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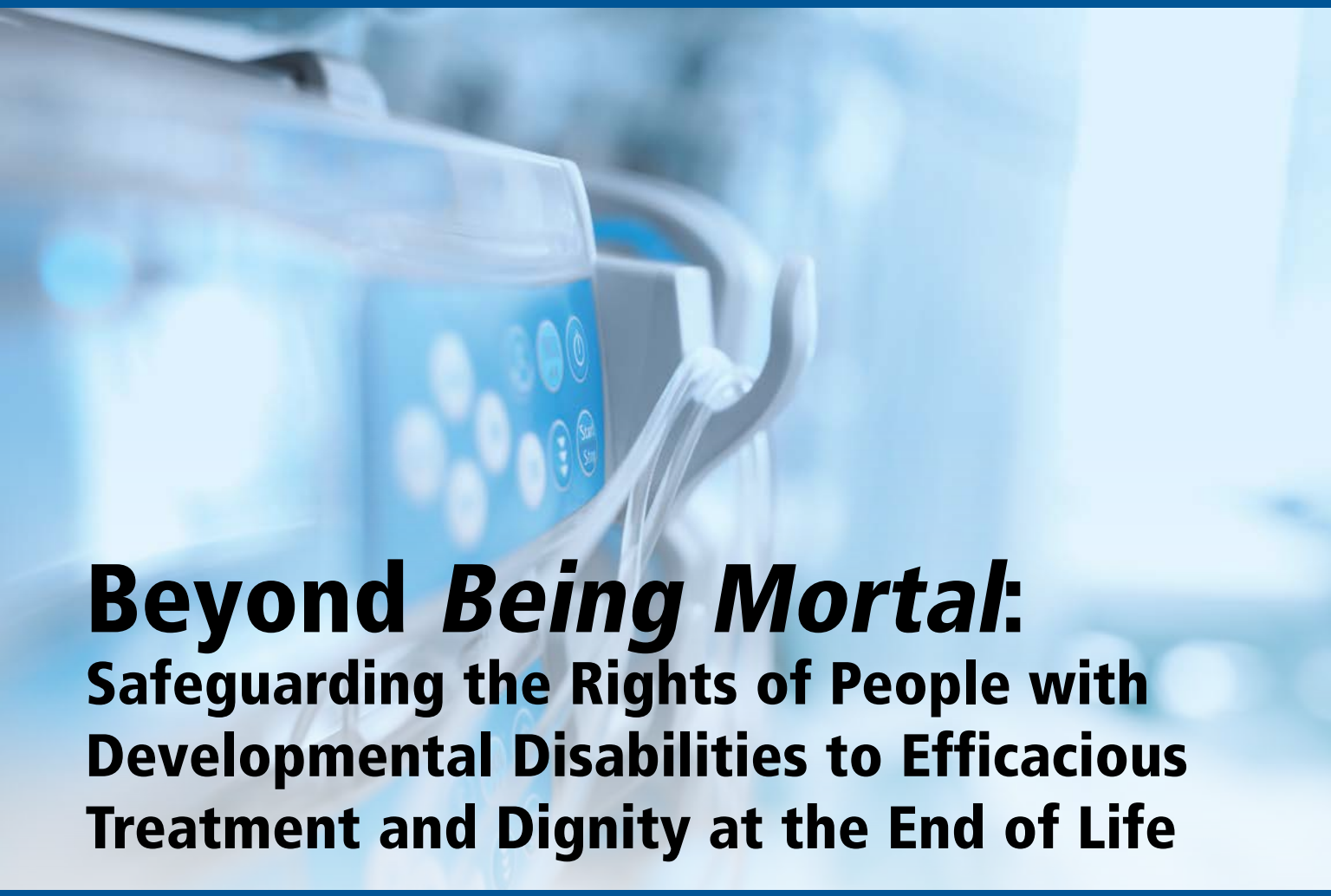

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Safeguarding the Rights of People with Developmental Disabilities to Efficacious Treatment and Dignity at the End of Life

By Christy A. Coe

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BEYOND *BEING MORTAL*: SAFEGUARDING THE RIGHTS OF PEOPLE WITH DEVELOPMENTAL DISABILITIES TO EFFICACIOUS TREATMENT AND DIGNITY AT THE END OF LIFE

BY CHRISTY A. COE

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DEPARTMENTS

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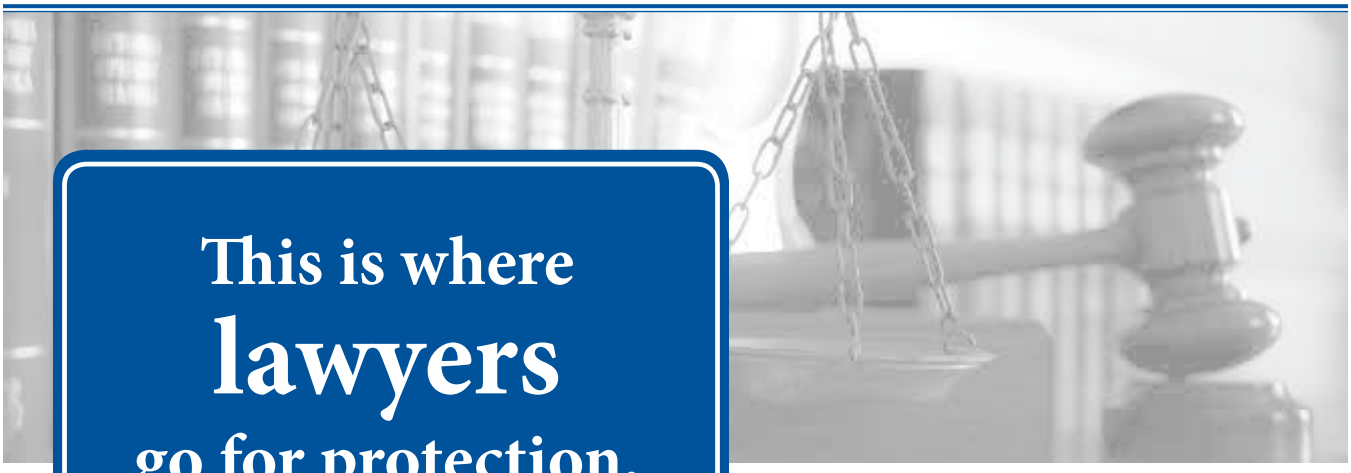

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CLAIRE P. GUTEKUNST

Do the Public Good

"Service to others is the rent you pay for your room here on earth."

– Muhammad Ali

At NYSBA, equal access to justice is one of our core values. Our motto is "Do the public good." I'm excited to update you on our recent activities and plans for this year.

Supporting Legal Services Providers – As I write, our biannual Partnership Conference, hosted by NYSBA's Pro Bono Services Department and Committee on Legal Aid, has just finished. The Conference brought together more than 500 legal services providers and pro bono coordinators from across the state to share ideas and develop lasting connections. We presented dozens of programs on subjects ranging from immigration, foreclosure, domestic violence, government benefits and housing, to program innovation, technology and management.

NYSBA lobbies tirelessly for increased government funding for civil legal services at the state level and through the Legal Services Corporation at the federal level. We have argued strongly for adoption of civil *Gideon* to provide all New Yorkers the right to counsel to protect their basic human needs, regardless of ability to pay. We also help fund access to justice. In 2015, The New York Bar Foundation, NYSBA's charitable arm, distributed $580,000 in grants to 98 civil legal service programs and nonprofits throughout the state. *You* can help increase access to justice, by donating at www.tnybf.org/donation/ or contributing to the Foundation when you renew your NYSBA membership.

Facilitating Pro Bono Service – Rule 6.1 of the New York Rules of Professional Conduct encourages New York attorneys to "aspire to provide at least 50 hours of pro bono legal services each year to poor persons." We want to make it easier for members to volunteer to do pro bono.

Our President's Committee on Access to Justice (PCAJ) recognized that attorneys working in government agencies often feel restricted in performing pro bono work because of unclear rules and the absence of a policy concerning outside work. To help break down these barriers, in June the PCAJ brought to our House of Delegates, and the House approved, a Model Pro Bono Policy and Procedures for Attorneys in State and Federal Government Agencies. Now each agency can tailor this model policy to its own needs, create an agency policy with clear rules and a referral process and increase pro bono opportunities for its attorneys.

To further expand pro bono opportunities for attorneys and increase access to legal assistance for low-income New Yorkers, we have launched a new online program sponsored by the ABA. At NY.FreeLegalAnswers.org, low-income New Yorkers can ask simple legal questions and volunteer attorneys can log on and answer them. We call it "pro bono in your PJs," because attorneys can provide pro bono assistance whenever and wherever it is convenient for them.

We are exploring other ways for attorneys to provide limited scope representation to low- and moderate-income New Yorkers who cannot afford a lawyer but do not qualify for free civil legal services or cannot get help from overtaxed civil legal services providers. This spring, the PCAJ produced a report recommending that NYSBA endorse limited scope representation for low- and moderate-income people. The House will consider the report at its November meeting.

The Domestic Violence Initiative I discussed in last month's President's Message, in partnership with the Women's Bar Association of the State of New York, has a large pro bono component. The Initiative will educate attorneys about what domestic violence is and how they can help. It will encourage them to volunteer to represent domestic violence survivors through existing legal services pro bono programs or through new pro bono programs the Initiative hopes to help develop in underserved communities.

Since 2006, NYSBA's Empire State Counsel program has honored members who perform 50 or more hours of pro bono service in a calendar year. I urge *you* to celebrate Pro Bono Week, October 23–29, by adding your name to the roster of Empire State Counsel honorees. ■

CLAIRE P. GUTEKUNST can be reached at cgutekunst@nysba.org.

NYSBACLE

Tentative Schedule of Fall Programs *(Subject to Change)*

The New York State Bar Association Has Been Certified by the New York State Continuing Legal Education Board as an Accredited Provider of Continuing Legal Education in the State of New York.

Risk Management 2016
(9:00 a.m. – 1:00 p.m.)
October 14 Long Island
October 21 Rochester
October 28 New York City
November 18 Westchester

Digital Evidence in Family Law
(9:00 a.m. – 1:00 p.m.)
November 30 Long Island
December 2 New York City

Henry Miller – The Trial
October 5 Long Island
October 19 Albany
November 29 New York City

Hot Topics in Trusts & Estates Law
(9 a.m. – 12:30 p.m., live & webcast)
October 13 New York City

Medical Marijuana in New York
(9:00 a.m. – 1:00 p.m., live & webcast)
October 14 New York City

Probate and Administration of Estates 2016
October 14 Syracuse
October 19 Buffalo
October 27 Albany, New York City, Rochester
October 28 Long Island, Westchester

Abstracts and Title Issues
(9:00 a.m. – 1:00 p.m., live & webcast)
October 20 Albany

Family Court Trial Institute: Orders of Protection
October 20 Long Island, Rochester, Westchester
October 21 Albany, New York City

Meet the Justices of the Fourth Department
(3:00 p.m. – 5:00 p.m.)
October 26 Rochester

Women on the Move
(12:00 p.m. – 5:00 p.m., live & webcast)
October 26 Albany

Handling and Taking Depositions
(9:00 a.m. – 1:00 p.m.)
October 27 Long Island
October 28 Syracuse
November 2 Albany
November 3 Buffalo, New York City

Emerging Issues in Environmental Insurance
(9:00 a.m. – 1:00 p.m.)
October 28 New York City

Intermediate Elder Law Update
November 1 New York City
November 2 Westchester
November 9 Buffalo
November 16 Albany, Long Island

2016 Marketing Conference for Small Law Firms
(Live & webcast)
November 4 New York City

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Beyond *Being Mortal*:

Safeguarding the Rights of People with Developmental Disabilities to Efficacious Treatment and Dignity at the End of Life

By Christy A. Coe

Introduction

In his *New York Times* bestselling book *Being Mortal: Medicine and What Matters in the End*,[1] Atul Gawande, M.D., explains that at the end of life, medicine often fails the people it is supposed to help. He laments that the "waning days of our lives are given over to treatments that addle our brains and sap our bodies for a sliver's chance of benefit."[2] Commentators observed that *Being Mortal* demonstrates the harm we do as a society by turning aging and death into a medical problem rather than a human one.[3] The author himself states that his book is "[a]bout the struggle to cope with the constraints of our biology, with the limits set by genes and cells and flesh and bones."[4]

The complexity of the issues surrounding death and dying as artfully captured by Dr. Gawande in his book

Christy A. Coe, M.S., J.D., is a Principal Attorney on the staff of the Mental Hygiene Legal Service for the Third Judicial Department. Many of the ideas expressed in this article are amplified in the author's Union College/Mount Sinai School of Medicine Masters in Bioethics project entitled: *Legal and Ethical Standards Available to Surrogates When Implementing a Plan of Hospice Care for People with Developmental Disabilities in New York State.* The project is available online at www.courts.state.ny.us/ad3/MHLS/Index.html. Special thanks is given to Sheila E. Shea, Esq., Director of the Mental Hygiene Legal Service, Third Judicial Department, for her support and participation in the preparation and editing of this article.

were presaged in New York State by the case of Sheila Pouliot, a person with a profound intellectual disability who never had the ability to make her own health care decisions. She could never consider the questions Dr. Gawande suggests are essential when a person is confronted with a life-threatening illness or terminal process: "What is your understanding of the situation and its potential outcomes? What are your fears and what are your hopes? What are the tradeoffs you are willing to make and not willing to make? And what is the course of action that best serves this understanding?"[5] In Sheila Pouliot's case, substituted decisions by involved family members who recognized the limits of medicine to reverse the course of an incurable disease process could not be implemented because of the constraints of the New York common law. At that time, the law did not permit a third party to decide that a patient's quality of life had declined to a point where treatment could be withheld absent a prior competent choice.[6]

Seemingly little known among the legal and medical professions, and largely as a result of the courageous legacy of Sheila Pouliot, is that since 2003, there has been a law in place to address decisions regarding end-of-life care for people with developmental disabilities who never had the capacity to make known their wishes and preferences. The Health Care Decisions Act for Persons with Mental Retardation (HCDA)[7] is codified at Surrogate's Court Procedure Act (SCPA) 1750-b and applies to the approximately 180,000 people in New York State with developmental disabilities. The statute protects the right of people with developmental disabilities to receive efficacious treatment when medically indicated while promoting dignity at the end of life by permitting excessively burdensome treatments to be withheld or withdrawn upon the consent of legally authorized surrogates and pursuant to statutory standards.

Codified seven years before the 2010 Family Health Care Decisions Act (FHCDA),[8] SCPA 1750-b remains a discrete health care decision-making statute for people with developmental disabilities.[9] By design, the FHCDA yields to preexisting surrogate decision-making statutes and regulations that apply to people with developmental disabilities and mental illness.[10] Thus, an understanding of SCPA 1750-b by lawyers and clinicians remains a timely and compelling exercise in New York State. This article provides historical context for the enactment of the HCDA and explains its essential provisions using two case studies to illustrate application of the law. The article closes with a discussion of legal and ethical principles demonstrating that HCDA has promoted fairness, justice and dignity for people with developmental disabilities.

Thoughtful Vision and Revision[11]

Upon the HCDA's March 13, 2003 effective date, and for the first time in New York, a court-appointed guardian for a person with mental retardation[12] was expressly authorized to make all health care decisions for her ward even absent a prior competent choice, including decisions to withhold and withdraw life-sustaining treatment. Subsequent chapter amendments broadened the meaning of the term "guardian" to permit surrogates to make end-of-life elections on behalf of people with developmental disabilities. Legally authorized surrogates now include actively involved family members, such as a spouse, parent, adult child or adult sibling.[13] The Consumer Advisory Board (CAB) is a legally authorized surrogate for developmentally disabled people who are members of the Willowbrook Class.[14] In addition, SPCA 1750-b protects an especially vulnerable class of people with developmental disabilities, those without guardians or interested family members, by recognizing Surrogate Decision-Making Committees which operate pursuant to Article 80 of the Mental Hygiene Law as "guardians" within the meaning of the act.[15] Thus, any narrative about § 1750-b assumes that a "guardian" is a person or entity with standing to consent or refuse life-sustaining treatment on behalf of a developmentally disabled person, with or without a court appointment.

> Quite significantly, the HCDA places an affirmative obligation on the part of the guardian "to advocate for the full and efficacious provision of health care, including life-sustaining treatment."

The HCDA may seem imposing at first, particularly to health care professionals who must navigate its essential provisions. Over time, however, the statute has demonstrated fulfilment of its thoughtful vision to end disparities in the law that permitted individuals who possessed decision-making capacity to confront the inescapable realities of aging and death by forgoing treatments that only prolonged suffering while denying such compassionate choices to individuals with lifelong intellectual disabilities.[16] As stated by the Court of Appeals in *In re M.B*,[17] in the wake of its prior precedent in *In re Storar:*[18]

> [A] distinction arose between the common-law rights of competent adults, who could make their wishes concerning end-of-life care known to family and friends, and mentally retarded persons who had never been competent to make their own health care decisions and for whom life-sustaining treatment could not be refused. When these mentally retarded indi-

> viduals became irreversibly, terminally ill they were, in effect, ineligible for hospice or other palliative care because their guardians were unable to refuse more intrusive, acute medical treatments aimed at extending life for as long as possible.
>
> As a consequence of this disparity, family members, caregivers and advocacy groups for the mentally retarded sought relief from the Legislature. They shared the stories of mentally retarded patients forced to suffer painful, intrusive life-sustaining medical treatments after it was clear that they would never regain any quality of life because the requests of their guardians (usually parents or siblings) to end life-sustaining measures could not be honored. This was the situation the Legislature sought to remedy when it enacted the Health Care Decisions Act for Persons with Mental Retardation.[19]

In perspective, the act was intended to prevent care from being forced upon a person, causing suffering. However, there was also a countervailing consideration that treatment might be arbitrarily withheld from a person with developmental disabilities due to their perceived diminished quality of life.[20] The HCDA attempts to balance these competing interests and is a reflection of legislative intent that life should be maintained in all but those situations where treatment would be an extraordinary burden on the person, in the life that they have, and in the case of artificial nutrition and hydration, that there is no reasonable hope of maintaining life.

The HCDA

Prior to the enactment of the HCDA, an SCPA article 17-A guardian was understood to exercise some degree of medical decision-making authority.[21] However, the scope of this power was unclear, particularly in the aftermath of *Storar*. Because article 17-A is a diagnosis-driven statute, a jurisdictional prerequisite exists requiring petitioners to file certificates from two physicians or a physician and a psychologist[22] that the subject of the proceeding is "incapable to manage him or herself and/or his or her affairs by reason of mental retardation and that such condition is permanent in nature or likely to continue indefinitely."[23] The 2003 chapter amendments to the SCPA imposed an additional certification requirement applicable to all future guardianship proceedings requiring the supporting certificates obtained from physicians or psychologists to address whether the subject possesses the capacity to make health care decisions.[24]

In the event the individual has the ability to make health care decisions, a guardian can still be appointed to make other types of decisions.[25] If the subject of the proceeding is found to lack capacity, the guardian is granted full medical decision-making authority.[26] In the latter event, the HCDA removed any uncertainty concerning the scope of that authority, clarifying that health care decisions include "any decision to consent or refuse to consent to health care,"[27] including decisions to withhold or withdraw life-sustaining medical treatment for a person who never had capacity to make such a decision.[28]

A substantive health care decision-making standard also emerged with the 2003 chapter amendments. Guardians must base all health care decisions "solely and exclusively on the best interests of the mentally retarded person and, when reasonably known or ascertainable with reasonable diligence, on the mentally retarded person's wishes, including moral and religious beliefs."[29] The statutory factors that must be considered in determining the person's best interests include the dignity and uniqueness of the individual; the preservation, improvement or restoration of the person's health; the relief of the person's suffering by means of palliative care and pain management; the effect of treatment, including artificial nutrition and hydration, on the person; and the patient's overall medical condition.[30] A medical decision cannot be based on financial considerations or a failure to afford the mentally retarded individual the respect that would be afforded any other person in the same circumstances.[31]

Quite significantly, the HCDA places an *affirmative* obligation on the part of the guardian "to advocate for the full and efficacious provision of health care, including life-sustaining treatment."[32] Life-sustaining treatment is defined as "medical treatment, including cardiopulmonary resuscitation and nutrition and hydration provided by means of medical treatment, which is sustaining life functions and without which, according to reasonable medical judgment, the patient will die within a relatively short time period."[33] In the event a guardian contemplates the withdrawal or withholding of life-sustaining treatment, SCPA 1750-b imposes a decision-making procedure that must be followed before the decision can be implemented.

The threshold requirement of the process is that the attending physician confirm to a reasonable degree of medical certainty, after consultation with another physician or a licensed psychologist, that the person currently lacks the capacity to make health care decisions.[34] Additionally, the attending physician and a concurring physician must attest that the person has a terminal condition, or is permanently unconsciousness or has "a medical condition other than such person's mental retardation which requires life-sustaining treatment, is irreversible and which will continue indefinitely," and must further certify that the life-sustaining treatment imposes or would impose an extraordinary burden on the person in light of the person's medical condition and the expected outcome of the life-sustaining treatment.[35] Before artificially provided nutrition or hydration may be withheld or withdrawn, two physicians must also confirm that "there is no reasonable hope of maintaining life" or that the artificial nutrition or hydration itself "poses an extraordinary burden" on the patient.[36] These conclusions by medical professionals are a condition precedent to any decision to

end life-sustaining treatment – without them, life-sustaining treatment must be afforded to the person.[37]

If the requisite medical determinations are made, the next step is for the guardian to express a decision to end life-sustaining treatment either in writing, signed by a witness, or orally in the presence of the attending physician and another witness, and the decision must be included in the person's medical record. The physician can then issue the appropriate medical orders or object to the guardian's decision but, in either case, the decision to end life-sustaining treatment cannot be implemented immediately.[38] The act grants a number of persons and organizations automatic standing to lodge an objection to a guardian's decision upon receiving notice from the attending physician – the mentally retarded person;[39] a parent or adult sibling; the attending physician; any other health care practitioner providing services to the patient; the director of a mental hygiene facility and the Mental Hygiene Legal Service, where the patient resides or resided in a mental hygiene facility;[40] and the commissioner of the Office of People with Developmental Disabilities (OPWDD), where the developmentally disabled person does not reside in a facility.[41] The statute provides that notice be provided to parties with standing by the attending physician at least 48 hours prior to the implementation of a decision to withdraw life-sustaining treatment, or at the earliest possible time prior to the implementation of a decision to withhold life-sustaining treatment.[42]

If there is no objection, the guardian's decision to withdraw or withhold life-sustaining treatment is put into effect, without judicial involvement. An objection, however, will suspend implementation of the guardian's decision (unless the suspension would itself result in the death of the patient) until the dispute is resolved through a dispute mediation where available, such as through a hospital ethics committee,[43] or by a court of competent jurisdiction.[44] Thus, the HCDA clarifies that guardians can make health care decisions for people with developmental disabilities who themselves were never competent to make those decisions, including elections to forgo life-sustaining treatment. But it imposes a series of procedural requirements – intended to safeguard the interests of the patient and prevent an improvident decision by the guardian – that must be satisfied prior to the implementation of such a decision.[45]

Medical Orders for Life Sustaining Treatment

New York State is one of the many states that subscribes to the use of Medical Orders for Life-Sustaining Treatment (MOLST). The MOLST is intended for patients who want to make end-of-life treatment decisions, who reside in long-term care facilities or require long-term care services and/or may die within a year.[46] Completion of the MOLST begins with a conversation between the patient, the patient's health care agent or surrogate, and a qualified, trained health care professional that defines the patient's goals for care, reviews possible treatment options, and ensures shared, informed medical decision-making.[47] The MOLST is an optional form, and only one of many to document a patient's treatment preferences concerning end-of-life care. However, the MOLST is the only authorized form in New York State for documenting both non-hospital DNR and DNI[48] orders. Additionally, the MOLST has proven beneficial to patients and providers as it provides specific medical orders and is recognized and used in a variety of health care settings, not just hospitals.[49]

Effective January 21, 2011, OPWDD approved the use of the MOLST for individuals with developmental disabilities. For people with developmental disabilities who never had capacity to make a decisions, the MOLST must be accompanied by the Legal Requirements Checklist for Individuals with Developmental Disabilities.[50] The required checklist mirrors the requirements of the HCDA, ensuring that SCPA 1750-b standards have been met prior to implementation of a decision to withhold or withdraw life-sustaining treatment for an individual with developmental disabilities.[51]

SCPA 1750-b as Applied

Decisions regarding end-of-life care for another are fraught with emotion and uncertainty for guardians, families, providers and advocates. Increased moral distress occurs when providers and medical systems are unfamiliar with the legal processes and are unable to effectively guide guardians. In addition, the procedural protections imposed by the law are seen by some as obstructions to providing quality care. There is no simple resolution to factual disputes, but experience tells us that familiarity with the mandated processes can ease this distress and ensure that appropriate treatment is rendered. While each case will turn on the person and his or her medical condition, the following examples demonstrate how the standards codified at SCPA 1750-b have been applied.

Loretta's Story

Loretta was 65 years old when this author met her. She had been born with Down syndrome and lived most of her life in facilities licensed or operated by OPWDD. While she lacked the capacity to make her own health care decisions, she was fortunate to have her sister as her advocate. By the time Loretta was 65 years old, she was burdened with many of the age-related health problems most of us will experience. She was also having seizure activity of unknown etiology and had been diagnosed with dementia. Loretta had become increasingly withdrawn from her usual activities and she found any deviation from her routine disruptive. She was physically frail, no longer ambulated, and spent her days dozing while in bed or a Geri-Chair. Devoted staff in her residential setting were sensitive to her needs.

Loretta was closely followed by her primary care physician and a neurologist. She continued to decline and was diagnosed with end-stage Alzheimer's disease, hypertensive heart disease, congestive heart failure, osteoporosis, recurrent pneumonia, seizure disorder, and aspiration. Her sister, confronted with Loretta's deteriorating condition, contacted the primary care physician, who agreed it was appropriate to limit aggressive treatment. The physician determined Loretta lacked capacity to make health care decisions and obtained a concurring opinion as to her capacity. The attending physician and a concurring doctor determined that Loretta had several irreversible medical conditions meeting the standards set forth in SCPA 1750-b.

Among the elections made for Loretta, her sister consented to a do-not-resuscitate order, a do-not-intubate order, no artificial nutrition or hydration and limited medical interventions. A MOLST form, with completed checklist, implementing the treatment elections was completed. The physician provided notice of the elections to the facility director and to my office, the Mental Hygiene Legal Service (MHLS). The medical literature, the opinions of the attending physicians and familiarity with the progression of end-stage Alzheimer's disease, in particular, led the MHLS and the facility to agree that the plan of care developed for Loretta would provide her with comfort and support at the end of her life, while sparing her the bodily insults that can come with intrusive interventions that are not curative and prolong suffering. In Loretta's case, the SCPA 1750-b standards were met and no objection was lodged to her surrogate's end-of-life decisions by either the facility director or MHLS. The doctor's orders were implemented and thus began a plan of compassionate care for Loretta.

Joseph's Story

The case of *In re Joseph P.* is not personal to this author, but is one of the few reported decisions applying the HCDA.[52] Joseph was a 55-year-old man who had profound intellectual disabilities, cerebral palsy with spastic quadriplegia, and curvature of the spine. He resided in an OPWDD group home when he became ill and was admitted to a hospital where he was diagnosed with aspiration pneumonia. An evaluation revealed that he suffered from dysphagia. It was determined that Joseph could no longer tolerate food or liquid orally and that, unless he received nutrition and hydration through a feeding tube, he would die within a short period of time.

Joseph's parents were his legally authorized surrogates and refused to consent to the insertion of a feeding tube. The attending physician and the chief medical officer of the hospital supported the parents' decision based upon their determination that providing such treatment would impose an extraordinary burden on Joseph. Upon receiving notice of the decision to withhold life sustaining treatment from Joseph, OPWDD objected. A proceeding was commenced pursuant to SCPA 1750-b seeking, among other things, an order authorizing surgical insertion of a feeding tube to deliver nutrition and hydration to Joseph.

Following a hearing, the Supreme Court denied OPWDD's petition, concluding that the guardians, through the respondent hospital, met their burden of establishing that insertion of a feeding tube would impose an extraordinary burden on Joseph in light of his medical condition other than mental retardation and the expected outcome of the life-sustaining treatment. Pursuant to SCPA 1750-b(5)(a), the decision to withhold artificially provided nutrition and hydration was suspended pending the completion of judicial review, including the determination of an appeal.

> Decisions regarding end-of-life care for another are fraught with emotion and uncertainty for guardians, families, providers and advocates.

On appeal, the Appellate Division, Fourth Department reversed the decision of the trial court.[53] In the court's view, the factors advanced by respondent, i.e., the difficulty Joseph would encounter when he was moved to a new facility; the need for restraints to prevent him from removing the feeding tube; the continuing risks of aspiration; and the potential complications arising from the feeding tube did not support finding that the treatment would impose an extraordinary burden on Joseph. The court relied on the testimony of the witnesses from the agency, the nurse and physician who cared for Joseph at his residential placement, and found that Joseph was "alert, responsive, seemingly pain free and the burdens of prolonged life are not so great as to outweigh any pleasure, emotional enjoyment or other satisfaction that [he] may yet be able to derive from life."[54]

Legal/Ethical Considerations

As the cases of Loretta and Joseph illustrate, when making a best interest determination for a person with developmental disabilities, there are many objective factors a surrogate must consider, such as the patient's ability to function, the degree of pain the person may be experiencing either with or without treatment, the person's overall condition and chance for recovery, as well as the risks,

side effects and benefits of proposed treatment. Even where objective criteria may be identified and applied, ambiguities inevitably consume surrogates, physicians and advocates when considering whether life-sustaining treatment would impose an "extraordinary burden" on another person.

The concept of "extraordinary burden" is not explicitly defined in the law or medicine. One court commented that extraordinary burden on the patient "could, in terms of the nature of the burden, reasonably mean an extraordinary physical, psychological, emotional or even economic burden."[55] While the HCDA defined parameters for when a treatment burden should be deemed "extraordinary" – consideration of the patient's medical condition and the expected outcome of the treatment – other factors no doubt weigh on physicians and surrogates. For instance, rendition of life-sustaining treatment might cause a person to be tethered to a respirator for the balance of her life in a skilled nursing home far from the people who supported her throughout her life. Such an outcome might be intolerable to some, but may not be intolerable to someone who has lived her life in residential settings.[56]

Additionally, the law requires the physician to opine if the provision of a medical treatment would pose an extraordinary burden on the patient. Some physicians complain that this is a judgment for surrogates, not physicians, to render. The doctor often has to assess the burdens on her patient at the bedside with little knowledge of the quality of life her patient enjoys. Medical records for people with developmental disabilities often describe the patient as "unfortunate" before all else, revealing a negative impression or bias toward the patient's circumstances that may intrude into the assessment of treatment benefit and burdens. Thus, conceivably, individuals who are not dying become the subject of DNR orders precisely because they are disabled.

Placing reliance on actively involved family surrogates to make elections for people with developmental disabilities who lack capacity is a thoughtful revision of the statutory framework. No doubt, however, the bond to an ever present caretaker can be stronger than attachments to family members in certain cases. Regrettably, still near are the days when doctors told parents of a child born with developmental disabilities to "send him away and put him out of your mind."[57] Those who care for people with developmental disabilities may have quite a different perspective on whether certain treatments would pose an extraordinary burden.[58]

The HCDA is crafted to mitigate the potential that negative perceptions about the quality of life led by people with developmental disabilities will intrude into surrogate decision-making. Primarily, surrogates must advocate for the full and efficacious provision of health care, including life-sustaining treatment.[59] Nonetheless, people with developmental disabilities are increasingly vulnerable and confront many health care inequalities.[60] Many depend upon governmental assistance which limits their access to medical providers and choice of care.

The law requires the physician to opine if the provision of a medical treatment would pose an extraordinary burden on the patient.

Issues relating to health care access, coupled with competing legal precepts, compound the difficulty in evenly applying a uniform system of end-of-life care for people with developmental disabilities.

Conclusion

Pursuant to the FHCDA, the Task Force on Life and the Law[61] is studying whether the FHCDA should be amended to incorporate procedures, standards and practices for decisions about the withdrawal or withholding of life-sustaining treatment from patients with mental disabilities, including those with developmental disabilities.[62] The outcome of the study and potential legislative action are unknown, but experience demonstrates that SCPA 1750-b continues to fulfill its laudable goals.

A simple yet enduring observation was made by Dr. Gawande in *Being Mortal*, when he said "as a person's end draws near, there comes a moment when responsibility shifts to someone else to decide what to do."[63] When others must choose, SCPA 1750-b has promoted fairness, justice and dignity during life and as it comes to an end.[64] ■

1. Atul Gawande, *Being Mortal: Medicine and What Matters In the End* (2014) (*Being Mortal*).

2. *Id*. at 9.

3. Marcia Angell, *A Better Way Out, Being Mortal: Medicine and What Matters in the End*, N.Y. Rev. of Books (Jan. 2015).

4. *Being Mortal* at 259.

5. *Id*.

6. *See Blouin v. Spitzer*, 213 F. Supp. 2d 184 (N.D.N.Y. 2002). Under the common law at that time, the refusal or termination of life-sustaining treatment was only permitted where there was "clear and convincing" evidence of the patient's intentions (*see In re Storar*, 52 N.Y.2d 363 (1981)).

7. 2002 N.Y. Laws ch. 500.

8. 2010 N.Y. Laws ch. 8, § 1. The legislature amended the Public Health Law (PHL) to "establish a decision-making process . . . whereby a surrogate is selected and empowered to make health care decisions for patients who lack capacity to make their own health care decisions and otherwise have not appointed a [health care] agent." *See* Robert Swidler, *New York's Family Health Care Decisions Act: The Legal and Political Backgrounds, Key Provisions and Emerging Issues*, N.Y. St. B.J., June 2010, p. 18.

9. PHL § 2994(b)(3)(c).

10. FHCDA also only applies in general hospitals, nursing homes and hospice programs. *See* PHL § 2994-b(1).

11. Turano, Practice Commentaries (McKinney's Cons Laws of NY, Book 59-A, SCPA 1750-b, p. 451).

12. Article 17-A of the SCPA is titled "Guardians of Mentally Retarded and Developmentally Disabled Persons." The term "mental retardation" has been largely repealed and removed from New York State statutes in favor of the term "developmental disability" (*see* 2010 N.Y. Laws ch. 168; 2011 N.Y. Laws ch. 37). A bill is pending in the New York State Senate to substantially reform Article 17-A of the SCPA and will, if enacted, repeal the term "mental retardation" while otherwise substantially modernizing the statute S. 04983.

13. The legislature delegated to the commissioner of the then Office of Mental Retardation and Developmental Disabilities the responsibility to promulgate a surrogate list (2007 N.Y. Laws ch. 105). The surrogate list is found at 14 N.Y.C.R.R. § 633.10.

14. The *Willowbrook* litigation was a civil rights action concerning the care and treatment of children and adults with developmental disabilities residing at the former Willowbrook State Developmental Center on Staten Island (*see generally N.Y. State Ass'n for Retarded Children v. Carey*, 393 F. Supp. 715 (E.D.N.Y.1975)). Pursuant to the Willowbrook consent decree, the Consumer Advisory Board (CAB) was created to oversee the care and treatment of class members and advocate for their due process rights.

15. MHL §§ 80.01 *et seq.*

16. Turano, *supra* note 11, at p. 451.

17. 6 N.Y.3d 437 (2006).

18. 52 N.Y.2d 363 (1981).

19. 6 N.Y.3d at 440.

20. Leslie P. Francis, *Discrimination in Medical Practice: Justice and the Obligations of Health Care Providers to Disadvantaged Patients*, The Blackwell Guide to Medical Ethics, Eds. Rosamond Rhodes, Leslie Francis and Anita Silvers, Blackwell Publishing Ltd. 2007, 162–79.

21. *See* Rose Mary Bailly & Charis Nick-Torok, *Should We Be Talking? Beginning a Dialogue On Guardianship for the Developmentally Disabled in New York*, 75 Alb. L. Rev 807 (2012).

22. SCPA 1750(1).

23. *Id.*

24. SCPA 1750(2). Capacity to make health care decisions is defined at PHL § 2980(3) and means the ability to understand and appreciate the nature and consequences of health care decisions, including the benefits and alternatives to any proposed health care and to reach and informed decision.

25. SCPA 1750(2).

26. *Id.*

27. *See* SCPA 1750-b(1), cross-referencing PHL § 2980(6).

28. In *In re MB, supra*, the Court of Appeals determined that guardians appointed before the effective date of the HCDA were empowered to make end-of-life treatment elections without the necessity of a judicial proceeding for an amended guardianship order that specifically authorized the guardian to makes these elections.

29. SCPA 1750-b(2)(a).

30. SCPA 1750-b(2)(b)(i–v).

31. SCPA 1750-b(2)(c).

32. SCPA 1750-b(4).

33. SCPA 1750-b(1). Under the statute, cardiopulmonary resuscitation is presumed to be life-sustaining treatment without the necessity of a medical judgment by an attending physician (*id.*)

34. SCPA 1750-b(4)(a).

35. SCPA 1750-b(4)(b)(i)(ii).

36. SCPA 1750-b(4)(b)(iii).

37. *In re MB*, 6 N.Y.3d at 443.

38. SCPA 1750-b(4)(e).

39. SCPA 1750-b(4)(e)(i). Notice to the patient can be dispensed with where it is determined within a reasonable degree of medical certainty that the person with would suffer immediate and severe harm from receiving notice.

40. A mental hygiene facility is a residential facility licensed or operated by the Office for People with Developmental Disabilities (OPWDD) and includes, a developmental center or school, a community residence and a family care home (MHL § 1.03(6); *In re Alexis H*, 174 A.D.2d 1030 (4th Dep't 1991)).

41. SCPA 1750-b(5); Presumably notice to the OPWDD Commissioner is designed to ensure oversight of the surrogate's decision in the absence of review by the Mental Hygiene Legal Service where the developmentally disabled person does not reside in a setting where the Service has jurisdiction.

42. SCPA 1750-b(4)(e).

43. SCPA 1750-b(5)(d). The statute provides that an objection shall be referred to a dispute mediation system, or similar entity for mediating disputes in a hospice. In the event that such dispute cannot be resolved within seventy-two hours or no such mediation entity exists or is reasonably available for mediation of a dispute, the objection shall proceed to judicial review pursuant to this subdivision.

44. SCPA 1750-b(6). Special proceeding authorized. The guardian, the attending physician, the chief executive officer, the MHLS (if the person is in or was transferred from residential facility or program operated, approved or licensed by the OPWDD) or the commissioner of OPWDD or his or her designee (if the person is not in and was not transferred from such a facility or program) may commence a special proceeding in a court of competent jurisdiction with respect to any dispute arising under this section.

45. *In re MB*, *supra* note 17 at 443–44.

46. Patricia Bomba, *Landmark Legislation in New York Affirms Benefits of a Two-Step Approach to Advance Care Planning Including MOLST: A Model of Shared Informed Medical Decision Making and Honoring Patient Preferences for Care at the End of Life*, 17 Widener Law Review 475 (2011).

47. *See* New York State Department of Health website, www.health.ny.gov/professionals/patients/patient_rights/molst.

48. "DNI" means do-not-intubate. A DNR order is distinct from a DNI order. A person whose respiratory status is failing may experience cardiac arrest, but not all patients do. It is important legally to separate "do-not-intubate" from "do-not-resuscitate" discussions. Katz, Paula. "Separating DNI from DNR Discussion," *Today's Hospitalist*, October 2014.

49. *See* New York State Department of Health Website, *supra* note 47.

50. *Id.*

51. *See* New York State Office for People with Developmental Disabilities website, www.opwdd.ny.gov/opwdd_resources/information_for_clinicians/MOLST.

52. *In re Joseph P*, 106 A.D.3d 1548 (4th Dep't 2013).

53. *Id.*

54. *Id.* at 1551, *citing In re DH*, 15 Misc. 3d 565 (Sup. Ct., Nassau Co. 2007).

55. *In re Leonard B.*, 164 Misc. 2d 518, 525 (Sup. Ct., Albany Co. 1995), *modified on other grounds*, *Finn v. Leonard C.*, 221 A.D.2d 896 (3d Dep't 1995).

56. Felicia Nimue Ackerman, *Patient and Family Decisions About Life-Extension and Death*, The Blackwell Guide to Medical Ethics, Eds. Rosamond Rhodes, Leslie P. Francis and Anita Silvers, Blackwell Publishing 2007, 52–68.

57. Lisa Reswick, *My Banished Brother*, New York Times, http://well.blogs.nytimes.com/2016/04/01.

58. Kathleen M. Fisher, Michael J. Green, Frederick K. Orkin & Vernon M. Chinchilli, *A Content Analysis from a US Statewide Survey of Memorable Healthcare Decisions for Individuals with Intellectual Disability*, Journal of Intellectual and Developmental Disability 34(3), 258–65 (2009).

59. SCPA 1750-b(4).

60. Roland L. Ward, Amanda Nichols, Ruth Freedman, *Uncovering Health Care Inequalities Among Adults with Intellectual and Developmental Disabilities*, Health and Social Work 35:4, November 2010.

61. The Task Force on Life and the Law, established in 1985, consists of experts who advise on public policy and issues arising at the interface of medicine, law and ethics (www.health.ny.gov/regulations/task_force.

62. 2010 N.Y. Laws ch. 8, § 28.

63. *Being Mortal* at 252.

64. *Health Care Choices: Who Can Decide?*, OPWDD (February 2012) (April 5, 2015), www.opwdd.ny.gov/health-care-choices-brochure.

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"New York Is the Louisiana of Civil Practice"

Introduction

I have taught New York Practice since 2000, and have tried to convey to students just how different, how much of an outlier, New York's CPLR is from the codes of civil procedure in most other states,[1] as well as the Federal Rules of Civil Procedure on which most of those codes are based (and which all law students have studied in the first year of law school).

To each class I have offered the following analogy:

> Do you remember how, in the first year of law school, professors would often state that there was the majority rule, the minority rule, and the law in Louisiana? Well, New York is the Louisiana of civil practice.

I gave this illustration, year after year, thinking myself rather clever, secure in the knowledge that I would never need to explain this slight to an audience in Louisiana. Until this year, when I was invited to present at this year's annual joint TICL/Trial Lawyers fall program in New Orleans. On top of that, in addition to participating in a panel discussion on the use of social media in litigation, I was invited to participate in a second panel discussion titled, "*Louisiana v. New York*: The Napoleonic Code and English Common Law." I accepted the invitation (I mean, it's New Orleans!), and now feel I need to make amends.

So, let me extend a sincere apology to the honorable State of Louisiana, and my esteemed colleagues there at the bar, for using their fine state as the butt of my little joke.

The Louisiana Civil Code

As penance, as well as to prepare to discuss the CPLR with an alien audience, I read up on the Louisiana Civil Code. I learned that misconceptions abound about its origin:

> The Louisiana Civil Code was greatly influenced by, and was modeled after, the Code Napoleon. However, lay beliefs and expressions that the Napoleonic Code has been in force in Louisiana are totally unfounded . . . the Louisiana Civil Code differed from the Napoleonic Code in its approach to the fundamental matter of sources of law. The extreme legal positivism of the Code Napoleon that has elevated legislation to the status of the single source of law may be contrasted with the genius of the Louisiana Civil Code that has always recognized custom as an authoritative source of law and equity as a source for the resolution of disputes in the absence of a positive law or custom.[2]

In 1958, the sesquicentennial of the enactment of the 1808 Civil Code of Louisiana, Judge John T. Hood, Jr., described it in glowing terms:

> The Louisiana Civil Code has been called the most perfect child of the civil law. It has been praised as "the clearest, fullest, the most philosophical, and the best adapted to the exigencies of modern society." It has been characterized as "perhaps the best of all modern codes throughout the world." Based on Roman law, modeled after the great Code Napoleon, enriched with the experiences of at least twenty-seven centuries, and mellowed by American principles and traditions, it is a living and durable monument to those who created it. After 150 years of trial, the Civil Code of Louisiana remains venerable, a body of substantive law adequate for the present and capable of expanding to meet future needs. At this Sesquicentennial it is appropriate for us to review the history and development of the Louisiana Civil Code.
>
> The event which we celebrate is the passage of an act by the Legislature of the Territory of Orleans, approved on March 31, 1808, promulgating a compilation of laws, now commonly referred to as the Civil Code of 1808.[3]

Also in 1958, an article by then-Columbia Law School Professor, now U. S. District Court Judge for the Eastern District of New York, the Hon. Jack B. Weinstein, appeared in this very publication.[4] Titled, *Revision of New York Civil Practice*, it examined the efforts then under way to craft what would become, five years later, the CPLR.

Echoing complaints today by those who believe that the CPLR is in need of a major overhaul, Judge Weinstein reflected on the then-current state of the Civil Practice Act (CPA), the civil procedure code that immediately preceded the CPLR:

> We have been too long cowed by the Civil Practice Act, by a monster of complexity created by us and for us, so that no one dares – except on an ad hoc basis – reexamine this creature that controls so much of what we do.[5]

When Judge Weinstein wrote those words, the CPA was 27 years old.[6] Our CPLR is now 53 years old.[7]

The 1808 Louisiana Civil Code was first amended in 1825, then again in 1870,[8] and then left untouched until 1987, when a series of revisions began.[9]

In contrast to our constant complaints about the CPLR, Louisianans are very proud of their civil code. In 1933, one writer described its impact this way:

> The Civil Code of Louisiana is the most important contribution of Louisiana to an American culture. It possibly is the most important accomplishment in the history of American law in the sense of the relation it bears to the future direction of American law . . . It is a rather grim commentary on our historians that the significance of the Louisiana Civil Code has been completely overlooked . . . As a cultural document, the Civil Code has its own merit. It is beautifully written, so carries the best tradition of civilian aesthetics.[10]

Would that the CPLR had such loyal fans.

Louisiana v. New York

Continuing my course of self-study, I compared three sections of the CPLR near and dear to my heart with their counterparts in the Louisiana Code. The first, setting forth the scope of disclosure, are very similar.

New York's CPLR 3101(a) provides:

> (a) Generally. There shall be full disclosure of all matter material and necessary in the prosecution or defense of an action, regardless of the burden of proof . . .[11]

In turn, Louisiana's Civil Code Art. 1422 provides:

> Parties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action, whether it relates to the claim or defense of the party seeking discovery or to the claim or defense of any other party, including the existence, description, nature, custody, condition, and location of any books, documents, or other tangible things and the identity and location of persons having knowledge of any discoverable matter. It is not ground for objection that the information sought will be inadmissible at the trial if the information sought appears reasonably calculated to lead to the discovery of admissible evidence.[12]

Not much sunlight between the two.

The next sections I compared govern deposition practice and are, once again, very similar (although, of course, CPLR 3115 must be read in conjunction with the Uniform Deposition Rules).[13] The essential provisions of CPLR 3115[14] are:

> (a) Objection when Deposition Offered in Evidence. Subject to the other provisions of this rule, objection may be made at the trial or hearing to receiving in evidence any deposition or part thereof for any reason which would require the exclusion of the evidence if the witness were then present and testifying.
>
> (b) Errors Which Might Be Obviated if Made Known Promptly. Errors and irregularities occurring at the oral examination in the manner of taking the deposition, in the form of the questions or answers, in the oath or affirmation, or in the conduct of persons, and errors of any kind which might be obviated or removed if objection were promptly presented, are waived unless reasonable objection thereto is made at the taking of the deposition.
>
> * * *
>
> (d) Competency of Witnesses or Admissibility of Testimony. Objections to the competency of a witness or to the admissibility of testimony are not waived by failure to make them before or during the taking of the deposition, unless the ground of the objection is one which might have been obviated or removed if objection had been made at that time . . .

Louisiana's Art. 1443 similarly provides:

> A. Examination and cross-examination of witnesses may proceed as permitted at the trial under the provisions of the Louisiana Code of Evidence . . .
>
> B. All objections made at the time of the examination to the qualifications of the officer taking the deposition, or to the manner of taking it, or to the evidence presented, or to the conduct of any party, and any other objection to the proceedings, shall be noted by the officer upon the deposition . . . Any objection during a deposition shall be stated concisely and in a non-argumentative and non-suggestive manner. Evidence objected to shall be taken subject to the objections. Counsel shall cooperate with and be courteous to each other and to the witness and otherwise conduct themselves as required in open court and shall be subject to the power of the court to punish for contempt . . .
>
> * * *
>
> D. Unless otherwise stipulated, or as provided in Article 1455, objections are considered reserved until

trial or other use of the deposition. A party may instruct a deponent not to answer only when necessary to preserve a privilege, to enforce a limitation on evidence imposed by the court, to prevent harassing or repetitious questions, or to prevent questions which seek information that is neither admissible at trial nor reasonably calculated to lead to the discovery of admissible evidence.

However, when it comes to expert disclosure, the two states' procedures diverge in significant respects. CPLR 3101(d) provides:

> (d) Trial preparation.
>
> 1. Experts.
> (i) Upon request, each party shall identify each person whom the party expects to call as an expert witness at trial and shall disclose in reasonable detail the subject matter on which each expert is expected to testify, the substance of the facts and opinions on which each expert is expected to testify, the qualifications of each expert witness and a summary of the grounds for each expert's opinion . . .
>
> * * *
>
> (iii) Further disclosure concerning the expected testimony of any expert may be obtained only by court order upon a showing of special circumstances and subject to restrictions as to scope and provisions concerning fees and expenses as the court may deem appropriate. However, a party, without court order, may take the testimony of a person authorized to practice medicine, dentistry or podiatry who is the party's treating or retained expert, as described in paragraph three of subdivision (a) of this section, in which event any other party shall be entitled to the full disclosure authorized by this article with respect to that expert without court order.

Louisiana's rules, found at Art. 1425, provide for additional disclosure, akin to the Federal Rules, upon motion:

> A. A party may through interrogatories or by deposition require any other party to identify each person who may be used at trial to present evidence under Articles 702 through 705 of the Louisiana Code of Evidence.
>
> B. Upon contradictory motion of any party or on the court's own motion, an order may be entered requiring that each party that has retained or specially employed a person to provide expert testimony in the case or whose duties as an employee of the party regularly involve giving expert testimony provide a written report prepared and signed by the witness. The report shall contain a complete statement of all opinions to be expressed and the basis and reasons therefor and the data or other information considered by the witness in forming the opinions. The parties, upon agreement, or if ordered by the court, shall include in the report any or all of the following: exhibits to be used as a summary of or support for the opinions; the qualifications of the witness, including a list of all publications authored by the witness within the preceding ten years; the compensation to be paid for the study and testimony; a listing of any other cases in which the witness has testified as an expert at trial or by deposition within the preceding four years.
>
> * * *
>
> D. (1) Except as otherwise provided in Paragraph E of this Article, a party may, through interrogatories, deposition, and a request for documents and tangible things, discover facts known or opinions held by any person who has been identified as an expert whose opinions may be presented at trial. If a report from the expert is required under Paragraph B, the deposition shall not be conducted until after the report is provided.
>
> * * *
>
> (3) Unless manifest injustice would result, the court shall require that the party seeking discovery pay the expert a reasonable fee for time spent in responding to discovery under this Paragraph; and with respect to discovery obtained under Subparagraph (2) of this Paragraph, the court shall also require the party seeking discovery to pay the other party a fair portion of the fees and expenses reasonably incurred by the latter party in obtaining facts and opinions from the expert . . .

Conclusion

Having learned that procedurally New York and Louisiana are more alike then not, I plan to retire my traditional opening in future New York Practice classes.

As for the CPLR, if revising it develops any momentum, Judge Weinstein made clear in 1958 who was best suited to undertake that work:

> This is a subject on which only we lawyers and judges can and should speak with authority. For, if we have any special competence and responsibility, surely it is in the procedures by which litigation is handled, the practice under which our judicial system vindicates the substantive rights of all the people of the state.[15]

1. I say "most other states" because I have been too lazy to do a 50-state survey.

2. Civil Law Commentaries, Vol. 1, Issue 1, Winter 2008, *The Civil Codes of Louisiana* 17.

3. John T. Hood Jr., *The History and Development of the Louisiana Civil Code*, 19 La. L. Rev. (1958), http://digitalcommons.law.lsu.edu/lalrev/vol19/iss1/14.

4. Though in 1958 it was called the *New York State Bar Bulletin*.

5. *Id.* at 308.

6. The CPA was enacted in 1921. *CPR For The CPLR*, N.Y. St. B.J., January 2010, p. 20.

7. The CPLR took effect September 1, 1963. *Id.*

8. Civil Law Commentaries, Vol. 1, Issue 1, Winter 2008, *The Civil Codes of Louisiana* 17.

9. *Id.*

10. Mitchell Franklin, *Book Review*, 7 Tul. L. Rev. 632, 633 (1933) (reviewing Benjamin W. Dart, *Civil Code of the State of Louisiana* (1932)).

11. CPLR 3101(a).

12. Art. 1422. Scope of discovery; in general.

13. 22 N.Y.C.R.R. § 202.21.

14. CPLR 3115. Objections to qualification of person taking deposition; competency; questions and answers.

15. Jack B. Weinstein, *Revision of New York Civil Practice*, 30 N.Y. St. B. Bull. 298, 1958.

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BY LUKAS M. HOROWITZ

Lukas M. Horowitz, Albany Law School Class of 2019, graduated from Hobart William Smith in 2014 with a B.A. in history and a minor in political science and Russian area studies. Following graduation, he worked for two years as a legal assistant at Gibson, McAskill & Crosby, LLP, in Buffalo, New York, and with the New York Academy of Trial Lawyers hosting CLE programs. Lukas can be reached at Lukas.horowitz@gmail.com.

Law School Lesson #1: You Can't Wing It

Time does funny things when a momentous event, in my case the start of classes at Albany Law School, looms on the horizon. In the months leading up to the start of school, time slowed to a crawl. In the weeks since the start of my three-year journey, time has moved at light speed. To help slow things down a bit, I decided to write about my journey.

During my final year of college I was pretty sure I wanted to be a lawyer. The previous summer I worked as an intern for Justices Laura Douglas and Elizabeth Taylor in Supreme Court, Bronx County. It was a great experience, and I learned a lot, but as I looked forward to graduation, the news on the law school/legal career front remained dicey. Recognizing that it was unlikely I would be able to become a judge immediately following graduation from law school, I decided I needed exposure to the day-to-day life of a lawyer before deciding if practicing law was what I wanted to do for the next 40 or so years. I had the good fortune to land a position as a legal assistant at an exceptional law firm, Gibson, McAskill & Crosby, LLP, in Buffalo, N.Y. My two years at the firm solidified my desire to pursue a legal career, and convinced me I possessed the necessary tools to tackle the three-year marathon through law school.

After a month of classes, I confess I have some doubts. I have experienced orientation, case briefs, the Socratic method, and Blue Book citations, and I have also experienced a level of anxiety I have never felt before. I realize I might need just a few more tools in my toolbox.

Law school orientation was nothing like undergraduate orientation, which was primarily social in nature, and by design, serving as an extended ice-breaker between members of the entering class. Law school orientation was something entirely different, focused on establishing, and explaining, the school's high expectations for the entering class. It was also reassuring, and I was impressed with the wide ranging support network and resources the Law School provided. It felt very user-friendly, and that was a relief. Through faculty presentations and participation in mock classes, my sense that I would be able to succeed in law school was renewed. However, I would be lying if I didn't admit to feeling, at times, both like a small fish in a big pond, and a fish out of water.

My first day of classes left my head spinning. I had spent the two days prior to that first day of classes going over, and over, the assigned readings. Never before had I done so much (actually, any) work before the first class of a semester, and never before had I been so confused. Cases are written in a different language, and learning Russian in college was much easier. One new and very useful tool I came upon prior to the start of classes was the "First-Year Law Student Cheat Sheet" from the State Bar, which contained useful tips to help navigate cases.

However, what stood out for me from that packet was the section regarding self-care. Essentially, it reminded readers that in order to graduate from law school, you had to be alive when the time comes to graduate, something that seemed more and more unlikely during the first week. The standout point was that I was not alone. I found myself constantly thinking, "Am I understanding this?" and, if not, "Am I the only one not understanding this?" The "Cheat Sheet" reminded me that I was not alone in my confusion and doubts, that I was surrounded by students with the same angst, and that the best solution was for us to help each other surmount the obstacles that lay ahead.

Having made it through the readings, I found myself sitting in my very first class, anticipating a casual, short introduction to the course, the professor, and the syllabus. Boy, was I wrong! We jumped right into the cases, covering topics from intent to negligence to promissory notes. Fortunately, the professors made it clear that it was not a sink or swim kind of day, and displayed the same anticipation and excitement that we as students were feeling. The discussions were rich with content, informative, and very confusing. Reality set in that first day. It was finally happening.

In my first class of the day, the professor informed the class that there are, in fact, "stupid questions." In the class immediately following, the professor informed the class that there is "no such thing as a stupid question." While I initially scratched my head at the contradiction, as I thought about it, I realized it was a perfect example of "thinking like a lawyer," holding two opposite views, neither one wrong.

All in all, my first month of law school has been a great experience. I remain optimistic, and hope to maintain that optimism going forward; so

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Gregory A. Barber, CFA, the managing director at Barber Analytics, LLC, is a corporate valuation expert focused on valuations for statutory and mediated minority shareholder buyouts. **Peter A. Mahler**, Esq., a partner at Farrell Fritz, P.C., assisted with legal research for this article; however, the opinions expressed are solely the author's.

Marketability Discounts in New York Statutory Fair Value Determinations

By Gregory A. Barber, CFA

As a securities analyst observing the discussion between appraisers, attorneys, and the courts regarding the applicability of marketability discounts in statutory shareholder buyouts, one can't help but feel the discussion has become an increasingly entangled series of misunderstandings, miscommunication, and inconsistencies. Appraisers appear to try earnestly to get the courts and attorneys to understand the valuation concepts, and when and how marketability discounts are applied, but it seems the parties are locked in either a state of perpetual disagreement or misunderstanding. Based upon a review of the leading New York cases, though, it seems only some of the courts may have misapplied marketability discounts. Some courts appear to have a clear understanding of when and how to apply marketability discounts, and believe it's what the language of the statute requires. And some New York courts now appear to be considering the broader impact of their decisions on entrepreneurial behavior in general. This factor can tip the balance in favor of not applying marketability discounts in general, but at the same time, introduce uncertainty for appraisers.

The Statute Language

New York Business Corporation Law (NYBCL) § 1104-a[1] allows holders of 20 percent or more of the votes of all outstanding shares of a corporation to "present a petition of dissolution on one or more" grounds, including (1) the "directors or those in control of the corporation have been guilty of illegal, fraudulent or oppressive actions toward the complaining shareholders" and (2) the "property or assets of the corporation are being looted, wasted, or diverted for non-corporate purposes by its directors, officers or those in control of the corporation." The statute also grants the court wide latitude when deciding whether to proceed with the involuntary dissolution to consider

whether "liquidation of the corporation is the only feasible means whereby the petitioners may reasonably expect to obtain a fair return on their investment . . . ."

As an alternative to involuntary dissolution, NYBCL § 1118 allows "any other shareholder or shareholders or the corporation" at any time within 90 days after the filing of the petition to "elect to purchase the shares owned by the petitioners at their fair value . . . ." If the parties are unable to agree to a fair value, the court may stay the proceeding to dissolve the company and determine "the fair value of the petitioner's shares as of the day prior to the date on which such petition was filed, exclusive of any element of value arising from such filing . . . ." The NYBCL does not provide a definition of fair value, leaving the determination to the courts. The New York courts routinely apply marketability discounts to company shares in determining fair value, and stand with only a few other jurisdictions in doing so.

Leading New York Cases

Blake v. Blake Agency

One of the most-cited and earliest cases that addresses the applicability of marketability discounts in § 1118 proceedings is *Blake v. Blake Agency* (*Blake*).[2] The case, an appeal from the Supreme Court, concerned the valuation of a 25 percent interest in a small insurance brokerage company, Blake Agency, Inc., located in Queens County. The holder of the interest sought dissolution under § 1104-a and the corporation elected to purchase the interest in a timely manner under § 1118. Justice Thompson's opinion for the appellate panel disallowed a minority discount on the shares because "§ 1104-a was enacted for the protection of minority shareholders, and the corporation should therefore not receive a windfall in the form of a discount because it elected to purchase the minority interest . . . ."[3] However, a discount for lack of marketability of 25 percent was allowed "because the shares of a closely held corporation cannot be readily sold on a public market. Such a discount bears no relation to the fact that the petitioner's shares in the corporation represent a minority interest."[4]

From an appraiser's perspective, these statements raise a number of questions, an exploration of which may resolve some of the apparent misunderstandings of when marketability discounts are applied and how they are measured. But before that, let's examine the support for this position referenced in the case. In support of this position, the *Blake* court cited two articles, *Valuation of Business Interests*[5] and *Valuing Closely Held Corporations and Publicly Traded Securities with Limited Marketability: Approaches to Allowable Discounts from Gross Values*,[6] and one court case, *Ford v. Courier-Journal Job Print. Co. (Ford)*.[7]

Haynsworth in *Valuation of Business Interests* does not appear to share the court's view that discounts should be applied in squeeze-out valuations, as he also states in his article that in

> some situations, however, no discount is proper. For example, it would be inappropriate to impose a discount in a dissenters' rights case or in a case where a minority interest has been improperly squeezed out of the business. Allowing discounts in these situations would undercut the purpose of dissenters' rights statutes to give minority shareholders the fair value of their shares, and it could also encourage squeeze outs.[8]

In addition, Lyons and Whitman in *Valuing Closely Held Corporations and Publicly Traded Securities with Limited Marketability: Approaches to Allowable Discounts from Gross Values* say that "when control of a business is for sale . . . we believe that as long as businesses are truly solvent . . . there are always markets for control blocks of stock. Given several months, or say a year's time, buyers virtually always can be found for such control positions."[9] Lyons and Whitman go on to state the generally held belief for minority positions in closely held companies that "there may be no market existing or creatable for such minority interests."[10] The authors also say that "as a general rule, and in the absence of compelling evidence to the contrary, where control shares exist, no discounts from gross value should be logically taken to account for a lack of marketability . . . ."[11]

The *Ford* case cited in *Blake* was a dissenting stockholders action decided by the Kentucky Court of Appeals. In the case, common shareholders holding 12.8 percent of the shares voted against a sale transaction and demanded payment of the fair value of their shares. Although the *Ford* court ultimately agreed to a 25 percent marketability discount in the valuation of Courier-Journal Job Printing Company, a close reading of the opinion suggests the court was using the marketability discount as a method of applying different weights to the valuation methods considered. The court states that the marketability discount used by the appraisers "merely indicates that the appraisers gave some weight to the market value of the stock in computing the fair value thereof, which they are free to do."[12] The market value approach used by the

When conducting a valuation of an interest in a company it is important to differentiate among the characteristics of the company, the interest, and the market into which the interest is sold.

appraisers examined sales of *minority* shares between officers of the company, which, with informed buyers and sellers, would have considered both the *minority* position the shares represented as well as the illiquid nature of the investment. But seeing no contradiction, the *Ford* court goes on to state that "[n]or do we feel that the [marketability] discount herein was applied merely because of the minority position of the appellants."[13] In support of the size of the marketability discount the appraisers cited studies conducted on *minority* interests in what appears to be restricted stock common shares, again seeing no contradiction in applying marketability studies of *minority* interests with an interest that is not discounted for its minority position, which can only be a majority or controlling position.[14]

Before returning to the *Blake* court's key statements and getting too nuanced in our critique of the support cited, let's shed more light on an appraiser's perspective. To begin simply, when conducting a valuation of an interest in a company it is important to differentiate among the characteristics of the company, the interest, and the market into which the interest is sold. All three of these features can have a material impact on the value of an interest. But to reach a fair value conclusion that is supported, defendable and explainable it is helpful, as much as possible, to keep these features separate.

Companies, of course, come in all shapes and sizes. Investors generally pay higher prices for businesses that are characterized by low risk and are expected to grow annual cash flow quickly. There are dozens of characteristics any investor (minority or majority) will consider in assessing these two basic features, such as the experience and record of company management and the historical growth in cash flow, but the important distinction to remember is these are all characteristics *of the company*.

Interests in companies are generally divided between controlling or majority interests (over 50 percent of the voting power) and minority interests (under 50 percent of the voting power).[15] If an investor controls the company he or she can select the board, choose the company's strategic direction, pay oneself a reasonable, but generous, salary, among other benefits. But most important for our discussion, the controlling shareholder can elect to sell the company or its underlying assets. Controlling interests in *publicly traded* companies *usually* sell for more on a per-share basis than the *minority interests* traded on stock exchanges.[16] The additional share price paid for control is called a control premium. The mirror image of the control premium is called the discount for lack of control and unfortunately, ambiguously, also called a minority discount. Controlling interests in *closely held* companies sell for more than their *minority* interests on a per-share basis also because those minority shares would have even less value than the marketable, exchange-traded minority shares.[17] Finally, a *controlling interest* in a private company also would sell for more on a per-share basis than the minority interest in an *identical* publicly traded company.[18]

Having an organized market for *minority* shares, such as the New York Stock Exchange or the NASDAQ, provides liquidity for investors and allows them to exit their investments, reducing the investor's risk. Without such a market *minority* shareholders in private companies suffer from increased risk and logically pay a lower price for their shares. Restricted stock studies compare the prices paid for *minority* interest – shares unable to be sold on the public stock exchange with the price of the freely traded *minority* shares *of the same company* to develop a measure of the discount for a lack of marketability for *minority* interests. Pre-IPO studies attempt to determine the appropriate marketability discount for closely held *minority* shares by examining the difference between a company's pre-IPO price and its IPO price.

Controlling interests of *both* closely held and publicly traded companies are usually sold in an informal market created by intermediaries.[19] Depending on the size of the company, the intermediary is either an investment banker (larger transactions) or a business broker (smaller transactions). In either case, the sale process usually takes a few to several months. To a buyer of 100 percent of a publicly traded company, there is no ongoing liquidity in the form of a publicly traded security. Since all the shares have been purchased by one buyer, there are no shares to trade and the company is delisted from the

stock exchange. Buyers of controlling interests of publicly traded companies enjoy no benefit of liquidity relative to control purchasers of private companies with respect to the *market* on which the interest could eventually be sold.

With this perspective in mind, let's return to the *Blake* court's statements. The first statement that "§ 1104-a was enacted for the protection of minority shareholders, and the corporation should therefore not receive a windfall in the form of a discount because it elected to purchase the minority interest . . ." leads appraisers to conclude the interest is not going to be discounted for its minority status, so the 25 percent interest being appraised in Blake Agency must be the pro-rata share of the value of a 100 percent controlling interest.

The second statement that a discount for lack of marketability of 25 percent was allowed "because the shares of a closely held corporation cannot readily be sold on a public market" is confusing because, if the *Blake* court is valuing the company on a controlling basis and controlling or 100 percent interests are not sold on the public markets, why is the comparison to the public stock market being made? The speed with which minority shares sell on the stock exchange seems irrelevant to the sale of a controlling interest in Blake Agency.

The final statement that "[s]uch a discount bears no relation to the fact that the petitioner's shares in the corporation represent a minority interest" seems to be made to distinguish the marketability discount applied to be one appropriate for a controlling interest, versus a minority interest, presumably because the company will take several months to sell. Taken together, the *Blake* court statements seem to say a marketability discount should be applied to a controlling interest in Blake Agency because it will take longer to sell the *entire* company than a *minority* interest in Blake Agency, if the company were publicly traded.

It is true that the sale of the *entire* company will take longer than a sale of *minority* shares, if the minority shares were traded on a national stock exchange. As stated above, it will take about five to seven months to sell the whole company, but only a few days to sell a very small interest, if it were traded on a stock exchange. So the key question, if we accept the *Blake* court's view that a marketability discount is correctly applied, is what discount *from the value of the entire company*, if any, is appropriate because the controlling interest will take several months to realize liquidity?

When determining marketability discounts it's very important to examine the sales of interests with similar characteristics, i.e., if you are applying a marketability discount to a privately held *minority* interest, you should look at liquidity discount studies for *minority* interests. It also helps to examine the discounts in companies with similar company characteristics (size, industry, level of profitability, and importantly, the level of dividends or distributions). And likewise, if you are determining a marketability discount for a *controlling* interest, it is best to examine studies of liquidity discounts for *controlling* interests. Again, similar company characteristics make the analysis better. In addition, the length of the period of illiquidity is very important to consider for both minority and majority interests. To look at marketability discount studies for shares that will be illiquid for two years and apply them to shares that have a six-month expected holding period would materially overstate the marketability discount.

Examining marketability discounts of *minority* interests *that have a few months until they are freely tradable* to a *controlling* interest that also has a few months until liquidity certainly would provide a better indicated marketability discount than the one selected by the *Blake* court, which didn't seem to apply much analysis in the selection of the discount.[20] But using minority interest marketability studies for controlling interests is a poor substitute for an analysis of marketability discounts in controlling interests in companies with similar characteristics and similar expected holding periods. Controlling interests, for the reasons discussed above, are generally more attractive than minority interests, and logically would not suffer from marketability discounts as high as those seen for minority interests. The appropriate analysis would examine the sales of *controlling* interests that could be sold immediately with sales of *controlling* interests that are sold in the normal time period of a few to several months. The problem is that no studies or analysis is possible because there are *no* controlling interests that sell within a few days because even if a buyer stands ready to buy the target company, the due diligence and negotiation of the merger or sale agreement takes time.[21]

Most appraisers however, in my experience do not apply marketability discounts to controlling interests outside of a statutory fair value proceeding as the *Blake* court proposes. This is for several reasons. First, the marketing or holding period is relatively short, just a few months, so the adjustment for marketability is viewed to be quite small and immaterial relative to the value conclusion. Second, and perhaps of more consequence, the holder of the controlling interest enjoys the earnings of the company and other benefits of control over the marketing period, offsetting the lack of dividends that a minority shareholder usually experiences. Most of the companies in the minority-interest restricted stock and pre-IPO studies referenced to develop marketability discounts (including those in the case cited by *Blake*, i.e., *Ford*) are in companies that are *not* paying dividends.

Finally, also consider that any holder of illiquid stock, whether holding a minority restricted stock interest that can only be sold in one year or a majority interest which could be sold in six months, is exposing his or her capital to negative company events that could occur over the holding period. This creates uncertainty around what the stock price will be when liquidity is available or when the

company is ultimately sold. In the same way, the minority shareholder that has elected to dissolve a company under § 1104-a and is being bought out under § 1118 is exposed to, as part of an unpredictable appraisal process, the risk that the value of his or her interest is unknowable and may not be realized for many months, and sometimes for years. Viewing the entire statutory buyout process as a whole, it seems to be applying a double burden to assess the petitioner's shares a marketability discount *as well as* subject them to an unpredictable statutory buyout process lasting much more than a few months.[22]

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In re Seagroatt Floral Co, Inc.

The next leading case chronologically is *In re Seagroatt Floral Co., Inc.* (*Seagroatt*).[23] The facts in *Seagroatt* followed a pattern typical of dissolution cases. Two corporations involved in growing and distributing cut flowers were held by the seven grandchildren of the founder. Dissention arose among the owners and two of the shareholders, each owning approximately 17 percent of the common shares of both companies, petitioned the court seeking a dissolution under § 1104-a, alleging oppressive behavior against the directors. Each corporation timely elected to purchase the shares under § 1118 and the Supreme Court stayed the dissolution proceedings and referred the matter to a referee to ascertain the fair value of the stock. The referee, in turn, valued the two companies together and applied a 25 percent discount for lack of marketability. The decision was appealed and the Appellate Division set aside the 25 percent marketability discount because the appraiser stated the "fact that it's a closely held company" had been considered in his selection of the company's capitalization rate.[24] The Court of Appeals agreed and refused to overturn the decision with respect to the marketability discount. In the opinion the Court of Appeals made a number of comments that provided a great deal of insight into its view of marketability discounts, as well as other associated valuation issues.[25]

The *Seagroatt* court's view of fair value was different, and arguably would result in a lower value, than the *Blake* court's perspective. The *Seagroatt* court said the "objective of a proceeding under Business Corporation Law § 1118 including the one now before us is to determine what a willing purchaser in an arm's length transaction would offer *for petitioners' interest in the company* [emphasis added] as an operating business."[26] In support of this statement the court cited *In re Pace Photographers* (*Pace*)[27] and *Blake*.[28] However, the language in *Pace* and *Blake* differs and says value "should be determined on the basis of what a willing purchaser, in an arm's length transaction, would offer *for the corporation* [emphasis added] as an operating business, rather than as a business in the process of liquidation." As stated above, the entire corporation could be sold in a few months through the retention of an intermediary, such as an investment banker, and would transfer with it all the benefits of control. The petitioner's minority interest would likely not be saleable at all. Conspicuously absent in the *Seagroatt* opinion was any discussion of the inapplicability of a minority discount, as there was in *Blake*. The *Seagroatt* court seems to be taking the position that fair value should take into consideration the minority nature of the interest and its lack of marketability.

Consistent with the first statement, the *Seagroatt* court goes on to say minority shareholders in close corporations are unlikely to find prospective buyers for their shares and it "follows that, whatever method of valuing an interest in such an enterprise, it should include consideration of any risk associated with illiquidity of the shares."[29] Again Haynsworth's *Valuation of Business Interests* is cited generally and *O'Neal's Close Corporations* specifically.[30] As discussed above, Haynsworth does not seem to share the court's view that discounts should be applied in squeeze-out valuations. In addition, although a copy of the third edition of *O'Neal's Close Corporations*, which was cited, is no longer available, the 2004 edition provides a balanced review of the relevant dissolution cases across the country addressing the illiquidity discount and doesn't appear to be an endorsement of the application of a marketability discount in the context of a statutory dissolution. O'Neal and Thompson state that "in a majority of states with decisions on this point the appreciation of such a discount is rejected."[31] They go on to state that it "seems particularly inappropriate to apply such a discount when a shareholder is selling to a person or family that owns all or must [sic] of the other shares of the corporation."[32] In support of the discussion above regarding *Blake*, they also state that while "the lack of a market affects the ability to sell minority shares in a company, the market for all of a company's assets or shares or for a controlling interest operates differently and may not be adversely influenced by the fact that the company's shares are not traded."[33]

The *Seagroatt* court clearly views fair value as the value of the petitioner's interest in an arm's-length sale taking into account the lack of marketability of the interest. After reviewing the court's language closely, many appraisers might think they should apply a minority discount as well. That the Court of Appeals in *Seagroatt* is attracted by the notion that the discounted value is the correct measure is not really surprising. Ignoring shareholder statutory rights for a moment, outside of an actual control transaction, minority interests in private companies usually have little value to third parties even when operated by honest, capable, fair-minded majority owners.[34] It could be argued that the value received by the petitioner in *Seagroatt* was above what could have been realized in a sale of the interest to an unrelated third party, especially if the grounds for the § 1104-a petition were accurate. It is only with the presence of fraudulent or oppressive behavior, or the looting or wasting of corporate assets by the majority, together with consideration of what is equitable to the parties as individuals *and* good public policy, that an observer begins to understand why other undiscounted values might, on balance, be the better remedy.

The *Seagroatt* court clearly views fair value as the value of the petitioner's interest in an arm's-length sale taking into account the lack of marketability of the interest.

Friedman v. Beway Realty Corp.

The *Beway*[35] decision is not a § 1118 case, but since the Court of Appeals expressed in the opinion that "there is no difference in analysis between stock fair value determinations under Business Corporation Law § 623, and fair value determinations under Business Corporation Law § 1118"[36] the case is relevant to our discussion. The case involved petitioners who voted their shares against the consolidation of nine corporations invested in real estate into a single partnership. The petitioners timely elected their appraisal rights under § 623 and asked the Supreme Court to determine the fair value of their shares. The Supreme Court and the Appellate Division both refused to apply a minority discount, but did apply a 21 percent marketability discount. The respondent's expert had recommended a 45 percent marketability discount based upon restricted stock studies of *minority* common shares, which the Supreme Court had adjusted down. The Court of Appeals accepted the lower courts' determination on the minority discount, but sent the discount for lack of marketability back for a new and likely higher determination.

The *Beway* court expressed a strong opposition to minority discounts, saying they were "inconsistent with the equitable principles developed in New York decisional law"[37] and that "imposing a minority discount . . . would result in minority shares being valued below that of majority shares, thus violating our mandate of equal treatment of all shares of the same class."[38] The Court of Appeals for the first time extends its language to include consideration of the impact of its decision on corporate activities in general, saying "a mandatory reduction in the fair value of minority shares to reflect their owners' lack of power in the administration of the corporation will inevitably encourage oppressive majority conduct."[39] The *Beway* court also returns to the definition of fair value detailed in *Blake*, saying courts should "determine the minority shareholder's proportionate interest"[40] in the corporation, that is, "what a willing purchaser, in an arm's length transaction, would offer for the *corporation* as an operating business."[41] Contrary to the extensive support cited for the *Beway* court's position on minority discounts, there is no support cited for the application of the marketability discount. However, the *Beway* court clearly thought one was appropriate since it sent the marketability discount back for reconsideration, saying the Supreme Court erred in reducing the marketability discount to 21 percent.

As was the case with *Blake*, it's hard to know if the court believed: (1) because the sale of the entire company would take several months a discount for lack of marketability was appropriate; or, (2) it should treat the interest as controlling for purposes of considering the minority discount, but as a minority interest for application of the marketability discount. If the latter is true, the court has created a value that doesn't exist in the real world, one that takes part of its characteristics from controlling interests, and part from minority interests in private companies. And this "split personality" of the New York court approach is what appraisers find so confusing. In valuing a particular interest, appraisers are trying to simulate how a market would react to an interest offered for sale. That interest can be either a controlling interest, a minority as-if-publicly-traded interest, or a minority, private interest. It can't be two different types of interests at the same time. Appraisers use discounts and premiums to move the values indicated by the valuation methods applied to reach the desired end point or "level of value."

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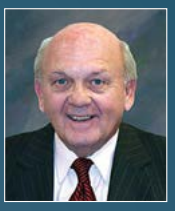

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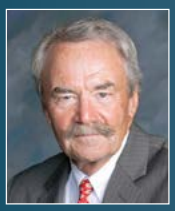

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But the foundation upon which all the analysis is constructed is the nature of the interest itself, or the qualities of the interest that have been defined (i.e., value a minority interest in a private company as its pro-rata share of the value of the entire company). But the New York courts in refusing to apply a minority discount, but then applying a marketability discount suitable for a minority interest, effectively are claiming the interest has attributes of two different types of interests – it is both a controlling and a minority interest at the same time. Although you *could* define such a value, such interests don't exist in actual markets between unrelated, informed parties.

It is also interesting to note that the *Beway* court saw no inconsistency in refusing to apply a minority discount because it "would result in minority shares being valued below that of majority shares"[42] but allowed a significant marketability discount which would yield a lower value for the minority shares, exactly what it had just refused to allow on principle. Allowing the majority to purchase the minority shares at a 21 percent or 30.4 percent discount from the value of the whole company *would allow* the majority to elect to sell the whole company within a few months with a significant profit on the discounted minority shares they just purchased. From a broader perspective, it doesn't matter what the discount is called; as long as the majority can sell the company for more it is a discount that violates the "mandate of equal treatment of all shares of the same class."[43]

Also of note is that almost all of the cases cited by the *Beway* court in support of its decision not to apply a minority discount also chose not to apply a marketability discount. Of the seven cases cited, five explicitly addressed the marketability discount and declined to apply it for the *same reasons* the minority discount was refused.[44] Of the two other cases, one could be interpreted as declining to apply a marketability discount as well, but the language isn't explicit.[45] The other case involved the valuation of a 90.2 percent interest in a business in a divorce and no marketability discount was applied.[46] These five decisions, which include four state Supreme Court decisions and one appellate court decision, saw no reason to differentiate between a marketability and minority discount as they both produce the same unequitable result, i.e., minority shares being valued below that of majority shares.

A Broader Perspective

To be candid, valuing an asset whose value changes depending on who holds it presents a thorny problem for the courts. A review of dissolution cases from the highest courts across the nation revealed a number of reasons they were opposed to applying a marketability discount. An often repeated reason was that applying the discount would be contrary to the purpose of the statute, i.e., to protect minority shareholders.[47] Other reasons cited were that discounts were not appropriate in inter-family transfers[48] or that discounts encourage corporate squeeze-outs and shouldn't be encouraged with a financial incentive.[49] The Rhode Island Supreme Court in *Charland v. Country View Golf Club* took the practical view that if the dissolution had been allowed to proceed, all the shareholders would have received the same amount, so no discount should apply.[50] Finally, the Indiana Court of Appeals in *Wenzel v. Hopper* believed that the dissolution proceeding and buyout created liquidity for the minority shareholder, so no liquidity discount was appropriate.[51]

The courts that applied marketability discounts were both unusual cases. In *Munshower v. Kolbenheyer*, the Florida District Court of Appeal applied a marketability discount relying "on New York case law as persuasive in this matter"[52] without any further discussion or comment. In *Balsamides v. Protameen Chemicals*,[53] the Supreme Court of New Jersey found itself in the unique position of deciding what fair value meant when the oppressed shareholder was buying out the oppressing shareholder. The *Balsamides* court was convinced by the expert that a marketability discount of 35 percent was appropriate because the *entire company* could only be sold for the discounted amount. The testimony of the expert that seemed to convince the court was, from an appraiser's perspective, doubtful. The expert stated that "whether you apply a marketability discount to one hundred percent of the shares of stock, fifty percent of the shares of stock, or twenty percent of shares of stock, the marketability discount would be the same."[54] As discussed above, this statement appears to contradict the fact that controlling interests are much more attractive and marketable than minority interests in private companies. Important in the *Balsamides* court's reasoning seemed to be that it didn't "want to afford a shareholder any incentive to oppress other shareholders."[55] And it is this consideration – the incentives and penalties that the law provides for business owners, investors and entrepreneurs – that brings a much broader and, for some, a helpful perspective to the marketability discount discussion.

There is an area of study in economics that seeks to understand the role of entrepreneurs in the economy. The most recent major contribution to this area of study was by William J. Baumol in 1990. He theorized that entrepreneurial individuals (i.e., business owners) have a choice to devote their labor toward private-sector wealth creation (e.g., product innovation, moving production to more profitable products), or toward securing wealth redistribution through political and legal processes (e.g., lobbying government to protect their industry, lawsuits).[56] The former activities are viewed as productive (creating new wealth) and the later as unproductive (redistributing existing wealth, and in some cases destroying existing wealth). Oppressive behavior on the part of majority shareholders seeking to squeeze out the minority at a discounted price would fall into the unproductive category. Baumol hypothesized that how "the

entrepreneur acts at a given time and place [in history] depends heavily on the rules of the game – the reward structure in the economy – that happens to prevail."[57] The "rules of the game" from an entrepreneur's perspective include the legal and judicial system. Baumol went on to propose that entrepreneurs are always present in societies, but societies that don't provide a "constructive and innovative script" for them are likely to find their growth atrophied.[58] Although Baumol's work is difficult to prove conclusively, other authors have conducted economic research that supports his theory.[59]

Seen from the entrepreneurial economist's perspective, oppressive behavior of majority shareholders should, at a minimum, not be rewarded with the opportunity to purchase minority shares at a discount. This would qualify as behavior that does not create wealth or contribute to the growth of the economy as a whole. Further, some oppressive behavior by majority shareholders does not appear much different from theft (e.g., grossly excessive salaries, the individual purchase of company assets well below value) and should be discouraged.

Alternatively, there are unusual instances where the oppressing shareholder is the *minority*. Imagine a scenario where an unrelated investor buys the shares of a family business from a minority shareholder at a price that reflects both discounts for lack of control and marketability. The investor then engages in a campaign to pressure the majority shareholders to purchase his shares by alleging the majority takes excessive salaries and threatening to disqualify the company for S-Corporation status by transferring the shares to an ineligible shareholder. If the majority is simply trying to operate and grow the business in a fair manner, respectful of the duties to, and rights of, all the shareholders, the behavior of the minority would be viewed as unproductive by entrepreneurial economists. Again, considering the incentives structure of the economy and society as a whole, it doesn't seem the oppressing minority should be rewarded for his behavior through the purchase of his interest at an undiscounted price, as it represents simply a redistribution of wealth and no new wealth creation. In fact, from the incentives perspective, one could argue the buyout price for this investor should reflect *both minority and marketability discounts*, a similar value as it was purchased for. Again, the instances where the minority shareholder is the oppressor seem to be the exception.

The current New York statutory scheme is ill-suited to allow for the consideration of shareholder behavior when determining a remedy. Under NYBCL § 1118, the election to purchase the petitioning shareholder's shares is almost always made before there can be any finding by the court that there are grounds for dissolution under § 1104-a. Once the election to purchase the shares is made, New York courts have viewed their role as simply determining the fair value of the minority shares without regard to shareholder behavior.[60] Such a statutory scheme, when combined with New York's rather consistent application of a significant marketability discount, allows for oppressive behavior on the part of the majority to be rewarded. From an incentives perspective, the New York statutory scheme and the courts are encouraging unproductive behavior on the part of entrepreneurs. Although one could imagine a discounted value for an oppressed minority shareholder is a remedy relative to receiving virtually nothing on the open market for his or her shares, from a broader perspective, it's hard to imagine the New York legislature intended to *reward* oppressive majority behavior when it enacted § 1104-a and § 1118.

From an appraiser's perspective, a flexible role for discounts in fair value determinations in general creates uncertainty as each case has its own facts. Whether discounts apply to the valuation may not be known until after the appraiser has done his or her work. But this uncertainty can be addressed by providing the court values with and without discounts. As the application of discounts is primarily a matter of law in any event, it seems better to leave the discount decision to the court. If the role of the courts is viewed as simply to contribute to the "rules of the game" for entrepreneurs and investors and to maximize wealth-creation behavior, the debate of whether to apply discounts in shareholder buyouts becomes a little less difficult. ■

1. Although some New York courts have stated that they consider the definition of fair value under NYBCL § 623 (appraisal or dissenter's rights actions) to be the same as fair value under § 1118, when making very nuanced distinctions between what is equitable and good public policy, it is better to confine the discussion to a single, similar action. So I will confine my discussion to § 1118 dissolution actions. Admittedly, however, in the case of minority shareholder oppression or "squeeze-outs," the distinction between methods used by the majority which trigger appraisal rights versus dissolution rights is sometimes a matter of form, and the underlying public policy and equity issues are very similar.

2. *Blake v. Blake Agency*, 107 A.D.2d 139 (App. Div. 1985).

3. *Id.* at 149.

4. *Id*.

5. Harry J. Haynsworth IV, *Valuation of Business Interests*, 33 Mercer L. Rev. 457 (1981–1982).

6. William P. Lyons and Martin J. Whitman, *Valuing Closely Held Corporations and Publicly Traded Securities with Limited Marketability: Approaches to Allowable Discounts from Gross Values,* 33 Bus. Law. 2213 (July 1978).

7. *Ford v. Courier-Journal Job Print. Co.*, 639 S.W.2d 553 (Ky. Ct. App. 1982).

8. Haynsworth, *supra* note 5, at 489.

9. Lyons and Whitman, *supra* note 6, at 2226.

10. *Id. at* 2227.

11. *Id*.

12. *Ford*, 639 S.W.2d at 556.

13. *Id.*

14. *Id*.

15. In practice, the level of control of an interest is viewed on a continuum. A 100 percent interest, for example, is more attractive than an 80 percent interest as the 80 percent interest must always be concerned with meeting its fiduciary duties to the minority shareholders.

16. Buyers of controlling interests are normally divided between financial and synergistic. Financial buyers are those that do not have existing operations and include private equity and hedge funds. Synergistic buyers are

operating companies that may be able to realize operating synergies with the target company. Although it's generally true that controlling interests sell at a premium to the exchange-traded stock price, there are times when the public market prices shares above the price control buyers are willing to pay.

17. However, because arm's-length, minority-interest sales of privately owned companies are extremely unusual, and if they do occur, are rarely reported, there are no studies to support this assertion.

18. Appraiser's often note that in control transactions private companies sell for lower multiples of earnings (a cheaper price) than their publicly traded counterparts. Although the research is not definitive, this is likely caused by the private companies having less attractive company characteristics (i.e., a lack of audited financial statements, less experienced management, slower earnings growth, less product and geographic diversification). In addition, buyers of publicly traded companies can often reduce or eliminate the target's standalone public company costs (such as executive and board member compensation, audit fees, and costs associated with internal controls), giving the impression they are paying more (i.e., a higher multiple) on a current earnings basis.

19. Controlling interests in private companies are sometimes sold on an exchange through a public offering, but this is a small number of transactions compared to the investment bank/business broker market.

20. The *Blake* court seems to have relied on the discount used in *Ford*. The *Ford* court relied upon the expert that appears to have cited restricted stock discount studies of minority shares where the restricted shares could not be sold for a period of two years (*Ford*, 639 S.W.2d at 556).

21. Ideally, the study would include 100-percent-interest sales of the *same* company in a process that took a few days and also several months, but this "dual reality" does not exist in the real world.

22. The petitioner also usually receives interest from the valuation date during the § 1118 process, similar to a controlling shareholder receiving dividends and other benefits during the sale of a controlling interest into the market by an intermediary, making the two positions reasonably analogous.

23. *In re Seagroatt Floral Co. Inc.*, 78 N.Y.2d 439 (1991).

24. *Id.* at 447.

25. Perhaps more significant as the *Seagroatt* court's direct comment on the applicability of marketability discounts is the court's interpretation of the statutory language with regard to the going-concern versus liquidation issue and whether shareholder misconduct is a consideration under § 1118. However, in the interest of brevity and focus, these topics will need to be addressed at another time.

26. *Seagroatt*, 78 N.Y.2d at 445.

27. *In re Pace Photographers, Ltd.*, 71 N.Y.2d 737, 748 (1988).

28. *Blake*, 107 A.D.2d 139, 146.

29. *Seagroatt*, 78 N.Y.2d at 445.

30. F. Hodge O'Neal and Robert B. Thompson, *O'Neal's Close Corporations* § 9.34, at 162–63 (3d ed. 1993).

31. F. Hodge O'Neal and Robert B. Thompson, *O'Neal and Thompson's Close Corporations* § 9.32, at 231 (Rev. 3d ed. 2004).

32. *Id.*

33. *Id.* at 232.

34. There are exceptions to this general rule. Some private technology/Internet companies have broad public awareness and a large shareholder base created by the exercise of options by their employees. Shares of these companies are exchanged by accredited investors by companies such as SharePost, Inc. and SecondMarket Solutions Inc. (purchased by NASDAQ).

35. *Friedman v. Beway Realty Corp.*, 87 N.Y.2d 161 (1995).

36. *Id.* at 168.

37. *Id.* at 167.

38. *Id.* at 169.

39. *Id.*

40. *Id.* at 168.

41. *Id.* (quoting *In re Pace Photographers, Ltd.*, 71 N.Y.2d 737, 748 (1988)).

42. *Id.* at 169.

43. *Id.*

44. *Cavalier Oil Corp. v Harnett*, 564 A.2d 1137, 1145 (Del. 1989) ("Discounting individual share holdings injects into the appraisal process speculation on the various factors which may dictate the marketability of minority shareholdings. More important, to fail to accord to a minority shareholder the full proportionate value of his shares imposes a penalty for lack of control, and unfairly enriches the majority shareholders who may reap a windfall from the appraisal process by cashing out a dissenting shareholder, a clearly undesirable result."); *Hickory Cr. Nursery v. Johnston*, 167 Ill. App. 3d 449, 455 (1988) ("Lastly, though Johnston's expert stated that a discounting of Johnston's interest would be in the range of 10% to 35% if it were marketed to an outsider as a minority interest and Hickory Creek's expert applied a minority discount of 25% in his unadjusted formula analysis, we find such discounting does not apply in the instant case when a minority interest is being assumed by the remaining shareholders resulting in a substantial pro rata increase in their share and control of the corporation."); *Woodward v. Quigley*, 133 N.W.2d 38, 44 (Iowa 1965) ("Plaintiffs cited *Felder v. Anderson, Clayton & Co., Del. Ch.*, 159 A.2d 278, 285, in which the court apparently approved a 10 percent discount from the average multiplier "for certain reasons, such as the lack of marketability of the stock, etc." In view of our interpretation of the purpose of the statute, we decline to follow the Delaware court in this position, if it, by this statement, approved such a discount."); *In re McLoon Oil Co.*, 565 A.2d 997, 1003 (Me. 1989) ("The referee expressly rejected Lido's contention that he should discount the full value of each company because of the minority status and lack of marketability of the Dissenters' stock. On appeal Lido's only serious challenge to the referee's finding of fair value is directed at the referee's recognition of the Dissenters' full proportionate interest in the whole value of each company, free of any minority or nonmarketability discount. We find Lido's arguments for such discounts unpersuasive. In our view application of those discounts would run directly counter to our appraisal statute's purpose of protecting dissenting shareholders."); *Rigel Corp. v. Cutchall*, 511 N.W.2d 519, 526 (Neb. 1984) ("We are persuaded, however, that in the event of a merger, neither a minority discount nor a deduction for lack of marketability is to be given in determining the fair value of a dissenter's shares under the provisions of § 21-2080. Only by not doing so can the statutory policy of fully compensating a dissenting minority shareholder be achieved.").

45. *Brown v. Allied Corrugated Box Co.*, 91 Cal. App. 3d 477, 487 (1979) ("According to that approach, the minority shares would then have to be valued in relation to what they would bring in the open market, with an appropriate reduction for the fact that they do not give their purchaser control of the corporation. Further, if, as was apparently the case here, the controlling shareholder has been using his position to insure that no benefits, such as dividends or employment, ever accrue to the owners of the minority shares, then an argument could be made that the value of the minority shares should be reduced even further, perhaps to zero. Thus, the very misconduct and unfairness which provoked the minority shareholders to seek involuntary dissolution could, in this manner, be used to further oppress them. This, the statutory scheme before us cannot be read as condoning.").

46. *Eyler v. Eyler*, 492 N.E.2d 1071, 1074 (Ind. 1986) ("Regardless whether using the date of separation, or using any other date through the completion of the final hearing, the shares constituting the 90.2% share of the business were at all said times held in joint ownership and not burdened by the factors which may warrant consideration of the "minority interest" discount.").

47. *Advanced Commc'n Design v. Follett*, 615 N.W.2d 285, 292 (Minn. 2000); *Morrow v. Martschink*, 922 F. Supp. 1093, 1105 (D.S.C. 1995).

48. *Morrow*, 922 F. Supp. at 1104; *Wenzel v. Hopper*, 779 N.E.2d 30, 39 (2002).

49. *Advanced Commc'n Design*, 615 N.W.2d at 292; *Wenzel*, 779 N.E.2d at 39.

50. *Charland v. Country View Golf Club, Inc.*, 588 A.2d 609, 613 (R.I. 1991).

51. *Wenzel*, 779 N.E.2d at 39.

52. *Munshower v. Kolbenheyer*, 732 So. 2d 385, 386 (Fla. Dist. Ct. App. 1999).

53. *Balsamides v. Protameen Chem.*, 734 A.2d 721 (N.J. 1999).

54. *Id.* at 737.

55. *Id.* at 738.

56. William J. Baumol, *Entrepreneurship: Productive, Unproductive and Destructive*, 98 J. Polit. Econ. 893 (1990).

57. *Id.* at 894.

58. *Id.*

59. Russell S. Sobel, *Testing Baumol: Institutional quality and the productivity of entrepreneurship*, 23 J. Bus. Venturing 641 (2008).

60. *Pace*, 71 N.Y.2d at 746.

The Treatment and Marshaling of Joint Accounts in an Article 81 Guardianship Proceeding

By Anthony J. Enea

The existence of joint bank or brokerage accounts has become ubiquitous in 21st century America. There are numerous legitimate and logical reasons for the creation of a joint account. However, when an Article 81 guardianship proceeding is commenced and the alleged incapacitated person (AIP) has accounts jointly owned with another person, it is imperative for the petitioner to determine the reason the joint account(s) was created, the benefits conferred to each joint owner, if any, and the impact the guardianship proceeding may have on the funds. This article will explore the different ways of holding joint assets and explain how to treat and marshal said joint assets for the purposes of a guardianship proceeding.

Joint Accounts

It is particularly common for married couples and seniors to have joint bank or brokerage accounts with their spouse, children, sibling(s) or other third parties. For example, the joint account may have been created because the parties to the joint account contributed the funds or assets comprising the account, or acquired said funds during their marriage. An owner may also decide he or she wants a joint owner to have full and unfettered access to the account during their lifetimes (especially helpful if there is a subsequent disability) or upon the death of the owner, irrespective of whether the joint owner made equal contributions to the account.

Joint accounts are also commonly utilized and recognized as an effective wealth transfer vehicle, which permits the transfer of assets from one party to another upon death without necessitating the probate of a Last Will & Testament or the creation of a trust. Joint accounts as well as what are known as "Totten Trusts," or "Transfer on Death Accounts" for brokerage and security accounts, pass by operation of law to the surviving joint tenant(s) or the designated person. For a Totten Trust or Transfer on Death Account, usually only an original death certificate is required by the bank or financial institution as proof that the surviving joint tenant(s) is authorized to access the funds.

For Convenience Accounts

The right to receive by operation of law the joint account upon the death of a joint tenant does not apply to a joint

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account that is created and held "for the convenience" of the depositor. Accounts "for the convenience" are regulated by § 678 of the N.Y. Banking Law. Section 678 provides that

> when a deposit of cash, securities or other property has been made, or shares shall be issued in or with any banking organization or foreign banking corporation transacting business in this state, in an account in the name of the depositor and another person, and in the form to be paid or delivered to either 'for the convenience' of the depositor, the making of such deposit or issuance of shares shall not affect the title to such deposit or shares and the depositor is not considered to have made a gift of one-half the deposit or of any additions or accruals thereon to the other person, and, on the death of the depositor, the other person shall have no right of survivorship in the account.[1]

675 may only be refuted by "direct proof or substantial circumstantial proof, clear and convincing and sufficient to support an inference that the joint account had been opened as a matter of convenience or by proving undue influence, fraud or lack of capacity."[4]

With respect to securities accounts or brokerage accounts in joint names, the Transfer on Death Security Registration Act (TOD) and Estates, Powers and Trusts Law 13-4.1 through 13-4.12 (EPTL) permits joint securities and brokerage account holders to have the same rights and choices that joint bank account holders have. The TOD was enacted on July 26, 2005 and it amended the EPTL by enacting a new part four to Article 13. It is essentially codified in EPTL 13-4.1 through 13-4.12. Under EPTL 13-4.2, a "transfer on death" or "payable on death" securities or brokerage account can only be established by sole owners or multiple owners having a right

Section 675(b) provides that the burden of proof is upon the one challenging the presumption of joint tenancy.

Section 678 of the Banking Law specifically gives the depositor the ability to have two signatories on an account who can withdraw funds from the account, but the "convenience" signatory is not permitted to make a gift of more than half of the funds in the account, and his or her access does not bestow any survivorship benefits upon the joint account title holder. In order for the provisions of § 678 to apply, the words "for the convenience" or similarly "for convenience only" must appear on the title of the account. If the aforesaid words do not appear, the presumptions created by § 675 of the Banking Law will be applied.

Section 675 provides that the making of a deposit in the name of the depositor and another to be paid to either the depositor or to the survivor is prima facie evidence that the depositor intended to create a joint tenancy, and that where such a deposit is made, the burden of proof is on the one challenging the presumption of joint tenancy. Under § 675, three rebuttable presumptions are created: (1) as long as both joint tenants are living, each has a present unconditional property interest in an undivided one-half of the money deposited; (2) that there has been an irrevocable gift of one-half of the funds in the account by the depositor to the other joint tenant; and (3) that the joint tenant has a right of survivorship in said entire joint account upon the death of the other joint tenant.

Section 675(b) provides that the burden of proof is upon the one challenging the presumption of joint tenancy. In *In re Camarda*[2] and *In re Coddington*,[3] the court held that the presumption of joint tenancy created by § 675 may only be refuted by "direct proof or substantial circumstantial proof, clear and convincing and sufficient to support an inference that the joint account had been opened as a matter of convenience or by proving undue influence, fraud or lack of capacity."[4]

With respect to securities accounts or brokerage accounts in joint names, the Transfer on Death Security Registration Act (TOD) and Estates, Powers and Trusts Law 13-4.1 through 13-4.12 (EPTL) permits joint securities and brokerage account holders to have the same rights and choices that joint bank account holders have. The TOD was enacted on July 26, 2005 and it amended the EPTL by enacting a new part four to Article 13. It is essentially codified in EPTL 13-4.1 through 13-4.12. Under EPTL 13-4.2, a "transfer on death" or "payable on death" securities or brokerage account can only be established by sole owners or multiple owners having a right of survivorship in the account. The owners of a securities or brokerage account held as tenants-in-common are expressly prohibited from creating a "transfer on death" account. Although the creation of a "transfer on death" or "payable on death" securities or brokerage account does not require that any specific language be utilized to create the account, the usage of the phrases "transfer on death" and "payable on death" or their abbreviations "TOD" or "POD" should be used to evidence the creation of the future interest.[5] However, under EPTL 13-4.4 evidence of the establishment of the account is the opening documentation that indicates that the beneficiary is to take ownership upon the death of the other owner(s).

The Potential Problems Caused by Joint Accounts in a Guardianship

In the past, some courts in New York, when dealing with the existence of joint accounts in a guardianship proceeding under Article 81 of the Mental Hygiene Law (MHL), did not fully analyze the ramifications of the use of a joint account(s) by the incapacitated person. For example, in the past, some courts have in their proposed form for the findings of fact, conclusions of law and judgment included an outright prohibition against the guardian maintaining any joint accounts as part of the guardianship estate. The taking of such a position by the court requires the attorney for the petitioner to be cognizant of such a position, so that he or she may be able to take the appropriate measures, and seek the appropriate and necessary relief as to the joint account(s) in the petition. If the court maintains a policy that joint accounts cannot

be maintained by the guardian, it will be necessary for the petitioner to assess how the joint tenant(s)' one-half interest and rights of survivorship in said joint account(s) will be impacted by the appointment of a guardian of the property, and whether the joint tenant will lose his or her rights to access the funds in the joint account, as well as his or her survivorship interest. In many instances where the guardianship proceeding is being initiated by the spouse of the alleged incapacitated person and the spouse is requesting a transfer of all joint accounts and assets to himself or herself (Medicaid planning/estate planning purposes) then the issue of how to title the account in the guardianship is often moot.

Additionally, it requires an assessment and review of how and why the joint account(s) was created, who is entitled to notice of the relief being sought and what is his or her right to be heard. Irrespective of what the court's proposed form judgment states, the survivorship rights of a joint tenant(s) cannot and should not be terminated or modified without the joint tenant being given notice of the proposed change and an opportunity to be heard. To accomplish this, it is necessary that the petitioner undertake a thorough investigation of the account(s) in issue and specifically delineate in the guardianship petition what is being proposed with respect to the joint account(s).

Identifying the Joint Accounts in the Petition

Section 81.08 of the MHL specifically provides for the disclosure of the approximate value of any property or assets held by the alleged incapacitated person in the petition for the appointment of a guardian. It is incumbent upon the petitioner to undertake the necessary investigation to determine which bank or brokerage accounts the AIP has in his or her name alone or holds jointly with others or is the beneficiary of, and to disclose that information in the guardianship petition.

In doing so, with respect to any bank or brokerage accounts, the petitioner should specifically identify any jointly held bank or brokerage account(s), and whether said joint account(s) are joint accounts entitled to the presumptions of § 675 of the Banking Law, or are "for the convenience" accounts under § 678 or "transfer on death" accounts with respect to any brokerage account pursuant to the TOD and EPTL 13-4.1 through 13-4.12. The petition should specifically identify any person who has an interest in the account, the extent of his or her interest and whether he or she has a right of survivorship in the account.

In most cases this should not be problematic if the joint account holder is the spouse of the AIP and he or she has a joint account with the AIP. However, if the joint account holder is a child of the AIP or a third party, the petitioner should obtain copies of the account signature cards and any other bank or financial institution record which may describe whether the account is a joint account with rights of survivorship that is entitled to the presumptions of Banking Law § 675; is a "transfer on death" account under EPTL 13-4.1 through 13-4.12; or is merely a "for the convenience" account under Banking Law § 678.

Specifically Delineate Your Proposal as to Any Joint Account(s) in the Guardianship Petition

The guardianship petition should contain a clear and concise description of the relief sought by the petitioner with respect to any joint bank or brokerage account(s). If a transfer of the title of the joint account from the AIP to the other named joint account holder is being sought, it is necessary that same be specifically delineated in the petition. The petition should also specifically identify the account by its account number, name of bank or brokerage firm, as well as the existing title on the account. It should also specify the title of the account to be created once the account or any part thereof has been marshaled by the guardian, or whether an apportionment of the account or outright transfer to the other named account holder is being sought. Additionally, it is critical to address the survivorship interest of each joint tenant in the petition.

As briefly stated above, if the potential exists that the AIP may need Medicaid (either nursing home or home care and/or has estate tax issues) and a transfer of the assets in a joint bank or brokerage account is being sought for the spouse, blind or disabled child (exempt transfer(s) for Medicaid eligibility) it is more likely that the Guardianship Court will approve a transfer of the AIP's interest in the account(s) to the other named title holder, without any apportionment to the AIP. This is also true if no objection to the proposed transfer is made by any other interested party to the proceeding and the AIP's testamentary scheme as reflected in any Last Will & Testament or trust is consistent with the proposed transfer.

Obviously, complications could arise when the proposed transfer is to a joint account holder who is not the spouse of the AIP. If, for example, the joint account holder is a child, family member or friend, there will be issues as to whether the child, family member or friend contributed any of the funds in the joint account(s), and whether the proposed transfer will create the five-year look-back period and a period of ineligibility for nursing home Medicaid purposes (unless it qualifies as an exempt transfer to a spouse, blind or disabled child). There will also be the issue of whether the other interested parties to the guardianship will consent to the transfer, and if the proceeds of the account are to be apportioned by and between the account holders, how will title to each apportioned account be held, and what impact will the apportionment have on the survivorship interest of each joint tenant. Whether it is in the new guardianship account created or the other account, the protection of the survivorship interest of each joint account holder must be addressed.

For example, if apportionment is not sought and a complete transfer is made to the non-incapacitated account holder, will it be necessary that the account be titled "in trust for" the incapacitated person? This could be problematic if the incapacitated person is a potential candidate for Medicaid, and the prior death of the non-incapacitated person would result in the passage of the funds by operation of law in the account to the incapacitated person. This problem may be obviated if the incapacitated party can be the beneficiary of a Supplemental or Special Needs Trust (SNT). In that event it would be appropriate to title the account of the non-incapacitated party "in trust for" the SNT of the incapacitated party.

Additionally, in order to protect the non-incapacitated account holder, it may be necessary to see that the account marshaled by the guardianship be titled "X, as Guardian of his or her property of Y, in trust for Z" so as to protect his or her survivorship interest.

Conclusion

There are a multitude of differing and complex scenarios that could arise then dealing with joint accounts within the context of a guardianship proceeding. However, irrespective of the scenario it is necessary that the petition address the issue of the joint account(s) head-on and clearly articulate the relief sought and the basis for the position being taken.

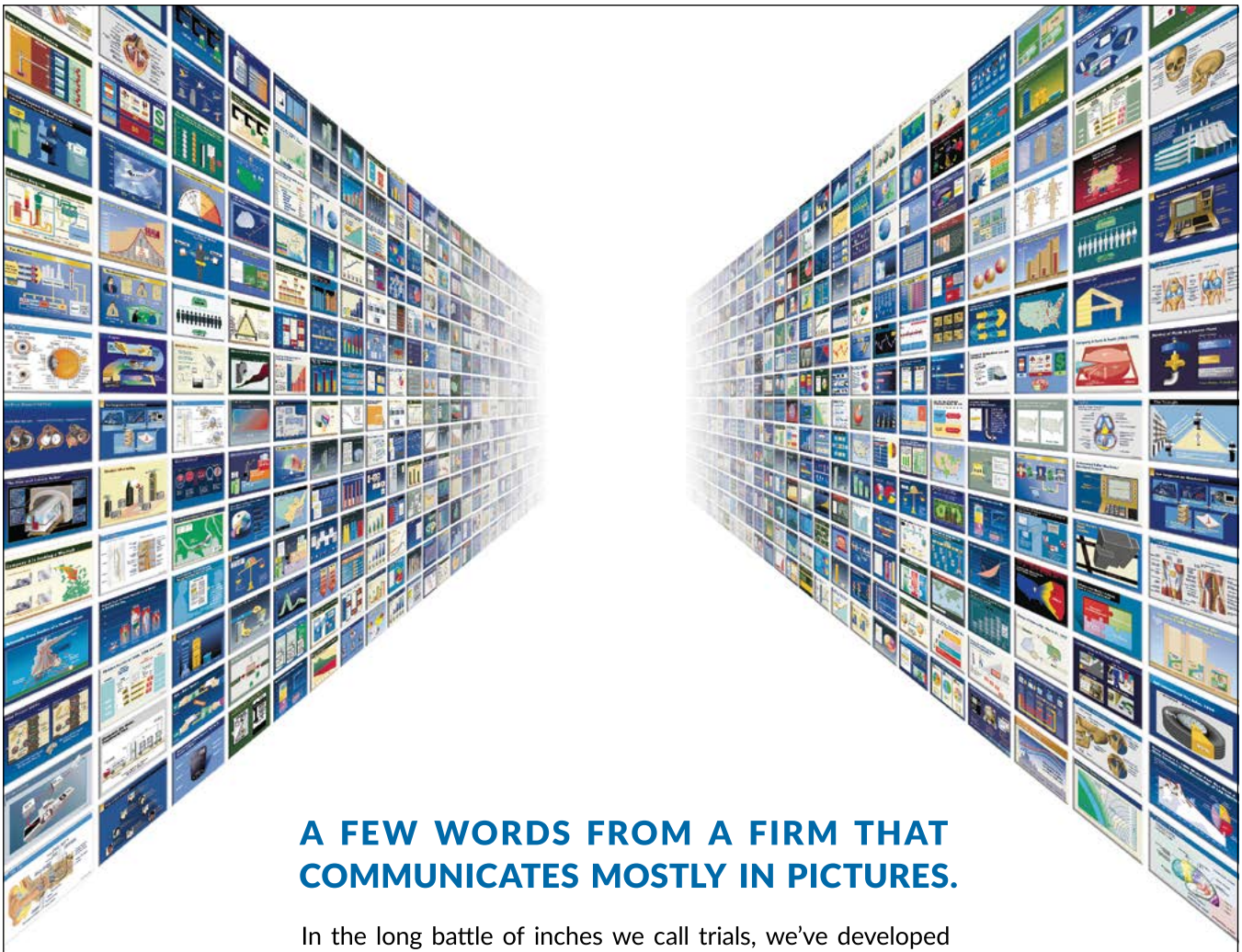
Additionally, in an age where the cost of long-term care is a significant issue for most seniors, it is imperative that all Medicaid eligibility issues also be properly addressed within the context of the guardianship proceeding. ■

1. N.Y. Banking Law § 678.
2. 63 A.D.2d 837.
3. 56 A.D.2d 697.
4. *Kleinberg v. Heller*, 38 N.Y.2d 836, 841.
5. EPTL 13-4.5.

Becoming a Lawyer
Continued from Page 20

far so good. Next month, I begin work on my first memorandum of law, and I have chosen to represent the defendant. The most unnerving aspects of the assignment are that first, we have only a month to complete the assignment, and second, the memo *cannot* exceed six pages. In the past, a six-page limitation meant that assignment was getting done the night before it was due, and with ease. Given the topic, and the amount of material to cram into the memo, I am quite sure I will come to dread the six-page limitation. As I struggle with my memorandum of law, I will also be volunteering for moot court and trying to figure out how the sound waves from a speaker can cause a battery to an individual. Wish me luck. ■

If you are a law student and you would like to submit comments to *Becoming a Lawyer*, please send an email to journal@nysba.org and include your name, your contact information, and what law school you attend.



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Earlier Registered Domain Names, Later Acquired Trademarks

By Gerald M. Levine

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I. The Rise of Cyber-Entrepreneurs

Trademarks have a long history; domain names are of recent origin. Trademarks were "invented" to "identify and distinguish [one person's] goods . . . from those manufactured or sold by others and to indicate the source of the goods."[1] Domain names are merely functional elements "invented" to identify and link locations on the Internet. The Lanham Act defines domain names as "any alphanumeric designation which is registered with or assigned by any domain name registrar . . . as part of an electronic address on the Internet."[2]

It took only a short time after the introduction of the Internet for entrepreneurs to figure out how to profit by buying domain names unassociated with trademarks and using them to generate income either through pay-per-click search sites or holding them in inventory for future sale.

With one caveat – that registrations not purposefully infringe third-party rights – there was not then and there is not now anything unlawful in registering strings of characters that happen to correspond to existing trademarks. Absent a legal basis for forfeiture, non-trademark domain names coexist with trademark domain names with this difference: while domain names are limited to the Internet, trademarks have a double identity in being present in both actual and virtual marketplaces, a factor that enhances their value to doppelgängers unlawfully taking advantage of the good will and reputations of trademarks established in actual marketplaces.

While alphanumeric designations and trademarks have distinct personalities, they come into conflict and are potentially injurious to trademark owners and deceptive to consumers when the strings are identical or confusingly similar. Unlike identical trademarks in the actual marketplace, which can coexist in different classes of goods and services, no two identical strings can coexist on the Internet. Strings that are similar can coexist, but as their similarities morph to the confusing end of the spectrum, they too may encroach on statutorily reserved rights.

Occupying locations on the Internet that arguably infringe third-party rights represent a potential threat to the integrity of existing trademarks. This threat

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was met in 1999 by the introduction of two remedial regimes designed specifically to protect trademark owners: the Uniform Domain Name Dispute Resolution Policy (UDRP),[3] an alternative, online dispute resolution process implemented by the Internet Corporation for Assigned Names and Numbers (ICANN), and the Anticybersquatting Consumer Protection Act (ACPA), a statutory scheme that is incorporated into the Lanham Act.[4]

II. Priority

As the Policy has been construed, bad-faith use alone is not a predicate for forfeiture.[5] Unless complainant proves that respondent both registered the domain name in bad faith and is using it in bad faith – a conjunctive or binary requirement as opposed to the disjunctive requirement of the ACPA – it cannot prevail on its complaint. Generally speaking, domain names that predate the existence of trademarks, even if their holders commence using them in bad faith, cannot by definition have been registered in bad faith. The consensus view is set forth in paragraph 3.1 of the WIPO Overview of WIPO Panel Views on Selected UDRP Questions:

> [W]hen a domain name is registered by the respondent before the complainant's relied-upon trademark right is shown to have been first established (whether on a registered or unregistered basis), the registration of the domain name would not have been in bad faith because the registrant could not have contemplated the complainant's then non-existent right.[6]

In other words, the owners of later-acquired trademarks complaining that earlier registered corresponding domain names are infringing have no basis for cybersquatting claims. The ACPA is more explicit in requiring that the plaintiff's marks must have been "distinctive at the time of the registration of the domain name."[7] This means that the owners of later-acquired trademarks lack standing for a cybersquatting claim, although they still may have a viable claim under the Lanham Act. This limitation of the UDRP has resulted in complaints by trademark owners that they are left with no remedy against bad-faith use by domain name holders taking advantage of the rising reputations of later-acquired trademarks. This objection presupposes bad-faith use after trademark owners have established a reputation in the marketplace even though the domain name preceded the establishment of rights in the trademark.

This situation is distinguishable from the common situation illustrated in *Success Bank v. ZootGraphics c/o Ira Zoot*,[8] in which the complainant had no commercial presence as "Success Bank" when the domain name was registered but later rebranded itself before obtaining a federal registration for the term. It nevertheless argued that having a registered trademark made its right to <successbank.com> superior to the respondent's right to the domain name. The Panel pointed out that although the complainant had some rights in the SUCCESS BANK mark, they were "junior to the rights of Respondent due to registration of the domain." The Panel criticized the complainant for "stretch[ing] [their] argument to the extreme." If the law were as the complainant wanted it to be, the Panel wrote, then any owner of later acquired trademarks "could peruse the lightly used or parked domains, initiate a trademark registration application years after the . . . disputed domain name was registered and then claim UDRP rights in the domain under the first element of the UDRP."

The Panel's reasoning in *Success Bank* represents the consensus view of the parties' respective rights in these circumstances, but it does not address the problem posed by domain names registered prior to trademark acquisition that subsequently resolve to infringing websites.

III. Departing from the Consensus

I have pointed out previously that the development of the UDRP is in the common-law tradition.[9] In deciding cases Panels are not limited to "statements and documents submitted" by the parties but may apply "any rules and principles of law that [they] deem applicable."[10] The consensus that bad-faith use following good-faith registration is not actionable even though registrants are obviously engaged in cyberpiracy is the product of construction, not statute, and it has been challenged by a new construction – first by the panelist who established it in the first decided case under the UDRP, *World Wrestling Federation Entertainment, Inc. v. Michael Bosman*,[11] before recanting it nine years later in *City Views Limited v. Moniker Privacy Service / Xander, Jeduyu, Algebralive*, D2009-0643 and *Octogen Pharmacal Company, Inc. v. Domains By Proxy, Inc./ Rich Sanders and Octogen e-Solutions*[12] (the *Mummygold* line of cases), and then by others applying this new construction in sometimes inappropriate circumstances.

The new construction rests on two principal propositions: first, that registrants are bound contractually by their representations in the registration agreements, and second, that the Policy should be read as requiring in appropriate fact situations a retroactive finding of bad-faith registration based on subsequent bad-faith use for breach of warranty. This is known as the unitary view of the Policy, as opposed to the consensus view that the Policy requires a binary finding, i.e., that bad faith use alone is insufficient to prove cybersquatting

While the *Mummygold* view has not dislodged the consensus that bad-faith use but good-faith registration is beyond the scope of the Policy – embodied most notably in *Guru Denim Inc. v. Ibrahim Ali Ibrahim abu-Harb*,[13] in which the dissenting panelist was the *Mummygold* Panel – it nevertheless has opened up a vigorous conversation on the issue of bad-faith use following renewal as evidence of bad-faith registration. In particular, against the backdrop of *Mummygold*, the Panel in *Eastman Sporto Group LLC v. Jim and Kenny*[14] introduced a new reading of

the Policy by focusing on pre- and post-renewal conduct. Before discussing *Eastman Sporto*, I summarize the legal reasoning underlying both the *Mummygold* and *Eastman Sporto* views.

First, trademark owners are either third-party beneficiaries of registration agreements, in which case they have derivative claims for registrants' breaches of their representations and warranties in their registration agreements, or they have direct claims for registrants' violations of paragraph 2 of the Policy. Below is a side-by-side comparison of the two representations:

Registration Agreement	**Paragraph 2 of the Policy**
You agree and warrant that: (i) *neither your registration nor use of the any of the Network Solutions services nor the manner in which you intend to use such Network Solutions Services will directly or indirectly infringe the legal rights of a third party . . .* and (vi) you agree to comply with all applicable laws and regulations" (emphasis added).	(a) the statements that you made in your Registration Agreement are complete and accurate; (b) to your knowledge, the registration of the domain name will not infringe upon or otherwise violate the rights of any third party; (c) *you are not registering the domain name for an unlawful purpose*; and (d) *you will not knowingly use the domain name in violation of any applicable laws or regulations* (emphasis added).

Note that while these provisions are similar, they not identical. They both extract promises from registrants about their purposes for registering and using domain names, but Paragraph 2 is more severe by introducing the concept that a registration could be "unlawful" – particularly Paragraphs 2(c) and (d). It naturally provokes a question about the offending use: What if, contrary to their representations, holders (having registered their domain names lawfully before the existence of a trademark) begin using their domain names unlawfully after a later-acquired trademark has developed a reputation?

The new construction has two branches. Panels adhering to Branch #1 (the "*Mummygold*" line of cases) take the position that bad-faith use alone is sufficient to find abusive registration. They reject the consensus view noted earlier – that complainants must prove that respondents both registered and are using the domain name in bad faith – and argue that registrants' representations that they will not use domain names for any unlawful purpose are a continuing obligation, not simply limited in time to the purchase of the domain name. The Panels of this view are reinforced by their reading of the preamble to paragraph 4(b) of the Policy to mean that the Policy requirement is not binary but unitary. They convert the "and" to an "or." Such a reading brings the UDRP into alignment with the disjunctive model of the ACPA (*see* n.5).

Panels adhering to Branch #2 (the "*Eastman Sporto*" line of cases) propose a less dramatic departure from the consensus. They take the view that the assessment of bad faith restarts upon renewal of registration. While this construction makes sense, it too is inconsistent with consensus as reported in Paragraph 3.7 of the WIPO Overview: "While the transfer of a domain name to a third party does amount to a new registration, a *mere renewal of a domain name has not generally been treated as a new registration for the purpose of assessing bad faith*" (emphasis added). Generally, renewal is regarded as a continuation of registration. However, the WIPO Overview does recognize that Panels are beginning to "consider the renewal of a domain name as equivalent to a new registration in certain circumstances, including where it is found that: the registrant changed its use of the domain name prior to renewal [and continued the bad faith thereafter]."[15]

The most recent case applying a version of the *Mummygold* reasoning without directly citing it is *Camilla Australia Pty Ltd v. Domain Name Admin, Mrs. Jello, LLC*,[16] in which a three-member Panel including the recanter in *Guru Denim* (but now joined with like-minded panelists) held that the representation and warranty applies to "the registrant's future conduct made at the time the registrant applies for registration of a domain name."[17]

While the *Mummygold* reasoning is essentially at a dead end notwithstanding *Camilla*, this is not true of the *Eastman Sporto* construction. Dissatisfaction with the consensus was first voiced in a 2004 case, *PAA Laboratories GmbH v. Printing Arts America*.[18] The Panel there held that "[t]he abusive refreshing of the original registration is an act which this Panel considers should be an act of a kind encompassed by paragraph 4(a)(iii) of the Policy." It then stated that the "benefit of an original good faith registration should not be perpetual to the point where it can cloak successors in title and successors in 'possession' long after the original registration would have expired." Notwithstanding this view, the Panel "reluctantly" denied the complaint because of "the need for consistency and comity in domain name dispute 'jurisprudence.'"

The *Eastman Sporto* Panel stated that he "share[d] [*PAA* Panel's] reservations," but instead of acquiescing, it rejected the traditional approach.[19] The Panel held that subsequent bad-faith use "should be an act of a kind encompassed by paragraph 4(a)(iii)" and concluded that "[b]ased upon the record in this proceeding . . . [the] Panel deems Respondent's 2009 renewal of the disputed domain name to be the date on which to measure wheth-

er the disputed domain name was registered and used in bad faith."

The *Eastman Sporto* reasoning – that forfeiture is justified when respondents intentionally change their uses of domain names to take advantage of complainants' marks – was applied recently in *Adam Milstein v. Benjamin Doherty*.[20] The Panel there held that "[w]hat is at issue here is the deliberate creating of a false impression by registering a domain name using the entirety of another person's name without permission and . . . [continuing that use after renewal of registration]." The factor that triggers a finding of abusive registration after renewal rests on the continuation of bad-faith use with knowledge that the use that began before renewal continues to be infringing, which is sure evidence of breach of registrant's registration agreement and violation of paragraph 2 of the Policy.

IV. Conclusion

Decisions favorable to trademark owners in branch #1 have become extremely rare because the majority of panelists are not in favor of amending the UDRP by construction. In contrast, Panels are more willing to find that bad-faith use commencing before and continuing after renewal of registration is actionable is a commonsense development of the jurisprudence, not a departure from it. In fact, as these renewal cases come down, it is becoming increasingly clear that where warranted by the facts, the Panel in *Eastman Sporto* was right, and the Panel in *PAA* was wrong. This conclusion would not be surprising under the ACPA because the statute is an either/or model: a trademark owner satisfies its burden by proving that the domain registrant "register[ed], traffic[ked] in, *or used* the domain name" in bad faith. ■

1. 15 U.S.C. § 1127.
2. *Id.*
3. Implemented by the Internet Corporation for Assigned Names and Numbers (ICANN) following a two-year study commencing in 1997 and publication of a Final Report in April 1999 by the World Intellectual Property Organization (WIPO).
4. 15 U.S.C. § 1125(e).
5. In contrast, the ACPA is an either/or model. Assuming trademarks were distinctive when domain names were registered, domain names can be forfeited on proof registrants either registered, trafficked in, or used them in bad faith.
6. http://www.wipo.int/amc/en/domains/search/overview/index.html#31.
7. 15 U.S.C. § 1125(d)(1)(ii)(I and II).
8. FA0904001259918 (Nat. Arb. Forum June 29, 2009).
9. *Domain Name Arbitration*, section 4.01-A (Sources of UDRP law).
10. Rule 15(a) of the Policy.
11. D99-0001 (WIPO Jan. 14, 2000) (Scott Donahey, sole panelist).
12. D2009-0643 (WIPO July 3, 2009) and D2009-0786 (WIPO Aug. 19, 2009).
13. D2013-1324 (WIPO Sept. 27, 2013) in which Mr. Donahey sitting as a wing in a three-member panel dissented: "It would be much easier for this panelist to maintain that his original decision [approving the binary concept] was correct, and not recant. But in view of the evidence [of the correctness of the unitary view], I am unable to do so."
14. D2009-1688 (WIPO March 1, 2010).
15. Paragraph 3.7, *supra*.
16. D2015-1593 (WIPO November 30, 2015) (Mr. Donahey is a panel member).
17. *Camilla Australia*, *supra*.
18. D2004-0338 (WIPO July 13, 2004).
19. *Eastman Sporto*, *supra*.
20. FA1511001647496 (Forum January 11, 2016).

Spies, Lies and a Hollow Nickel

A former prosecutor recalls his role in convicting Soviet spy Rudolf Abel

SPY's PROSECUTOR, Assistant Attorney General Tompkins, who directed the operation which resulted in Abel's arraignment, stands in the arcade of Brooklyn federal courthouse with his special assistants, Anthony R. Palermo (left) and James J. Featherstone. (This photo and caption appeared in the August 19, 19578 issue of Life.)

With its release last year, the Steven Spielberg movie Bridge of Spies *sparked renewed interest in Cold War espionage, specifically the arrest and conviction of a high KGB operative known as Col. Rudolf Abel, who was later swapped for U2 pilot Francis Gary Powers. In 1964, James B. Donovan, Abel's defense counsel, recounted his experiences in a best-selling book titled* Strangers on a Bridge, *portions of which were extracted for an article in the June 2016 issue of the* Journal. *But what about the prosecution? That side of the story might have remained an afterthought were it not for Tony Palermo, the sole surviving member of the government team that prevailed all the way up to the Supreme Court. Recently, Mr. Palermo, a former NYSBA President, has been in the spotlight, including an article by Rosemary Byrne in the Spring 2016* Senior Lawyer *newsletter, published by NYSBA, and talks before various audiences. He was a panelist in a November 4, 2015 discussion at the Brooklyn Historical Society, televised by C-SPAN, and a panelist on an ABC Radio talk show from Los Angeles the day before Mark Rylance won an Oscar for his portrayal of Abel. Below is a condensed version of a talk Mr. Palermo gave on November 24, 2015 before the Monroe County Bar Association, titled "Recollections of a Prosecutor: Trial of KGB Master Spy Rudolf Abel." Comments in brackets have been added by Mr. Palermo for clarity and continuity.*

Introduction

We have to thank Steven Spielberg, Tom Hanks (who portrayed James Donovan), and Mark Rylance for an excellent movie that focuses attention on issues that existed back in the 1950s and how it's relevant today – the ability to communicate, to negotiate, to understand your friends and to understand your enemies . . . But the movie does not really spend much time about the trial itself and very importantly doesn't spend an awful lot of time on how the man known as Abel was apprehended. So my remarks today, speaking to a lawyers group, may focus more on legal issues. I'm looking at my original memorandum that I personally prepared and submitted in opposition to the (defense) motion to suppress evidence and declare the search illegal, [which] the government prevailed on in the trial court, the government prevailed on in the Court of Appeals and the government prevailed on after arguing two times in the United States Supreme Court, albeit by a narrow margin of 5 to 4 (see excerpts of the memorandum on page 44).

Facts vs. Dramatic Effect

I was happy to see that (in the movie) the profession was held to be an honorable profession, as I have always believed that we are. They [movie producers/scriptwriters] had a couple of things that were wrong ethically. Back-dooring the prosecution by talking to the judge at his home about sentencing is not a very ethical thing to do, and Donovan did not do that. The fact of the matter is, Donovan and the prosecution did meet with the court and did explain how we felt about the issue of sentencing

and, to his credit, Jim Donovan did raise the issue both in private sessions with the court as well as in public on the record, in which he said, "You know, it might be in the best interest of the United States if we don't sentence this man to death, because he may very well be useful in exchanging someone, maybe we've got somebody that we would like back." And lo and behold, five years later, that is indeed what happened.

Who Initiated the Prisoner Swap?

I'm not sure we'll ever know whether it was the United States that initiated it. . . . [T]he day of the exchange I was called, I think around six o'clock in the morning, maybe it was five o'clock, by the *Democrat and Chronicle*. They knew that I had been involved in the case and asked me what I thought and I said, "Gee, we're giving up a real spy and what are we getting, we're getting an airplane pilot." Well, at the time, we didn't know that this flying over Russia had been going on for six years, that we had massive coverage of everything that was going on in the Soviet Union and that the plane shouldn't have been found and the pilot shouldn't have been found. So my guess is that we might very well have said the time has come . . . but I'm still not sure who initiated that [the exchange].

Assignment of Counsel

The indictment was handed down on August 7 and Assistant Attorney General [William F.] Tompkins, Jim Featherstone and I are the guys who presented the case to the grand jury and got the indictment. Abel was known to the government only by a lot of other names, and so the indictment reads "USA vs. Rudolph Ivanovich Abel, aka "Mark," aka Martin Collins, aka Emil R. Goldfus, Defendant." Well, the transcript gets into the Bar Association [involvement] because there's this dialogue of the judge [Judge Matthew Abruzzo] asking do you have a lawyer, do you want me to appoint a lawyer? The court explains that this is a capital case and he is allowed to appoint one or two lawyers. . . . And so finally, Abel said, "Well, I think that's a good idea but would you consider checking with the Bar Association?" [The request demonstrates Abel's intelligence and his comprehension of the American legal system, as well as his astuteness in avoiding potential government involvement in his defense, as the movie *Bridge of Spies* implies.] It's fascinating that in a case of this magnitude, the idea that this intelligent spy (and his background is absolutely incredible; you would not believe the integrity, the experience, the linguistic ability, the mathematical ability, everything this man possessed) . . . ultimately was himself responsible for getting Jim Donovan appointed.

The Indictment Is Shared

Incidentally, in the transcript that I alluded to where Abel asked about (getting a lawyer) he also says, "May I have, may I see the indictment?" The judge said, "Well, these are legal things and normally we give the indictment to lawyers. But you seem like an intelligent man. Can we get a copy of the indictment for this defendant?" And I said, "I have a copy, your honor." So I'm the guy who handed the indictment to Abel. And it's a fascinating document. In terms of the conspiracy that's alleged, the overt acts that are alleged, they made some very interesting reading and I believe for the most part we proved every one of them.

> I was happy to see that (in the movie) the profession was held to be an honorable profession, as I have always believed that we are.

The Hollow Nickel

I think this is a fascinating story. The newsboy, James Bozart, was collecting for the *Brooklyn Eagle* in his neighborhood and in the course of receiving a collection . . . he found it sounded a little bit different. He found 45 cents and he knew that this person always gave him 50 cents. So he continued to feel around on the landing where he had dropped these coins and he found half of one nickel and half of another one. He found a piece of photographic paper stuck in a hollow chamber on one of the halves of the nickel [which contained an encrypted numeric message on microfiche, an important piece of evidence for the prosecution].

Cracking the Code

The nickel [microfiche] had a lot of numbers on it, columns of numbers. And the finest intelligence agencies of the United States, all of them, including the secret ones that we didn't know about, could not decode this message until one day in May, 1957, a guy (Reino Hayhanen) walks into the embassy in Paris and says, "I'm a spy and I've been operating in the United States of America and I'm going back to Moscow and I don't think I'm going back for a vacation. So could I have asylum?" And he tells a lot of stories about how they operated, the methods of a secret network of communication with all sorts of drop areas and signal areas and mechanisms with hollowed out pencils and hollowed out coins and trick devices and so forth. And bingo, that coin that we hadn't been able to (decode), it was broken.

Well, the code, basically, it says, "Welcome to the United States. This is how you communicate. You're going to be given money, your family is fine." There were all sorts of mechanisms as to how he had backup in case a signal was missed.

Drop Areas

There was a drop area in a hole in a step in Prospect Park at a certain entrance. And the FBI goes to Prospect Park and they discover that there is not a hole there, the whole step had been repaired. They break it open and would you believe they found inside of it a metal bolt. And the metal bolt, when examined by the FBI laboratory, opens up and inside is microfiche and a typewritten message [which was later determined to belong to Abel, who had loaned his typewriter to an artist friend before his arrest. On the witness stand, the friend, the artist Burt Silverman, was upset at having his honeymoon in Italy cut short in order to testify and said he could not definitively identify the typewriter as Abel's. However, it was linked to him through a serial number and receipt that Silverman had signed when he turned the typewriter over to the FBI.]

The Training of a Spy

This guy Hayhanen was trained for over 20 years in Finland with a new identity and a new background. This is the extent to which the espionage system was working

Excerpts from the Majority Decision and Dissents

On March 28, 1960, the Supreme Court, in a 5-4 decision, upheld the conviction of Soviet spy Rudolph Abel. Below are excerpts from the majority decision written by Justice Frankfurter and the dissents of Justice Douglas and Justice Brennan.

Mr. Justice Frankfurter delivered the opinion of the Court:

> The question in this case is whether seven items were properly admitted into evidence at the petitioner's trial for conspiracy to commit espionage. All seven items were seized by officers of the Government without a search warrant. The seizures did not occur in connection with the exertion of the criminal process against petitioner. They arose out of his administrative arrest by the United States Immigration and Naturalization Service as a preliminary to his deportation.
>
> * * *
>
> Petitioner's basic contention comes down to this: even without a showing of bad faith, the FBI and INS must be held to have cooperated to an impermissible extent in this case, the case being one where the alien arrested by the INS for deportation was also suspected by the FBI of crime. At worst, it may be said that the circumstances of this case reveal an opportunity for abuse of the administrative arrest. But to hold illegitimate, in the absence of bad faith, the cooperation between INS and FBI would be to ignore the scope of rightful cooperation between two branches of a single Department of Justice concerned with enforcement of different areas of law under the common authority of the Attorney General.
>
> * * *
>
> Surely no consideration of civil liberties commends discouragement of such cooperation between these two branches when undertaken in good faith. When undertaken in bad faith to avoid constitutional restraints upon criminal law enforcement the evidence must be suppressed. That is not, as we have seen, this case.

Mr. Justice Douglas, with whom Mr. Justice Black concurs, dissenting:

> No effort was made by the FBI to obtain a search warrant from any judicial officer, though, as I said, there was plenty of time for such an application. The administrative warrant of arrest was chosen with care and calculation as the vehicle through which the arrest and search were to be made. The FBI had an agreement with the officials of INS that this warrant of arrest would not be served at least until petitioner refused to "cooperate."
>
> * * *
>
> The issue is not whether these FBI agents acted in bad faith. Of course, they did not. The question is how far zeal may be permitted to carry officials bent on law enforcement. . . . The facts seem to me clearly to establish that the FBI agents wore the mask of INS to do what otherwise they could not have done.
>
> * * *

Mr. Justice Brennan, with whom the Chief Justice, Mr. Justice Black and Mr. Justice Douglas join, dissenting:

> These arrest procedures, as exemplified here, differ as night from day from the processes of an arrest for crime. When the power to make broad, warrantless search is added to them, we create a complete concentration of power in executive officers over the person and effects of the individual. We completely remove any independent control over the powers of executive officers to make searches. They may take any man they think to be a deportable alien into their own custody, hold him without arraignment or bond, and, having been careful to apprehend him at home, make a search generally through his premises. I cannot see how this can be said to be consistent with the Fourth Amendment's command; it was, rather, against such a concentration of executive power over the privacy of the individual that the Fourth Amendment was raised.

and the curiosity as to how successful it was is part of the reason why for the last 58 years I've been continuing to ask who was Abel, what did he accomplish and so forth. There's a lot of literature now that demonstrates that he was extremely successful and basically was probably in charge of the network of North and South America.

And he was a very humble, reasonable, rational person. He really was. Well, the guy who turns on him tells us all these things about him and we obviously scour the neighborhood. One of the places where he had been is right across from the Federal Courthouse. There was a studio building, which is no longer there now, and they find that, yes, there is such a person that bears resemblance to that [Hayhanen's description of Abel] and his name is Emil Goldfus and yes, he's an artist and has a studio on the fifth floor.

At this point, and it's at a much higher level than yours truly, somebody is making a decision, what do we do? And at that point, Hayhanen, the defector, is worried about his family back in Russia. He's worried about the spot [target] that's on his back and he is not about to testify. And he is saying, "I refuse to testify." So the Department of Justice, which happens to be made up of a lot of different entities, at the time the Immigration and Naturalization Service, the FBI, the Internal Security Division, etc., at the highest level has got to decide what we're going to do here. Essentially, they decided that they would try to see if they could get this guy to cooperate with them. And the FBI went into the hotel room (not quite as shown in the movie), but they did talk with him for a half hour, addressed him as Colonel, and said, "Would you cooperate with us?" And he said, "What are you talking about?" They said, "Well, you're going to be arrested if you don't cooperate." He said, "Well, I don't know what you're talking about." So they call in the INS agents who are out in the hall and basically the arrest was made.

The Legal Issue

The INS agents had a civil administrative warrant, not a criminal warrant, and the legal issue is, can you seize [evidence]? In the process of packing they noticed that Abel was trying to conceal things, tucking things up his sleeve and even throwing things into the toilet. And then he discarded stuff. He chose what stuff he would put into his suitcase and he discarded stuff into the waste basket. After he left, the FBI went to the owner of the hotel and said we'd like permission to search the basket, and the basket contained incredible stuff with hollowed out pencils, reams of information, radio receiving schedules and all sorts of good things, letters from home.

So that's where the legal issue comes in and you've got to give Donovan and his team credit. He had two former Assistant U.S. Attorneys from the Southern District of New York who worked with him on the case and they recognized the legal issue and that's the one we're still talking about today and it's relevant to society as we find it today – what do you do with immigrants, do you hold them?

We continued to talk with Hayhanen and the investigation continued and kept piling up, and we really knew that this was the big cheese. I mean, you've got connections with the Rosenbergs and the message that was found in Prospect Park led to a Sergeant Rhodes, who had been recruited to work with the Soviets when he was a mechanic [in charge of the motor pool] at the American Embassy in Moscow. So we [government investigators] kept uncovering stuff and it [the investigation] was on a fast track. That's probably one of the reasons that I was on the case. I was asked to go up to New York City for two days and I took my toothpaste and two white shirts and a suit. And six months later I got back to Washington. We were on a very, very fast track. I interviewed all of those FBI agents and the Immigration and Naturalization agents. I got their affidavits, I prepared them both for grand jury and for trial, the hearing before Judge [Mortimer] Byers and so forth.

There was no time. I read in Jim Donovan's book [how] he [was] trying to figure out what he's doing and he focuses on the constitutional issue and he's saying the government has been following this guy for two years, they know all about him and they've got reams of lawyers and research being done, and I'm reading the book and saying, "Huh? That's me." First year out of law school. I graduated from Georgetown Law School in September, joined the Justice Department in November and this is now July of the next year, I'm not even out one year. Basically, I'm the guy that's doing this research. And there was no case law on the issue. And I'm thinking, how come every time they get a legal problem, there's no authority?

Audience question: To what extent at that time and today do we know the exact information that he acquired and transmitted?

Answer: That's part of the inquiry we make in terms of evaluating the success of the conspiracy. All you have to do is establish the agreement to obtain information and in this instance it happened to be atomic and security information. And that's what we provided. What really did he acquire and how successful was he? One of the things that we put in, one of the facts, was payment of money to the Rosenberg group. That's just one illustration that there were successes. The Rhodes situation – that was critical in our case because that's essentially how we got the interest in atomic energy and atomic bombs. And Rhodes had a brother who was employed in an atomic facility and so that's the type of proof that we had. . . . I've got a long list of primarily high level KGB people who have defected and have written books, including one that is ironic. [It's about] the heat-sensitive thermal thing that's used to find metal and used in missiles to find the target. And that is something that came

through the Rosenberg network and is believed to have been monitored and used by Abel. That particular device is probably what brought down Gary Powers' plane. For six years as the planes were flying over Russia, the Russians did not have the capacity to bring down that plane. But it's theft of that information which probably brought down Powers and brought down our planes in Vietnam, as a matter of fact.

I do think he [Abel] had a fair trial and let me say this: If you read the summation of [Assistant Attorney General] Tompkins, it's something that you can be proud of, it's something I've always stood for and I've been on both sides, as a prosecutor for five years with the Justice Department [and as a court-assigned and independent criminal defense counsel]. I was a special prosecutor for the District Attorney's Office. The role of the prosecutor is to see that justice is done, it's not to get a conviction. You don't decide victory by whether you win or lose, it's whether or not justice is done. And that's the approach that we argued both to the jury and throughout.

I was surprised that the Powers' sentence was 10 years. Considering what he was doing and what information the United States was getting with those flights over Russia, I think they were fairer on the sentencing than the United States was.

And I probably shouldn't say this, but my guess is that all was not in unison in terms of how you conduct [defend] this case. How do you defend a guy when you have the evidence that we were able to bring to this case . . . where do you go? I'm thinking, even in retrospect, 58 years later, how would I have tried to examine that witness [Rhodes] and I'm not sure I would have spent a hell of a lot of time on it. But Donovan did. And essentially, his approach was, even to the jury, that Abel was a

Excerpts from Palermo's Memorandum

The following are excerpts from Tony Palermo's memorandum in opposition to Abel's petition in the Southern District of New York for return of property and suppression of evidence:

Point I

Petitioner contends that the search and seizure involved in this case was illegal because the warrant on which he was arrested was a "civil" one and did not charge the commission of a crime.

> Assuming, for the sake of Petitioner's argument, that it is the *nature of the charge* in an arrest warrant which controls the legality of any search which follows as an incident to arrest, the Government does not agree with Petitioner's classification that he was arrested on a "civil warrant." The cases which Petitioner cites do not support his contention, but rather, they stand for the proposition that *deportation proceedings*, not the issuance of an alien arrest warrant, are civil and not criminal proceedings.
>
> * * *
>
> Thus, we feel it is incorrect to label an arrest under such an Alien Warrant as "civil arrest." It would be equally incorrect to refer to it as a "criminal arrest." It is more appropriately termed a *sui generis* arrest, authorized by Congress in exercise of its power to deport aliens . . .

Point II

It is well settled law that a search without warrant may be reasonable as an incident to a lawful arrest.

> * * *
>
> It seems to be Petitioner's contention that because the government suspected him of espionage, they could proceed against him only on espionage charges. Under Petitioner's contention that the Government was in "bad faith" in proceeding against him under the Immigration Laws (i.e., statutes under which the Government could proceed) and not commencing a prosecution under the Espionage Laws (i.e., statutes under which the Government could not legally proceed), the only way the Government could function in good faith would be to do nothing against Petitioner at all.

In the circumstances of this case, Immigration authorities not only had the right but the duty to apprehend the Petitioner and proceed against him for deportation . . .

> * * *
>
> Their search here . . . was not a general exploration but was specifically directed to the means and instrumentalities by which the Petitioner effected and concealed his illegal entry into the United States, the charge in the Arrest Warrant.

Point III

In his application, Petitioner requests the Court for an order directing the return and the suppression for use as evidence of "any and all property seized on the 21st day of June, 1957 in Room 839, Hotel Latham, 4 East 28th Street, New York, New York . . ."

> * * *
>
> He does not lay any specific claim to any article nor does he allege that articles were taken from him. Therefore, assuming for the sake of argument that the search and seizure after Petitioner's departure were unlawful, Petitioner is without standing to move to suppress or to assert any rights under the Fourth Amendment because he has failed to claim any possessory or proprietary interest in the articles which he now seeks to suppress for use as evidence.

patriot, he was not a traitor, [but] this guy [Rhodes] was a traitor. So I'm thinking to myself, then and now, how does that help you defend this particular accused? But I honestly don't know how you could have done it.

Audience question: The movie obviously suggested that the judge had made up his mind and this is a slam dunk, let's get this thing over with. Is that the impression that you got?

Answer: It was extremely critical that the case go forward. And basically, the judge [Byers] did indicate that it is going to go forward. The whole question [was where] the [defense] motion for a suppression and return of property would take place – in the Eastern District [Brooklyn, where the criminal charges were pending] or the Southern District of New York [Manhattan, where the hotel evidence was seized]. So Donovan and his team did try to postpone and we argued the motion that they made [in the Southern District], and they made it right away, and we had to work up affidavits and so forth over in the Southern District [and] argued before Judge [Sylvester] Ryan, and he reserved decision on it. And the case is now scheduled to start and Ryan ends up deciding, "I'm going to exercise discretion and I'm going to deny the motion and reserve your rights to make it before the trial court." They [defense team] took it up to the Second Circuit. And the Second Circuit declined to do anything with it. So it now comes back before [Eastern District] Judge Byers and he says, "Okay, can we agree on things that you can return?" We'll give him back his money – but we're not giving him back the stuff that we're using as evidence." And that's what the issues focused on in the hearing. The hearing went on for two days and the judge ended up with a decision promptly. I think it was October 6 and the jury commenced, opening statements were made on October 14 and we [the trial] went through October 25. So yeah, it was a fast track. You don't get faster justice than that.

Audience question: Tony, did you say before I came in what happened to Abel?

Answer: Essentially they gave him roles of teaching and going around and showcasing him and he was not a happy camper. He died 10 years after the exchange and they buried him . . . next to his father, and I think I may have mentioned this – his father happened to have been a friend of Lenin. And the family was not very happy that his tombstone read Rudolf Abel. According to some of the books that I've read, it was a code that if he was arrested and was not cooperating and everything was fine, he would use the name of Rudolf Abel, who was a colleague of his and a dear friend. His family petitioned to have that [tombstone markings] changed and they re-carved the stone to also have Willy Fisher [Abel's real name]. William Fisher was born in Newcastle in England in 1903, on July 11, which happens to be the date the Second Circuit came down with the opinion affirming his conviction.

Editor's Note: When the Abel case was finally decided at the Supreme Court, Chief Justice Warren wrote a note of thanks and praise for the work of the defense team. It would take a while longer for Tony Palermo to receive his just recognition for his role as part of the prosecution, but it came in January, 1958, after he had resigned from the Justice Department to become Assistant U.S. Attorney in the Southern District of New York. In accepting the resignation, Attorney General William F. Tompkins wished Tony well and noted, "I should like at this time to express my appreciation for the outstanding services you have rendered to the Department in everything you have undertaken and, particularly, in the prosecution and conviction of Rudolf Abel." ■

BY PETER SIVIGLIA

Peter Siviglia has practiced law in New York for more than 50 years, representing clients both domestic and foreign, public and private. He has served as special counsel to other firms on contract matters and negotiating. Peter is the author of *Commercial Agreements – A Lawyer's Guide to Drafting and Negotiating*, Thomson Reuters, supplemented annually; *Writing Contracts, a Distinct Discipline*, Carolina Academic Press; and numerous articles on writing contracts and other legal topics, many of which have appeared in this *Journal*.

Two Laws and a Case

This article is broken into two parts. Part I discusses § 630 of the N.Y. Business Corporation Law (BCL) and § 609 of the N.Y. Limited Liability Company Law (LLCL), which impose on the 10 largest shareholders and members of privately held corporations and LLCs liability for the company's compensation obligations. Part II discusses a recent Appellate Division case that deals with the application of the statute of limitations to warranties. Both parts will offer suggestions to address the issues revealed.

Part I: Liability of Shareholders and LLC Members for the Company's Compensation Obligations

A. The Two Laws

As a general rule, shareholders and members of an LLC are not liable for the debts of their companies. However, under BCL § 630 and LLCL § 609, the 10 largest shareholders and members (as determined by value) of privately held corporations and LLCs, both domestic and foreign, are liable for compensation obligations of their companies.

Interestingly, BCL § 630 was recently amended (A) to state that it applies to both "domestic" and "foreign" LLCs, and (B) to limit its application to compensation for "unpaid services . . . performed in [New York]." However, in contrast, as of August 25, 2016, LLCL § 609 had not been similarly changed. Section 609 of the LLCL applies to "every limited liability company," and it does not contain the New York State limitation on unpaid services. The language of LLCL § 609 – "every limited liability company" – probably comprehends both domestic and foreign LLCs; but, in assessing this conclusion, please examine LLCL § 102(k) and (m) defining foreign and domestic LLCs and LLCs generally without the "foreign" or "domestic" designation.

Also, the N.Y. Partnership Law, in respect of limited partnerships, does not yet contain provisions similar to BCL § 630 and LLCL § 609.

B. Possible Antidotes (Somewhat Convoluted; Not Vetted by the Courts; But Surely Fun to Consider)

1. Use a limited partnership as the operating company with a corporation or LLC as the sole general partner in which the limited partners (either corporations or LLCs) are shareholders or members of the general partner and elect the directors or managers that determine how the general partner will run the partnership.

2. Have the investors use one or more intervening corporations or LLCs as the shareholders or members of the operating company. To address the risk of piercing the corporate veil, the intervening entities should be reasonably capitalized, say by at least the amount of the initial investments in the operating company.

3. For shareholders and members who are not subject to the jurisdiction of New York courts, organize the operating company or its intervening companies in a jurisdiction that insulates shareholders and LLC members from all company debt in the hope that any attempt to enforce a New York judgement in that other jurisdiction would be denied as against public policy, which is an exception to the full faith and credit clause of the U.S. Constitution.

C. Additional Considerations

1. In any event, lawyers must advise clients beginning business in and expanding business into New York of these rules. Lawyers should also advise clients with existing businesses in New York of these rules.

2. Consider whether to try to obtain liability insurance against the risk. It may well be proper for the company to pay the premiums for that insurance to induce the investment in the company.

D. Musings

I wonder why lawmakers devise laws that might well deter entrepreneurs and businesses from investing in New York unless the rationale is to stimulate legal business in our state.

Part II: Warranties vs. the Statute of Limitations

In *Deutsche Bank Nat'l Trust Co. v. Flagstar Capital Mkts. Corp.*, [1] the Appellate Division, First Department, was asked to decide whether the statute of limitations barred a claim based on a breach of warranties in the sale of mortgage-backed securities. The court, in a draft of its opinion on August 11,

2016, summarized the issue and its findings as follows:

> In this appeal, we must decide whether the statute of limitations bars a breach of contract [*2]action that was brought more than six years after the seller made allegedly false representations and warranties as to loans underlying residential mortgage-backed securities (RMBS). We find that dismissal of the action is mandated by the Court of Appeals' decision in *ACE Sec. Corp., Home Equity Loan Trust, Series 2006-SL2 v DB Structured Prods., Inc.* (25 NY3d 581 [2015]), which sets forth a clear rule that a breach of contract claim in an RMBS put-back action accrues on the date the allegedly false representations and warranties were made. Notwithstanding the parties' sophistication and their assent to a contract provision specifying a set of conditions that would have delayed the cause of action's accrual, we find that the accrual provision is unenforceable as against public policy, because it is tantamount to extending the statute of limitations based on an imprecise "discovery" rule, which the Court of Appeals has consistently rejected in the commercial sphere (*see id.* at 593-594). Moreover, the accrual provision does not compel defendant to undertake a promised future performance, separate from its obligations to cure or repurchase defective loans, so as to trigger the statute of limitations anew; nor does it contemplate a substantive condition precedent to defendant's performance that would delay accrual of the breach of contract claim (*see id.* at 595, 597; *Deutsche Bank Natl. Trust Co. v Quicken Loans Inc.*, 810 F3d 861 [2d Cir 2015]). Therefore, we affirm the motion court's dismissal of the action as barred by the six-year statute of limitations applicable to breach of contract actions (CPLR 213[2]).

The clause in question, which was designed to delay the accrual of a cause of action based on a breach of warranty, specified, as stated by the court,

> that any cause of action . . . relating to a breach of representations and warranties "shall accrue as to any Mortgage Loan upon (i) discovery of such breach by the Purchaser or notice thereof by the Seller to the Purchaser, (ii) failure by the Seller to [cure, repurchase or substitute] and (iii) demand upon the Seller by the Purchaser for compliance with this Agreement."

The underlying premise of this clause [item (i)] is the breach of a representation or warranty pertaining to matters existing at the time of the sale. The clause did not target a future performance of the loans, such as a default. Hence, the court, in a unanimous decision, found that the provision was no more than an "unenforceable" attempt under the Court of Appeals' decision in *ACE Sec. Corp., Home Equity Loan Trust*,[2] to expand the date on which a cause of action accrues under the statute of limitations relating to representations and warranties. Compare, for example, Uniform Commercial Code § 2-725(2).

A Few Comments

1. The lawyers for the buyer may have been guilty of malpractice for not knowing the law or for not knowing how to safely navigate within the law, but, ironically, a claim for malpractice may be barred by the statute of limitations.

2. A relatively simple provision along the following lines, obviating the need for lengthy, complex warranties, would have done the job (much like a credit default swap) – especially in light of the court's emphasis on "a substantive condition precedent to defendant's performance:"

> If at any time [*or, in the alternative, specify a period*] the total number of loans on which a default in payment of any amount occurs that is not cured within 30 days after buyer notifies seller of that default – and regardless of whether the default is cured at a later date, exceeds __X__, the buyer may put all of the outstanding loans to seller at a price equal to the sum of (A) the price buyer paid for those loans multiplied by a fraction, the numerator of which is the outstanding principal balance of those loans at the time payment is made to buyer, and the denominator of which is the outstanding principal balance of those loans purchased by the buyer at the time of their purchase by buyer, plus (B) ___% of the amount under item (A) [that is, a percentage to reimburse buyer for costs and lost profit]. A default in payment will be deemed to occur on the date of a default in payment as specified in the applicable loan agreement. If the applicable loan agreement does not specify the date on which a default in payment occurs, the date of default of any payment not made when due will be the due date of the payment.

3. To address concerns raised by attorney Robert Kantowitz[3] that sellers might have with the credit default–type swap above, I believe a provision along the following lines will satisfy the "future performance" test because it is conditioned on a default in payment under a loan at some future date, not on discovery of a breach of a warranty made at the time of sale relating to matters existing at that time.

> In addition to any rights and remedies that the buyer has for a breach of a representation or warranty, if at any time [*or, in the alternative, specify a period*] a default in payment occurs on any loan that is not cured within 30 days after buyer notifies seller of that default, and
>
> Alternative A: if that default is attributable in whole or in part to a breach of a representation or warranty,

Alternative B: if there has been a material breach of any representation or warranty respecting that loan,

then, at any time before the default in payment is cured, the buyer may put that loan to seller at a price equal to the outstanding balance of principal and interest on the loan at the time payment of that amount is made to buyer. A default in payment will be deemed to occur on the date of a default in payment as specified in the applicable loan agreement. If the applicable loan agreement does not specify the date on which a default occurs, the date of default of any payment not made when due will be the due date of the payment.

Additional Considerations

In the case of the credit default swap, the purchase agreement, whether with the initial buyer or a subsequent buyer on resale, should specify the price paid for each loan in the package and the outstanding principal balance of each loan at that time.

The seller will be subrogated to the buyer's rights against the borrower for any defaults that the seller cures, so the buyer may wish to add some provisions regarding the seller's enforcement of those rights prior to exercise of the put, taking into consideration the statute of limitations on claims against the borrower for the defaulted amount. ■

1. http://www.courts.state.ny.us/reporter/3dseries/2016/2016_05780.htm.

2. 25 N.Y.3d 581 (2015).

3. Robert Kantowitz has been a tax lawyer, investment banker and consultant for over 35 years. He is responsible for the creation of a number of widely used capital markets products, including "Yankee preferred stock" and "trust preferred," as well as numerous customized financial solutions and techniques for clients. He is a longtime member of the New York State Bar Association Committee on Attorney Professionalism and, as such, co-authored the Committee's "Report on Attorney Ratings" dated December 7, 2015 and has contributed to the monthly *Attorney Professionalism Forum* feature in this *Journal*.

BY ROBERT KANTOWITZ

Robert Kantowitz has been a tax lawyer, investment banker and consultant for over thirty-five years. He is responsible for the creation of a number of widely used capital markets products, including "Yankee preferred stock" and "trust preferred," as well as numerous customized financial solutions and techniques for clients. He is a longtime member of the New York State Bar Association Committee on Attorney Professionalism and, as such, co-authored the Committee's "Report on Attorney Ratings" dated December 7, 2015 and has contributed to the monthly *Attorney Professionalism Forum* feature in this *Journal*.

"The Bad, the Good and the Beautiful"

A Suggested Approach to the Statute of Limitations Problem Raised by *Deutsche Bank v. Flagstar Capital Markets*

Editor's note: Mr. Kantowitz had advance notice of the content of Mr. Siviglia's October Contracts column. Here, he presents an alternative view of the issues raised in the Deutsche Bank v. Flagstar Capital Markets case.

I have been a "tax guy" pretty much all my professional life. In the course of "doing tax," one necessarily learns the importance of both substance and form and of knowing the implications of the words that one uses, all of which enter into the analysis of the statute of limitations issue that was the subject of a recent Appellate Division decision in *Deutsche Bank v. Flagstar Capital Markets Corp*. (1st Dep't Aug. 11, 2016). Before I was a tax guy, I was a "math and physics guy," which informs an observation that I will make toward the end of this article (no peeking).

The Bad

The *Deutsche Bank* case[1] involved mortgage-backed securities that had gone sour and claims that the representations and warranties made at the outset by the seller had been false. The court held that it was compelled by Court of Appeals precedent, *ACE Securities Corp., Home Equity Loan Trust, Series 2006-SL2 v. DB Structured Prods.*,[2] to negate what was an apparent good faith agreement by the parties that the time to commence an action would not start to run until the time of discovery of a defect – in this case, a defect in underwriting standards of the mortgage-backed securities – rather than at the closing, when the representations and warranties were made falsely and the contract had thereby been breached. Instead, the court insisted that the parties had no power to agree to a longer statute of limitations than that provided in the law[3] and therefore held that the filing was untimely because it was made after the six-year statutory period.

In the words of the court in the present case:

> Notwithstanding the parties' sophistication and their assent to a contract provision specifying a set of conditions that would have delayed the cause of action's accrual, we find that the accrual provision is unenforceable as against public policy, because it is tantamount to extending the statute of limitations based on an imprecise "discovery" rule, which the Court of Appeals has consistently rejected in the commercial sphere (citation omitted).[4]

The court made a point of noting that New York has a strong interest in giving repose to human affairs.[5]

Leaving aside certain notorious areas of child abuse, of course, this is perfectly appropriate and not normally a problem. In a classic contract setting, for example, the relevant facts are generally apparent at the outset or when they come into existence later, and a six-year window from when something that was not supposed to happen does happen, or *vice versa*, adequately serves the interests of the parties and the state. Unfortunately, as financial arrangements and entanglements have become more complicated, this construct can pose a problem because in certain commercial settings – apparently this was one – the parties feel that they must address the possibility or likelihood that actionable defects might not be apparent in the first six years. This case involved mortgage-backed securities, but one could easily analogize to numerous other situations where:

- The parties agree that the party that has superior knowledge or risk-bearing capacity is to be responsible for a long time for certain matters that are uniquely within its knowledge or control at the outset, while
- The second party takes the risk that things were, in fact, as they were supposed to be at the outset, but nonetheless do not evolve in the way that it reasonably had expected.

The Good

Peter Siviglia, in another article in this *Journal*, has proposed to address this

problem with either of two suggested clauses, which reflect different allocations of risks.

His first suggestion reads as follows:

> If at any time [*or, in the alternative, specify a period*] the total number of loans on which a default in payment of any amount occurs that is not cured within 30 days after buyer notifies seller of that default – and regardless of whether the default is cured at a later date, exceeds __X__, the buyer may put all of the outstanding loans to seller at a price equal to the sum of (A) the price buyer paid for those loans multiplied by a fraction, the numerator of which is the outstanding principal balance of those loans at the time payment is made to buyer, and the denominator of which is the outstanding principal balance of those loans purchased by the buyer at the time of their purchase by buyer, plus (B) ___% of the amount under item (A) [that is, a percentage to reimburse buyer for costs and lost profit]. A default in payment will be deemed to occur on the date of a default in payment as specified in the applicable loan agreement. If the applicable loan agreement does not specify the date on which a default in payment occurs, the date of default of any payment not made when due will be the due date of the payment.

I agree that this approach is effective in preventing the statute of limitations from commencing to run at the time of closing. However, this language also reflects an allocation of risks different from that in the typical transaction. Under this language, a cause of action accrues if and when a sufficient number of defaults have actually occurred and the defaults have not been cured. As a result, the seller bears the risk that that many defaults happen to occur regardless of the cause. Yet, in many transactions what is intended from a commercial perspective is that the seller must perform certain quality control tests in aggregating the loans that go into the security but as long as that has been done as it was supposed to be done, the risk of *actual* defaults rests with the buyer of the security. In the words of the *Deutsche Bank* court:

> [D]efendant, as originator and seller of the loans, made various representations and warranties to . . . purchaser, *concerning the characteristics, quality, and risk profile of the loans*.[6]

And in the words of the Court of Appeals in the *ACE Securities* case:

> [I]t makes sense that [the] sponsor . . . would not guarantee future performance of the mortgage loans, which might default 10 or 20 years after issuance for reasons entirely unrelated to the sponsor's representations and warranties. The sponsor merely warrants certain characteristics of the loans, and promises that if those warranties and representations are materially false, it will cure or repurchase the non-conforming loans within the same statutory period in which remedies for breach of contract (i.e., rescission and expectation damages) could have been sought.[7]

The seller thus *did not promise* that there would not *actually* be defaults. The seller said things about the loans on the basis of which the buyer felt it could conclude that, as a statistical matter, the incidence and severity of defaults would likely be tolerably low. Because it was not possible to be sure that the seller's failure to do what it had promised would become manifest within six years after the closing, the parties attempted to give the buyer longer to act, but the court said no. Mr. Siviglia's clause above indeed gives the buyer longer, but in doing so penalizes the seller for defaults even if the seller had impeccably and faithfully followed the processes that it said it would follow and even if everything that the seller claimed to be true at the outset was indeed true. Thus, the court's holding frustrates the parties' intent to give the buyer a more commercially reasonable time to discover a problem, while the proposed fix swings the pendulum back further than intended by the parties.

I do note that Mr. Siviglia's clause does employ a statistical measure as its trigger, so the departure from what the parties might have wanted may not be severe, except if the market changes radically, which is what happened as flocks of "black swans" descended from the sky in the post-2007 years. And I also note that it is not normally a good idea for a buyer to skip due diligence and instead rely blindly on a seller's representations, but in certain situations in the capital markets, especially in connection with complex securities, such due diligence is impossible or impractical and a good faith allocation of risks based on credit ratings and/or representations of the party in a position of knowledge is appropriate and is market practice.

To reflect the desired risk allocation, Mr. Siviglia has also suggested a second clause:

> In addition to any rights and remedies that the buyer has for a breach of a representation or warranty, if at any time [*or, in the alternative, specify a period*] a default in payment occurs on any loan that is not cured within 30 days after buyer notifies seller of that default, and
>
> Alternative A: if that default is attributable in whole or in part to a breach of a representation or warranty,
>
> Alternative B: if there has been a material breach of any representation or warranty respecting that loan,
>
> then, at any time before the default in payment is cured, the buyer may put that loan to seller at a price equal to the outstanding balance of principal and interest on the loan at the time payment of that amount is made to buyer. A default in payment will be deemed to occur on the date of a default in payment as specified in the applicable loan agreement. If the appli-

> cable loan agreement does not specify the date on which a default in payment occurs, the date of default of any payment not made when due will be the due date of the payment.

I agree that this clause is effective in accomplishing the goal of allocating the risks essentially as the parties intended. However, I believe that Mr. Siviglia and I disagree as to why this clause works. He relies on the presence of the default trigger as the all-important discrete future event that must take place as a predicate to an action, which was absent in the *Deutsche Bank* case. By contrast, I believe that as long as the parties say clearly what they intend to be the future predicate, they should be free to do so.

In my view, the recent cases display less than clear reasoning, but one can read them, or at least I read them, as reflecting the baggage associated with certain legal terms. In particular, the shorthand way of saying that a seller is taking the risk that something is not true is to say that the seller "represents and warrants" as to that something at the closing. Thus, in the contract at issue in this case:

> Section 9.03 also included a provision that purported to delay the accrual of a breach of contract claim until three conditions were met. The accrual provision specified that any cause of action against defendant relating to a breach of representations and warranties "shall accrue as to any Mortgage Loan upon (i) discovery of such breach by the Purchaser or notice thereof by the Seller to the Purchaser, (ii) failure by the Seller to [cure, repurchase or substitute] and (iii) demand upon the Seller by the Purchaser for compliance with this Agreement."[8]

But in tying everything to representations and warranties, the parties are necessarily agreeing that the seller will have performed its obligation if and only if the statements are true at that closing time, regardless of what happens at any later date. Hence, the six-year contract statute of limitations must begin to run on the date the representations and warranties are made, i.e., at the closing of the sale. The law in New York is that contracting parties cannot extend the statute of limitations in the contract. Case closed (unless the Court of Appeals can be convinced in an appeal that the parties really meant what I am about to suggest; I do not have a strong sense that an appeal would be successful, but I would not be embarrassed to make the argument).

I would like to read the cases to have left a door just a bit ajar, so as to allow parties to avoid the inflexibility regarding statutes of limitations by avoiding certain language. Thus, suppose that the parties had steered clear of the traditional legalese and its attendant but invisible balls and chains, and instead used plain English such as the following:

> If at any time in the future, it is discovered that the state of affairs at the time of closing was actually different [in a material way] from what is described in the attached "Schedule of Assumptions," then the seller shall be obligated to pay the buyer amounts [or buy back the securities at prices] computed as provided in Appendix X [and any action to enforce this clause must be brought by the buyer within two years [of the date of discovery]. For the avoidance of doubt, this clause creates a cause of action that will come into existence, if at all, only upon discovery as provided herein, and is separate and independent from any "representations and warranties" made by the seller as of closing.

The parties should also specify whether, if a cause of action arises both under this language and under the representations and warranties, the causes of action are independent – so as to give the buyer the benefit of whichever one has a longer time to sue – or this one controls exclusively. Note as well that the language is neutral in that it refers to a list of assumptions rather than to the seller's having made representations; indeed, it is conceivable that a contract might give both parties rights to the extent that there is a deviation in one direction or another from such assumptions.

Implicit in the formulation that I have laid out above, perhaps, is that there will have been a default, or else the measure of damages would be zero (more on that below). If a default

is implicitly or explicitly required, I would posit that this formulation works largely as does Mr. Siviglia's second suggestion with its default trigger.

To illustrate the difference in our approaches, however, suppose that the parties want to allow the buyer to sue, even in the absence of an actual present default, for compensation for a diminution of value due to the perception of a likelihood of eventual default that is higher than would have been the case had the assumptions been true. This could be especially important in circumstances where the sponsor or a guarantor can prop up the deal and its cash flows in order to avert a default and thereby keep the buyer locked into what feels like a slow-moving train wreck. That this could happen and thereby run out the clock on the six-year of statute of limitations is acutely unfair, and the parties may wish to contract around it. The formulation I have laid out above, perhaps with a qualifier as to how much diminution in value there must have been and how it must be demonstrated, would reflect this agreement, yet without using any discrete default as a trigger.

Reasonable people may differ on this, but to my mind all of these variations share certain elements in common:

- In the future there is something (a default or a diminution in value or whatever else is specified in the contract) that represents an impairment of the buyer's position relative to the buyer's reasonable expectations at the outset.
- Something that happens in the future (in Mr. Siviglia's formulation the discrete event of default and in mine discovery of the variance from the assumed state of affairs) is clearly and unequivocally agreed to be the trigger for a cause of action.
- In *none* of these formulations is the *seller* guilty of any post-closing action or non-action, and in *all* of these formulations the parties have agreed that a cause of action springs into existence based on something that occurs in the future only if and when it occurs.

The Court of Appeals in *ACE Securities* emphasized that New York has a strong policy of repose and a skepticism regarding discovery-based accrual times that are hard to pin down with certainty, and yet the court also implied that parties can include substantive obligations as they wish.[9] Hence, it ought to be possible to create an obligation in plain language that springs into existence, if at all, only at a later time, as long as that later time is reasonably well defined. In dealing with such a contractual provision, a court should not twist itself into a pretzel or wrap itself in the state flag to insist that what the parties *really meant* must have been to make a representation as of closing on which a cause of action for breach, with a six-year time limit, accrues no later than closing. It strikes me that, other than where the rule against perpetuities applies, parties should be free to choose either of two approaches: (i) to say that a representation is being made now, in which case the clock starts ticking now if the representation in fact is not true now, or (ii) to create a contingent springing obligation that comes into existence if another Columbus runs his ships aground and discovers another continent (even though the continent was always there, though theretofore unknown).

Let's also remember that contrary to what was implied by that famous *New Yorker* cover, there really is a "rest of the country" out there. Choice of law and choice of jurisdiction clauses are not necessarily dull boilerplate. It behooves parties and their attorneys to consider whether they can achieve what they want by specifying a state whose law and/or courts are more favorably disposed to the "discovery" trigger. I have not performed the tasks of surveying the rules in other jurisdictions or of fully analyzing and answering the conflicts of laws questions, which I leave to others. To push this envelope further, suppose that there is another state whose positions are favorable on this issue but other aspects of whose law may not be optimal. Might the parties provide that the contract is governed by the laws of New York with the exception of the designated provision, which is governed by the laws of that other state? The questions of whether that could be done and how to interpret such a contract I leave for another day, but suffice it to say that that methodology could be useful for any number of purposes.

The Beautiful

All of the approaches suggested above are traditional contract approaches in that they say what the parties mean and they say it clearly. Yet, there is language in the cases that gives one concern that courts still might balk at allowing formulations that appear to be an "end run" around holdings that vigorously defend the sanctity of the fixed six-year statute of limitations as a matter of public policy. To avoid that risk in another way, here is an approach that I intend to be the equivalent of the Lombardi Power Sweep.

Rather than simply saying under what circumstances and conditions the buyer has certain rights against the seller, the parties could create two separate options:

- *The put*. First, there would be a provision giving the buyer an absolute and unconditional put of the securities to the seller at par (or at the remaining unpaid value, or at some formula price, as the case may be) in the event of sufficient defaults or diminution of value or whatever the parties want the trigger to be. Upon the buyer's giving notice, the put might close in, say, 30 days.
- *The call*. In addition, there would be a provision giving the seller a *conditional* call right: if and only if the seller's representations were in fact [materially] true when made, the seller has an independent right to call the securities from the buyer for their actual current trading value. The call could be exercised

during the period that begins on any date on which the buyer has given notice of its intent to exercise the put, and once the call is exercised, it would close in 10 days. Obviously, therefore, the seller's timely exercise of the call would preempt the put.

Taking these two provisions together, the combination achieves what the parties want over an indefinite period of time by giving the buyer nothing and costing the seller nothing if and only if the representations had been true when made. Importantly, because the call depends on the *truth* of the representation rather than upon a *breach*, it either exists at all times or does not exist at all, without implicating the statute of limitations in the slightest. Could a court chafe at this if it felt sufficiently strongly about the six-year statute of limitations? Maybe, but a judge might have trouble writing that opinion with a straight face.

I have structured such pairs of options in a variety of settings. One example with which some readers may be familiar is contained in typical convertible securities such as convertible debentures or convertible preferred stock. The holder of a convertible security (the investor) typically has stated yield plus a right, but not an obligation, to exchange the security for a fixed number of shares of common stock of the issuer. Normally (as a result of option pricing theory), a rational investor will not convert the security until maturity, at which time the investor will elect whether to convert or to collect the par amount, whichever is larger. At any time before such maturity if the price of the underlying shares has advanced significantly from where it was at the time of issuance, the security will be "in the money" and will trade for a price more reflective of the conversion value than of the par amount, and investors will realize their profits by selling rather than by converting. Yet, an issuer may want to bring matters to a head, to "force conversion" early so as to stop having to pay the stated yield on the security, which is generally higher than the dividends on the common stock. The typical transaction will provide that if the trading price of the underlying common stock rises sufficiently (say, to 130% of the security's par amount), the issuer may call the securities for par. The issuer issues a call notice but never actually repurchases the securities for cash because the holders quickly convert them into the underlying shares with a higher value before the call's effective date.

In my proposal:

- The seller's ability to nullify the put if the representations were not false when made would deter the buyer from pressing the red button on its desk. To deter the buyer from thinking it has nothing to lose by pressing the button, the seller's call could even be at a non-trivial discount from the trading price.
- On the other hand, if the seller's representations were false, the seller's call simply has never existed, and the seller has no way to block the buyer's par put.

The Real Point of this Article

With all of the above in mind, it is but a small step to what I really think is appropriate: New York should change its position on whether parties may agree to an extended statute of limitations to govern a particular contract. As between consenting and well advised parties in a commercial setting, no purpose within the law of contracts is served by denying them the right to allocate the real risk that an arbitrary six years may not be long enough to figure out whether or not the seller should owe the buyer something.

In order to demonstrate that this is not just facially sensible but is compelled as a matter of logic, here is where I revert to math and physics. Consider three sequential propositions:

A. The buyer has unconditional protection from default for the entire duration of the transaction, or in any event more than six years, in the form of a par put in the event of a certain number of defaults, regardless of why the defaults happened or whether the seller's representations were true when made.
B. The buyer has conditional protection, i.e., only if the representations turn out not to have been true when made, for longer than six years, starting when the problem is discovered. (This is what the parties in the *Deutsche Bank* case wanted to accomplish, which the court refused to allow.)
C. The buyer has conditional protection but for only six years from closing. (This is the limit enforced in the *Deutsche Bank* case.)

In mathematical terms, clearly, A > B > C. Since A and C are both permissible contractual provisions, there is no defensible reason why the intermediate position B – in which there is only conditional protection but for longer than six years – should not be allowed. After all, this is not quantum mechanics, where only certain levels of energy, and nothing in between, can exist.

I welcome readers' thoughts (except on quantum mechanics) at robert.kantowitz@gmail.com. ■

1. I refer to this case as the *Deutsche Bank* case, as that party, although I note that in the world of finance, the same institution can sometimes be on either or both sides of an issue. Here, Deutsche Bank was seeking enforcement, while in last year's Court of Appeals' *ACE Securities* case, on whose holding this case turned, an affiliate of Deutsche Bank was the defendant resisting enforcement. And to put the procedural and contractual issues into a broader context, I note that the federal government announced that it is seeking an unprecedented $14 billion fine against Deutsche Bank in connection with its sale of mortgage-backed securities.
2. 25 N.Y.S.3d 589 (2015).
3. CPLR 213(2).
4. Slip Op. at 2.
5. *Id*. at 3.
6. *Id*. at 2 (emphasis added).
7. 25 N.Y.S.3d at 595–96 (citations omitted).
8. Slip Op. at 2.
9. 25 N.Y.S.3d at 596–97.

Title – Last Name. *Example:* "Dear Dr. White:".

- **Introduction**.
  Introduce the situation. Note whom you represent, the general purpose of the letter ("This letter is to inform you that . . . ." or "My client, Mr. X, has instructed me to . . . ."), and your request. Summarize the problem and state what action the recipient should take to solve the situation. Keep the introduction short and concise to avoid confusing readers with unnecessary detail.[9] This'll put them on clear notice of what'll follow.
- **Body**.
  State facts. Explain the law supporting your client's position. Address the recipient's misbehavior and your client's position. Base your demand on a legal foundation, such as breach of contract. Explain which clause of a contract was violated and how. Go into clear, specific detail about the action you expect from the letter's recipient. It could be to do something or to stop doing something. Explain not only what needs to be done but how it must be done, who must do it, the time frame for completion, and the steps required for the recipient to address your client's needs.
- **Deadline**.
  Explain the consequences of not complying with the demand and applicable deadlines. This'll urge the recipient to take action, and it shows you're serious that your demands be met.[10]
- **Closing**.
  Close your letter professionally. *Example:* "Respectfully yours."
- **Sign** your letter.

Respect basic letter-writing principles when drafting a demand letter. Address why you're entitled to what you're asking for. Otherwise, why would your readers comply? Put yourself in their shoes; the reason for your demand must be clear. *Example:* "The contract provides that the buyer must pay $5,000 in exchange for the car he bought from our client. The undersigned never received any part of the $5,000."-

Organize your facts chronologically. If the exact dates of the events are unclear, preface the date with the phrase "on or about." *Example:* "We discussed this matter on or about June 15, 2016."

Articulate the time period you're giving the recipient to respond to your demand. The period must be reasonable: It must be realistic and sufficient for the person to respond to your request. *Example:* "You have 15 business days to repair the window or to pay me $250 in cash or certified funds."

State what you plan to do if the recipient doesn't respond to your demand on time. *Example:* "If you do not fix the situation within 15 business days, the undersigned will hire a professional to repair the window at your expense and commence legal action against you for financial compensation."

Tone: professional but firm

As is always the case when writing to a potential adversary, your letter should be formal. Adapt your tone; every case is unique. Ethical considerations and notions of professional civility should guide your tone and the content of your letter.[11]

Know what you're aiming for, and try to achieve it in a one- or two-page demand letter. Pay special attention to your language. Take your audience into account.[12] Use active verbs and no legalese. Be courteous but firm. This writing style will capture your readers' attention and make them feel that your demand is serious. Don't be harsh, humorous, or snarky. Don't display sarcasm or anger.[13] Don't threaten to raise criminal or disciplinary charges. Don't use your letter to embarrass, blame, shame, or delay.[14] Don't offer the recipient legal advice.[15] You never know where your demand letter might end up. It could be in the hands of a judge, the media, or a disciplinary committee.

> If you drown your letter in unnecessary information, your reader will be at sea.

Work Toward Resolution

Encourage solutions to the problem. Demonstrate that you're willing to consider creative options to benefit everyone. Show that you want to find a mutually beneficial solution and that you're open to working with the other side toward that outcome. *Example:* "As your project deadline is approaching soon, our client will continue construction work on the site once a written promise to comply with the demands is received from you." A reasonable and open attitude helps if the dispute spirals toward trial.[16]

Seize the opportunity to show you're open to means other than litigation, such as mediation or arbitration, to settle the dispute. Parties on all sides will often prefer to resolve a dispute without going to court. *Example:* Your client, Mr. Quiet, lives in a co-op building in Queens, New York. For the past three months, his next-door neighbor has been playing the drums loudly and past the hours the co-op rules allow. Mr. Quiet talked to his neighbor about his issue a few times, but the disturbances continue. Mr. Quiet consults you for advice. Knowing that your client is willing to do whatever it takes to solve the situation, write in your demand letter that you'd like to solve the dispute out of court.

There are many advantages to alternative-dispute settlement. Ultimately, reaching a settlement without litigation will allow both parties to save time, money, heartache, and more. Trials come with unintended costs. Your client will want to avoid them. A trial often means that both parties lost control over the outcome of the dispute.

Be firm. Use demand letters to show that even if you're open to settle, you want the issue resolved. Convey that if the recipient doesn't take steps to solve the conflict, you won't hesitate to sue.

Facts

Provide information about the alleged wrongdoing. State facts and use them to convey that your request isn't trivial. Answer persuasively and in advance any inevitable question you might receive in response.[17] *Example:* "Why didn't the plaintiff complain of shoulder pain until five months after the accident?"

Be concise. Concision will encourage the recipient to read your letter and help contextualise the claim. Don't include irrelevant or unnecessary details.

Consider the following. Your client, Mr. Bank, owns a commercial building in Syracuse, New York. He tells you that Mr. Enessef, one of his tenants, has been giving him checks without sufficient funds for the past two months. Mr. Enessef has been ignoring your client's calls and emails. Mr. Bank is coming to your office today seeking your advice after his numerous, unsuccessful attempts to speak with Mr. Enessef.

Your solution to Mr. Bank's situation is to write a demand letter – a rent demand – to Mr. Enessef. The demand letter's body will include three things:

> An instruction to Mr. Enessef to perform a certain act and why, (2) a set period within which the act must occur, and (3) a warning of the consequences if the recipient does not comply.

Your demand letter might look like this: "Dear Mr. Enessef: (1) Take notice that you owe rent to Mr. Bank, your landlord, for the following period: $3,000 for May 2016 and $3,000 for June 2016, for a total of $6,000. (2) If you do not pay the total rent due within the next 15 days from the date of the service of this notice, (3) Mr. Bank will initiate a summary proceeding to evict you."

Demand clearly what and when you want it done

You can seek a specific outcome, such as requesting that a recipient obey a contract or refrain from doing something.[18] Your request must be precise so the recipient can respond accurately. The recipient shouldn't wonder what you're asking for.[19] If you drown your letter in unnecessary information, your reader will be at sea: The focus of your demand will be lost. That'll make it seem like your claim is weak and that you're on a fishing expedition for useful information to strengthen your claim. Be clear and concise. Less is more.

Avoid using phrases that suggest your demand is based on personal observations. Avoid "I feel" or "It is our belief." And don't be overly cautious in presenting your contentions. Avoid "It appears that" or "It is suggested that." Your cowardly assertion won't persuade.[20]

Enduring the problems the other party causes is never pleasant. Ask recipients to remedy their faults. Ask for what you're entitled to — don't aim for less — but be reasonable. Recipients are entitled to a reasonable time to respond to your request; not allowing enough time will defeat your goals.

Example: A few weeks ago, you notified Walter Damage, your landlord in Lake George, New York, about leaks coming from your bathroom ceiling. Noting Damage's inaction in fixing the plumbing, you write him a demand letter requesting that he fix the leaks without delay or you'll take legal action against him. You can't stand living in these conditions. You want the renovation work to start as soon as possible.

Being reasonable means that even if you want the work finished in a day, it isn't realistic to ask Mr. Damage to find a professional qualified for this kind of renovation, for him to hire the professional, for the professional to be available, and for the work to be done right away. A reasonable demand offers him sufficient time to respond to your request. Perhaps a two-week notice — to hire the worker and for the worker to complete the renovation work — is reasonable in this situation. The reasonableness of a notice will always depend on the circumstances of each situation.

Sending

When you send a demand letter, follow through with what you say you'll do if the time period you set expires. The recipient might not address your demand appropriately, and your issue might end up in court. Send your letter once you're certain you're ready, both legally and mentally, to take the matter to the next phase if the recipient doesn't comply with your demand.[21] Don't bluff.

Demand letters shouldn't be sent lightly. Make sure your client understands why you're sending one. Send-

ing demand letters when you're not ready to follow through with your threat of further action will affect your credibility. Your next demand won't be taken seriously. Send a demand letter only when a situation needs to be resolved or when your client wants to solve a dispute and is seriously considering legal action.[22]

Keep records

When you send demand letters, keep a record of what you wrote and when you sent it. A contract or statute might not require that notice be sent by certified mail or by another method in which the recipient must sign for the letter. Even so, you should send the notice by a method that produces a signed receipt.[23] A delivery receipt is useful to track the time since the recipient has received notice of the situation. Keep this receipt. If the recipient does nothing in response to the demand, or if the recipient refuses to comply, having this receipt along with a copy of the demand letter will allow you to prove that the recipient received the demand letter and knew your demands. You can use the receipt to prove that a fair notice of performance was given to the recipient and that the recipient failed to comply timely with the demand.[24]

Privilege

According to the New York Court of Appeals in *Front, Inc. v. Khalil*, a demand letter sent during the preliminary stages of an anticipated action will be subject to a qualified privilege to protect a writer in a future defamation action from what's stated in the letter "[i]f the statements are pertinent to a good faith anticipated litigation."[25]

Be careful with what you write, therefore. Never make a false declaration. If you do, a privilege might not apply to your letter. A qualified privilege is subject to "the requirements of good faith, an interest to be upheld, a proper purpose, and publication in a proper manner and to proper parties only. The person claiming the privilege, moreover, must stand in such relation to the circumstances as to justify the language used."[26]

Responding

Receiving a demand letter is stressful, but don't rush your response. Before responding, analyze the demand and assess your options. When responding to demand letters, remember the relevant information discussed above and take your time working through the three key stages:

1. Analyze

Before answering a demand letter, consider some relevant questions. Verify whether the claim is well-founded. Does the adverse party have the right to demand what's demanded? Is the claim reasonable? If the demand seeks money or performance, is the relief sought reasonable?

Consider settling the dispute. Measure the efforts it'll take to comply with the demand against what it'll take to contest the case in court, including attorney fees, time, missing work, and the uncertainty of the outcome. Is all this worth it? Consider whether the chances that a judge will rule in your favor outweigh the time and money it'll cost you and your client to go through the judicial process.

2. Prepare

Whether you want to negotiate with the claimant or fight it out before a judge, be organized and efficient.

Recall the chain of events: chronologically, what led to what. Write it all down. If documents support your demand, gather and organize them. You're trying to convey that you're telling the truth. It could be letters, bills, emails, pictures — anything that'll support your argument. If other people were involved, note their contact information as witnesses who'll support you.

3. Respond

If you recognize that you're wrong and that the claimant is entitled to what's claimed, you may agree to the demand and act accordingly.

If you disagree with the demand, you may contact the claimants or their lawyer, if they're represented, to explain your position and negotiate. You can also tell them that you refuse to comply with their demand and explain why. Doing nothing and waiting to be sued is the last option. It doesn't show you're willing to cooperate, and it buys you a bushel of trouble.

Conclusion

You can't always get what you want through litigation. But a letter is sometimes all you need. ■

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ATTORNEY PROFESSIONALISM FORUM

To the Forum:

My client insists that we use a private investigator to "dig up" dirt on his adversary to use in our litigation. I certainly can see the benefits of doing so, but I'm also concerned about the ethical pitfalls and my obligations with respect to a third-party over whom I may not have control. What are the ethical issues I should be aware of? Should I have my client retain the private investigator? Would that protect me if the private investigator goes AWOL? Am I responsible in any way for the private investigator's actions if her or she is taking directions from my client and is not adhering to the guidelines I provide? How do I protect myself?

Sincerely,

A.M. I. Paranoid

Dear A.M. I. Paranoid:

In many circumstances, hiring a private investigator may be beneficial to, *inter alia*, help you gather useful information that may strengthen your case. Moreover, the use of a private investigator offers certain protections. For example, although you may be tempted to investigate some underlying facts yourself, a private investigator can help prevent a situation where you inadvertently become a witness on a significant issue in your case and have to resign as counsel as a result. *See* New York State Rules of Professional Conduct (RPC) 3.7. There are, however, myriad legal and ethical considerations you must consider when working with a private investigator. Many of those issues frankly merit separate treatment. Nevertheless, we will try to briefly touch upon the main legal and ethical issues raised by your question.

The first issue that should be addressed is privilege. A private investigator's work and communications may be protected under both attorney-client privilege and work-product privilege. In *United States v. Kovel*, 296 F.2d 918 (2d Cir. 1961), the seminal case on this subject, the Second Circuit ruled that the attorney-client privilege may extend to communications with a private investigator hired to assist the attorney in representing the client. *Kovel*, 296 F.2d at 922; *see In re Grand Jury Proceeding*, 79 Fed. Appx. 476, 477 (2d Cir. 2003). "Like any communications protected by the attorney-client privilege, however, communication with such third-party agents is only protected if it is 'made in *confidence* for the purpose of obtaining *legal* advice *from the lawyer.*'" *In re Grand Jury Proceeding*, 79 Fed. Appx. at 477, citing *Kovel*, 296 F.2d at 922 (emphasis in original). Similarly, documents prepared in anticipation of litigation by a private investigator are also protected by the work-product privilege. *Costabile v. Westchester, New York*, 254 F.R.D. 160, 164 (S.D.N.Y. 2008). But there are limits to the application of both privileges and they can be lost for several reasons. *See, e.g.*, *Meyer v. Kalanick*, 15 CIV. 9796, 2016 WL 3981369, at *5 (S.D.N.Y. July 25, 2016) ("there is a 'crime-fraud' exception to the work-product doctrine, as there is to the attorney-client privilege" and declining to apply the work-product doctrine where a party's investigation included "fraudulent and arguably criminal conduct"); *Spanierman Gallery v. Merritt*, 00 CIV. 5712, 2003 WL 22909160, at *2–3 (S.D.N.Y. Dec. 9, 2003) (holding that work-product immunity is waived when its production to another is inconsistent with the protection).

Privilege questions aside, the next issue involves an attorney's ethical obligations and responsibilities when engaging a private investigator. If you or your clients utilize the services of a private investigator for your case, and you use the information in the litigation, you can be held responsible for the private investigator's conduct. Under RPC 5.3(b)(1), "[a] lawyer shall be responsible for 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*, if: (1) the lawyer orders or directs the specific conduct or, with knowledge of the specific conduct, ratifies it." RPC 5.3(b)(1) (emphasis added). In Professor Roy Simon's annotation on RPC 5.3(b), he notes that the "category of nonlawyers 'associated with' the law firm should include all nonlawyers who are working side by side with the law firm on a matter, even though the law firm itself did not retain them." Roy D. Simon & Nicole Hyland, Simon's New York Rules of Professional Conduct Annotated 1412 (2016 ed.). Professor Simon specifically identifies a private investigator in an example of RPC 5.3(b), noting that this provision would apply where "a private investigator may be investigating a defendant on behalf of multiple plaintiffs." *Id*.

When considering whether you are ratifying a private investigator's conduct, Professor Simon states that "any lawyer who learns of misconduct after the fact and then takes advantage of that misconduct (or simply lets it slide) may be found to have ratified the misconduct." *Id.* at 1390, 1413. Recently, a federal court in the Southern District of New York dealt with this issue and

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stated that the RPC "require lawyers to adequately supervise non-lawyers retained to do work for lawyers in order to ensure that the non-lawyers do not engage in actions that would be a violation of the Rules if a lawyer performed them." *Meyer v. Kalanick*, 15 CIV. 9796, 2016 WL 3981369, at *7 (S.D.N.Y. July 25, 2016). This opinion is also consistent with RPC 8.4(a), which prohibits an attorney from knowingly assisting or inducing another person to attempt to violate the RPC through another person's actions. RPC 8.4(a). However, ensuring that private investigators do not engage in actions that would violate the New York Rules of Professional Conduct, if performed by a lawyer, can be a significant undertaking particularly where those investigators are being paid directly by a client who demands certain results and actions.

One aspect of a private investigator's practice that warrants extra scrutiny and consideration is where a private investigator makes misrepresentations to an adversary or unrepresented witness in an attempt to gain information. This is known as "pretexting." While one might think that pretexting is not an unexpected business practice, our profession is held to a very strict standard. RPC 8.4(c) specifically precludes attorneys from "engag[ing] in conduct involving dishonesty, fraud, deceit or misrepresentation" and RPC 4.1 states that, "a lawyer shall not knowingly make a false statement of fact or law to a third person." RPC 4.1; 8.4(c). This includes, for example, situations where a witness inquires as to whom the investigator represents. In such a situation, the investigator should disclose the relationship. RPC 8.4(c); *see* NYSBA Comm. on Prof'l Ethics, Op. 402 (1975) [if "inquiry is made by the witness as to whom the investigator represents, he should, of course, disclose the lawyer-principal"].

In addition, RPC 4.2 prohibits an attorney from "communicat[ing] or caus[ing] another to communicate about the subject of the representation with a party 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." RPC 4.2. Each communication between a private investigator and a potential witness, adversary, or agent of an adversary, creates a potential breach of these rules and consequently requires consideration and discussion with the private investigator before he or she interacts with any potential witness.

Online social media websites have become a valuable source of evidence in litigation, and "friending" a potential witness or adversary could give a private investigator access to significant amounts of information without ever having to leave the office. An ethics opinion addressed whether a private investigator could "friend" an unrepresented potential witness on a social networking website to gain access to information helpful in litigation. N.Y.C. Ass'n B. Comm. Prof. Jud. Eth., *Obtaining Evidence From Social Networking Websites,* N.Y.C. Eth. Op. 2010-2, 2010 WL 8265845 (2010). In its opinion, the Committee on Professional and Judicial Ethics concluded that as long as a private investigator used his or her real name and profile to send the friend request, even without disclosing the reason for making the request, it would not cross any ethical boundaries. (*Id.*). The opinion noted, however, that a private investigator may not use deception to obtain information from a social networking site under RPC Rules 5.3(b)(1) and 8.4(a). *Id.*. This opinion is consistent with a Court of Claims' decision in which a private investigator interviewed Department of Transportation employees who were likely witnesses after a notice of intention was served against the state, but before the action was commenced, and the attorney general had not provided the low-level employees with any privileged information about the subject matter of the case. *Schmidt v. State*, 181 Misc. 2d 499 (Ct. Cl. 1999), *aff'd*, 279 A.D.2d 62 (4th Dep't 2000). The court in *Schmidt* ruled that the employees were not represented by an attorney when the private investigator interviewed them and the court denied the motion to suppress the statements and disqualify the claimant's counsel. *Id.*.

Like most rules, courts may sometimes make exceptions where public policy interests supersede the rote application of the rules. Where there is a strong public policy in deterring activity that may escape discovery without the use of undercover investigatory techniques, one court refused to preclude evidence even where a private investigator made misrepresentations to an employee of a party represented by counsel in obtaining evidence. In *Gidatex, S.r.L. v. Campaniello Imports, Ltd.*, 82 F. Supp. 2d 119 (S.D.N.Y. 1999), a private investigator posed as an interior designer and recorded interactions with furniture sales clerks in an effort to gather evidence that the defendants engaged in "bait and switch" tactics in violation of the Lanham Act and the common law in New York. *Id.* at 120–21. Even though the defendant corporation was known to be represented by counsel, and the clerks were deemed parties, the court found that because the sales clerks were not *tricked* into making statements that they would not have otherwise made in the course of their regular business routine, there were no ethical violations. *Id.* at 125–26. The court noted:

> To prevent this use of investigators might permit targets to freely engage in unfair business practices which are harmful to both trademark owners and consumers in general. Furthermore, excluding evidence obtained by such investigators would not promote the purpose of the rule, namely preservation of the attorney/client privilege.

Id. at 122.

The public policy interest in allowing undercover investigations was also cited in an action where the court permitted the admissibility of covert audio recordings made by a private investigator, without misrepresentations, demonstrating that a supervisor

used racial slurs in a racial bias suit. *Mena v. Key Food Stores Co-op., Inc.*, 195 Misc. 2d 402, 407 (Sup. Ct., Kings Co. 2003). In *Mena*, the court reasoned that "weighed against th[e] ethical imperative" of "insuring that all [members of the public] are treated with that modicum of respect and dignity that is the entitlement of every employee regardless of race, creed or national origin," the attorney's involvement in the undercover recording did not warrant the suppression of evidence or the disqualification of counsel. (*Id.* at 407).

This narrow public policy exception, however, is unlikely to expand to all situations where, as your client might hope, a private investigator seeks to merely "dig up dirt" on an adversary. In the Southern District of New York's recent decision in *Meyer*, the court held that evidence obtained by an unlicensed private investigator, through the use of materially false statements, made with the intent to gain personal information about the plaintiff and his counsel, was enjoined. *Meyer*, 2016 WL 3981369, at *10. The issue of sanctions was obviated by the parties reaching a publicly undisclosed agreement to pay a reasonable reimbursement of attorney fees and expenses by the investigating party. *Id.*. The *Meyer* court distinguished the *Gidatex* holding because, in *Meyer*, the undercover investigation was not focused on the misconduct at issue in the lawsuit and instead focused on the personal investigation of the party and his counsel. *Id.*. Despite the numerous clear distinctions in the manner and purpose of the investigations in *Gidatex* and *Meyer*, the court went on to reject the holding in *Gidatex* and the proposition that "investigators working on behalf of a party to litigation may properly make misrepresentations in order to advance their own interest vis-à-vis their legal adversaries." *Id.*.

Another common investigative technique that can be fraught with ethical and legal implications is an investigator's recording of communications. In New York State, it is not a crime to record a conversation without the knowledge or consent of the other person. *See* New York Penal Law § 250.00, *et seq.*; *Gidatex, S.r.L.*, 82 F. Supp. 2d at 121. As noted by the court in *Mena*, "[c]ontemporary ethical opinions hold that a lawyer may secretly record telephone conversations with third parties without violating ethical strictures so long as the law of the jurisdiction permits such conduct." *Mena*, 195 Misc. 2d at 404–05, citing ABA Comm. on Ethics & Professional Responsibility Formal Op 422 (2001); New York County Lawyers' Ass'n Comm. on Professional Ethics Op. 696 (1993). Accordingly, an investigator's in-person recording of a conversation within New York State will be permissible even without the other person's consent. Many states, however, require both parties' consent to record conversations. *Meyer*, 2016 WL 3981369, at *8. Phone conversations with an individual in a two-party consent state can be much more complicated. Whereas many communications are on cellphones, and it may be unclear as to where part of a conversation is taking place, a number of conflict of law scenarios can arise. Suffice it to say, if the investigator is recording communications where there is a likelihood of interstate communications, some research of the legality of the recordings is advisable. Under CPLR 4506, evidence obtained in violation of Penal Law 250 for wiretapping and eavesdropping would be inadmissible. Evidence obtained by unethical or unlawful means, absent specific legal authority, however, may still be admissible. *See Gidatex*, 82 F. Supp. 2d at 126, citing *Stagg v. N.Y. C. Health & Hosp. Corp.*, 162 A.D.2d 595 (2d Dep't 1990) (admitting testimony allegedly in violation of ethics rule and finding, "even if the matters to which the investigator testified were unethically obtained, they nevertheless would be admissible at trial. New York follows the common law rule that the admissibility of evidence is not affected by the means through which it is obtained. Hence, absent some constitutional authority mandating the suppression of otherwise valid evidence [ ], such evidence will be admissible even if procured by unethical or unlawful means").

It is important to supervise and stay informed of the private investigator's methods for obtaining information as the private investigator is prohibited from revealing your client's confidential information and from improperly inducing witnesses to change their testimony. Under General Business Law § 82 (GBL), a licensed private investigator "shall not divulge to any one other than his employer, or as his employer shall direct, except as he may be required by law, any information acquired by him during such employment in respect of any of the work to which he shall have been assigned by such employer." Similarly, you have an obligation under the RPC to use reasonable care to prevent the private investigator from disclosing the confidential information of your client. RPC 1.6(c). It is highly likely that the private investigator will communicate with other people in the course of the investigation. You should be very clear with your investigator what information her or she is able to reveal in his or her discussions.

Additionally, an overzealous private investigator may be inclined to cross a line in investigating a matter and inadvertently attempt to persuade a witness to change his or her testimony. This would likely violate RPC 3.4(b) and possibly the Penal Law's prohibition on tampering and intimidation of a witness. *See* NYSBA Comm. on Prof'l Ethics, Op. 402 (1975) (The opinion notes that "[c]are must be taken . . . that the investigator not offer any improper inducement to persuade the witness to change the testimony previously given"); RPC 3.4(b) ("A lawyer shall not . . . offer an inducement to a witness that is prohibited by law or pay, offer to pay or acquiesce in the payment of compensation to a witness contingent upon the content of the witness's testimony"); Penal Law § 215, *et seq.* (this section of the Penal Law addresses the prohibition of tampering and intimidation of witnesses).

The manner in which private investigators are compensated must also be given close attention. Under GBL § 84, it is unlawful for a licensed

private investigator to perform services on a contingent basis or based upon the result achieved. As a result of this provision, and a number of Rules of Professional Conduct, neither you nor your client may compensate a private investigator on a contingent fee basis or based upon the result the private investigator obtains. (*See* RPC 1.2(d) ("A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is illegal or fraudulent"); 8.4(a); 3.4(b); N.Y.C. Assn. B. Comm. Prof. Jud. Eth., NYC Eth. Op. 1993-2 , 1993 WL 765495 (1993)). Similarly, a lawyer cannot engage in fee-sharing with a nonlawyer. RPC 5.4(a); *see In re Friedman*, 196 A.D.2d 280 (1st Dep't 1994).

Attorneys may, however, advance the fees of a private investigator, make the repayment by the client contingent on the outcome of the case, and charge actual interest incurred for the expenses. Specifically, RPC 1.8(e)(1) provides that "a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter." Professor Simon notes that "expenses of litigation" include the "fees of a private investigator." (Simon, *Simon's New York Rules of Professional Conduct Annotated*, p. 543; *see* NYSBA Comm. on Prof'l Ethics, Op. 1044 (2014)). To the extent that a lawyer incurs interest charges for the advanced fees in a contingent fee action, the client may be charged for interest actually incurred by the lawyer if it is explained to the client in advance, including the method by which the rate of interest is calculated, and it is agreed upon by the client in writing. RPC 1.5(c); N.Y.C. Ass'n B. Comm. Prof. Jud. Eth., NYC Eth. Op. 1997-1, 1997 WL 1724481 (1997). You must also retain proof of payments to private investigators for seven years. RPC 1.15(d)(1)(vi).

In summary, utilizing a licensed private investigator can be very helpful to both you and your client if the investigation focuses on the issues that are the subject of your litigation. It is inadvisable, however, to bury your head in the sand when it comes to the private investigator's actions as they can have severe repercussions for you, your firm, and your client. A *Kovel* letter establishing the terms of the private investigator's engagement to you at the outset of the litigation is advisable. This can help you to preserve attorney-client and work-product privilege, establish how you want the investigator to communicate with you, make it clear that the investigator does not disclose confidential information to anyone else, and raise any potential legal or ethics issues that you believe might be relevant in the investigation. If you believe that your investigator is acting unethically or in violation of the law, it is certainly advisable that, at a minimum, you end your engagement with the private investigator.

Sincerely,

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QUESTION FOR THE NEXT ATTORNEY PROFESSIONALISM FORUM

I work for a governmental agency. We recently held a training workshop for our junior staff attorneys pertaining to trial advocacy. The attorneys were required to cross-examine witnesses, and give opening and closing statements as part of the training. After their closing statements, they received feedback from me as well as other senior staff attorneys. After one of the junior attorneys had concluded his summation, one of my colleagues critiqued him as follows: "You did a great job, but next time try to turn down the gay. A jury is not likely to react positively to it." The junior attorney is openly gay. I watched his reaction and he was visibly upset and taken aback by the comment. As his supervisor, I'm deeply concerned about how to address this situation. One the one hand, my senior colleague was trying to provide constructive feedback because jury bias toward counsel may clearly have an effect on the outcome of a case. On the other hand, my colleague's comments could be construed as being highly offensive and insensitive, if not discriminatory. How should I, as a supervisor, be addressing this issue internally with my colleagues and with the junior attorney? Do I have an obligation to do something? And if so, how do I approach the issue without exposing my team to liability?

Sincerely,

A. M. AWKWARD

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BY GERALD LEBOVITS

By Popular Demand: Demand Letters

You don't always need to litigate to get what your client wants. Sometimes all you need is a letter. In this column, we'll discuss how to write a demand letter and what to do when you get one.

Meaning and Purpose

A demand letter is a pre-litigation tool designed to fix a problem before you're forced to go to court. Demand letters serve a number of favorable purposes: to prompt recipients to resolve conflict; to help recipients understand the consequences of their acts; and to warn recipients what'll happen if they don't remedy the situation. A successful demand letter will persuade the recipient to take your demands seriously.

Respect basic letter-writing principles when drafting a demand letter.

Some statutes or rules require attorneys to send a demand letter as a prerequisite, or condition precedent, to suing. Even if the law doesn't require a demand letter as a condition precedent to litigation, an agreement might. An agreement is the law between the parties. If an agreement dictates the steps to take before suing, both your actions and your demands must comply with the agreement.

You can use demand letters to tell recipients that they can solve a conflict by performing an act or obligation in a given time frame.[1] If the conflict isn't solved by then, use your demand letter to persuade a court that you gave fair notice to the recipients for them to perform their obligations and warned about the potential consequences of a failure to perform.[2]

Before you write

Research

Before you write a demand letter, evaluate your client's chances of succeeding in future litigation. Interview your client, review documents, and conduct legal research.[3] Your letter might not get your intended result if you neglect pre-writing research.

Identify and understand the issue before drafting your letter. Objectively analyze your client's claim and investigate the facts. Make sure you have the most up-to-date information from your client. Use the information you get, but examine the accuracy of the information. Verify that your client has clean hands and hasn't been neglecting any part of the contract. If your client is partly responsible for the situation, adapt your demand accordingly.[4]

Get copies of pertinent documents. For example, if your client has agreed to lend money to a friend and they have a written agreement regulating the parties' obligations and rights, obtain the agreement. Follow the agreement's prerequisites. If the agreement dictates that a 10-day notice be sent before a lawsuit may be initiated, comply with the agreement.

Example: Your client, Ms. Imitate, is reading a newspaper and sees bad reviews about a neighborhood restaurant. The restaurant has the same name as the one she opened six months ago. Alarmed, Ms. Imitate calls you to ask the owner to stop using her restaurant's name. She doesn't want those bad reviews to affect her business. You write a demand letter to the party at your client's request. In response, the other restaurant owner asserts that he's been using the trademark longer than Ms. Imitate has, and sues her.[5]

In this example, pre-writing research could have helped Ms. Imitate make a decision in light of the facts and avoided unintended consequences.

Once you've prepared, the research stage concludes with your identifying your letter's purpose and audience,[6] including your reader's legal experience, educational level, language skills, age, and physical, emotional, and mental condition.[7]

Writing demand letters

Once you're ready, start drafting. Be clear, concise, accurate, and straightforward. A professional and effective demand letter can be structured using these guidelines.[8]

Form

Demand letters follow similar rules as other formal letters:

- **Heading**.
  Include your contact information, the client's contact information, and the current date. Unlike other letters, you don't need a "regarding," or "re," line to indicate the purpose of your letter. On the left, write the recipient's contact information.
- **Salutation**.
  Usually takes the form of Dear –

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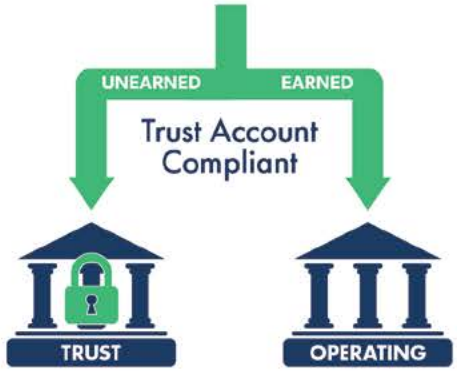

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