5 of the New York Rules of Professional Conduct (the "Rules") addresses fees and expenses charged by lawyers. Rule 1.5(b) requires a lawyer to communicate to a client the scope of the representation and the basis or rate of the fees and expenses for which the client will be responsible. Rule 1.5(d)(3) provides that a lawyer "shall not enter into an arrangement for, charge or collect … a fee based on fraudulent billing." Comment [1A] to Rule 1.5 says that billing is fraudulent if it is "knowingly and intentionally based on false or inaccurate information." Comment [1A] also says that "where the client has agreed to pay the lawyer's cost of in-house services, such as for photocopying or telephone calls, it would be fraudulent knowingly and intentionally to charge a client more than the actual costs incurred." *Accord*, ABA 93-379 (1993) ("A lawyer may not charge a client more than her disbursements for services provided by third parties like court reporters, travel agents or expert witnesses, except to the extent that the lawyer incurs costs additional to the direct cost of the third-party services").

Question B: Providing Lien Searches Through the Law Firm's Own Employees

7. If the law firm itself provides lien search services through its own employees, the applicable rule is Rule 5.7 ("Responsibilities Regarding Nonlegal Services"), which covers a law firm's provision of both legal and nonlegal services. Rule 5.7(a) provides, in pertinent part:

> (1) A lawyer or law firm that provides nonlegal services to a person that are ***not distinct*** from legal services being provided to that person by the lawyer or law firm is subject to these Rules with respect to the provision of both legal and nonlegal services. [Emphasis added.]

8. Thus, if the legal and nonlegal services provided by the law firm are "not distinct" from each other—as when a law firm renders both legal services and lien search services related to the same transaction—the Rules of Professional Conduct apply both to the legal services and the nonlegal services. For example, the mandates of Rule 1.5 with respect to fees (see above), as well as the mandates of Rules 1.7 and 1.8 covering conflicts of interest, apply both to the legal services and the lien search services when those services are not distinct from each other.

9. Regarding conflicts, Comment [5] to Rule 5.7 notes that "the lawyer may have a financial interest in the nonlegal services that would constitute a conflict of interest under Rule 1.7(a)(2), which governs conflicts between a client and a lawyer's personal interests." In addition, Comment [5A] to Rule 5.7 notes that if the legal representation involves exercising judgment about whether to recommend nonlegal services and which provider to recommend, or if the representation involves overseeing the provision of the nonlegal services, then a conflict with the lawyer's own interests under Rule 1.7(a)(2) is likely to arise on that ground as well.

10. Under Rule 1.7(a)(2), a lawyer may not represent a client if "a reasonable lawyer would conclude that…there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property, or other personal interests" unless the lawyer complies with Rule 1.7(b). To comply with Rule 1.7(b), the lawyer must reasonably believe that the lawyer can provide competent and diligent legal representation despite the conflict, and the lawyer must obtain the client's informed consent, confirmed in writing. In obtaining the client's informed consent under Rule 1.7(b), the lawyer should disclose the advantages and risks of obtaining legal and nonlegal services from the same provider in a matter, including the effect of the lawyer's financial interest in providing the nonlegal services. For example, if the payment of legal fees is contingent upon closing the transaction, the lawyer may have an incentive not to perform an exhaustive lien search or not to reveal information that might prevent the closing from occurring.

11. A lawyer or law firm providing both legal and lien search services in the same matter must also comply with Rule 1.8(a), which governs business transactions between lawyers and their clients. See Rule 5.7, cmt. [5A]. As Comment [6] to Rule 5.7 explains, when a law firm provides both legal and nonlegal services to a client in the same matter (or in substantially related matters), Rule 1.8(a) requires that: (i) the nonlegal services be provided on terms that are "fair and reasonable" to the client, (ii) the terms on which the nonlegal services will be provided are fully disclosed to the client in writing in understandable form, (iii) the client is advised to seek the advice of independent counsel about the lawyer's provision of the nonlegal services,

and (iv) the client gives informed consent, in a writing signed by the client, to the terms of the transaction in which the nonlegal services are provided and to the lawyer's inherent conflict of interest. If the lawyer provides nonlegal services on terms generally available to the public in the marketplace, Rule 1.8(a)'s "fair and reasonable" requirement is ordinarily met. But if the lawyer charges above-market prices for the nonlegal services, then the "fair and reasonable" requirement of Rule 1.8(a) might not be met. In addition, Comment [7] to Rule 5.7 notes that "in the context of providing legal and nonlegal services in the same transaction, Rule 1.8(a) requires a full disclosure of the nature and extent of the lawyer's financial interest or stake in the provision of the nonlegal services."

Question C: Providing Lien Searches Through an Affiliated Third Party

12. When a lawyer or law firm refers a client to a company owned in whole or in part by the lawyer or law firm, Rule 5.7(a)(3) and (4) are relevant. They provide as follows:

> (3) A lawyer or law firm that is an owner, controlling party or agent of, or that is otherwise affiliated with, an entity that the lawyer or law firm knows to be providing nonlegal services to a person is subject to these Rules with respect to the nonlegal services if the person receiving the services could reasonably believe that the nonlegal services are the subject of a client-lawyer relationship.
>
> (4) For purposes of paragraphs (a)(2) and (a)(3), it will be 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, or if the interest of the lawyer or law firm in the entity providing nonlegal services is *de minimis*.

13. Thus, Rule 5.7(a)(3) provides that the law firm is subject to the Rules with respect to the lien search services if the person receiving those services could reasonably believe he or she is the subject of a client-lawyer relationship. If the law firm's interest in the affiliated entity is more than *de minimis*, Rule 5.7(a)(4) establishes a presumption that the person receiving nonlegal services believes the services to be the subject of a client-lawyer relationship *unless* the law firm advises the client in writing that the services are not legal services and lack the protection of an attorney-client relationship. Even if the law firm has informed the client in writing that the lien search services are not subject to the Rules of Professional Conduct and lack the protection of an attorney-client relationship, Rule 5.7(b) reminds the affiliated law firm not to allow the nonlegal entity to undermine the lawyer's independent professional judgment and not to compromise the lawyer's own duty of confidentiality. Rule 5.7(b) states:

> Notwithstanding the provisions of paragraph (a), a lawyer or law firm that is an owner, controlling party, agent, or is otherwise affiliated with an entity that the lawyer or law firm knows is providing nonlegal services to a person shall not permit any nonlawyer providing such services or affiliated with that entity to direct or regulate the professional judgment of the lawyer or law firm in rendering legal services to any person, or to cause the lawyer or law firm to compromise its duty under Rule 1.6(a) and Rule 1.6(c) with respect to the confidential information of a client receiving legal services.

14. Providing lien search services to a client through a lien search company owned in whole or in part by the law firm or by lawyers in the firm also raises the same conflict of interest concerns under Rule 1.7(a)(2) that we discussed above in answering Question B. However, if the lawyer or law firm has advised the client in writing pursuant to Rule 5.7(a)(4) that the lien search services are not legal services and lack the protection of an attorney-client relationship, then referring a client to a lien search company wholly or partly owned by the lawyer or law firm does not constitute a business transaction with a client and Rule 1.8(a) does not apply. *See* N.Y. State 755 (2002) ("A lawyer owning or operating a separately incorporated or distinct non-legal business who adequately informs the client that the non-legal business is not subject to the pro-

tections of the attorney-client relationship…may refer clients to the non-legal business without complying with" the rule governing business transactions between lawyer and client).

Conclusion

15. A law firm may subcontract lien search work to a third party but may not bill the client more than the law firm pays the third party for those services, except to the extent that the law firm incurs additional costs.

16. A law firm may provide lien search services to a client through the law firm's own employees, but if the lien search services are "not distinct" from the legal services the law firm is providing to the client, then the law firm must comply with the Rules of Professional Conduct—including Rule 1.5 (governing fees and expenses), Rule 1.7 (governing conflict of interest), and Rule 1.8(a) (governing business transactions with clients)—with respect to both the legal and non-legal services.

17. A law firm may provide lien searches to a client through a lien search firm owned in whole or in part by the law firm or its lawyers, and bill the client at cost for such services, but the law firm must comply with the Rules of Professional Conduct with respect to both the legal and non-legal services unless the law firm has advised the client in writing that the lien search services are not legal services and that the protection of a client-lawyer relationship does not exist with respect to the lien search services. Even then, the law firm must obtain the client's informed consent pursuant to Rule 1.7(b) because the law firm's financial interest in providing the nonlegal services through an affiliated entity creates a personal conflict of interest.

(41-10)

Ethics Opinion 897

Committee on Professional Ethics of the New York State Bar Association (12/13/11)

Topic: Marketing of legal services by use of a "deal of the day" or "group coupon" website.

Digest: Lawyer may market legal services on a "deal of the day" or "group coupon" website provided that the advertising is not misleading or deceptive and makes clear that no lawyer-client relationship will be formed until the lawyer can check for conflicts and competence to provide the services. If the lawyer is unable to provide the offered service due to a conflict or competence issue, the lawyer must give the coupon buyer a full refund. If the coupon buyer terminates the representation, the buyer is entitled to a refund subject to the lawyer's *quantum meruit* claim.

Rules: 1.1, 1.5, 1.10(e), 1.16(e), 7.1, 7.2(a), 7.3

Facts

1. A number of websites offer subscribers a "deal of the day" or "group coupon" which enables the subscribers to purchase specified goods or services at a discount. For example, such a website might invite consumers to purchase a coupon which can later be exchanged for a described good or service, such as a spa treatment or a restaurant meal. The consumer buys the coupon from the website for an amount which can be significantly less than the regular price for the item in question.

2. The website negotiates the discount with participating vendors, who agree to provide the described good or service in exchange for the coupon or voucher which was purchased at a discount price. The coupon offer may involve a number of conditions or restrictions. Many times the offer is valid only if a certain minimum number of subscribers buy the coupon. Generally the coupon is valid for a specified limited time period after which it expires and is of no further value.

3. The website collects the cost of the coupon via credit card from the consumers who purchase it. Upon the close of the "deal of the day," the website deducts a percentage of the gross receipts as its compensation and pays the balance to the participating vendor.

Question

4. May an attorney market legal services by participating in a "daily deal" or "group coupon" website?

Opinion

5. A recent ethics opinion from South Carolina approves of lawyers' use of such websites, subject to various limitations and conditions. *See* South Carolina Opinion 11-05.

6. Although not all legal services are suited to this kind of discount marketing, at least some might be. For example, a participating lawyer might offer the preparation of a simple will, for which the lawyer normally charges $500, for $250.[1] Indeed, a lawyer could permissibly publish an equivalent discount coupon advertisement in the newspaper, *see* N.Y. State 563 (1984), subject to the rules governing advertising.[2]

7. The use of such a website as a means of marketing legal services raises a number of issues. These include:

   A. Whether the arrangement is an improper payment for a referral, Rule 7.2(a);

   B. Whether the amount received by the lawyer could, under certain circumstances, result in a prohibited excessive fee, Rule 1.5;

   C. Whether any statements made by or on behalf of the lawyer are false or misleading or otherwise violative of the rules regarding lawyer advertising, Rule 7.1; and

   D. Whether the logistical arrangement of payment in advance for a legal service, before the lawyer has had the opportunity to check for conflicts or determine whether the lawyer is competent to perform the service and whether the client needs the service, constitutes a premature and improper formation of a lawyer-client relationship, Rule 1.1, Rule 1.10(e).

Is the money retained by the website an improper payment for a referral?

8. Rule 7.2(a) provides: "A lawyer shall not compensate or give anything of value to a person or

organization to recommend or obtain employment by a client, or as a reward for having made a recommendation resulting in employment by a client," with two exceptions that do not apply here.

9. Comment 1 to Rule 7.2 notes that Rule 7.2(a) "does not prohibit a lawyer from paying for advertising and communications permitted by these Rules...."

10. The question then arises whether the money retained by the website is merely an appropriate payment for a novel form of advertising or is a compensation for the referral of a client.

11. South Carolina Op. 11-05 concluded that the money retained by the website was the payment for "the reasonable cost of advertisements."

12. We note that the website has no individual contact with the coupon buyers other than collecting the cost of the coupon. The website has not taken any action to refer a potential client to a particular lawyer—instead it has carried a particular lawyer's advertising message to interested consumers and has charged a fee for that service.

13. We are not privy to the percentage amount retained by these various websites, but assuming that it is a reasonable payment for this form of advertising, we conclude that there is no violation of Rule 7.2.[3] This conclusion rests on the facts and assumptions stated here. Different arrangements between the lawyer and the website could lead to the opposite conclusion, i.e., that the lawyer is paying for a referral in violation of Rule 7.2.

Excessive Fee

14. Some coupon buyers may not, for various reasons, receive all or any of the legal services to which the coupons entitle them. Rule 1.5 prohibits excessive legal fees as an ethical matter, and fee arrangements are also subject to other rules as a matter of law. Applying these rules requires consideration of the various reasons that the legal services may not be delivered.

15. As described above, the lawyer's portion of the gross amount of the website's coupon sales receipts is paid to the lawyer shortly after the offer closes and before the individual buyers receive services. In some cases, when the buyer comes to receive the service, the lawyer may determine that he or she is unable to render the described services, either because of a conflict of interest or because the lawyer is not able to deliver competent services that are appropriate for the client. In such a case, the lawyer cannot provide what the coupon buyer purchased, and must give the buyer a full refund.[4]

16. In other cases, the coupon buyer, having changed his or her mind about going forward with the representation, may discharge the lawyer. If that occurs, rules of ethics and law require the lawyer to give a full refund, subject to any *quantum meruit* claim for services rendered prior to the termination of the representation. *See* Rule 1.16(e) (providing that upon termination of representation, lawyer must promptly refund any part of a fee paid in advance that has not been earned); N.Y. State 599 (1989) (citing case law for proposition that a client "may always discharge his attorney, with or without cause, and in the absence of a contract providing otherwise an attorney discharged without cause is entitled to be compensated in quantum meruit").

17. Some buyers might purchase the coupon from the website and then never seek the discounted services from the lawyer. Other buyers might wait too long to use the coupon, which has a stated expiration date, and try to use it after that date. In either case, the lawyer is entitled to treat the advance payment received as an earned retainer for being available to perform the offered service in the given time frame.

Compliance With Rules Regulating Advertising

18. Like all lawyer advertising, the "daily deal" advertisement must not be false, deceptive or misleading, Rule 7.1(a)(1). The lawyer must comply with Rule 7.1(j), requiring the availability to the public of a written statement describing the scope of the service advertised for a fixed fee. Having offered a particular service for a fixed fee, the lawyer must provide the service for the advertised fee if the coupon purchaser seeks that service within the specified time frame, Rule 1.7(*l*). The offered discount must not be illusory, but must represent an actual discount from an established fee for the named service. Otherwise the advertisement would be misleading. *See* N.Y. State 563 at n. 2. The advertisement must include the words "Attorney Advertising" on the web page and in the subject line of any related email, as required by Rule 7.1(f). If the specific language of the advertisement makes it "targeted," then the advertisement is a solicitation and must comply with Rule 7.3 as well.

Premature and Improper Formation of Lawyer-Client Relationship

19. Purchase of the coupon entitles the consumer to the described legal service. The danger is that the arrangement could be taken to establish a lawyer-client relationship before the lawyer has had any opportunity to check for conflicts, determine whether the described legal services are appropriate for the consumer, and whether the lawyer is competent to provide those services.

20. South Carolina Ethics Advisory Opinion 11-05 confronted this issue and concluded that the problem could be avoided with proper logistical arrangements and disclosures. We agree.

21. To avoid the premature and improper formation of a lawyer-client relationship, the lawyer's advertisement on a "deal of the day" website must make clear that the offer made on the website is subject to a number of conditions. These would include that before such a relationship is formed, the lawyer will check for conflicts and determine that the lawyer is competent to provide legal services that are appropriate to the consumer. If the lawyer determines that the lawyer-client relationship is untenable for these reasons, the lawyer must give the coupon buyer a full refund. This arrangement should be disclosed as part of the coupon offer on the website, along with any other information needed to avoid making the offer misleading in any way.

22. If the lawyer-client relationship is formed, the lawyer must promptly describe the scope of the services to be performed and the fee arrangement as required by Rule 1.5(b).

Conclusion

23. A lawyer may properly market legal services on a "deal of the day" or "group coupon" website, provided that the advertisement is not false, deceptive or misleading, and that the advertisement clearly discloses that a lawyer-client relationship will not be created until after the lawyer has checked for conflicts and determined whether the lawyer is competent to perform a service appropriate to the client. If the offered service cannot be performed due to conflicts or competence reasons, the lawyer must give the coupon buyer a full refund. The website advertisement must comply with all of the Rules governing attorney advertising, and if the advertisement is targeted, it must also comply with Rule 7.3 regarding solicitation.

Endnotes

1. It has long been established that a lawyer may properly offer a particular legal service at a specified price, so long as the lawyer actually performs the service for that price. *Bates v. State Bar of Arizona*, 433 U.S. 350 at 372-73, 378-79 (1977).
2. For example, N.Y. State 563 makes clear that an offer of a discount from a customary fee would be misleading if the customary fee were not "readily ascertainable."
3. A useful comparison might be to an arrangement where the lawyer publishes an advertisement on, for example, a directory website. Clicking on the ad follows a link to the lawyer's website. Instead of paying a flat fee for the placement of the ad, the website's compensation (and the lawyer's cost of advertising) is determined by how many times the lawyer's ad is clicked. In this arrangement the lawyer is still paying the cost of advertising, but the calculation of the cost is different from the traditional arrangement customary in newspaper or television advertising.
4. In reaching this conclusion we have assumed that the original advertisement on the website did not include any contrary provision regarding refunds.

(26-11)

Ethics Opinion 898

Committee on Professional Ethics of the New York State Bar Association (12/19/11)

Topic: Legal advice to unrepresented person.

Digest: A lawyer does not give legal advice to an unrepresented person in violation of Rule 4.3 merely by including in a letter a legally mandated notice regarding expiration of the statute of limitations on the subject claim.

Rules: Rule 4.3

Background

1. The debt collection industry, including law firms engaged in the collection of consumer debt, have come under greater regulation and scrutiny since Congress enacted the Fair Debt Collection Practices Act ("FDCPA"), 15 U.S.C. §§ 1692 *et seq*., in 1978. Many states and various local legislative bodies have followed with legislation modeled upon the FDCPA and, in certain instances, have expanded the obligations imposed upon collection law firms. In particular, the New York City Council has added obligations upon lawyers engaged in the collection of consumer debt within New York City. In this opinion we address New York City's requirement that lawyers who correspond with an alleged consumer debtor regarding a debt that is beyond the statute of limitations must include a notice that the legal time limit for suing upon the debt has expired.

2. New York City Administrative Code Section 20-490 requires every "debt collection agency" that deals with the consumer public to be licensed by the New York City Department of Consumer Affairs. Under Code Section 20-489(a), a lawyer comes within the definition of a debt collection agency if the lawyer "regularly engages in activities traditionally performed by debt collectors, including, but not limited to, contacting a debtor through the mail or via telephone with the purpose of collecting a debt."

3. Section 20-493.2(b) provides that a debt collection agency shall not "[c]ontact a consumer about or seek to collect a debt on which the statute of limitations for initiating legal action has expired unless such agency first provides the consumer such information about the consumer's legal rights as the [Commissioner of Consumer Affairs] prescribes by rule." The Commissioner has promulgated a rule providing that a debt collection agency (which, as seen above, may include a lawyer) is required to include the following statement in a communication when the agency is seeking to collect upon a debt beyond the statute of limitations:

> WE ARE REQUIRED BY LAW TO GIVE YOU THE FOLLOWING INFORMATION ABOUT THIS DEBT. The legal time limit (statute of limitations) for suing you to collect this debt has expired. However, if somebody sues you anyway to try to make you pay this debt, court rules REQUIRE YOU to tell the court that the statute of limitations has expired to prevent the creditor from obtaining a judgment. Even though the statute of limitations has expired, you may CHOOSE to make payments. However, BE AWARE: if you make a payment, the creditor's right to sue you to make you pay the entire debt may START AGAIN.

6 R.C.N.Y. § 2-191(a) (emphasis in original). If a lawyer were ethically barred from giving this notice, or other mandated notices,[1] it could impede the lawyer's ability to engage in debt collection work.

Question

4. May a lawyer ethically engage in debt collection activities in compliance with the Commissioner's rule requiring communications to include the above-quoted notice?

Opinion

5. Under the New York Rules of Professional Conduct, communications between a lawyer and a person unrepresented by counsel are governed by Rule 4.3, which in relevant part provides: "The lawyer shall not give legal advice to an unrepresented person other than the advice to secure counsel if the lawyer knows or reasonably should know that the interests of such person are or have a reasonable possibility of being in conflict with the interests of the client."

6. When a lawyer's client is a creditor seeking to collect a debt, it should be clear that the interests of the debtor "are or have a reasonable possibil-

ity of being in conflict with the interests of the client" (the creditor) within the meaning of Rule 4.3. In addition, we assume for the purposes of this opinion that the debtor is unrepresented. Accordingly, the predicates of Rule 4.3 have apparently been met, and the lawyer is prohibited from giving the debtor "legal advice" within the meaning of the Rule, other than the advice to secure counsel.

7. The term "legal advice" is not defined by the Rules. Whether a particular communication constitutes legal advice may depend not only on the words used but also on the context of their use. *See* Rule 4.3, Cmt. [2] (whether a lawyer is giving impermissible advice may depend in part on "the setting in which the behavior and comments occur"). When the broadest possible reading of the term "legal advice" would not serve the Rule's purpose, then a more common-sense reading may be appropriate.[2]

8. Taking into account the purpose of Rule 4.3 and the setting in which the mandated notice is given, we believe that merely providing that mandated notice to the debtor would not constitute giving legal advice within the meaning of the Rule.

9. The basis for the rule against giving legal advice to unrepresented parties is "the possibility that the lawyer will compromise the unrepresented person's interests." Rule 4.3, Cmt. [2]. In this case, the notice is designed not to compromise but rather to serve those interests. It is not the lawyer who has made that assessment of the debtor's interests; rather, the assessment was made in the course of a legislative and administrative process. Nor does the mandate allow the lawyer to vary the form of the notice in any way that could serve the debtor's interests less effectively. The exact words of the notice are prescribed.

10. Moreover, it is in the nature of giving legal advice that a lawyer exercises professional judgment to apply legal principles to particular facts, and to impart some particular advice rather than some other possible advice so as to help guide decisions of the recipient.[3] None of those features are present here. Far from exercising professional judgment or choosing between different possible forms of advice, the lawyer is doing no more than complying with the explicit requirements of a rule that applies to every debt collection agency. The nature of a mandated notice and the purpose of this particular notice lead us to conclude that a lawyer who gives it is not giving impermissible legal advice.[4]

Conclusion

11. A lawyer's compliance with the New York City Rule requiring a specified notice as part of a communication to collect a debt beyond the statute of limitations does not constitute giving legal advice to an unrepresented person as prohibited by Rule 4.3.

Endnotes

1. For instance, every summons issued to a defendant on a consumer debt collection case requires the summons to include specified language to the unrepresented party. The language required in the New York City Civil Court on consumer credit transactions is as follows:

   > THIS IS A COURT PAPER—A SUMMONS. DON'T THROW IT AWAY!! TALK TO A LAWYER RIGHT AWAY!! PART OF YOUR PAY MAY BE TAKEN FROM YOU (GARNISHEED). IF YOU DO NOT SEE A LAWYER, YOUR PROPERTY CAN BE TAKEN AND YOUR CREDIT RATING CAN BE HURT!! YOU MAY HAVE TO PAY OTHER COSTS TOO!! IF YOU CAN NOT PAY FOR YOUR OWN LAWYER BRING THESE PAPERS TO THIS COURT RIGHT AWAY!!

   22 NYCRR §208.6(d) (emphasis in original).
2. *See*, *e.g.*, Rule 4.3, Cmt. [2] (stating that in "negotiating the terms of a transaction or settling a dispute with an unrepresented person," if the lawyer has complied with other requirements of the Rule, the lawyer may explain "the lawyer's view of the underlying legal obligations"); N.Y. State 728 (2000) ("Although the disciplinary rule, by its terms, forbids a lawyer from giving any advice to a party whose interests conflict with those of the lawyer's client, other than the advice to secure counsel, the rule has been understood to allow a lawyer, additionally, to give certain non-controvertible information about the law to enable the other party to understand the need for independent counsel").
3. As expressed in EC 3-5 of our former Code of Professional Responsibility: "The essence of the professional judgment of the lawyer is the educated ability to relate the general body and philosophy of law to a specific legal problem of a client…."
4. *Cf.* Pennsylvania Inf. Opinion 93-139 (opining that lawyer representing a party in a divorce proceeding could ethically send an unrepresented party a letter and concurring affidavit because these materials in part reflected standard notices required by civil procedure rules, and to the extent the papers went beyond that, they constituted merely a recitation of the applicable legal principles and did not constitute legal advice).

(28-11)

Ethics Opinion 899

Committee on Professional Ethics of the New York State Bar Association (12/21/11)

Topic: Solicitation; answering legal questions on the Internet.

Digest: A lawyer may provide general answers to legal questions from laymen on real-time or interactive Internet sites such as chat rooms, but the lawyer may not engage in "solicitation" in violation of Rule 7.3. If a person initiates a request on the site to retain the lawyer, the lawyer may respond with a private written proposal outside the site so that those who did not request it cannot see it.

Rules: 1.0(a) & (c), 7.1(a), (q) & (r), 7.3(a) & (b)

Questions

1. May a lawyer answer legal questions in chat rooms or on other social media sites on the Internet?

2. If so, may the lawyer also offer his or her legal services in the course of answering questions?

Opinion

3. A lawyer asks whether he may visit real-time interactive Internet or social media sites on which individuals post legal questions and, if so, whether he may answer questions and advise individuals of his availability as a lawyer. For example, if a layperson in an Internet chat room asks how long a person can wait to sue a lawyer for legal malpractice, may the lawyer respond by saying, "The statute of limitations in New York is three years"? May the lawyer also say, "Please call me at the following number as soon as possible for a free evaluation of your case"?

General principles of advertising and solicitation by lawyers

4. Rule 7.1 of the New York Rules of Professional Conduct (the "Rules") governs attorney advertisements, and Rule 7.3 governs a special form of advertising called "solicitation." We begin our analysis with the definitions of "advertisement" and "solicitation."

5. An "advertisement" is defined under Rule 1.0(a) as "any public or private communication made by or on behalf of a lawyer or law firm about that lawyer or law firm's services, the primary purpose of which is for the retention of the lawyer or law firm. It does not include communications to existing clients or other lawyers."

6. "Solicitation" is defined in Rule 7.3(b) as follows:

> For purposes of this Rule, ''solicitation'' means any advertisement initiated by or on behalf of a lawyer or law firm that is directed to, or targeted at, a specific recipient or group of recipients, or their family members or legal representatives, the primary purpose of which is the retention of the lawyer or law firm, and a significant motive for which is pecuniary gain. It does not include a proposal or other writing prepared and delivered in response to a specific request of a prospective client.

7. Thus, Rule 7.3(a) excludes from solicitation a response in writing to a specific request of a potential client.

8. In general, Rule 7.1(a)(1) regulates the content of an advertisement by prohibiting any lawyer advertisement that "contains statements or claims that are false, deceptive or misleading." Rule 7.3(a)(1) regulates the manner of advertising by expressly prohibiting a lawyer from engaging in solicitation "by in-person or telephone contact or ***by real-time or interactive computer-accessed communication*** unless the recipient is a close friend, relative, former client or existing client.…" (Emphasis added.)

9. The term "computer-accessed communication," which is used in Rule 7.3(a)(1), is defined in Rule 1.0(c) as follows:

> "Computer-accessed communication" means any communication made by or on behalf of a lawyer or law firm that is disseminated through the use of a computer or related electronic device, including, but not limited to, web sites, weblogs, search engines, electronic mail, banner advertisements, pop-up and pop-under advertisements, chat rooms, list servers, instant messaging, or other internet presences, and any attachments or links related thereto.

10. Comment [9] to Rule 7.3 sets forth the rationale for prohibiting solicitation by in-person or telephone contact or by real-time or interactive computer-accessed communication:

> [I]n-person solicitation poses the risk that a lawyer, who is trained in the arts of advocacy and persuasion, may pressure a potential client to hire the lawyer without adequate consideration. These same risks are present in telephone contact or by real-time or interactive computer-accessed communication and are regulated in the same manner.…

11. Comment [9] also explains that "[o]rdinary email and web sites are not considered to be real-time and interactive communications," but "[i]nstant messaging, chat rooms, and other similar types of conversational computer-accessed communication are considered to be real-time or interactive communication." Thus, the lawyer must not engage in solicitation in those forums. With that background in place, we turn to the specific questions before us.

Question 1: May the lawyer answer legal questions in chat rooms?

12. The first question is whether the lawyer may answer legal questions posted by laymen in chat rooms or on other social media sites on the Internet. Answering questions on the Internet is analogous to writing for publication on legal topics. As set forth in Rule 7.1(r), a lawyer may write for publication on legal topics without affecting the right to accept employment, as long as the lawyer does not undertake to give individual advice.[1] Comment [9] to Rule 7.1 echoes Rule 7.1(r) by cautioning that, in the course of educating members of the public to recognize their legal problems a lawyer "should carefully refrain from giving or appearing to give a general solution applicable to all apparently similar individual problems, because slight changes in fact situations may require a material variance in the applicable advice; otherwise, the public may be misled and misadvised." Comment [9] adds that talks and writings by a lawyer aimed at the public "should caution them not to attempt to solve individual problems" on the basis of the information conveyed by the lawyer. A lawyer who adheres to those guidelines may answer legal questions posted by laymen on the Internet.

13. Comment [9] to Rule 7.1 also says that lawyers "should encourage and participate in educational and public relations programs concerning the legal system, with particular reference to legal problems that frequently arise." A lawyer's participation in an educational program "is ordinarily not considered to be advertising because its primary purpose is to educate and inform rather than to attract clients." If a communication is not advertising, then it also cannot be solicitation—see Rule 7.3, cmt. [1]. But Comment [9] to Rule 7.1 also notes that an educational program "might be considered advertising if, in addition to its educational component, participants or recipients are expressly encouraged to hire the lawyer or law firm." In that case, the communications would have to comply with Rules 7.1 and 7.3. *See, e.g.,* N.Y. State 830 (2009) (a lawyer may ethically contact lay organizations to inform them that he or she is available to speak on legal topics, but "must adhere to advertising and solicitation requirements under the Rules where the communication is made expressly to encourage participants to retain the lawyer or law firm"). We therefore turn to Question 2.

Question 2: May the lawyer offer his or her legal services in chat rooms?

14. The second question is whether the lawyer may offer his or her legal services in the course of answering legal questions on the Internet. As already noted, Rule 7.3(a) prohibits solicitation in chat rooms and other similar types of conversational computer-accessed sites because they are considered to be "real-time" or "interactive" communications. However, the definition of "solicitation" in Rule 7.3(b) expressly excludes "a proposal or other writing prepared and delivered in responds to a ***specific request*** of a prospective client." (Emphasis added.)

15. Standing alone, a legal question posted by a member of the public on real-time interactive Internet or social media sites cannot be construed as a "specific request" to retain the lawyer. Thus, encouraging a layperson to retain the lawyer in response to such a question is prohibited by Rule 7.3(a)(1). On the other hand, if a lawyer's primary purpose in answering a question is not to encourage his own retention but rather is to educate the public by providing general answers to legal questions, then Rule 7.3(a)(l) does not prohibit the lawyer's responses.

16. Moreover, Rule 7.1(q) generally allows a lawyer to accept employment resulting from educational activities. Rule 7.1(q) provides as follows:

> (q) A lawyer may accept employment that results from participation in activities designed to educate the public to recognize legal problems, to make intelligent selection of counsel or to utilize available legal services.

17. Thus, if a potential client initiates a specific request to retain the lawyer during the course of permissible real-time cyberspace communications, then the lawyer's response to that person does not constitute impermissible solicitation. Yet because the lawyer's response in a chat room or interactive social media site would constitute a solicitation to everyone on the site who did not specifically request the lawyer's services, the lawyer may not post a response that encourages everyone on the site to retain the lawyer. Therefore, if the person making the request includes contact information, the lawyer may respond only to that person.

18. If the person making the request does not include contact information, however, then the lawyer's response must be in two stages. The first stage is to ask the layperson to communicate directly with the lawyer off the site, by email, phone, or otherwise. For example, if the person whose question the lawyer answered in a chat room says, "Can you represent me in my case?" the lawyer may post a response such as, "My communications on this site are for the purpose of educating the general public about legal issues. If you are seeking an individual consultation, please visit my website at *www.jones.com*." Alternatively, the lawyer may provide an office phone number, email address, and/or mailing address, without giving any information about the lawyer's services. If the person who requested the lawyer's services then uses one of these methods to contact the lawyer directly outside the real-time or interactive site, then the lawyer will not violate the restrictions on solicitation by preparing and delivering a proposal or other writing that responds to the specific request made by that prospective client. (Because advertising includes both public and private communications for the purpose of seeking retention, these communications must comply with Rule 7.1.)

19. However, the lawyer may not post a proposal offering his or her legal services on the real-time interactive Internet or social media site, because posting that information would be a real-time and interactive computer-accessed solicitation to people who did not request it, in violation of Rule 7.3(a)(1).

20. This Committee cannot answer questions of law. Accordingly, we cannot determine whether private responses to a layperson's specific request on a real-time or interactive computer-accessed site would violate § 479 of the New York Judiciary Law, which prohibits solicitation by attorneys. Nor can we determine whether § 479 or the Rules regulating advertising and solicitation are constitutional in light of *Bates v. State Bar of Arizona*, 433 U.S. 350 (1977), and its progeny.

Conclusion

21. A lawyer may provide general answers (not individual advice) in response to legal questions from laypersons on real-time or interactive social sites on the Internet, but the lawyer may not engage in "solicitation" absent compliance with Rule 7.3. If a person initiates a request on the site to retain the lawyer, the lawyer may respond with a private written proposal outside the site so that persons who did not request the proposal cannot see it.

Endnote

1. We add that a lawyer who gives individual advice in a chat room or on a public social media site might also be establishing an attorney-client relationship without undertaking the conflict check required by Rule 1.10(e) and would be revealing privileged legal advice in a public place in violation of Rule 1.6(a).

(20-11)

Ethics Opinion 900

Committee on Professional Ethics of the New York State Bar Association (12/28/11)

Topic: Assistant County Attorney as mediator in Child Permanency Mediation.

Digest: An Assistant County Attorney ("ACA") may agree to serve as a paid or unpaid mediator in Child Permanency Mediations in which the County Department of Social Services ("DSS") is represented by another ACA, but the mediator should disclose and explain his connection to the County Attorney's Office. An ACA who is representing DSS in the mediation may have a personal conflict of interest, and that conflict will be imputed to all ACAs in the same office unless the conflict can be and is cured by DSS's informed consent, confirmed in writing. If the County Attorney's Office begins or continues working on a matter in which the inquiring ACA is serving or has finished serving as the mediator, then the office must timely and effectively screen the mediator and consider whether the circumstances give rise to any appearance of impropriety.

Rules: 1.0(e), (h), (j) & (*l*), 1.7(a), 1.10(a), 1.11(d), 1.12(b), (d) & (d), 2.4(a) & (b)

Facts

1. While inquiring counsel ("Inquirer") was a paid employee of a Community Dispute Resolution Program ("CDRC"), he was trained as a Permanency Mediator for the New York State Unified Court System's Child Welfare Court Improvement Project ("CIP"). Inquirer then applied to be on the roster of Permanency Mediators for a county. After Inquirer filed his application to be on the roster but before his application was accepted, Inquirer became an Assistant County Attorney ("ACA") for the County Department of Law. After Inquirer became an ACA, his application to be a Permanency Mediator was accepted and he is now on the roster in the same county where he serves as an ACA.

2. Inquirer's inquiry states, by way of background, that (a) mediators must disclose to all mediation participants any relationship to any party that may impact the mediator's appearance of neutrality, and (b) if any participant objects to a mediator on such grounds, the mediator will not facilitate the case. Inquirer does not cite authority for these assertions, but we will accept them as true for purposes of this opinion.

3. Permanency cases may be referred to mediation by various individuals, including employees of DSS. In addition, DSS employees may be parties to the mediation process. DSS itself, as an agency, always has an interest in the outcome of the permanency mediation process and may choose to be a party to a permanency mediation. Inquirer personally does not represent the county Department of Social Services in any matters in his capacity as an ACA, but another ACA does represent DSS in various matters, including permanency mediations.

4. Mediators are usually paid at the rate of $75 per hour. In some cases roster mediators are asked to mediate in the course of their employment. In that case the hourly rate is paid to the employer, with no financial benefit inuring to the mediator. However, Inquirer also mediates other cases either on a volunteer basis or in the course of Inquirer's employment with the mediation program, and neither Inquirer nor his employer is paid for such cases.

Questions

5. *Question A.* May Inquirer, who is employed as an Assistant County Attorney, ethically mediate a case, either on a paid or unpaid basis, if another Assistant County Attorney from the same county represents DSS in the mediation?

6. *Question B.* If Inquirer serves as the mediator in a matter in which another Assistant County Attorney represents the Department of Social Services, will Inquirer create a conflict of interest for the Assistant County Attorney representing DSS in the mediation and, by imputation, for other attorneys in the County Attorney's Office?

7. *Question C.* If Inquirer is currently serving as a mediator (or has completed service as a mediator) in a matter in which the County Attorney's Office represents DSS, must Inquirer be screened from other lawyers at the County Attorney's Office?

Opinion

Additional background regarding Permanency Mediation

8. The Child Welfare Court Improvement Project, a federally funded initiative, supports the New York State Family Court's mandate to promote the safety, permanence and well-being of abused and neglected children. Recognizing the integral role courts play in charting the course for children who are the subject proceedings for abuse, neglect, foster care, termination of parental rights and adoption, CIP provides resources and technical assistance to enhance and promote innovation in court operations and practices, especially alternative dispute resolution.

9. As part of the New York State Unified Court System's Community Dispute Resolution Centers Program ("CDRCP"), the Unified Court System partners with local non-profit organizations known as "CDRCs" to provide mediation, arbitration, and other dispute resolution options as an alternative to court. CDRCs serve as neutrals in (among other things) landlord/tenant disputes, consumer/merchant disputes, and—most relevant to this inquiry—Child Permanency Mediation ("CPM"). CPM mediates child protective proceedings where the Family Court has placed children in foster care due to alleged parental abuse or neglect. *See, e.g.,* Cynthia A. Savage, *Recommendations Regarding Establishment of a Mediation Clinic*, 11 Cardozo J. Conflict Resol. 511, 546 (2010). Children and families referred to CPM are usually at a stage in the Family Court proceeding when a decision must be reached about the child's permanent home. "CPM" provides a forum where parents, attorneys, social service agency staff, and other interested parties can focus on resolving problems that pose barriers to permanency for the child. It is always conducted under the auspices of a court—there is no such thing as a "private" CPM.

10. We addressed child protective proceedings in N.Y. State 800 ¶ 3 (2006), where we said: "The local child protective service investigates allegations and the county attorneys present ('prosecute') the case in the Family Court. Family offense cases by their nature pose a great risk of criminal charges being brought." DSS and the parents are thus always adverse to one another in a Family Court child protective proceeding. In John M. Zenir, *Litigating Neglect Cases in Nassau Family Court*, 60 Nassau Lawyer No. 9, at 11 (May 2011), the author stresses the adversarial nature of these proceedings, and the consequent necessity for "aggressive advocacy."

11. The parents in permanency proceedings may be represented or unrepresented.[1] In the Child Permanency Mediations contemplated here, the parents are typically either unrepresented or represented by an appointed lawyer. The parents have allegedly committed abuse and/or neglect and are attempting to mediate a determination as to the permanent placement of their child. In that volatile context, Inquirer could be selected to serve as a neutral, and DSS or its employees could be represented at the mediation by an Assistant County Attorney who works in the same office as Inquirer. Against that background, we turn to Inquirer's three questions.

Question A: May Inquirer facilitate if another ACA represents DSS in the mediation?

12. The first question is whether Inquirer may ethically mediate a case, either on a paid or unpaid basis, if another Assistant County Attorney from the same county is representing DSS in the mediation. The provision in the New York Rules of Professional Conduct (the "Rules") most relevant to our analysis is Rule 2.4 ("Lawyer Serving as Third-Party Neutral"), which expressly addresses lawyers serving as mediators and other neutrals.

13. Before applying Rule 2.4, we pause briefly to consider whether Inquirer, as a lawyer in the County Attorney's Office, is deemed to represent not only the County itself but also the County's DSS. Inquirer has told us that he does not personally represent DSS in any matters, but that another ACA in the County Attorney's Office does. The identity of a government lawyer's client is a question of law—see N.Y. City 1999-6—but for purposes of this opinion, we will accept Inquirer's statement that he does not represent DSS. We will also assume that Inquirer, when acting as a mediator, will not be representing DSS (or any other client) in the mediation. Rather, he will be serving only as a third-party neutral. Rule 2.4(a) defines a "third party neutral" as one who "assists two or more persons ***who are not clients of the lawyer*** to reach a resolution of a dispute or other matter that has arisen between them." (Emphasis added.) Rule 2.4 thus specifically contemplates that lawyers serving as third-party neutrals do not represent the parties. As noted in SIMON'S NEW YORK RULES OF PROFESSIONAL CONDUCT ANNOTATED 198-199 (West 2009), Rule 2.4(a) makes clear that a "third-party neutral" is not representing the parties.[2]

14. Nothing in Rule 2.4 (or any other Rule) prohibits an ACA from serving as a mediator, whether in a Child Permanency Mediation or any other type of mediation, paid or unpaid, even though another lawyer in the County Attorney's Office represents a party. But Rule 2.4(b) does impose special obligations on lawyer/mediators. Rule 2.4(b) provides as follows:

> A lawyer serving as a third-party neutral shall inform unrepresented parties that the lawyer is not representing them. When the lawyer knows or reasonably should know that a party does not understand the lawyer's role in the matter, the lawyer shall explain the difference between the lawyer's role as a third-party neutral and a lawyer's role as one who represents a client.

15. The import of Rule 2.4(b) is examined in Comment [3] to Rule 2.4, which says:

> Unlike nonlawyers who serve as third-party neutrals, lawyers serving in this role may experience unique problems as a result of differences between the role of a third-party neutral and a lawyer's service as a client representative. The potential for confusion is significant when the parties are unrepresented in the process.… Where appropriate, the lawyer should inform unrepresented parties of the important differences between the lawyer's role as a third-party neutral and as a client representative…. The extent of disclosure required under this paragraph will depend on the particular parties involved and the subject matter of the proceeding, as well as the particular features of the dispute-resolution process selected.

16. Thus, while Rule 2.4 does not prohibit Inquirer from serving as a mediator when another ACA is participating in a Child Permanency Mediation, Rule 2.4(b) does require certain disclosures to unrepresented parties. At a minimum, Inquirer "shall inform unrepresented parties" that he "is not representing them." Further, when Inquirer knows (or reasonably should know) that a party does not understand the lawyer's role in the matter, Inquirer "shall explain the difference between the lawyer's role as a third-party neutral and a lawyer's role as one who represents a client." In nearly all instances where parents are unrepresented by counsel and inexperienced in mediation and other legal matters, Inquirer "reasonably should know" that the parents do not understand Inquirer's role, and Inquirer therefore should explain that difference.

17. In addition, if another ACA is participating in the mediation as counsel for DSS, Inquirer should disclose that (i) Inquirer is an Assistant County Attorney, (ii) another ACA from the same office will be participating in the mediation, and (iii) the parents have the right to object to Inquirer serving as facilitator. These disclosures may enable participants who object to Inquirer on those grounds to have a different mediator assigned to the case.

18. Our answer to Question A is the same whether Inquirer is a paid mediator or an unpaid mediator. Rule 2.4 makes no distinction between paid mediators and volunteer mediators. Nor would payment trigger an analysis under Rule 1.7(a)(2), which provides that a lawyer generally "shall not represent a client if a reasonable lawyer would conclude that … there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests." Rule 1.7 does not apply to Inquirer because a mediator does not "represent a client" in the mediation. As noted in Rule 2.4(a), the parties to a mediation "are not clients of the lawyer."

19. We do not know whether any court rules, mediation rules, or other guidelines outside the Rules of Professional Conduct would prohibit Inquirer from facilitating a case in which another lawyer from the County Attorney's Office represents a party or is otherwise participating in the mediation, or whether any such rules or guidelines would require more extensive disclosures by Inquirer than we have suggested. However, Comment [2] to Rule 2.4 expressly notes that a lawyer (as opposed to a nonlawyer) who serves as a third-party neutral—especially under court auspices—may be subject to rules and codes outside the Rules of Professional Conduct. Comment [2] says, in relevant part, as follows:

> [T]he lawyer may be subject to court rules or other law that applies either to third-party neutrals generally or to lawyers serving

> as third-party neutrals. Lawyer-neutrals may also be subject to various codes of ethics, such as… the Model Standards of Conduct for Mediators jointly prepared by the American Bar Association, the American Arbitration Association and the Society of Professionals in Dispute Resolution.

20. If any such rules, standards, or guidelines apply to Inquirer, we express no opinion on them because our jurisdiction is limited to interpreting the New York Rules of Professional Conduct. We therefore strongly suggest that Inquirer determine whether he is subject to any such authorities outside the Rules of Professional Conduct, that he also study the ethics codes and policies that govern the County Attorney's Office in which he works, and that he consult with the County Attorney (if he has not done so already) before agreeing to serve as a mediator in any matter.

Question B: Will Inquirer create a conflict of interest for the ACA representing DSS?

21. The second question is whether Inquirer's service as the mediator in a matter in which another Assistant County Attorney represents DSS will create a conflict of interest for the ACA representing DSS, and (by imputation) for all other ACAs in the same office. At this point, Rule 1.7(a)(2) becomes relevant—not for Inquirer (who, as in Question B, does not "represent a client") but for the ACA who represents DSS in the mediation. Rule 1.7(a)(2) applies to a lawyer representing a client if "there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests." A determination under Rule 1.7(a)(2) depends on all the facts and circumstances, but we believe that the presence of a fellow ACA as mediator will ordinarily create a "significant risk" of an adverse impact on the professional judgment of any ACA who represents DSS in that mediation. For example, the ACA representing DSS may want to please Inquirer by reaching a settlement even if the settlement is not in the best interests of DSS.

22. Furthermore, under Rule 1.10(a), the conflict of any one ACA will be imputed to all other ACAs in the same County Attorney's Office. Rule 1.10(a) provides: "While lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rule 1.7…." (The County Attorney's Office is a "firm" because Rule 1.0(h) defines "firm" to include "a government law office….") Thus, every ACA in the County Attorney's Office will typically have the same conflict, and the conflict cannot be cured by substituting one ACA for another to represent DSS in the mediation.

23. However, a conflict arising under Rule 1.7(a)(2) can usually be cured by complying with Rule 1.7(b), which provides as follows:

> (b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:
>
> (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
>
> (2) the representation is not prohibited by law;
>
> (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
>
> (4) each affected client gives informed consent, confirmed in writing.

24. Accordingly, any individual ACA who represents DSS in a mediation facilitated by Inquirer will have to determine as a threshold matter whether she "reasonably believes" that she can "provide competent and diligent representation" to DSS (a question dependent on all of the facts and circumstances of the particular mediation), and whether the representation of DSS when another ACA is serving as the mediator is "not prohibited by law" (a question beyond this Committee's jurisdiction). If the tests under Rule 1.7(b)(1) and (b)(2) are satisfied, then the ACA may proceed to represent DSS despite the conflict if the ACA obtains DSS's "informed consent" as defined in Rule 1.0(j), and that consent is "confirmed in writing" as defined in Rule 1.0(e). (Rule 1.7(b)(3) is irrelevant here because Inquirer is not representing any client, and the County Attorney's Office therefore is not representing clients on both sides of the same mediation.) If the ACA obtains the requisite informed

consent, confirmed in writing, then the conflict will be cured and will not be imputed to other ACAs under Rule 1.10(a).

25. If the ACA fails either or both tests (*i.e.*, if the ACA does not reasonably believe she can competently and diligently represent DSS and/or if the representation is prohibited by law), then the ACA cannot proceed and consent from DSS cannot cure the conflict. Moreover, the conflict will be imputed to all other ACAs in the same office. However, this scenario may never occur, because as soon as the County Attorney's Office recognizes the conflict, it is likely to object to the inquiring ACA's participation as the mediator, requiring his withdrawal. Once he withdraws as the mediator, the conflict will evaporate.

Question C: Must the County Attorney's Office screen Inquirer?

26. The third question is whether the County Attorney's Office must screen Inquirer from other ACAs in the County Attorney's Office if that office begins or continues to participate in the matter after Inquirer has begun serving as the mediator in the matter. The relevant rule is Rule 1.12 ("Specific Conflicts of Interest for Former Judges, Arbitrators, Mediators or Other Third-Party Neutrals"). Rule 1.12(b) provides as follows:

> (b) [U]nless all parties to the proceeding give informed consent, confirmed in writing, a lawyer shall not represent anyone in connection with a matter in which the lawyer ***participated personally and substantially*** as:
>
> (1) an arbitrator, ***mediator*** or other third-party neutral…. [Emphasis added.][3]

27. Plainly, Inquirer will have "participated personally and substantially as…mediator" in any matter in which Inquirer is currently serving (or has finished serving) as the sole mediator. Thus, once Inquirer has begun serving as a mediator in a particular matter, Inquirer is personally barred from working on that matter as a lawyer "unless all parties give informed consent, confirmed in writing…." If the County Attorney's Office does not seek such consent or cannot obtain it (and we doubt that any party would consent to let the current mediator work on the same matter as a lawyer for a party), then other lawyers in Inquirer's firm (the County Attorney's Office) cannot work on that matter unless Inquirer is timely and effectively screened from the matter. The screening condition derives from Rule 1.12(d), which provides as follows:

> (d) When a lawyer is disqualified from representation under this Rule, no lawyer in a firm with which that lawyer is associated may knowingly undertake or continue representation in such a matter unless:
>
> (1) the firm acts promptly and reasonably to:
>
> (i) notify, as appropriate, lawyers and nonlawyer personnel within the firm that the personally disqualified lawyer is prohibited from participating in the representation of the current client;
>
> (ii) implement effective screening procedures to prevent the flow of information about the matter between the personally disqualified lawyer and the others in the firm;
>
> (iii) ensure that the disqualified lawyer is apportioned no part of the fee therefrom; and
>
> (iv) give written notice to the parties and any appropriate tribunal to enable it to ascertain compliance with the provisions of this Rule; and
>
> (2) there are no other circumstances in the particular representation that create an appearance of impropriety.

28. The term "matter" is defined in Rule 1.0(*l*) to include "any litigation, judicial or administrative proceeding, case, claim, application, request for a ruling or other determination, contract, controversy, investigation, charge, accusation, arrest, negotiation, arbitration, ***mediation*** or any other representation involving a specific party or parties." (Emphasis added.) Thus, once Inquirer has commenced service as a mediator—whether or not the mediation is over—Inquirer must be effectively screened from any involvement with the ongoing Family Court case. Unless the County Attorney's Office effectively screens Inquirer from any participation in the Family Court matter from the moment he begins serving as the mediator in the Child Permanency

Mediation, the parties and the public have no assurance that Inquirer has not (even inadvertently) shared the parents' confidential information with other ACAs, and that lack of assurance will usually (if not always) create an "appearance of impropriety" that should preclude the County Attorney's Office from representing DSS.

29. Furthermore, unless the County Attorney's Office screens Inquirer from participation in every Family Court matter that may ultimately result in a CPM in which Inquirer may serve as the facilitator, the public and the parties will have no assurance that Inquirer will not (intentionally or inadvertently) share DSS's confidential information with the parents during the mediation. This situation, too, will usually (if not always) create an "appearance of impropriety" that should preclude the County Attorney's Office from representing DSS. We offer no opinion as to whether the so-called "rule of necessity" embodied in Rule 1.11(d)(1) would, by analogy, permit the County Attorney's Office to continue representing DSS despite this appearance of impropriety. Rule 1.11(d)(1) provides that "[e]xcept as law may otherwise expressly provide, a lawyer currently serving as a public officer or employee shall not: (1) participate in a matter in which the lawyer participated personally and substantially while in private practice or nongovernmental employment, unless ***under applicable law*** no one is, or ***by lawful delegation*** may be, authorized to act in the lawyer's stead in the matter…." (Emphasis added.) Thus, the rule of necessity presents questions of law beyond our jurisdiction. We note, however, that Rule 1.12 does not contain any equivalent rule of necessity.

Conclusion

30. An Assistant County Attorney ("ACA") may agree to serve as a paid or unpaid mediator in Child Permanency Mediations in which the County Department of Social Services ("DSS") is represented by another ACA, but when serving as a mediator the Inquirer should disclose and explain to all parties his connection to the County Attorney's Office. The ACA who is representing DSS in the mediation may have a personal conflict of interest, and that conflict will be imputed to all ACAs in the same office unless the conflict can be and is cured by DSS's informed consent, confirmed in writing. If the County Attorney's Office begins or continues working on a matter in which the inquiring ACA is serving or has finished serving as the mediator, then the office must timely and effectively screen Inquirer and must consider whether the circumstances give rise to any appearance of impropriety.

Endnotes

1. Zenir, *supra*, reports that in Nassau County Family Court, "the overwhelming majority of respondents … usually parents or other custodial parties, are represented by assigned counsel, either by attorneys employed by the Legal Aid Society of Nassau County or by 18-B Attorneys…because they are indigent." However, N.Y. City 2009-2 n. 2 cited informal surveys revealing that approximately 75% of litigants in New York City Family Court appeared without a lawyer for critical types of cases, including those involving domestic violence, child custody, guardianship, visitation, support, and paternity.
2. Under Rule 1.7(a)(1), a lawyer generally "shall not *represent a client* if a reasonable lawyer would conclude that…the representation will involve the lawyer in representing differing interests." (Emphasis added.) Rule 1.7 will not apply to Inquirer because Inquirer will not "represent a client" in the mediation.
3. Rule 1.12(e), which concerns "an arbitrator selected as a partisan of a party in a multimember arbitration panel," creates an exception to Rule 1.12(b) that makes the consent of all parties unnecessary, but a Child Permanency Mediation involves neither a "multimember" panel nor an "arbitration," so the exception in Rule 1.12(e) is irrelevant here.

[Inquiry 22-11]

Ethics Opinion 901

Committee on Professional Ethics of the New York State Bar Association (12/28/11)

Topic: Simultaneous representation of corporation and individual director, officer, or shareholder.

Digest: Simultaneously representing both a corporation and a director, officer or shareholder of that corporation can create conflicts, but if the conflicts are consentable, then the conflicts can be cured by obtaining informed consent from each affected client, confirmed in writing.

Rules: 1.0(f) & (j), 1.7(a) & (b), 1.9(a) & (c), 1.13(a), (d) & (e)

Questions

1. *Question A.* May an attorney who has in the past provided personal legal services to an individual officer, director, or shareholder of a closely held corporation in matters relating to the corporation thereafter undertake to represent the corporation?

2. *Question B.* May an attorney who currently represents a corporation also represent an officer, director, or shareholder of the corporation in matters unrelated to the corporation?

Background

3. The inquiring attorney ("Attorney") has represented a client ("Officer") over the course of a few years in various legal matters involving transactions. One representation related to Officer's interest as a minority shareholder and officer of a private, closely held corporation, X Corp. Attorney's representation of Officer's interests in X Corp included negotiations concerning Officer's employment relation with and part ownership of X Corp. Those negotiations involved both the CEO of X Corp and the attorneys retained by the CEO to represent X Corp.

4. After the negotiations involving Officer and X Corp ended, Officer informed Attorney that Officer had been discussing with X Corp's CEO the possibility of X Corp using Attorney as its attorney on future matters, in place of X Corp's previous counsel. The CEO followed up with a direct contact to Attorney to request that he represent X Corp. Officer advised Attorney of Officer's understanding that A would not be able to continue representing Officer in any future matters related to Officer's interest in X Corp if X Corp became one of A's clients. However, Officer informed Attorney that Officer would like to continue using Attorney's legal services in the future for matters unrelated to the affairs of X Corp, such as the purchase of a summer home.

Opinion

Question A: If Officer is Attorney's former client, may Attorney begin representing X Corp?

5. The facts that have been presented to us describe the past and contemplated representations of Officer and X Corp in general terms, so we cannot apply the applicable New York Rules of Professional Conduct (the "Rules") with precision. Rather, our opinion sets out general principles that Attorney should consider in evaluating whether conflicts of interest exist and whether and how any such conflicts can be cured.

6. We begin by discussing conflicts with former clients. We assume that Attorney has completed all of his legal work for Officer and that Officer is only a former client of Attorney, not a current client, at the time X Corp asks Attorney to begin representing X Corp. The rule governing conflicts of interest with former clients is Rule 1.9(a), which provides as follows:

> A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.

7. Since Attorney formerly represented Officer in negotiations with X Corp, Attorney could not represent X Corp in the same or a "substantially related" matter, without informed consent from Officer, confirmed in writing. The key term is "substantially related." When are two matters substantially related? Comment [3] to Rule 1.9 explains the concept as follows:

> [3] Matters are "substantially related"…if they involve the same transaction or legal dispute or ***if, under the circumstances, a reasonable lawyer would conclude that***

> ***there is otherwise a substantial risk that confidential factual information that would normally have been obtained in the prior representation would materially advance the client's position in the subsequent matter***. For example, a lawyer who has represented a businessperson and learned extensive private financial information about that person may not then represent that person's spouse in seeking a divorce. Similarly, a lawyer who has previously represented a client in securing environmental permits to build a shopping center would be precluded from representing neighbors seeking to oppose rezoning of the property on the basis of environmental considerations…. [Emphasis added.]

8. Attorney should test each proposed engagement for X Corp against the principles in Comment [3]. If X Corp asks Attorney to represent it in a matter that is not substantially related to Attorney's prior legal work for Officer, Attorney may ethically undertake the new matter even if X Corp's interests are "materially adverse" to Officer's interests. But if X Corp asks Attorney to represent it in a matter that is substantially related to Attorney's prior legal work for Officer and materially adverse to Officer's interests, then Attorney may not ethically undertake the new matter on behalf of X Corp without obtaining informed consent, confirmed in writing, from Officer. According to Rule 1.0(j), the term "informed consent" requires, among other things, that the lawyer adequately explain to each person "the material risks of the proposed course of conduct and reasonably available alternatives." The requirements for confirming informed consent in writing are set forth in Rule 1.0(e).

9. If Officer gives informed consent (confirmed in writing) for Attorney to represent X Corp against him in a substantially related matter, that consent does not automatically allow him to use Officer's confidential information against Officer.[1] Absent Officer's consent to use Officer's confidential information to Officer's disadvantage, Attorney must still take one more step—Attorney must determine whether he has a conflict of interest under Rule 1.7(a), either because he cannot avoid using Officer's confidential information while representing X Corp or because Attorney's possession of Officer's confidential information would adversely affect Attorney's independent professional judgment in representing X Corp. *See* N.Y. City 2005-2 (addressing conflicts arising solely from possession of confidential information of another client). If Attorney has no such confidential information, then there is no conflict under Rule 1.7(a).[2] If Attorney does have such confidential information, then Attorney must determine whether he nevertheless "reasonably believes" that he can "provide competent and diligent representation" to X Corp within the meaning of Rule 1.7(b)(1) despite his continuing duty of confidentiality to Officer under Rule 1.9(c).

10. If Attorney does reasonably believe that he can provide competent and diligent representation to X Corp despite his continuing duty of confidentiality to Officer, then Attorney must obtain X Corp's informed consent, confirmed in writing. In obtaining X Corp's informed consent, however, Attorney must not disclose Officer's confidential information that is at the root of the conflict. If Attorney cannot disclose sufficient information to obtain X Corp's informed consent, or if Attorney believes that his continuing duty of confidentiality to Officer will prevent him from providing competent and diligent representation to X Corp, then the conflict is non-consentable.

Question B: If Officer is or becomes Attorney's current client, may Attorney concurrently represent both Officer and X Corp?

11. The second question is whether Attorney may concurrently represent both Officer and X Corp. The first sentence of Rule 1.13(d)—which had no equivalent in our former Code of Professional Responsibility—specifically addresses this situation, stating: "A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7." Therefore, Rule 1.13(d) directs us to analyze the second question under Rule 1.7, which provides as follows:

> Rule 1.7. Conflict of Interest: Current Clients
>
> (a) Except as provided in paragraph (b), a lawyer shall not represent a client if a reasonable lawyer would conclude that either:
>
> (1) the representation will involve the lawyer in representing differing interests; or
>
> (2) there is a significant risk that the lawyer's professional judgment on

behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) The representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

12. The term "differing interests" in Rule 1.7(a)(1) is broadly defined in Rule 1.0(f) to include "every interest that will adversely affect either the judgment or the loyalty of a lawyer to a client, whether it be a conflicting, inconsistent, diverse, or other interest."

13. To apply Rule 1.7, we need to evaluate whether Attorney's representation of X Corp would conflict with Attorney's continuing or renewed representation of Officer by creating "differing interests" under Rule 1.7(a)(1).[3] To make that evaluation, we need to know what legal work Attorney will be doing for Officer and what legal work Attorney will be doing for X Corp. The inquiry stated that Officer understands that Attorney cannot represent Officer in any future matters related to Officer's interest in X Corp, so we will assume that Attorney will not do so.

14. As Attorney's inquiry also gave the purchase of a summer home as an example of the kinds of legal work Officer might want Attorney to perform in the future, so we will assume that Attorney is engaged in representing Officer in buying a summer home at the time X Corp asks Attorney to take on a new matter for X Corp. We will further assume that X Corp has no interest of any kind in Officer's purchase of a summer home, and that Officer's purchase of a summer home therefore does not involve the Attorney in representing "differing interests" under Rule 1.7(a)(1). With all of those assumptions in place, we will analyze several hypothetical examples to illustrate different types of matters that Attorney might be asked to undertake for the X Corp.

15. *Hypothetical # 1.* As a first hypothetical, suppose X Corp asks Attorney to represent it in the defense of a personal injury claim in which Officer is not involved and has no interests, differing or otherwise. Because there are no "differing interests" between X Corp and Officer regarding the personal injury claim, a reasonable attorney could conclude that no conflict exists. If no conflict exists, then informed consent pursuant to Rule 1.7(b)(4) is not necessary.

16. *Hypothetical # 2.* As a second hypothetical—at the opposite extreme—suppose X Corp asks Attorney to represent X Corp in a dispute directly adverse to Officer (*e.g.,* asserting a claim against Officer for usurping a corporate opportunity, or defending X Corp against a breach of contract action brought by Officer).[4] Representing X Corp in a suit by or against Officer obviously will "involve the lawyer in representing differing interests," so Rule 1.7(a)(1) prohibits Attorney from representing X Corp against Officer unless Attorney "reasonably believes" he can "provide competent and diligent representation" per Rule 1.7(b)(1) to "each affected client" (X Corp and Officer). The aim of Rule 1.7(b)(1) is to ensure that Attorney's loyalty to Officer does not impair his competence and diligence on behalf of X Corp, and that Attorney's loyalty to X Corp does not impair his competence and diligence on behalf of Officer. The "reasonably believes" test in Rule 1.7(b)(4) depends on all of the circumstances. For example, it might be easier to meet in a minor breach of contract suit than in a fraud suit. If Attorney satisfies the "reasonably believes" test, then he must obtain informed consent, confirmed in writing, from both Officer and X Corp, per to Rule 1.7(b)(4), before undertaking the representation of X Corp.[5]

17. *Hypothetical # 3.* As a third hypothetical, suppose X Corp were to ask Attorney to advise the corporation concerning its by-laws, corporate compliance manual, compensation system, management structure, or the like. Those matters would potentially affect the rights and obligations of Officer, who is a shareholder and officer of X Corp. In some situations, a reasonable lawyer could conclude that Attorney's simultaneous representation of Officer and X Corp "will involve the lawyer in representing differing interests," which would create a conflict under Rule 1.7(a)(1). For example, Attorney might be reluc-

tant to give advice to X Corp that, if followed, could adversely affect Officer's compensation or power at X Corp. Accordingly, Attorney could not undertake such a representation without obtaining informed consent, confirmed in writing, from both Officer individually and X Corp as an entity.[6]

18. Finally, whether Officer is a current client or a former client, he continues to be an officer and shareholder of X Corp. Consequently, when Attorney is acting on behalf of X Corp, Attorney should take steps to avoid any misunderstanding by Officer (or other X Corp personnel) about Attorney's role. As stated by Rule 1.13(a), when the organization's interests "may differ from those of the constituents with whom the lawyer is dealing, the lawyer shall explain that the lawyer is the lawyer for the organization and not for any of the constituents."

Conclusion

19. Simultaneously representing both a corporation and a director, officer or shareholder of that same corporation can create conflicts, but if the conflicts are consentable, then the conflicts can be cured by obtaining informed consent from each affected client, confirmed in writing.

Endnotes

1. Consent to oppose the former client in a substantially related matter would be sought under Rule 1.9(a), but consent to use the former client's confidential information to the former client's disadvantage would be sought under Rule 1.6(a), which is incorporated by reference into Rule 1.9(c). Consent under Rule 1.9(a) does not imply consent under Rule 1.9(c), and vice versa. A lawyer who desires both to oppose a former client in a substantially related matter and to use the former client's confidential information to the former client's disadvantage must obtain consent under both provisions.

2. The "substantially related" test assumes that Attorney acquired confidential information from the former client, see Rule 1.9, cmt. [3], but that assumption should not carry over to Rule 1.7(a). If Attorney did not in fact acquire any confidential information that he needs to use on X Corp's behalf against Officer, then no conflict arises under Rule 1.7(a) because Attorney's representation of X Corp against Officer will not be impaired in any way.

3. Attorney's representation of X Corp could also, in theory, create conflicts under Rule 1.7(a)(2), which prohibits a representation when a reasonable lawyer would conclude that "there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests." However, nothing in the facts suggests that such personal interest conflicts are more likely here than in any other context, so we will not address Rule 1.7(a)(2).

4. We assume that Attorney is not representing Officer against X Corp. Nor could Attorney represent Officer and X Corp against each other in the same litigation matter even if both X Corp and client Officer gave their informed consent, because such a conflict would be non-consentable. Under Rule 1.7(b)(3), a lawyer may never handle both sides of the same litigation before a tribunal. That is a *per se* conflict and cannot be cured by consent.

5. In the facts here, Officer was the one who first suggested that X Corp retain Attorney as its counsel, which implies that Officer has already give his consent (express or implied) for Attorney to represent X Corp. However, Officer's consent was not necessarily *informed* consent. Each time Attorney A considers taking on a new matter for X Corp, he needs to make sure, per Rule 1.0(j), that Officer understands the material risks, advantages, and alternatives, and give Officer the opportunity to withhold consent in light of that explanation. Alternatively, Attorney may seek an advance waiver from Officer (and from X Corp) waiving conflicts before they arise, obviating the need to obtain a waiver for each new matter—*see* Rule 1.7, cmts. [22] and [22A] (headed "Consent to Future Conflict").

6. Whenever Rule 1.7 requires X Corp's consent to a conflict between X Corp and Officer, Rule 1.13(d) demands that "the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders." Thus, someone other than Officer will have to consent on behalf of X Corp, because Officer may consent to the conflict on his own behalf but not on behalf of the corporation.

(79-09)

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