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ONEONONE

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A Message from the Chair

The end of a year brings an opportunity not only to review the accomplishments realized but also the remaining goals to be achieved. In our case this has been a positive year on which the Section can rely as a basis to continue our efforts in the future.

As we have previously reported, our membership recruiting efforts have brought us many new members, including many younger attorneys and law students. This influx of new members promises to furnish us with new ideas and future leadership as well as an opportunity to broaden our perspective in affording value to our members. On the other hand, we are aware the current economic crisis has made it more difficult for many of our existing members, particularly solos and small practitioners, to believe continued membership in the Bar Association and our Section is economically feasible. We believe such a conclusion is unwise since it costs the departing member the valuable benefits available with membership without obtaining value in return.

For our part, we have continued to seek new ways to benefit the Section and its members.

Our program at the Annual Meeting in January, which was put together by Martin Kera, was very successful. In addition to the perennially popular "Hot Topics" segment, the program recognized both the continuing need for awareness of procedure in litigated matters and the special problems caused by the economic crisis. David H. Rosen presented an

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update of the recent changes in the Civil Practice Law and Rules, while Joel Sharrow and Vincent J. Gallo discussed various aspects of subprime mortgages and mortgage foreclosures. The program was well attended and received high marks from the audience.

The Section has also sponsored or co-sponsored numerous CLE teleconference programs. We continue to believe that these relatively short programs covering discrete subjects furnish great value to our members. The programs, which last about two hours, can be attended at one's desk, are presented at modest cost and still permit the lawyer to spend most of the day solving the problems of the client.

We have also begun implementing our program of creating meetings in each judicial district so that our members can meet their peers, discuss common problems in the district and enable the Section to serve its members and their concerns without requiring them to travel extensively to realize the benefits of membership. We are also seeking to develop a panel of mentors in each district so members may seek the guidance of experienced practitioners in that district to guide in the solution of their problems. Although this project is in its infancy we are optimistic that its implementation and expansion in future years will bring substantial advantages to the Section and all of its members.

As is always the case, there remain areas, many of which may not have been considered or explored to date, where the Section can improve benefits to its members. I urge our members to become more active in Section activities and let us know how we may give you better value from your Section membership. We are on this journey together and each of us has a vested interest in its success.

I have been privileged to be Chair of the Section this year but I know that little would have been achieved without the hard work and guidance of the current officers and members of our Executive Committee. I am particularly indebted to the co-chairs of our Membership Committee, Lynne Hilowitz and Pete Roe, and to my predecessor, Harriette Steinberg, for their tireless efforts to increase and diversify our membership. Of course, nothing would have been possible without the superb staff of the Bar Association, especially Terry Brooks and Pam McDevitt, our staff liaisons, and Kim McHargue, each of whom had the right solution before we knew there was a problem.

Finally, I want to welcome and congratulate my successor, Martin Minkowitz, as Chair and his new officers, Leonard E. Sienko, Jr., Chair-Elect, Martin S. Kera, Secretary, and Joel E. Abramson, Treasurer. I wish you great success and will do all I can to help you achieve it.

Paul J. O'Neill, Jr.

From the Editor

As I reach the end of my term as Editor, I want to take this opportunity to thank all my colleagues and committee chairs for their help and support over the past years.

The current economic climate has definitely presented challenges that have affected every aspect of how we operate. It has become increasingly more important to be more conscious of the efficiencies we deliver to our clients on a day-to-day basis.

Through our newsletters and other activities we have made an effort to enhance your understanding of current issues and various areas of practice regardless of whether you are an in-house or private practitioner.

Each year, with the rising cost of outside products and services, it gets increasingly more difficult to sustain the standards in which we operate. Thanks to the participation of our general practice members, we have been able to keep our membership fee stable. And, we encourage those of you who wish to contribute to our publication to contact us. We welcome hearing from you.

In that regard, the contributions to our newsletter and our blog by our membership enables the rest of the membership to benefit from the experiences we have and the knowledge we have gained. We encourage those of you who wish to contribute to contact us and we look forward to hearing from you.

In June, I moved into the position of Section Chair. You will still be hearing from me, not as the Editor of *One-On-One* but on behalf of the membership . . . an opportunity I look forward to. Moving forward, Maria Sclafani will be assuming the position of Editor and can be reached at 212-867-0228 or via email at mcs@thebeaumontgroup.com.

Again, I wish to extend my sincere thanks to those of you who continue to support the General Practice Section's good works. Your participation is a testament of your belief in the value and benefits the Section offers its members.

Sincerely,
Martin Minkowitz

Security Fund for Workers' Compensation

By Martin Minkowitz

In bad economic times, when insurance carriers are challenged, there is a renewed interest in "security funds." Actually there once were two security funds in New York protecting against workers' compensation insurance company failures. In 1990, the stock insurance company's and mutual insurance company's funds were consolidated into one fund.[1]

This fund (which currently exists) is intended to assure that all claimants receive the benefits under the Workers' Compensation Law. It also covers the employer's liability portion of the workers' compensation insurance policy, but payment from the fund for this coverage is limited to $1 million on any one claim. No such limitation exists in New York if the workers' compensation carrier is solvent and paying benefits.

The fund is administered by the Superintendent of Insurance.[2] Security funds were in existence in New York since Governor Lehman signed the law in 1935 to prevent the obvious hardship to employees and employers when a workers' compensation carrier was declared to be insolvent.

The way it is funded is that the workers' compensation insurance carriers make a payment into the fund based on an assessment directed by the Insurance Department. Assessments are made when the fund's assets fall below $74 million. It is paid on a quarter annual basis.[3] The assessment can be up to two percent of the net written premiums, as reported to the Insurance Department by the workers' compensation carrier on its quarterly report. The Superintendent has the discretion to assess as high as two percent, so it can be lower. The carriers, however, can then recoup this assessment by a designated surcharge on the premiums paid by their policyholders over a reasonable period of time.[4] Therefore, the ultimate cost of the assessment will be borne by the insureds.

What it all comes down to is that the Insurance Department has now made the determination that the net value of the security fund[5] was less than the statutory requirement of $74 million and that contributions must now be resumed. They have notified the carriers that workers' compensation insurance carriers can recoup the contributions to the fund from a surcharge against its policyholders at a rate of one-and-one-half percent on policies written or renewed on or after January 1, 2009. That was provided in a circular letter issued by the Insurance Department[6] at the end of 2008.

This will clearly not be a welcome event for businesses in New York who, in these times, are seeking to cut costs and expenses, not increase them.

Endnotes

1. *See* Section 106 WCL.
2. *See* Section 107 WCL.
3. *See* Section 108 and 109 WCL.
4. *See* Section 108(4) WCL.
5. As of the end of the 3rd quarter of 2008.
6. Circular letter #24 (2008).

Martin Minkowitz is of counsel to the law firm of Stroock & Stroock & Lavan, LLP in New York City.

Alternative Dispute Resolution: An Invaluable Tool in Difficult Economic Times

By Irwin Kahn

As we are all aware, our economy is in a downward spiral. This creates an atmosphere wherein both legal clients and law firms themselves are inclined to want to speed up the case management process in order to bring disputes to a swift resolution. Claimants are likely to be more inclined to be realistic with regard to their expectations and defendants should be able to make adjustments so that their reserves can be favorably revised.

Effective case management mandates that we explore the utilization of Alternative Dispute Resolution ("ADR") as a means of bringing cases to an efficient conclusion, properly using the time and resources available to both claimants and respondents. In previous sessions, I have discussed the tools offered under the ADR umbrella, namely mediation, arbitration, fact or coverage determination, mini-trials, and as many variations of same as the imagination and creativity of the participants, including the neutral, can create.

Litigating cases can be costly, time-consuming and an inefficient way to manage caseloads. Since ninety-five percent of civil cases ultimately settle, litigants are turning more and more to ADR as a means of bringing speedy, certain and cost-efficient conclusion to many of their cases. Whether you represent a plaintiff or a defendant, this results in greater client satisfaction.

In the Securities industry, FINRA, the successor to the New York Stock Exchange and the National Association of Securities Dealers, has a successful mediation program in addition to the well established arbitration program.

The American Arbitration Association has arbitration and Mediation programs in a number of areas, such as commercial, construction, insurance and labor. In the federal courts, ADR is in effect in both the Southern and Eastern Districts. George O'Malley is ADR Administrator of the Southern District of New York and Gerald P. Lepp is ADR Administrator for the Eastern District of New York. Both report that a high percentage of cases settle in Mediation and a significant portion settle thereafter. Those participating benefit from expedited discovery and the narrowing of issues.

The New York State Unified Court System Office of Alternative Dispute Resolution Programs is led by Daniel M. Weitz, Esq., State Alternative Dispute Resolution Coordinator. There are a number of ADR programs throughout the state, including Family Court, Community Dispute Resolution Centers, the New York County Commercial Division, and several other County Commercial Division programs. New York County also has a Matrimonial Mediation pilot program as well as the availability of Tort Mediation.

There are a number of commercial providers that supply skilled neutrals at a reasonable cost. These providers usually aid the parties in agreeing to participate, deciding which ADR modality would be most beneficial, scheduling the session at a convenient place before a well qualified neutral.

ADR is a voluntary process. It is private, quick, cost effective, and final. Quite often direct negotiations between the parties have resulted in an impasse. For a case to be ready it is necessary that both sides have evaluated all aspects of the matter including liability, damages, and the potential verdict in the venue. Both sides must be ready to enter into good faith negotiations before a skilled impartial neutral as an agent of reality.

To obtain a good result, the parties must be completely familiar with the strengths and weaknesses of their case and the case of their opponent. An ADR session should be approached the same as one would approach a trial. A concise memorandum setting forth the facts, the law, liability, damages and current applicable jury verdicts will be of great value in educating both your opponent and the Neutral. Reports from experts and Jury Verdict Reports of similar fact patterns should be included as part of the package submitted to the Mediator or Arbitrator. Whenever possible, your client should be present at the ADR session, but if this is not possible you should be able to reach your client immediately should this become necessary. Good preparation leads to the likelihood of a satisfactory conclusion to the ADR session.

General Practice Session: Hot Topics, January 27, 2009

Irwin Kahn has been a civil litigator for more than forty years. He is a principal of the New York City law firm of Kahn & Horwitz, P.C. He is an experienced arbitrator and mediator and is on the New York State Supreme Court Commercial Division Panel of Mediators for New York County and is on the Panel of Mediators and Arbitrators of the United States District Court Eastern District. He is on the Mediation Panel of the Bankruptcy Court for the Eastern and Southern Districts. Presently he serves as a Mediator and Arbitrator for FINRA and performed the same functions for its predecessors, the New York Stock Exchange and National Association of Securities Dealers.

Of Sound Mind, Yes, But Did She Understand the Tax Clause?

How much do clients really know about their own wills?

By Eve Rachel Markewich

Every lawyer knows the requirements of an enforceable will: the testator must have capacity, and the will must be validly executed. In fact, the general parameters of the process are so ingrained in our jurisprudence that, next to the necessity of *Miranda*[1] warnings, or proof "beyond a reasonable doubt," they are probably among the best known legal requirements in the non-lawyer's ken. And, like *Miranda* warnings and the criminal burden of proof, the subject of a will's validity is always ripe for fictional treatment movies, television and novels.[2]

The assumption is that once a will is admitted to probate, in all but the unusual case, that decree ends the disputes relating to distribution of assets. But should it be, and must it be? Do testators, even those of "sound mind," understand the effect of their testamentary provisions?

Execution and Capacity

Our law requires that certain formalities be observed in order to achieve a valid execution of a will. EPTL 3-2.1 provides, in relevant part: the will must be in a writing, signed at the end by the testator;[3] the signature must be affixed in the presence of at least two attesting witnesses, or acknowledged by the testator to each of them to have been affixed by her; the testator must declare to each attesting witness that the instrument is her will; the witnesses must make their attestations within a 30-day period; and the witnesses must sign at the testator's request.

These requirements are precise, and while litigation will often entail examination as to whether or not the statute is satisfied, the analysis is seldom complicated, and relies more on issues of credibility than analysis of legal standards. In fact, last year, the Appellate Division, First Department, provided what is essentially a primer in the simple steps a lawyer can take to ensure a finding of due execution. *In re Will of Falk*, 47 A.D.3d 21 (2007), *lv. to app. denied*, 10 N.Y.3d (2008).

In contrast to issues of due execution, the other requisite of an enforceable will—capacity—is a malleable standard. The statute states the bare minimum: a testator must be "of sound mind and memory." EPTL 3-1.1.[4] Case law has recited standards, and there is no argument that the best iteration of the standard, and the one most oft-cited, is *Matter of Kumstar*, 66 N.Y.2d 691 (1985), in which the Court of Appeals wrote:

> It is the indisputable rule in a will contest that "[t]he proponent has the burden of proving that the testator possessed testamentary capacity and the court must look to the following factors: (1) whether she understood the nature and consequences of executing a will; (2) whether she knew the nature and extent of the property she was disposing of; and (3) whether she knew those who would be considered the natural objects of her bounty and her relations with them" (*Matter of Slade*, 106 A.D.2d 914, 915; see also, *Matter of Delmar*, 243 N.Y. 7). 66 N.Y.2d at 692.[5]

It has for centuries been regularly stated that the capacity for executing a will is the lowest in the law, and that capacity to make a will is far lower than capacity to contract:

> The same clearness of comprehension and ability of expression which is required to enable a man to enter into a contract need not exist to enable him to make a valid will. If it shall appear that, at the time the will was executed, he was possessed of sufficient comprehension to enable him to appreciate generally the extent of his property, to remember the persons who were dependent upon him, and to decide intelligently as to the propriety of his benefactions to them, the will which he makes is valid. *In re Seagrist's Will*, 1 A.D. 615 (1st Dep't 1896), *aff'd without op.*, 153 N.Y. 682 (1897); *see also In re Coddington*, 281 A.D. 143 (3d Dep't 1952), *aff'd*, 307 N.Y. 181 (1954).

The reasons for the low standard, it is understood, are based in our desire for testator autonomy, and a societal concern that we allow individuals to dispose of their assets as they wish, without requiring sophisticated business acumen. We are, as a society, apparently disinterested in systems that recall forced heirship or primogeniture.[6]

Nonetheless, New York, like all other states, does have in place a statute that provides for distribution of assets if one dies without a will. The intestacy statute is designed to accommodate what are believed to be societal norms—taking care of one's spouse and children, or if dying without spouse or children, then distributing assets to siblings, parents and other relatives in ordered priority. EPTL § 4-1.1. We do not encourage escheat to the state.

The intestacy statute should provide comfort, in all but the grossest situations, that even if a will fails, the "right" disposition is effected. That, however, is not the case. We feel outraged and cheated if a decedent apparently goes to the trouble to create a testamentary plan and to reduce it to a written testament, and then it is thwarted.

In *In re Will of Khazaneh*, 15 Misc. 3d 515 (N.Y. Surr. Ct. N.Y. 2006), in which the author represents the petitioner in favor of probate, Surrogate Kristin Booth Glen analyzed the second prong of the capacity test—whether the testator knew the nature and extent of his assets at the time of execution—and referred to "the requirement of contextualization in applying the Kumstar test."

Following an analysis of the facts, including testimony from three SCPA § 1404 examinations, the Surrogate incorporated an analysis of Mental Hygiene Law Article 81 standards, which specifically require that guardianship powers be individually tailored to the needs of the incapacitated person. By extension, Surrogate Glen then concluded that an analysis of testamentary capacity "appropriately requires an individualized, contextualized investigation of the testator's task-specific functionality at the time her will was executed." *Khazaneh*, 15 Misc. 3d 515, 520.

The "individualized, contextualized" investigation specifically related to the task at hand is, of course, precisely what is necessary to actually give effect to our expectation that a testator's will reflects her particular intent. Even the contextualized investigation urged by Surrogate Glen, however, addresses the "task" of generally disposing of one's assets, but does not address the "task" of understanding the intricate interplay among a will's clauses, or the complex effect of individual "boilerplate" legalisms.

Thus, our current analysis of "capacity" does not fully ensure that will probate truly effectuates a testator's knowing and intentional distribution of her assets. To do so, the contextualized investigation would have to include an analysis of whether the testator understood at least the general effect of all clauses in the instrument including, but not limited to: tax clauses; executorial powers; trustee powers; rights of income beneficiaries versus rights of principal beneficiaries.

There is no willingness, however, for the courts to specifically address individual testamentary clauses when making a determination of capacity. Capacity to make a will, even capacity determined to exist after a jury trial and affirmance by two appellate courts, does not translate to a conclusion that the testator understood the actual provisions contained in the will, except in a very gross manner. For example, the testator may know that she left the house to Jane and "the rest" to John, but still have no comprehension that the tax clause directing all taxes to be paid by the residuary will result in Jane receiving a gift worth $2 million and John receiving a gift worth $1 million.

"Construction" Cases

SCPA § 1420 provides a vehicle for an interested party, or a personal representative, to seek a "construction" of a particular clause or disposition in a will, and to attempt to tease out the testator's actual intent. Will construction cases offer direction.

> [I]n construing a will, the intention of the testator must be our 'absolute guide' (*Williams v. Jones*, 166 N.Y. 522, 532, 60 N.E. 240; *see also*, *Haug v. Schumacher*, 166 N.Y. 506, 513, 60 N.E. 245 ['It is always the effort of the court to sustain, if possible, the will of the testator and to give force and effect to the scheme that he has devised for the benefit of those depending upon him']; *Matter of Selner*, 261 App. Div. 618, 622, 26 N.Y.S.2d 783, *aff'd. without opn.*, 287 N.Y. 664, 39 N.E.2d 287). That intent is to be ascertained 'not from a single word or phrase but from a sympathetic reading of the will as an entirety and in view of all the facts and circumstances under which the provisions of the will were framed' (*Matter of Fabbri*, 2 N.Y.2d 236, 240, 159 N.Y.S.2d 184, 140 N.E.2d 269, *rearg. denied* 2 N.Y.2d 979, 162 N.Y.S.2d 618, 142 N.E.2d 652; *see also*, *Matter of Larkin*, 9 N.Y.2d 88, 91, 211 N.Y.S.2d 175, 172 N.E.2d 555; *Williams v. Jones*, 166 N.Y. at 532-533, 60 N.E. 240, supra). Thus, where the entire will manifests a general testamentary scheme, it is "the duty of the courts to carry out the testator's purpose, notwithstanding that 'general rules of interpretation' might point to a different result" (*Matter of Thall*, 18 N.Y.2d 186, 192, 273 N.Y.S.2d 33, 219 N.E.2d 397).

Matter of Bieley, 91 N.Y.2d 520, 525 (1998).

In *Bieley*, the testator's will directed that her estate go to her mother, if she survived, and then upon the mother's death to two close friends. The mother predeceased, and distant cousins of the testator ("laughing heirs") argued that the gift to the friends was contingent upon survival of the decedent's mother, and that as a result of the mother predeceasing, the estate should pass to them by intestacy.

The Court of Appeals upheld the Surrogate's disposition and, to avoid intestacy, held that the testator's obvious intent was to benefit her close friends and not her distant relatives with whom she had no relationship; on that basis, the Court construed the will as not requiring the mother's survivorship. The Court, however, noted that the resolution of the case in a manner contrary to the instrument's clear words, was "one of those rare and exceptional cases where common sense and justice compel the reasoned application of the doctrine of gift by implication to redress a situation arising from obvious omission." 91 N.Y.2d 520, 526 (1998).

The SCPA §1420 analysis comes close to a framework for allowing an analysis of capacity with reference to specific clauses and dispositions but, although courts will use the construction proceeding to make equitable determinations regarding the testator's intent, the common construction proceeding relates to avoiding intestacy or partial intestacy, or addressing some type of a lapsed gift. *See Matter of Bellows*, 103 AD2d 594 (2d Dep't 1984), *aff'd*, 65 N.Y.2d 906 (1985); *Matter of Fabbri*, 2 N.Y.2d 236 (1957). There are exceptions, such as *Matter of Doe*, 7 Misc. 3d 352 (N.Y. Surr. N.Y. Co. 2005), in which Surrogate Renee Roth held that a testator's exclusion of adopted children from a class should not be construed to also exclude children born as a result of in vitro fertilization. But those cases tend to be brought as a result of an "ambiguity" in the language of the instrument.

Construction cases do not, as a rule, address capacity. Moreover, there is reluctance in a construction case to resort to evidence extrinsic to the will. The courts are fond of stating that the analysis in a construction proceeding is "the search for the decedent's intent, and not for that of the draftsman." *Matter of Cord*, 58 NY2d 539, 544 (1983), citations omitted.

On the other hand, determinations of capacity always include inquiries outside the four corners of the instrument. In reality, however, the admission to probate of many wills is the admission of an instrument containing numerous clauses with effects never considered, let alone intended, by the testator—clauses inserted by the drafter. When those clauses arise in practice, is it not appropriate to try to determine the testator's intent, rather than that of the drafter?

Should these issues of understanding and intent be examined in the context of a construction proceeding? Capacity in that "context" could include the level of education and learning of the testator, as well as the circumstances surrounding execution of the will, including whether or not specific clauses were discussed with the testator. In *Khazaneh*, for example, the Surrogate specifically referred to certain issues that the drafting attorney had addressed in his discussions with the testator, and in his discussions with other attorneys at his firm who aided in drafting the instrument.

If analyzing capacity to make a valid will requires a contextual investigation of "task-specific functionality," it makes sense that construction of a will should include a similar contextual investigation regarding the testator's intent as to specific clauses. Such an approach is consistent with the courts' current willingness, in a construction proceeding to overtly ignore the "literal meaning" of a clause, in favor of an understanding consistent with the intent of the testator in the document as a whole. *See Matter of Fabbri*, 2 NY2d 236, 240 (1957).

Endnotes

1. *Miranda v. Ariz.*, 384 U.S. 436 (1966).
2. *See* Grisham, John, *The Testament* (Doubleday 1999); *Murder, She Wrote: It's a Dog's Life* episode (1984); *see also*, Dickens, Charles, *Bleak House* (while not exactly about a probate contest, certainly it conjures up the images of lawyers fighting over an estate).
3. The statute also provides a procedure for a person to sign "at the direction of the testator." EPTL 3-2.1(1)(C).
4. EPTL 3-1.1 also requires that the testator be at least 18 years of age.
5. In *Kumstar*, the Court of Appeals held that the testator had capacity to make a will, and by so doing overturned a jury verdict that had been affirmed by the Appellate Division. The case involved an 85-year-old woman who executed a will a week before her death. A treating physician testified as to her competence, but objections were submitted to the jury on the bases that: 1) the will included a bequest to a deceased brother, although the drafting attorney stated that he had inserted the identifier 'brother' and the testator conceivably meant a nephew by the same name; 2) the will failed to make a charitable bequest the decedent had several times stated she intended to make; and 3) the will created trust funds of "relatively small amounts."
6. However, New York does have in place a statutory construct that requires certain dispositions to be made, even if the testator wishes otherwise. Thus, the statute provides that a spouse is entitled to an "elective share"—the greater of $50,000 or one-third of the net estate. EPTL 5-1.1-A.

Eve Rachel Markewich is a member of Markewich and Rosenstock and represents the petitioner in *In re Will of Khazaneh,* which is discussed in this article. Isaac Tilton, an associate at the firm, assisted in researching this article.

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Applying the Doctrine of Work-for-Hire and Joint Works to Web Site Development

By Han Sheng Beh

Terminology such as "Web page," "domain name" and "the Internet" used to be part of a language reserved for only those who were computer savvy. Eight years into the Twenty-First Century, and the technology these words describe has permeated our everyday lives. As the Internet expands, copyright protection for the content and designs that are placed on the "information superhighway" become increasingly necessary.

Under section 201(a) of the Copyright Act, an author of a piece of work is the initial copyright owner.[1] However, the statute also authorizes the shifting of the initial vesting of copyright ownership to an employer or commissioner of the work upon creation.[2] This exception to section 201(a) is known as the work-for-hire doctrine.[3]

The work-for-hire doctrine is a flexible standard that has been thoroughly litigated in a myriad of fields.[4] Nevertheless, because the Internet is arguably an infant in comparison to the other forms of information media, parameters of the doctrine in this area are barely defined.

This article will explore the copyright issues faced by the Web development industry, particularly with regard to the history and current flux of the work-for-hire and joint works doctrines. It will show how the development of Web sites can fit under the work-for-hire doctrine due to the latter's flexible nature, and why Web site development should also be able to satisfy the joint work doctrine. Furthermore, this article posits that a distinction between Web sites and Web pages is needed, as simplifying these two separate entities into one could give rise to unreasonable results in copyright ownership.

A Brief Explanation on the Technology of Web Sites

Generally, a Web site is comprised of three main components, a Web address, Web pages and a computer, more specifically, a service provider or host.[5] A Web address, also known as a domain name, allows others who are "online" to locate a Web site by typing the address into a browser. Web addresses can come in the form of the direct address of a computer or a registered domain name, an alias that points to a computer's address. A domain name has significant advantages, as it provides a memorable, user friendly way of locating a Web site.[6]

A Web page is computer code used to display content on a Web site that requires interpretation by a browser. When a browser is directed to an address, the initial Web page, or home page, is displayed on the user's browser. From the home page, a user can click on "links" or manipulate the Web address to visit other Web pages related to the Web site. Sometimes links can refer a user to another Web site, which has its own group of Web pages.[7]

Finally, a service provider, also known as a host, is where the Web pages are stored. A host stores the Web page code and delivers the code to users who request it. By pointing their browsers to an address, users retrieve the code from the host to view it on their own computers. A Web site can be hosted from any computer, including a personal computer. However, most Web sites employ service providers to supply better speed and stability.[8]

The word "Web site" used in the everyday context broadly describes the interaction of all three components. When a Web site is "down" or "offline," that can refer to a multitude of technical problems that can be associated with a Web site. For example, the home page could have been changed to reflect that maintenance is taking place so that the users visiting the site cannot access the information that they seek; the service provider could be experiencing some technical difficulty either with its hardware (where the Web page code is stored) or network (the transmission of code to users asking for it); or the domain name has expired and no longer points to the Web pages that a user wants to access.[9]

The Statutory Basis: The Federal Copyright Act

Important to the discussion at hand is the Copyright Act of 1976, the federal statutes that govern, among other things, copyright ownership and the work-for-hire doctrine.[10] Section 201(a) states that the author of a work is the initial copyright holder while Section 201(b) of the Copyright Act outlines the work-for-hire exception.[11] Section 201(b) states:

> In the case of a work made for hire, the employer or other person for whom the work was prepared is considered the author for purposes of this title, and, unless the parties have expressed otherwise in a written instrument signed by them, owns all the rights comprised in the copyright.[12]

Read textually, this section shifts the authorship to either the employer or the person who commissioned the work. This shift gives copyright ownership to the employer or commissioner instead of the creator of the work. Section 101 complements Section 201 by providing the definition of a work made for hire. Section 101 states in pertinent part that a work for hire is:

1. a work prepared by an employee within the scope of his or her employment; or
2. a work specially ordered or commissioned for use as a contribution to a collective work, as a part of a motion picture or other audiovisual work, as a translation, as a supplementary work, as a compilation, as an instructional text, as a test, as answer material for a test, or as an atlas, if the parties expressly agree in a written instrument signed by them that the work shall be considered a work made for hire.[13]

The plain text of the definition shows that there are two ways to fall under the work-for-hire doctrine. One is through the employer-employee relationship in which the employee creates or performs some work within the scope of employment. The other is where there is no employment relationship but the work was 1) specially commissioned for 2) one of the nine statutorily enumerated works and 3) expressly agreed to be a work for hire in a signed written instrument. Read together, the two sections should give a good explanation of the work-for-hire doctrine. However, despite its seeming clarity, the doctrine has been thoroughly litigated with issues such as the employer-employee relationship, and the scope of employment becoming major points of contention in work-for-hire cases.

The Work-for-Hire Standard

Copyright ownership under work-for-hire has been applied to numerous situations. Each case would apply the relevant statutes and the cases preceding it to mold the work-for-hire doctrine within a particular technology or circumstance. Work for hire has been applied to arts, academia and even computer programming.[14] This section will discuss the doctrine's rich background and gradual evolution to the current issue of copyright within Web site development.

Sculpting the Face of Work-for-Hire: *CCNV v. Reid*

The seminal case dealing with work made for hire is *Community for Creative Non-Violence v. Reid*. *Reid* resolved the copyright ownership of a sculpture between an artist and the organization that hired him.[15] The Community for Creative Non-Violence (CCNV) contacted James Reid to create a sculpture depicting the "plight of the homeless" for a pageant.[16] Mr. Reid agreed to do so and the parties established that the sculpture would cost no more than $15,000, excluding Mr. Reid's workmanship, which he donated.[17] The copyright ownership dispute arose after the creation of the sculpture when both parties wanted control over the sculpture's touring schedule.[18]

Examining section 101(2) of the Copyright Act, the U.S. Supreme Court held that a sculpture did not fall under one of the nine enumerated works,[19] and there was no express written agreement that the work was to be made for hire.[20] As a result, the Court easily dismissed the applicability of section 101(2). Instead it focused its reasoning on whether there was an employer-employee relationship that would trigger work-for-hire under section 101(1).[21] Interpreting Congress' intent, the Court outlined a 12-factor test, grounded in the common law of agency, to determine if Mr. Reid was an employee of CCNV.[22] The Court found that sculpting was a skilled profession, that Mr. Reid used his own tools, controlled his own work time, received payment in the manner of an independent contractor, was retained for less than two months, and that CCNV did not pay Social Security taxes or offer employee benefits to Mr. Reid.[23] These factors weighed heavily in favor of Mr. Reid's status as an independent contractor and not an employee.[24]

To reach its decision, the Supreme Court dismissed three other tests used by the circuit courts to determine if an employer-employee relationship exists.[25] First, the Court found that CCNV monitored parts of the creation of the sculpture. For example, CCNV took Mr. Reid around Washington to observe homeless people, suggested he visit a homeless shelter to view suitable models, and insisted that each person depicted in the sculpture use a shopping cart to hold his belongings instead of shopping bags.[26] However, it rejected the argument that CCNV's monitoring actions determined Mr. Reid's status as an employee.[27] Consequently, the Court held that Mr. Reid was an independent contractor.[28] The Supreme Court did not determine whether the sculpture was a joint work, and this issue was reserved on remand.[29]

Evident within the *Reid* opinion was the Court's motivation to maintain predictability of copyright ownership by establishing what it believed to be a test that could be applied uniformly.[30] However, due to the extensive list of factors outlined within *Reid*, criticism has arisen regarding the probability of unequal application of such a subjective, complex test.[31] Nevertheless, *Reid* established strong precedent that would be applied to subsequent cases involving different works and circumstances.

Scope of Employment Clarified in Academia Cases

In the arena of schools and universities, the focal point of the work-for-hire doctrine is different. Whereas the *Reid* decision concentrated on whether the creator of a work was an employee or an independent contractor, the debate in the school setting focuses on whether employees are working within their scope of employment.[32] As a teaching position is usually a salaried position and is heavily controlled by the educational institution, teachers are usually unable to deny that they are employees of a school or university. Nevertheless, *Reid* clearly affected these cases, as it established that the common law of agency was to be used to determine whether an employee was working within the scope of employment.

Disputes between professors and educational institutions decided prior to *Reid* articulated what came to be known as the "teacher exception" to the work-for-hire doctrine.[33] For example, in *Weinstein v. Univ. of Illinois*, the court held that a professor's scholarly article was not a work for hire because publishing articles was not a required duty.[34] Similarly, in *Hays v. Sony Corp. of America*,[35] the Seventh Circuit stated that due to the teacher exception, high school teachers who created a word processor manual for class would probably hold the copyright due in that manual.[36]

However, the viability of the teacher exception came into question after *Reid* because the opinion made no mention of it.[37] In addition, cases in the academic setting, such as *Shaul v. Cherry Valley-Springfield Cent. School District,*[38] applied the *Reid* standard while limiting the teacher exception.

In *Cherry*, the court held that a high school teacher's tests, quizzes and homework assignments fell under the work-for-hire doctrine, and therefore, the school was the author and owner of the teaching materials.[39] In determining whether an employee's conduct falls within the scope of employment, the court used a three-part test: "(1) It is of the kind of work [an employee] is employed to perform; (2) It occurs substantially within authorized work hours; (3) It is actuated, at least in part, by a purpose to serve the employer."[40] As preparing testing materials was a regular duty of a school teacher, preparation outside of class was commonplace in the profession, and the tests were created to fulfill the goals of the school, the court held that Mr. Shaul was an employee working within his scope of employment when he created the tests and quizzes.[41] Furthermore, the court distinguished the teacher exception in *Weinstein* because the materials were not "explicitly prepared for publication."[42] As a result, the school was the author of the teaching materials under section 201 of the Copyright Act.[43] Similarly, cases like *Genzmer v. Public Health Trust of Miami-Dade County*[44] and *Vanderhurst v. Colorado Mountain College District*[45] apply the three-prong common law test without mentioning the teacher exception.

Although the teacher exception issue still arises, commentators generally agree that the exception was not preserved in the 1976 Copyright Act.[46] The Supreme Court of Kansas even questioned whether the narrow teacher exception is already accounted for in the common law scope of employment requirement.[47] It is relatively clear from the cases decided after *Reid* that the teacher exception holds little, if any, weight.

Ones and Zeros: Work-for-Hire Applied to Computer Programming

The work-for-hire test laid out in *Reid* was based on the common law of agency. This method of evaluating work for hire has made the test easily applicable to new forms of media and circumstances. However, as the analysis of each case requires a fact specific inquiry, courts have decided a healthy number of cases involving computer programming.

Applying the Employer-Employee Test to Programmers

As in prior work-for-hire cases, courts dealing with computer programmers had to determine if the creator of the work was an employee or independent contractor. In *Aymes v. Bonelli*, Aymes, a computer programmer, was held to be an independent contractor and therefore owned the copyright to a computer program that he wrote. Similar to *Reid*, Aymes was asked by Island Swimming Sales, Inc. (Island) to write a program that maintained records for the corporation, but there was no written agreement between the parties.[48] Aymes worked on the project at Island's office and the project was monitored and tuned to fit the company's needs.[49] However, Mr. Aymes "enjoyed considerable autonomy" when he worked, did not receive health benefits, and was not treated by Island as an employee in its tax and payroll system.[50] Applying the *Reid* factors to these elements, the court latched onto the fact that Island treated Mr. Aymes as an independent contractor through its failure to provide employee benefits and pay payroll taxes for Aymes.[51] The court then held that Island should not be allowed to re-categorize Mr. Aymes' status to deny him rights to his program.[52] As a result, Mr. Aymes was found to be an independent contractor.[53] However, as the suit was a copyright infringement case, the court remanded to determine if the work could be held as a joint work.[54]

Similarly, in *Graham v. James*[55] the court reasoned that the defendant Larry James was an independent contractor because "James is a skilled computer programmer, he was paid no benefits, no payroll taxes were withheld, and his engagement by Graham was project-by-project."[56] Conversely, programmers were found to be employees if the *Reid* factors, as applied to the facts of the case, produced a different result.[57]

Scope of Employment of a Programmer

In addition to the employee / independent contractor analysis, courts have also decided whether programmers were acting within their scope of employment. Although courts have come down on different sides of the issue, the standard has produced sound results.[58] An example of how the standard has been applied to computer programmers can be seen in *Avtec Sys. v. Peiffer*.[59] In *Avtec*, a programmer who developed a program at home, within his field of employment, was nevertheless found to be working outside the scope of employment.[60] The court in *Peiffer* reasoned that Mr. Peiffer's "orbital simulation for satellites" program was work that Mr. Peiffer was hired to perform due to the fact that Avtec was in the business of selling space-related computer services.[61] This satisfied the first prong of the common law scope of employment test. However, the court affirmed the lower court's finding that because Mr. Peiffer worked on the program at home and the program was not meant to serve Avtec's interest, that the second and third prongs, respectively, were not satisfied.[62] As a result, Mr. Peiffer was not acting within the scope of employment when he created the orbital simulation program.[63]

Section 101(2) and the Writing Requirement Debate

Section 101(2) of the Copyright Act of 1976 provides a second method for qualification under the work-for-hire doctrine. To fall under this provision, the work must be: 1) specially commissioned for 2) one of the nine statutorily enumerated works and 3) expressly agreed to be a work-for-hire in a signed written instrument.[64] Although many litigated cases involve the absence of a writing between the parties, the cases that try to fit under section 101(2) have raised an issue as to the meaning of the writing requirement.

Textually, section 101(2)'s meaning is straightforward: to determine the outcome of work-for-hire under this definition, one would look at the facts provided and attempt to check off each of the three elements required. However, Judge Posner, in *Schiller & Schmidt, Inc., v. Nordisco Corp.*,[65] read a temporal requirement into the third element. *Schmidt* entailed a dispute over photographs that were taken by Bertel, a photographer, for Rybak, when Rybak was employed by Schiller. Rybak then left the company and created a competing business, using the photographs in his catalogues.[66] Schiller sued for copyright infringement. According to Judge Posner, Bertel could not in any way fit under the classification of an employee of Schiller, and therefore Schiller had to rely on section 101(2) to establish copyright ownership.[67] Although there was no writing that would support work-for-hire between Schiller and Bertel when the photographs were taken, Schiller obtained Bertel's signature on an agreement after litigation had commenced. The agreement stated that Schiller owned the copyright to the photographs and any remaining copyrights would also be assigned to Schiller.[68] Schiller, however, did not sign the agreement.[69] Judge Posner reasoned that this agreement could not satisfy the writing requirement because "signed by them" under the statute meant that both parties had to sign the agreement.[70] In addition, "the statement also came too late" because work-for-hire shifts the vesting of copyright ownership to the commissioner and attaches when the work is created.[71] Therefore, a written agreement is required to precede the creation of the work for the purposes of work for hire under section 101(2).[72] As the writing was created retroactively, Schiller could not be the copyright owner.[73]

The requirement articulated in *Schmidt* was rejected by the Second Circuit three years later in *Playboy Enterprises, Inc. v. Dumas*.[74] In *Dumas*, the court discarded the Seventh Circuit's bright-line test in favor of a different temporal requirement.[75] The Second Circuit held that as long as "the parties agree before the creation of the work that it will be a work made for hire[,]" the writing itself need not "be executed before the creation of the work."[76] At issue in *Dumas* were legends on the back of checks that Playboy issued to Mr. Nagel, a graphic artist. The legends contained the work-for-hire provision and were signed by both parties.[77] However, neither party in the suit "proffered any direct evidence of the intent of the parties before the creation of the works."[78] Nevertheless, the court found that although Nagel's first check could not be evidence of an agreement prior to the creation of the work, his subsequent endorsement of checks could infer a "pre-creation consent to such a relationship."[79] Accordingly, the court found that the writing requirement under section 101(2) could be satisfied and the illustrations could be considered work-for-hire.[80]

Schmidt and *Dumas* show a split between the two circuits when interpreting the temporal requirement of section 101(2). The only court to weigh in on this split is the U.S. District Court in the Southern District of Texas. In *Compact Computer Corp. v. Ergonome Inc.*,[81] the court chose to follow the Second Circuit's reasoning that a pre-creation agreement is required for a work-for-hire relationship to occur.[82] In addition, the agreement does not have to be memorialized prior to the creation of the work.[83]

The question remains open as to whether there is a bright-line requirement. Yet what is clear is that there is a temporal requirement under section 101(2). The Seventh Circuit's bright-line test encompasses the Second Circuit's pre-creation intent requirement because a written agreement cannot exist without the intent to enter into a work-for-hire relationship. Therefore, if there is a written document prior to the creation of the work, there has to be an agreement pre-creation.

In summary, the cases dealing with the writing requirement highlight two key points. First, the intent to partake in a work-for-hire relationship must precede the creation of the work. Second, the writing memorializing the agreement must be signed by both parties.[84]

The Web Site Copyright Problem

Copyright, Work-for-Hire and Web Site Development

One of the latest disputes over copyright ownership involved a criminal trial for fraud. In *State v. Kirby*,[85] the Supreme Court of New Mexico held that a Web page designer who created and owned the copyright to the Web pages owned the Web site where the Web pages were located.[86] Richard Kirby, the defendant, approached Loren Collett, a Web site developer operating under a sole proprietorship, to design and develop a Web site. The defendant agreed that he would pay Collett $1,890 for the latter's services.[87] However, after the Web developer created and incorporated the Web pages into the Web site, the defendant did not pay Collett and changed the password on the Web site to lock the developer out.[88] A written contract between the parties made no explicit agreement pertaining to the Web site but it did discuss copyright ownership of the Web pages.[89] The Court found that pursuant to the contract, Collett reserved the copyright of the Web pages and that "[u]pon payment, Defendant would receive a kind of license to use the Web site."[90]

The prosecution was required to prove that "*the Web site* [that the defendant obtained] *belonged to someone other than defendant*" for a conviction as criminal fraud.[91] Consequently, the defendant argued that no reasonable jury could have found that the Web site belonged to someone else, because he owned the Web site.[92] The defendant had obtained the domain name, hosting service and passwords, which are necessary components to any Web site.[93]

The Supreme Court of New Mexico rejected the defendant's contentions, finding that a Web site and its Web pages are interchangeable terms for the purposes of copyright and ownership. The court pointed to cases where copyright disputes similar to *Kirby* arose and no distinctions were made between Web pages and Web sites.[94] It also reasoned that part of the interchangeable nature of Web sites and Web pages was due to the fact that a Web site is virtually non-existent without a Web page that "gives it life."[95] Following this reasoning, the court only had to establish who owned the copyright to the Web pages to determine ownership of the Web site. As the contractual agreement between Kirby and Collett established that copyright of the Web pages remained with the Web developer, the court held that a reasonable jury could have found that Kirby committed fraud by taking a Web site he did not own.[96]

Although *Kirby* is a state case, the Supreme Court of New Mexico referred to federal cases and federal statutes to make its decision. The court alluded to the work-for-hire doctrine in its opinion and applied the rule of law established by *Reid*, section 101 and section 201 of the Copyright Act, to the facts of *Kirby*.[97] It found that Collett would have been an independent contractor and that the written agreement between the parties was an assignment of right instead of a work-for-hire.[98] Therefore, Collett's Web pages, and the Web site where the Web pages were located, were not a work–for-hire.[99] In addition, the court stated that because the defendant did not argue that the Web site was a joint work, it did not have to address that possibility.[100]

It is unclear what the court intended with its analysis of federal law. Section 301 of the Copyright Act pre-empts the "general scope of copyright" from being litigated in state courts, and therefore a state court may not decide work-for-hire issues.[101] One possibility is that the court made a holding when it did not have the power to do so. Another more likely possibility is that it applied the federal statute as a method of interpreting the contract between the defendant and Collett.[102]

Importance of the Technical Distinction Between a Web Site and a Web Page

Compared to other forms of media, the Internet, Web sites and Web pages are still considered a new development. This is evidenced in *Kirby* and other cases where courts have outlined a basic explanation of the Internet and the Web site / Web page relationship.[103] The outcome of *Kirby* seems fair, as the defendant's conduct of refusing to pay someone and then blocking him from taking back the work was egregious. However, the court goes too far in holding that a copyright holder of Web pages placed on a Web site is the owner of the Web site itself.

In its technical explanation, the Supreme Court of New Mexico delineates the difference between a Web page and Web site. Citing *Sublett v. Wallin*,[104] the court explains that a "Web site consists of a number of webpages" and therefore, a "webpage is an integral part of a Web site."[105] By adopting this definition, the court places Web pages as a subset of a Web site. Although it is possible that one who owns a subset owns the whole, automatically attributing ownership of an entire set to the owner of a subset is illogical.

After distinguishing a Web page from a Web site, the court turned around and cited precedent in which other courts discussed Web sites and Web pages as one entity.[106] It then adopted this overly simplified view and affirmed the defendant's conviction on the ground that the Web developer owned the Web site.[107] Instead of coming to this conclusion, the court could have used a different line of reasoning to find that the defendant committed fraud. After all, he was effectively preventing the Web developer from reclaiming or accessing the Web pages that he owned.

The number of people who use the Internet and computer technology is growing at a rapid pace.[108] As this shift occurs, it will be more and more difficult to find people without a minimal, low-level understanding of the Internet and the different roles played by a Web site or a Web page. By grouping Web site and Web page as one, the court ignores the fact that on a technical level, the two are distinct, and that there should be a legal separation with regard to the rights involved.

Interdependency of Web Pages, Web Address and Service Providers

The *Kirby* court justifies its holding that a Web page owner is also the owner of the Web site by explaining that a Web page is the substance that gives a Web site "life."[109] Although it is true that a Web site without Web pages is of little to no value, if any of the other necessary components of a Web site were missing, it would also render a Web site valueless.[110] Minimizing the value of a domain name, the court states that "it is nothing more than an address."[111] However, without this address, a Web site will be unable to provide its content with ease on the World Wide Web. Users who wish to access a Web site without a domain name would have to obtain the direct address from the service provider, which is usually a series of forgettable numbers.[112] Without an address, one of the main purposes of a Web site—convenience—is greatly burdened. Furthermore, the value in a domain name is significant, as evidenced by the protection given by the federal government to domain names through the "Anticybersquatting" statute.[113]

Similarly, without a commercial service provider, a Web site's Web pages would have to be stored and run from a personal machine. This would tax the bandwidth of most Web sites causing a dramatic loss of speed and possibly crashes under a high load.[114] An unreliable and slow Web site would be, as the *Kirby* court described, of "little use to any business enterprise."[115] It is not being argued that the owner of the domain name or service provider owns a Web site. These components, like Web pages, are subsets of a Web site that rely on each other to create a functional Web site.[116] As a result, basing ownership of a Web site on ownership of any one of these components is illogical.

Web Sites with User-Controlled Web Pages

By simplifying Web sites and Web pages as one, the *Kirby* decision also established dangerous precedent that could give rise to illogical results. The success of Web sites as sources of cutting-edge information stems partly from the level of interactivity and freedom given to users on the Internet. Many Web sites are set up not to directly disperse information, but instead to spur discussion.[117] This method allows users to read input from other users regarding a topic. To follow this trend of horizontal information sharing, there are numerous Web sites on the Internet that relinquish control of their individual Web pages to users or visitors of the Web site. For example, Web sites like wikipedia.com and other "wikis" allow users to edit parts of the Web pages to contribute information.[118] Similarly, myspace.com allows users to upload entire blocks of Cascading Style Sheet (CSS)[119] code to create their personal Web pages within the site.[120] Finally, Web sites like geocities.com provide free hosting where users are given passwords and server space to upload their own Web pages in HTML form.[121]

Although most of these Web sites are protected by Terms of Use agreements, if a site happens to lack a user agreement or a court finds that an agreement is unenforceable, it is plausible after *Kirby* that a user or group of users who own the copyright to the individual Web pages will be able to take ownership of a Web site. This would be an unacceptable result, as it would threaten companies that allow for more widespread personalized user interaction that is unique to the way the Internet compiles and distributes information.

Can Web Sites be Works-for-Hire?

Kirby did not focus much on the application of work for hire within its analysis. However, the case highlights the importance of understanding the work-for-hire doctrine and applying the doctrine in appropriate situations. The *Kirby* case found that Collett, the Web developer, was an independent contractor under the *Reid* test.[122] Although the court did not specifically analyze the factors involved, the fact that Collett ran a sole proprietorship, did not retain any benefits from Kirby, and was to be compensated in a lump sum at the completion of work, made it virtually indisputable that Collett was an independent contractor.[123] Categorized as an independent contractor, Collett owned the copyright to the Web pages under Section 201(a) of the Copyright Act. On the other hand, if the facts were different and Collett were found to be an employee working within the scope of employment, the Web sites that he created would fall under work-for-hire.[124]

Not as certain is whether a Web site can fall under section 101(2). The extent of the *Kirby* court's analysis under 101(2) was outlining the three requirements and stating that "these elements are lacking."[125] Although the court was probably motivated by the fact that the only written agreement between the parties was a contract of assignment, one can only guess at which element or elements were lacking.[126]

In the context of a hypothetical Web development situation, element one requiring that the work be specially contracted for usually would not be an issue. This is because the relationship between parties in a Web development context usually requires a client to approach a Web developer who is then informed as to the scope of the Web site and any features that the client would like to have implemented. Even if the Web developer is given artistic freedom, the developer would still have to be given basic facts, such as the type of Web site (business or personal), the information to be placed on the Web site, and a Web address (depending on whether the client has purchased a domain name) before the developer can begin work on a Web site. Similarly, element three would not bar a Web site from being a work-for-hire as it is up to the parties to produce a written agreement.[127] In addition, the temporal requirement that the parties agree before the creation of the work should be easily satisfied following the same reasoning as element one.[128]

On the other hand, element two requires that the work be one of the nine specifically enumerated works listed in the statute.[129] Courts have not weighed in on whether a Web site can fall under one of the nine enumerated works in section 101(2). As the creation of Web sites can differ drastically from case to case, each Web site would have to be analyzed individually to determine if it could fall within the enumerated works. A Web site could fit within the realm of a compilation if it was created as a listing of other sites addressing a topic, or if it was a hub for a network for spoke sites.[130] Conversely, if a Web developer was employed to create a Web site that merely focuses on distributing information, it will probably not fit within one of the enumerated works.

Precautions to Take Under the Work-for-Hire Doctrine

The work-for-hire doctrine's flexible test creates difficulty in predicting whether it can be applied to the field of Web development. However, having the understanding that current copyright laws are not yet fully adapted to this new technology highlights a few precautions that each party can take before entering into a business deal involving the creation of Web sites.

Why Collett in the *Kirby* case ended up developing the Web pages directly on the defendant's system is somewhat of a mystery.[131] Within the industry it is commonplace for a developer to first program the pages locally and host the Web page from his machine so that clients may view, test and request changes be made.[132] After the pages are approved, the Web developer will then publish the Web site onto the client's service provider, to which a domain name has been attached.[133] Developing a Web site or Web page this way allows developers to have complete control over their own works through completion. Although it does not protect a developer from a client who intends from the outset to swindle the programmer, it alleviates the situation where payment is withheld due to a client's belief that the work is unsatisfactory. This method does not give control to the client until the last moment of the business transaction.

It is easy for a Web site manager to believe that he owns a Web site when he has the power to control what is accessible through the domain name or the service provider. However, as seen in *Kirby* and the cases that it cites, courts in some instances have simplified the technological difference between a Web site and a Web page.[134] As a result, a prudent Web site manager would not only discuss copyright ownership of the Web pages that a developer creates, but also specifically address the ownership of the Web site as a whole in any contractual agreement. In addition, a Web site manager must be careful about locking a developer out by changing passwords. What seems to be a mere disrespectful action could result in dire circumstances, as witnessed in *Kirby,* where the defendant was convicted of a criminal fraud.[135]

For an attorney drafting contracts to fit under section 101(2), there are some issues not apparent in a textual reading of the statute. First, the written agreement must describe with specificity the exact work that is being commissioned.[136] In the event that one person is being used for a series of works, separate contracts or clauses specifying each piece of work should be drafted. In the Web development context, an attorney should make sure that copyrights with regard to the Web pages and the Web site are specifically discussed to avoid future confusion or possible litigation. Second, the agreement to engage in a work for hire relationship must occur before the creation of the work.[137] Although there is a split in the Circuits as to whether an agreement has to be memorialized before the work begins,[138] it would be advisable to follow the stricter rule from the Seventh Circuit and execute the written agreement prior to the creation of the work. This will minimize the risk of litigation, regardless of the jurisdiction. Until the law pertaining to this issue is more settled, there is no predictability. Employing this method would also protect a client from unnecessary disputes with regard to the temporal requirement, as the documentation would serve as solid evidence of a pre-creation agreement if a dispute goes to trial.

Nonetheless, the above method only works if an attorney is given the opportunity to advise a client prior to the creation of the work. Many situations involve works that have already been started but are not yet completed. For example, a company that seeks to develop products based on proposals will usually encounter a situation where a prototype or some work has already been completed. To ensure that a client seeking to use the work-for-hire doctrine in this type of situation is protected, it would be prudent to draft a contract clause that deals with copyright in two steps. First, the creator assigns any and all current copyright to the commissioner of the work; and second, a separate clause, preferably using the phrase "work for hire," should be included to cover all future work done by the creator. This type of drafting would comply with the temporal requirement of work for hire while ensuring that the commissioner has the copyright.

The Next Big Case: Can the Creation of a Web Site Be a Joint Work?

As cases dealing with copyright and work for hire in the field of computer programming and Web site development are scarce, the question of whether a Web site can constitute a joint work has not been considered. In addition, the joint-work standard depends on the circumstances surrounding the work. Some cases declined to evaluate the joint work standard because the parties never argued the issue, while others remanded the issue back to lower courts.[139]

The Joint-Work Standard

Similar to work for hire, the joint-work standard is established in sections 201(a) and 101 of the Copyright Act of 1976. Section 201(a) states that "authors of a joint work are co-owners of copyright in the work," while section 101 defines joint work to be "a work prepared by two or more authors with the intention that their contributions be merged into inseparable or interdependent parts of a unitary whole."[140] The joint-work standard is best illustrated in *Weissmann v. Freeman*.[141] *Weissmann* involved an assistant to a researcher who co-authored a few articles. The assistant produced a derivative work of one of the articles which the researcher used as his own.[142] The court first held that the district court was mistaken in finding that when a derivative work is created, the authorship of the derivative work is automatically the same as the authors of the original.[143] Instead, each author must have intended to contribute an inseparable part to the whole work, and in fact contributed to the work.[144] As the court found that the researcher never had the intention to be a co-author of his assistant's derivative work, it reversed the lower court and held that the researcher infringed upon his assistant's copyright interests.[145] The court noted that the intent requirement should not be mistaken to mean that the parties must know who the other contributors will be at the time a contribution is created.[146] As long as a contributor knows that his work is going to produce a final joint work, the intent requirement is satisfied.[147]

The joint-work standard was further explained in *Erickson v. Trinity Theatre, Inc.*[148] The Seventh Circuit in *Erickson* held that in addition to the intent to create an inseparable work, each alleged author's contribution must be independently copyrightable.[149] The court scrutinized the Nimmer and Goldstein tests for joint works.[150] Under the Nimmer test, achieving joint author status requires only that the author make "more than a *de minimis* contribution."[151] In contrast, the Goldstein test requires that each contribution to the whole must be independently copyrightable.[152]

In adopting the latter test, the court reasoned that Goldstein's "copyrightability test str[uck] an appropriate balance in the domains of both copyright and contract law" because it allows authors to receive suggestions without risking authorship rights.[153] In addition, contributors who deemed their suggestions to be useful, but not copyrightable, could protect themselves by contract.[154] Applying the facts under the Goldstein test, even though the defendant could establish that there was intent to be joint authors for one of the plays written by the plaintiff, the suggestions were not copyrightable.[155] As a result, the preliminary injunction was affirmed, as the defendant could not be a joint author, raising the likelihood that the plaintiff would succeed on her infringement claim.[156]

However, a decision by the same circuit 10 years later in *Gaiman v. McFarlane*[157] questioned if the Goldstein test should be applied in all cases. In *McFarlane*, the court held that in cases where the "nature of the particular creative process" makes it so each person's contribution, standing alone, is not copyrightable, but the end product is copyrightable, each contributor can be considered an author of a joint work.[158] *McFarlane* dealt with the comic book industry, where the work is naturally divided into writing, penciling, inking and coloring. Judge Posner envisioned the situation where each individual contribution to the comic book would not rise to the level of copyrightability but the final work would be copyrightable.[159] Reasoning that it would be paradoxical to find that no one owned the copyright to a copyrightable piece of work, the court held that in these situations, each contributor would be a joint author if each intended at the outset to create the joint work.[160] Judge Posner then considered the Nimmer test that was rejected in *Erickson* and applied the test to *McFarlane*.[161] As Mr. Gaiman was specifically hired as a writer to help develop characters in the *Spawn* comic series, Judge Posner found that the parties set out to create a joint work. In addition, the court found that Mr. Gaiman's contributions to certain comic book characters were not mere suggestions or ideas, even though they would not have been copyrightable standing alone.[162]

Application of the Nimmer test in the *McFarlane* case poses the question of whether *Erickson* is still good law in the Seventh Circuit. The *McFarlane* decision refused to apply the Goldstein test but also did not specifically overrule *Erickson*. Furthermore, the opinion makes note that the Goldstein test generally produces correct results but does not account for the case where every part contribution would not be copyrightable while the finished product would be.[163] It is possible that the cases are consistent with each other. If the *McFarlane* decision is read narrowly, the Goldstein test would still be the standard to determine authors in a joint-work situation unless the nature of the work makes it so that each contribution would not rise to the level of copyrightability.[164]

Can Web Sites Fall Under the Joint-Work Standard?

For a Web site to be considered a joint work between a commissioner and a Web developer, the parties and Web site will have to meet the elements articulated by sections 101 and 102 of the Copyright Act and case law. Specifically, the creators of a Web site must have the intent of creating a piece of inseparable work together. In addition, depending on which test a jurisdiction applies, each contribution must either be individually copyrightable or exceed the threshold of mere suggestion. *Kirby* never decided whether the Web site was a joint work.[165] Therefore, this section will use the relevant facts in *Kirby* to evaluate if a typical Web site development relationship will produce a Web site with joint authors.[166]

Intent to create a joint work

For a joint work to exist the authors involved must have the intent to create it together.[167] In *Kirby*, the defendant purchased the domain name and obtained a service provider. He then approached a Web page designer to create the pages that would be associated with the domain name and host. In this situation, it is reasonable to infer that the parties had the intent to jointly create a Web site. The defendant would have known that without the content providing Web pages, his Web site would not exist. Similarly, the designer with the advantage of technical knowledge would know that his Web pages would not be found on the Internet without a domain name or host. Therefore, the defendant and the Web developer in *Kirby* would have had the intent to create a Web site together.

Conversely, another typical Web site development relationship is where the commissioner asks the Web developer not only to design the Web pages, but also to obtain all the other necessary components for a Web site. Intent to create a joint work is less evident in this instance, as the Web developer would be in control of all the components of a Web site. The relationship established in this scenario is more likely to be interpreted as intent to purchase or license a Web site rather than the intent to create a joint work.

Work must be inseparable

The second element of joint work is that each contribution must be inseparable from the whole.[168] Web pages and a domain name are easily interchangeable on a technological level because Web pages can be placed under any domain name and vice versa.[169] Yet, when viewed within the context of a Web site, it can be argued that they cannot be separated. Web pages are usually tailored to fit a specific domain name, because having a Web page with an arbitrary or misleading domain name is not functional.[170] The consistency of a domain name and its Web pages serve the primary functions of a Web site by making the site memorable and searchable. Thus, a Web site's domain name and the Web pages created for that particular Web site should be considered inseparable contributions to the whole.

Jumping through the hoops of Goldstein and Nimmer

The final requirement for a joint work depends on which test a court chooses to follow. Under the jurisdictions following the Goldstein test, each individual contribution would have to be copyrightable. Courts have found that Web pages are works that are generally afforded copyright protection.[171] On the other hand, domain names are considered an uncopyrightable "short phrase" under 37 C.F.R § 202.1(a).[172] Even if a commissioner were to argue that he gave the idea and direction for the Web site, a court applying the Goldstein test probably would find that the suggestions are not protected by copyright.[173] Therefore, under the Goldstein test, the defendant in *Kirby* would not have been considered a joint author of the Web site, as he only contributed suggestions and a domain name.

Web site development is analogous to the comic book industry. The same way a character-writer and an inker are important to a comic book, a domain name and host are valuable. Yet these components are not independently copyrightable. In spite of this, under the Nimmer test, a court would probably find each contribution to be above the threshold to allow a commissioner to be a joint author. Applying the Nimmer test, the court in *McFarlane* outlined a hypothetical involving two professors who intend to create a joint work:

> Here is a typical case from academe. One professor has brilliant ideas but can't write; another is an excellent writer, but his ideas are commonplace. So they collaborate on an academic article, one contributing the ideas, which are not copyrightable, and the other the prose envelope, and . . . they

sign as coauthors. Their intent to be joint owners of the copyright in the article would be plain, and that should be enough to constitute them joint authors . . . .[174]

Web site development can involve a situation very similar to that expressed by Posner where one person has the vision and artistic planning of a Web site, while the other merely has the technical prowess to code and carry out that vision. The parties in this instance would work hand in hand until the Web site is completed. This situation would be one of those paradoxical instances described by Judge Posner where the Nimmer test should be applied. If the Nimmer test is applied to this hypothetical, the planning and vision should be more than a *de minima* contribution, making it probable that the Web site would be considered a joint work.[175]

Web sites should be considered joint works

As discussed above, Web sites should easily satisfy the first and second element of joint work. The third element depends on whether a court decides to apply the Nimmer or the Goldstein standard.[176] Judge Posner delivers a strong argument for applying the Nimmer test in *McFarlane* because of the paradoxical nature of certain industries. Although it is unclear, it seems that Posner is advocating use of the Nimmer test only in specific situations when the Goldstein test is unsuitable.[177] If that is the case, the Nimmer test for the third element should be used for the Web development industry. Web development suffers from the same problems that the comic book industry encountered in *McFarlane*. If a commissioner pours energy into visualizing a Web site and does the "ground work" of obtaining a domain name and a service provider, he has contributed necessary components to a Web site. However, these necessary portions of a Web site are not copyrightable. Applying the Goldstein test strictly would leave the commissioner's valuable contribution unprotected. Unlike the Goldstein test, the Nimmer test would produce a more just result in the context of Web site development.

Conclusion

When dealing with new forms of media, technical definitions in the trade should correlate to the legal world. A Web page and a Web site are two technically distinct entities and should be treated as such. Although a Web site consists mainly of Web pages, other components, such as a domain name and server space, are also necessary. Each component plays an important part to the functionality of a Web site and sometimes has significant monetary value.[178] The *Kirby* court decided to group a Web site and its corresponding Web pages because it deemed Web pages to be the most important aspect of a Web site.[179] Such simplification produced a sound result in *Kirby*. However, there are a host of problems involved with this line of reasoning.

The industry does not use the term Web page and Web site interchangeably.[180] A Web page is considered a subset of a Web site, and the legal world should draw this distinction. It is illogical to assume that the owner of a subset also owns the entire parent set, especially when the other components in the parent set have significant value. Furthermore, the Internet thrives on the wealth of information compiled through many different sources. This has evolved into a world where individual users can make significant contributions to a Web site through forums, personalized Web pages and other interactive methods of information sharing. If owners of Web pages also own the Web site, it is plausible that Web sites that allow heavy user interaction with unenforceable or invalid terms of use agreements could eventually be taken over by their users. This is a result that is unreasonable and a hindrance to the unique way the Internet functions.

Apart from the technical distinctions of a Web page and a Web site, courts are also faced with the application of the work-for-hire doctrine in the area of web development. There are two ways to fall under the work-for-hire doctrine of section 201(b). The first is through the work-for-hire standard articulated in *Reid*.[181] The employer-employee test is a flexible 12-factor test that requires a fact-specific inquiry based on whether an employer-employee relationship exists. Although a multi- factored test is hard to apply, the standard is malleable to fit the various forms of media in today's world and any new types of media that may develop in the future. The *Reid* work-for-hire doctrine can easily be molded to fit the Web development industry and the outcomes depend on the facts. Web developers could work as in-house Information Technology personnel, thereby probably placing them under the employee category, or they could be independent contractors commissioned to produce Web sites, where the commissioner has no control over the developers.

The second method requires three elements: (1) the work must be specifically commissioned, (2) there must be a writing, and (3) the work has to fall under one of the nine enumerated works.[182] The first two requirements do not act as bars for the Web development work to be considered works for hire. However, falling into one of the nine enumerated works is more difficult. Determination of what type of work a Web site is relies mainly on the content provided by the Web pages. As Web pages can consist of content that reaches the bounds of imagination, it would be possible for a Web page to fall under "a contribution to a collective work . . . other audio visual work [or] . . . a compilation."[183]

Other than work for hire, the joint-work doctrine seems a better fit for the Web development industry.

A Web site could be considered a joint work under the doctrine as it would be simple to satisfy the intent and inseparable requirements.[184] In addition, even though the Goldstein test would bar a Web site from being a joint work, the decision in *McFarlane* to apply the Nimmer test in select situations should also apply to the Web development industry.

The nature of Web development produces situations where a contributor provides necessary components to a Web site. However, those components by themselves do not rise to the level of copyrightability. Following the Nimmer test in a Web development situation will give protection to the contributor of a concept and domain name of a Web site.

Although application of the work-for-hire and joint-work doctrines require case-by-case analysis, understanding the nuances of the doctrines is invaluable to any attorney, businessperson or author who will encounter copyright issues. Working carefully with the Copyright Act, one should be able to minimize the risk of litigation or future disputes regarding ownership and the intent of the parties.

Endnotes

1. 17 U.S.C.A. § 201(a) (West 2005).
2. 17 U.S.C.A. § 201(a); 17 U.S.C.A § 201(b) (West 2005).
3. 17 U.S.C.A. § 201(b).
4. *See, e.g.*, *Cmty. for Creative Non-Violence v. Reid*, 490 U.S. 730 (1989); *Aymes v. Bonelli*, 980 F.2d 857 (2d Cir. 1992); *Weinstein v. Univ. of Illinois*, 811 F.2d 1091 (7th Cir. 1987).
5. S. Ignacimuthu, s.j., Basic Bioinformatics 17 (2004).
6. Comm. on Internet Navigation and the Domain Name Sys.: Technical Alternatives and Policy Implications, Signposts in Cyberspace 1-2 (2005).
7. Ignacimuthu, *supra* note 5, at 17.
8. *Id.* at 17-18.
9. *See* What Is Offline, *available a*t http://searchnetworking.techtarget.com/sDefinition/0,,sid7_gci542056,00.html (last visited Sept. 22, 2008).
10. Copyright Act of 1976, 17 U.S.C.A. §§ 101-1332 (West 2005).
11. 17 U.S.C.A. § 201(a); 17 U.S.C.A. § 201(b).
12. 17 U.S.C.A. § 201(b).
13. *Id.* §101.
14. *See, e.g.*, *Reid*, 490 U.S. 730 (1989); *Aymes*, 980 F.2d 857 (2d Cir. 1992); *Weinstein*, 811 F.2d 1091 (7th Cir. 1987).
15. *Reid*, 490 U.S. at 732.
16. *Id.* at 733.
17. *Id.* at 734.
18. *Id.* at 735.
19. *See supra* Part III.
20. *Reid*, 490 U.S. at 738.
21. *Id.*
22. *Id.* at 751-52. The relevant factors are:

    > [T]he skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional project to the hired party; the extent of the hired party's discretion over when and how long to work; the method of payment; the hired party's role in hiring and paying assistants; whether the work is part of the regular business; the provision of employee benefits; and the tax treatment of the hired party.

    Id. at 740.
23. *Id.* at 752-53.
24. *Id.* at 752.
25. *Reid*, 490 U.S. at 742, 743 n.8 (rejecting the "right to control test," "actual control test" and that an employee only refers to a salaried or formal employee).
26. *Id.* at 734.
27. *See Id.* at 734, 741.
28. *Id.* at 753.
29. *Id.*
30. *See Reid*, 490 U.S. at 740.
31. Charles D. Ossola, *Recent Developments Relating to Copyright Ownership and Transfer*, 441 PLI/Pat *7, *12-13 (1996).
32. *Compare Reid*, 490 U.S. 730, *with Weinstein*, 811 F.2d 1091 (7th Cir. 1987).
33. Jeff Todd, *Student Rights in Online Course Materials: Rethinking the Faculty/University Dynamic*, 17 Alb. L.J. Sci. & Tech. 311, 322-23 (2007).
34. *Weinstein*, 811 F.2d at 1094.
35. 847 F.2d 412 (7th Cir. 1988), *abrogated by Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384 (1990) (abrogated for other reasons).
36. *Hays*, 847 F.2d at 416.
37. *See generally Reid*, 490 U.S. 730.
38. 363 F.3d 177 (2d Cir. 2004).
39. *Id.* at 185.
40. *Id.* at 186 (citing Restatement (Second) of Agency § 228 (1958)).
41. *Id.*
42. *Id.*
43. *Cherry*, 363 F.3d at 186.
44. 219 F. Supp. 2d 1275, 1283 (S.D. Fla. 2002) (holding that a post-graduate intern working as a physician who wrote a computer program to assist with research did so within the scope of employment).
45. 16 F. Supp. 2d 1297, 1307 (D. Colo. 1998) (reasoning that a professor's outline was connected to his employment and therefore within the scope of employment).
46. Todd, *supra* note 33, at 323.
47. *See Pittsburg State Univ. v. Kansas Bd. of Regents*, 122 P.3d 336, 346 (Kan. 2005) (citing Symposium on Kansas Law and Legislation, Wadley & Brown, *Working Between the Lines of Reid: Teachers, Copyrights, Work-For-Hire and A New Washburn University Policy*, 38 Washburn L.J. 385, 432 (1999)).
48. *Aymes*, 980 F.2d at 859; *See also Reid*, 490 U.S. at 738.
49. *Aymes*, 980 F.2d at 859.
50. *Id.*
51. *Id.* at 862-63.
52. *Id.* at 862.
53. *Id.* at 864.

54. *Aymes*, 980 F.2d at 865.
55. 144 F.3d 229 (2d Cir. 1998).
56. *Id.* at 235.
57. *See Montgomery v. Alocoa, Inc.*, No. 99-CV-73350-DT, 2000 WL 1769526 at *7-8 (E.D. Mich. Sept. 29, 2000) (holding that a programmer who received benefits, was paid and taxed like a salaried employee, maintained an eight-to-five time schedule and developed a program on company time and equipment was an employee under the *Reid* test).
58. *Compare Kelstall-Whitney v. Mahar*, No. 89-4683, 1990 WL 69013 at *8 (E.D. Pa. May 23, 1990) (holding that a computer programmer was not working within the scope of employment) *with Rouse v. Walter & Assoc., L.L.C.*, 513 F. Supp. 2d 1041, 1057-61 (S.D. Iowa 2007) (deciding that a scientist who developed a program to assist with compiling research results was acting within the scope of employment when writing the program).
59. No. 94-2364, 1995 WL 541610 (4th Cir. Sept. 13, 1995).
60. *Id.* at *4-5.
61. *Id* at *1, *4.
62. *Id.* at *4-5.
63. *Id.* at *1.
64. *See supra* Part III; 17 U.S.C.A. § 101(2).
65. 969 F.2d 410 (7th Cir. 1992).
66. *Id.* at 411-12.
67. *Id.* at 412.
68. *Id.*
69. *Id.*
70. *Schmidt*, 969 F.2d at 412.
71. *Id.* at 412. 17 U.S.C.A § 201(b).
72. *Schmidt*, 969 F.2d at 413.
73. *Id.*
74. 53 F.3d 549 (2d Cir. 1995).
75. *Id.* at 559.
76. *Id.*
77. *Id.* at 552.
78. *Id.* at 560.
79. *Dumas*, 53 F.3d at 560.
80. *Id.*
81. 210 F. Supp. 2d 839 (S.D. Tex. 2001).
82. *Id.* at 843.
83. *Id.*
84. *See Dumas*, 53 F.3d 549; *Schmidt*, 969 F.2d 410.
85. 161 P.3d 883 (N.M. 2007).
86. *Kirby*, 161 P.3d at 884.
87. *Id.* at 884-85.
88. *Id.* at 885.
89. *Id.* at 886.
90. *Id.*
91. *Kirby*, 161 P.3d at 885 (citing Memorandum Opinion, *State v. Kirby*, 161 P.3d 883 (N.M. Ct. App. May 10, 2005) (No. 24,845).
92. *Id.*
93. *Id.* at 887.
94. *See id.* at 888-89 (citing *Janes v. Watson*, No. SA-05-CA-0473-XR, 2006 WL 2322820 (W.D. Tex. Aug. 2, 2006); *Holtzbrinck Publ'g Holdings, L.P. v. Vyne Commc'ns, Inc*, No. 97 CIV. 1082, 2000 WL 502860 (S.D.N.Y. April 26, 2000)).
95. *Kirby*, 161 P.3d at 887.
96. *Id.* at 889.
97. *Id.* at 887 n.1.
98. *Id.*
99. *Id.*
100. *Kirby*, 161 P.3d at 887 n.1.
101. 17 U.S.C.A. § 301(a) (West 2005).
102. *Kirby* was decided in a state court that does not have the power to expand or reduce copyrights. However, state courts can decide contracts that deal with copyright in certain instances like assignments of copyrights. This author believes that it is important to understand that the decision was probably made on the basis of contract and not the federal work-for-hire statute. However, the *Kirby* court used federal principles to help interpret the terms of the contract. For a more extensive discussion of copyright preemption and Section 301, see Trotter Hardy, *Contracts, Copyright and Preemption in a Digital World*, 1 Rich. J.L. & Tech. 2 (1995).
103. *See, e.g., Kirby*, 161 P.3d at 885; *Janes*, 2006 WL 2322820; *Holtzbrinck*, 2000 WL 502860.
104. 94 P.3d 845 (N.M. Ct. App. 2004).
105. *Kirby*, 161 P.3d at 885 (citing *Sublett*, 94 P.3d 845).
106. *Id.* at 887-88 (citing *Janes*, 2006 WL 2322820; *Holtzbrinck*, 2000 WL 502860).
107. *Id.* at 889.
108. Growth of users on the Internet has risen 265.6 percent from 2000 to 2007. World Internet Usage Statistics, http://internetworldstats.com/stats.htm (last visited Sept. 22, 2008).
109. *Id.* at 887.
110. *Kirby*, 161 P.3d at 887.
111. *Id.* (citing Steven D. Imparl, Internet Law: The Complete Guide Part.II.4.1 (2006)).
112. *See* Comm. on Internet Navigation and the Domain Name Sys.: Technical Alternatives and Policy Implications, *supra* note 6, at 19.
113. *See* Anticybersquatting Consumer Protection Act, 15 U.S.C.A. § 1125 (d) (preventing a person to register and hold highly sought after domain names for the sole purpose of selling them) (West 1998 & Supp. 2007).
114. *See, e.g.*, Darren Dahl, *Traffic's Up; Website's Down*, INC.COM, Mar. 2008, http://www.inc.com/magazine/20080301/traffics-up-websites-down.html (last visited Sept. 22, 2008).
115. *Kirby*, 161 P.3d at 887.
116. *See* IGNACIMUTHU, *supra* note 5 at 17.
117. For example, many law school professors use "TWEN," a Westlaw teaching tool that provides an online forum for outside class discussions. *See* The West Education Network, http://lawschool.westlaw.com/twen (last visited Sept. 22, 2008).
118. *See* Wikipedia:Overview FAQ, http://en.wikipedia.org/wiki/Wikipedia:Overview_FAQ (last visited Sept. 22, 2008).
119. KEITH HARMAN & ALEX KOOHANG, LEARNING OBJECTS: STANDARDS, METADATA, REPOSITORIES, & LCMS 119 (2007).
120. *See* MySpace Frequently Asked Questions, http://myspace.com/index.cfm?fuseaction=misc.faq&Category=4&Question=7 (last visited Sept. 22, 2008).
121. *See* Yahoo! Geocities, http://geocities.com (last visited Sept. 22, 2008); see also HARMAN & KOOHANG, *supra* note 119, at 118.
122. *Kirby*, 161 P.3d at 887 n.1.

123. *See id.* at 884-85.

124. *See supra* Part IV.A.

125. *Id.* at 887 n.1 (stating that in order for 17 U.S.C.A. § 101(2) to apply, "the parties must expressly agree in a signed written instrument that the work will be work for hire and the work must be commissioned for one of nine uses listed in the Copyright Act.").

126. *See id.* at 886.

127. 17 U.S.C.A. § 101(2).

128. *See supra* Part IV.D. It is up to the parties to have a pre-creation agreement; what work is involved is irrelevant for the temporal requirement.

129. *See* 17 U.S.C.A. § 101(2) (the nine enumerated works are "contribution to a collective work, as a part of a motion picture or other audiovisual work, as a translation, as a supplementary work, as a compilation, as an instructional text, as a test, as answer material for a test, or as an atlas").

130. *See, e.g.*, *Janes*, 2006 WL 2322820, at *12 (dismissing work-for-hire claim acknowledging that a Web site where multiple persons were involved in creating components of the site could be a compilation).

131. *See Kirby*, 161 P.3d at 885.

132. *See, e.g.*, *Attig v. DRG, Inc.*, No. Civ.A.04-CV-3740, 2005 WL 730681 at *1 (E.D. Pa. Mar. 30, 2005).

133. *Id.*

134. *Kirby*, 161 P.3d at 888-89.

135. *Id.* at 884.

136. 17 U.S.C.A. § 101(2).

137. *See Dumas*, 53 F.3d at 559.

138. *See supra* Part VIII.D.

139. *See Kirby*, 161 P.3d at 887 n.1; *see also Janes*, 2006 WL 2322820, at *10; *Aymes*, 980 F.2d at 865.

140. 17 U.S.C.A. § 201(a); 17 U.S.C.A. § 101.

141. 868 F.2d 1313 (2d Cir. 1989).

142. *Id.* at 1315.

143. *Id.* at 1317.

144. *Id.* at 1318.

145. *Id.* at 1327.

146. *Weissmann*, 868 F.2d at 1319 (citing *Edward B. Marks Music Corp. v. Jerry Vogel Music Co.*, 140 F.2d 266, 267 (2d Cir. 1944) (holding that a lyrics writer knew that his work will be part of a joint work even though he did not know who would sing or produce the song)).

147. *Weissmann*, 868 F.2d at 1319 (citing *Marks*, 140 F.2d at 267).

148. 13 F.3d 1061 (7th Cir. 1994).

149. *Id.* at 1070-71.

150. *Id.* at 1069.

151. *Id.* at 1069-70.

152. *Id.* at 1070-71.

153. *Erickson*, 13 F.3d at 1071 (citing *Childress v. Taylor*, 945 F.2d 500, 507 (2d Cir. 1991)).

154. *Id.*

155. *Id.* at 1066.

156. *Id.* at 1073.

157. 360 F.3d 644 (7th Cir. 2004).

158. *Id.* at 658-59.

159. *Id.* at 659.

160. *Id.* at 658-59.

161. *Id.* at 659.

162. *McFarlane*, 360 F.3d at 661.

163. *Id.* at 658-59.

164. *See Brown v. Flowers*, 196 F. App'x 178, 188 n.5 (4th Cir. 2006) (questioning if *McFarlane* should be limited to "mixed media" circumstances).

165. *Kirby*, 161 P.3d at 887 n.1.

166. *See supra* Part III.E.

167. 17 U.S.C.A § 101.

168. *Id.*

169. *See* IGNACIMUTHU, *supra* note 5, at 17.

170. *See* COMM. ON INTERNET NAVIGATION AND THE DOMAIN NAME SYS.: TECHNICAL ALTERNATIVES AND POLICY IMPLICATIONS, *supra* note 6, at 1-2.

171. *See, e.g.*, *Kirby*, 161 P.3d 833; *Kantemirov v. Goldine*, No. C05-01362 HRL, 2005 WL 1593533 (N.D. Cal. Jun. 29, 2005).

172. 37 C.F.R. § 202.1(a) (2007); *see also Fryer v. Brown*, No. C04-5481 FDB, 2005 WL 1677940, * 4 (W.D. Wash July 15, 2005) (interpreting C.F.R. § 202.1 and holding a domain name not copyrightable).

173. Under *Erickson*, suggestions and direction are not enough to rise to the level of copyrightability. *See supra* note 155 and accompanying text.

174. *McFarlane*, 360 F.3d at 659.

175. *See* footnote 159 and accompanying text.

176. *See supra* Part VIII.B.1-3.

177. *McFarlane*, 360 F.3d at 659 (stating that in the majority of instances the Goldstein test yields sound results but the test is flawed in certain situations).

178. *See* Comm. on Internet Navigation and the Domain Name Sys.: Technical Alternatives and Policy Implications, *supra* note 6, at 1-2.

179. *Kirby*, 160 P.3d at 887.

180. *See* IGNACIMUTHU, *supra* note 5, at 17.

181. *See supra* note 15.

182. 17 U.S.C.A. § 101.

183. 17 U.S.C.A § 101(2).

184. *See supra* Part VIII.B.1-2.

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Landmark Settlement in *Authors Guild et al. v. Google* Class Action

Authors, Publishers, and Google Reshape Digital Publishing and Online Access to Books

By Jan F. Constantine and Isabel Howe

On October 28, 2008, the parties to the class action copyright infringement litigation, *Authors Guild et al. v. Google*, issued a press release announcing a groundbreaking settlement agreement. The U.S. District Court for the Southern District of New York granted the parties' motion for preliminary settlement approval, the first step in the long process of requirements including class notification, claims registration, opt-outs, objections and fairness hearing, now scheduled for June 11, 2009.[1]

Background

The settlement resolves two separate lawsuits filed by a group of authors (who filed the class action) and publishers[2] in the fall of 2005, alleging copyright infringement by Google in its scanning of millions of books (in copyright as well as public domain) from partner libraries in order to provide user access to small portions of text or "snippets" as part of the Google Book Search program. Google's legal position was that its actions in copying entire books but displaying snippets constituted "fair use" under Section 107 of the Copyright Act. The two lawsuits were coordinated by the court and lengthy settlement discussions ensued parallel with discovery. If approved, the settlement agreement would enhance the ability of authors and publishers to distribute their content in digital form and benefit the public by expanding online access to works through Google Book Search. The agreement also acknowledges the rights and interests of copyright owners, provides the means for them to control how their intellectual property is accessed online, and enables them to receive compensation for online access to their works.

What the Settlement Does and Does *Not* Do

The settlement does not resolve the underlying legal issue of whether Google's use of "snippets" violates the copyright law or constitutes "fair use." The settlement will not be operative for uses outside the United States, nor will it cover public domain books or books published and/or registered with the U.S. Copyright Office after January 5, 2009. Newspapers, journals, most pictorial material and sheet music are also specifically excluded from the settlement.

Through the class action mechanism, however, the settlement creates digital access to, and new markets for, in-copyright, out-of-print books, including so-called "Orphan Works," by granting licenses to Google and participating libraries.

Settlement Agreement Terms

The comprehensive 323-page settlement agreement with attachments is available at the official settlement website, http://googlebooksettlement.com. There are several key provisions which will be addressed here.

Under the settlement, Google will pay a minimum of $45 million to rights-holders of books and inserts already scanned through May 5, 2009. (Inserts are text [e.g., forewards, poems, short stories, song lyrics] or tables, charts, graphs and children's chapter book illustrations that are contained within a book, the copyright holder of which is not the rights holder.)

As discussed above, if approved, the settlement promises to create new markets for out-of-print books, while vastly improving reader access to those books. It will accomplish this by establishing a new not-for-profit organization initially funded by Google but jointly controlled by authors and publishers, the Book Rights Registry (the Registry), which will collect and distribute revenues from Google and maintain a database on rights-holders. The board will be composed of an equal number of author and publisher representatives, initially appointed by the Authors Guild and the American Association of Publishers. Google will provide start-up funds for the registry; ongoing funding will come from an administrative fee the Registry will draw from overall rights-holders' revenues.

The Google Book Search "library" will be composed of both out-of-print and in-print books. Out-of-print books scanned by Google from academic libraries are included in the database by default, although authors or publishers may request that specific books be removed. In-print books work in the opposite fashion: they are not included without the approval of the author and publisher. One of the first tasks Google will have under the settlement is to help determine what is in-print and what is out-of-print, by ascertaining which books are commercially available.

Out-of-print books are the central focus of the database. The goal was not to displace traditional markets for in-print books, but to create new markets for out-of-print books. Many books that were unavailable to the general public, and thus earned nothing for their authors, will get a second chance for monetization as a result of the settlement.

Authors (or their agents on their behalf) and publishers can easily opt out of the settlement by following procedures as part of the class action. At any time rights-holders can choose to exclude (or to include) their books from some or all of the display uses (i.e., preview, institutional subscriptions, online book purchases, and public access) by notifying the Registry. Until April 5, 2011, they can also irrevocably remove any of their titles from the database entirely.

All licensing revenues will go initially to Google, which will keep its 37 percent share and forward the remaining 63 percent to the Registry. The Registry will then pay the appropriate amount to rights-holders, after deducting an administrative fee. Google will also pass on usage data to the Registry, which will determine how the payments are to be distributed.

The revenue split between authors and publishers will vary, depending on the status and publication date of the book: For out-of-print books, there are three possibilities:

- If the rights have reverted to the author, the author will get 100 percent of the rights-holder income (minus the Registry's fee).
- If the rights have not reverted, and the book was published in or after 1987, there will be a 50/50 split between the author and publisher.
- If the book was published before 1987, the revenue split will be 65/35 between the author and the publisher, the majority going to the author.

Revenues for out-of-print books will be paid directly to authors and publishers.

For in-print books, the author-publisher split will depend on the terms of the book contract, with royalties paid by the Registry to the publisher for distribution of appropriate royalties to the author (or author's agent where applicable).

Under the settlement, there are four initial sources of revenue: institutional licensing, purchase of individual online editions, advertising, and fees from printing at public access terminals available at public libraries and institutions of higher education. It is anticipated that institutional licensing will be the most significant economically. Google will license unlimited access to the database to colleges and universities for a flat fee based on the number of full-time students and faculty.

The second source of revenue is from individual online use, which allows individuals to set up accounts with Google Book Search and pay to access specific books. Google will establish initial prices on books ranging from $1.99 to $29.99, but these can be overridden by authors or publishers, who can set the price for their own books. These online editions will not be downloadable by users; instead, account holders will log in to a Google account in order to view books they have purchased.

Unless rights-holders have directed Google not to place ads on their books, the same 37/63 split will apply to the third source of income, advertisements. When readers use Google Book Search individually, not through a university license, they will see ads—plain text only, with no pop-ups, audio or motion permitted—on various pages. Google will receive the income from ads displayed on most of the pages, such as those that list search results, but income from ads that show up when a reader is looking at a full page of text from a specific book will be split between Google and the rights-holders.

The fourth source of revenue is from printouts from public access viewings of books if libraries have printing capability.

Conclusion

The settlement has been described as a "win-win-win" for authors and publishers, Google and libraries, all of whom were involved in the lengthy negotiations leading to the document, which admittedly contains many compromises needed to resolve the litigation. The reality, recognized by all parties, is that even a clear win by either side could not have achieved the many benefits that the negotiated settlement agreement brings to all the parties to the litigation, not to mention the reading public.

Endnotes

1. The Hon. John E. Sprizzo signed the order granting the motion on Nov. 14, 2008. Judge Sprizzo passed away on Dec. 16, 2008; the case was reassigned to Hon. Dennis Chin.
2. McGraw Hill, Simon & Schuster, Pearson, Putnam and John Wiley filed the lawsuit under the auspices of the American Association of Publishers.

Jan F. Constantine is General Counsel and Assistant Director of the Authors Guild. Isabel Howe is the Assistant Editor of the Authors Guild Bulletin.

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Changes for Powers of Attorney in New York

By Rose Mary Bailly and Barbara S. Hancock

On January 27, 2009, Governor David Paterson signed Chapter 644 of the Laws of 2008, amending the General Obligations Law to provide significant reforms to the use of powers of attorney in New York. Chapter 644 was the result of eight years of study by the New York State Law Revision Commission and was the subject of much debate and comment by several Sections of the New York State Bar Association.

The power of attorney is an effective tool for attorneys and the public at large for estate and financial planning and for avoiding the expense of guardianship. The power of attorney is also a simple document to create. It can be obtained from any number of Web sites on the Internet or in a stationery store, and its execution merely requires the principal's signature and its acknowledgment before a notary public. But this simplicity belies the extraordinary power that the instrument can convey, and its popularity has also led to its use for transactions far more complex than were originally contemplated by the law, particularly in the areas of gift giving and property transfers.

"Chapter 644 was the result of eight years of study by the New York State Law Revision Commission and was the subject of much debate and comment by several Sections of the New York State Bar Association."

The instrument's power is also demonstrated by the potential authority the agent can hold. This can include power to transfer assets that pass by will as well as those that usually pass outside a will, such as joint bank accounts, life insurance proceeds and retirement benefits.

The principal can delegate these sweeping powers to the agent without fully recognizing their scope (particularly if the principal executes the document without the benefit of legal counsel). The agent can act immediately, unless the instrument is a springing power of attorney, i.e., one that becomes effective upon the occurrence of a specified event such as the principal's incapacity. In all cases, the agent can act without notifying the principal. Under a durable power of attorney or springing durable power of attorney, which continues in effect after the principal's incapacity, the agent acts without oversight when an incapacitated principal is no longer able to control or review the agent's actions – a situation which under common law would have terminated the power of attorney.

Despite the broad authority associated with this important, popular and powerful tool for financial management, the N.Y. General Obligations Law (GOL), which governs powers of attorney, has been silent as to a number of matters. These omissions include descriptions of the agent's fiduciary obligations and accountability, the manner in which the agent should sign documents where a handwritten signature is required, the limits of the agent's authority to make gifts to third parties and to himself or herself, the manner in which the principal can revoke the document, the circumstances under which a third party may reasonably refuse to accept a power of attorney, and the effect on powers of attorney of the 2003 Health Insurance Portability and Accountability Act (HIPAA) Privacy Rule regarding medical records. The statute's provisions have been ambiguous in other areas such as gift-giving authority and authority to make other property transfers.

Based on its study, the Commission concluded that while a power of attorney should remain an instrument flexible enough to allow an agent to carry out the principal's reasonable intentions, the combined effect of its potency and easy creation, the General Obligations Law's silence about several significant matters, and ambiguities about the authority to transfer assets can frustrate the proper use of the power of attorney, particularly when a principal is incapacitated and can no longer take steps to ensure its proper use. Chapter 644 addresses these statutory gaps and clarifies the ambiguities to assist parties creating powers of attorney and third parties asked to accept them.

The revised Power of Attorney Law has an original effective date of March 1, 2009. However, the effective date was delayed until September 1, 2009, after the extension was passed by the Senate (S.1728) on February 24 and by the Assembly (A.4392) on February 10. The bill was signed into law by the Governor as Chapter 4 of the Laws of 2009.

The New York State Bar Association supported this extension in order to provide practitioners with sufficient time to prepare for these significant changes.

For more information please visit our Web site, www.nysba.org.

This article is based on the New York State Law Revision Commission's *2008 Recommendation on Proposed Revisions to the General Obligations Law – Powers of Attorney*. The Commission's 2008 Recommendation, Chapter 644 and other material related to Chapter 644 can be found at the Commission's Web site: http://www.lawrevision.state.ny.us.

General Provisions

Chapter 644 creates a new statutory short form power of attorney. On or after the chapter's effective date, to qualify as a statutory short form power of attorney, an instrument must meet the requirements of GOL § 5-1513.[1] The statutory short form is not valid until it is signed by both the principal and agent, whose signatures are duly acknowledged in the manner prescribed for the acknowledgment of a conveyance of real property.[2] The date on which an agent's signature is acknowledged is the effective date of the power of attorney as to that agent; if two or more agents are designated to act together, the power of attorney takes effect when all the agents so designated have signed the power of attorney and their signatures have been acknowledged.[3]

A power of attorney executed prior to the effective date of Chapter 644 will continue to be valid, provided that the power of attorney was valid in accordance with the laws in effect at the time of its execution.[4]

Major Gifts and Other Property Transfers

Chapter 644 requires that a grant of authority to make major gifts and other asset transfers must be set out in a major gifts rider to a statutory power of attorney, which contains the signature of the principal duly notarized and which is witnessed by two persons who are not named in the instrument as permissible recipients of gifts or other transfers, in the same manner as a will.[5] In the alternative, the principal may grant such authority to the agent in a nonstatutory power of attorney executed in the same manner as a major gifts rider.[6] The creation of a major gifts rider or its alternative nonstatutory power of attorney allows the principal to make an informed decision as to whether the agent may make gifts or other transfers of the principal's property to third parties as well as to the agent. The execution requirements alert the principal to the gravity of granting the agent this type of authority. An agent acting pursuant to authority granted in a major gifts rider or a nonstatutory power of attorney must act in accordance with the instructions of the principal or, in the absence of such instructions, in the principal's best interests.[7] All statutory provisions relating to major gifts and property transfers have been located in a new GOL § 5-1514, rather than spread throughout the statute.

Powers of attorney often serve two very different purposes: management of the principal's everyday financial affairs and reorganization or distribution of the principal's assets in connection with financial and estate planning. The General Obligations Law has allowed the use of the statutory short form power of attorney for both purposes.

The former statutory language and statutory form made it difficult for a principal to make an informed decision about what, if any, authority he or she wants to give the agent with respect to making gifts and transferring property interests in connection with financial and estate planning.

First, the gifting and transfer provisions were scattered among other arguably more routine provisions. The statutory gifting authority was listed 13th (M) of 16 powers, and authority over insurance transactions and retirement benefit transactions, which can include changing beneficiaries, were listed sixth (F) and 12th (L) respectively; all of these could easily be overlooked. Unlike the gifting power, the insurance and retirement benefit powers listed on the form gave no hint that their construction sections allow the agent to change beneficiary designations. In giving the agent authority over insurance policies and retirement benefits, the principal might have been thinking of more routine matters, such as the need for more insurance or a different type of insurance and might have been unaware that he or she had given the agent authority that could alter the estate plan or reduce his or her property.

Second, the statutory short form did not indicate that the agent may be able to engage in self-gifting or designate himself or herself as the beneficiary of the principal's insurance policies and retirement benefits.

The potential for confusion was compounded by a third factor, namely, the ambiguity of the law regarding these types of transactions. The statutory construction sections for the authority to open joint bank accounts, and to change beneficiaries of insurance policies and retirement plans, did not require on their face that in order to exercise such authority the agent also be granted authority to make gifts or vice versa. So it might appear from a reading of the statute, that the agent could open a joint bank account and make changes in beneficiary designations without having separate gifting authority. However, cases interpreting the statute appeared to hold that if the principal intends to authorize the agent to open joint bank accounts with the principal and change the beneficiaries of the principal's insurance policies and retirement benefits, the principal must grant gifting authority in addition to authority over joint bank accounts, and insurance and retirement benefits.

Finally, the statute permitted modifications to the statutory short form to authorize significant transfers; but, like the powers listed explicitly on the form, they could be buried amid masses of legal text and could fail to attract the principal's attention to the significance of these modifications.

HIPAA Privacy Rule

Chapter 644 adds the term "health care billing and payment matters" to the term "records, reports and statements" as those terms are explained in construction § 5-1502K,[8] so that an agent can examine, question, and pay medical bills in the event the principal intends to grant the agent power with respect to records, reports and statements, without fear that the HIPAA Privacy Rule would prevent the agent's access to the records. This provision is applicable to all powers of attorney executed before, on or after the effective date of Chapter 644.[9] It does not change the law forbidding the agent from making health care decisions.[10]

The General Obligations Law has been silent as to the relationship between the power of attorney, an agent's authority to access medical records under New York law, and the Privacy Rule, a federal regulation regarding individual medical information promulgated in April 2003 pursuant to HIPAA. The ambiguity about an agent's authority to access medical records under New York law arose out of several factors. Neither subdivision K on the statutory short form (power to access records), nor § 5-1502K, which construed the term "records," contained an express reference to medical records. Moreover, § 18 of the Public Health Law, which identifies qualified persons who are entitled to access to a patient's health records, does not include all agents acting pursuant to a power of attorney.[11] As a result, health care providers have refused to make records available to an agent seeking clarification of a medical bill, without the express language in the power of attorney document authorizing such release.

The ambiguity thus created is exacerbated by the HIPAA Privacy Rule, which creates national standards limiting access to an individual's medical and billing records to the individual and the individual's "personal representative." Under the Privacy Rule, health information relating to billings and payments may be available to an agent if the agent can be characterized as the principal's "personal representative" as defined in the Privacy Rule. Under the regulations, the "personal representative" for an adult or emancipated minor is defined as "a person [who] has authority to act on behalf of a individual who is an adult or an emancipated minor in making decisions related to health care."[12]

The General Obligations Law has limited the authority of the agent to financial matters, and expressly prohibits the agent from making health care decisions for the principal. The Public Health Law defines a health care decision as "any decision to consent or refuse to consent to health care."[13] "Health care," in turn, is defined as "any treatment, service or procedure to diagnose or treat an individual's physical or mental condition."[14]

The principal may grant health care decision making authority to a third party only by executing a health care proxy pursuant to § 2981 of the Public Health Law. The health care proxy law makes clear that financial liability for health care decisions remains the obligation of the principal.[15] As a practical matter, payment issues are left to the principal or the principal's agent. The Privacy Rule regarding access to records does not take into account a statutory structure such as New York's, which permits the division of the responsibilities for health care decisions and bill paying between two representatives, the health care agent and the agent.

Agent

Chapter 644 includes a statutory explanation of the agent's fiduciary duties, codifying the common law recognition of an agent as a fiduciary.[16] A notice to the agent is added to the statutory short form explaining the agent's role, the agent's fiduciary obligations and the legal limitations on the agent's authority.[17] If the agent intends to accept the appointment, the agent must sign the power of attorney as an acknowledgment of the agent's fiduciary obligations.[18]

Chapter 644 also requires that, in transactions on behalf of the principal, the agent's legal relationship to the principal must be disclosed where a handwritten signature is required.[19] In all transactions (including electronic transactions) where the agent purports to act on the principal's behalf, the agent's actions constitute an attestation that the agent is acting under a valid power of attorney and within the scope of the authority conveyed by the instrument.[20] Chapter 644 allows for the principal to provide in the power of attorney that the agent receive reasonable compensation if the principal so desires.[21] Without this designation, the agent is not entitled to compensation.[22]

Both the durable and springing durable power of attorney permit the agent to continue to act after the principal has become incapacitated. The intent behind this change to the common law was laudable – to allow an agent to act for the principal precisely at a time when the principal needs assistance, to permit the principal to plan for possible incapacity, and to eliminate the need for expensive alternatives such as a trust or guardianship. However, the principal's incapacity leaves the principal unable to monitor the agent's actions and to revoke the power if he or she is not satisfied with the agent's conduct. Thus an agent could take actions on behalf of the principal for months or years, without any supervision and not always to the benefit of the principal. Recognizing that the potential for financial exploitation was inherent in the delegation of authority to an agent, public hearings in the early 1990s led to a two-pronged recommendation for reform—educating the principal and holding the agent account-able. Changes to the law regarding the principal's education were adopted but the statute was not revised to reflect the agent's accountability until now.

Principal

Chapter 644 adds a section to the statute that explains how the power of attorney can be revoked.[23] It expands the "Caution" to the principal so that the principal will be better informed about the serious nature of the document.[24] Chapter 644 also permits the principal to appoint someone to monitor the agent's actions on behalf of the principal,[25] and gives the monitor the authority to request that the agent provide the monitor with a copy of the power of attorney and a copy of the documents that record the transactions the agent has carried out for the principal.[26] Such accountability is consistent with the common law requirement that where one assumes to act for another he or she should willingly account for such stewardship.

Third Parties

Chapter 644 provides that third parties have the ability to refuse to accept powers of attorney based on reasonable cause.[27] The basis for a reasonable refusal includes, but is not limited to, the agent's refusal to provide an original or certified copy of the power of attorney and questions about the validity of the power of attorney based on the third party's good faith referral of the principal and the agent to the local adult protective services unit, the third party's actual knowledge of a report to the local adult protective services unit by another person, actual knowledge of the principal's death, or actual knowledge of the principal's incapacity when he or she executed the document, or when acceptance of a nondurable power of attorney is sought on the principal's behalf.[28] When a third party unreasonably refuses to accept a power of attorney, the statute authorizes the agent to seek a court order compelling acceptance of the power of attorney.[29] Chapter 644 expands the definition of "financial institution" to include securities brokers, securities dealers, securities firms, and insurance companies[30] and provides that a financial institution must accept a validly executed power of attorney without requiring that the power of attorney be on the institution's own form.[31] The third party does not incur any liability in acting on a power of attorney unless the third party has actual notice that the power is revoked or otherwise terminated.[32] A financial institution is deemed to have actual notice of revocation after the financial institution receives written notice at the office where the account is located and has had a reasonable opportunity to take action.[33]

One of the goals of the original creation of a statutory short form was to encourage financial institutions to accept such documents. The anticipated results did not follow. Many institutions instead required that the principal execute a document prepared by the institution. The enactment of the durable power of attorney actually exacerbated the situation. If the financial institution would not accept a statutory short form durable power of attorney and the principal had already lost capacity, serious difficulties could ensue because the principal could not legally execute another document. In 1986, the General Obligations Law was amended to make it unlawful for a financial institution to refuse to accept a statutory short form. Notwithstanding this statutory provision, financial institutions apparently continue to refuse to accept statutory short form powers of attorney and continue to demand that the institution's own form be completed.

"An attorney can certify a copy of a power of attorney instead of having to record it to get certified copies from the county clerk, which result protects client's privacy and limits costly trips to the county clerk's office."

Other Major Provisions

Chapter 644 increases the amount of the gifting provision to that of the annual exclusion amount under the Internal Revenue Code.[34] It adds a provision allowing gifting to a "529" account, up to the annual gift tax exclusion amount.[35] These "529" accounts, authorized in the Internal Revenue Code at § 529, are popular tax-advantaged savings accounts for education expenses. Chapter 644 amends the provisions regarding gift splitting to allow the principal to authorize the agent to make gifts from the principal's assets to a defined list of relatives, up to twice the amount of the annual gift tax exclusions, with the consent of the principal's spouse.[36]

Other Provisions

An attorney who has been instructed by the principal not to disclose the document to the agent at the time of the agent's appointment may do so without concern that it is already a legally effective document because the instrument does not become effective until the agent signs.[37] An attorney can certify a copy of a power of attorney instead of having to record it to get certified copies from the county clerk, which result protects client's privacy and limits costly trips to the county clerk's office.[38] In addition, the default statutory provisions regarding annual exclusion gifting will always be up to date with federal law.[39]

Financial institutions may demand an affidavit that the power of attorney is in full force and effect when they are asked to accept it.[40]

Investigative agencies and law enforcement officials can request a copy of the power of attorney and the records of the agent[41] and bring a special proceeding to compel disclosure in the event of the agent's failure to comply.[42]

Additionally, the basis for termination and revocation of a power of attorney and resignation of an agent are described,[43] as are the relationships among co-agents and the initial and successor agents.[44]

Conclusion

With these changes, New York's law has been updated and refined to reflect the complexities that surround the use of powers of attorney in financial and estate planning matters.[45]

Endnotes

1. 2008 N.Y. Laws ch. 644, § 2, 5-1501B; § 19, 5-1513. All statutory references for amendments to the General Obligations Law are to the sections in Chapter 644.
2. 2008 N.Y. Laws ch. 644, § 2, 5-1501B(1).
3. 2008 N.Y. Laws ch. 644, § 2, 5-1501B(3).
4. 2008 N.Y. Laws ch. 644, § 21.
5. 2008 N.Y. Laws ch. 644, § 2, 5-1501B(2)(a), § 19, 5-1514.
6. 2008 N.Y. Laws ch. 644, § 2, 5-1501B(2)(b), § 19, 5-1514.
7. 2008 N.Y. Laws ch. 644, § 19, 5-1514(5).
8. 2008 N.Y. Laws ch. 644, § 12.
9. 2008 N.Y. Laws ch. 644, § 21.
10. 2008 N.Y. Laws ch. 644, § 12, 5-1502K(1).
11. *See* N.Y. Public Health Law § 18(1)(g) (PHL) (refers only to attorneys who hold a power of attorney from an otherwise qualified person or the patient's estate specifically "authorizing the holder to execute a written request for patient information." An otherwise qualified person is the patient, Article 81 guardian, parent of an infant, guardian of an infant, or distributee of deceased patient's estate if no executor or administrator has been appointed).
12. 45 C.F.R. § 164.502(g)(2).
13. PHL § 2980(6).
14. PHL § 2980(4).
15. *See* PHL § 2987.
16. 2008 N.Y. Laws ch. 644, § 19, 5-1505.
17. 2008 N.Y. Laws ch. 644, § 2, 5-1501B(1)(d)(2); § 19, 5-1513(n).
18. 2008 N.Y. Laws ch. 644, § 2, 5-1501B(1)(c); § 19, 5-1513(o).
19. 2008 N.Y. Laws ch. 644, § 19, 5-1507(1).
20. 2008 N.Y. Laws ch. 644, § 19, 5-1507(2).
21. 2008 N.Y. Laws ch. 644, § 19, 5-1506(1).
22. *Id.*
23. 2008 N.Y. Laws ch. 644, § 19, 5-1511.
24. 2008 N.Y. Laws ch. 644, § 2, 5-1501B(1)(d)(1); § 19, 5-1513(a).
25. 2008 N.Y. Laws ch. 644, § 19, 5-1509.
26. *Id.*
27. 2008 N.Y. Laws ch. 644, § 18, 5-1504.
28. *Id.*
29. 2008 N.Y. Laws ch. 644, § 19, 5-1510(2)(i).
30. 2008 N.Y. Laws ch. 644, § 2, 5-1501(5).
31. 2008 N.Y. Laws ch. 644, § 18, 5-1504(1)(b)(1).
32. 2008 N.Y. Laws ch. 644, § 18, 5-1504(3).
33. *Id.*
34. 2008 N.Y. Laws ch. 644, § 19, 5-1514(6)(1).
35. *Id.*
36. 2008 N.Y. Laws ch. 644, § 19, 5-1514(6)(2).
37. 2008 N.Y. Laws ch. 644, § 2, 5-1501B(3)(a).
38. 2008 N.Y. Laws ch. 644, § 18, 5-1504(1)(a)(1).
39. 2008 N.Y. Laws ch. 644, § 19, 5-1514(6)(1).
40. 2008 N.Y. Laws ch. 644, § 18, 5-1504(5).
41. 2008 N.Y. Laws ch. 644, § 19, 5-1505(2)(a)(3).
42. 2008 N.Y. Laws ch. 644, § 19, 5-1510(1).
43. 2008 N.Y. Laws ch. 644, § 19, 5-1511.
44. 2008 N.Y. Laws ch. 644, § 19, 5-1508.
45. In so doing, New York's law has come in line with the laws of many other jurisdictions and the recent amendments to the Uniform Power of Attorney Act, available at http://www.law.upenn.edu/bll/archives/ulc/dpoaa/2008_final.htm.

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Power of Attorney New York Statutory Short Form

(a) CAUTION TO THE PRINCIPAL: Your Power of Attorney is an important document. As the “principal,” you give the person whom you choose (your “agent”) authority to spend your money and sell or dispose of your property during your lifetime without telling you. You do not lose your authority to act even though you have given your agent similar authority.

When your agent exercises this authority, he or she must act according to any instructions you have provided or, where there are no specific instructions, in your best interest. “Important Information for the Agent” at the end of this document describes your agent’s responsibilities.

Your agent can act on your behalf only after signing the Power of Attorney before a notary public.

You can request information from your agent at any time. If you are revoking a prior Power of Attorney by executing this Power of Attorney, you should provide written notice of the revocation to your prior agent(s) and to the financial institutions where your accounts are located.

You can revoke or terminate your Power of Attorney at any time for any reason as long as you are of sound mind. If you are no longer of sound mind, a court can remove an agent for acting improperly.

Your agent cannot make health care decisions for you. You may execute a “Health Care Proxy” to do this.

The law governing Powers of Attorney is contained in the New York General Obligations Law, Article 5, Title 15. This law is available at a law library, or online through the New York State Senate or Assembly websites, www.senate.state.ny.us or www.assembly.state.ny.us.

If there is anything about this document that you do not understand, you should ask a lawyer of your own choosing to explain it to you.

(b) DESIGNATION OF AGENT(S):

I, ____, hereby appoint:
[name and address of principal]

____ as my agent(s)
[name(s) and address(es) of agent(s)]

If you designate more than one agent above, they must act together unless you initial the statement below.

(___) My agents may act SEPARATELY.

(c) DESIGNATION OF SUCCESSOR AGENT(S): (OPTIONAL)

If every agent designated above is unable or unwilling to serve, I appoint as my successor agent(s): __________
____
[name(s) and address(es) of successor agent(s)]

Successor agents designated above must act together unless you initial the statement below.

(___) My successor agents may act SEPARATELY.

(d) This POWER OF ATTORNEY shall not be affected by my subsequent incapacity unless I have stated otherwise below, under “Modifications”.

(e) This POWER OF ATTORNEY REVOKES any and all prior Powers of Attorney executed by me unless I have stated otherwise below, under “Modifications”.

If you are NOT revoking your prior Powers of Attorney, and if you are granting the same authority in two or more Powers of Attorney, you must also indicate under “Modifications” whether the agents given these powers are to act together or separately.

(f) GRANT OF AUTHORITY:

To grant your agent some or all of the authority below, either (1) Initial the bracket at each authority you grant, or (2) Write or type the letters for each authority you grant on the blank line at (P), and initial the bracket at (P). If you initial (P), you do not need to initial the other lines.

I grant authority to my agent(s) with respect to the following subjects as defined in sections 5-1502A through 5-1502N of the New York General Obligations Law:

(___) (A) real estate transactions;
(___) (B) chattel and goods transactions;
(___) (C) bond, share, and commodity transactions;
(___) (D) banking transactions;
(___) (E) business operating transactions;
(___) (F) insurance transactions;
(___) (G) estate transactions;
(___) (H) claims and litigation;
(___) (I) personal and family maintenance;
(___) (J) benefits from governmental programs or civil or military service;
(___) (K) health care billing and payment matters; records, reports, and statements;
(___) (L) retirement benefit transactions;
(___) (M) tax matters;
(___) (N) all other matters;
(___) (O) full and unqualified authority to my agent(s) to delegate any or all of the foregoing powers to any person or persons whom my agent(s) select;
(___) (P) EACH of the matters identified by the following letters: ______________________________
____

You need not initial the other lines if you initial line (P).

(g) MODIFICATIONS: (OPTIONAL)

In this section, you may make additional provisions, including language to limit or supplement authority granted to your agent. However, you cannot use this Modifications section to grant your agent authority to make major gifts or changes to interests in your property. If you wish to grant your agent such authority, you MUST complete the Statutory Major Gifts Rider.

____
____

(h) MAJOR GIFTS AND OTHER TRANSFERS: STATUTORY MAJOR GIFTS RIDER (OPTIONAL)

In order to authorize your agent to make major gifts and other transfers of your property, you must initial the statement below and execute a Statutory Major Gifts Rider at the same time as this instrument. Initialing the statement below by itself does not authorize your agent to make major gifts and other transfers. The preparation of the Statutory Major Gifts Rider should be supervised by a lawyer.

(___) (SMGR) I grant my agent authority to make major gifts and other transfers of my property, in accordance with the terms and conditions of the Statutory Major Gifts Rider that supplements this Power of Attorney.

(i) DESIGNATION OF MONITOR(S): (OPTIONAL)

I wish to designate ____, whose address(es) is (are) ____ as monitor(s). Upon the request of the monitor(s), my agent(s) must provide the monitor(s) with a copy of the power of attorney and a record of all transactions done or made on my behalf. Third parties holding records of such transactions shall provide the records to the monitor(s) upon request.

(j) COMPENSATION OF AGENT(S): (OPTIONAL)

Your agent is entitled to be reimbursed from your assets for reasonable expenses incurred on your behalf. If you ALSO wish your agent(s) to be compensated from your assets for services rendered on your behalf, initial the statement below. If you wish to define “reasonable compensation”, you may do so above, under “Modifications”.

(___) My agent(s) shall be entitled to reasonable compensation for services rendered.

(k) ACCEPTANCE BY THIRD PARTIES: I agree to indemnify the third party for any claims that may arise against the third party because of reliance on this Power of Attorney. I understand that any termination of this Power of Attorney, whether the result of my revocation of the Power of Attorney or otherwise, is not effective as to a third party until the third party has actual notice or knowledge of the termination.

(l) TERMINATION: This Power of Attorney continues until I revoke it or it is terminated by my death or other event described in section 5-1511 of the General Obligations Law.

Section 5-1511 of the General Obligations Law describes the manner in which you may revoke your Power of Attorney, and the events which terminate the Power of Attorney.

(m) SIGNATURE AND ACKNOWLEDGMENT: In Witness Whereof I have hereunto signed my name on ______ ____________________________,20_____.

PRINCIPAL signs here: ==>____

(Acknowledgment)

[STATE OF)

) ss.:

COUNTY OF)

On the ___________ day of ______________________, in the year __________________, before me, the undersigned, a Notary Public in and for said state, personally appeared ____ ______________, personally known to me or proved to me on the basis of satisfactory evidence to be the person whose name is subscribed to the within instrument and acknowledged to me that he / she executed the same in his / her capacity, and that by his / her signature on the instrument, the person or the entity upon behalf of which the person acted, executed the instrument.

____

Notary Public]

(n) IMPORTANT INFORMATION FOR THE AGENT:

When you accept the authority granted under this Power of Attorney, a special legal relationship is created between you and the principal. This relationship imposes on you legal responsibilities that continue until you resign or the Power of Attorney is terminated or revoked. You must:

(1) act according to any instructions from the principal, or, where there are no instructions, in the principal's best interest;

(2) avoid conflicts that would impair your ability to act in the principal's best interest;

(3) keep the principal's property separate and distinct from any assets you own or control, unless otherwise permitted by law;

(4) keep a record or all receipts, payments, and transactions conducted for the principal; and

(5) disclose your identity as an agent whenever you act for the principal by writing or printing the principal's name and signing your own name as "agent" in either of the following manner: (Principal's Name) by (Your Signature) as Agent, or (your signature) as Agent for (Principal's Name).

You may not use the principal's assets to benefit yourself or give major gifts to yourself or anyone else unless the principal has specifically granted you that authority in this Power of Attorney or in a Statutory Major Gifts Rider attached to this Power of Attorney. If you have that authority, you must act according to any instructions of the principal or, where there are no such instructions, in the principal's best interest. You may resign by giving written notice to the principal and to any co-agent, successor agent, monitor if one has been named in this document, or the principal's guardian if one has been appointed. If there is anything about this document or your responsibilities that you do not understand, you should seek legal advice.

Liability of agent:

The meaning of the authority given to you is defined in New York's General Obligations Law, Article 5, Title 15. If it is found that you have violated the law or acted outside the authority granted to you in the Power of Attorney, you may be liable under the law for your violation.

(o) AGENT'S SIGNATURE AND ACKNOWLEDGMENT OF APPOINTMENT: It is not required that the principal and the agent(s) sign at the same time, nor that multiple agents sign at the same time.

I / we ____, have read the foregoing Power of Attorney. I am / we are the person(s) identified therein as agent(s) for the principal named therein.

I / we acknowledge my / our legal responsibilities.

Agent(s) sign(s) here:==>________________________________

(acknowledgement(s))

[STATE OF NEW YORK)

) ss.:

COUNTY OF)

On the ___________day of ______________________, in the year ___________, before me, the undersigned, a Notary Public in and for said state, personally appeared ____ _____________________________, personally known to me or proved to me on the basis of satisfactory evidence to be the person whose name is subscribed to the within instrument and acknowledged to me that he / she executed the same in his / her capacity, and that by his / her signature on the instrument, the person or the entity upon behalf of which the person acted, executed the instrument.

____

Notary Public

STATE OF NEW YORK)

) ss.:

COUNTY OF)

On the ___________day of ______________________, in the year ___________, before me, the undersigned, a Notary Public in and for said state, personally appeared ____ _____________________________, personally known to me or proved to me on the basis of satisfactory evidence to be the person whose name is subscribed to the within instrument and acknowledged to me that he / she executed the same in his / her capacity, and that by his / her signature on the instrument, the person or the entity upon behalf of which the person acted, executed the instrument.

____

Notary Public]

2008 N.Y. Laws ch. 644, § 19, 5-1513; 2009 N.Y. Laws ch. 4 (amending effective date from March 1, 2009 to September 1, 2009).

Editor's Note: This form is a draft POA which is being distributed for comment/suggestions. If you have any comments/suggestions, please e-mail them to Dan McMahon, NYSBA Publications Director at dmcmahon@nysba.org. A final version of the new POA form will be distributed once any necessary changes (if any) have been made. Final spacing has not been determined by the official publishers. Italics have been added to the portions of the new Statutory Short Form Power of Attorney and Major Gifts Rider that are instructional. Lines representing spaces and acknowledgments in brackets are lustrative only and have been added for clarity and convenience.

Power of Attorney New York Statutory Major Gifts Rider Authorization to Make Major Gifts or Other Transfers

CAUTION TO THE PRINCIPAL: This OPTIONAL rider allows you to authorize your agent to make major gifts or other transfers of your money or other property during your lifetime. Granting any of the following authority to your agent gives your agent the authority to take actions which could significantly reduce your property or change how your property is distributed at your death. "Major gifts or other transfers" are described in section 5-1514 of the General Obligations Law. This Major Gifts Rider does not require your agent to exercise granted authority, but when he or she exercises this authority, he or she must act according to any instructions you provide, or otherwise in your best interest.

This Major Gifts Rider and the Power of Attorney it supplements must be read together as a single instrument.

Before signing this document authorizing your agent to make major gifts and other transfers, you should seek legal advice to ensure that your intentions are clearly and properly expressed.

(a) GRANT OF LIMITED AUTHORITY TO MAKE GIFTS

Granting gifting authority to your agent gives your agent the authority to take actions which could significantly reduce your property. If you wish to allow your agent to make gifts to himself or herself, you must separately grant that authority in subdivision (c) below.

To grant your agent the gifting authority provided below, initial the bracket to the left of the authority.

(____) I grant authority to my agent to make gifts to my spouse, children and more remote descendants, and parents, not to exceed, for each donee, the annual federal gift tax exclusion amount pursuant to the Internal Revenue Code. For gifts to my children and more remote descendants, and parents, the maximum amount of the gift to each donee shall not exceed twice the gift tax exclusion amount, if my spouse agrees to split gift treatment pursuant to the Internal Revenue Code. This authority must be exercised pursuant to my instructions, or otherwise for purposes which the agent reasonably deems to be in my best interest.

(b) MODIFICATIONS:

Use this section if you wish to authorize gifts in excess of the above amount, gifts to other beneficiaries or other types of transfers. Granting such authority to your agent gives your agent the authority to take actions which could significantly reduce your property and/or change how your property is distributed at your death. If you wish to authorize your agent to make gifts or transfers to himself or herself, you must separately grant that authority in subdivision (c) below.

(____) I grant the following authority to my agent to make gifts or transfers pursuant to my instructions, or otherwise for purposes which the agent reasonably deems to be in my best interest:

____

____

(c) GRANT OF SPECIFIC AUTHORITY FOR AN AGENT TO MAKE MAJOR GIFTS OR OTHER TRANSFERS TO HIMSELF OR HERSELF: (OPTIONAL)

If you wish to authorize your agent to make gifts or transfers to himself or herself, you must grant that authority in this section, indicating to which agent(s) the authorization is granted, and any limitations and guidelines.

(____) I grant specific authority for the following agent(s) to make the following major gifts or other transfers to himself or herself:

____

____

____

This authority must be exercised pursuant to my instructions, or otherwise for purposes which the agent reasonably deems to be in my best interest.

(d) ACCEPTANCE BY THIRD PARTIES: I agree to indemnify the third party for any claims that may arise against the third party because of reliance on this Major Gifts Rider.

(e) SIGNATURE OF PRINCIPAL AND ACKNOWLEDGMENT:

In Witness Whereof I have hereunto signed my name on ____________________, 20____.

PRINCIPAL signs here:

____

(acknowledgment)

[STATE OF NEW YORK)

) ss.:

COUNTY OF)

On the ___________ day of _____________________, in the year __________, before me, the undersigned, a Notary Public in and for said state, personally appeared ____ _______, personally known to me or proved to me on the basis of satisfactory evidence to be the person whose name is subscribed to the within instrument and acknowledged to me that he / she executed the same in his / her capacity, and that by his / her signature on the instrument, the person or the entity upon behalf of which the person acted, executed the instrument.

____

Notary Public]

(f) SIGNATURES OF WITNESSES:

By signing as a witness, I acknowledge that the principal signed the Major Gifts Rider in my presence and the presence of the other witness, or that the principal acknowledged to me that the principal's signature was affixed by him or her or at his or her direction. I also acknowledge that the principal has stated that this Major Gifts Rider reflects his or her wishes and that he or she has signed it voluntarily. I am not named herein as a permissible recipient of major gifts.

______________________________	______________________________
Signature of witness 1	Signature of witness 2
______________________________	______________________________
Date	Date
______________________________	______________________________
Print name	Print name
______________________________	______________________________
Address	Address
______________________________	______________________________
City, State, Zip code	City, State, Zip code

(g) This document prepared by: ____

2008 N.Y. Laws ch. 644, § 19, 5-1514; 2009 N.Y. Laws ch. 4 (amending effective date from March 1, 2009 to September 1, 2009).

Editor's Note: This form is a draft POA which is being distributed for comment/suggestions. If you have any comments/suggestions, please e-mail them to Dan McMahon, NYSBA Publications Director at dmcmahon@nysba.org. A final version of the new POA form will be distributed once any necessary changes (if any) have been made. Final spacing has not been determined by the official publishers. Italics have been added to the portions of the new Statutory Short Form Power of Attorney and Major Gifts Rider that are instructional. Lines representing spaces and acknowledgments in brackets are illustrative only and have been added for clarity and convenience.

Whatever Happened to Article 78?

By Adam Leitman Bailey and Dov Treiman

The courts hearing cases challenging administrative agencies stand accused of rubber stamping the most vacuous statements paraded before them as findings of fact.[1] Indeed, an analysis of landlord-tenant cases over the past 10 years arising from the First and Second Judicial Departments[2] reveals some amazing patterns, sustaining the overall impression common in the landlord-tenant bench and Bar that Article 78 so rarely results in a victory for the petitioner that pursuing it has become nearly futile.

CPLR Article 78 gathers together the old writs used by the common law courts to review the work of administrative agencies. Section 7803 limits the questions that can be raised in such proceedings to whether the agency failed to perform its duty, acted in excess of jurisdiction, violated lawful procedure, was affected by an error of law, was arbitrary and capricious, abused discretion, or acted in the absence of substantial evidence. Of these, the question that has come to dominate all the others is whether the agency was arbitrary and capricious.

> *"[T]he overall impression common in the landlord-tenant bench and Bar [is] that Article 78 so rarely results in a victory for the petitioner that pursuing it has become nearly futile."*

The question that demanded answering is whether a raw count of the numbers of times courts affirm the agencies sustains the accusation of "rubber-stamping."

Meaningful research must focus on the work of three courts: The Court of Appeals and the Appellate Divisions for the First and Second Departments. There are four possible substantive outcomes to an Article 78 proceeding: affirming the decision of the agency ("*Aff'd*)," affirming it as modified ("*Mod*"),[3] reversing it ("*Rev'd*"), and remanding the matter to the agency for further processing ("*Rem*").[4] In order for an analysis of judicial decisions to have any meaning, one must navigate between the necessity for enough decisions to display a statistical trend and having the decisions close enough to each other in time to show then "current" thinking. In order to achieve both goals, we present our data in 10-, five-, and three-year chunks.[5]

In examining the record of cases decided over the past 10 years by these courts, we examined numbers of cases on landlord-tenant matters as follows:

Courts	3 yrs	5 yrs	10 yrs
All	68	137	334
Court of Appeals ("CoA")	2	6	13
App. Div. 1st Dep't ("1st")	41	87	230
App. Div. 2d Dep't ("2d")	24	44	91

The chart below gives the percentages of each of affirmances, reversals, modifications, and remands in ten ("10"), five ("5"), and three ("3") year study periods.[6]

Certain additional facts emerge from a study of the data. For example, in 1999 and almost all of 2000, 100% of landlord-tenant based Article 78 proceedings before the Second Department sustained the agency's rulings. In the past five years, the Court of Appeals has never reversed an agency on a landlord-tenant matter. Unlike past practice, these courts have not modified any landlord-tenant agency decisions for the past three years. For the First Department that handled 69% of the cases in the study,[7] it has been nearly a decade since it modified an agency decision.

We find that for the entire study period, the Appellate Divisions tend to sustain the agency outright roughly 85% of the time, but the Court of Appeals only sustains the agencies roughly half the time. Those data would at least suggest that the Appellate Divisions are misreading the will of the Court of Appeals. However, given the fact the high court has only been averaging slightly more than one landlord-tenant related Article 78 proceeding a year, there is limited validity to any statement made on statistics alone.[8] The remands to the agency reinforce this idea that the Appellate Divisions are not following the Court of Appeals' lead. While the Appellate Divisions remand to the agency in roughly 10% of cases, the Court of Appeals does so in the 30%-50% range.[9]

Independent of the statistics, both practitioners and some few judges are complaining increasingly loudly that Article 78 has become a mere "rubber stamp" for agency action. As Justice Marlow wrote in his stinging dissent in *333 East 49th Assocs., LP v. DHCR*,[10]

Courts	Aff'd 10	Aff'd 5	Aff'd 3	Rev'd 10	Rev'd 5	Rev'd 3	Mod 10	Mod 5	Mod 3	Rem 10	Rem 5	Rem 3
All	84%	82%	84%	4%	16%	3%	2%	2%	0%	10%	4%	12%
CoA	54%	50%	50%	8%	0%	0%	8%	17%	0%	30%	33%	50%
1st	86%	90%	88%	3%	2%	2%	2%	0%	0%	9%	8%	10%
2d	85%	73%	83%	5%	9%	4%	2%	5%	0%	8%	14%	13%

> While I agree with the majority's statement of law that "[t]he administrative agency charged with enforcing a statutory mandate has broad discretion in evaluating pertinent factual data and inferences to be drawn therefrom, and its interpretation will be upheld so long as not irrational and unreasonable," I respectfully disagree that this record meets even that modest standard.
>
> Instead, I believe that a reviewing court must be presented with a record containing factually meaningful findings so as to enable appellate judges to draw those rational inferences to support, and thus affirm, a result that affects parties' legitimate and significant rights. Otherwise, this Court's mandate —intended to be a conscientious review power over governmental action—will be transformed into a superficial habit of "rubber stamping" the most vacuous statements paraded before us as findings of fact.

The key phrase in the *333* dissent is "conscientious review power over governmental action." Intriguingly, Justice Marlow cites to nothing to back up his assertion that Article 78 should be "conscientious" and there is much in the literature to suggest to the contrary.

The problems originate in the statute itself, CPLR 7803(3), that directs the Supreme Court to consider whether the agency's actions were "arbitrary and capricious." Occasional decisions directly proceed under the "arbitrary and capricious" standard, but the overwhelming bulk of decisions hold that "arbitrary and capricious" means "irrational."[11] The problem with "irrational" is that it means a range of things: illogical, unreasonable, foolish, crazy, ridiculous, absurd, silly, unfounded, or groundless. Noting the range of nuance in these terms, we see it is a vastly different thing to say that a court may reverse an administrative decision because it is merely "unfounded" than to say that the administrator was "crazy." In truth, the "irrational" standard is rarely used at either of these extremes, although our research would suggest that the courts come closest to upholding all that which is not "crazy."

In one of its rare landlord-tenant decisions to overturn an agency decision, *Gilman v. DHCR*,[12] the Court of Appeals goes to the heart of its reasoning for overturning the agency without setting forth its latest understanding of when it is allowed to do so. There are two passages in the decision that afford some guidance, one where the court criticizes the DHCR for violating its own rules, and the other where the court accuses the DHCR of "extinguish(ing) . . . sound policy basis." Of course, "extinguishing sound policy" is a difficult standard to apply, but it does seem to be more severe than "unwarranted" and less extreme than "insane." So perhaps, this, insofar as it represents a standard, could be regarded as "violating public policy." If that is the rule, it is certainly more restrictive than Justice Marlow's "conscientious review power."

Where a court *will* overturn an agency will at times turn on interpretation of other CPLR 7803 grounds: failure to perform a duty, acting in excess of jurisdiction, abusing discretion, or acting without substantial evidence. The basis of the controversy may be that one side finds that one of these other grounds exists, but the other sees it really as the "arbitrary and capricious" standard. Thus in *I.G. Second Generation Partners LP v. DHCR*,[13] the majority saw a lack of jurisdiction for a result and the dissent saw that exercise of jurisdiction as having been rational. Amazingly, a court could think that an agency can "rationally" arrogate to itself a power denied to it by statute. Yet, such has become the power of the Article 78 rubber stamp.

That the administrative agencies mete out a substantial amount of injustice is clear even from the very cases that affirm their actions. For example, in *Partnership 92 LP v. DHCR*,[14] the agency took 21 years to process an application and, in doing so, applied a law passed more than a decade after the proceeding had been filed. In *333 East 49th Assocs., LP v. DHCR, supra*, the Appellate Division sustained a rent reduction order based on the agency making a finding that there was "filth" even though the agency's own record had no evidence to back that up. In *Hersh v. HPD*,[15] the agency delayed two years before beginning the processing of an application for a certificate of no harassment and, upon doing so, substantially relied upon hearsay.[16]

In examining the judicial literature in this field, one is perhaps most shocked by passages such as that found in *Verbalis v. DHCR*,[17] in which the First Department found that the Supreme Court had "exceeded its authority in determining that DHCR's decision on remand was inequitable." It justifies this shocking statement with the well familiar adage, "If the agency's decision is rational, it must be upheld, even though the court, if viewing the case in the first instance, might have reached a different conclusion." We must underline what is happening here: The second highest court in the State of New York is saying that fundamental fairness and equity are *irrelevant* in Article 78 proceedings. So long as there is some non-insane way of seeing the agency's decision as obeying the law, it does not matter how badly a litigant is unfairly hurt by that application of the law. Lewis Carroll's Queen of Hearts[18] would certainly approve.

Endnotes

1. Justice Marlow's dissent at *333 East 49th Assocs., LP v. DHCR,* 40 A.D.3d 516 (lst Dep't 2007).
2. Article 78 proceedings in the Third and Fourth Judicial Departments regarding landlord-tenant matters are almost entirely unheard of.
3. In the statistical analysis presented in this article, no attempt is made to differentiate among the various kinds of modifications.
4. In *Peckham v. DHCR,* N.Y.L.J., July 2, 2008, 26:1, the First Department insisted on affirming the DHCR over the latter's objection and refused a requested remand!
5. Both the raw data and a more complex analysis of them are available at www.alblawfirm.com / rubberstamp.pdf.
6. Cases in which the agency was sustained on Article 78 review are referred to as "*Aff'd,*" those in which the agency was reversed on such review, "*Rev'd,*" those in which the agency's action modified, "*Mod,*" and those for which the Article 78 court decided to remand the matter to the agency for further consideration, "*Rem.*"
7. The Court of Appeals handled 4%, the Second Department, 27%.
8. On the other hand, the Court of Appeals has not once reversed an agency ruling on a landlord-tenant matter in some five years. It did reverse agencies some 16% of the time from the period 10 years ago to five years ago.
9. In our judgment, for statistical purposes, it was not meaningful to compile numbers for reversals and affirmances of the Appellate Divisions by the Court of Appeals. The point of this article is how much deference the courts show the agencies, not each other.
10. *Supra* note 1.
11. S*ee Nehorayoff v. Mills*, 95 N.Y.2d 671 [2001]; *County of Monroe v. Kaladjian*, 83 N.Y.2d 185 [1994]; *Pell v. Board of Educ.*, 34 N.Y.2d 222, [1974]).
12. 99 N.Y.2d 144 (2002).
13. 34 A.D.3d 379 (1st Dep't 2006).
14. 46 A.D.3d 425 (1st Dep't 2007).
15. 44 A.D.3d 525 (1st Dep't 2007).
16. Actually it was, as the team from Adam Leitman Bailey, P.C. argued, double and triple hearsay in places, but the Appellate Division's decision was silent on the hearsay issue.
17. 1 A.D.3d 101, (1st Dep't 2003).
18. In Lewis Carroll's Alice's Adventures in Wonderland, the character of the Queen of Hearts is most famous for her repeated line, "Off with their heads!" Yet, the underlying premise of her justice system is all the more appropriate to this study of CPLR Article 78 in landlord tenant proceedings: "Sentence before verdict."

Adam Leitman Bailey is the founding partner and Dov Treiman, the landlord-tenant managing partner of Adam Leitman Bailey, P.C. This article was prepared with extraordinary research assistance from Leni Morrison, of the same firm.

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When Are Ideas Protectible?

By Marc Jonas Block

I. Introduction

Original ideas such as advertising pitches, television show proposals, and business models are commonly submitted by their creators to others with the expectation of receiving valuable consideration. What recourse creators have against those who refuse or fail to compensate them is an important question. Under federal intellectual property law, protection (under copyright, patent, or trademark law)[1] is granted only to the *expression* of artistic, scientific, and commercial ideas and concepts.[2] Ideas are protected only under state law. As demonstrated by a string of recent federal and state court decisions,[3] the protection of ideas is an area of increasing litigation. This article provides an overview of the protection of ideas under New York law and discusses the differing protection under California law.

In general, the use of a disclosed idea[4] does not in and of itself create a legal obligation to compensate the creator under New York law. After all, an idea is

> impalpable, intangible, incorporeal, yet it may be a stolen gem of great value, or merely dross of no value at all, depending on it novelty and uniqueness. Its utility is not the test. An idea may be regarded as useful, and worth putting into execution, even though the imparting of it gives no claim for recovery to its originator.[5]

However, since 1922 New York courts have recognized the value in some ideas and the importance of protecting them from being stolen. At the same time, they have recognized that "[n]ot every 'good idea' is a legally protectible idea."[6]

In an effort to protect only ideas of value, New York courts have required that an idea be both original and novel to give rise to a claim for compensation. The central question is: To whom must the idea be novel? The creator, the person to whom it is disclosed, a segment of the public, or the world?

For claims brought under contracts entered into prior to disclosure of the idea, courts have held that the idea must have been novel to the buyer in order to constitute valid consideration.[7] Disputes arising from contracts entered into after the idea has been disclosed are treated as simple contract actions, with courts deeming the idea to have value to the contracting parties with no proof of novelty or originality required. New York also recognizes a property right in an original and novel idea. A misappropriation of idea claim requires a legal relationship between the parties and proof that the idea is original and novel in an absolute sense.

II. New York Courts Recognize Protection of Ideas Under Contract and Misappropriation Law

The first case to find protection for the disclosure of ideas in New York was *Soule v. Bon Ami Co.*,[8] a 1922 Appellate Division decision. Plaintiff Louis Soule and defendant Bon Ami Company entered into an agreement whereby Soule agreed to disclose allegedly valuable information that would increase the Bon Ami Company's profits, and Bon Ami Company promised to pay Soule one-half of the increased profits arising from the yet-to-be-disclosed information. Soule then disclosed his business model, which was that an increase in the gross price of a product would increase the profit margin. Bon Ami Company refused to comply with the agreement, and Soule sued.[9]

The First Department overturned a directed verdict for Soule, holding that an idea or a piece of information might in fact be valuable consideration for a contract, but "the information must be new."[10] The court stated that although an original idea may be considered valuable consideration for a contract, "[n]o person can by contract monopolize an idea that is common and general to the whole world."[11] The Court of Appeals affirmed without comment.[12] Thus, under *Soule*, an idea could be consideration for a contract provided it is new and original and not a fact already known.[13]

Applying *Soule*, courts in New York have found that the "lack of novelty in an idea is fatal to any cause of action for its unlawful use."[14] After all, there exists an inherent inequity in any disclosure agreement:

> An agreement premised on the disclosure of a secret is a blind deal. When the purveyor of that secret exacts a promise of confidentiality, he knows what he is dealing with, but the recipient is in the dark. The enforceability of such a threshold agreement—a promise in exchange for a revelation—turns on the value of the disclosure. . . . If the idea is of such a nature that it cannot be appropriated by a party, it cannot be misappropriated by another.[15]

Although *Soule* recognized that an idea may be consideration for a contract, subsequent decisions broadened the holding, recognizing original and novel ideas as property. In 1972, in *Downey v. General Foods Corp.*,[16] the Court of Appeals held:

> An idea may be a property right. But, when one submits an idea to another, no promise to pay for its use may be implied, and no asserted agreement enforced, if the elements of novelty and originality are absent, since the property right in an idea is based upon these two elements.[17]

Plaintiff John Downey was an airline pilot who submitted a proposal for increasing the sale of defendant General Foods Corporation's gelatin product "Jell-O" by targeting the children's market and renaming the product "Wiggly," or a variation thereof, including "Mr. Wiggle."[18] Downey's wife allegedly called General Foods' Jell-O product "Mr. Wiggle" to their children. Downey sent an unsolicited suggestion to General Foods that it adopt the trademark "Mr. Wiggle" throughout the United States. At about the same time plaintiff made this unsolicited proposal to General Foods, General Foods' advertising firm, Young & Rubicam, on its own initiative, independently developed the trademark "Mr. Wiggle" for use in the children's market.[19] In March 1965, General Foods informed Downey that it had no interest in his proposal,[20] but in July General Foods began offering its Jell-O product under the trademark "Mr. Wiggle."[21] Downey sued for misappropriation of the idea to use the trademark "Mr. Wiggle" for the marketing of General Foods' Jell-O product. The Appellate Division affirmed the denial of summary judgment motions brought by both sides.[22]

The Court of Appeals reversed the denial of General Foods' summary judgment motion and dismissed the action.[23] The Court held that original ideas are the property of their creators, and the theft or unauthorized use of them is actionable as misappropriation.[24] Ideas are not subject to protection, however, if they are not novel and original.[25] In concluding that Downey was not entitled to compensation for his idea, the Court of Appeals held that the use of the word "wiggly" or "wiggle" was descriptive of the most obvious characteristic of plaintiff's gelatin product and thus was lacking in novelty and originality.[26] Although the Court did not define novelty and originality, it relied on General Foods' evidence of previous knowledge and prior usage of the word "wiggles" to rule out the existence of novelty and originality in Downey's idea.[27]

Downey did not base his claim on a contract with the defendant; there was none. Instead, he sued for misappropriation, and the Court examined the claim under a property theory. In treating the idea as property, *Downey* expanded the rights afforded to a creator of an idea. Indeed, whereas under *Soule* creators were limited to the enforcement of contracts, now creators of original and novel ideas also could seek redress under a tort theory.

Based on the theory that an original and novel idea is property, courts recognized a cause of action for the misappropriation of ideas distinct from claims arising under contract or quasi-contract theories:

> In order for an idea to be susceptible to a claim of misappropriation, two essential elements must be established: the requisite legal relationship must exist between the parties, and the idea must be novel and concrete. The legal relationship between the plaintiff and defendant may be either a fiduciary relationship, or based on an express contract, an implied-in-fact contract, or a quasi-contract.[28]

The concept of novelty was examined by the Second Circuit, applying New York law, in *Murray v. National Broadcasting Co.*[29] Plaintiff Hwesu Murray claimed NBC's production and broadcast of the television series "The Cosby Show," about everyday life in an upper middle-class African-American family in New York City, was derived from an idea he had presented to NBC in 1980, years before the show premiered.[30]

The Second Circuit confined itself to the question of whether Murray's proposal of a non-stereotypical portrayal of African-Americans on television was novel and thus protectible. The court held that

> ideas that reflect 'genuine novelty and invention' are fully protected against unauthorized use. *Educational Sales Program*, 317 N.Y.S.2d at 844. But those ideas that are not novel "are in the public domain and may freely be used by anyone with impunity." *Ed Graham Productions*, 347 N.Y.S.2d at 769. Since non-novel ideas are not protectible as property, they cannot be stolen. In assessing whether an idea is in the public domain, the central issue is the uniqueness of the creation.[31]

Although "The Cosby Show" was recognized unquestionably as innovative, the mere fact that such a program had not been made before did not necessarily mean the idea for the program was novel. Cosby himself had outlined his "dream" project years earlier in a 1965 interview quoted by the Second Circuit:

> There'll be the usual humorous exchanges between husband and wife. . . . Warmth and domestic cheerfulness

> will pervade the entire program. Everything on the screen will be familiar to TV viewers. But this series will be radically different. Everyone in it will be a Negro.
> . . . I'm interested in proving there's no difference between people, [explained Cosby]. My series would take place in a middle-income Negro neighborhood. People who really don't know Negroes would find on this show that they're just like everyone else.[32]

The court noted that "not every good idea is a legally protectible idea" and that an idea is not novel if it merely represents an "adaptation of existing knowledge and of 'known ingredients' and therefore lack[s] 'genuine novelty and invention'."[33] The court concluded that the plaintiff's idea, although innovative, was not novel, as ideas for presenting African-American actors in non-stereotypical roles and family situation comedies had been circulating in the television industry for years.[34] Finding that the idea was not novel, the court affirmed the dismissal of the breach of implied contract, misappropriation, conversion, and unjust enrichment claims.[35]

In dissent, Judge Pratt argued that the novelty standard employed by the majority was too high:

> To say, as a matter of law, that an idea is not novel because it already exists in general form, would be to deny governmental protection to any idea previously mentioned anywhere, at anytime, by anyone. I do not believe New York law defines "novelty" so strictly. . . .
>
> Novelty, by its very definition, is highly subjective. As fashion, advertising, and television and radio production can attest, what is novel today may not have been novel 15 years ago, and what is commonplace today may well be novel 15 years hence.[36]

Judge Pratt's dissent highlights the extremely high standard of novelty the courts have adopted in New York. Although the courts continued to recognize and develop the law of idea protection under both contract and misappropriation law, few, if any, plaintiffs have been able to meet the burden of demonstrating novelty and originality.

III. The Court of Appeals Defines "Novelty"

In the seminal 1993 decision *Apfel v. Prudential-Bache Securities Inc.*,[37] the New York Court of Appeals finally addressed the degree of originality and novelty required for the protection of ideas under pre- and post-disclosure contracts. The plaintiffs, an investment banker and a lawyer, submitted a detailed written proposal to Prudential for issuing municipal securities through a system that allowed bonds to be sold, traded, and held exclusively by means of a computerized "book entry only" format, which Prudential accepted and implemented.[38] Initially, Prudential signed a confidentiality agreement that it would review the proposal detailed in a 99-page summary.[39] After nearly a month of negotiations, all parties entered into a sale agreement "under which plaintiffs conveyed their rights to the techniques and certain trade names and defendant agreed to pay a stipulated rate based on its use of the techniques for a term from October 1982 to January 1988."[40] The post-disclosure agreement provided that Prudential was obligated "to pay even if the techniques became public knowledge or standard practice in the industry and applications for patents and trademarks were denied."[41]

The Court of Appeals stated that the real issue was not whether the idea was novel but whether it had value. Novelty, the Court held, is an element of plaintiff's proof of either a proprietary interest in an idea or of the validity of the consideration under a contract theory:

> While our cases have discussed novelty as an element of an idea seller's claim, it is not a discrete supplemental requirement, but simply part of plaintiff's proof of either a proprietary interest in a claim based on a property theory or the validity of the consideration in a claim based on a contract theory.[42]

Thus, novelty is not a prerequisite in all cases involving idea disclosure.[43] The Court held that novelty is not required to validate a contract. The decisive question is whether the idea has value, not whether it is novel.[44]

The Court found no real question that the idea disclosed to Prudential had value to the defendant:

> It decided to enter into the sale agreement and aggressively market the system to potential bond issuers. For at least a year, it was the only underwriter to use plaintiffs' "book entry" system for municipal bonds, and it handled millions of such bond transactions during that time. Having obtained full disclosure of the system, used it in advance of competitors, and received the associated benefits of precluding its disclosure to others, defendant can hardly claim now the idea had no value to its municipal

> securities business. Indeed, defendant acknowledges it made payments to plaintiffs under the sale agreement for more than two years, conduct that would belie any claim it might make that the idea was lacking in value or that it had actually been obtained from some other source before plaintiffs' disclosure.[45]

The Court distinguished *Downey*, *Soule*, and other cases in which there were no further contractual negotiations or payment post-disclosure:

> Such transactions pose two problems for the courts. On the one hand, how can sellers prove that the buyer obtained the idea from them, and nowhere else, and that the buyer's use of it thus constitutes misappropriation of property? Unlike tangible property, an idea lacks title and boundaries and cannot be rendered exclusive by the acts of the one who first thinks it. On the other hand, there is no equity in enforcing a seemingly valid contract when, in fact, it turns out upon disclosure that the buyer already possessed the idea. In such instances, the disclosure, though freely bargained for, is manifestly without value. A showing of novelty, at least novelty as to the buyer, addresses these two concerns. Novelty can then serve to establish both the attributes of ownership necessary for a property-based claim and the value of the consideration—the disclosure—necessary for contract-based claims.
>
> There are no such concerns in a transaction such as the one before us. Defendant does not claim that it was aware of the idea before plaintiffs disclosed it but, rather, concedes that the idea came from them. When a seller's claim arises from a contract to use an idea entered into after the disclosure of the idea, the question is not whether the buyer misappropriated property from the seller, but whether the idea had value to the buyer and thus constitutes valid consideration. In such a case, the buyer knows what he or she is buying and has agreed that the idea has value, and the Court will not ordinarily go behind that determination. The lack of novelty, in and of itself, does not demonstrate a lack of value.[46]

The Court thus identified value to the defendant as the determining factor. That the plaintiff may not have a property right in the idea does not, by itself, render the contract void for lack of consideration.

Under *Apfel*, two distinct standards exist for contract-based claims arising out of idea disclosure. First, a showing of novelty as to the buyer is required for claims based on the unauthorized use of an idea disclosed after the parties enter into a contract.[47] In this respect, *Apfel* marked a significant change in the legal standard for idea submission cases. Whereas under *Downey*, *Soule*, and *Murray* an idea could be property and valid consideration for a contract only if it were novel to the entire world, under *Apfel*, an idea can be valid consideration so long as it is original to the defendant.[48] Second, with respect to contracts entered into after the disclosure of the idea, *Apfel* held that novelty is not required.[49] *Apfel* did not directly address the novelty and originality required for a misappropriation of idea claim.

IV. Application of *Apfel*

Apfel serves as the benchmark on the law of idea protection in New York. Its holding has been applied to both contract-based and misappropriation-based claims in idea-submission cases. In *Oasis Music, Inc. v. 900 U.S.A.*,[50] a computer game developer sued the distributor of video games over cell phones. After a joint venture between the developer and distributor for the creation, marketing, and commercial exploitation of an interactive telephone game fell through, the developer created and released a different game. The developer claimed the distributor had misappropriated its ideas by incorporating them into the game ultimately developed. The trial court granted summary judgment for the defendant.

The trial court in *Oasis* examined a situation in which the parties had entered into a confidentiality agreement with payment based on use, but, unlike in *Apfel*, there was no post-disclosure contract for use of the idea. The court stated that the *Apfel* Court

> did not repudiate the long line of cases requiring novelty in certain situations. Rather, the *Apfel* Court merely clarified that novelty is not required in *all* cases. *Apfel* held that when a seller and buyer enter into both a confidentiality agreement and a post-disclosure contract, the post-disclosure contract for the sale of an idea may be supported by adequate consideration even if the idea is not novel. However, if "the buyer and seller contract for *disclosure* of the idea with payment based on use, but no separate post-disclosure contract for

> *use* of the idea has been made" there is a problem in establishing "whether the idea the buyer was using was, in fact, the seller's. Thus, in this latter category of cases, the New York courts require '[a] showing of novelty, at least novelty as to the buyer'."[51]

Since there was no post-disclosure contract in *Oasis*, the court examined the idea under a property-based theory and stated:

> For an idea to be susceptible to a claim of misappropriation, two elements must be established. First, a requisite legal relationship must exist between the parties and second, the idea must be novel and concrete. . . . The legal relationship between the plaintiff and defendant may be either a fiduciary relationship, or based on an express contract, an implied-in-fact contract, or a quasi-contract. . . .[52]

The court held that a confidentiality agreement satisfied the requirement of legal relationship between the parties.[53]

In 2000 in *Nadel v. Play-By-Play Toys & Novelties, Inc.*,[54] the Second Circuit revisited *Apfel* in an effort to clarify the principles enunciated there. Plaintiff Craig Nadel was a toy developer who regularly submitted toy ideas to manufacturers to develop and market new toy concepts as quickly as possible.[55] "To facilitate the exchange of ideas, the standard custom and practice in the toy industry calls for companies to treat the submission of an idea as confidential. If the company subsequently uses the disclosed idea, industry custom provides that the company shall compensate the inventor, unless, of course, the disclosed idea was already known to the company."[56] Nadel submitted to Play-By-Play, a toy developer, a proposal for a dancing table-top plush monkey. Play-By-Play did not pay Nadel for his proposal and thereafter developed a similar toy. Nadel sued Play-By-Play, alleging that it had violated the parties' alleged agreement. Play-By-Play claimed that it independently developed the toy and that Nadel's proposal was not original.[57] The district court dismissed all claims on summary judgment, and both sides appealed. The Second Circuit reversed the dismissal of Nadel's claims and remanded for a determination of "whether Nadel's product concept was inherently original or whether it was novel to the industry prior to October 1996."[58]

In reviewing some of the post-*Apfel* cases, the *Nadel* court stated that it found New York case law in this area to be "relatively clear when viewed through the prism of *Apfel*," but it nevertheless recognized some post-*Apfel* confusion among the courts."[59] The court observed:

> In *Apfel*, the Court of Appeals discussed the type of novelty an idea must have in order to sustain a contract-based or property-based claim for its uncompensated use. Specifically, *Apfel* clarified an important distinction between the requirement of "novelty to the buyer" for contract claims, on the one hand, and "originality" (or novelty generally) for misappropriation claims, on the other hand.[60]

The *Nadel* court noted that *Apfel* made clear that the "novelty to the buyer" standard is not limited to cases involving an express post-disclosure contract for payment based on an idea's use. Where there is only a pre-disclosure contract, a seller might bring an action against a buyer who allegedly used his ideas without payment, claiming both misappropriation and breach of an *express* or *implied-in-fact contract*.[61]

The *Nadel* court also clarified the factors that determine novelty:

> The determination of whether an idea is original or novel depends upon several factors, including, *inter alia*, the idea's specificity or generality (is it a generic concept or one of specific application?), its commonality (how many people know of this idea?), its uniqueness (how different is this idea from generally known ideas?) and its commercial availability (how widespread is the idea's use in the industry?).[62]

In sum, under *Apfel* and its progeny, there are three different standards governing idea submission cases. Contract claims arising from pre-disclosure contracts require a showing that the disclosed idea was novel to the buyer in order to constitute valid consideration.[63] Contract claims arising from a post-disclosure contract require no proof of novelty or originality. And property-based misappropriation claims require a legal relationship between the parties and that the idea in question be original and novel in an absolute sense.[64] Finally, for both contract and misappropriation claims, an idea may be so unoriginal or lacking in novelty that, as a matter of law, the buyer is deemed to have knowledge of the idea. In such cases, neither a property- nor a contract-based claim for uncompensated use of the idea will lie.[65]

This review of the law of idea protection in New York points to the importance of being able to document when and how the idea was disclosed to the other side, the nature of the relationship between the parties, and, of course, any agreement between the parties. On the other hand, companies should maintain records of proposals received and trends in the relevant industry, which can be used to demonstrate that an idea was not novel as to it, in which case, absent a post-disclosure agreement, the plaintiff's claim will not survive. It also is advisable, of course, to maintain records of all proposals submitted by those with whom a business relationship exists.

V. New York v. California

Many states have adopted a legal framework for idea submission cases similar to that identified in *Soule* and *Apfel*, including New Jersey,[66] Illinois,[67] Georgia,[68] and Texas,[69] protecting ideas under contracts, both express and implied, and as property under misappropriation law. However, not all states recognize a property right in original ideas, thus precluding any protection outside of contracts.

California bases protection of ideas upon the relationship between the parties, without any analysis of the originality of the idea. The Ninth Circuit,[70] discussing the California Supreme Court's decision in *Desny v. Wilder*,[71] explained:

> To establish a *Desny* claim for breach of implied-in-fact contract, the plaintiff must show that the plaintiff prepared the work, disclosed the work to the offeree for sale, and did so under circumstances from which it could be concluded that the offeree voluntarily accepted the disclosure knowing the conditions on which it was tendered and the reasonable value of the work.[72]

Under California law the disclosure itself is the consideration; novelty is not part of the analysis.[73] In other words, California does not recognize a property right in novel and original ideas.

Thus, whereas in New York a creator can seek protection for the unauthorized use of his / her original idea whether or not a contract exists, in California only a creator who discloses an idea pursuant to a contract has any legal protection.

VI. Conclusion

New York protects the submission of ideas under both contract and misappropriation law upon a demonstration of value to the disclosed party, generally through proof of novelty and originality. Ideas are protected under a pre-disclosure contract if the idea was novel to the buyer.[74] Disputes arising from a post-disclosure contract are treated as simple contract actions; no proof of novelty or originality is required.[75] Finally, property-based misappropriation claims require a legal relationship between the parties (not necessarily contractual) and that the idea in question be original and novel in an absolute sense.[76]

Unlike New York, which recognizes a property right in original and novel ideas, California protects only those ideas disclosed pursuant to an agreement, express or implied. Thus, although the threshold is high, greater protection is available under New York law for creators of original and novel ideas.

Endnotes

1. *Irizarry y Puente v. President & Fellows of Harvard College*, 248 F.2d 799, 802 (1st Cir. 1957) ("An idea, as distinguished from the copyrighted contents of a book or a patented device or process, is accorded no protection in the law unless it is acquired and used under such circumstances that the law will imply a contractual or fiduciary relationship between the parties.").
2. The Copyright Act does not extend its protections to ideas or concepts. 17 U.S.C. § 102(b).
3. *American Bus. Training, Inc. v. American Mgt. Assn.*, 50 A.D.3d 219, 851 N.Y.S.2d 491 (1st Dep't 2008); *Alliance Sec. Prods. v. Fleming & Co., Pharms.*, 290 Fed. Appx. 380, 2008 U.S. App. LEXIS 16098 (2d Cir. 2008), *cert. denied*, 129 S. Ct. 739 (2008); *Hudson v. Universal Studios, Inc.*, 2008 U.S. Dist. LEXIS 86146, 89 U.S.P.Q.2d (BNA) 1132 (S.D.N.Y. 2008); *sit-up Ltd. v. IAC/Interactive Corp.*, 2008 U.S. Dist. LEXIS 12017 (S.D.N.Y. 2008).
4. The term "idea" is defined as: "A rational conception; the complete conception of an object when thought of in all its essential elements or constituents; the necessary metaphysical or constituent attributes and relations, when conceived in the abstract." Webster's Revised Unabridged Dictionary, *available at* dictionary.com http: / / dictionary.reference.com / browse / idea.
5. *Educational Sales Program Inc. v. Dreyfus Corp.*, 65 Misc.2d 412, 415, 317 N.Y.S.2d 840 (Sup. Ct. N.Y. Co. 1970).
6. *Id.*
7. *See Alliance Sec. Prods., Inc.*, 290 Fed. Appx. at 382.
8. 201 A.D. 794, 195 N.Y.S. 574 (2d Dep't 1922), *aff'd*, 235 N.Y. 609 (N.Y. 1923).
9. *Id.* at 795.
10. *Id.* at 796.
11. *Id.* at 797.
12. *Soule v. Bon Ami Co.*, 235 N.Y. 609, 139 N.E. 754 (N.Y. 1923).
13. *Soule*, 201 A.D. at 797.
14. *Bram v. Dannon Milk Products, Inc.*, 33 A.D.2d 1010, 307 N.Y.S.2d 571 (1st Dep't 1970).
15. *Educational Sales Program Inc.*, 65 Misc.2d at 416.
16. 31 N.Y.2d 56, 286 N.E.2d 257, 334 N.Y.S.2d 874 (N.Y. 1972).
17. *Id.* at 61.
18. *Id.* at 58–59.
19. *Id.* at 60.
20. *Id.* at 59.
21. *Id.*
22. *Id.* at 58.
23. *Id.* at 63.
24. *Id.* at 61.
25. *Id.*

26. *Id.* at 61–62.
27. *Id.*
28. *McGhan v. Ebersol*, 608 F. Supp. 277, 284 (S.D.N.Y. 1985) (*citing Vantage Point, Inc. v. Parker Brother, Inc.*, 529 F. Supp. 1204, 1216-7 (E.D.N.Y. 1981), *aff'd without op. sub. nom. Vantage Point, Inc. v. Milton Bradley*, 697 F.2d 301 (2d Cir. 1982)).
29. 844 F.2d 988 (2d Cir. 1988).
30. *Id.* at 992.
31. *Id.* at 993.
32. *Id.* at 989 (quoting Lardine, *Looking to the Future: Bill Cosby Has Dreams of an All-Negro TV Series*, New York Daily News Sunday Magazine, Sept. 19, 1965, at 6).
33. *Id.* at 992.
34. *Id.*
35. *Id.* at 994.
36. *Id.* at 997.
37. 81 N.Y.2d 470, 616 N.E.2d 1095, 600 N.Y.S.2d 433 (N.Y. 1993).
38. *Id.* at 474.
39. *Id.*
40. *Id.*
41. *Id.*
42. *Id.* at 477.
43. *Id.*
44. *Id.* at 473.
45. *Id.* at 476.
46. *Id.* at 478.
47. *Id.* ("A showing of novelty, at least novelty as to the buyer, addresses these two concerns. Novelty can then serve to establish both the attributes of ownership necessary for a property-based claim and the value of the consideration--the disclosure--necessary for contract-based claims.").
48. *Id.* at 478.
49. *Id.*
50. 161 Misc.2d 627, 614 N.Y.S.2d 878 (Sup. Ct. N.Y. Co. 1994).
51. *Id.* at 630–631.
52. *Id.* at 631.
53. *Id.*
54. 208 F.3d 368 (2d Cir. 2000).
55. *Id.* at 371.
56. *Id.* at 371–372.
57. *Id.*
58. *Id.* at 382.
59. *Id.* at 379.
60. *Id.* at 374.
61. *Id.* at 376.
62. *Id.* at 378.
63. *See Alliance Sec. Prods., Inc.*, 290 Fed. Appx. at 382 ("[U]nder a contract-based theory a plaintiff need only prove novelty to the defendant.").
64. *Id.* ("[U]nder a tort based misappropriation theory a plaintiff must prove novelty with respect to the world at large." 290 Fed. Appx. at 382); *See also sit-up Ltd.*, 2008 U.S. Dist. LEXIS 12017 at *63-*64 ("To succeed on [a misappropriation of idea] claim under New York law, a party must prove (1) the existence of a legal relationship between the parties in the form of a fiduciary relationship, an express or implied-in-fact contract, or quasi-contract; and (2) the idea must be novel and concrete.").
65. *Id.* at 378–379.
66. *Duffy v. Charles Schwab & Co.*, 2001 U.S. Dist. LEXIS 14070 (D.N.J. 2001).
67. *Phillips v. Avis, Inc.*, 1996 U.S. Dist. LEXIS 7342 (N.D. Ill. 1996).
68. *Burgess v. Coca-Cola Co.*, 245 Ga. App. 206, 536 S.E.2d 764 (G.A. 2000).
69. *Kleck v. Bausch & Lomb, Inc.*, 145 F. Supp. 2d 819 (W.D. 2000).
70. *Grosso v. Miramax Film Corp.*, 383 F.3d 965 (9th Cir. Cal. 2004).
71. 46 Cal. 2d 715, 299 P.2d 257 (Cal. 1956).
72. *Grosso*, 383 F.3d at 967.
73. Ronald Caswell, *Comment, A Comparison and Critique of Idea Protection in California, New York, and Great Britain*, 14 Loy. L.A. Int'l & Comp. L.J. 717, 735 (July 1992) ("California courts now protect idea disclosures under both express and implied-in-fact contract theories. Since the act of disclosure suffices as consideration for a contract, novelty is a non-issue.").
74. *See Alliance Sec. Prods., Inc.*, 290 Fed. Appx. at 382.
75. *Apfel*, 31 N.Y.2d at 478.
76. *See sit-up Ltd.*, 2008 U.S. Dist. LEXIS 12017, at *63-*64.

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The Enforceability of Cross-Default Provisions in Bankruptcy

By Nili Farzan

Introduction

One of the most notable privileges of bankruptcy filing is that the debtor in possession or the trustee has the right to reject its unprofitable executory contracts or unexpired leases and assume its profitable ones.[1] However, the debtor must reject or assume the contract in its entirety and cannot "cherry-pick" its obligations under the contract or lease.[2] Landlords, being aware of such rights and limitations under bankruptcy, often attempt to protect themselves by drafting cross-default provisions in their agreements, providing that a default under one lease triggers a default under all leases with the same tenant.[3] In bankruptcy courts, the landlords argue that the multiple agreements are essentially a single agreement, and the debtor must assume or reject the contracts in their entirety or cure a default under one lease before any other leases are assumed.[4]

Different jurisdictions have used various approaches to evaluate the enforceability of cross-default provisions.[5] Some courts have exclusively examined the enforceability of cross-default provisions under section 365 of the Bankruptcy Code. Such courts have refused to enforce cross-default provisions by analogizing them to anti-assignment[6] or *ipso facto* provisions,[7] both of which are unenforceable under section 365.[8] The majority of courts confronted with the issue of multiple contracts and cross-default provisions have recognized that divisibility of contracts should be evaluated under state law. If they find the contract severable, they invalidate the cross-default provision by citing equitable bankruptcy principles, typically without much analysis.[9] A number of courts, however, have not invoked the Bankruptcy Code or these equitable principles. Instead, they evaluate whether the cross-default provision was essential to the parties' bargain under state contract principles.[10] As a result of the different approaches invoked by various courts, courts reach contradictory outcomes when confronted with similar facts.

As most courts recognize, contract law interpretations are property interests governed by state law.[11] Cross-defaults as a term of the contract or lease should also be evaluated under state law. This note will argue that cross-defaults should be held invalid if their enforcement under state contract law would result in forfeiture for the debtor.[12] This approach will ensure that parties will receive the benefit of their bargains. Part I of this note presents a general overview of the debtor's right of assumption and rejection of executory contracts, and limitations thereof under the Bankruptcy Code. Part II examines bankruptcy cases that have relied on federal bankruptcy law rather than state law to evaluate the enforceability of cross-default provisions. This part also examines cases that purport to evaluate divisibility of contracts under state law, but ultimately rely on bankruptcy principles to invalidate the cross-default provisions if they hold the contracts divisible. This note posits that this approach, driven by so-called equitable principles, is a flawed interpretation of the Bankruptcy Code and is inconsistent with the determination of the intent and bargain of the parties. Part III explains that the concept of forfeiture under state contract law may serve as an adequate basis for evaluating the enforceability of the cross-default provision. Though there are no bankruptcy court cases that have considered the concept of forfeiture in their evaluation, there are some cases that have properly alluded to this principle by solely relying on state law and examining whether the cross-default provision is an essential element of the parties' bargain. If courts find that a cross-default provision is immaterial, then their decision to excuse the condition can be strengthened by illustrating that it would be a forfeiture for the debtor not to be able to assume the lease or contract by the virtue of the cross-default provision.

I. Assumption and Assignment of Executory Contracts and Unexpired Leases

A. General Overview of Assumption and Rejection

Under section 365(a) of the Bankruptcy Code, the trustee or debtor in possession may assume or reject an executory contract or unexpired lease.[13] The Bankruptcy Code does not define the term "executory contracts," but the legislative history of the Code defines it as a contract "on which performance remains due to some extent on both sides."[14] A majority of courts have adopted the definition of bankruptcy scholar Vern Countryman, which specifically defines an "executory contract" as "a contract under which the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other."[15] This definition is distinguishable from the generally accepted meaning of "executory contract" under non-bankruptcy law which includes any contract not fully performed, even though performance has been completed on one side.[16] Bankruptcy courts look to state law to determine whether the failure to perform an obligation under a contract constitutes a material breach.[17]

The purpose of assuming or rejecting executory contracts is to provide the debtor an opportunity to reorganize its business and eliminate disadvantageous contracts and leases.[18] By allowing the debtor to eliminate burdensome contracts and keep beneficial ones, section 365 "advances one of the core purposes of the Bankruptcy Code: 'to give worthy debtors a fresh start.'"[19] Accordingly, the debtor has broad discretion to evaluate each of its unexpired contracts or leases to determine whether it would be in its best interest to assume or reject them.[20] The court applies the "business judgment"[21] standard to approve the assumption or rejection of the contract. A mere showing of benefit to the estate is sufficient for the court to approve assumption or rejection of the contract.[22] Further, the debtor can assign the assumed lease or contract to a third party, "with a payment to the estate reflecting its excess value over the market."[23]

To alleviate the burden of an under-market contract or lease on the bankruptcy estate, the debtor's rejection is deemed a breach of contract occurring immediately before the commencement of the bankruptcy case.[24] Consequently, the non-debtor's damages as a pre-petition general unsecured claim do not receive priority over any other unsecured claims.[25] Whereas the claim for most contracts is equal to the amount of damages that the creditor suffers as the result of the rejection, damages for rejection of a real estate lease are capped at the greater of one year's worth of rent under the lease, or 15 percent of the remaining term's rent, but not exceeding three years' worth of rent.[26]

B. Restrictions on the Right of Assumption

While the debtor has broad discretion to either assume or reject contracts, section 365(b)(1) imposes some "restrictions on the debtor's power to assume executory contracts and unexpired leases."[27] Section 365(b)(1) protects the non-debtor by requiring the debtor to cure any defaults, compensates the non-debtor party for any actual pecuniary loss caused by the default, and provides adequate assurance of future performance under the contract prior to assuming the contract.[28] In contrast to rejection, where damages are regarded as unsecured claims, assumption requires the debtor to pay any outstanding defaults in full.

Another recognized restriction on the debtor's ability of assumption is that the debtor must assume or reject an executory contract or unexpired lease in its entirety.[29] That is, the debtor in possession or trustee "may not reject (i.e., breach) one obligation under a contract and still enjoy the benefits of the same contract."[30] As stated by the Supreme Court, if "the debtor-in-possession elect[s] to assume the executory contract, however, it assumes the contract *cum onere*."[31] The *cum onere* rule is expanded to apply to multiple contracts intended to form a single integrated transaction.[32] Moreover, whereas in contract law a party may sever and strike the unconscionable clauses of a contract and have the rest of the contract enforced, the *cum onere* principle in bankruptcy provides that a debtor may not sever the unconscionable part of the contract and assume the remainder of the agreement.[33] Accordingly, the lessor gets the full benefit of the bargain when the debtor assumes both the burdens and the benefits of the contract.[34]

II. Invalidation of Cross-Default Provisions Under Bankruptcy Law

Based on the aforementioned requirements of curing defaults under the Bankruptcy Code and the assumption of contracts as a whole, when a landlord drafts leases on more than one property with the same tenant, he or she may employ a cross-default provision in an attempt to integrate the multiple leases as one to prevent assumption or rejection of some of the contracts.[35] Cross-default provisions provide that a default under one lease with the lessor constitutes a default under all leases with the same lessor, and, if the default is not cured, the landlord can exercise remedies in respect to all leases.[36] That is, when the debtor rejects a contract or lease the rejection triggers a default that must be cured in order to assume another contract.[37] Under the plain meaning of section 365(b), requiring cure of all defaults and the judicial recognition of the *cum onere* principle, a cross-default provision in a contract or lease would be seemingly valid. "To hold otherwise, would construe the bankruptcy law as providing a debtor in bankruptcy with greater rights and powers under a contract than the debtor had outside of bankruptcy."[38]

Nevertheless, based on notions of equity, in order to help the debtor to rehabilitate its estate, bankruptcy courts have been reluctant to enforce cross-default provisions that prevent the debtor from assuming the profitable leases and rejecting the burdensome ones. Some courts have used justifications under the Bankruptcy Code to relieve the debtor from the enforcement of the cross-default provision. However, as the following discussion demonstrates, it is erroneous to apply these Bankruptcy sections to cross-default provisions.

A. *Per se* Invalidation of Cross-Default Provisions

1. Cross-default provision as an Anti-Assignment Clause

One justification for invalidating cross-default provisions is based on pure statutory construction of section 365.[39] To aid the debtor in reorganizing its business, the Code allows the debtor to assume its unexpired contracts with the option of keeping them for itself or assigning them to another entity where it can get the value of the lease in cash to further help its reorganization. To allow the debtor to take opportunity of this reorganization tool, section 365(f)(1) invalidates any anti-assignment clauses in contracts.[40] Section 365(f)(1) states:

> [e]xcept as provided in subsection (b) and (c) of this section, notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restrict, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease . . .[41]

As stated earlier, subsection (b) refers to cure of defaults. Further, subsection (c) refers to three instances where an executory contract may not be assigned. Essentially, they include personal service contracts, loan contracts, and nonresidential real property leases that have been terminated. Since cross-default provisions are not included among these exceptions, under the strict statutory interpretation of section 365(f), courts rule that cross-default provisions should be deleted because they restrict debtors' ability to assume or assign an executory contract.[42] Courts upholding this view claim that such provisions "impermissibly infringe upon the debtor's right to assume and assign leases."[43] Even when an assignment is not involved in the debtor's reorganization case, courts conclude that the section 365(f) also applies to restrictions on assumptions because "section 365(f)(2)(A) requires assumption as a predicate to assignment of a contract."[44]

In re Sambo's Restaurants, Inc. demonstrates where the court used the anti-assignment justification to invalidate the cross-default provision.[45] In this case, the lessor, Net Realty Trust, leased to Sambo's Restaurant, Inc. separate leases for 10 different locations. The leases had a cross-default provision providing a default under one lease constitutes a default under all of the leases. Before filing for Chapter 11, Sambo's closed two of its locations and continued to operate the remaining eight locations. The lessor argued that Sambo's may not assume those leases without assuming all the leases and curing the defaults under all of the leases. One issue presented before the court was whether the cross-default provision was enforceable. The court held the cross-default provision to be unenforceable based on various grounds.[46] In respect to its anti-assignment rationale, without much analysis the court stated that "[a]ny contractual restriction on assignment other than those specified in 365(c) is proscribed by 365(f)."[47]

Another case, *In re Sanshoe*, also concluded that a cross-default provision is unenforceable under the anti-assignment principle.[48] In that case, the tenant, Sanshoe, leased three separate floors under separate agreements from the landlord with cross-default provisions. The lease for the 11th floor was subleased to Hart. Upon the filing of Chapter 11, two of the leases were rejected, and the lease for the 11th floor, which was subleased to Hart, was assumed and assigned to a third party. In order to escape liability under the sublease, Hart, the sublessee, argued that the underlying assignment was void. He alleged that the cross-default provisions prevented the tenant from rejecting some leases and assuming and assigning another lease.[49] The court, without further explanation, took the same position as the Central District of California in *Sambo's*, holding that "[c]ontractual limitations on the ability to assign unexpired leases other than those specified in 365(c) are prohibited under 365(f)."[50]

2. Criticism of anti-assignment justification

Though this result is consistent with the policy of protecting debtors' rights to assume beneficial contracts only, the anti-assignment justification is highly criticized. Deleting a cross-default provision because it may consequently restrict debtors' ability to assume or assign a lease goes beyond the plain meaning of section 365(f). Some of these cases, such as *In re Sambo's*, only involved the assumption of a contract, but the court applied an anti-assignment principle.[51] In *In re UAL Corp.*, the court rejected the anti-assignment reasoning, stating that since all defaults must be cured before assumption, then any default provision in a contract could be regarded as an anti-assignment provision.[52] This "would totally gut the *cum onere* principle of any meaning whatsoever, by allowing a bankruptcy debtor to assume the benefits of an executory contract while rejecting its burdens."[53] As such, even if the landlord proves without any doubt that the agreements were intended to be integrated as one, the court may still refuse to enforce the cross-default provision solely because the debtor is potentially restricted to assign the contract or lease.

In line with their equitable considerations, bankruptcy courts have invalidated other types of provisions in agreements based on the rationalization that the provisions are *de facto* anti-assignment provisions. For example, a landlord's right of first refusal regarding any assignment of the lease has also been rejected as a restriction on assignment.[54] However, the court in *In re E-Z Serve Convenience Stores, Inc.*[55] offers a proper response to flat rejection of *de facto* anti-assignment provisions. In that case, the court rejected the trustee's assertion that the lessor's right of first refusal to purchase improvements a tenant made on a leased property is a *de facto* anti-assignment provision.[56] The court acknowledged that many courts have refused to enforce de facto anti-assignment clauses that come in various versions, "including lease provisions that limit the permitted use of the leased premises, lease provisions that require payment of some portion of the proceeds or profit realized upon assignment, and cross-default provisions."[57] However, this court ruled that when a lease provision does not expressly prevent assignments, the court must carefully analyze the facts of the agreement to ensure that the bargain of the non-debtor party is not harmed.[58] By reviewing the circumstances of the transaction, the court noted the provision cannot be excised because it was fully negotiated as a significant element of the parties' bargain.

3. Cross-default provisions as *ipso facto* provisions

Courts have also refused to enforce cross-default provisions by holding that the cross-default provision is an exception to the requirement of cure of defaults as an *ipso facto* clause, also known as bankruptcy termination clauses.[59] Section 365(e) invalidates *ipso facto* clauses, namely, clauses that terminate or modify an executory contract due to insolvency or the debtor's financial condition. It provides that

> [n]otwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified and any right or obligation not be terminated or modified and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on (A) the insolvency or financial condition of the debtor at any time before the closing of the case; or (B) the commencement of a case under this title; or (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.[60]

The statute has been broadly construed to incorporate clauses that do not even mention bankruptcy, but terminate the contract or lease based on some financial condition.[61]

In an attempt to hold cross-default provisions unenforceable, "several courts have analogized cross-default provisions to *ipso facto* clauses."[62] In addition to its holding that the cross-default provision was a *de facto* anti-assignment provision, *In re Sambo's* also held that the cross-default provision was a financial condition.[63] The reason to characterize cross-default provisions as financial conditions provisions is that "a debtor cannot be faulted for failing to accomplish these conditions or for failing to use its best efforts, when the event which prevented satisfaction of these conditions was the debtor's insolvency and need for bankruptcy relief."[64] The court in *In re Sambo's* reasoned that section 365(e)(1)(A) "renders ineffective any contractual provision conditioned upon the financial condition of the debtor. The cross-default provisions operate as financial condition clauses. The inability to perform under one lease is indicative of SRI's financial problems."[65] The court further analogized other provisions that have been rejected by courts under section 365(e)(1)(A).[66] The following types of provisions have been voided in contracts based on the principle that they are bankruptcy termination clauses: a clause in a limited partnership agreement converting a debtor's general partnership interest into limited partnership interest as a result of bankruptcy filing; a clause accelerating payment of principal and accrued interest under an indenture; a clause declaring due the entire balance of a retail installment contract.[67]

4. Criticism of cross-defaults as *ipso facto* clauses

Interpretation of cross-default provisions as ipso facto provisions are criticized just like anti-assignment provisions. Payment defaults must be distinguished from financial condition defaults. Financial condition provisions "are traditionally written to require that specified numerical goals are to be achieved (a net worth test), or specified ratios are to be maintained (debt to equity, current assets to current liabilities, etc.), and are not couched in terms of performance under other agreements."[68] Many times, nonperformance of covenants in a lease will stem from the "tenant's financial inability to perform the covenant rather than from a desire to willfully default under the provision in question."[69] If cross-default provisions are characterized as financial condition clauses, then nearly every provision in a lease, including the rent clause, is a financial covenant. As such, when a contract provides that a payment default under one lease is considered as a default under another lease, this may not flatly be generalized as a financial condition default.

The legislative history of section 365(e) also sheds light on its proper application to cross-default provisions.[70] While Congress intended to avoid any burden on a debtor's ability to assume a contract, the legislative history prompting the inclusion of the sections 365(e)(1) and 365(b)(2) indicates that Congress did not want to frustrate the benefits of bargain given to the non-debtor under the contract.[71] Congressional Reports declared:

> [t]he unenforceability of ipso facto or bankruptcy clauses proposed under this section will require the courts to be sensitive to the right of the nondebtor party to executory contracts and unexpired leases. If the trustee is to assume a contract or lease, the court will have

> to insure that the trustee's performance under the contract or lease gives the other contracting party the full benefit of his bargain.[72]

Accordingly, invalidating a cross-default provision as an ipso facto clause without evaluating the bargain between a lessor and a lessee contradicts the Congressional intent.

5. Balancing of bankruptcy courts' policies

Courts that have broadly interpreted the application of financial conditions or anti-assignment provisions to include cross-default provisions have essentially based their interpretation on an equitable policy of bankruptcy. These courts reason that if cross-defaults are enforced, debtors' rights to reorganize the bankruptcy estate, by assuming profitable contracts and rejecting unprofitable contracts, would be frustrated. Many courts may justify their ends by referring to the pre-Code Supreme Court decision that declared, "[t]he bankruptcy court does not look with favor upon forfeiture clauses in leases. They are liberally construed in favor of the bankrupt lessee so as not to deprive the estate of property which may turn out to be a valuable asset."[73] However, it is more important to note that

> the Supreme Court has made clear that Congress's comprehensive modernization, reform, and codification of the federal bankruptcy laws in the 1978 legislation enacting the Bankruptcy Code means "that whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code."[74]

Even though bankruptcy courts are courts of equity providing a debtor various ways to rehabilitate its business under the Bankruptcy Code, the courts must ensure that the non-debtor receives the benefit of the bargain. After all, the purpose of curing upon assumption of an executory contract under section 365(b) is to preserve the bargain for the non-debtor,[75] and "equity will not countenance the debtor's exercise of § 365 to relieve itself of conditions which are clearly vested by the contracting parties as an essential part of their bargain and which do not contravene overriding federal policy."[76] Therefore, analysis of cross-default provisions as *ipso facto* or anti-assignment provisions would ignore the Bankruptcy Code's goal of finding the balance between equity and the non-debtor's bargain.

B. Examination of Contract Divisibility Under State Law but Ultimate Reliance on Bankruptcy Principles

In contrast to the cases mentioned above that have flatly rejected cross-default provisions under the Bankruptcy Code, most bankruptcy courts acknowledge that contract divisibility is a question of state law.[77] The courts, by applying their respective state laws, generally first determine whether the parties intended to integrate the multiple leases.[78] Nevertheless, the driving force of equitable policy to aid the debtor becomes even more evident when the courts factually examine the divisibility of the contracts under state law, and if they conclude that the contracts are in fact severable, they disregard the cross-default provision.[79]

As the Court in *In re Plitt Amusement Co. of Wash.*[80] explained succinctly:

> The legal regime governing bankruptcy cases is a mixture of federal and state law. Federal bankruptcy law determines some rights of the parties. Where bankruptcy law does not govern, the underlying non-bankruptcy law (usually state law) determines the rights of the parties. *Cf. Butner v. United States*, 440 U.S. 48, 54-55, 59 L. Ed. 2d 136, 99 S. Ct. 914 (1979) (holding that property interests are created and defined by state law; unless some federal interest requires a different result, there is no reason why such interest should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding). Frequently the best method of analysis is to begin by examining the rights of the parties outside of bankruptcy, usually based on state law. After this analysis, we then examine the impact of applicable bankruptcy law, to determine whether it changes those rights.[81]

1. Factors considered under state law to determine divisibility of contracts

Most courts confronted with the issue of divisibility among multiple contracts begin their analysis by applying different factors under their respective state's contract interpretation laws to determine whether the parties intended the contracts to be integrated or divisible. To evaluate intent, courts consider many factors, including:[82] interdependence of the agreements, the language used in the contract,[83] contemporaneous execution of the documents by the same parties,[84] nature and purpose of the various agreements,[85] termination clauses, type of consideration, and presence of cross-default provisions. "In short, courts attempt to recreate the objective intent of the parties by examining the documents, facts, and circumstances under which they were signed."[86]

2. Application of factors by courts

For instance, the trustee in *In re Plitt Amusement Co. of Washington*[87] wanted to reject one lease that was part of a transaction involving five other documents, including a purchase agreement, a promissory note, a security agreement, and two other non-residential leases. The leases and the promissory note were governed by Washington law while the purchase agreement was governed by California law.[88] The court examined both states' laws and stated that "[a]bsent ambiguity in the terms of the instruments, the intent . . . must be gleaned from the terms contained within four corners of the documents involved."[89] The court concluded that the leases were distinct and severable from the sales transaction since the duration of the lease was different from the duration of the sale agreement. Further, each lease operated independently since "each contains provisions regarding rent amount, rent due date, commencement and termination dates of the lease, and location of the leased real property."[90]

While the court in *In re Plitt Amusement Co. of Washington* analyzed the divisibility of the multiple contracts under the respective applicable state laws, the court contradicted its own analysis by stating in a footnote that "[n]o federal case has specifically held that state law governs whether obligations in a transaction are severable. Rather, the cases that have applied state law to the severability issue have done so incidentally to their holdings."[91] The court cited to *In re Sambo's* and stated "that, in the bankruptcy context, cross-default provisions do not integrate otherwise separate transactions or leases . . . the cross-default provisions must be disregarded in the bankruptcy law analysis, because they are impermissible restrictions on assumption and assignment."[92] This justification has indeed been so well recognized by courts that once courts establish that the contracts are severable under state law, without much further reasoning the courts cite to the cross-default rule, which essentially comprises the anti-assignment and / or *ipso facto* justification.

Similarly, the court in *In re Convenience USA, Inc.*[93] first evaluated the divisibility of 27 lease locations and determined that the leases were divisible based on the intention and conduct of the parties. Nevertheless, in addition to holding that "cross-default provisions do not integrate executory contracts or unexpired leases that otherwise are separate or severable," the court, without further elaboration, cited to section 365(c) and section 365(f), as well as to *In re Sambo's* and *In re Sanshoe*, proclaiming that any contractual limitations on assumptions and limitations are invalid.[94]

The unenforceability of cross-default provisions as anti-assignment provisions has also been applied to loan and lease agreements in a very recent case. In *Papago Paragon Partners, LLC v. Three-Five Sys.*,[95] Three-Five sold a commercial building and real property to Papago. In addition to paying upfront for some of the costs of the property, Papago executed a promissory note and gave a deed of trust as collateral. Simultaneously, the parties executed a lease by which the property was leased back by Papago to Three-Five. The note had a cross-default clause providing "that Papago's payment obligations on the note are to be excused if Three-Five defaults on the lease and fails to cure its default."[96] Upon filing of Chapter 11, Three-Five rejected the lease and Papago argued that the loan and the lease were indivisible agreements; thereby the cross-default provision was enforceable. After the court factually evaluated the agreements and concluded that the contracts were in fact divisible, it declared that the cross-default provision was unenforceable in bankruptcy as long as it prohibits the debtor's option to assume or reject a contract.[97]

Similarly, the court in *In re Adelphia Business Solutions, Inc.* first determined that the leases were severable under state law but ultimately applied the cross-default rule to hold the cross-default provision unenforceable.[98] The debtor in this case had leased two separate offices from the same landlord in the same building. When the debtor moved to reject one lease and assume the other, the landlord claimed that the leases were integrated. The court interpreted the contract under Missouri law, evaluating the parties' intent by reviewing "all relevant evidence, including prior or contemporaneous negotiations and agreements."[99] The court concluded that the leases pertained to distinct properties, provided for separate consideration, and their relevant terms were different. After the court found that the leases were not "integrally related," the court, citing to *In re Sanshoe*, held that the cross-default provision was unenforceable.[100]

III. Enforceability of Cross-Defaults Under State Law

A. Analysis Under Forfeiture Law

Most courts presented with the issue of divisibility of contracts analyze the issue under state law. If the courts establish that the contracts are severable, they simply turn to the well-established justification that cross-default provisions are unenforceable, based on anti-assignment or *ipso facto* principles. Rather than evaluating the enforceability of the cross-default provision under the Bankruptcy Code, the proper approach should be to continue the analysis under non-bankruptcy contract law.[101] Under Restatement (Second) of Contracts § 229, "[t]to the extent that the non-occurrence of a condition would cause disproportionate forfeiture, a court may excuse the non-occurrence of the condition unless its occurrence was a material part of the agreed exchange."[102] Accordingly, a court should evaluate whether the cross-default provision is in fact an essential part of the parties' bargain. If it is not a material element of the parties' agreement, then not allowing the debtor to choose between its agreements "would cause disproportionate forfeiture."[103] "'[F]orfeiture' is used to refer to the denial of compensation that results when the obligee loses his right to the agreed exchange after he has relied substantially, as by preparation or performance of the expectation of that exchange."[104] Accordingly, just as the bankruptcy courts have been factually examining whether the parties intended the multiple contracts to be severable, the courts should also factually determine whether the parties intended the cross-default provision to be an essential part of their bargain. If it is not an essential element, but the contract is not allowed to be assumed, then the debtor would be forfeiting an important contract.

B. Whether the Cross-Default Provision Is a Material Term of the Contract

Even though bankruptcy courts have not cited to the Restatement, the materiality standard used by some courts is similar to the forfeiture justification. Some courts have concluded "that where two agreements are 'necessary' or 'essential' or 'fundamental' elements of the same transaction, the cross-default provisions found within the two agreements must be enforced."[105]

These courts have articulated the evaluation of the necessity of the cross-default provision among multiple agreements in terms of the economic interdependence of the contracts, which the cross-default provision links.[106] That is, the courts ask whether the "non-debtor party would not have entered into one agreement without the other."[107] If the facts establish that the consideration of one agreement supports the other, then the courts conclude that the cross-default provision is an essential term of the parties' bargain.[108] On the other hand, if the facts establish that the agreements are not interdependent, they do not deem the cross-default provision as an essential term of the contract.

In re FFP Operating Partners is an example of a case[109] where the court did not resort to the anti-assignment or *ipso facto* grounds to conclude that the cross-default provision is unenforceable. In this case, the debtor moved to reject 10 of its leases with the same landlord. The landlord opposed the rejection, contending that there was one single agreement consisting of the different properties. Though the testimony of the landlord was clear that he intended the leases to be integrated, the court pointed out various provisions in the lease that indicated otherwise.[110] By analyzing the testimony of the parties and the express terms of the lease, the court pointed out that the separate agreements could operate independent of each other based on the fact that the rent was apportioned to certain schedules, and that the leases allowed the landlord to sell any one of the subject properties under the lease without affecting the balance of the other leases. Further, if any one of the properties were to be destroyed or condemned, the balance of the leases would not terminate under the terms. Based on these observations, and without using the rationalization under the Bankruptcy Code, the court disregarded the cross-default provision as an immaterial element of the transaction.

Even though *In re Wolflin Oil, L.L.C.*,[111] like *In re FFP Operating Partners*, did not discuss forfeiture law, it too examined the materiality of the cross-default provision. In this case, a cross-default provision linked six separate leases for "quick lube stores," as part of an Asset Purchase Agreement, but the leases were eventually assigned to Wolflin Oil without the assignment of the Asset Purchase Agreement. When the debtor moved to reject two of the unprofitable stores, the court focused on whether the non-debtor would have entered into the agreement without the presence of the provision. The court concluded that the cross-default provision was not an essential element of the leases because the eventual assignment of the six leases to the debtor did not incorporate the terms of the original Asset Purchase Agreement. In addition, at one point, the assignor to the debtor remained in possession of some of the leases, while he assigned the rest of them. Furthermore, each location was operated independently with separate staff and rent calculations. The court concluded that based on such factors it was evident that the lessor would have entered into the agreement without the cross-default provision.[112]

In contrast to *In re FFP* and *In re Wolflin Oil*, the court in *In re Karfakis* found the cross-default provision to be a fundamental element of the agreement.[113] The provision was between a lease and a franchise agreement of a Dunkin' Donuts business. The court considered both the contemporaneous execution and coterminous nature of the documents to conclude that the franchise agreement and the lease were interdependent, meaning that the franchise agreement would not have had any use without the lease and vice versa.[114] The court pointed out that "[t]he Franchise Agreement permits the Debtor to operate a specific location which is simultaneously leased to the Debtor / Franchisee by a Dunkin Donuts affiliate as Lessor."[115] The court concluded that the parties would not have executed the agreements if the agreements were not considered unified.[116] In this case, the court determined that the "Franchise Agreement and the Lease are inextricably interwoven,"[117] such that if one of them was terminated pursuant to its terms, and the other was viable, the whole agreement remained viable.

In re FFP, *In re Wolflin Oil*, and *In re Karfakis* illustrate that it is possible for courts to determine the enforceability of cross-default provisions based on the parties' non-bankruptcy rights and obligations. Courts finding a cross-default provision immaterial can further refer to forfeiture principles under state contract law to bolster their decisions to invalidate the provision. Analysis of cross-default provisions under forfeiture principles is consistent with the recognition that contract interpretations should be evaluated under state law. It is important to undertake this analysis because it ensures that beneficial contracts for the bankruptcy estate are not forfeited while it preserves the non-debtor's expectation of an indivisible contract. If a material cross-default is disregarded, a non-debtor's expectation of a united contract is frustrated when the non-debtor is left with an unsecured claim as a result of the debtor's rejection of only the unattractive leases.

Conclusion

The cross-default provision is a term of a contract negotiated and drafted by the parties, and it has to be enforced if the parties intended it to be an essential term of the contract. Parties who draft cross-default provisions in their agreement are sophisticated parties, cognizant of a debtor's rights under bankruptcy. The bankruptcy courts' general adherence to invalidate the cross-default provision as a restriction on assignment and or financial condition provision is unjustified. The limitations found within the Bankruptcy Code, its legislative history, and the judicial recognition of the *cum onere* principle indicate that the Bankruptcy Code does not address cross-default provisions. Cross-default provisions are terms of contracts and contract rights must be evaluated under state law. Under state law, it is possible to disregard a contract provision if the provision creates forfeiture for any of the parties. It may be a forfeiture for the debtor not to be able to use his contracts or leases to reorganize the bankruptcy estate. Nevertheless, this has to be counterbalanced against the necessity of the cross-default provision for the bargain of the contracting parties.

Endnotes

1. 11 U.S.C. § 365(a) (2007); *see* Kristin Schroeder Simpson, *Fifth Circuit's Executory Contract Standards Deconstructed: The Mirant Lessons*, 26 Miss. C. L. Rev. 225, (2006 / 2007) (contending that some file bankruptcy so they can use the Bankruptcy Code to reject contracts and leases, or assume and assign them to third parties).
2. *See NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984).
3. *See generally* Jerry M. Markowitz, *Contracting to Avoid-Assumption: A Review of the Availability of Certain Contractual Provisions that may be Employed to Assist Landlords in Asserting and Enforcing Bargained-For Rights*, 11 J. Bankr. L. & Prac. 155 (2002).
4. *See, e.g.*, *In re Sanshoe Worldwide Corp.*, 139 B.R. 585, 597 (Bankr. S.D.N.Y. 1992); *In re Brainiff, Inc.*, 118 B.R. 819 (Bankr. M.D. Fla. 1990); *In re Wheeling-Pittsburgh Steel Corp.*, 54 B.R. 772 (Bankr. W.D. Pa. 1985); *In re Sambo's Restaurants, Inc.*, 24 B.R. 755 (Bankr. C.D. Cal. 1982).
5. *See* Jerald I. Ancel, *All For One and One For All? The Assumption and Rejection of Multiple Intertwined Executory Contracts and Unexpired Leases*, 18 Am. Bankr. Inst. J. 16, (1999).
6. 11 U.S.C. § 365(f)(1) (2006) (invalidating anti-assignment clauses in contracts of debtor).
7. 11 U.S.C. § 365(e) (2006) (providing clauses which terminate or modify an executory contract due to insolvency or the debtor's financial condition are unenforceable in bankruptcy).
8. *See, e.g.*, *In re Sanshoe Worldwide Corp.*, 139 B.R.at 597 (Bankr. S.D.N.Y. 1992); *In re Brainiff, Inc.*, 118 B.R. 819 (Bankr. M.D. Fl 1990); *In re Wheeling-Pittsburgh Steel Corp.*, 54 B.R. 772 (Bankr. W.D. Pa. 1985) (indicating cross-default provisions are *de facto* anti-assignment provisions because they restrict debtor's ability to assign lease or contract); *In re Sambo's Restaurants, Inc.*, 24 B.R. 755 (Bankr. C.D. Cal. 1982).
9. *See, e.g.*, *In re Adelphia Bus. Solutions, Inc.*, 322 B.R. 51 (Bankr. S.D.N.Y. 2005); *In re Plitt Amusement Co. of Wash., Inc.*, 233 B.R. 837 (Bankr. C.D. Cal. 1999) ("It is well-settled that . . . cross-default provisions do not integrate otherwise separate transactions or leases.").
10. *See, e.g.*, *In re FFP Operating Partners, LP*, No. 03-90171, 2004 Bankr. Lexis 1192, (Bankr. N.D. Tex. Aug. 12, 2004); *In re* Wolflin Oil, L.L.C., 318 B.R. 392 (Bankr. N.D. Tex. 2004).
11. *See In re Karfakis*, 162 B.R. 719, 725 (Bankr. E.D. Pa. 1993) ("[C] ontract interpretation is a matter of state law and, therefore, bankruptcy courts should rely on applicable state law to determine whether an agreement is indivisible."); *see also In re Pollock*, 139 B.R. 938, 940 (B.A.P. 9th Cir. Cal. 1992); *In re* Cafe Partners / Washington 1983, 90 B.R. 1, 5 (Bankr. D. D.C. 1988).
12. *See* Ralph Brubaker, *Cross-Default Provisions in Executory Contracts and Unexpired Leases: Assumption Cum Onere and Unenforceable Ipso Facto Provisions*, 26 No. 11 Bankr. Law Letter 1 (Nov. 2006) (discussing applicability of forfeitures under contract law to cross-default provisions).
13. 11 U.S.C. § 365(a) (2006) (providing "[e]xcept as provided in . . ., the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor"); see Kristin Schroeder Simpson, *Fifth Circuit's Executory Contract Standards Deconstructed: The Mirant Lessons*, 26 Miss. C. L. Rev. 225, 226 (2007) (listing debtor's or trustee's options to be: "(1) reject the contract; (2) assume the contract; (3) assume and assign the contract to a third party; or (4) do nothing and let the contract 'ride through' the bankruptcy").
14. S. Rep. No. 95-989, at 58 (1978); H.R. Rep. No. 95-595, at 347 (1977).
15. Vern Countryman, "*Executory Contracts in Bankruptcy*," Part I, 57 Minn. L. Rev. 439, 460 (1973) (offering the prevailing definition of executory contracts).
16. 6 Norton Bankr. L. & Prac. 3d § 119:13 (William L. Norton, Jr. ed., 2007).
17. *See In re Worldcom*, 343 B.R. 486, 495 (Bankr. S.D.N.Y. 2006) (referring to state law to conclude materiality of non-debtor's obligation to refrain from making a motion to vacate judgment coupled with debtor's material obligations establishes the executory nature of the amended settlement agreement subject to assumption).
18. *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984) ("[T]he authority to reject an executory contract is vital to the basic purpose [of] a Chapter 11 reorganization, because [it] can release the debtor's estate from burdensome obligations that can impede a successful reorganization."); *In re Bradlees Stores*, 194 B.R. 555, 558 n.1 (Bankr. S.D.N.Y. 1996) (stating "[t]he right of a debtor in possession to reject certain contracts is fundamental to the bankruptcy system because it provides a mechanism through which severe financial burdens may be lifted while the debtor attempts to reorganize").

19. *Eagle Ins. Co. v. Bankvest Capital Corp. (In re Bankvest Capital Corp.)*, 360 F.3d 291, 296 (1st Cir. 2004) (*quoting In re Carp*, 340 F.3d 15, 25 (1st Cir. 2003)).

20. *In re Plitt Amusement Co. of Wash., Inc.*, 233 B.R. 837, 840 (Bankr. C.D. Cal. 1999) (pointing out "[s]ection 365 establishes a structure under which a trustee may evaluate the advantages and disadvantages of an executory contract or unexpired lease" by "reviewing the net performance on both sides").

21. *See Orion Pictures Corp. v. Showtime Networks* (*In re Orion Pictures Co.*), 4 F.3d 1095, 1099 (2d Cir. 1993) (noting that the business judgment rule is the same test applied to judicial review of corporate decisions outside of bankruptcy). *But see In re Maxwell Newspapers, Inc.*, 981 F.2d 85, 90 (2d Cir. 1992) (holding that, with regard to a collective bargaining agreement, under section 1113 an employer "has the burden of proving that its propos[ed modifications] are necessary").

22. *In re Orion Pictures Co.* 4 F.3d at 1098.

23. *In re UAL Corp.*, 346 B.R. 456, 467 (Bankr. N.D. IL. 2006) (citing U.S.C § 365(f)(2)(a)).

24. 11 U.S.C. §§ 365(g)(1), 502(g) (2006); *In re FBI Distrib.*, 330 F.3d 36, 42 (1st Cir. 2003); *In re O.P.M. Leasing Servs., Inc.*, 79 B.R. 161, 163 (Bankr. S.D.N.Y. 1987) (indicating that a breach of contract "is treated as occurring immediately preceding the date of the petition"); *see In re Annabel*, 263 B.R. 19, 25 (Bankr. N.D.N.Y. 2001).

25. *See* 11 U.S.C. §§ 365(g), 502(g); Simpson, *supra* note 1, at 227 (contrasting bankruptcy law from non-bankruptcy law where the breaching party would be responsible for full contract damages).

26. 11 U.S.C. § 502(b)(6)(A) (2006).

27. *In re Eagle Ins. Co. v. Bankvest Capital Corp. (In re Bankvest Capital Corp.)*, 360 F.3d 291, 296 (1st Cir. 2004).

28. 11 U.S.C. § 365(b)(1) (2006).

29. *In re Nat'l Gypsum Co.*, 208 F.3d 498, 506 (5th Cir. 2000); *Stewart Title Guar. Co. v. Old Republic Nat'l Title Ins. Co.*, 83 F.3d 735, 741 (5th Cir. 1996).

30. *In re Comdisco, Inc.*, 270 B.R. 909, 911 (Bankr. N.D.Ill. 2001) (explaining assumption of contracts in entirety is grounded in contract law rather than in bankruptcy code).

31. *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 531 (1984).

32. *See In re Karfakis*, 162 B.R. 719, 725 (Bankr. E.D. Pa. 1993) (finding that debtor could not assume real property lease without assuming related franchise agreement); *see also In re Braniff, Inc.*, 118 B.R. 819, 844 (Bankr. M.D. Fla. 1989) ("Multiple contract documents may form one uniform agreement.").

33. *See In re Plaza*, 363 B.R. 517, 522 (Bankr. S.D. Tex. 2007).

34. *See In re Harry C. Partridge, Jr. & Sons, Inc.*, 43 B.R. 669, 671 (Bankr. S.D.N.Y. 1984).

35. *See* 6 Norton Bankr. L. & Prac. 3d § 119:13, at 119-61 (William L. Norton, Jr. ed., 2007) (pointing out corporations operating several hospitals in buildings rented from a single landlord may have leases incorporating cross-default provisions).

36. *See id.*

37. See Collier Lending Institutions and the Bankruptcy Code ¶ 2.02, at 2-9 (Alan N. Resnick et al. eds., 2007) (discussing various other transactions utilizing cross-default provisions including single loan transactions consisting of several documents and executory contracts or unexpired leases serving as collateral to secure loans of borrower).

38. *Cottman Transmissions, Inc. v. Holland Enters., Inc.* (*In re Holland Enters., Inc.*), 25 B.R. 301, 303 (E.D.N.C 1982).

39. *See* 6 Norton Bankr. L. & Prac. 3d § 119:13, at 119-64 (William L. Norton, Jr. ed., 2007).

40. *See id.*

41. 11 U.S.C. § 365(f)(1) (2006).

42. *See EBG Midtown S. Corp. v. McLaren/Hart Envtl. Eng'g Corp.* (*In re Sanshoe Worldwide Corp.*), 139 B.R. 585, 597 (S.D.N.Y. 1992); *In re Brainiff, Inc.*, 118 B.R. 819, 845 (Bankr. M.D. Fla. 1989); *In re Wheeling-Pittsburgh Steel Corp.*, 54 B.R. 772, 778 (Bankr. W.D. Pa. 1985) (indicating cross-default provisions are *de facto* anti-assignment provisions because they restrict debtor's ability to assign lease or contract); *In re Sambo's Rests., Inc.*, 24 B.R. 755, 757 (Bankr. C.D. Cal. 1982).

43. *In re Kopel*, 232 B.R. 57, 64 (Bankr. E.D.N.Y. 1999).

44. *Id.* Section 365(f)(2)(A) states that "the trustee may assign an executory contract or unexpired lease of the debtor only if—the trustee assumes such contract or lease in accordance with the provisions of this section." 11 U.S.C. § 365(f)(2)(A) (2006).

45. *In re Sambo's Rests., Inc.*, 24 B.R. at 757.

46. *Id.* at 756–58 (refusing to enforce the cross-default provision, reasoning it was an anti-assignment clause, a financial condition imposition, and its enforcement would be inconsistent with the damage limitations set forth under section 502(b)(7) of the Bankruptcy Code).

47. *Id.* at 757.

48. *In re Sanshoe Worldwide Corp.*, 139 B.R. 585, 590, *aff'd*, 993 F. 2d 300 (2d Cir. 1993).

49. *Id.* at 596.

50. *Id.* at 597.

51. *See id.*; *see also Papago Paragon Partners, LLC v. Three-Five Sys., Inc.*, 2007 U.S. Dist. LEXIS 48041 (D. Ariz. July 2, 2007).

52. *In re UAL Corp.*, 346 B.R. 456, 468 (Bankr. N.D. Ill. 2006).

53. *See* Ralph Brubaker, *Cross-Default Provisions in Executory Contracts and Unexpired Leases: Assumption Cum Onere and Unenforceable Ipso Facto Provisions*, 26 No. 11 Bankr. Law Letter 1 (Nov. 2006).

54. *In re Mr. Grocer, Inc.*, 77 B.R. 349, 352–53 (Bankr. D.N.H. 1987).

55. 289 B.R. 45 (Bankr. M.D.N.C 2003).

56. *Id.*

57. *Id.* at 50 (citing *In re Jamesway Corporation*, 201 B.R. 73 (Bankr. S.D.N.Y. 1996) (stating lease provision requiring tenant to pay landlord 50% to 60% of the "profits" received by tenant from the assignee or sublessee is unenforceable pursuant to section 365(f)(1)); *see, e.g.*, *In* re Convenience USA, Inc., 2002 WL 230772, at *7 (Bankr. M.D.N.C. Feb. 12, 2002) (providing when a debtor is a party to a number of unexpired leases, cross-default clauses that would prevent the debtor from assuming some of the leases without assuming others are unenforceable under § 365(f)); *In re Howe*, 78 B.R. 226, 228 (Bankr. D.S.D. 1987) (invalidating provision of executory sale contract conditioning consent to assignment upon payment by debtor of "assumption fee" equal to 4% of amount outstanding under contract); In re U.L. Radio Corp., 19 B.R. 537 (Bankr. S.D.N.Y. 1982) (noting that debtor could assume and assign its lease to assignee who would operate premises as a small bistro even though lease contained clause providing that lessee could use premises only for television service and sales store).

58. *In re E-Z Serve Convenience Stores*, 289 B.R. at 51 (pointing out in addition to evaluation of non-debtor's bargain, facts of case must be examined carefully to determine whether first-refusal clause in fact restricts debtor to reorganize).

59. 3 Collier on Bankruptcy, ¶ 365.07 (Alan N. Resnick et al. eds., 15th ed. rev. 2007) (noting that in contrast to unenforceability of anti-assignment clauses under former Bankruptcy Act, *ipso facto* clauses terminating leases upon filing of bankruptcy were enforceable).

60. 11 U.S.C. § 365(e) (2006); *see* 11 U.S.C. § 365(b)(2) (providing exception to requirement of cure when "default that is a breach of a provision relating to (A) the insolvency or financial condition of the debtor at any time before the closing of the case; (B) the commencement of a case under the title; (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement; or (D) the satisfaction of any penalty rate or penalty provision relating to a default arising from any failure by the debtor to perform non-monetary obligations under the executory contract or unexpired lease").

61. *See, e.g.*, *In re Thomas B. Hamilton Co.*, 969 F.2d 1013 (11th Cir. 1992); *see also In re Bulldog Trucking, Inc.*, 173 B.R. 517 (Bankr. W.D.N.C. 1994); 1-2 Collier Lending institutions & Bankruptcy Code ¶ 2.02 (2004) (showing certain financial conditions such as debt to net-worth ratio has been recognized as *ipso facto* clauses).

62. Robert J. Rosenberg et al., Collier Lending inst. & Bankr. Code ¶ 2.02-1(F) (2004).

63. *In re Sambo's Restaurants, Inc.*, 24 B.R. 755, 757 (Bankr. C.D. Cal. 1982).

64. Am. jur. 2d. Bankruptcy § 2345 (2008).

65. *In re Sambo's*, 24 B.R. at 757.

66. *See, e.g.*, *In re U.L. Radio Corp.*, 19 B.R. 537 (Bankr. S.D.N.Y. 1982) (refusing to enforce a use clause).

67. *Id.*

68. Laurence D. Cherkis et al., Collier Real Estate Trans. & Bankr. Code ¶ 3.06-6 (2005) (discussing reasons for not characterizing cross-default provisions as *ipso facto* provisions).

69. *Id.*

70. 6 Norton Bankr. L. & Prac. 3d § 119:13 (William L. Norton, Jr. ed., 2007).

71. *Id.*

72. H.R. Rep. No. 95-595, at 348 (1977).

73. *Finn v. Meighan*, 325 U.S. 300, 301 (1945) (evaluating financial condition clauses in leases prior to adoption of *ipso facto* invalidation under the Bankruptcy Code).

74. Ralph Brubaker, *Cross-Default Provisions in Executory Contracts and Unexpired Leases: Assumption Cum Onere and Unenforceable Ipso Facto Provisions*, 26 Bankr. Law Letter 6 (2006) (citing *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988)).

75. William M. Winter, *Preserving the Benefit of the Bargain: The Equitable Result*, 13 Bank. Dev. J. 543 (1997) (discussing the origin of cure provision from the Bankruptcy Reform Act of 1978).

76. *In re Matter of East Hampton Sand & Gravel Co., Inc.* 25 B.R. 193 (Bankr. E.D.N.Y 1982) (dismissing debtor's argument that "rehabilitative spirit of the Bankruptcy Code" tolerates divisibility of obligations).

77. *In re Karfakis*, 162 B.R. 719, 725 (Bankr. E.D. Pa. 1993) ("[C]ontract interpretation is a matter of state law and, therefore, bankruptcy courts should rely on applicable state law to determine whether an agreement is indivisible."). *See In re Pollock*, 139 B.R. 938, 940 (B.A.P. 9th Cir. 1992); *In re Cafe Partner/Washington 1983*, 90 B.R. 1, 5 (Bankr. D.D.C. 1988).

78. 3 Collier on Bankruptcy, ¶ 365.07 (Alan N. Resnick et al. eds., 15th ed. rev. 2007) (explaining "single integrated transactions" to be when breach of one contract would, independent of the cross-default provision, excuse performance under the other").

79. *See, e.g.*, *Lifemark Hosps. Inc. v. Liljeberg Enters. Inc.* (*In re Liljeberg*), 304 F.3d 410, 444-45 (5th Cir. 2002) (acknowledging authority from bankruptcy courts and district courts for the proposition that cross-default provisions do not integrate otherwise separate transactions or leases); *In re Kopel*, 232 B.R. 57, 65 (Bankr. E.D.N.Y 1999) ("Although cross-default provisions are inherently suspect, [they do not require] per se invalidation.").

80. *In re Plitt Amusement Co. of Wash., Inc.*, 233 B.R. 837 (Bankr. C.D. Ca. 1999).

81. *Id.* at 840-41.

82. Nancy A. Peterman & Robert W. Lannan, *Precautions Against "Cherry Picking" for Developers and Other Lessors of Multiple Nursing Homes Facilities*, 21-MAY Am. Bankr. Inst. J. 26 (2002) (discussing various factors courts consider to determine the parties' intent).

83. *Id.* (citing *In re Karfakis*, 162 B.R. 719, 725 (Bankr. E.D. Pa. 1993)).

84. *Id.* (citing *In re Eastern Systems Inc.*, 105 B.R. 219, 228 (Bankr. S.D.N.Y. 1989)).

85. *Id.* (citing *In re GP Express Airlines Inc.*, 200 B.R. 222, 227 (Bankr. D. Neb. 1996)).

86. Risa Lynn Wolf-Smith, *The Word Game: Current Bankruptcy Developments in Leases, Licenses and IP Contracts Executory Contracts and the Franchise Relationship, American Bankruptcy Institute Ninth Annual Rocky Mountain Bankruptcy Conference* (February 5–7, 2004).

87. 233 B.R. 837 (Bankr. C.D. CAL. 1999).

88. *Id.* at 841.

89. *Id.* at 844.

90. *Id.*

91. *Id.* at 846 n.10.

92. *In re Plitt Amusement Co. of Washington*, 233 B.R. 837, 844 (Bankr. C.D. Cal.1999).

93. *In re Convenience USA, Inc.*, No. 01-81478, 2002 Bankr. LEXIS 348 (Bankr. M.D.N.C. 2002).

94. *In re Convenience USA Inc.*, 2002 Bankr. LEXIS 348, at *21.

95. *Papago Paragon Partners, LLC v. Three-Five Sys.*, No. 06-2448, 2007 U.S. Dist. LEXIS 48041 (D. Ariz. 2007).

96. *Id.* at *2.

97. *Id.* at *14.

98. *In re Adelphia Business Solutions, Inc.*, 322 B.R. 51 (Bankr. S.D.N.Y. 2005).

99. *Id.* at 55.

100. *Id.* at 63 (stating cross-default provision may restrict assignments of unrelated contracts without any explanation).

101. *See* Ralph Brubaker, *Cross-Default Provisions in Executory Contracts and Unexpired Leases: Assumption Cum Onere and Unenforceable Ipso Facto Provisions*, 26 No. 11 Bankr. Law Letter 1 (Nov. 2006) (discussing applicability of forfeitures under contract law to cross-default provisions).

102. Restatement (Second) of Contracts § 229.

103. *Id.*

104. Restatement (Second) of Contracts § 229 cmt. b (1981).

105. *In re Adelphia Business Solutions, Inc.*, 322 B.R. 51, 62–63 (Bankr. S.D.N.Y. 2005).

106. *See In re UAL Corp.*, 346 B.R. 456, 469 (Bankr. N.D. Ill. 2006) (citing the courts of *Liljeberg* and *Kopel*, where "the agreements linked by a cross–default clause were economically interdependent: the consideration for one agreement supported the other").

107. *Id.*

108. *See In re Kopel*, 232 B.R. 57, 59-67 (Bankr. E.D.N.Y. 1999) (enforcing cross–default provision, which said that defaults under a $350,000 Note for a purchase of a business and a consulting agreement constituted defaults under the lease and remarking

seller's right to repossess the assets of the business "would have been of limited value without the corresponding entitlement to operate from the Building").

109. *In re FFP Operating Partners, LP*, 43 Bankr. Ct. Dec. (LRP) 141, (Bankr. N.D. Tex. Aug. 12, 2004).

110. *See id.* at *7 (applying the following factors under Texas law: "(1) the intent of the parties; (2) the subject matter of the agreement; and the (3) conduct of the parties," *Id.* at * 5–6).

111. *In re Woflin Oil, L.L.C.*, 318 B.R. 392 (Bankr. N.D. Tex. 2004).

112. *See id.* at 399 ("Despite Webb's self-serving testimony that he would not have entered into the leases with the Debtor without the cross-default provisions, the Court remains unconvinced.").

113. *In re Karfakis*, 162 B.R. 719, 725 (Bankr. E.D. Pa. 1993) (determining divisibility of the agreements, by applying Pennsylvania law stating, "'[t]he primary inquiry in resolving this question is whether the language employed in the contract clearly indicates the intention of the parties to be entire or severable.'" If the language is not clear, then the court can use other evidences such as the conduct of the parties. The court was "persuaded by these facts that the parties intended the two separate contracts, the Lease and Franchise Agreement, to constitute a single, contractual agreement.").

114. *See id.* ("In the instant case, the evidence established that the Franchise Agreement and the Lease are inextricably interwoven and for all practical purposes comprise a single contractual relationship. Aside from being coterminous and containing cross-default provisions, it is readily apparent that one agreement is of no utility without the other.").

115. *Id.*

116. *See id.* (resulting from the facts that both contracts were executed on the same date, "the Franchise Agreement and the Lease [were] inextricably interwoven," and "comprise[d] a single contractual relationship").

117. *Id.*

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Ethics Opinion No. 826

Committee on Professional Ethics of the New York State Bar Association

9/12/08

Topic: Conflicts of interest; multiple representation

Digest: No *per se* rule prohibits a lawyer from representing plaintiffs in declaratory judgment actions against an insurance carrier and simultaneously defending that carrier against other insureds in other declaratory judgment actions, or from obtaining advance waivers of the conflict. Where the actions involve related issues of law, however, whether the clients can validly consent depends on, among other things, potential "positional conflicts," the possibility that the lawyer may need to cross-examine employees of a client, and the possibility that confidential information derived from one representation may be of use in another.

Code: DR 4-101(B)(2); DR 5-101(A); DR 5-105(A) and (C); EC 5-15

Question

1. May a lawyer agree to defend an insurance company in coverage disputes arising out of construction accidents while simultaneously representing other insureds in other coverage cases against that insurance company arising out of unrelated construction accidents?

Opinion

2. The inquirer is a member of a law firm that regularly represents property owners and construction managers who are defendants in construction accident cases and who were denied insurance coverage. The firm represents these clients, as plaintiffs, in actions filed against the insurance carriers for declaratory relief invalidating the coverage disclaimers and enjoining the carriers to defend and indemnify them, on grounds that the plaintiffs are "additional insureds" in subcontractor liability policies. The firm has been approached by one of the defendant insurance companies to represent it as a defendant in other, unrelated declaratory judgment and injunction actions brought by other insureds. The inquirer asks whether the firm may take on these engagements.

3. A lawyer may not take on or continue the concurrent representation of multiple clients if the representation would "involve the lawyer in representing differing interests" or if "the exercise of independent professional judgment in behalf of a client will be or is likely to be adversely affected," unless the lawyer obtains the informed consent of each client affected by the conflict "after full disclosure of the implications of the simultaneous representation and the advantages and risks involved" and "a disinterested lawyer would believe that the lawyer can competently represent the interest of each."[1] "Differing interests" are defined broadly by the Code to "include every interest that will adversely affect either the judgment or the loyalty of a lawyer to a client, whether it be conflicting, inconsistent, diverse or other interest."[2]

4. Here, there clearly is a conflict with respect to the matters involving the carrier that the lawyer or law firm proposes to defend. If the lawyer or law firm takes on those matters, the lawyer or firm will be representing in the existing actions one client—the insurance company—adverse to another client—the insureds—and can proceed only if the conflict is consentable and all clients involved provide informed consent.[3] In considering whether the conflict is consentable and the nature of the disclosure required in obtaining consent, the situation in this inquiry presents particular issues.

5. First, because of the standardized nature of many insurance policies, there is a significant probability that a lawyer or law firm representing the carrier may be called upon to take the opposite side of an issue that the lawyer is simultaneously litigating on behalf of a declaratory judgment plaintiff in another case – for example, the outer time limit for timely notice of claim, the required specificity for a valid notice of disclaimer, or the scope of coverage afforded by a particular clause. This type of "positional" or "issue conflict" does not present an automatic bar to the multiple representation. EC 5-15 states, "[A] lawyer may generally represent parties having antagonistic positions on a legal question that has arisen in different cases, unless representation of either client would be adversely affected. Thus, it is ordinarily not improper to assert such positions in cases pending in different trial courts."[4]

6. Even where there is a risk of creating an adverse precedent, such conflicts are generally subject to consent if the client is adequately informed of the issues involved.[5] There may be circum-

stances, however, in which the lawyer's effectiveness on behalf of one client may be impaired by the representation of the other client, as for example, where the lawyer's own advocacy of the contrary position may be used against the lawyer in the representation of one of the clients, or where the lawyer will feel constrained by the position he or she has taken in one case from arguing vigorously for the contrary position. In such cases, it will generally not be possible to meet the requirement of DR 5-105(C) that "a disinterested lawyer would believe that the lawyer can competently represent the interest of each."

7. A second consideration is whether the lawyer may need to cross-examine an employee of the carrier client in the representation of an insured. There is nothing in the abstract that prevents an adequately advised client from consenting to be sued by the client's lawyer in unrelated matters, particularly if the client is a sophisticated consumer of legal services, as are most insurance companies. But depending on such questions as the seniority of the employee, the importance of the testimony, and the nature of the cross-examination, it may be impossible to meet the disinterested-lawyer test where such a suit would require cross-examination of an insurance carrier employee. Similar considerations would be presented if the lawyer were required to cross-examine an expert that the lawyer might have used or be using in a case for the other side.

8. Third, the firm that seeks to represent both the carriers and the declaratory judgment plaintiffs in coverage disputes should be mindful of DR 5-101(A), which concerns conflicts arising from a "lawyer's own financial, business, property or personal interests." To the extent there may be a significant disparity in the fees likely to be generated by the owners and construction managers on the one hand, and the carrier on the other hand, there may be an "inclination . . . to 'soft peddle' or de-emphasize certain arguments or issues—which otherwise would be vigorously pursued—so as to avoid impacting the other case."[6]

9. In addition, a lawyer may not use for the benefit of the insureds any confidential information that the lawyer has learned in the course of representing the carrier.[7] If in a particular case for an insured, for example, the practices of the carrier or of individual employees of the carrier with respect to a certain issue may be called into question, it may well not be possible for the lawyer to avoid using confidential information derived from a prior representation of the carrier regarding those practices.[8] In such cases, again, the lawyer might not be able to satisfy the "disinterested lawyer" test.

10. To the extent that the lawyer concludes that a conflict is consentable, the lawyer should advise the clients of these considerations in obtaining that consent. The lawyer's disclosure should address, as necessary in a particular case and depending on the sophistication of the client, questions such as the possibility that advocating a favorable legal position in one client's case may be prejudicial to a client in another case, the possibility that the lawyer or a lawyer in the firm may need to cross-examine an employee of the carrier, and any other considerations that may reasonably be thought to affect the lawyer's independent professional judgment or the vigor of the lawyer's representation of the clients.

11. A further consideration is whether the lawyer or law firm seeking to represent a carrier in a series of actions while continuing to bring actions by insureds against that carrier may seek an advance waiver of conflicts with respect to future cases the lawyer or law firm may take on. If the conflicts are otherwise consentable, there is sufficient disclosure of the nature of the conflicting representations that may arise and the client is capable of understanding the waiver, a lawyer or law firm generally may ethically request and rely upon the advance waiver of a future multiple-representation conflict.[9] The extent of the disclosure necessary, and potentially the scope of the advance waiver, may depend on, among other things, the sophistication of the client.[10] For example, where a client is relatively unsophisticated in legal matters, an advance waiver is more likely to be enforceable if it is limited to lawsuits on behalf of the carrier of the same general kind as the lawyer or law firm is then prosecuting, as opposed to a more open-ended waiver.

12. The lawyer should review the validity of such an advance waiver both when the waiver is given and when it is triggered. For example, the lawyer would not be able to rely on an advance waiver by an insured broadly permitting the lawyer or firm to represent the carrier defendant in other construction-accident suits against other insureds if the lawyer or firm thereafter wishes to take on a lawsuit on behalf of the carrier that would require the lawyer or firm to argue for a position that would limit the lawyer's effectiveness in arguing for the insured.

Conclusion

13. There is no per se rule that would disqualify a lawyer from representing certain declaratory judgment plaintiffs against the insurance carrier and simultaneously defending the carrier against other declaratory judgment plaintiffs in coverage disputes. The possibility of positional conflicts, however, will require careful consideration in each case of the nature of the issues presented and the effect on the representation of other clients of the positions taken on behalf of one. In some cases, considerations such as the identity of the likely witnesses and whether the lawyer has confidential information derived from representation of the carrier that may be of use in the representation of the insured may also limit the lawyer's ability to obtain informed consent to the conflict. For these reasons, the burden of satisfying the "disinterested lawyer" test in these cases will often be a high one.

Endnotes

1. DR 5-105(A) and(C).
2. Code Definitions.
3. Under the Code, individual lawyers have the conflict, but pursuant to DR 5-105(D) their conflict is imputed to every lawyer in their firm.
4. *See also* Model Rule 1.7 cmt. 24 ("The mere fact that advocating a legal position on behalf of one client might create precedent adverse to the interests of a client represented by the lawyer in an unrelated matter does not create a conflict of interest. A conflict of interest exists, however, if there is a significant risk that a lawyer's action on behalf of one client will materially limit the lawyer's effectiveness in representing another client in a different case; for example, when a decision favoring one client will create a precedent likely to seriously weaken the position taken on behalf of the other client."); ABA 93-377 ("[I]f the two matters are being litigated in the same jurisdiction, and there is a substantial risk that the law firm's representation of one client will create legal precedent, even if not binding, which is likely materially to undercut the legal position being urged on behalf of the other client, the lawyer should either refuse to accept the second representation or (if otherwise permissible) withdraw from the first, unless both clients consent after full disclosure of the potential ramifications of the lawyer continuing to handle both matters."); Restatement (Third) of the Law Governing Lawyers § 128(f) (2000) ("A lawyer ordinarily may take inconsistent legal positions in different courts at different times. . . . However, a conflict is presented when there is a substantial risk that a lawyer's action in Case A will materially and adversely affect another of the lawyer's clients in Case B. . . . If a conflict of interest exists, absent informed consent of the affected clients . . . , the lawyer must withdraw from one or both of the matters.").
5. *See, e.g.*, Model Rule 1.7 cmt. 24 ("If there is significant risk of material limitation, *then absent informed consent of the affected clients*, the lawyer must refuse one of the representations or withdraw from one or both matters.") (emphasis added); sources cited in the preceding footnote.
6. ABA 93-377.
7. DR 4-101(B)(2) bars a lawyer from knowingly using "a confidence or secret of a client to the disadvantage of the client."
8. *See* N.Y. City 2005-2 ("There are situations, however, where information that the lawyer has in his or her mind from the first representation is so material to the second representation that the lawyer cannot avoid using the information.").
9. *See* N.Y. City 2006-1.
10. *See id.* at 5.

Ethics Opinion No. 827

Committee on Professional Ethics of the New York State Bar Association

11/3/08

Topic: Direct payment of client's audit expense from law firm account; sharing of legal fees

Digest: Not unethical to cooperate with outside audit of client's billings, nor to pay a percentage of gross billing to the auditor directly from firm account, at the direction of the client.

Code: DR 1-102, DR 2-103, DR 3-102, DR 4-101

Question

1. Where a client hires an outside vendor to monitor and administer its legal bills and requires that the lawyer or law firm pay the auditor's bills, may the firm ethically participate in the auditing function and may the lawyer permit the costs of such services to be paid by the law firm, where the bills are based on a percentage of the firm's billings to the client? May the firm permit the payments to the auditor to be made directly from its operating account?

Opinion

2. A law firm regularly defends an entity in personal injury defense litigation. The entity "self-insures," so no insurance company is involved in retaining the law firm or conducting the client's defense. The client has hired an outside vendor (an auditor) to monitor and administer the client's legal expenses. The auditor's bills will be based on a percentage of the law firm's billing. The client informs the law firm that the law firm must permit the auditor's fee to be withdrawn automatically from the law firm's bank account.

3. In N.Y. State 716 (1999), this Committee considered whether a lawyer might ethically cooperate with an outside auditor hired by an insurer, where the lawyer represented not the insurer, but the insured. There, where the decision to employ the auditor was not the client's decision, we looked primarily to DR 4-101, which deals with the lawyer's duty of confidentiality to the client. We determined that the lawyer would need to obtain informed and knowledgeable consent from the client before sharing confidential billing records with the auditor. We did not, however, view cooperation with the auditor as intrinsically impermissible.

4. Here, where the client has sought the auditor's services, the problem addressed in N.Y. State 716 is less immediate. Even so, a lawyer should take steps to ensure that the client understands any risks for the client that follow from disclosure of billing information to the auditor. These risks include the possibility of further disclosure by the auditor to others, the possibility that the disclosure will waive the attorney-client privilege, and the possibility that the information disclosed to the auditor might somehow be used adversely to the client.[1]

5. Assuming the client understands and wishes to go forward despite these risks, we turn next to DR 3-102 which states that "[a] lawyer or law firm shall not share legal fees with a non-lawyer," with exceptions not relevant on these facts. The rule in its apparent simplicity might seem to prohibit the arrangement described above. We think it does not.

6. The arrangements here at issue are simply an incident of fee-negotiation with a client, an agreement to allocate costs between client and lawyer. They are not, properly speaking, fee division. While no lawyer is obligated to agree to the arrangement, the mere fact that the auditor's fee is calculated based upon the lawyer's billings does not make the payment from the lawyer to the auditor the division of a legal fee. Moreover, as we opined in N.Y. State 733 (2000), the intention of DR 3-102 is to secure the client-attorney relationship against outside interference: "fee-splitting between lawyer and layman poses the possibility of control by the lay person, interested in his own profit, rather than the client's fate."[2] This concern is absent in the allocation of fees between a lawyer and a client.[3]

7. The arrangement here also does not raise any concerns under DR 2-103(D), which prohibits a lawyer from "compensat[ing] or giv[ing] anything of value to a person or organization to recommend or obtain employment by a client," again with exceptions not relevant here.[4] Here, the client is already the firm's client. The auditor is engaged by the client to monitor its legal bills, and compensated for that service—not for bringing the client to the lawyer.

8. This conclusion is not affected by the manner of payment requested by the client. Nothing in the Code bars a lawyer from agreeing to permit the client or the auditor from automatically withdrawing the auditor's fees from the lawyer's operating account.

Conclusion

9. Subject to the conditions described—notably that the client, with a full understanding of the arrangements and their implications, chooses to employ the auditor—the lawyer may cooperate with and compensate the auditor from the firm's operating account.

Endnotes

1. "The nature of the necessary disclosure [to the client] will vary somewhat from case to case and client to client. . . . Ordinarily, however, the lawyer should at least discuss the nature of the information to be found in the billing records sought by the auditor as well as the relevant legal and nonlegal consequences of the client's decision." N.Y. State 716.
2. N.Y. State 733, citing *Emmons v. State Bar of California*, 6 Cal. App. 3d 565, 574, 86 Cal. Rptr. 367, 372 (Ct. App. 1970).
3. *See also* N.Y. State 819 ¶ 7 (2007) (no violation of DR 3-102 when a lawyer agrees to accept less than a judicially determined fee in a domestic relations matter).
4. To similar effect see Judiciary Law § 491, which prohibits the sharing of fees with non-lawyers "as an inducement for placing, or in consideration of having placed, in the hands of such attorney-at-law, or in the hands of another person, a claim or demand of any kind for the purpose of collecting such claim, or bringing an action thereon." *See also* N.Y. State 698 (1998), in which we opined that a lawyer may not accept a case tendered by a "consultant" who makes the payment of a "contingent consultant's fee" a precondition of referral to the lawyer.

Ethics Opinion No. 828

Committee on Professional Ethics of the New York State Bar Association

3/10/09

Topic: Staff attorneys of state agency; communication with persons represented by counsel; imputation of non-lawyer investigator's conduct.

Digest: Conduct of state agency's non-lawyer investigators would not be imputed to its staff attorneys unless investigators operated under staff attorneys' supervision.

Code: DR 1-104(C) and (D), DR 7-104(A) and (B)

Question

1. A certain New York State agency maintains a staff of attorneys and non-lawyer investigators to oversee the operations of its licensees. Usually, an investigation will be undertaken by the agency without any supervision of the investigators by staff counsel. When misconduct by a licensee is discovered, a report will be prepared by one of the investigators for review by counsel; and, where appropriate, counsel may then prosecute the matter pursuant to the New York State Administrative Procedure Act.[1]

2. On occasion, before a matter is assigned to a staff attorney, an investigator will learn that one of the licensees under investigation is represented by counsel. Under such circumstances, what are the ethical obligations of the staff attorneys employed by the agency and do they have any obligation to condition or prevent its investigator from continuing to communicate directly with the licensee?

Opinion

3. DR 1-104 states in relevant part:

    C. A law firm shall adequately supervise, as appropriate, the work of . . . non-lawyers who work at the firm. . . .

    D. A lawyer shall be responsible for a violation of the Disciplinary Rules by another lawyer or for conduct of a non-lawyer employed by or retained by or associated with the lawyer that would be a violation of the Disciplinary 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; or

        2. The lawyer . . . has supervisory authority over the . . . non-lawyer, and knows of such conduct, or in the exercise of reasonable management or supervisory authority should have known of the conduct so that reasonable remedial action could be or could have been taken at a time when its consequences could be or could have been avoided or mitigated.

4. DR 7-104 states in relevant part:

    A. During the course of the representation of a client a lawyer shall not:

        1. Communicate or cause another to communicate on the subject of the representation with a party the lawyer knows to be represented by a lawyer in that matter unless the lawyer has the prior consent of the lawyer representing such other party or is authorized by law to do so.

        * * *

    B. Notwithstanding the prohibitions of DR 7-104(A) . . ., a lawyer may cause a client to

> communicate with a represented party . . . provided the lawyer gives reasonable advance notice to the represented party's counsel that such communications will be taking place.

5. In light of the foregoing provisions, we will initially assume for purposes of our analysis that the agency's investigators are acting under the supervision or control of its staff attorneys. If that were so, then once the staff attorneys knew that the subject licensees were represented by counsel in connection with the agency's investigation of their conduct, the staff attorneys would be prohibited from ordering or directing the agency's non-lawyer investigators to communicate further with the licensees without obtaining the prior consent of the licensees' counsel or complying with the "advance notice" requirement of DR 7-104(B). *See, e.g.,* N.Y. State 768 (2003) (explaining when lawyer "knows" that counter-party is represented by counsel); N.Y. State 735 (2001) (defining "party"). In such circumstances, the lawyers' ethical responsibility would derive from the expectation that they would properly supervise the investigators; it would not derive from the mere fact that they use non-lawyer investigators.

6. On the facts stated, however, the agency's investigators do not appear to be acting under the supervision or control of the staff attorneys. It also does not appear that the staff attorneys have any ethical responsibility under DR 1-104 to supervise the non-lawyer investigators' conduct.[2]

7. The non-lawyer investigators are clearly not "employed or retained" by the staff attorneys. *Cf.* DR 1-104(D). Rather, they are employed by the agency. Similarly, they do not "work at the firm." *Cf.* DR 1-104(C). Rather, they work at the agency. Nor can the investigators be said to be "associated" with the staff attorneys because, as that term is used in DR 1-104, the non-lawyer investigators are deemed to be associated only with the agency, not with its counsel.

8. Hence, on the facts here present, the provisions of DR 1-104 must be deemed inapposite to the relationship between the agency's investigators and its staff counsel. Accordingly, absent other factors discussed below, the agency's staff attorneys would have no ethical obligation to supervise the non-lawyer investigators.

9. Although the Code would not necessarily require the agency's staff attorneys to supervise the non-lawyer investigators, the agency could require such supervision as a condition of their counsel's employment. Once such supervision becomes a condition of the staff attorneys' employment, the ethical responsibility described in DR 1-104 would follow. Under such circumstances, the requirements of DR 1-104(C) and DR 1-104(D)(2) would then prohibit the staff attorneys from being willfully ignorant of their investigators' conduct, and responsibility for that conduct could be imputed to the staff attorneys.

10. Ultimately, imputation of the non-lawyer investigators' conduct to the agency's staff attorneys will thus depend on whether the lawyer has "supervisory authority" over the conduct of the non-lawyer. Whether a lawyer has supervisory authority over the conduct of a non-lawyer, *vel non*, will often be a matter of analyzing the operational relationship between the two individuals within the context of the organization, and the purpose and function of the agency in question. Where, for example, the agency requires its investigators to be instructed by staff attorneys concerning the procedures to be followed before undertaking an investigation, the conduct of the investigators will generally be imputed to the attorneys. *Cf.* N.Y. County 737 (2007). Where, on the other hand, there is no requirement or expectation that the agency's investigators will operate under the guidance of the staff attorneys, then consistent with the standards set forth in DR 1-104, the conduct of the investigators will not ordinarily be imputed to the staff attorneys.

11. The new New York Rules of Professional Conduct that will take effect on April 1, 2009 are substantially identical to the Disciplinary Rules construed and applied in this opinion.

Conclusion

12. For the reasons stated, subject to the qualifications set forth above, the question posed is answered in the negative.

Endnotes

1. We express no opinion on whether the New York State Administrative Procedure Act authorizes the procedures described in this opinion. Our jurisdiction is limited to answering questions of professional ethics and does not extend to deciding issues of substantive or procedural law.
2. We caution that, even in the absence of any systemic supervision or control of the non-lawyer investigators, the agency's staff lawyers would still be prohibited by the provisions of DR 1-102(A)(2) ("circumvent . . . through the actions of another") and DR 7-104(A)(1)("cause another to communicate") from directing or causing the non-lawyer investigators to continue having such communications in violation of the lawyer's prescribed ethical responsibilities under the Code.

Ethics Opinion 829

Committee on Professional Ethics of the New York State Bar Association

4/29/09

Topic: Conflicts of interest, consent confirmed in writing.

Digest: A consent to a conflict of interest that was validly given prior to April 1, 2009, the effective date of the new Rules of Professional Conduct, does not need to be obtained anew solely on account of the adoption of the new Rules.

Rules: 1.0(e), 1.0(j), 1.7(b), 1.9.

Question

1. Under Rules 1.0(e), 1.0(j), 1.7 and 1.9 of the New York Rules of Professional Conduct, which prescribe new rules for a client's consent to a conflict of interest, including a new requirement that such consents be "confirmed in writing," does a lawyer who obtained a consent to a conflict prior to the effective date of those rules need to obtain a new consent to the conflict?

Opinion

2. New York's Rules of Professional Conduct became effective April 1, 2009. Under Rule 1.7(b), where a lawyer has a conflict of interest arising out of the lawyer's representation of two or more clients or out of the lawyer's own financial, business, property or other personal interests, the lawyer may proceed with the representation or representations if:

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

   (2) the representation is not prohibited by law;

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

   (4) *each affected client gives informed consent, confirmed in writing.*[1]

Rule 1.0(j) defines "informed consent" as follows:

> "Informed consent" denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated information adequate for the person to make an informed decision, and after the lawyer has adequately explained to the person the material risks of the proposed course of conduct and reasonably available alternatives.

Rule 1.0(e) defines "confirmed in writing" as follows:

> "Confirmed in writing" denotes (i) a writing from the person to the lawyer confirming that the person has given consent, (ii) a writing that the lawyer promptly transmits to the person confirming the person's oral consent, or (iii) a statement by the person made on the record of any proceeding before a tribunal. If it is not feasible to obtain or transmit the writing at the time the person gives oral consent, then the lawyer must obtain or transmit it within a reasonable time thereafter.

3. These provisions are broadly similar to those that applied under the former New York Code of Professional Responsibility (the "Code"), except that the requirement that client consents be confirmed in writing is new. The Code, which was in effect prior to April 1, 2009, did not specify any particular form for such consents.[2]

4. The inquirer has represented a client for a number of years pursuant to a retainer agreement. The retainer agreement includes a waiver of certain conflicts that may arise out of then-existing engagements, or future engagements, on behalf of other clients. The inquirer asks whether it is necessary to obtain a new consent to conflicts otherwise covered by the existing waiver and execute a new retainer agreement reflecting the new consent.

5. In adopting the new Rules, the Appellate Division of the Supreme Court of the State of New York directed that the new Rules would be effective April 1, 2009, but the Court did not provide for any other transitional rules.[3] There is no basis for concluding that consents given prior to the adoption of the new Rules are impaired or invalid as a consequence of the change in the Rules.[4] Thus, if a consent to a conflict of interest was valid when given, and by its terms con-

tinues to apply to ongoing or new representations after April 1, 2009, and the application of the consent to a new matter is otherwise valid, there is no need to re-confirm or re-obtain the consent solely on account of the adoption of the new Rules. (We do not here address the circumstances under which a consent to a waiver may be valid in any other respect.)

6. With respect to the particular inquiry before us, the inquirer states that the consent was contained in a retainer agreement. It thus already satisfied the new requirement that the consent be confirmed in writing, but the same conclusion would apply to oral consents that were validly given prior to the effective date of the new Rules. The new requirement that consent to a conflict be "confirmed in writing" modifies the *giving* of consent. Thus, only consents that are given under the new Rules—that is, on or after April 1, 2009—must be "confirmed in writing." This conclusion is supported by the second sentence of Rule 1.0(e) (defining "confirmed in writing"), which specifies that the writing must be obtained or transmitted at the time the person gives oral consent or within a reasonable time thereafter. There is no suggestion that consents given much earlier must now meet the formal requirements of the new Rules. We note also that the new Rules do not require that the client actually sign an agreement containing the consent. See Rule 1.0(e)(ii). Moreover, any type of writing, even an e-mail, from the lawyer to the client confirming an oral consent would be sufficient. *See* Rule 1.0(x) (defining "writing" to include email or any other "tangible or electronic record of a communication or representation").

Conclusion

7. The requirements in the new Rules of Professional Conduct that govern obtaining consents to conflicts, including the new requirement that consents be "confirmed in writing," do not apply to consents validly given before the effective date of those Rules. Client consents to conflicts validly given prior to April 1, 2009 do not need to be obtained anew solely on account of the adoption of the new Rules.

Endnotes

1. Rule 1.7(b) (emphasis added). Similarly, under Rule 1.9, where a lawyer has a conflict of interest arising out of a representation of a former client, the lawyer may proceed with the representation of the current client if "the former client gives informed consent, confirmed in writing."
2. DR 5-101(A) (if "client consents to the representation after full disclosure of the implications of the lawyer's interest"); DR 5-105(C) ("if each [client] consents to the representation after full disclosure of the implications of the simultaneous representation and the advantages and risks involved").
3. Joint Order of the Appellate Division, December 30, 2008.
4. *See, e.g., Hays v. Ward*, 179 A.D.2d 427, 429, 578 N.Y.S.2d 168, 169 (1st Dep't 1992) ("Where a statute states in clear and explicit terms, as here, that it takes effect on a certain date, it is to be construed as prospective in application."); *Murphy v. Board of Education*, 104 A.D. 796, 797, 480 N.Y.S.2d 138, 139 (2d Dep't 1984) ("As a general rule statutes are to be construed as prospective only in the absence of an unequivocal expression of a legislative intent to the contrary, and where a statute directs that it is to take effect immediately, it does not have any retroactive operation or effect. . . ."), *aff'd*, 64 N.Y.2d 856, 476 N.E.2d 651, 487 N.Y.S.2d 325 (1985).

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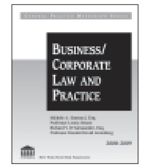

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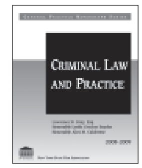

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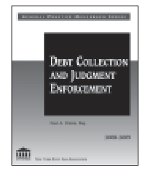

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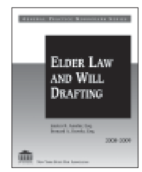

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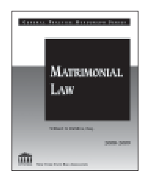

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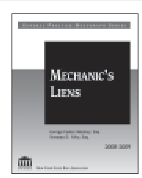

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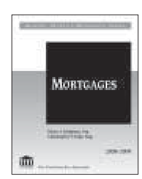

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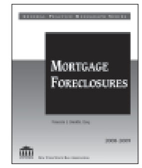

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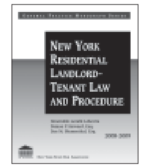

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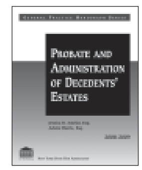

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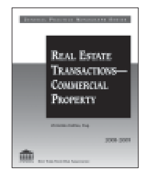

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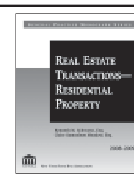

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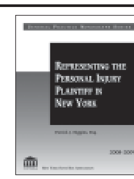

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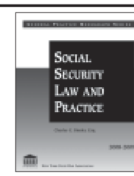

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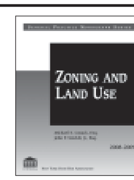

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