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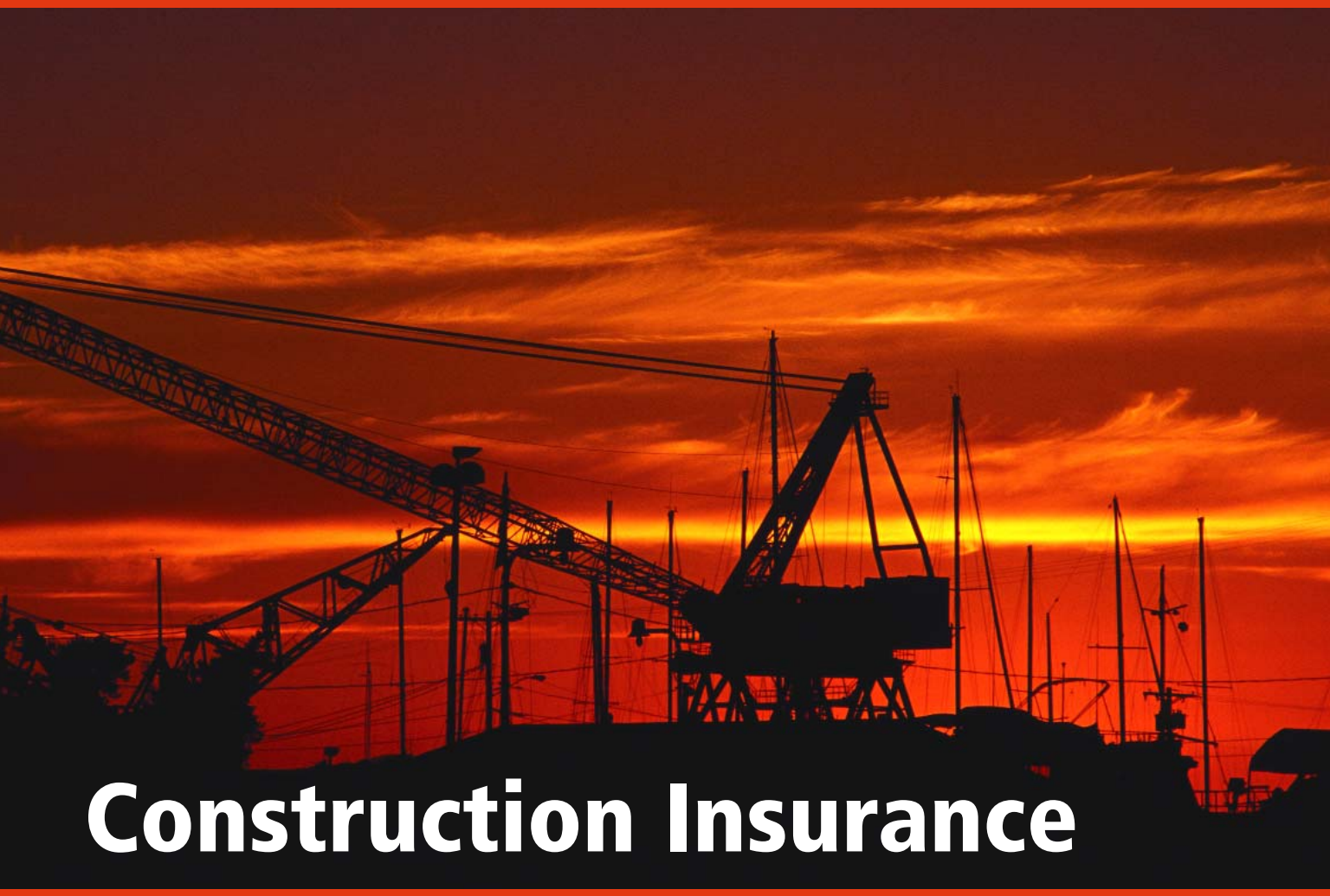

Construction Insurance

Do You Only Get What You Pay For?

A look at whether owner-controlled insurance programs provide contractors with the protection they expect.

by John J. Loveless

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March / April 2006

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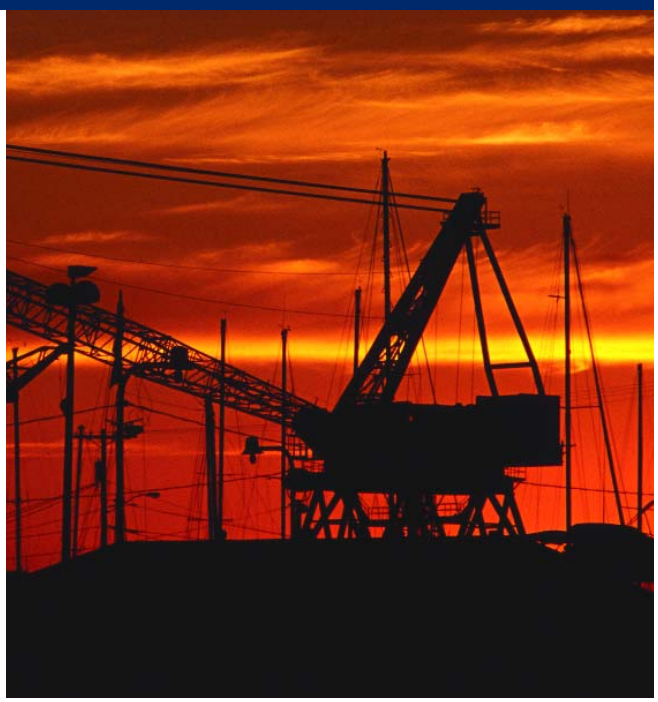

CONSTRUCTION INSURANCE

Do You Only Get What You Pay For?

A Look at Whether Owner-Controlled Insurance Programs Provide Contractors With the Protection They Expect

BY JOHN J. LOVELESS

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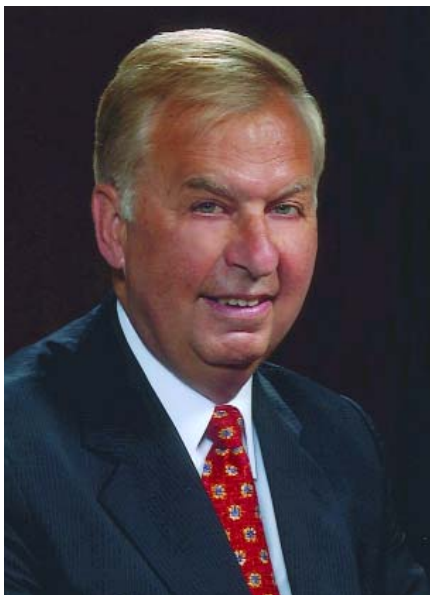
DEPARTMENTS

The *Journal* welcomes articles from members of the legal profession on subjects of interest to New York State lawyers. Views expressed in articles or letters published are the authors' only and are not to be attributed to the *Journal*, its editors or the Association unless expressly so stated. Authors are responsible for the correctness of all citations and quotations. Contact the editor-in-chief or managing editor for submission guidelines. Material accepted by the Association may be published or made available through print, film, electronically and/or other media. Copyright © 2006 by the New York State Bar Association. The *Journal* (ISSN 1529-3769), official publication of the New York State Bar Association, One Elk Street, Albany, NY 12207, is issued nine times each year, as follows: January, February, March/April, May, June, July/August, September, October, November/December. Single copies $18. Periodical postage paid at Albany, NY and additional mailing offices. POSTMASTER: Send address changes per USPS edict to: One Elk Street, Albany, NY 12207.

PRESIDENT'S MESSAGE

A. VINCENT BUZARD



A "Red Hot Time"

I have been involved in the Association for decades, but in the past eight months, I have learned that the only real way to comprehend the depth and breadth of what we do is to serve as President. The uniqueness and greatness of our Association became particularly apparent to me as I participated in our Annual Meeting this past January in New York City.

The first time the meeting was held in New York City, in 1907, members from the City promised attendees a "red hot time." Nearly 100 years later, we still make good on that promise – depending on your definition of "red hot time." This year, as President, I attended more than 40 meetings and had the privilege of speaking at each one. I was exhilarated to see our members' excitement, enthusiasm, and commitment to our Association and the profession.

Chief Judge Judith Kaye was second only to me in the number of speeches delivered and, along with other members of the Court of Appeals and Chief Administrative Judge Jonathan Lippman, participated in many Annual Meeting events. We appreciate their support and involvement in the Annual Meeting, which is symbolic of the close working relationship the Association enjoys throughout the year with Judges Kaye and Lippman, and the court system.

The sheer magnitude of what we undertake at the Annual Meeting is amazing. For example, while attending the Tax Section luncheon, I spoke to 1,000 people. The Commercial and Federal Litigation Section luncheon had 500 attendees, while on the floor below at the same time, the Trusts and Estates Law Section drew 750 people. We pull together vast resources to make such meetings happen, and we have a fantastic Meetings Department with an extraordinary director, Kathy Heider, who leads legions of Association staff in handling daunting logistics.

The realization that the total number of lawyers – 5,000 – attending our Annual Meeting this year was greater than the entire population of my hometown of Sullivan, Indiana, put the meeting in perspective for me. Presidents of other large state bars have told me that their annual meetings are not nearly as broad as ours, and they feel fortunate to have a couple hundred people attend. As a voluntary association, on the one hand, we must be more concerned than mandatory, unified bars about offering programs that appeal to our members; but on the other hand, we have greater freedom to advocate for our positions. That is key to our strength as the nation's largest voluntary bar association.

I was particularly pleased about this year's Presidential Summit. Four hundred people attended, the highest number ever. Choosing Summit topics is a President's prerogative, and the first topic we tackled this year – concerns about government requests for waivers of the attorney-client privilege – generated intense debate. The Supreme Court nomination and confirmation process, our second topic, turned out to be more timely than I could have imagined. For both Summit panels, we had tremendous speakers, including federal judges, professors, prosecutors, and law firm leaders – another manifestation of the strength of our Association and the pre-eminence of many of our members. The energy and enthusiasm so evident at the Summit spilled over to the President's Reception, where we again had hundreds of people in attendance.

In the House of Delegates, we witnessed two important developments. A set of recommendations was adopted to deal with misleading lawyer advertising, while protecting lawyers' constitutional rights. I don't think any

A. VINCENT BUZARD can be reached at president@nysbar.com.

other bar association could have marshaled the resources needed to produce such a significant proposal in such a short time. (Just last June, I appointed the task force on lawyer advertising!) Another important event in the House was Chief Judge Kaye's announcement that her Commission on the Future of Indigent Defense Services recommends creation of a statewide, state-funded system for delivery of indigent defense services. Moments later, our House called for a statewide oversight commission, when it adopted a report of our Special Committee to Ensure Quality of Mandated Representation.

One of the ways we celebrate our profession at the Annual Meeting is to present awards, and I offer my congratulations to everyone honored. Our highest honor, the Gold Medal, was presented to John Dunne, senior counsel in the Albany firm of Whiteman Osterman & Hanna. In a long, distinguished career, John has provided outstanding service to the legal profession, the state, and the nation – New York State Senator and Assistant Attorney General in Charge of the Civil Rights Division in the United States Department of Justice are just two of the key posts he has held.

We also recognize and celebrate diversity at the Annual Meeting. The third annual Celebrating Diversity in the Bar reception was a great success – introducing more than 250 minority attorneys to the rewarding opportunities for professional development available through Association involvement and providing a forum for the Committee on Minorities in the Profession to honor three outstanding jurists.

Amid all of the celebrating and the "red hot time," there was a broad range of great CLE programs, including an elder law update, practical tips for general practitioners and young lawyers, advice on using forensic reports and handling child support issues in Family Court, in-depth discussions on eminent domain after the *Kelo* decision and on the reporter's privilege in light of the Judith Miller case, as well as sessions on a myriad of other bread-and-butter and cutting-edge topics. My thanks to the Sections and Committees, which did such a superb job organizing the CLE programs.

I would like to thank everyone involved in this year's Annual Meeting. If you did not attend, I strongly encourage you to come next year. When you join us, you will see that we have a great and unique Bar Association, and you will come away better informed and more enthusiastic about our Association and the practice of law. ■

NYSBACLE

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

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

†Second Annual International Estate Planning Institute
(one-and-one-half day program)
Note: NYSBA CLE seminar coupons and complimentary passes CANNOT be used for this program
Fulfills NY MCLE requirement (11.5): 11.5 in skills, practice management and/or professional practice
March 16–17 New York City

Electronic Evidence: Be Prepared for Changes in the Matrix
(half-day program)
Fulfills NY MCLE requirement for all attorneys (4.5): 2.5 in skills and 2.0 in practice management and/or professional practice
March 23 Rochester
April 6 New York City

Representing Persons with Disabilities
Fulfills NY MCLE requirement for all attorneys (7.0): 1.0 in ethics and professionalism; 3.0 in skills and 3.0 in practice management and/or professional practice
March 24 Albany; Buffalo
March 31 New York City

†Ethics for Litigators and Trial Lawyers (video replay)
(half-day program)
Fulfills NY MCLE requirement (4.0): 4.0 in ethics and professionalism
March 30 Jamestown

Practical Skills Series: Family Court Practice
Fulfills NY MCLE requirement for all attorneys (7.5): 2.0 in ethics and professionalism; 3.0 in skills and 2.5 in practice management and/or professional practice
April 4 Albany; Buffalo; New York City; Rochester; Syracuse; Uniondale, LI; Westchester

Representing Physicians and Other Health Care Practitioners in the Professional Disciplinary Process
(half-day program)
Fulfills NY MCLE requirement for all attorneys (4.0): 2.0 in skills and 2.0 in practice management and/or professional practice
April 7 Melville, LI
April 28 New York City
May 5 Albany
May 19 Rochester

Gaining an Edge: Effective Writing Techniques for the New York Attorney
(half-day program)
Fulfills NY MCLE requirement for all attorneys (3.5): 3.5 in skills
April 20 Albany
April 21 Syracuse
April 26 Uniondale, LI
April 28 New York City

Ethics and Civility in Litigation: Introductory Lessons for 21st Century Litigators
(half-day program)
April 21 Albany; New York City
April 28 Buffalo
May 5 Melville, LI

Automobile Litigation: Update and Strategies
April 21 Uniondale, LI
May 8 Tarrytown
May 11 Buffalo
May 19 New York City

Ethical Issues in Matrimonial Cases: What's the Good Lawyer to Do?
(half-day program)
Fulfills NY MCLE requirement for all attorneys (4.5): 4.0 in ethics and professionalism; and 0.5 in practice management and/or professional practice
April 28 Tarrytown
May 12 Melville, LI
May 19 Rochester
June 2 Albany
June 16 New York City

* Denotes addition
** Denotes revision
† Does not qualify as a basic level course and, therefore, cannot be used by newly admitted attorneys for New York MCLE credit.

Immigration Law
(one-and-one-half day program)
May 2–3 New York City

†The New Regime in Medicaid Planning – Changes Wrought by the Deficit Reduction Act of 2005
May 2 Tarrytown
May 19 Melville, LI
May 24 Albany
May 31 New York City
June 5 Syracuse
June 8 Buffalo

Practical Skills Series: Mortgage Foreclosures and Workouts
Fulfills NY MCLE requirement for all attorneys (6.5): 2.0 in skills and 4.5 in practice management and/or professional practice
May 3 Albany; Buffalo; Melville, LI; New York City; Rochester; Syracuse; Westchester

DWI on Trial – The Big Apple VI
(one-and-one-half day program)
Note: NYSBA CLE seminar coupons and complimentary passes CANNOT be used for this program
Fulfills NY MCLE requirement for all attorneys (10.0): 1.5 in ethics and professionalism; 6.0 in skills and 3.0 in practice management and/or professional practice
May 4–5 New York City

Trial Evidence with James McElhaney
Note: NYSBA CLE seminar coupons and complimentary passes CANNOT be used for this program
Fulfills NY MCLE requirement for all attorneys (7.0): 7.0 in skills
May 4 Tarrytown
May 5 New York City

Commercial Lines: Coverage for the Construction Defect Claim
May 5 Buffalo
May 12 New York City; Syracuse
May 19 Albany; Uniondale, LI

Long Term Care and the Law: Issues and Skills
May 12 New York City; Rochester
May 19 Albany

Practical Skills Series: Tort and Insurance Law Practice
Fulfills NY MCLE requirement for all attorneys (6.5): 0.5 in ethics and professionalism; 2.5 in skills and 3.5 in practice management and/or professional practice
May 16 Albany; Buffalo; Long Island; New York City; Syracuse; Westchester

Surrogate's Courts Proceedings
May 17 Albany; Buffalo
May 18 Tarrytown
May 23 Binghamton
May 24 New York City
May 31 Rochester; Uniondale, LI
June 1 Syracuse

***Public Sector Labor and Employment Law**
May 18 Melville, LI
June 6 New York City
June 8 Albany
June 9 Rochester

***Attorney Trust Accounts – What Every Attorney Needs to Know**
(half-day program)
Fulfills NY MCLE requirement for all attorneys (4.5): 4.5 in ethics and professionalism
May 31 Albany
June 5 New York City
June 15 Melville, LI

Bridging the Gap: Crossing Over into Reality
(two-day program)
June 8–9 New York City

Practical Skills Series: Basics of Bankruptcy Practice
Fulfills NY MCLE requirement for all attorneys (7.5): 1.0 in ethics and professionalism; 1.5 in skills and 5.0 in practice management and/or professional practice
June 13 Albany; Buffalo; Melville, LI; New York City; Rochester; Westchester
June 14 Syracuse

Construction Insurance: Do You Only Get What You Pay For?

A Look at Whether Owner-Controlled Insurance Programs Provide Contractors With the Protection They Expect

By John J. Loveless

Owner-Controlled Insurance Programs (OCIPs)[1] were developed to make the insurance programs used primarily for construction projects more equitable, uniform and efficient. OCIPs eliminate the costs of overlapping coverage and delays caused by coverage or other disputes between the parties involved in a project and, at the same time, protect all the contracting parties by bringing the risk of loss from the project within the insurance coverage of the OCIP.[2]

By intent and design, OCIPs are most effective for larger construction projects. The owner negotiates the appropriate price and terms of the policies for the project and directly benefits by eliminating the cost of overlapping coverage. The greater the number of contractors involved in the OCIP, and the greater the number of overlapping policies that are eliminated, the greater are the savings to the owner. The money the owner saves does not come from the contractors' pockets. The contract price is reduced because insurance costs are not incurred by the contractors on the project. The cost of doing the work should be constant, and the owner and contractors alike would be amply covered by the insurance policies covering the project.

John J. Loveless
(jloveless@huffwilkes.com) is an attorney with the law firm of Huff Wilkes, LLP, in Westchester, where he heads the firm's Construction Law and Litigation practice. Mr. Loveless received his undergraduate degree from Brown University and his law degree from Georgetown University Law Center.

Benefits to owners from OCIPs are obvious. However, courts have only recently begun to interpret OCIPs so as to ensure that contractors receive the benefits and protection the parties, or at least the contractors, intended. So the question remains whether, in practice, OCIPs provide the parties with the protection intended under the contract.

The following fact pattern illustrates how various losses could be resolved under a conventional insurance program – that is, a program where each entity carries its own insurance – and those same losses under an OCIP.

A Loss Under a Conventional Insurance Program

Owner hires Contractor to renovate an office building. Owner has its own property damage and liability insurance coverage. Contractor is required to carry $5,000,000 worth of liability coverage for the project and $5,000,000 of insurance for property damage. Owner is to be named an additional insured on the policy and Contractor agrees to defend and indemnify Owner for any loss arising from Contractor's work.

Contractor hires Sub-Contractor. Sub-Contractor is required to maintain identical coverage for the project, as Contractor was required to maintain, and to name Owner and Contractor as additional insureds on the policy. Sub-Contractor also agrees to defend and indemnify Owner and Contractor for any loss arising from Sub-Contractor's work.

As the direct result of one of Sub-Contractor's employee's negligence, another of Sub-Contractor's employees sustains a grave injury. $500,000 of property damage also results from the negligence.

The injured employee sues Owner and Contractor, claiming the injuries arose from their negligence or the breach of a statutory duty. Contractor's carrier initially defends both Owner and Contractor and, due to the grave injury sustained by the employee, a third-party action against Sub-Contractor is commenced. Not only is it alleged that the injury arose from Sub-Contractor's own negligence, but also the contract required Sub-Contractor to defend and indemnify Owner and Contractor. Sub-Contractor assumes the defense of Owner and Contractor and Sub-Contractor's carrier settles the case for $750,000.

Owner's own carrier also assesses the property damage and issues a check for the loss, minus a deductible. Pursuant to the authority set forth in the terms of the insurance policy, a subrogation action is then brought against Contractor and Sub-Contractor.

Again, Sub-Contractor's carrier assumes the defense of Contractor. The case proceeds to trial and Owner's carrier recovers the money paid to Owner and Owner does not recover the deductible.[3]

With respect to these two losses: (1) Owner has been defended and indemnified from loss in the personal injury action and has been made whole with respect to the property damage, minus the deductible; (2) Contractor is defended and indemnified in both cases by Sub-Contractor's carrier; and (3) Sub-Contractor, while ultimately responsible for the losses, is defended by its carrier and covered for the losses under its own policies.

Notwithstanding the claims of negligence interposed against Owner and Contractor, Sub-Contractor's carrier pays the losses. This result is permissible under General Obligations Law § 5-322.1(1).[4] For years this statute, and the legions of cases interpreting and enforcing the statute, provided the blueprint for parties to a construction project to protect themselves from claims through insurance. Courts have consistently held that parties to a construction contract cannot seek to indemnify themselves for their own negligence but they can agree to purchase insurance to cover any loss. Courts draw a marked distinction between contractual provisions where a contractor seeks to exempt itself from liability for damages or injuries and contractual provisions that simply require one party to provide insurance for other parties.[5]

Courts have consistently held that parties to a construction contract cannot seek to indemnify themselves for their own negligence but they can agree to purchase insurance to cover any loss.

Each party to the contract, as well as the parties' respective carriers, has received exactly what was bargained for. The carriers have priced their policies based upon the risk of loss covered, and the parties have fulfilled their contractual requirements in terms of the coverage they provide to each other, while at the same time the parties assure that they themselves are protected by insurance.

The project also included numerous overlapping policies that raised the cost of the project without providing any additional benefit to any party.

The Loss Under an OCIP

Owner seeks to renovate a building. Owner purchases a $5,000,000 policy protecting the property from damage and a $5,000,000 policy for liability during the construction. Contractor and Sub-Contractor both agree to participate in the OCIP and they are named as additional insureds on the policy. Additionally, each party agrees to waive any right to subrogate any claim paid under the OCIP policies.

As the direct result of one of Sub-Contractor's employee's negligence, another of Sub-Contractor's employees sustains a grave injury and $500,000 of property damage results from the negligence.

The injured employee sues Owner and Contractor claiming the injuries arose from their negligence and breach of a statutory duty. Owner's liability carrier defends both Owner and Contractor. The case settles for $750,000.

Owner's own carrier also assesses the loss and issues a check for the damage, minus a deductible.

If the claims play out as described above, the OCIP has done exactly what was intended. The insurance policies protected the project and the parties; the resolution of the underlying claims was considerably more efficient because of the reduced number of parties and claims; the overall cost of the project was reduced by eliminating the overlapping coverage in redundant policies.

Under the OCIP, only one policy was available for personal injury claims and one for the property damage claims on the project, regardless of which of the parties involved in the project caused the loss. The property loss was adjusted and paid and the personal injury claim was resolved on its merits. If a carrier had the right to pursue any claim against another contractor based upon a claim that the contractor was somehow responsible for the loss, there would be no policy in effect to cover the loss. Under the OCIP, the contractor would not obtain its own policies. If a contractor had decided to purchase its own policy as a "belt and suspenders" approach to coverage, it could never compete against contractors who would not include such costs in their bids. Therefore, an essential element of any OCIP is an agreement that the parties waive any right to subrogation of a loss. The waiver, if enforceable, is necessary for contractors to protect themselves by making sure that they too are protected by the policies obtained under the insurance program.

In *St. Paul Fire & Marine Insurance Co. v. Universal Builders Supply, Inc.*, the United States Court of Appeals for the Second Circuit recently affirmed a decision, from the United States District Court for the Southern District of New York, enforcing the waiver of subrogation such that it provided the contractors with the protection intended under the OCIP.[6] This case, and another recent reported decision from the Southern District of New York,[7] reversed the prior trend in the Southern District where a series of holdings had eroded much of the protection contractors had received (or thought they were receiving) from an OCIP.[8]

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In *St. Paul*, the plaintiff was the subrogee in an action brought to recover the damages paid by St. Paul to the owners for losses that arose under a builders' risk policy.[9] Under the construction contract, the owners obtained a builders' risk insurance policy covering the owners as well as all contractors and sub-contractors. The contract also provided that the parties waived the right to recover against other parties for claims covered by the policy ("the waiver of subrogation clause").[10]

After the loss, St. Paul paid the owners what it determined was due under the policy. Had the matter ended there, the claim would have been resolved consistent with the terms of the OCIP, as set forth in the fact pattern above. It did not end there.

In order to avoid the terms of the OCIP, St. Paul commenced a subrogation action against a contractor primarily to recover the sum paid to the owner by the insurer. The complaint alleged, among other things, that the damages resulted from the defendant contractor's gross negligence.[11] St. Paul argued that such claims were not barred by the waiver of subrogation clause in a contract, relying on a public policy in New York that "forbids a party's attempt to escape liability, through a contractual clause, for damages occasioned by grossly negligent conduct."[12]

St. Paul's claims were bolstered by the Southern District cases that held that waiver of subrogation clauses do not bar subrogated claims arising from gross negligence.[13] While the courts in *Travelers' Indemnity* and *Charter Oak* offered no rationale in their holdings for disregarding the insurance programs, the decisions appeared to support St. Paul's attempt to avoid the terms of the insurance program. These holdings allow a party to escape the effect of a waiver of subrogation clause in a comprehensive insurance program by simply claiming the losses arose from gross negligence. In *American Motorist*, the court offered a justification for its holding. It refused to enforce the waiver after determining that to do so would eliminate the wrongdoer's liability.[14]

As the Second Circuit Court of Appeals specifically noted in *St. Paul*, these three decisions all ignore the very real distinction between an agreement to procure insurance and an agreement to indemnify a tortfeasor for its own gross negligence.[15] In the district court's decision in *St. Paul*, that court also noted that the earlier district court decisions ignored equally compelling public policies that insure a victim is paid; or a policy that permits parties to agree on how insurance will be procured on a project.[16]

The linchpin of the holdings in *St. Paul*, and the later case that enforced the waiver of subrogation clause in an OCIP, seems to be the New York Court of Appeals's specific holding that a party may procure insurance as protection against losses occasioned by its own gross negligence.[17] Given that fact, the courts would not differentiate between contract provisions that merely require one party to purchase insurance for another party, regardless of whether the loss covered by that policy was occasioned by negligence or gross negligence.[18]

> There is a very real distinction between an agreement to procure insurance and an agreement to indemnify a tortfeasor for its own gross negligence.

If one returns to the fact patterns above, and substitutes "gross negligence" for "negligence," one sees a marked difference when the scenarios are considered under a conventional program, or the holdings in *American Motors* versus *St. Paul*.

Under the conventional insurance program, the results are identical to the above. The sub-contractor's carrier bears the cost of defending the lawsuits and the damages.

Under the OCIP though, the results can be quite different. In *American Motors*, the waiver of subrogation would not be enforced and the suit would continue. The con-

tractor would not only have to bear the cost to defend the suit, but there would be a risk of damages against a now uninsured party. The defendant would only be protected by the burden of proof imposed upon the plaintiff in the case. The gross negligence necessary to avoid enforcement of a waiver of subrogation is a tough burden to satisfy. The conduct must "smack of intentional wrongdoing. It is conduct that evinces a reckless indifference to the rights of others."[19]

Under such circumstances, the increased burden of proof is hardly the protection a contractor thought it was receiving under an OCIP where the parties explicitly waived the right to subrogation. Even though the burden necessary for the plaintiff to recover on a claim of gross negligence is high, courts have held that the question of gross negligence is normally one for a jury to decide at trial.[20] Therefore, under *American Motors*, simply using the words "gross negligence" in a complaint may get the subrogation claim to the jury and impose significant cost upon a contractor. Even if the contractor ultimately escapes liability, the costs of defending the suit, through trial, have been incurred.

As the Vermont Supreme Court noted in a decision that considered New York law extensively in its holding:

> If we were to accept plaintiffs' argument, plaintiffs in later cases would be able to negate waiver of subrogation provisions, and the public policy considerations supporting them in contexts such as the instant one, merely by alleging gross negligence and trusting that the trial court would allow the jury to determine if defendant's conduct sunk to that uncertain level.[21]

The uninsured loss would be devastating if the contractor is found liable.

The "anti-subrogation" rule as it has developed in New York courts does not appear to provide any refuge for the uninsured contractor subjected to a suit for damages, notwithstanding the terms of the waiver of subrogation in the OCIP. Generally speaking, the anti-subrogation rule provides that an insurer has no right of subrogation against its own insured for a claim arising from the very risk for which the insured was covered.[22] The rule, on its face, would appear to protect the contractors in our fact pattern. The contractors were insureds under the policy that covered the loss at issue in the subrogation claim. Unfortunately, courts have declined to interpret the rule to protect contractors under such circumstances. Courts will only enforce the anti-subrogation rule to the extent that a contractor has an "insurable interest in the property that is the subject of the insurance policy."[23] With respect to a builders' risk policy, the contractor only has an insurable interest in its own tools and the equipment.[24] The contractor does not ordinarily have an insurable interest in the building. Therefore, it is unlikely that courts will enforce the anti-subrogation rule and dismiss a subrogation claim brought under a builders' risk policy.

Under *St. Paul*, however, the owner's policy pays the loss and the project moves forward. This result is consistent with the intent of the parties and their carriers – at least at the time the contract was signed, because insurers should consider whether an insured has waived the right to subrogation in fixing the cost of the premiums.[25]

If courts do not have a problem with a carrier paying the loss under the conventional program, they should not allow the owner's carrier to avoid payment of the loss under the OCIP. As set forth above, under the conventional program, the bid price would include the cost of insurance. By simply eliminating that amount of the contract price under the OCIP, the owner is using the same money, or less of it, to purchase similar insurance coverage. It shouldn't matter who paid for the policy under these circumstances as long as the policy is in place and the parties to the contract understand their rights and responsibilities.

If, under the conventional program, the contractor's price for the work is $450,000 and that price included $25,000 for insurance, under the OCIP, the contractor's contract could be $425,000 and the owner is free to use up to $25,000 toward the insurance program. The difference is the profit for the owner. If the cost of the OCIP is too high, the owner would not obtain the program. If the cost is not too high, the court should not care whether Insurer A pays the loss rather than Insurer B, or who wrote the check for that particular insurance policy when the cost of the policy between the parties was simply a negotiated term of the contract.

The OCIP is designed to provide the parties with more certainty, less litigation and less expense. So, do OCIPs provide the same coverage as a conventional insurance program at a significantly reduced cost? Until quite recently, the answer was unclear. Fortunately, however, the Second Circuit has now rendered a decision that should allay fears of contractors, and their counsel, who had remained wary of OCIPs and their enforcement, primarily in the federal courts of this state. ■

1. An OCIP or its counterpart, a Contractor Controlled Insurance Program, is sometimes more generally referred to as a "controlled insurance program" or even a "wrap-up" policy.

2. *Tokio Marine & Fire Ins. Co. v. Employers Ins. of Wausau*, 786 F.2d 101, 104 (2d Cir. 1986).

3. For the purpose of this fact pattern, the form insurance agreements provide that the subrogated losses take priority over the deductible. Due to compromise as part of the settlement and the vagaries of provable or recoverable damages at trial, we assume the deductible and some of the subrogated damages are never recovered in the property damage action.

4. GOL § 5-322.1(1) provides:

> A covenant, promise, agreement or understanding in, or in connection with or collateral to a contract or agreement relative to the construction, alteration, repair or maintenance of a building, structure, appurtenances and appliances including moving, demolition and excavating connected therewith, purporting to indemnify or hold harmless the promisee against liability for damage arising out of bodily injury to persons or damage to property contributed to, caused by or resulting from the negligence of the promisee, his agents or employees, or indemnitee, whether such negligence be in whole or in part, is against public policy and is void and unenforceable; *provided that this section shall not affect the validity of any insurance contract, workers' compensation agreement or other agreement issued by an admitted insurer.* This subdivision shall not preclude a promisee requiring indemnification for damages arising out of bodily injury to persons or damage to property caused by or resulting from the negligence of a party other than the promisee, whether or not the promisor is partially negligent (emphasis added).

5. *Bd. of Educ., Union Free Sch. Dist. No. 3 v. Valden Assocs., Inc.*, 60 A.D.2d 617, 618 (2d Dep't 1977), *aff'd*, 46 N.Y.2d 653, 416 N.Y.S.2d 202 (1979); *Trump-Equitable Fifth Ave. Co. v. H.R.H. Constr. Co.*, 106 A.D.2d 242, 245 (1st Dep't), *aff'd*, 66 N.Y.2d 779, 497 N.Y.S.2d 369 (1985).

6. *St. Paul Fire & Marine Ins. Co. v. Universal Builders Supply, Inc.*, 317 F. Supp. 2d 336 (S.D.N.Y. 2004), *aff'd in part, modified in part*, 409 F.3d 73 (2d Cir. 2005).

7. *Indus. Risk Insurers v. Port Auth.*, 387 F. Supp. 2d 299 (S.D.N.Y. 2005).

8. *Charter Oak Fire Ins. Co. v. Trio Realty*, 2002 WL 123506 (S.D.N.Y. 2002); *Travelers Indem. Co. v. Losco Group, Inc.*, 136 F. Supp. 2d 253 (S.D.N.Y. 2001); *Am. Motorist Ins. Co. v. Morris Goldman Real Estate Corp.*, 277 F. Supp. 2d 304 (S.D.N.Y. 2003).

9. *St. Paul Fire & Marine Ins. Co.*, 317 F. Supp. 2d at 338.

10. *Id.*

11. *Id.*

12. *St. Paul Fire & Marine Ins. Co.*, 409 F.3d at 85.

13. *Charter Oak Fire Ins. Co. v. Trio Realty*, 2002 WL 123506 (S.D.N.Y. 2002); *Travelers Indem.*, 204 F. Supp. 2d 639; *Am. Motorist Ins. Co.*, 277 F. Supp. 2d 304.

14. *Am. Motorist Ins. Co.*, 277 F. Supp. 2d at 308.

15. *St. Paul Fire & Marine Ins. Co.*, 409 F.3d at 86.

16. *St. Paul Fire & Marine Ins. Co.*, 317 F. Supp. 2d at 342.

17. *St. Paul Fire & Marine Ins. Co.*, 409 F.3d at 86; *St. Paul Fire & Marine Ins. Co.*, 317 F. Supp. 2d at 341.

18. *St. Paul Fire & Marine Ins. Co.*, 409 F.3d at 87.

19. *Kalisch-Jarcho, Inc. v. City of N.Y.*, 58 N.Y.2d 377, 385, 461 N.Y.S.2d 746 (1983).

20. *Sommer v. Fed. Signal Corp.*, 79 N.Y.2d 540, 555, 583 N.Y.S.2d 957 (1992).

21. *Behr v. Hook*, 787 A.2d 499, 503–04 (Vt. 2001).

22. *Pa. Gen. Ins. Co. v. Austin Powder Co.*, 68 N.Y.2d 465, 471, 510 N.Y.S.2d 67 (1986).

23. *S.S.D.W. Co. v. Brisk Waterproofing Co.*, 76 N.Y.2d 228, 557 N.Y.S.2d 290 (1990).

24. *Paul Tishman Co. v. Carney & Del Guidice, Inc.*, 36 A.D.2d 273, 274, 320 N.Y.S.2d 396 (1st Dep't 1971), *aff'd*, 34 N.Y.2d 941, 359 N.Y.S.2d 561 (1974).

25. *Kaf-Kaf, Inc. v. Rodless Decorations, Inc.*, 90 N.Y.2d 654, 661, 665 N.Y.S.2d 47 (1997).

BY DAVID PAUL HOROWITZ

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Spoliation . . . Not Spoilation

Second in number only to the myriad mispronunciations of *Daubert* are the permutations of pronunciation of the word *spoliation*. As one scholar has explained: "Spoliation. A learned word, is, in the hands and mouth of the less-than-learned, often misspelled and mispronounced, spoilation, as in a 1992 legal seminar on the subject of "Spoilation [read] Spoliation of Evidence."[1] Having addressed the most confusing aspect of spoliation, a few pointers on its role in New York State court practice:

Spoliation is the intentional or negligent loss, destruction or alteration of evidence. When evidence is lost, destroyed or altered, a sanction may be sought by the party seeking the evidence against the party responsible for the loss, destruction or alteration of the evidence in question: a.k.a., the spoliator. There are two, independent grounds for the imposition of a spoliation sanction: a statutory penalty pursuant to CPLR 3126 and a penalty under the common law doctrine of spoliation.[2] Attorneys are expected to "recognize the elevated priority of preserving the evidence, so that drastic sanctions are not necessarily unduly harsh sanctions when a critical item of evidence is not preserved."[3]

Courts will weigh a number of factors in deciding whether to impose a spoliation sanction:

1. Who lost, destroyed or altered the evidence?
2. Was the spoliation intentional or negligent?
3. When did the spoliation occur?
4. Was the spoliator on notice that the evidence was needed for future litigation?
5. Was the evidence "key evidence"?
6. What is the impact of the spoliation on, or prejudice to, the ability of the party seeking the evidence to prosecute or defend its case?
7. Does the nature of the evidence and/or the conduct of the party responsible for the loss warrant a sanction?
8. What penalty/sanction is appropriate?

Not every piece of destroyed, lost or altered evidence will give rise to a claim for spoliation; not every act of spoliation will result in the imposition of a disclosure sanction pursuant to CPLR 3126 or a common law penalty; and not every incident where a spoliation sanction is imposed will result in the severe sanction of striking a party's pleading.

Spoliation may be intentional or negligent. "Although originally defined as the intentional destruction of evidence arising out of a party's bad faith, the scope of spoliation has been extended to the non-intentional destruction of evidence."[4] The most severe spoliation sanction, striking a party's pleading, may be imposed even though the spoliation was negligent, rather than intentional, "and even if the evidence was destroyed before the spoliator became a party, provided it was on notice that the evidence might be needed for future litigation."[5]

The penalty to be imposed, if any, depends on the nature of the evidence and its relationship to the ability of a party to prove a claim or defense.[6] "The determination of whether a sanction is warranted is based on the extent that the spoliation prejudices the other party and whether the sanction is necessary as a matter of elementary fairness."[7] If the parties are impacted

equally by the loss of the evidence, "and neither have reaped an unfair advantage in the litigation, it is improper to dismiss a pleading on the basis of spoliation of evidence."[8] For example, where an auto manufacturer in a defective design case conducted a physical inspection and took extensive photographs before the product was inadvertently lost, dismissal of the plaintiff's complaint was unwarranted.[9]

In order for a party to be subject to a spoliation sanction, that party must have a responsibility to preserve the evidence in question. The responsibility may then shift to the party's attorney when the attorney takes custody of the evidence.

Whether or not a court imposes a spoliation sanction will be influenced by who was responsible for the loss, destruction or alteration of the evidence, whether the spoliation was negligent or intentional, and when the spoliation took place – that is, did it occur before or after litigation was commenced, or before or after a demand to preserve the evidence was made.

Where the striking of a pleading is being considered by a court, "such a drastic remedy is typically imposed in cases where the offending party knew, or had reason to know, that the missing evidence was the subject of pending or future litigation."[10]

Intentional spoliation may be admitted, proved or inferred by the conduct of a party. Once a notice has been served upon a party to preserve evidence, it may be inferred that the spoliation was deliberate. "Where a noticed party discards evidence without moving for a protective order, a 'negative inference' may be drawn that the destruction was deliberate (i.e., 'willful')."[11]

Where the spoliating party acts negligently, rather than intentionally, in losing or altering evidence, the imposition of the full panoply of spoliation sanctions is available.[12] The rationale for imposing the sanction of dismissal for negligent spoliation is that where the record clearly demonstrates that crucial evidence was negligently destroyed and the spoliating party took no steps to safeguard the preservation of the evidence, any sanction other than dismissal would "unfairly compel a party, which was not even a party at the time crucial evidence was lost, to defend an action when such loss has fatally compromised its ability to defend."[13]

The time when the spoliation of evidence occurred will often be the pivotal factor in determining whether or not a spoliation sanction is imposed and, if imposed, the severity of the sanction. To hold a party responsible for spoliation of evidence, it may be a requirement to formally request that the party preserve, intact, the evidence in question. Where a formal request is not required, as where a party has an obligation to preserve evidence once it has knowledge of litigation involving the evidence, a formal request that the party preserve, intact, the evidence in question, will often be useful when a motion is made for a spoliation sanction.

A key element is whether there was an opportunity for all parties to examine the evidence and document their findings prior to the loss, destruction or alteration of the evidence.[14]

For there to be a sanction imposed for spoliation, the evidence that is lost, destroyed or altered must be "key" evidence.[15] It may be inferred that spoliated evidence is relevant, thereby bolstering the claim that a spoliation sanction should be imposed: "The likely relevance of the destroyed evidence is easily inferred."[16]

If the evidence that is lost, destroyed or altered is not relevant, or not necessary to establish a claim or defense, the common law doctrine of spoliation will not come into play, although a discovery sanction for the failure to exchange matter pursuant to a court order may warrant a penalty pursuant to CPLR 3126 or a sanction under Rule 130-1.1.

The time when the spoliation of evidence occurred will often be the pivotal factor in determining whether or not a spoliation sanction is imposed and, if imposed, the severity of the sanction.

Trial courts are granted wide discretion to furnish an appropriate sanction where spoliation of evidence has occurred.[17] However, that discretion is not absolute, and appellate courts may review both the determination concerning whether spoliation occurred and the sanction imposed under an abuse of discretion standard. A reviewing court has the power to substitute its discretion for the discretion of the trial court.[18]

A motion for spoliation of evidence should be made within a reasonable period of time from when the spoliation becomes known, because a party opposing the motion may always argue that the doctrine of laches should estop the party seeking a spoliation sanction from having relief granted. Where a party fails to seek a spoliation sanction pursuant to CPLR 3126 or under the common law doctrine of spoliation and then moves for a directed verdict based upon the spoliation, a trial court is without authority to *sua sponte* strike the pleading of the spoliating party.[19]

A party making a spoliation motion should consider utilizing an expert to offer testimony, by way of an affidavit or affirmation, detailing the manner in which the spoliation of the evidence in question prejudices the party and why

there is no satisfactory alternative to an inspection of the unaltered evidence in order to alleviate the prejudice.

Where it has been established that the spoliated evidence is "key" evidence, it is still possible for the spoliating party to escape the severe sanction of having its pleadings stricken if the offending party can find a way to make the other party whole, or at least ameliorate sufficiently the prejudice to the other party.

The most common way for this to be done is for the party that has not had an opportunity to examine or test the evidence prior to its being lost, destroyed or altered, to be given access to all of the factual information, including facts documented by any expert that examined or tested the product on behalf of the spoliating party. In this way, the argument can be made that the party that did not have the opportunity to examine the spoliated evidence has been "made whole" and may now supply all of the factual information supplied by the spoliating party to an expert of its own choosing to analyze and reach his or her own conclusions.

When such an exchange is offered by a party, or ordered by a court, it is appropriate to redact any opinions formed by the expert who did have the opportunity to inspect and test the evidence because, the argument goes, the other party, once armed with all of the factual data, should be able to obtain an opinion from its own expert.

While other jurisdictions have recognized an independent cause of action for spoliation, New York State courts did not have the occasion to rule on the validity of such a claim until 1998. In that year, the Second Department recognized the right of an employee to sue an employer who spoliated evidence, where the spoliation impaired the employee's right to sue a third-party tortfeasor.[20]

In 2004 the Court of Appeals was confronted with whether to recognize a cause of action for third-party negligent spoliation of evidence and impairment of a claim or defense and, on the facts before it, declined to do so.[21] A recitation of the facts is instructive.

A fire occurred in a vehicle, owned by a Chevrolet dealer, which was parked in a garage attached to a private home, and the home sustained damage of over $330,000. The homeowner's carrier, MetLife, paid the claim and was the plaintiff-appellant before the Court of Appeals. It was determined that the fire originated at the driver's side dashboard, and the Chevrolet dealer's insurance carrier, Royal, took possession of the vehicle, and agreed in a telephone conversation to preserve the vehicle.

Before commencement of a lawsuit, a group of potential parties arranged to inspect the vehicle, but before the inspection could take place Royal notified the parties that the vehicle had been disassembled and disposed of. MetLife, as the homeowner's subrogee, commenced an action against the dealer, the manufacturer, and the installer of a remote starting device in the dashboard sounding in negligence, breach of warranty, and strict liability. A fourth claim, against Royal, was for spoliation and impairment of the right to pursue claims against the other defendants. Royal filed a pre-answer motion to dismiss MetLife's claim, the trial court dismissed, and the Appellate Division affirmed, finding "no cause of action exists in New York for 'third-party spoliation' of evidence/impairment of claim or defense, either under the principles of negligence law or as an independent tort."

On appeal, MetLife argued both that Royal had a duty to preserve the evidence, and even if it did not, Royal assumed the duty by agreeing to preserve the vehicle. Royal argued that there was no policy reason for expand-

Attorneys must take steps early on to identify "key" evidence.

ing tort liability since there was no allegation the vehicle had been deliberately destroyed. After reviewing the recent development of the law involving claims of negligent spoliation, the Court described its traditional method of dealing with spoliation through CPLR 3126 sanctions. Citing *DiDomenico*, the Court of Appeals acknowledged that the Appellate Divisions have held a common-law cause of action exists when an employer's spoliation impairs an employee's right to sue a third-party tortfeasor, but distinguished *DiDomenico* because, in the case before it,

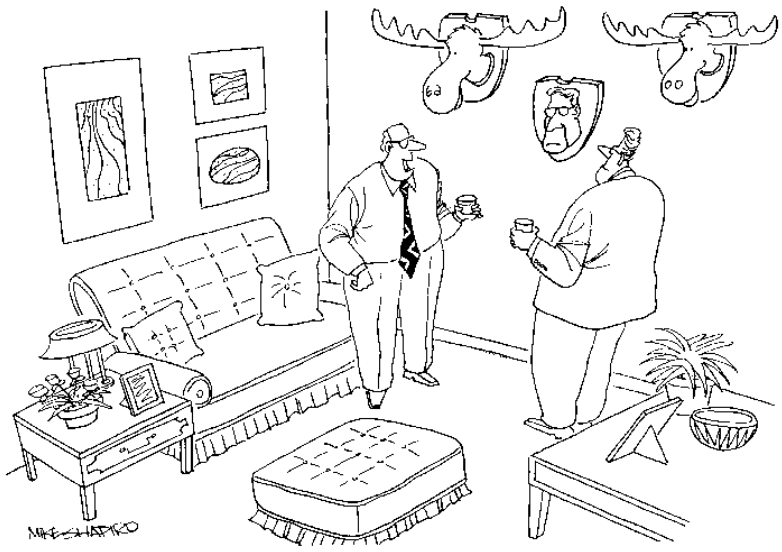
> at no time did MetLife seek or obtain a court order to compel the preservation of the vehicle. As MetLife acknowledges, it could have sought pre-action disclosure or a temporary restraining order. It could also have bought the car from Royal, offered to pay the costs associated with preservation or commenced suit and issued a subpoena duces tecum to Royal. MetLife did none of these things.[22]

The Court concluded:

> Although MetLife verbally requested the preservation of the vehicle, it never placed that request in writing or volunteered to cover the costs associated with preservation. The burden of forcing a party to preserve when it has no notice of an impending lawsuit, and the difficulty of assessing damages militate against establishing a cause of action for spoliation in this case, where there was no duty, court order, contract or special relationship.[23]

Although the Court declined to permit the cause of action in the case before it, the Court did leave the door open to such a claim where the required elements are established.

Attorneys must take steps early on to identify "key" evidence, and take prompt action to secure evidence in their possession or the possession of their clients and, at the same time, alert other parties in possession of such evidence of the need to preserve the evidence, intact, and provide timely and meaningful access to the evidence to allow necessary inspection and testing. These steps will help prevent spoliation from spoiling an otherwise meritorious claim or defense. ■

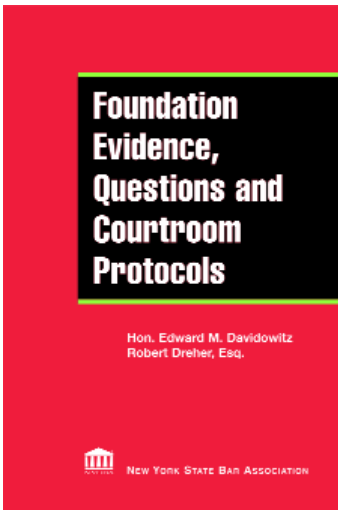


"One of the toughest settlements I've ever been involved in."

1. A Dictionary of Modern Legal Usage (2d ed.).
2. The trial court may

   > review on the basis of the common-law doctrine of spoliation, allowing dismissal when key evidence is destroyed prior to examination by the opposing party, in which case willfulness or bad faith may not be necessary predicates, or on a proper exercise of the court's discretion under CPLR 3126, addressing willful conduct by a nondisclosing party.

   Sage Realty Corp. v. Proskauer Rose, L.L.P., 275 A.D.2d 11, 16, 713 N.Y.S.2d 155 (1st Dep't 2000) (citation omitted).
3. *Kirkland v. N.Y. City Hous. Auth.*, 236 A.D.2d 170, 666 N.Y.S.2d 609 (1st Dep't 1997).
4. *Standard Fire Ins. Co. v. Fed. Pac. Elec. Co.*, 14 A.D.3d 213, 786 N.Y.S.2d 41 (1st Dep't 2004).
5. *DiDomenico v. C&S Aeromatik Supplies, Inc.*, 252 A.D.2d 41, 53, 682 N.Y.S.2d 452 (2d Dep't 1998).
6. *Gerber v. Rosenfeld*, 18 A.D.3d 812, 795 N.Y.S.2d 463 (2d Dep't 2005).
7. *Tomkins v. Armstrong*, 7 Misc. 3d 311, 793 N.Y.S.2d 736 (Sup. Ct., Kings Co. 2005).
8. *De Los Santos v. Polanco*, 21 A.D.3d 397, 799 N.Y.S.2d 776 (2d Dep't 2005).
9. *Klein v. Ford Motor Co.*, 303 A.D.2d 376, 756 N.Y.S.2d 271 (2d Dep't 2003).
10. *Bigelow v. Dick's Sporting Goods*, 1 A.D.3d 777, 766 N.Y.S.2d 629 (3d Dep't 2003).
11. *DiDomenico v. C&S Aeromatik Supplies, Inc.*, 252 A.D.2d 41, 682 N.Y.S.2d 452 (2d Dep't 1998).
12. *Squitieri v. City of N.Y.*, 248 A.D.2d 201, 669 N.Y.S.2d 589 (1st Dep't 1998).
13. *Kirkland v. N.Y. City Hous. Auth.*, 236 A.D.2d 170, 666 N.Y.S.2d 609 (1st Dep't 1997).
14. *Bigelow*, 1 A.D.3d 777.
15. *Standard Fire Ins. Co. v. Fed. Pac. Elec. Co.*, 14 A.D.3d 213, 786 N.Y.S.2d 41 (1st Dep't 2004); *Bigelow*, 1 A.D.3d 777.
16. *Sage Realty Corp. v. Proskauer Rose, L.L.P.*, 275 A.D.2d 11, 713 N.Y.S.2d 155 (1st Dep't 2000).
17. *Gilbert v. Albany Med. Ctr.*, 13 A.D.3d 753, 787 N.Y.S.2d 153 (3d Dep't 2004).
18. *Id.*
19. *Wetzler v. Sisters of Charity Hosp.*, 17 A.D.3d 1088, 794 N.Y.S.2d 540 (4th Dep't), *modified on other grounds*, 20 A.D.3d 944, 797 N.Y.S.2d 327 (4th Dep't 2005).
20. *DiDomenico v. C&S Aeromatik Supplies, Inc.*, 252 A.D.2d 41, 682 N.Y.S.2d 452 (2d Dep't 1998).
21. *MetLife Auto & Home v. Joe Basil Chevrolet, Inc.*, 682 N.Y.S.2d 452, 1 N.Y.3d 478, 775 N.Y.S.2d 754 (2004).
22. *Id.* at 483.
23. *Id.* at 484.



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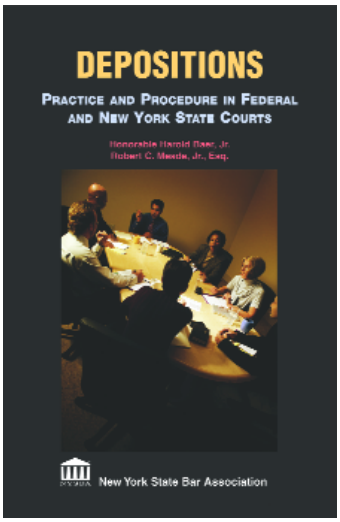

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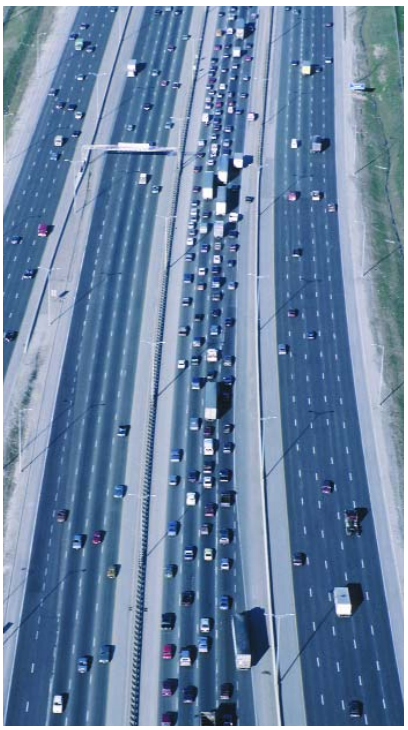

Not for the Faint of Heart

Additional Personal Injury Protection (APIP) Benefits

By Gregory V. Pajak and Kevin E. Loftus, Jr.

An insurance carrier has a subrogation right against a tortfeasor to recoup Additional Personal Injury Protection (APIP) benefits paid, but such a recovery can be illusory and, in many instances, is terminated before an APIP payment is even made. Plaintiffs' attorneys and defense counsel representing insureds should also be cautious. The practitioner (either plaintiff or defense) may believe a case is resolved; however, if an APIP issue is not addressed properly, the case may not be settled – contrary to the parties' belief. Issues involving APIP benefits can unravel a settlement, resulting in further litigation and, unfortunately, serving as potentially fertile ground for attorney malpractice.

Background

New York State was seeking a means to reform a system in dire need of change when it enacted the no-fault statute in 1973. Personal injury claims arising out of motor vehicle accidents were increasing at an alarming rate, causing insurance premiums to skyrocket. In response, the Legislature enacted the no-fault law.[1]

No-fault insurance, required for all New York drivers, provided for the "prompt disposition of claims and a swift resolution of priority obtainment issues."[2] Many of the claims that would have been litigated in the past due to questions of who was at fault would be disposed of relatively quickly. The goal was to resolve a large percentage of motor vehicle claims litigation, irrespective of fault.

The no-fault law of New York State provides mandatory insurance coverage for any person involved in a motor vehicle accident. Any accident victim will be covered for "basic economic loss" up to $50,000.[3] Under the Insurance Law, "basic economic loss" includes medical expenses, loss of earnings, and any other reasonable and necessary expenses arising out of the accident.[4] These benefits are commonly called "no-fault payments" or "personal injury protection benefits" (PIP).

A year after the institution of the no-fault statute, the Superintendent of Insurance enacted the "Additional Personal Injury Protection (APIP)" endorsement.[5] This endorsement, which gave insureds the option for more coverage, contained mandatory language to be included in any automobile insurance policy issued in the State of New York. Insureds who opted for APIP coverage would be covered for any "extended economic loss" – in other words, economic loss above and beyond "basic economic loss" that is referred to in the mandatory PIP endorsement.[6] Thus, APIP provides an insured with additional coverage for medical expenses and lost wages beyond the basic PIP.

Significantly, APIP is potentially reimbursable to the insurer while PIP, except in limited circumstances, is not. Indeed, basic PIP paid out under the mandatory endorsement is rarely recovered by the carrier. Only in extreme and limited circumstances is a carrier even permitted to recover basic PIP payments.

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One such circumstance is found in Insurance Law § 5105: An insurer pays PIP due to negligence involving a vehicle weighing more than 6,500 pounds or a vehicle used in the transportation of people for hire;[7] if one of the vehicles involved in the accident fits either of these categories, the insurer has a right of recovery.

The only other circumstance in which PIP payments are recoverable is in accidents involving a "covered person" versus a "non-covered person." Insurance Law § 5102(j) defines a "covered person" as any pedestrian injured through the use or operation of a motor vehicle or any owner, operator or occupant of a motor vehicle that has in effect the financial security required by New York State law. This would include most passenger vehicles within the state. Common exceptions would be farm vehicles and motorcycles. Another exception would be a tortfeasor involved in an automobile accident that is not operating a vehicle at all, but is, *e.g.*, a municipality against which there is an allegation of negligent road maintenance. These would be examples of "non-covered persons." Thus, in a case involving a "covered person" and a "non-covered person," Insurance Law § 5104 gives the no-fault carrier a right to sue for reimbursement and a lien on the plaintiff's recovery.

In direct contrast with the limitations on PIP recovery by the insurers, the mandatory APIP endorsement – which was included in the regulations – appears to grant broad recovery rights through subrogation to obtain reimbursement of APIP benefits paid. This mandatory subrogation clause states:

> In the event of any payment for extended economic loss, the company is subrogated to the extent of such payments to the rights of the person to whom, or for whose benefit, such payments were made. Such person must execute and deliver instruments and papers and do whatever else is necessary to secure such rights. Such person shall do nothing to prejudice such rights.[8]

Not surprisingly, the creation of this new system brought along new problems and disputes. Recently, these have focused on the area of subrogation or reimbursement for APIP benefits paid.

The common law doctrine of equitable subrogation allows the insurer to stand in the shoes of the injured party already connected in some way to the carrier and gives insurers the same rights that the insured would possess. Subrogation, in theory, attempts to prohibit a "double dip" recovery by the plaintiff. For example, if an

injured person recovers lost wages and medical payments from her APIP carrier, she should not be entitled to also recover that amount from the tortfeasor. Subrogation requires the tortfeasor to reimburse the insurer for the damages he or she had caused. A right is created for the insurer to obtain recovery as soon as the first APIP payment is paid out.

Under the doctrine of subrogation, the plaintiff who received the APIP benefits has an obligation to protect the APIP insurer's rights. This duty usually arises in settlement negotiations because the execution of a general release running in favor of the tortfeasor, by an insured who has received APIP benefits, will terminate the subrogation rights of the APIP carrier. Ideally, a plaintiff who has received APIP payments would not enter into a settlement with the tortfeasor without first notifying its APIP insurer. As its definition clearly states, subrogation allows the insurer to take on the rights of its insured and no more. Thus, a release could be fatal to an APIP carrier's right of recovery.

This dynamic presented interesting questions for courts across the state as to when the statute of limitations for an APIP subrogation action began to run.

Because an APIP carrier's right of subrogation is derived from the insured's rights and is subject to the same limitations and restrictions, this dynamic presented interesting questions for courts across the state as to when the statute of limitations for an APIP subrogation action began to run. If one adhered to the strict definition of subrogation, a right of recovery for APIP payments would always have a statute of limitations of three years and would always begin on the date of the underlying accident. A competing view was that the APIP carrier's right of recovery would exist when the cause of action accrued – in other words, when a payment was made. Initially, some Appellate Divisions held that an APIP insurer's right to recovery accrues not on the date of the accident, but on the date of first payment; but others disagreed. This issue came to a head in January 2004 when the Court of Appeals ruled on *Allstate Insurance Co. ex rel. Walker v. Stein*.[9]

Allstate v. Stein

On May 24, 1995, the plaintiff, Amy Walker, was involved in a motor vehicle accident with the defendant, Daniel Stein. Ms. Walker was seriously injured and she collected PIP benefits from her no-fault carrier, Allstate. Ms. Walker also carried APIP coverage on her vehicle. However, it was not until June 29, 1998, that Ms. Walker's no-fault carrier, Allstate, made its first APIP payment to her as a result of the accident. Allstate's first APIP payment therefore occurred three years and one month following the date of the accident.

On November 20, 2000, Allstate notified the attorneys for Walker and the tortfeasor Stein that $42,000 had already been paid in APIP benefits and that Allstate had a subrogation right in order to obtain reimbursement for these benefits. A few months later, on February 20, 2001, counsel for Walker, Stein, and Allstate all appeared before Supreme Court Justice John Lane to place a $300,000 settlement on the record relative to the underlying bodily injury claim. Allstate, not a party to the action, appeared as a courtesy to all parties to settle its APIP claim. All parties were aware that there was $1.1 million in coverage to settle all claims. The record also stated that all parties were aware of Allstate's APIP subrogation right. Justice Lane specifically said, "[A]ll three parties are saying that they intend to fully enforce their rights to the full extent of the law and the defenses they may have." Shortly after that settlement conference, the attorney for Stein sent the plaintiff, Walker, a general release along with two settlement checks. One of the settlement checks was for $200,000 and was made payable to "Amy Walker." The second check, for $100,000, was payable to the Walkers *and* Allstate Insurance Co. – an apparent attempt to tie up loose ends with the APIP claim and close the matter. However, the Walkers retained the $200,000 check, returned the $100,000 check, and filed a judgment for the latter amount against Stein. On May 4, 2001, Allstate commenced an action against the tortfeasor, Stein, seeking reimbursement of the APIP benefits paid to Ms. Walker.

In response to Allstate's action, Stein immediately moved to dismiss Allstate's subrogation action based upon the statute of limitations. Stein's main contention was that the time to bring any action for subrogation expired three years from the date of accident. The trial court ruled in favor of Allstate and dismissed Stein's motion. The Fourth Department reversed.[10]

The Fourth Department Decision

In a 3-2 decision, the Fourth Department held that Allstate's subrogation action was "governed by the same statute of limitations applicable to action number one, the personal injury action."[11] That court characterized Allstate's action as a "non-statutorily derived" subrogation action.[12] The court also adhered to the strict definition of "subrogation" and held that Allstate's claim was derivative of the underlying claim "with no enlargement or diminution of rights."[13] The Fourth Department also

had a different view of accrual; the majority characterized the lower court's ruling that accrual occurred at first payment as "erroneous."[14] The Appellate Division viewed this situation as entirely the fault of Allstate, in that Allstate should have known about this potential problem from the date of accident in 1995. In other words, Allstate should have planned for APIP recovery long before any APIP payment was even made.

The Fourth Department also took issue with the lower court's reliance on so-called "statutory recoupment" cases, in which the statute of limitations begins three years from the date of first payment. The majority refused to compare this set of facts to cases involving the Motor Vehicle Accident Indemnification Corporation (MVAIC) because, in their opinion, MVAIC was "purely a creation of statute," in contrast to APIP, which was considered optional. The Fourth Department, in its decision, specifically distinguished the Court of Appeals's decisions in *MVAIC v. Aetna Casualty & Surety Co.*[15] and *Aetna Life & Casualty Co. v. Nelson*.[16]

MVAIC v. Aetna

MVAIC v. Aetna warrants further elaboration. In 1986, the Court of Appeals was faced with essentially this same issue regarding the statute of limitations and its accrual in the context of no-fault payments. In *MVAIC*, the Court stated that the statute of limitations in an action by MVAIC to recover no-fault benefits paid is three years and begins to run upon the initial payment of those benefits.[17] In *MVAIC*, the plaintiff sought confirmation of an arbitration award ordering the no-fault insurer of the owner of a vehicle to reimburse MVAIC for benefits paid to injured passengers. At issue in the case was not only when the statute of limitations began, but whether the statute of limitations was the three-year limitation period for actions arising out of statutorily imposed or created liabilities or the six-year period for contract actions.

MVAIC contended that despite the statutory basis for its obligations and remedies under the no-fault system, the six-year contract action statute of limitations (CPLR 213(2)) applied because MVAIC had stepped in to fulfill an insurance carrier's obligations under its contract of insurance covering the accident, in other words, the payment of first-party benefits to the insured passengers in that vehicle.[18] MVAIC argued that CPLR 213(2) governed because its rights against that carrier were grounded in quasi-contract indemnification.

In contrast, Aetna, the carrier for the vehicle, contended that the applicable statute of limitations was set forth in either CPLR 214(2), the three-year statute of limitation period arising out of liabilities created or imposed by statute, or CPLR 214(5), a three-year limitation period for actions to recover damages for personal injury. In either case, Aetna maintained that MVAIC's right to recover payment of no-fault benefits was in the nature of subrogation and thus MVAIC could only assert the rights each injured party was entitled to assert against the primary insurer. Aetna contended that because the covered parties' claim arose as a result of the injuries they sustained in the accident, MVAIC's cause of action accrued upon the date of accident.

After examining New York State public policy and applicable case law, the Court of Appeals concluded that MVAIC was entitled to recover payments of no-fault benefits from the primary insurer and that the three-year limitation period of CPLR 214(2) controlled because the liability was created or imposed by statute.[19] The Court of Appeals further stated that the statute of limitations began to run against MVAIC upon the initial payment to the claimant.[20] The Court wrote that a statute of limitations is triggered once a cause of action accrues, which is "when all of the facts necessary to the cause of action have occurred so that the party would be entitled to obtain relief in court."[21] The Court's reasoning appeared to be that when MVAIC made its first payment to the claimant, it was only at that point that all the facts necessary to afford MVAIC a right to recovery were in existence.

The Court in *MVAIC* relied heavily on the opinion of *Aetna Life*, which was also decided in 1986. In *Aetna Life*, the insurer sought to recoup first-party no-fault benefits that it had previously paid to its insureds, by enforcing a statutory no-fault lien against the portion of damages Aetna's insureds received as settlement for losses paid by Aetna under Insurance Law § 5104(b).

Initially, the Court had to determine whether the statute of limitations was three years pursuant to CPLR 214(2), dealing with liabilities created or imposed by statute. The Court stated that CPLR 214(2) only governs liabilities that would not exist but for a statute.[22] The provision does not apply to liabilities existing in common law that have been recognized or implemented by statute. The Court then examined the Insurance Law and no-fault scheme it created and concluded that no-fault modifies the common-law system of reparation for personal injuries under tort law because first-party no-fault benefits are a form of compensation unknown in common law, resting on predicates independent of the fault or negligence of the injured party. Thus no-fault law cannot be held to codify common law principles.[23]

Instead, no-fault creates new and independent statutory rights and obligations in order to provide a more efficient means for adjusting financial responsibilities arising out of automobile accidents. Thus, the option available to the insured to recoup amounts paid as first-party benefits, as Aetna was trying to do, created new liabilities subject to the three-year statute of limitations of CPLR 214(2).

After holding that the applicable statute of limitations was three years, based on CPLR 214(2), the Court of Appeals noted that the question was not when the lien

belonging to Aetna first attached, or when the insurer could have established the lien, but rather when the insurance company first had the opportunity to enforce or foreclose the lien and actually recover from the defendants the amounts it had previously paid to them as first-party benefits under the no-fault law.

The Court ultimately held that Aetna's time to commence its action began when it had its opportunity to enforce the lien. This holding, along with the Court's holding in *MVAIC*, essentially meant that where reimbursement for no-fault benefits is sought, the statute of limitations is three years from the date the cause of action accrues; in other words, when all of the facts necessary to that cause of action have occurred.

Cardinell v. Allstate Insurance Co.

The majority of the Fourth Department in *Allstate* also chose to disregard the Third Department case of *Cardinell v. Allstate Insurance Co.*[24] The Fourth Department stated that *Cardinell* erroneously relied on a statutory recoupment case in its decision. The Third Department in *Cardinell* had held that an insurer's subrogation claim arising out of APIP payments accrues on the date of first payment. The Third Department also relied heavily on the Court of Appeals decision in *MVAIC.*

Fourth Department Dissent

The dissenting opinion of the Fourth Department in *Allstate* adhered to the reasoning of *MVAIC*, *Aetna*, and *Cardinell*, and agreed with the trial court's ruling that Allstate's action was timely commenced. The dissent based its opinion on the general principle that "a cause of action accrues, for the purpose of measuring the period of limitations, when all of the facts necessary to the cause of action have occurred so that the party would be entitled to obtain relief in court."[25] This definition of accrual, the dissent points out, is not simply limited to statutory recoupment cases, but to all cases.

The dissent in the Fourth Department provided an excellent description of the paradox APIP insurers face. If Allstate's right of subrogation is dependent on an APIP payment, how can its statute of limitations begin to run before any such payment is ever made? The majority's proposal that Allstate should have commenced a preemptive subrogation action would be "a waste of judicial resources"[26] according to the minority, not to mention a logistical nightmare for insurers all over the state.

The Court of Appeals Decision

Allstate appealed as of right to the Court of Appeals. In a unanimous decision, the Court of Appeals affirmed the Fourth Department's holding, stating that the statute of limitations began to run on the date of accident and not the date of first payment.[27] Within its opinion, the Court carefully distinguished *Allstate*'s set of facts from those of *MVAIC* and *Aetna*. *Allstate* ultimately turned on the question of whether the APIP subrogation right asserted by Allstate was a "creature of statute."[28] If it was, *MVAIC* and *Aetna* would apply and the statute of limitations would begin at first payment. The Court stated, however, that the *Allstate* case was different from *MVAIC* and *Aetna* because it involved a "traditional equitable subrogation, not a liability created by statute."[29]

In its brief and at oral argument, Allstate based its reasoning largely on the fact that APIP benefits were created solely through New York State Insurance Regulations. Allstate referred specifically to the additional personal injury protection endorsement, which is set forth at 11 N.Y.C.R.R. § 65-1.3. This endorsement contains mandatory language to be included in any automobile insurance policy issued in the state of New York.

Allstate further argued that as a result of these insurance regulations, a subrogation right had been created that previously did not exist in common law. This right, Allstate contended, allows the insurance carrier that pays out APIP benefits to be subrogated to its insured and to obtain reimbursement from the tortfeasor responsible for the loss. Just as in the Court of Appeals cases of *MVAIC* and *Aetna*, the liability and this particular right of subrogation only existed because of the no-fault law; this is an obligation created by statute and is therefore governed by CPLR 214(2) for APIP benefits. Despite the fact that Allstate's subrogation right in *Allstate Insurance Co. ex rel. Walker v. Stein* was created by regulation, the Court of Appeals refused to acknowledge that it was statutorily derived, and instead referred to it in terms of basic common law subrogation. APIP has no basis in any statute and is only referred to in an Insurance Department Regulation.

The Court's reasoning was that the Insurance Regulation does not create a new right that did not exist at common law, but instead merely prescribes the form of a clause that declares Allstate's pre-existing right. The Court stated that even if there was no applicable regulation or clause in an insurance policy, the right of subrogation would still exist. The doctrine of subrogation has been around for years and was not, in the words of the Court, "a recent invention of the Insurance Department."[30]

According to the Court, the situation Allstate faced was one of the risks inherent with subrogation. Subrogees are limited to only those rights the subrogors possess. If the subrogee's claim is defeated by a subrogor's action or inaction, as was the case with Allstate, then it is one of the risks the insurer assumed.

The Court also supported the Fourth Department's holding that Allstate should have somehow "insisted" on the resolution of its claim during the underlying personal injury settlement.[31] The Court did not explain, however, how an APIP insurer could insist on a settlement when

technically it is not a party to the underlying lawsuit. The Court seemingly ignored the fact that Allstate was not required to be at the settlement table in the lower court and was only there as a courtesy.

Impact of *Allstate v. Stein*

The decision in *Allstate v. Stein* restricts insurance carriers in their ability to obtain reimbursement for any APIP benefits paid. Clearly, the Court of Appeals recognized Allstate's reimbursement right and did not deny its existence. However, according to *Allstate v. Stein*, Allstate should have attempted to obtain reimbursement for monies it had not yet paid out from the tortfeasor in the underlying bodily injury action. The Court does not explain how Allstate was to accomplish this. It of course would have been problematic for Allstate to attempt to obtain reimbursement from the tortfeasor and his or her insurance carrier for amounts that had not been paid in the form of APIP benefits while Allstate had a ripe APIP claim.

How might a carrier, facing an approaching statute of limitations, which had not yet made an APIP payment when it was obvious it would occur, "insist on a settlement of its case"? It would have been highly unlikely for State Farm, the tortfeasor carrier in *Allstate*, to agree to settle with Allstate for a hypothetical or potential APIP subrogation claim that had not yet actually materialized. Yet, the suggestion seems to be that this is what Allstate and, presumably, any APIP carrier, must do. Further, it appears the fact that an APIP reimbursement claim is against the *tortfeasor* and not the APIP insured was overlooked; the claim in fact is not a lien on the APIP insured/plaintiff's recovery.

How might a carrier, facing an approaching statute of limitations, which had not yet made an APIP payment when it was obvious it would occur, "insist on a settlement of its case"?

Therefore, an APIP carrier faced with an uncooperative plaintiff's attorney and tortfeasor carrier will not be in a position to insist on anything. If its cause of action is still alive, it can commence its own action as Allstate did in *Allstate v. Stein*. Naturally, if no payment has been made and the statute of limitations has nearly run, there is little the APIP carrier can do in light of *Allstate v. Stein*.

Insurers are today left with many unanswered questions. Most obvious is, what is the value of a right of recovery if it expires before payment is made? What could Allstate and other APIP insurers have done to guarantee reimbursement? The Court in *Allstate*, while referring to the Fourth Department opinion, stated that Allstate "failed to insist on the resolution of its subrogation claim against the tortfeasor for APIP payments as part of a global settlement of the personal injury claims."[32] This could appear to give APIP insurers the option of commencing an action within three years from the date of the accident and before an APIP payment is ever made. An action such as this could perhaps take the form of a declaratory matter and request that a court determine that the APIP insurer does, in fact, have a right for reimbursement. Of course, such an action would face arguments that it was not ripe or that there was no judiciable controversy.

In a hypothetical scenario, where PIP payments were at $45,000 and a three-year statute of limitation is winding down, it would be wise and essential for the APIP insurer to commence an action for APIP recovery. If any attorney objected regarding the ripeness of such a claim, the APIP insurer may rely on the *Allstate* decision. Commencing an action, even before any APIP payment is made, is one way of "insist[ing] on the resolution of its subrogation claim."[33]

From a policy standpoint, APIP coverage as a whole requires a re-evaluation by its providers. APIP coverage, which has always been seen as recoverable by the insurers, will now be regarded as somewhat of a gamble. This could ultimately raise premium rates and make APIP coverage more expensive. The *Allstate* decision should also force insurance companies to petition for a change in the law. Lobbying the Superintendent of Insurance for a change in the regulations or the New York State Legislature for an amendment to the CPLR could help solve this problem and curtail the commencement of potentially hundreds of declaratory actions by APIP insurers.

What alternatives are used and how insurance companies confront this problem remain to be seen. What is certain is that as a result of the *Allstate* decision, APIP insurers need to be alert and vigilant.

The lawyer, both plaintiff and defense, must also be extremely cautious when handling cases involving APIP benefits. From the plaintiff's perspective, the attorney must be careful when settling the case to resolve any outstanding APIP issues. An execution by the plaintiff of a general release in favor of the tortfeasor will extinguish any subrogation right that the APIP carrier may have against the tortfeasor. The regulation also requires an APIP recipient to protect the APIP carrier's subrogation rights. A plaintiff/APIP recipient that does not do so

could wind up a defendant in a subsequent lawsuit by the APIP carrier. Counsel for the plaintiff may also become a named defendant.

For example, if the plaintiff's counsel knows that his or her client has been receiving APIP benefits and is aware that the statute of limitation remains alive for the recoupment of APIP benefits by the APIP carrier, and if a case is settled without taking into consideration a resolution of the APIP issue, the APIP carrier may commence an action against both its insured and the plaintiff's counsel. This is because the general release given to the tortfeasor prevents the APIP carrier from commencing its own action against the tortfeasor.

Plaintiffs' attorneys must be quite cautious in resolving a case to avoid becoming a defendant in a subsequent lawsuit with the APIP carrier.

The plaintiff's counsel should also be cautious in resolving a case, particularly when, as often happens, the plaintiff's counsel takes responsibility for satisfying any "liens" or rights of reimbursement. While APIP certainly does not create a lien, it is a reimbursement right. A plaintiff's attorney who promises the tortfeasor, either in writing or on the record, to "take care of" a reimbursement right could potentially be held responsible for the APIP carrier's claim.

On the defense side, an attorney representing an insured defendant must also be vigilant. Because the defense attorney's client is the insured and not the tortfeasor carrier, a defense attorney must keep in mind that any potential APIP claim would be against his or her client. If the tortfeasor carrier is paying its entire insurance policy to the injured party, then potentially the tortfeasor himself or herself would be personally responsible for any eventual APIP claim made by the APIP carrier. Defense counsel should make every effort, therefore, to resolve both a viable APIP claim when the underlying claim between the injured plaintiff and the tortfeasor is being negotiated.

Where the tortfeasor carrier is not paying its entire policy to the injured party, defense attorneys will of course want to avoid the need to advise the client that the APIP carrier has now commenced a lawsuit for APIP benefits in a case the carrier believed was resolved.

In conclusion, APIP benefits are a complicating factor in every personal injury lawsuit. From the insurance carrier's perspective, APIP benefits provide a limited right of recovery in relation to a tortfeasor. However, given the fact that the statute of limitations starts to run from the date of the underlying accident as opposed to first payment, such a right of recovery can, unfortunately (from the carrier's perspective) end before it has even begun. APIP insurance carriers must be proactive in resolving any APIP claim. An APIP issue must be made known early and often in any underlying personal injury lawsuit. An APIP carrier should participate in any settlement discussions and advise the court of the existence of an APIP claim or potential APIP claim.

Plaintiffs' attorneys must be quite cautious in resolving a case to avoid becoming a defendant in a subsequent lawsuit with the APIP carrier. The defense attorney as well must remember that his or her client is the insured and that a resolution of any bodily injury case against the client must also include a resolution of any APIP claim; otherwise such a claim would also be against the insured and if there is limited insurance coverage, the insured would be personally responsible in such a situation.

If one is aware of one's rights and responsibilities in an APIP situation, the potential pitfalls can usually be avoided. ■

1. N.Y. Insurance Law § 5102 ("Ins. Law").
2. *Motor Vehicle Accident Indemnification Corp. v. Aetna Cas. & Sur. Co.*, 89 N.Y.2d 214, 222, 652 N.Y.S.2d 584 (1996) (hereinafter "*MVAIC*").
3. Ins. Law § 5102.
4. *Id.*
5. 11 N.Y.C.R.R. § 65-1.3.
6. 11 N.Y.C.R.R. § 65-1.1.
7. Ins. Law § 5105.
8. 11 N.Y.C.R.R. § 65-1.3
9. *Allstate Ins. Co. ex rel. Walker v. Stein*, 1 N.Y.3d 416, 775 N.Y.S.2d 219 (2004).
10. *Allstate Ins. Co. ex rel. Walker v. Stein*, 305 A.D.2d 972, 758 N.Y.S.2d 451 (4th Dep't 2003).
11. *Id*. at 974.
12. *Id.*
13. *Id.*
14. *Id.* at 975.
15. *MVAIC*, 89 N.Y.2d 214.
16. 67 N.Y.2d 169, 501 N.Y.S.2d 313 (1986).
17. *MVAIC*, 89 N.Y.2d at 222.
18. *Id.* at 220.
19. *Id.* at 221.
20. *Id.*
21. *Id.*
22. *Aetna Life & Cas. Co.*, 67 N.Y.2d at 174.
23. *Id*. at 175
24. 258 A.D.2d 853, 686 N.Y.S.2d 155 (3d Dep't 1999).
25. *Allstate Ins. Co. ex rel. Walker*, 305 A.D.2d at 977.
26. *Id.*
27. *Allstate Ins. Co. ex rel. Walker*, 1 N.Y.3d at 422.
28. *Id.* at 421.
29. *Id*. at 422.
30. *Id.*
31. *Id.* at 423.
32. *Id.*
33. *Id.*

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The Other Shoe

IRS Begins Enforcement Action Under Offshore Credit Card and Financial Arrangement Probe

By Richard E. Andersen

Beginning in the early 1980s, the Internal Revenue Service became worried about the use of offshore tax and financial privacy havens by U.S. persons to evade their federal tax obligations, a concern that has grown over the succeeding two decades and is now shared by other institutions, including the Organisation for Economic Co-Operation and Development. A major problem is credit and debit cards issued by offshore financial institutions through the major card providers to permit U.S. individuals to covertly access concealed overseas assets.

After a well-publicized effort to delineate the scope of the problem and to encourage voluntary compliance through the use of a limited tax amnesty period, the IRS has moved to a more aggressive strategy in its campaign against the unlawful use of offshore cards and financial accounts. This new phase involves direct action against individual U.S. taxpayers whose names came to the attention of the IRS during the earlier stages of the probe. Affected taxpayers must take action that is both prompt and well thought out in order to respond appropriately if they receive notice from the IRS that they have become a target. This article lays out the current state of play and provides a framework for making good tactical and strategic decisions when faced with such a notice.

Background

Before enactment of the USA Patriot Act of 2001, the federal government had two principal methods of policing the money laundering rules and the related requirement that U.S. taxpayers report their worldwide income:

1. The Bank Secrecy Act, requiring (a) financial institutions to report currency transactions of over $10,000 on BSA Form CTR 104, and (b) separate annual disclosure by account holders of all overseas financial accounts over which they have signature authority on Form TD F 90-22.1; and
2. The Internal Revenue Code, under which (a) a U.S. taxpayer must check a box on Schedule B of Form 1040 disclosing the existence of an overseas financial account and (b) whoever controls a foreign corporation must attach IRS Form 5471 to the return.

By the year 2000 it was clear that these methods were not effective. Large bank transfers were being divided and re-routed through multiple accounts so as to avoid triggering the $10,000 threshold for reporting under the Bank Secrecy Act; and in the absence of effective exchange of information arrangements with bank secrecy havens, the IRS was largely powerless to monitor compliance with the requirements of the Code and the Bank Secrecy Act.[1]

Between 2000 and 2002, the IRS raised the ante. It obtained court approval to issue so-called "John Doe" summonses against several card issuers requiring them to disclose U.S. participants in offshore credit card arrangements with banks in several Caribbean Basin nations. As a result of this probe, the IRS estimated that over one million U.S. individuals may have improperly used credit cards issued by offshore banks to conceal reportable income.

Phase One: The OVCI

In order to validate the information in its possession, expand the scope of its investigation and obtain tax revenue from delinquent taxpayers, while using a minimum of enforcement resources, in early 2003 the IRS announced a new program called the Offshore Voluntary Compliance Initiative (OVCI).[2] Under OVCI, a taxpayer who came forward to disclose unreported income or impermissible deductions associated with the use of offshore cards or accounts would be required to pay the delinquent tax with interest and could be subject to the delinquency- or accuracy-related penalties, but would generally not face either the civil fraud penalty or criminal prosecution. Participation in the OVCI also meant that the taxpayer had to turn over all records of the arrangement, thereby assisting the IRS in locating other promoters or delinquent taxpayers.

At the time of its expiration in April of 2003, the OVCI had generated only about 1,300 applications – a tiny minority of the number of U.S. taxpayers estimated to be involved in offshore card schemes. One can only assume that the remainder was either unaware of the initiative or decided to play the "audit lottery." The consequences are about to be felt.

Phase 2: The LCCI

As a "carrot-and-stick" technique to make enforcement more efficient, while locating more potential delinquent taxpayers, the IRS instituted an unofficial policy referred to obliquely in the Internal Revenue Manual as the "Last Chance Compliance Initiative" (LCCI). As part of the initial notice and information document request (IDR) to a taxpayer, informing the taxpayer of an investigation of an offshore card or account ("LCCI Notice"), the IRS is making a time-limited offer to cap the civil penalties that may be asserted in exchange for, in effect, the taxpayer's capitulation on the liability issue, cooperation in determining the amount of the delinquency, and assistance in locating promoters of the scheme in which the taxpayer participated.

Specifically, the LCCI Notice contains an offer to limit civil penalties (where they would otherwise be appropriate) and to impose the civil fraud penalty[3] with respect to only one year – the year to which the largest delinquency is attributable. In addition, the monetary penalty for failure to file Form TD F 90-22.1[4] will be imposed on only one year's failure. The delinquency- and accuracy-related penalties may be imposed for any year. The taxpayer's cooperation in determining the amount of the underpayment and associated interest, as well as complete disclosure of all documents and information in the taxpayer's possession related to the offshore card scheme, is a condition of the offer.

A sample LCCI Notice – taken from an actual example, but modified to protect taxpayer confidentiality – appears on page 33.

Significantly, there is no mention of any limitation on the ability of the IRS to make a criminal referral, even where the taxpayer has timely accepted an LCCI offer and has complied with all of its requirements. Certain practitioners appear to take the view that acceptance of the offer should protect the taxpayer from criminal prosecution, and it is certainly the case that (1) acceptance of the offer lowers the agency's incentive to make a criminal referral and (2) there are arguments that such a referral should not be permitted under traditional customs and practices. However, the author believes it would be a dangerous mistake to assume that acceptance of the LCCI offer, by itself, will take the possibility of criminal prosecution off the table: rather, the process of dealing with the IRS after receiving an LCCI Notice must be designed with a view to ascertaining the agency's appetite for a criminal referral and the ways the IRS might be persuaded to back away from pursuing that option.

As a result of this probe, the IRS estimated that over one million U.S. individuals may have improperly used credit cards issued by offshore banks to conceal reportable income.

Taxpayer Options

Taxpayers who participated in arrangements involving offshore payment cards or financial accounts and who did not take advantage of the OVCI amnesty are faced with two choices:

1. Making a full voluntary disclosure of their involvement to the IRS before they come up for examination, or
2. Responding to an LCCI Notice if and when they receive one.

Voluntary disclosure can be an appealing option, even though it provides somewhat less comfort than participation in the OVCI would have. However, as a practical matter, coming forward in compliance with the current IRS standards for voluntary disclosures generally takes criminal prosecution off the table (unlike what may be the

case under the LCCI). Given that, and aside from being a likely breach of a taxpayer's legal obligations, the "audit lottery" route is unwise where, as here, the issue is high on the IRS priority list and third-party record-keepers are cooperating with the IRS investigation.

If, however, an LCCI Notice is received prior to a voluntary disclosure being made, prompt action is required to determine whether to accept the LCCI offer. If in a specific case the taxpayer believes that the IRS has the facts wrong or that there are particular legal impediments to IRS enforcement, the taxpayer may choose to reject the offer and defend the audit in the traditional manner. In other cases it is imperative to determine whether the revenue agent in charge of the investigation is thinking about a potential criminal referral and whether that possibility can be foreclosed by accepting the LCCI offer. Early involvement of counsel is critically important, both to try to avoid criminal action and to preserve defenses and possible privileges.

Conclusion

It seems clear that the IRS focus on offshore card arrangements is not going to fade any time soon. Taxpayers who became involved – even in good faith – in such arrangements that are now in the agency's crosshairs should begin evaluating their options and seeking professional guidance at the earliest possible moment. ■

1. The IRS has, in fact, signed a number of exchange-of-information agreements with such jurisdictions in more recent years. The author's own experience in negotiating the terms of such an agreement with the Treasury Department on behalf of a foreign country suggests that the offshore credit card problem was a significant factor in the federal government's heightened interest in concluding such agreements with Caribbean Basin and other bank secrecy havens.

2. News Release, IR 2003-5, 2003 WL 122411 (Jan. 14, 2003). Many of the characteristics of the OVCI were set out shortly thereafter in Rev. Proc. 2003-11, 2003-1 C.B. 311.

3. The civil fraud penalty is 75% of the underpayment. I.R.C. § 6663.

4. This penalty is greater of (1) $25,000 or (2) the highest balance in the account for the year, capped at $100,000. 31 C.F.R. § 103.57(g).

Sample LCCI Notice

Internal Revenue Service

Department of the Treasury

Taxpayer Identification Number:
000-00-0000

Person to Contact:
Theophilus P. Coleslaw

Contact Telephone Number:
(000) 000-0000

Date: June bb, 200z

Employee Identification Number:
00-00000

Refer Reply to:
Internal Revenue Service
XX:X:X:XXX:Anywhere:XX

John Public
000 Taxpayer Avenue
Anywhere, ZZ 12345

Appointment Date and Time:
July aa, 200_ @ 9:00 am

Appointment Location:
000 Agency Boulevard, Anywhere, ZZ 12345

Dear Mr. Public:

We have selected you for examination because you were involved in financial transactions and maintained foreign bank account(s) in a tax haven country with financial secrecy laws. Although this letter does not include all of the information that we have obtained about your offshore activities, we do have information that you had signature authority over the following:

- Credit Card Brand
- Account Number 0000-0000-0000-0000
- Issued By: Offshore Bank Ltd.

Our records indicate that you did not disclose the existence of any foreign bank accounts on your income tax returns, nor did you file any Forms TD F 90-22.1, *Reports of Foreign Bank and Financial Accounts (FBARs)*. Failure to file an FBAR where one is due can carry a penalty of at least $25,000 for each violation, in addition to whatever income tax, penalties and interest may be due for failing to report transactions related to the accounts.

Before conducting the examination, we are giving you an opportunity to minimize your exposure to penalties. In exchange for complete information about any unreported offshore activity, including correct amended or delinquent returns for all tax years ending after December 31, 200t, we are willing to limit the fraud penalty to one year and the FBAR penalty to one year, if those penalties are determined to apply. The full details of this offer are set forth in the attached Notice 1341, *Terms of Last Chance Offer*, which we have enclosed for your convenience. Because certain individuals are ineligible to accept this offer, please read the "Eligibility" section of Notice 1341 carefully to see if you qualify.

If after reading the terms of this offer you wish to resolve your case on this basis, you must advise me of your intent to do so ***in writing within 15 days of the date of this letter***.

We have scheduled an appointment for you at the place and time indicated above. If you accept this offer, the purpose of the meeting will be to discuss the specifics of resolving your case. If you do not accept this offer, the purpose of the meeting will be to commence the examination. We have enclosed Form 4564, *Information Document Request (IDR)*, to help you prepare for the examination. If you decide not to accept the offer to resolve your case, you should bring the information and documents indicated in the enclosed Form 4564 to the appointment referenced above.

If you have questions about the terms of this offer, please call me at the number indicated above. **If we do not hear from you within 15 days of the date of this letter this offer is withdrawn**.

[The IDR accompanying the letter generally requests, among other items, copies of the following information covering a period of between one and four years: (1) individual tax returns filed, and information returns received (on Form 1099), by the taxpayer; returns filed by partnerships where the taxpayer was a general partner or a "tax matters partner"; (2) returns for US and foreign corporations that were more than 50%-owned by the taxpayer; (3) returns for trusts or estates where the taxpayer was a fiduciary or a beneficiary; (4) all financial statements prepared by or for the taxpayer for any purpose; monthly statements for all bank accounts and CDs over which the taxpayer had signing authority; (5) records of wire transfers in and out of those accounts, checks written from one such account and deposited into another, correspondence with banks concerning such accounts; (6) documentation regarding non-taxable cash receipts, such as gifts and loans; and (7) records relating to all credit cards used by the taxpayer. In addition, the IDR asks for a schematic of all entities in which the taxpayer held an ownership interest (legal or beneficial) during the period; a list of all private bankers, brokers and other financial consultants or advisers used by the taxpayer; and a list of all payments (including payment details) of salaries, fees, rents, insurance premiums and the like made by the taxpayer during the period.]

What Makes a Case "Exceptional"?

Awarding Attorney Fees in Trademark Litigation

By Lara A. Holzman, Sarah C. Hsia, and Philippe Bennett, with additional research assistance by Michael S. Burns

There are certain statutory exceptions to the "American" rule in litigation that each party is responsible for paying its own attorney fees, regardless of who prevails.[1] One such exception is set forth in § 35 of the Lanham Act,[2] which provides that "[t]he court in *exceptional* cases may award reasonable attorney fees to the prevailing party."[3]

The "exceptional" standard is subjective, and has forced courts to develop their own standards and guidelines for what kind of conduct makes a case eligible for the award of attorney fees to a prevailing party. The legislative history of § 35 provides some basic guidance, stating that an exceptional case is one "where the act of infringement can be characterized as 'malicious,' 'fraudulent,' 'deliberate,' or 'willful'" or "when equitable considerations justify such awards."[4] But, because there is no bright-line test for conduct that sinks to such a level as to make a case exceptional, different courts have taken different approaches, which has resulted in inconsistent holdings across circuits.[5]

The determination of whether a case is exceptional is left to the trial court judge's discretion.[6] The prevailing party must demonstrate the exceptional nature of the case by "clear and convincing evidence."[7] An appeal from an award of attorney fees is generally reviewed on an abuse-of-discretion standard.[8] On appellate review, a district court's determination may be set aside if it fails to articulate the reasoning behind its award, unless the record supports the district court's decision.[9]

The "Bad Faith" Requirement

Because the legislative history of § 35 of the Lanham Act mentions willfulness as a type of infringement that can be characterized as exceptional, some courts have awarded attorney fees merely upon a showing of willful or intentional infringement.[10] Most courts, however, require a showing of more than just willful infringement. There is usually an additional showing of culpable conduct akin

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to *malice*, *fraud* or *bad faith* on the part of the losing party when attorney fees are awarded.[11] This additional culpable conduct does not necessarily have to be connected to the infringing activity; instead, it can be malicious or oppressive litigation tactics or other bad behavior on the part of the losing party. Some courts have even gone so far as to classify a case as exceptional if there is any type of culpable conduct on the part of the losing party, even if there is no finding of willful infringement.[12]

Type of Misconduct

The courts, thus, consider a wide variety of behavior in making the determination as to whether a case is exceptional. Often, it is the exceptional nature of the infringing activity itself that gives rise to the award of attorney fees.[13] Courts have found a case to be exceptional where, prior to adopting a mark, an accused infringer did not search and clear the mark for use.[14] Many courts have found cases to be exceptional where the accused infringer continues to violate the trademark owner's rights after the infringer has been put on notice that its conduct violates the Lanham Act.[15]

More often than not, it is a combination of bad acts on the part of the infringer that warrants an award of attorney fees. For example, the First Circuit awarded attorney fees to the plaintiff in *Tamko Roofing Products, Inc. v. Ideal Roofing Co.*, based on a combination of the defendant's willful behavior in connection with the infringement and its bad-faith conduct after receiving notice of the infringement. This included, among other things, failing to clear the mark, using a similar stylized format for the mark, violating settlement terms, and ignoring the court's preliminary injunction.[16] And at least one court has found that reverse passing off – *i.e.*, where a defendant passes off the plaintiff's products as those of the defendant – is more egregious than passing off, as reverse passing off involves "actual theft" and thus clearly qualifies as exceptional.[17]

Attorney fees can also be awarded based merely on the parties' conduct during litigation. For example, in the Southern District of New York, as well as in several other Circuits,[18] the failure to appear, answer or participate in discovery, permits a court to infer willfulness and demonstrates bad faith so as to warrant an award of attorney fees to the prevailing party.[19] Additional types of bad-faith conduct during litigation can also provide cause for a court to find that a case is exceptional. For example, where a party gives false testimony, disobeys a court order, commits discovery abuse or has engaged in vexatious litigation, attorney fees have been awarded, even though the infringement itself did not provide a basis for a finding of an exceptional case.[20] In another action, despite a jury finding of no bad-faith infringement on the part of the defendants, the court awarded attorney fees to the plaintiff, based on the defendants' making false testimony, ordering a look-alike product, failing to obtain an opinion of counsel, avoiding discovery, intentionally failing to keep financial records and continuing to sell the infringing product for two years after the lawsuit was initiated.[21]

Often, it is the exceptional nature of the infringing activity itself that gives rise to the award of attorney fees.

Facts that warrant *against* an attorney fee award include:

- the area of law is unclear;
- defendants have a reasonable belief that they do not infringe;[22]
- there is a close legal question as to whether infringement exists;[23]
- the defendant relied upon advice of counsel;[24]
- there was no intention to deceive the public;[25]
- there was a concerted effort to create a non-infringing mark;
- the plaintiff suffered no damage.[26]

Yet the existence of some or all of these factors is not determinative.[27] It is the totality of the circumstances surrounding the infringing activity, and the parties' conduct in connection with the lawsuit, that is examined to determine whether a case is exceptional.[28]

Damages Required?

The test for whether a case is exceptional tends to overlap with the evaluation of whether damages should be awarded and trebled under § 35 of the Lanham Act. While many courts agree that damage, or the lack thereof, is an important consideration in making a determination of an exceptional case under the statutes, in several circuits a showing of damage is not required for the court to award attorney fees.[29]

For example, in *Post Office v. Portec, Inc.*, the Tenth Circuit awarded attorney fees to the prevailing plaintiff, despite the jury's failure to award any damages on the Lanham Act claim, citing the jury's finding of willful and intentional infringement sufficient to render the case exceptional.[30] Likewise, the Southern District of New York in *Fruit of the Loom, Inc. v. American Marketing Enterprises, Inc.*, stated that "the failure to prove actual damages does not preclude an award of attorney's fees."[31]

However, some courts maintain that the lack of damage is germane to the basic determination of whether a case is exceptional. In *CJC Holdings, Inc. v. Wright & Lato, Inc.*, the Fifth Circuit cited the lack of proof of damage in upholding the district court's determination that the case was unexceptional, despite deliberate copying.[32] Likewise, the Sixth Circuit has found that where there

was "no loss of sales due to the infringement," the district court did not abuse its discretion in finding the case unexceptional and denying the award of attorney fees.[33] It remains to be seen in these circuits whether a lack of proof of damage in cases involving other conduct that is generally found to be exceptional, like litigation misconduct, would preclude recovery of attorney fees.

Prevailing Defendants Can Also Be Awarded Attorney Fees

An award of attorney fees is not limited to prevailing plaintiffs. The legislative history of § 35 of the Lanham Act indicates that fees are not only intended to fully compensate certain victims of infringement, but also to afford protection to defendants "against unfounded suits brought by trademark owners for harassment and the like."[34] Some courts interpret this legislative history to provide relief to prevailing defendants only when it can be shown that the plaintiff brought or litigated the suit in bad faith.[35] Other courts do not necessarily require such a finding of bad faith, but instead examine other independent factors such as the merits of the lawsuit.[36]

In analyzing a prevailing defendant's claim for attorney fees, the District of Columbia Circuit has held that a defendant was subjected to "harassment," and thus entitled to attorney fees, where the plaintiff brought suit in a distant forum, 3,000 miles from the infringing activity, and ignored controlling case law as to the impropriety of such action.[37] The Eighth and Ninth Circuits ask whether a plaintiff's claim is "groundless, unreasonable, vexatious, or pursued in bad faith."[38]

The Tenth Circuit adopts a more holistic approach, looking to "the plaintiff's conduct in bringing the lawsuit and the manner in which it is prosecuted" to determine if a case is "exceptional" within the meaning of the statute.[39] For example, in *National Ass'n of Professional Baseball Leagues, Inc. v. Very Minor Leagues, Inc.*, the Tenth Circuit took into consideration a lack of foundation for the suit, the plaintiff's bad faith in bringing the suit, the unusually vexatious and oppressive manner in which the suit is prosecuted, as well as other reasons.[40] The court held that the plaintiff's claims were not unfounded in that some evidence of similarity of marks and confusion was proffered. Additionally, the suit was not harassing even though it was filed in Florida but ultimately transferred to another venue. The court also found that the initiation of the lawsuit, despite an ongoing Trademark Trial and Appeal Board proceeding, was not harassing.[41]

Similarly, vexatious litigation tactics on the part of a plaintiff were held to warrant an attorney fee award to a defendant in the Third Circuit.[42] A finding of culpable conduct on the part of a plaintiff "necessarily center[s] on the act of filing the lawsuit and on the plaintiff's litigation tactics."[43] "The court should consider both the objective merits of plaintiff's action . . . and the plaintiff's subjective conduct throughout the litigation. The plaintiff does not need to have acted in bad faith . . . though bad faith is an appropriate factor to consider."[44]

The Seventh Circuit adopts the idea that a defendant must prove that the plaintiff's claim was "oppressive," a standard that falls between bad faith and deliberateness. Oppressive suits are "something that might be described not just as a losing suit but as a suit that had the elements of abuse of process."[45] A suit can also be oppressive because of lack of merit or cost of defense.[46]

Fees are not only intended to fully compensate certain victims of infringement, but also to afford protection to defendants "against unfounded suits brought by trademark owners for harassment and the like."

Even in the Second Circuit, where a showing of "fraud or bad faith" is required to obtain fees under the Lanham Act, "where . . . the prevailing party is a defendant, the cases demonstrate that the plaintiff's pursuit of patently frivolous claims is circumstantial evidence of bad faith."[47]

The Fifth Circuit at one point seemed to require a showing of bad faith on behalf of the plaintiff for a prevailing defendant to recoup attorney fees; however, in a later decision, the court instructed the district court to "consider the merits and substance of the civil action when examining the plaintiffs' good or bad faith."[48] Clearly, among the circuits that do not require a showing of fraud or bad faith, the standard varies significantly, and an award of attorney fees to a prevailing defendant lies squarely within the discretion of the court.

Subsequent History

In *Tamko Roofing Products, Inc. v. Ideal Roofing Co.*,[49] the court addressed the issue of whether attorney fees should be awarded to a prevailing party for an appeal when that same party was awarded attorney fees at the district court level because the case was found to be exceptional. The First Circuit Court of Appeals established a middle ground between the appellee's argument that such an award should be automatic and the appellant's argument that the appeal must be frivolous in order to warrant a fee award. Accordingly, the court in *Tamko* concluded that, in

making this determination, the court should assess and weigh the following factors: whether the appeal was on issues different from those that caused the trial court to find the case exceptional; the strength of the appellate issues; the extent the appeal prolonged, without justification, a particularly bad exceptional case; and whether the losing party's position on appeal "appears to be of a whole with the earlier 'malicious, fraudulent, deliberate or willful' acts of infringement or is otherwise inequitable."[50] In *Kellogg Co. v. Toucan Golf, Inc.*, the Sixth Circuit held that any claim for attorney fees cannot be raised for the first time on appeal; if the issue is not raised with the district court, it is waived.[51]

Conclusion

Although there is no guarantee, to avoid paying an adversary's attorney fees if you lose a Lanham Act case (or to attempt to collect attorney fees for your client if you prevail), consider the following:

1. Ignorance is not bliss: always get an opinion of counsel. Current case law appears to suggest that a "reasonable" opinion of counsel can be relied upon by a losing defendant to render infringement not in bad faith or "unexceptional" for purposes of the statute.
2. Do not ignore cease-and-desist letters. A cease-and-desist letter should be properly investigated and such investigation documented; otherwise there is a risk that continued infringement after notice, without a reasonable belief that the alleged infringement claim is unfounded, can be held to make a case exceptional.
3. A finding of willful infringement does not necessarily guarantee an award of attorney fees. Depending on the jurisdiction, the court may require a heightened showing of culpable activity like "bad faith" in order to award attorney fees.
4. Damages are not necessarily required. Even if your client is unable to prove lost sales or damages, the court may still be willing to award attorney fees against the losing party. Conversely, just because a plaintiff is unable to prove or does not request damages, a losing defendant may be liable for the prevailing plaintiff's attorney fees.
5. Avoid any appearance of litigation misconduct. Even if the infringing activity itself was not willful or in bad faith, you are not off the hook. Untruthful testimony, withholding or destroying discovery, defaults, being in contempt of court orders, and other oppressive litigation tactics are never advisable, especially in a Lanham Act case where such conduct can result in a substantially higher award against a losing party.
6. Prevailing defendants are also entitled to attorney fees in certain circumstances. Consider whether the plaintiff's claims lacked any merit, were brought merely to harass or the plaintiff's litigation tactics were oppressive.
7. "Exceptional" cases are . . . exceptional. An award of attorney fees is still the exception, not the rule. You will need to show, by clear and convincing evidence, that the losing party's conduct sunk to a level such that you deserve an award of attorney fees. ■

1. *Hensley v. Eckerhart*, 461 U.S. 424, 429 (1983) (citations omitted); *Aleyska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 257 (1975).

2. 15 U.S.C. § 1117.

3. *Id.* (emphasis added). The award of attorney fees to a prevailing party in an action involving counterfeiting is generally mandatory under 15 U.S.C. § 1117(b). *See, e.g., Hospitality Int'l, Inc. v. Mahtani*, No. 2:97CV87, 1998 U.S. Dist. LEXIS 16445, at *92 (M.D.N.C. Aug. 3, 1998); *Rolex Watch U.S.A., Inc. v. Zeotec Diamonds, Inc.*, No. CV02-1089, 2003 WL 23705748, at *1 (C.D. Cal. May 2, 2003).

4. S. Rep. No. 93-1400, at 5–6 (1974), *reprinted in* 1974 U.S.C.C.A.N. 7132–33, 7137.

5. *See, e.g., Yankee Candle Co. v. Bridgewater Candle Co.*, 140 F. Supp. 2d 111, 120 (D. Mass), *aff'd*, 259 F.3d 25 (1st Cir. 2001).

6. *Tamko Roofing Prods., Inc. v. Ideal Roofing Co.*, 282 F.3d 23, 31 n.5 (1st Cir. 2002).

7. *Fin. Inv. Co. v. Geberit AG*, 165 F.3d 526 (7th Cir. 1998); *Seven-Up Co. v. Coca-Cola Co.*, 86 F.3d 1379, 1390 (5th Cir. 1996); *March Madness Athletic Ass'n v. Netfire, Inc.*, 310 F. Supp. 2d 786, 818 (N.D. Tex. 2003).

8. *Tamko Roofing Prods., Inc.*, 282 F.3d at 30; *Securacomm Consulting, Inc. v. Securacom, Inc.*, 224 F.3d 273, 279 (3d Cir. 2000); *Waco Int'l, Inc. v. KHK Scaffolding Houston Inc.*, 278 F.3d 523, 529 (5th Cir. 2002); *Johnson v. Jones*, 149 F.3d 494, 503 (6th Cir. 1998); *Waymark Corp. v. Porta Sys. Corp.*, 334 F.3d 1358, 1363 (Fed. Cir. 2003); *Horphag Research Ltd. v. Pellegrini*, 337 F.3d 1036, 1042 (9th Cir. 2003); *Retail Servs. Inc. v. Freebies Publ'g*, 364 F.3d 535, 550 (4th Cir. 2004). *But see Competition Specialties, Inc. v. Competition Specialties, Inc.*, 87 Fed. Appx. 38, 42 (9th Cir. 2004) ("We review the determination of whether a case is 'exceptional' de novo").

9. *Mattel, Inc. v. Walking Mountain Prods.*, 353 F.3d 792, 815 (9th Cir. 2003) (vacating and remanding district court's decision because "the record did not support the court's conclusions"); *see also Earthquake Sound Corp. v. Bumper Indus.*, 352 F.3d 1210, 1216 (9th Cir. 2003) ("district court's failure to articulate its findings [is] not an abuse of discretion if the record supports the decision of the district court") (citing *Tamko Roofing Prods., Inc.*, 282 F.3d at 31).

10. *See, e.g., Horphag Research Ltd.*, 337 F.3d at 1042 (concluding district court properly found infringement willful and deliberate and thus sufficient to justify fee award); *BASF Corp. v. Old World Trading Co.*, 41 F.3d 1081, 1099 (7th Cir. 1994) (holding that deliberate, not malicious, conduct suffices to meet the "exceptional" standard); *Tamko Roofing Prods., Inc.*, 282 F.3d at 32–34 ("a finding of bad faith or fraud is not a necessary precondition. Willfulness short of bad faith or fraud will suffice when equitable considerations justify" such an award); *Hartman v. Hallmark Cards, Inc.*, 833 F.2d 117, 123 (8th Cir. 1987) ("Bad faith is not a prerequisite to a Lanham Act fee award"); *Perfumania, Inc. v. Perfulandia, Inc.*, No. 02-2733, 2004 WL 1753249, at *22 (D.P.R. July 30, 2004) (finding willful and deliberate infringement shown at preliminary injunction hearing justified prejudgment attachment was appropriate for attorney fees incurred by plaintiff); *MasterCard Int'l Inc. v. Ishak*, No. 01-4300, 2004 WL 1059795, at *6 (S.D. Fla. Mar. 11, 2004) (deliberate and willful behavior of defendant made case exceptional); *Earthquake Sound Corp.*, 352 F.3d at 1219 (deliberate or willful behavior will suffice).

11. *See, e.g., Conopco Inc. v. Campbell Soup Co.*, 95 F.3d 187, 194–95 (2d Cir. 1996); *Scotch Whisky Ass'n v. Majestic Distilling Co.*, 958 F.2d 594, 599 (4th Cir. 1992) ("for a prevailing plaintiff to succeed in a request for attorney fees, she must show that the defendant acted in bad faith"); *Moore Bus. Forms, Inc. v. Ryu*, 960 F.2d 486, 491–92 (5th Cir. 1992) (high degree of culpability required) (citing *Texas Pig Stands, Inc. v. Hard Rock Café Int'l, Inc.*, 951 F.2d 684, 697 (5th Cir. 1992)).

12. *Patsy's Brand, Inc. v. I.O.B. Realty, Inc.*, 317 F.3d 209, 221–22 (2d Cir. 2003) (although willful infringement not found, attorney fees awarded to prevailing plaintiff based on defendant's litigation misconduct in presenting fraudulent

documents); *Securacomm Consulting, Inc.*, 224 F.3d at 279 (culpable conduct comes in many forms and may vary depending on the circumstances of a particular case; culpable conduct may be broader than willful infringement).

13. *See, e.g.*, *N.Y. State Soc'y of Certified Pub. Accountants v. Eric Louis Assocs., Inc.*, 79 F. Supp. 2d 331, 347–50 (S.D.N.Y. 1999) (exceptional case where defendant did not respond to two cease and desist letters or seek advice of counsel); *Discovery Commc'ns, Inc. v. Animal Planet, Inc.*, 172 F. Supp. 2d 1282, 1292 (C.D. Cal. 2001) (willful infringement found and attorney fees awarded where defendants chose to use plaintiff's mark despite constructive and actual notice as to plaintiff's rights thereto); *AT&T Corp. v. Synet, Inc.*, No. 96 C 0110, 1998 U.S. Dist. LEXIS 1405, at *5 (N.D. Ill. Feb. 5, 1998) (defendants' conduct found to be deliberate, and thus exceptional, due to continued infringement after cease and desist letter).

14. *N.Y. State Soc'y of Certified Pub. Accountants*, 79 F. Supp. 2d at 347–50. However, consulting with an attorney is not a complete bar to a finding of willfulness, as some courts have found a case to be exceptional where the defendant consulted with an attorney prior to the adoption of a mark. *Teaching Co. v. Unapix Entm't, Inc.*, 87 F. Supp. 2d 567, 571 (E.D. Va. 2000); *Takecare Corp. v. Takecare of Okla., Inc.*, 889 F.2d 955, 957–58 (10th Cir. 1989) (where defendant sought advice of counsel, but failed to show what that advice was, defendant did not prove reasonable reliance on opinion of counsel, and case was found to be exceptional).

15. *See Bear U.S.A., Inc. v. JooAn, Co.*, No. 98 Civ. 7649, 2001 U.S. Dist. LEXIS 637, at *29 (S.D.N.Y. Jan. 25, 2001). *But see Moore Bus. Forms, Inc.*, 960 F.2d at 492 (distinguishing between continued use after notice and adoption of a trademark with notice); *WSM, Inc. v. Wheeler Media Servs., Inc.*, 810 F.2d 113 (6th Cir. 1987) (defendants' continued use of allegedly infringing mark during good-faith defense of lawsuit rendered case not exceptional).

16. *Tamko Roofing Prods., Inc.*, 282 F.3d at 33.

17. *Johnson v. Jones*, 149 F.3d 494, 504 (6th Cir. 1998).

18. *See, e.g.*, *Rio Props., Inc. v. Rio Int'l Interlink*, 284 F.3d 1007, 1022–23 (9th Cir. 2002) (finding plaintiff's allegation in its complaint that defendant's acts were committed "knowingly, maliciously, and oppressively, and with an intent to . . . injure" enough to warrant attorney fee award on default); *Discovery Commc'ns, Inc.*, 172 F. Supp. 2d at 1291–92 (case may be considered exceptional if defendant disregards the proceeding or does not appear or defaults); *see also PepsiCo. v. Triunfo-Mex, Inc.*, 189 F.R.D. 431, 432–33 (C.D. Cal. 1999); *Taylor Made Golf Co. v. Carsten Sports, Ltd.*, 175 F.R.D. 658, 663 (S.D. Cal. 1997); *Philip Morris USA, Inc. v. Catsworld Prods., Inc.*, 219 F.R.D. 494, 502–03 (C.D. Cal. 2003).

19. *See, e.g.*, *Christian Dior Couture, S.A. v. Fred's Int'l Handbags*, No. 98 Civ. 6265, 2002 U.S. Dist. LEXIS 778, at *14 (S.D.N.Y. Jan. 17, 2002) (defendant's failure to appear and provide discovery warranted an award of attorney fees to plaintiff); *Bear U.S.A., Inc.*, 2001 U.S. Dist. LEXIS 637, at *29 (defendants breached agreement with plaintiff, defaulted on the lawsuit, ignored the proceedings and violated the court's order) (citations omitted); *Sara Lee Corp. v. Bags of N.Y., Inc.*, 36 F. Supp. 2d 161, 170 (S.D.N.Y. 1999) (defendant's default in Lanham Act case and its acts in contempt of default found to be exceptional because they were in willful defiance and protracted the judicial process attempting to stop the illegalities).

20. *See, e.g.*, *Patsy's Brand, Inc. v. I.O.B. Realty, Inc.*, 317 F.3d 209, 222 (2d Cir. 2003) (upholding district court's determination of "exceptional" case due solely to litigation misconduct); *Securacomm Consulting, Inc. v. Securacom, Inc.*, 224 F.3d 273, 279–83 (3d Cir. 2000) (defendant's vexatious litigation conduct sufficient to support determination of "exceptional"); *S Indus., Inc. v. Stone Age Equip., Inc.*, 12 F. Supp. 2d 796, 819–20 (N.D. Ill. 1998) (plaintiff's litigation misconduct warrants attorney fees).

21. *Coach, Inc. v. We Care Trading Co.*, No. 99 Civ. 11672, 2001 U.S. Dist LEXIS 9879, at **49–54 (S.D.N.Y. July 19, 2001), *aff'd*, 67 Fed. Appx. 626, 630 (2d Cir. 2002); *see also Competition Specialties, Inc. v. Competition Specialties, Inc.*, 87 Fed. Appx. 38, 42 (9th Cir. 2004).

22. *But see Leatherman Tool Group, Inc. v. Cooper Indus., Inc.*, 47 U.S.P.Q.2d 1049 (D. Or. 1998) (attorney fees awarded in trade dress infringement case despite defendant's strong functionality arguments).

23. *See March Madness Athletic Ass'n v. Netfire, Inc.*, 310 F. Supp. 2d 786, 818 (N.D. Tex. 2003) (although infringement willful and defendant was on notice of alleged infringement, ownership rights were at issue, so no fee award).

24. However, statements that there was reliance on counsel are not adequate proof of lack of bad faith or willfulness. The Court must have a means for assessing the reasonableness of the advice of counsel and the reliance by the alleged infringer or the plaintiff. *See Takecare Corp. v. Takecare of Okla., Inc.*, 889 F.2d 955, 957–58 (10th Cir. 1989); *Universal City Studios, Inc. v. Nintendo Co.*, 797 F.2d 70, 76–77 (2d Cir. 1986); *Thomas Nelson, Inc. v. Cherish Books Ltd.*, 595 F. Supp. 989 (S.D.N.Y. 1984); *Johnson v. Jones*, 149 F.3d 494, 504 (6th Cir. 1998).

25. *VIP Foods, Inc. v. Vulcan Pet, Inc.*, 675 F.2d 1106, 1107 (10th Cir. 1982) (no fees awarded because defendant had no intent to deceive).

26. *See, e.g.*, *Ferrero U.S.A., Inc. v. Ozark Trading, Inc.*, 952 F.2d 44, 49 (3d Cir. 1991); *Martin's Herend Imps., Inc. v. Diamond & Gem Trading USA, Co.*, 112 F.3d 1296, 1305 (5th Cir. 1997); *Roulo v. Russ Berrie & Co.*, 886 F.2d 931, 942 (7th Cir. 1989); *Bishop v. Equinox Int'l Corp.*, 154 F.3d 1220, 1224 (10th Cir. 1998); *Cuisinarts, Inc. v. Robot-Coupe Int'l Corp.*, 580 F. Supp. 634, 638 (S.D.N.Y. 1984).

27. For example, failure to conduct a trademark search before use may evidence carelessness, not bad faith. *See Tamko Roofing Prods. v. Ideal Roofing Co.*, 282 F.3d 23, 33–34 (1st Cir. 2002) (citing *Securacomm Consulting, Inc. v. Securacom Inc.*, 166 F.3d 182, 188–89 (3d Cir. 1999)).

28. *See Procter & Gamble Co. v. Amway Corp.*, 280 F.3d 519, 527 (5th Cir. 2002); *Tamko Roofing Prods.*, 282 F.3d at 33–34; *Yankee Candle Co. v. Bridgewater Candle Co.*, 140 F. Supp. 2d 111, 120 (D. Mass.), *aff'd*, 259 F.3d 25 (1st Cir. 2001).

29. *See, e.g.*, *Fruit of the Loom, Inc. v. American Mktg. Enters.*, No. 97 Civ. 3510, 1999 U.S. Dist. LEXIS 11060, at **6–7 (S.D.N.Y. July 22, 1999); *Centaur Commc'ns, Ltd. v. A/S/M Commc'ns, Inc.*, 830 F.2d 1217, 1229 (2d Cir. 1987) (showing of lost sales not required to obtain attorney fees); *Coach, Inc. v. We Care Trading Co.*, No. 99 Civ. 11673, 2001 U.S. Dist. LEXIS 9879, at **49–54 (S.D.N.Y. July 19, 2001); *aff'd*, 67 Fed. Appx. 626, 630 (2d Cir. 2002); *Silva v. Karlsen*, 43 Fed. Appx. 486, 488 (3d Cir. 2002) (unpublished). *But see Hindu Incense v. Meadows*, 692 F.2d 1048, 1052 (6th Cir. 1982) (finding of no lost sales renders a case "unexceptional"); *VIP Foods, Inc.*, 675 F.2d at 1107; *see also CJC Holdings, Inc. v. Wright & Lato, Inc.*, 979 F.2d 60, 66 (5th Cir. 1992) (lack of damages important consideration for determination of "exceptional").

30. *Post Office v. Portec, Inc.*, 913 F.2d 802, 812 (10th Cir. 1990), *vacated and remanded on other grounds*, 499 U.S. 915 (1991). *But see VIP Foods, Inc.*, 675 F.2d at 1106 (lack of damages considered in determining that case was not "exceptional" and denying attorney fees); *Texas Pig Stands, Inc. v. Hard Rock Café Int'l, Inc.*, 951 F.2d 684, 696 (5th Cir. 1992) (while lack of damages does not prohibit finding case exceptional, it is an important factor to consider).

31. *Fruit of the Loom, Inc.*, 1999 U.S. Dist. LEXIS 11060, at *8 (citing *Spring Mills, Inc. v. Ultracashmere House, Ltd.*, 724 F.2d 352, 356–57 (2d Cir. 1983)); *see also Coach, Inc.*, 2001 U.S. Dist. LEXIS 9879, at **55–57.

32. *CJC Holdings, Inc. v. Wright & Lato, Inc.*, 979 F.2d 60, 66 (5th Cir. 1992).

33. *Hindu Incense v. Meadows*, 692 F.2d 1048, 1052 (6th Cir. 1982).

34. S. Rep. No. 93-1400 at 5–6, *reprinted in* 1974 U.S.C.C.A.N. 7132, 7136 (1974); *Noxell Corp. v. Firehouse No. 1 Bar-B-Que Rest.*, 771 F.2d 521, 524 (D.C. Cir. 1985).

35. *See, e.g.*, *Conopco Inc. v. Campbell Soup Co.*, 95 F.3d 187, 195 (2d Cir. 1996) (to recover fees, defendant must show suit brought in bad faith); *Securacomm Consulting, Inc. v. Securacom, Inc.*, 224 F.3d 273, 282 n.2 (3d Cir. 2000); *Lipscher v. LRP Publ'ns, Inc.*, 266 F.3d 1305, 1320 (11th Cir. 2001) (prevailing defendant must prove fraud or bad faith on behalf of plaintiff). *But see Retail Servs., Inc. v. Freebies Publ'g*, 364 F.3d 535, 550–51 (4th Cir. 2004) (plaintiff who prevails on counterclaims entitled to make "lesser showing required of a prevailing defendant").

36. *See, e.g.*, *Ale House Mgmt., Inc. v. Raleigh Ale House, Inc.*, 205 F.3d 137, 144 (4th Cir. 2000) (facts to consider include economic coercion, groundless arguments and failure to cite controlling law); *see also Retail Servs., Inc.*, 364 F.3d at 550 (fees denied because plaintiff's claims and assertions were not so lacking in merit); *Door Sys., Inc. v. Pro-Line Door Sys., Inc.*, 126 F.3d 1028, 1032 (7th Cir. 1997) (oppressive suits, caused by lack of merit or cost of defense, even if brought in good faith, can warrant award of attorney fees to prevailing defendant); *Fin. Inv. Co. v. Geberit AG*, 165 F.3d 526, 533–34 (7th Cir. 1998) (suit lacked merit and was oppressive including protracted discovery disputes, pending four years, and lots of document translation from German to English); *Hartman v. Hallmark Cards, Inc.*, 833 F.2d 117, 123 (8th Cir. 1987) (absence of bad faith not determinative); *Noxell Corp.*, 771 F.2d at 525–26 ("[s]omething less than 'bad faith' . . . suffices to mark a case as 'exceptional'"); *Stephen W. Boney, Inc. v. Boney Servs., Inc.*, 127 F.3d 821, 827 (9th Cir. 1997) ("mere absence of bad faith" does not preclude award of attorney fees to defendant, but fees denied because plaintiff's claims raised colorable issues of law and fact); *Procter & Gamble Co. v. Amway Corp.*, 280 F.3d 519, 527 (5th Cir. 2002) (remanding to consider underlying merits of action in assessing whether attorney fees should be awarded to prevailing defendant).

37. *Noxell Corp.*, 771 F.2d at 524–26; *see also* S. Rep. No. 93-1400, *reprinted in* 1974 U.S.C.C.A.N. 7132, 7136; *WSM, Inc. v. Wheeler Media Serv., Inc.*, 810 F.2d 113, 116 (6th Cir. 1987).

38. *Cairns v. Franklin Mint Co.*, 292 F.3d 1139, 1156 (9th Cir. 2002) (upholding award for attorney's fees to prevailing defendant in a false advertising suit brought under the Lanham Act because statements in the advertisement were

true and plaintiff had no reasonable basis to believe they were false); *Avery Dennison Corp. v. Sumpton*, 189 F.3d 868, 881 (9th Cir. 1999) (exceptional case when claim brought "is groundless, unreasonable, vexatious, or pursued in bad faith"). *But see Hartman*, 833 F.2d at 123 (attorney fees denied to defendant who won case on summary judgment. Existence of weak element in a potential theory of recovery does not warrant an award of attorney fees).

39. *Nat'l Ass'n of Prof'l Baseball Leagues, Inc. v. Very Minor Leagues, Inc.*, 223 F.3d 1143, 1147 (10th Cir. 2000).

40. *Id.*

41. *Id.* at 1149.

42. *Securacomm Consulting, Inc. v. Securacom, Inc.* 224 F.3d 273, 282 n.2 (3d Cir. 2000) (plaintiff's deliberate effort to bury opponent financially and take everything defendant had by filing multiple suits against defendant and its attorney in different form amounted to vexatious litigation tactics and was sufficient to support an award of attorney's fees to prevailing defendant); *see also Yankee Candle Co. v. Bridgewater Candle Co.*, 140 F. Supp. 2d 111, 121–22 (D. Mass.), *aff'd*, 259 F.3d 25 (1st Cir. 2001) (awarding attorney fees to defendant because of plaintiffs' abusive, expensive litigation conduct and unsupported claims).

43. *J & J Snack Foods Corp. v. Earthgrains Co.*, No. 00-6230, 2003 U.S. Dist. LEXIS 8040, at **12–13 (D.N.J. May 9, 2003) (citing *Securacomm Consulting, Inc.*, 224 F.3d at 280–82).

44. *Securacomm Consulting, Inc.*, 224 F.3d at 280–82 (internal citations omitted) (finding case exceptional because plaintiff continued to pursue claim after court's preliminary injunction ruling detailing the many weaknesses in plaintiff's case).

45. *Door Systems, Inc. v. Pro-Line Door Systems, Inc.*, 126 F.3d 1028, 1031–32 (7th Cir. 1997).

46. *Id.* at 1032; *Rohr-Gurnee Motors, Inc. v. Patterson*, No. 03 C 2493, 2004 WL 422525, at *3 (N.D. Ill. Feb. 9, 2004) (lawsuit found oppressive when continued after a hearing where court ruled that plaintiff "did not have a better than negligible chance of success on the merits"); *see also Zila Swab Techs., Inc. v. Van Dyke*, No. 01C 8729, 2003 WL 1745901 (N.D. Ill. Apr. 1, 2003).

47. *Nat'l Distillers Prods. Co. v. Refreshment Brands, Inc.*, No. 00 Civ. 8418, 2002 U.S. Dist. LEXIS 13962, at **2–3 (S.D.N.Y. July 30, 2002) (fees awarded for defense against dilution claim found to be vexatious because court believed that plaintiff knew or should have known that the plaintiff's mark was neither famous, nor had acquired secondary meaning, but not awarded for defense of weak claim withdrawn mid-trial).

48. *Proctor & Gamble Co. v. Amway Corp.*, 280 F.3d 519, 527–58 (5th Cir. 2002); *see also Fuji Photo Film Co. v. Shinohara Shoji Kabushiki Kaisha*, 754 F.2d 591 (5th Cir. 1985) (finding of good faith on behalf of plaintiff in bringing action precluded award of fees to prevailing defendant).

49. 294 F.3d 227 (1st Cir. 2002) (denying award of attorney fee on appeal even though trial court found this case to be exceptional.); *see also AANP v. Am. Ass'n of Naturopathic Physicians*, 37 Fed. Appx. 893, 894 (9th Cir. 2002).

50. *Tamko Roofing Prods., Inc.*, 294 F.3d at 230.

51. 337 F.3d 616, 629 (6th Cir. 2003).

"It seems pretty easy to make partner here."

BY DENISE ARMSTRONG

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Ensuring an Accurate Transcript

Often, the accuracy of testimony submitted at pre-trial proceedings is critical to winning your case. Errors or omissions in transcripts can be detrimental to the case you are putting together for trial. A word can alter the meaning of a sentence; a misinterpretation of a non-verbal response can become an unforeseen problem. This article will focus on key techniques to help ensure that an accurate transcript is recorded with minimal interruptions and maximum efficiency.

Before the Deposition Begins

Keep in mind that the reporter has the responsibility of preserving the record and ensuring accuracy in the transcript. Help by providing the reporter with sample court papers, such as a bill of particulars, to record the caption and appearances of counsel. To ensure accuracy, counsel should provide the proper spelling of names, addresses, and other relevant information and confirm whether the attorney is with the firm or "of counsel." A glossary of terminology, particularly in technical cases, is also helpful. Marking exhibits at this point will also save time.

Marking Exhibits

To ensure that all the material you want entered on the record is recorded, provide the reporter with a brief description of the item to be entered on the index page; or, if you are going back on the record after the item has been marked, give a brief description in colloquy format for accuracy of the record.

Starting the Deposition

Witnesses are sworn in by the court reporter and, as a courtesy to counsel, the reporter will ask the witnesses to state their names and addresses for the record.

During the Deposition

Many issues can arise that may cause errors in the record during the examination. It is helpful to keep the following in mind:

Speed Reading –
When a document or statement is read into the record, it is generally at a greater rate of speed than a conversational exchange. Therefore, it is recommended that a copy of the document be provided to the reporter to ensure that the full statement is recorded accurately.

Recording Verbatim Testimony –
This is easier when parties do not speak over one another. Counsel generally advises the witness to wait until the question is finished before answering. The reverse is also true: counsel should wait until witnesses complete their answer before asking the next question.

Interpreters –
Depositions of witnesses who speak another language can be among the most difficult testimony to record. Many interpreters take their jobs literally: they *interpret* the answers as opposed to *translating* them. This will hamper your examination of the witness and may lead to answers in the record that are not reflective of what was actually said, and may be unfavorable to your case. Counsel must instruct the interpreter to translate *everything* that is said. Failure to do so may lead to an inaccurate record. Even if the witness answers in English, the interpreter should translate the testimony anyway. This solves the problem of adding long parentheticals and requiring the reporter to process a word that may be said in English but

with a heavy accent. Counsel must always remember that he or she is directing questions to the witness through the interpreter, but key to this exchange is being mindful that the interpreter is not the witness.

If you wish to have the reporter physically remove the question or comments from the record, you must instruct the reporter accordingly, and all parties must agree to the request.

"Also Present" Individuals Speaking on the Record –
Although counsel may instruct family members or friends that they may not speak on the record, occasionally they may do so, such as to offer to clarify a date or some other item. When this occurs, bear in mind that the reporter is recording all comments, so advise the reporter whether those comments should be stricken from the record.

Error in Names, Dates, and Other Relevant Information –
If an incorrect name, date or address is provided by the witness and counsel discovers this and decides it is significant, the request can be made in colloquy format on the record, but the error is not physically changed. However, if all parties agree, the error can be physically changed throughout the transcript.

Nonverbal Responses –
In fast-paced exchanges, nonverbal responses often occur. Counsel must be alert to this because the reporter will only record the responses exactly as spoken. When the transcript is read afterwards, the meaning of some responses may be lost or left to the reader to interpret. Avoid this by instructing the witness to verbally respond in all instances.

Requesting Documents for Production/Insertions –
Be specific: counsel should describe exactly what should be inserted in blanks left in the transcript. Do not let the reporter interpret what it is you are looking for. The same applies for marking questions for a ruling.

Off-the-Record Discussions –
Court reporters outside the courtroom are trained to go off the record only if *all* parties agree to do so. When counsel says "off the record," a reporter will generally look at opposing counsel to determine if there is opposition to the statement; seeing none, the reporter will stop writing until instructed to go back on the record. At that point, anything said in colloquy is not recorded, so if you want to go back on the record, you must direct the reporter accordingly.

Questions Withdrawn –
Reporters can strike questions that are withdrawn when they are false starts, such as a few words that begin a question before a thought process changes and a new, fully formed question is asked. However, once a question is answered to any extent or there is any colloquy at all in relation to it, the question will remain on the record and is withdrawn in colloquy format only. If you wish to have the reporter physically remove the question or comments from the record, you must instruct the reporter accordingly, and all parties must agree to the request.

With these considerations in mind, you will ensure a more accurate record of the testimony and avoid unnecessary and sometimes lengthy parentheticals. A "clean" record that is easier to read and understand, and which allows for clearer citations, will help you to better prepare for trial. ■

BY JOEL A. ROSE

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Partner Compensation Plans

How attorneys are paid – and how much – are perhaps the most controversial topics in law firm management. These issues also have the potential for the most constructive (or destructive) response to management and productivity problems and other priorities that affect law firms. Why then, do so many firms have difficulty in reaching agreement about partner compensation? The answer may best be found in the personality of the firm, the availability of distributable dollars, and the egos of attorneys, most frequently demonstrated in the willingness of partners to make the compensation system work. Every law firm has a method for compensating its partners. Some compensation plans are highly structured, but many others include subjective elements.

The primary objective of every distribution plan should be fairness. Partners must believe they are compensated adequately for their contribution to the success of the firm. An inherent problem with the concept of fairness, however, involves differences of opinion regarding what is fair. Lockstep compensation plans based entirely on seniority are less popular today than in the past. Many of the better-established firms have introduced incentives to recognize lawyers' contributions. Incentives may be provided to attorneys who generate business from new clients, obtain work from current clients, maintain business, produce work, record and collect a predetermined number of billable hours, manage the firm or its practice areas, train attorneys or participate in bar association or community activities that enhance the firm's reputation. Each firm needs to decide on the relative importance of each of the factors to be rewarded. If a formula is used, specific criteria must be constructed to provide for the desired results.

The partners should understand the rules of the compensation plan before a new year begins. The compensation plan should be supported with records that are comprehensible, reliable and readily available.

Any compensation plan is only as good as its implementation. Plans should be fairly administered and their rules and results evaluated appropriately. A good plan can be badly handled; conversely, even a bad plan can be handled reasonably well by fair-minded attorneys.

Basic Decisions

For most firms, certain basic decisions have to be made for the plan to operate. As the firm matures, the nature of the plan and its elements may change. Among these decisions are:

1. Who, or what body, will make the decision on allocation of income?
2. Will the allocation be based on percentages or units of participation?
3. Will the distribution be prospective, with distribution percentages or units of participation determined in advance of the year, or retrospective, with distribution percentages or units of participation determined when year-end results are known? Alternatively, will an initial percentage be prospective and a specified percentage or amount of money be withheld for end-of-year distribution based on retrospective considerations?
4. Will the profits to be distributed consist of all that is left over after overhead is paid, or will profits be considered everything after a predetermined draw, or salary equivalent, is paid to partners or shareholders, in addition to overhead?
5. Will there be a class of non-capital partners or principals whose salaries and bonuses are exempt from the final distribution of income to capital partners or shareholders? Or will there be a gross percentage divided among capital partners, and other pools divided among other partners?

In addition, records of past earnings, the competitive legal market for younger partners or outstanding specialists, and unusual provisions involving capital, retirement or death may have a bearing on the criteria applied in income distribution.

Plan Examples

The following is a digest of selected partnership distribution plans.

Percentages: The most frequently used system involves percentages determined at the beginning of each year, backed by statistics that show, for each attorney, billable and consequential non-billable time, billings, collections, aging of accounts receivable, amounts of write-offs and write-downs of unbilled time, disbursements and write-ups of bills.

Partners are assigned percentages of net profit by a compensation committee. For example, a firm of three partners may determine that each will share in the net profit by allocating 45%, 30% and 25%, respectively. The gross fees collected total $650,000; with overhead at 42%, the net profit to be distributed is $377,000. At the end of the year, the first partner, with a 45% allocation, receives $169,650; the second, with 30%, received $113,100; and the third, with 25%, receives $94,250.

The percentages the committee recommends may be final or subject to approval by the firm's management.

Committees charged with administering compensation are increasingly expanding the age range of their members; more mid-level and younger partners are being elected to serve. In many firms, nominees are preselected. The decision-making process may involve some or all of the partners on the committee. A few firms use a secret ballot, completed by all of the partners and submitted to the committee for implementation.

Although many large firms use a percentage system, as a firm increases in size, problems frequently arise. First, it may become burdensome to calculate each partner's percentage share. Second, a difficulty inherent in using a percentage system is that the total of percentage points must equal 100. If a partner is desirous of receiving a greater percentage, one or more other partners must relinquish a corresponding share.

Units of Participation: A units-of-participation distribution plan allows the partners to achieve the same allocation results as a percentage plan without having to contend with the 100% ceiling. Under a units plan, partners are assigned units in accordance with their contributions and other factors. There is no limit to the total number of units that may be assigned to any partner.

For instance, in the firm of A, B & C, Partner A may have 40 units, B may have 35 units and C may have 25 units. A will receive 40/100ths of net profit. B will receive 35/100ths and C will receive 25/100ths. The following year, the allocations of B and C are increased: A receives 40 units, B 40 units and C 30 units. A and B each receive 40/110ths of the firm's net profit; C receives 30/110ths of net profit. Although A's proportionate share of income decreases in the second year in relation to B and C, he or she has not had to "give up" any units.

If a three-attorney firm invites a fourth to join, and one of the partners is reluctant to reduce his or her interest, the firm may opt to allocate profits on the basis of units of participation. The three attorneys retain their numerical units and the fourth attorney is given a share of units. The problem, common to percentages schemes, under which partners may not want to relinquish any of their points, is avoided, and the compensation plan can more easily accommodate the needs of a growing firm.

Percentages or Units of Participation With a Reserve: Many firms use plans that include a reserve ranging from 5% to 10% of net profit, based on the year's performance. The reserve is allocated to individual partners based upon their perceived contribution to the firm, determined either under a formula or subjectively. The following will illustrate how the reserve is allocated.

Suppose a firm has a net profit of $377,000 and a 10% reserve. The distributable profit to be allocated, according to straight percentage, would be $339,300 – that is, $377,000 minus $37,700. The reserve, $37,700 is allocated to deserving partners subjectively, based on their contribution to the previous year's performance. Factors that a committee may consider in determining how to allocate the reserve may include hours worked, fees collected, consequential non-billable hours devoted, business origination, profitability as the result of billings and collections, administrative skills and the like.

After analyzing the partners' respective contributions, the committee may determine that one partner should receive 50% of the reserve, or $18,850, for having originated substantial fees. A second partner receives 35% of the reserve, or $13,195, for having managed a large case and collecting substantial fees. A third partner receives 15%, or $5,655, for having developed an in-house specialty and managing the associates' career development program.

Variable of Percentages or Units: Another way to allocate profits is to establish a variable of percentages or units based upon seniority, reputation, past performance and anticipated performance, with the balance of profits divided equally.

Each partner receives a variable draw: for example, A receives $120,000; B, $105,000; and C, $95,000 – determined according to the above factors. At the end of the year, the balance of the net profit to be distributed amounts to $57,000. This is divided equally so that each partner receives a bonus of $19,000.

Some firms establish standard draws among all partners or among classes of partners, paying variable bonuses according to each partner's contribution. For example, at the beginning of the year, all partners or classes of partners may receive a standard draw of $95,000. At year end, the committee allocates variable bonuses based upon partners' contributions to the firm.

Statistical Plans

Statistical plans are frequently calculated according to mathematical formulas. The following examples describe various formula plans.

Simple Formula: Many firms are successful in using compensation plans based on relatively simple formulas. Some firms establish the basis as 30% for originating the work, 30% for producing the work and 40% set aside for overhead. This simple formula uses a one-to-one ratio for the origination and production of work.

As a firm grows larger, however, it is increasingly difficult to evaluate the contribution of one partner in relation to the total contribution of other partners. Most formula systems include a method of prorating origination of work and production of work, and provide credit for managing the firm and performing other firm-approved, non-fee-producing activities.

Weighted Credit Formula: Under a credit formula, weights are assigned to key elements – for example, business origination, work production, profitability, and attorney responsibility. The weighting process is usually a function of a firm's needs and priorities.

For example, a firm with a substantial volume of institutional client business may allocate one-and-a-half credits to business origination in a given matter, six-and-a-half credits to work production and two credits for managing the matter, for a total of 10. Another firm that has an ever-changing transactional client base and constantly needs to generate business may allocate three credits to business origination, one or two credits for procuring additional work from current clients – if the additional work results from the efforts of an attorney other than the originating lawyer – six credits to work production and one credit to profitability.

Other variations involve splitting credit for business origination into subfactors, such as credit for maintaining clients or case responsibility. A firm also may modify weights based on difficulty of case, transfer of responsibility for large estates or base association activity.

Much business comes to most firms without any clear indication of who should receive credit for origination. The firm will then have to decide whether to exclude these totals from its figures, allocate them to the lawyer handling the work or distribute the credit. Some firms allocate credit to the firm, which receives credit in the same manner as a partner. In such a case, however, the total of credits allocated to the firm may subsequently be reallocated to individual partners and reflected in their total credit calculation.

Credit for Profitability

The weight and use of the profitability factor depends on the firm's concept of profit. For compensation purposes, profit may be calculated as a figure exceeding the partners' draws, associate salaries and overhead. Profit may also be based on a figure related to the time-dollar value of services on particular matters. The manner in which the law firm calculates profitability and the personal effort expended by the lawyer who benefits from the credit should determine the weight accorded to this factor.

The statistics for work production may consist of such records as fees produced or total hours; the hours worked by each lawyer, prorated against the final fee; the time-dollar value of the assisting lawyer without regard to the total fee; or an estimate of the value of the effort contributed by each lawyer to the matter.

It is strongly recommended that the basis for any formula be actual fees received. Until the money is received, the business origination or work performed credit has no economic value and contributes only to overhead. The following system illustrates a formula that is based on time records and hourly rates. A firm receives a fee of $2,000 for a matter for which two attorneys were required to perform the work. The first attorney recorded four hours at an hourly rate of $190, for a total time-dollar value of $760, and the second attorney spent seven hours at an hourly rate of $175, for a total time-dollar value of $1,225.

The firm's final percentage distribution is based on the total time-dollar value of the matter. When the actual fee of $2,000 is collected, the first attorney is credited with 38.3%, or $766; the second attorney receives 61.7%, or $1,234.

Another method of calculating how to distribute the profits of the firm among partners is a formula system, in which the firm allocates fee credits for origination and production of work. Under this plan, business origination equals a multiplier of one, and work production equals a multiplier of two. The partners decide to use these two factors as a partial basis for determining compensation. They also subjectively consider such other factors as profitability, management, bar activities and community work.

In the system for allocation of fee credits for origination and production, the data collected are based on fees received and are set up in three columns headed "Fees Received," "Origination Attorney" and "Production Attorney." Total fees collected are posted in the "Fees Received" column. The fees attributable to individual or shared effort, by attorney, are posted under the "Origination Attorney" and "Production Attorney" headings.

An alternative is an equal-sharing-plus formula, or statistical information plan. Under this formula, 90% of 95% of the net income is shared equally among all partners and the remainder is distributed according to a judgment based on statistics and subjective factors. This alternative recognizes the contributions that all partners make in many firms in aiding those who originate and those who maintain the business of their firms.

Combination Plan

Still another alternative is a combination plan, which might operate according to this formula:

Work Incentive: To keep every partner a working partner, a proportion of each paid bill is based on the amount of time invested in the matter. The percentage of distribution, for example, is 50%.

Group Incentive: To provide each partner with an interest in the performance of the others, seniority – based on

number of years as a partner, up to a given limit – is multiplied by the average compensation for the past three or four years. The percentage of distribution, for example, is 20%.

Business Development Incentive: To make every partner business-conscious, as well as work-conscious, data on business produced by the individual is considered, along with the judgment of the committee. The percentage of this distribution – for example, 20% – is usually determined by the compensation committee after reviewing computer-produced financial data and management information and consulting with the chair of the firm's business development committee. Credit may be given for business generated from new clients and the development of additional business from current clients. This credit is usually shared if two or more attorneys have been instrumental in attracting the business.

Incentive to Use Associates: This is based on information regarding work delegated and on supervision of associates. The objective is to stimulate partners to delegate work. The percentage of this distribution to a given partner – for example, 5% – is usually determined by the billing attorney or the chair of the department to which the matter is assigned.

Contingency Fund: This is sparingly used to compensate for extended illness, public service, difficult cases, consequential non-billable work, firm business and outstanding achievement. The percentage of distribution, for example, is 5%.

When considering various types of compensation plans, partners are cautioned that the lawyer compensation practices of other firms may not be satisfactory for their own offices. The fact the certain plans are in use does not indicate that they may be suitable elsewhere or even that they work well for the offices that use them.

As any firm evolves, time will bring changes in its personnel and in the values and goals of the partners. What pleased the founding partners may not necessarily be welcomed by the new order. This is a natural and inevitable course of events. The firm that succeeds in establishing a sound compensation plan is one in which partners view decision making as a dynamic process and understand that the plan is not etched in stone. ■

Definition of Origination Credit

Origination credit will be assigned to partners who clearly initiate, individually or with others, business from new, existing and former clients. Any partner receiving origination credit is expected to maintain contact with that client's activity with the firm. Origination credit which is a result of the development activities of two or more lawyers will be divided appropriately to the circumstances, by agreement between the partners interested. The obligations of partners receiving origination credit will be to:

- Bring the client through the door and make certain that the work is referred to the appropriate attorney/practice area;
- Ensure the client's work is performed in a quality, timely and cost-effective manner;
- Maintain active contact with the client, keeping in mind the opportunity to aid in the development of new business from that client or spheres of client activity;
- Maintain a personal/professional relationship with the client and deal with any potential or actual problems which may arise during the processing of legal work or the collection of fees;
- Ensure that the timely status and other reporting to the client is accomplished according to the schedules agreed upon with the client or internal schedules maintained by the partner receiving origination credit;
- Oversee and shepherd the client matter through the firm to ensure that work is performed in a timely manner; and
- Oversee timely and appropriate billing and collection of bills for fees and costs.

Definition of Production Credit

Production credit is equivalent to the time-dollar value of the amount of time that timekeepers devote to working on a particular client matter.

A few examples of Origination and Production Credit:

1. A brings a client into the office and performs all of the work on that matter; A receives all origination and production credit.
2. A brings a client into the office, performs a small portion of the work and assigns the balance of the work to B to perform. A will receive all of the origination credit and A and B receive production credit.
3. A and B bring a client into the office and B performs all of the work. Both A and B will share the origination credit 50-50 (or it may be shared proportionately, *i.e.*, 60-40, etc.) and B will receive the production credit.

In the event there may be a dispute involving credit for which one or more partners will receive some origination credit, the management committee will have the final say.

	Fees Received	Origination Credit		Production Credit	
Attorney:		A	B	A	B
Example 1:	$10,000	$10,000	–	$10,000	–
Example 2:	$20,000	$20,000	–	$5,000	$15,000
Example 3:	$15,000	$7,500	$7,500	–	$15,000
Weighting		$37,500	$7,500	$15,000	$30,000
		x 1	x 1	x 2	x 2
Total Weights		$37,500	$7,500	$30,000	$60,000

Weighting of the fee credits for origination and production should be determined by the current requirements and future plans of the firm. For example, 1 credit for origination and 2 credits for production.

Is the Glass Half-Empty or Half-Full?

The Unused or Underused License or Degree

By Harvey G. Landau

Recently, the Court of Appeals in *Holterman v. Holterman*[1] reaffirmed its landmark decision, in *O'Brien v. O'Brien*,[2] that enhanced earning capacity due to the acquisition of a professional license or degree acquired during the marriage is a marital asset subject to equitable distribution.[3] In *Holterman*, two dissenting judges argued that *O'Brien* should be limited or applied only to cases involving the student-spouse and working-spouse scenario. However, the majority of the Court did not address the argument on its merit, ruling that the titled-spouse had not raised this issue on appeal or in the lower court, and therefore it was not properly before the Court for appellate review. New York is the only state to adhere to the view that a non-transferable advanced degree, license, or certification constitutes marital assets subject to distribution.

In some states, the equitable relief awarded to a self-supporting spouse who has contributed directly to the career of a degree-holding or licensed spouse, is an award of special or equitable maintenance. This often takes the form of a lump-sum payment or a periodic payment to compensate the non-titled spouse for his or her efforts.[4]

The Court of Appeals in *O'Brien* specifically rejected as an alternative remedy an award of rehabilitative or reim-

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bursement maintenance. The Court held there is a lack of statutory authority for such a remedy.[5] Nevertheless, some courts, most recently in *Sonnenfeld v. Sonnenfeld*, have fashioned the remedy of awarding a percentage of future earnings for a fixed period of time in lieu of a theoretical lump-sum distributive award.[6]

In this article, the focus of discussion is on the issues raised in cases in which it is claimed that the license or degree did not enhance the spouse's earning capacity, or was not fully utilized. In addition, if the titled-spouse intentionally abandons or fails to pursue a lucrative career opportunity, this article considers whether such acts constitute marital waste or dissipation.

If titled-spouses can establish that their license or degree did not directly result in enhanced earnings, the asset is generally held not to have value for equitable distribution purposes. Similarly, if spouses can establish that throughout their career, their license was not utilized, it will be deemed to have no value. As the issue was framed by Justice Spolzino in *Fanelli v. Fanelli*,[7] "[it is] that the value of a long-held license is determined on the basis of the holder's actual earnings, rather than its theoretic value."

The finding that there is no value to a license or degree that had no economic impact on a spouse's earnings is a reasonable conclusion when the spouse's career is well established.[8] The difficulty is presented in cases where the titled-spouse is in the early stages of his or her career and the unused license or degree may be used in the future. There is no hard-and-fast rule as to the numbers of years of non-use for the asset to "lose its value." However, the evidence must be sufficient to establish that the spouse's career change would be unlikely.

In *Fanelli*, the parties were married in 1973, and the husband obtained his license as a professional engineer in 1978. For the 22-year period involved, the husband made minimal or no use of his license. His employment and earnings were found not related to his having the license. The forensic evaluator gave an opinion as to the value of the license based both upon the husband's actual earnings during the marriage and a theoretical earnings analysis of a professional engineer. The court held that the valuation should be the lesser amount because projection of future earnings should be based on the history of actual earnings, and that valuing a long-held license on the basis of its theoretical value is inconsistent with the appellate decisions as to license valuation.

Yet, the Appellate Division, Second Department in *Klutchko v. Baron*,[9] held that it was error for the court below to opine that a law license had no value because the wife had not practiced law in a number of years. The court observed that this ruling by the lower court was inconsistent with the way in which the court was willing to include the value of the husband's now-suspended medical license for equitable distribution purposes. The opinion did not disclose how long the wife had not utilized her law license.

In *Savasta v. Savasta*,[10] the physician-husband worked for 10 years as an emergency room doctor. However, he was board-certified in internal medicine, although he never practiced as an internist. The wife apparently did not object to the husband's field of medical practice. At trial, there was evidence that the husband (38 years old) had expressed a desire to open his own medical office to practice internal medicine. The court held while it could not "foretell the future, it could not ignore the acquisition of this certification." (A certification in internal medicine statistically would enhance a physician's earning capacity over that of a general practitioner.) The court held that the present value of Dr. Savasta's enhanced earnings was $571,878. Despite 20 years of marriage, the court only awarded the wife a 10% interest, or $57,188 as a distributive award. The court further stated that in doing so, it was applying the specific facts of the case and was not adopting as a rule of law "best use" of a license/certification theory. The court opined as dictum that if the facts of the case had been one in which the marriage was of long duration, *i.e.*, 30 years and the physician-spouse acquired an unused internal medicine board certification in the early stages of their marriage, and instead was employed for the next 25 years as an emergency room doctor, then in such a case, the earning potential of the spouse should be based only upon his actual earning capacity as a doctor practicing emergency room medicine.

The difficulty is presented in cases where the titled-spouse is in the early stages of his or her career and the unused license or degree may be used in the future.

Differentiated from the cases where the titled-spouse has not used his or her license (or degree) during the marriage, is the case where the titled-spouse has only worked on a part-time basis. The part-time use of a license requires further analysis. First, what is the proper projected income stream to consider for valuation purposes? Second, if the titled-spouse is seeking maintenance and/or child support, should the spouse's earning capacity, for support purposes, be calculated based upon his or her potential full-time employment? Third, if the spouse

refuses to engage in full-time employment, or use the license, do such acts constitute marital waste or dissipation?

In *Farrell v. Cleary-Farrell*,[11] the parties were married for nine years at the time of their divorce. During the marriage, the wife obtained an Associate's degree and was licensed as a dental hygienist. The wife was employed "part-time," working between 32 and 34 hours per week. The forensic evaluator relied on governmental data to opine that employment less than 35 hours a week is considered "part-time" employment. The court agreed that the valuation of the wife's license should be based upon the assumption that she would continue to work part-time. A strong argument can be made that the court erred in not holding that if the wife was working (part-time) 32–34 hour a week, that an additional hour or two could be available to her if the wife wanted or was required to engage in full-time employment.

If the titled-spouse is working part-time, at an early stage in his or her career, earning projections based upon anticipated full-time employment would in the author's opinion, result in a more realistic projection of future earnings. Another possibility is if the other spouse has acquiesced to an arrangement whereby the titled-spouse works part-time to be available for child rearing, a two-prong period of projected earnings may be appropriate. (Based upon earnings realized from part-time employment and another period of years based on full-time employment when the spouse's childcare role is no longer necessary.)

The forensic evaluator in these cases should be requested to consider three valuation options: (1) value the enhanced earnings on the assumption of full-time employment; (2) value the enhanced earnings on the assumption that the spouse will only work part-time; or (3) value based upon part-time employment earnings for a period of years and full-time employment earnings to an anticipated retirement age of 65.[12]

If a spouse is seeking maintenance and/or child support, the court, absent unusual circumstances, should impute income to the titled-spouse based upon his or her ability to be employed full-time.[13] A court can differentiate between a best use approach for equitable distribution and for support purposes. Both spouses should be required to use their best efforts to maximize their earnings, especially to support their children.

Finally, if a slothful spouse obtains a license (or degree), but refuses to seek employment, particularly contrary to the expressed desires of the other spouse, does such act constitute marital waste? Courts have held that marital waste includes a spouse intentionally abandoning lucrative employment or refusing to pursue employment.[14] In such cases, a measure of marital waste may not just be the lost earnings of the titled-spouse to the marital partnership, but also the amount of marital funds invested in obtaining the degree or license. The offer of proof of lost earnings can be established by testimony of a vocational expert.

The valuation and distribution of enhanced earnings, based upon a license and degree to prevent inequities in a divorce, may be noble in purpose, but difficult in reality to equitably accomplish. There are an increasing number of commentators who have raised questions about how the court and the legislature should address this problem. Twenty years after the Court of Appeals decision in *O'Brien*, the experience has been that the cure may be worse than the disease. ■

1. 3 N.Y.3d 1, 781 N.Y.S.2d 458 (2004).

2. 66 N.Y.2d 576, 498 N.Y.S.2d 743 (1985).

3. *Grunfeld v. Grunfeld*, 94 N.Y.2d 696, 709 N.Y.S.2d 486 (2000); *McSparron v. McSparron*, 87 N.Y.2d 275, 639 N.Y.S.2d 265 (1995); *Procario v. Procario*, 164 Misc. 2d 79, 623 N.Y.S.2d 971 (Sup. Ct., Westchester Co. 1994) (Collabella, J.); Domestic Relations Law § 236B(1)(c), (5)(c) (DRL).

4. *Hamlet v. Hamlet*, 583 So. 2d 654 (Fla. 1991); *Canakaris v. Canakaris*, 382 So. 2d 1197 (Fla. 1980). "The court may consider any other fact necessary to do equity and justice between the parties." Fla. Stat. Ann. 61.08(2)(g). *See also Kutanovski v. Kutanovski*, 120 A.D.2d 571, 502 N.Y.S.2d 218 (2d Dep't 1986).

5. *O'Brien*, 66 N.Y.2d at 587.

6. *Sonnenfeld v. Sonnenfeld*, 7 Misc. 3d 1005(A), 801 N.Y.S.2d 242 (Sup. Ct., Nassau Co. 2005); *Kutanovski*, 120 A.D.2d 571 (court awarded the wife a 10% interest in the husband's (medical license) future earnings for a period of 10 years).

7. 191 Misc. 2d 123, 740 N.Y.S.2d 823 (Sup. Ct., Westchester Co. 2002) (Spolzino, J.).

8. *Dugan v. Dugan*, 238 A.D.2d 741, 656 N.Y.S.2d 769 (3d Dep't 1997); *Pudlewski v. Pudlewski*, 309 A.D.2d 1296, 765 N.Y.S.2d 570 (4th Dep't 2003); *Holihan v. Holihan*, 159 A.D.2d 685, 553 N.Y.S.2d 434 (2d Dep't 1990); *Semans v. Semans*, 199 A.D.2d 790, 605 N.Y.S.2d 510 (3d Dep't 1993).

9. 1 A.D.3d 400, 768 N.Y.S.2d 217 (2d Dep't 2003) (citing *inter alia Finocchio v. Finocchio*, 162 A.D.2d 1044, 1045, 556 N.Y.S.2d 1007 (4th Dep't 1990)); *see* DRL § 236B(1)(c), (5).

10. 146 Misc. 2d 101, 549 N.Y.S.2d 544 (Sup. Ct., Nassau Co. 1989) (Maro, J.).

11. 306 A.D.2d 597, 761 N.Y.S.2d 357 (3d Dep't 2003); *Jafri v. Jafri*, 176 Misc. 2d 246, 671 N.Y.S.2d 589 (Sup. Ct., Rockland Co. 1997) (Miller, J.).

12. *Harrington v. Harrington*, 6 A.D.3d 799, 775 N.Y.S.2d 379 (3d Dep't 2004); *Hickland v. Hickland*, 39 N.Y.2d 1, 382 N.Y.S.2d 475 (1976); *Blasdell v. Steiner*, 14 A.D.3d 898, 788 N.Y.S.2d 688 (3d Dep't 2005).

13. *K. v. B.*, 13 A.D.3d 12, 784 N.Y.S.2d 76 (1st Dep't 2004); Galasso, *Something Smells Like Marital Waste*, NYSBA Fam. L. Rev., Fall 2004, vol. 36, no. 2, citing *Southwick v. Southwick*, 202 A.D.2d 996, 612 N.Y.S.2d 704 (4th Dep't 1994); *Gastineau v. Gastineau*, 151 Misc. 2d 813, 573 N.Y.S.2d 819 (Sup. Ct., N.Y. Co. 1991).

14. Florescue, *The Degree Without the License*, N.Y.L.J., June 27, 1989, p. 3, col. 1; *Preventing Inequities in Divorce and Education: The Equitable Distribution of a Career Absent an Advance Degree or License*, 9 Cardozo Women's L.J. 133, 156 (2002); Scheinkman, New York Practice, New York Law of Domestic Relations § 14:31 (2004). *See also Sonnenfeld*, 7 Misc. 3d 1005(A); *Kutanovski*, 120 A.D.2d 571.

BY WILLIAM H. MANZ

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Recent Developments

Change is a constant in legal research, and comprehensive legal research guides are often slightly out of date even before publication, demanding constant effort to keep current. This is particularly true in New York State, which boasts a wide-ranging body of both electronic and print legal materials. In the quest to keep New York attorneys up-to-date, notable recent additions to the legal research arsenal include a valuable new case law database, additional electronic availability for appellate briefs and legislative history materials, and new editions of several major treatises and practice books.

Cases Online

The latest addition to Internet sites providing free case law is the Law Reporting Bureau's New York Official Reports Service, which appeared on the Bureau's Web site in May 2005.[1] The new site's contents include the opinions of the Court of Appeals, the Appellate Division, the Appellate Term, the supreme court, and miscellaneous other courts selected for inclusion in the Official Reports. The site currently contains the full text of the over 2,100 Appellate Term and 1,300 lower court opinions abstracted in Miscellaneous Reports 3d.[2] Coverage is from January 2000 through the most recent advance sheets. Although all opinions are full text, the editorial enhancements found in the print reporters, including case synopses, head notes, and for Court of Appeals decisions, points of counsel, are not provided. Typically, sites offering free case law have only the most basic search options, and function best as document retrieval services. This is not true of the Bureau site. Since it is maintained in conjunction with Thomson West, the publisher of the Official Reports, it offers most of the same search options as Westlaw, including keyword, official citation, case name, judge name, counsel name, opinion type and decision date.

The new Official Reports database is the companion to the Law Reporting Bureau's older slip opinion service, which contained cases decided since late 2003, and in addition to Court of Appeals and Appellate Division cases, included over 3,700 lower court opinions by the end of 2005. Originally, it posted only new decisions that had not yet appeared in the Official Reports and those not chosen for publication in the print reporters; cases selected for inclusion in the Official Reports were removed once they appeared in print. However, since January 2004, all opinions once posted remain in the database.

Previously, the only other free site offering the same level of search sophistication as a subscription service was LexisNexis's LexisOne.[3] Like the Law Reporting Bureau database, LexisOne provides access to Court of Appeals and Appellate Division cases, but only for the past five years. In addition, it does not provide cases from the lower New York courts, although it does offer Second Circuit cases. Unlike the new Law Reporting Bureau site, LexisOne requires a free registration. It is also more overtly commercial, containing advertising for other LexisNexis services, including eAdvance Sheets, *Shepard's* Citations, CLE courses, and the LexisNexis bookstore. In contrast, the Law Reporting Bureau site has only unobtrusive links connecting to the Westlaw sign-in page, Westlaw by Credit Card, CLE products, and the online bookstore.

For lower court cases decided since 2001, the other comprehensive alternative is the Unified Court System eCourts database[4] which currently has civil cases from 28 counties and criminal cases from 13. Since not all opinions from the lower courts are actually forwarded to the Law Reporting Bureau and because most, but not all, cases they do receive are posted online, this site may contain unreported cases unavailable elsewhere. Unlike the Law Reporting Bureau site, the opinions posted here are pdf scans of the original document. Thus, as a notice at the site warns, the opinions are "uncorrected and subject to revision in the Official Reports," and "may or may not have been entered in the County Clerk's Office."

Through a partnership with Loislaw, the New York State Bar Association also offers free legal research, but it is limited to NYSBA members. Using

the Loislaw search engine, members can search cases from the Court of Appeals, the Appellate Division, the Miscellaneous Cases included in the Official Reports, as well as U.S. Supreme Court and Second Circuit cases. Coverage is for the last three years, with live links to all cited cases and statutes. No registration with Loislaw is required. Once a NYSBA member logs on to the NYSBA Web site, Loislaw can be accessed in several ways, including through a link at the bottom of the Association's home page, found at <www.nysba.org>.

Finally, it should be noted that those seeking older online case law than that found at the Law Reporting Bureau sites have only limited options. Although free New York case law is available on various individual court Web sites, except for the Court of Appeals nothing predates the year 2000. For the Court of Appeals, attorneys seeking comprehensive databases of older cases free online can obtain Court of Appeals decisions since 1992 on both Findlaw.com and the Legal Information Institute Web site.[5] In addition, selected landmark cases such as *Palsgraf* and *MacPherson* are available at the Historical Society of the Courts of the State of New York Web site.[6]

Briefs Online

Another case-related online enhancement during 2005 came when Westlaw, as part of an ongoing database expansion project, added appellate briefs for the Appellate Division, Second Department. Briefs since 1997 are now available in the NY–BRIEFS and the new NY–APP–BRIEF databases. (West hopes to add the other departments by the end of 2006.) This is a notable addition since Appellate Division briefs are often in far more demand among practitioners than those prepared for cases decided in the Court of Appeals. Previously, Westlaw's briefs database only contained selected Court of Appeals briefs since 1997. In addition to the Westlaw databases, attorneys also have the option of directly contacting another Thomson West service, Court Records Services.[7] Its coverage for the Second Department matches that on Westlaw, but it also has the records and briefs for the other three departments since 2000; there are also plans to extend Second Department coverage back to 1995.

Previously, the only readily available source for Appellate Division briefs since the 1990s was the microfiche version currently distributed for the Unified Court System by Court Records Services, Inc. The fiche, which cover cases decided since the late 1980s, are currently sent to 26 locations, most notably several supreme court libraries, and the libraries of the Association of the Bar of the City of New York and the New York County Lawyers' Association.

Bill Jackets Online

During 2005, Thomson West also enhanced Westlaw's coverage of the sometimes problematical area of New York legislative history.[8] For years, Westlaw's coverage of New York legislative history materials was essentially limited to memoranda and occasional reports as reprinted in *McKinney's Session Laws*. In 2004, Thomson West added sponsor's, executive, and judicial memoranda since 1996 in the NY–LH database. Then last year, it added the NY–LH–BILLJACKETS database, which currently contains jackets from 1996–2003. The bill jacket contents, as provided by the database, are the same as those compiled for the governor, but they are delivered as one document in html format. The bill jackets are a "Premier Advantage" database, and if not part of a user's contract, will incur per-minute or per-document charges in addition to the cost of printing.

Obtaining bill jackets from the longtime provider of these documents, the New York Legislative Service,[9] is more costly than using Westlaw, but the researcher receives photocopies of the original documents, and will also usually obtain additional useful materials. For example, Westlaw provides the original bill jacket for chapter 453 of the Laws of 1999 which amended Megan's Law, which contains a budget report and memos from the Division of Criminal Justice Services and the attorney general. The bill jacket as provided by the Legislative Service has these documents, but also contains a governor's program bill memo, a *New York Law Journal* article on the passage of the law, and two press releases, all containing quotes from the bill's sponsor, Sen. Dean Skelos, and various other government figures. For some enactments, additional documents may also include debate transcripts if they consist of only a few pages. Otherwise, they are available as separate documents. The Legislative Service offers same-day service and will email as pdf files the contents of the bill jackets.

Using the Loislaw search engine, members can search cases from the Court of Appeals, the Appellate Division, the Miscellaneous Cases included in the Official Reports, as well as U.S. Supreme Court and Second Circuit cases.

Treatises

Among the long-established New York legal titles that appeared in new editions during 2005 are several of the multi-volume loose-leaf practice guides published by the Matthew Bender division of LexisNexis. These include *New York Civil Practice – CPLR*, whose 15-volume second edition de-

emphasizes coverage of the old Civil Practice Act, integrates coverage of the Uniform Rules for the Trial Courts, and has completely revised sections dealing with Articles 4, 40, 41, 78, 80, and 92. Other major Bender titles for which second editions were issued during 2005 were the four-volume *Matrimonial Actions*, the four-volume *Family Court Proceedings*, the seven-volume *Warren's Negligence in the New York Courts* (several parts completely revised and others updated) and the 15-volume *New York Criminal Practice*. Bender also issued a new 15-volume fifth edition for *Warren's Weed New York Real Property*, and *White, New York Business Entities*, 14th edition, which is a complete revision of the 13th edition of *White, New York Corporations*.[10]

Among other standard treatises appearing in new editions in the past year is Professor David Siegel's classic *New York Practice*, whose fourth edition brings the treatise up-to-date through the Legislature's 2004 session and early 2005 case law. Another classic title now in a new edition is *Powers of the New York Court of Appeals*, first published in 1953 by Arthur Karger and Henry Cohen. Prepared by Anne M. Payne, the edition completely replaces the 1997 volume and its pocket part, and is reorganized and renumbered to conform to the usual West format. Thomson West also issued a complete set of new pages for *Elder Law and Guardianship in New York* by Justice Edwin Kassoff et al., a one-volume loose-leaf *Callaghan's Family Court Law and Practice in New York*, a revised edition of the old Callaghan-Lawyers' Cooperative title; and a new two-volume version of *New York Law of Domestic Violence* by Judge Lee H. Elkins and Jane Fosbinder, which first appeared in 1998.

The New York State Bar Association also updated or revised many of its publications in 2005. Alan Scheinkman and Professor David Siegel prepared a second edition of the *Practitioner's Handbook for Appeals to the Appellate Division of New York State*, which replaces the 1979 edition by Professor Siegel. NYSBA also updated the 15 titles in the Association's General Practice Monograph Series and the five-volume, *New York Lawyer's Deskbook* and *Formbook*, which serves as a text of first reference in 23 different areas of practice. New monographs include *Foundation Evidence, Questions and Courtroom Protocols*, written by Honorable Edward M. Davidowitz and Robert Dreher to guide attorneys in preparing appropriate foundation testimony, and *Depositions Practice and Procedure in Federal and New York State Courts*, by Honorable Harold Baer, Jr. and Robert C. Meade, Jr. ■

1. *Available at* <http://www.courts.state.ny.us/reporter/Decisions.htm>.

2. For a detailed discussion of the Third Series of the Official Reports, see Gerard Lebovits, *The Third Series*, N.Y. St. B.J., Mar./Apr. 2005, at 30.

3. *Available at* <http://www.lexisone.com>.

4. *Available at* <http://decisions.courts.state.ny.us/search/query3.asp>.

5. *Available at* <http://www.law.cornell.edu>.

6. *Available at* <http://www.nycourts.gov/history/Cases.htm>.

7. *Available at* <http://www.courtrecordservices.com>.

8. For further information about researching New York State legislative history, see William H. Manz, *If It's Out There: Researching Legislative Intent in New York*, N.Y. St. B.J., Mar./Apr. 2005, at 43.

9. For more detailed information on the Legislative Service, see <http://www.nyls.org>.

10. More information about the Matthew Bender titles is available at the LexisNexis bookstore Web site <http://bookstore.lexis.com/bookstore/catalog>.

ATTORNEY PROFESSIONALISM FORUM

To the Forum:

I am a senior associate, hoping to soon become a partner, at a mid-size but very successful firm. The final challenge for all senior associates in my position is handling a case under the personal supervision of the firm's founding partner. The matter I describe below is that case, and thus is my big chance.

One of our large clients is a real estate brokerage firm. This client has informed us that a number of individuals who are members of minority groups suspect that the client steered them away from desirable homes. If this is true, it would be of course both tortious and illegal. No action has yet been filed, but the client has learned that a national civil rights organization plans to send "testers" into the areas where it conducts business, with the goal of creating a record that will support claims of discrimination.

Our client has obtained an impressively detailed summary and explanation of the organization's plans (as to how, I was told "don't ask"). The information includes the pseudonyms the testers will use and the dates on which they will contact our client, posing as homebuyers. The organization does not have the funds to purchase even one house, and therefore the testers will not make any offers; the strategy will be to show that members of minority groups were never even shown any desirable homes. The information in the client's possession also indicates that the testers will be encouraged to describe their experiences to prosecutors and to testify later in court in a "results-oriented" fashion.

The founding partner told the client that he considers the use of testers to be immoral, and that he believes it is not allowed under New York law. I have been assigned to hire "counter-testers": homeowners who will pose as sellers, whose homes the client will show to the testers so as to frustrate the testers' intent to produce a favorable record.

All this might be very interesting and even exciting, but for one hitch. A close friend of mine recently left the employ of this client, and, based on what she told me, I have little doubt that it does indeed engage in discrimination and "steering" of a most reprehensible nature.

What can I do? What should I do?

Sincerely,

Torn on the Partnership Track

Dear Torn:

You certainly find yourself in a situation that would make good fodder for a television program.

The first thing you need to understand is that your ethical obligations are yours, and consequently you must decide what to do without regard to the effect it might have on your prospects for partnership. DR 1-104(E).

Having said that, you should take advantage of any formal or informal procedure or committee your firm has in place to address ethical and professional issues faced by associates. Many firms have set up such mechanisms precisely because associates may feel ill at ease questioning the judgment of their superiors. However, once you get an answer you still must exercise independent judgment as to whether that answer is sound. In making your decision, you may rely upon "a supervisory lawyer's *reasonable* resolution of an arguable question of professional duty." *Id.* (emphasis added.) Our answer is set forth below; your firm's may be different, but that does not mean that it is unreasonable. You must be the judge.

There are two "nested" issues raised by your question: (i) is it appropriate, in general, to hire counter-testers, and (ii) should you do as instructed in this case, given what you have been told of the client's behavior?

Use of Counter-Testers, Generally

The validity of using testers to build a statistical case for discrimination is an open question in New York, as the courts have not yet provided final answers. Therefore, the assertion that the use of testers is immoral or illegal in New York seems neither unequivocally right nor clearly wrong. A resolution of that issue is beyond the scope of this column; in any event your question is whether you can use counter-testers regardless of whether the other side's actions are appropriate or effective.

The use of testers might be considered "conduct involving dishonesty, fraud, deceit or misrepresentation" that violates DR 1-102(A)(4), or might arguably fall on the wrong side of DR 7-102(A)(5) insofar as it involves causing someone to "make a false statement." However, as noted above, it is neither barred nor approved in New York, even though the use of such testers has apparently been approved elsewhere. It might logically follow that using counter-testers should be appropriate to foil a tester strategy, in that it involves no greater a degree of deception. However, we note that there is no known authority in favor of this approach, as opposed to the use of the testers themselves.

The Attorney Professionalism Committee invites our readers to send in comments or alternate views to the responses printed below, as well as additional hypothetical fact patterns or scenarios to be considered for future columns. **Send your comments or questions to: NYSBA, One Elk Street, Albany, NY 12207, Attn: Attorney Professionalism Forum, or by e-mail to journal@nysba.org.**

This column is made possible through the efforts of the NYSBA's Committee on Attorney Professionalism. Fact patterns, names, characters and locations presented in this column are fictitious, and any resemblance to actual events or to actual persons, living or dead, is entirely coincidental. These columns are intended to stimulate thought and discussion on the subject of attorney professionalism. The views expressed are those of the authors, and not those of the Attorney Professionalism Committee or the NYSBA. They are not official opinions on ethical or professional matters, nor should they be cited as such.

Moreover, the rationale for allowing the use of testers – that there is often no other way to demonstrate in a statistically valid way that a defendant is engaging in prohibited discriminatory practices – cannot support the counter-tester maneuver. Note also that as a practical matter, testers can be employed to prove a discriminatory pattern without having advance knowledge of the defendant's intent or identities, while you and your client could not possibly employ counter-testers effectively without knowing who the testers were or when they were coming.

Testers are used to develop a sample that is supposed to be statistically valid; your planned use of counter-testers is designed to develop a specific picture that is intentionally not based on a random sample. The distinction strikes us as significant. Still, as long as the counter-testers were being employed to ensure that the errors inherent in random sampling did not lead to a skewed statistical picture indicating discrimination – especially where you have reason to believe that the testers themselves may be willing to falsify testimony – one might not be offended.

Consider, finally, the "smell test." Would you be comfortable telling your parents what you are doing, or seeing it all written up above the fold on page 1 of *The Wall Street Journal*? Phrased more officially, do you consider what you are being asked to do to be "morally reprehensible conduct" (EC 1-5), and would it or would it not promote "public confidence in our system and the legal profession" (EC 9-1)? The answers, in our view, could go either way, but from the tone of your question we suspect that you are already leaning against participating in the counter-tester activity.

The Specific Facts of This Case

If upon a full consideration of the issue in the abstract, you are comfortable with the idea of hiring counter-testers, you must still address the peculiar facts of your situation, specifically, what you know and how you know it.

In this vein, first consider the fact that you and your client have detailed knowledge of the testers' plans. It appears that there is no ethical rule or consideration that would actually prohibit you or your client from using this information. The situation does not fall within the rules for inadvertent communications for two reasons.[1] We are not dealing, at least at this stage, with trial strategy or the conduct of a trial. In addition, despite the ominous "don't ask" admonition, you do not necessarily have a reason to suspect that the disclosure was in violation of a duty that a *lawyer* for the civil rights organization owed to its client, or was otherwise illegal. It could very well be that someone within the organization is dissenting from what he believes are over-the-edge tactics (*e.g.*, encouraging the testers to shade their stories toward allegations of discrimination, or even the very use of the testers).

Note, however, that the situation could change for the worse in a number of ways if litigation and a trial ensue.

First, how the memo came into your client's and your firm's possession, and what impact this can have on your trial strategy, may become relevant. Although an exposition of the issue is beyond the scope of this column, there is an evolving body of authority governing inadvertent communications and information improperly obtained or disclosed.[2] In deciding what to do now, you should consider what the impact might be if, in a trial, your firm is prohibited from benefiting from having had this information.

Next, depending on how certain you are about the truth of your friend's horror stories concerning the client's discriminatory practices, a number of Ethical Considerations or Disciplinary Rules under Canon 7 may affect what you and your firm may do at trial. If, for example, you know that there is discrimination, your firm may not be able to advance a claim that there is not, and certainly may not use testimony you know to be false.

There is also a chance you may be called as a witness at trial to testify that your friend told you that the client actually does discriminate. The hearsay rule likely would not bar that testimony, as your friend's statement could be construed as an admission against interest. Under DR 5-105, that might well preclude you and your firm from representing your client at trial. Although this does not bar the current phase of the representation, you should disclose this to your firm, so that your firm is able to advise the client accordingly, perhaps to hire other counsel.

Finally, consider the fact that you may have actual knowledge of discrimination, based on your friend's descriptions of the client's actions. You may or may not believe these statements, but from the tone of your question I suspect that you think that they are truthful. Under these circumstances, the creation of a statistical picture of non-discrimination as part of your representation could be seen as involving "the creation . . . of evidence when the lawyer knows or it is obvious that the evidence is false," in violation of DR 7-102(A)(6).

In sum, given your knowledge of the client's behavior, the recommendation here is to avoid using the counter-testers. It is to be hoped that full disclosure to the powers that be at your firm will lead them to agree that using counter-testers is a bad idea. They should also advise the client to consider engaging other counsel for this matter, given the effect your knowledge could have on the representation. If not, we would advise you to turn down the assignment, and if the firm goes ahead to consider leaving the firm, preferably before you become aware of any actual misconduct. Although that last advice may seem harsh, it should be noted that this is based primarily on the unusual complication of your having acquired information from a third party that is adverse to your client.

Finally, although "don't get caught" should never be the guide to a lawyer's course of action, we would be remiss in not pointing out that things could get rather nasty if the civil rights organization or a state or federal prosecutor were to become aware of the activities of the counter-testers. A decision might be made to bring a civil or criminal action against your client, the counter-testers as individuals or even your firm itself for violating, or for conspiring to violate, civil rights statutes, or for obstructing justice. Even if it may be permissible in the abstract to employ counter-testers, doing so while one is aware of actual discrimination may be another thing altogether.

The Forum, by
Robert Kantowitz, Esq.
Lawrence, New York

1. N.Y. City Bar Ass'n Comm. on Professional & Judicial Ethics Formal Op. 2003-04; *see* DR 4-101.

2. *See Galison v. Greenberg*, 5 Misc. 3d 1025(A), 799 N.Y.S.2d 160 (Sup. Ct., N.Y. Co. 2004); *see also Mfrs. & Traders Trust Co. v. Servotronics, Inc.*, 132 A.D.2d 392, 522 N.Y.S.2d 999 (4th Dep't 1987).

QUESTION FOR THE NEXT ATTORNEY PROFESSIONALISM FORUM:

I have been appointed a Law Guardian for a 14-year-old boy, who is the only child of a divorcing couple. Each parent seeks full custody of the son. Under a *pendente lite* order, the mother, who resides in the marital home, has temporary physical custody of my client. The father has liberal visitation.

It seems to me that although the mother is a bit of a disciplinarian, the father is overly permissive. During his visitation with the parties' son the father is catering to all of his wishes, including buying him expensive presents, such as a motor bike, which was purchased over the mother's objection. He allows the son to neglect his homework and to watch "R"-rated movies. The father even moved into a co-op apartment on the boardwalk of an ocean community just because his son loves the beach and swimming. In addition, the son has confided to me that his father's girlfriend sleeps over in the apartment while he is there for visitation.

I am convinced that it is in my client's best interest to reside with the mother, and to have visitation with his father, as the Court's final disposition of the custody issue. My client, however, is adamant that he wants the reverse — to live with his father and have visitation with his mother. Obviously, what I want to recommend to the Court would be contrary to his wishes. What is my proper course of action?

Sincerely,
Guardian *ad* Adolescent

LANGUAGE TIPS

BY GERTRUDE BLOCK

Question: When, if ever, is it correct to omit the relative pronouns *that* and *who* or *whom* from sentences like the following:

- The committee *that* the governor appointed has already convened.
- The woman *who was* nominated declined the position.
- The woman *whom* the governor nominated declined the position.

Answer: Illinois attorney Fred Baird, who submitted this question, touched on a subject others have also asked about. In all the above statements, the italicized words could have been omitted. Both sentences are grammatical and just as clear without the pronouns. So because "less language is better," all else being equal, omit the pronouns.

But in some contexts the pronouns cannot be omitted. When the pronoun is the subject of the clause it introduces, it cannot be omitted. For example, in the two following statements, the pronouns *that* and *who* must be present:

- The commission *that* had accomplished its goal has convened.
- The person *who* represented me was competent.

Read those sentences and you will agree that if you omit the relative pronouns *that* and *who*, the sentences would not be standard English – and would not make sense. But there's an exception to that exception! When the verb following the pronoun is a form of *be*, you can – and usually should – omit the relative pronoun and the verb:

- The book that is on the table . . .
  The book on the table . . .
- The person who is responsible . . .
  The person responsible . . .
- The court which is in session today . . .
  The court in session today . . .

But not all *that*s are stylistically expendable even when they can be deleted grammatically. Consider the following ambiguous constructions, all from legal documents:

- The judge held the flowerpot could constitute a deadly weapon.
- The defendant could reasonably have foreseen cutting the line would cause trouble.
- The court held the color-blind language of the statute was constitutional.

These sentences are ambiguous. In each sentence, the second noun seems to be the object of the verb. Did the judge "hold the flowerpot"? Could the defendant have "foreseen cutting the line"? And how could a court have "held the color-blind language"? With the pronoun *that* included, it becomes clear that the entire clause, not just the nearest noun, is the object of the verb:

- The judge held that the flowerpot could constitute a deadly weapon.
- The defendant could reasonably have foreseen that cutting the line would cause trouble.
- The court held that the color-blind language of the statute was constitutional.

But only one *that*, please. In an effort to make a statement "perfectly clear," people sometimes add a second *that*. Here are three illustrations of the redundant *that*:

- The court ruled *that* because quantity, price, and conditions were stated, *that* there was a valid offer.
- It is argued *that* because students panic in a single examination, *that* several tests should be given throughout the term.
- The plaintiff said *that* if he had seen the defendant coming toward him, *that* he would have left the vicinity.

In speech, the second *that* is probably added because the speaker has forgotten the first *that*. In a document the second *that* is probably added because the drafter failed to proofread the original draft. In the first two sentences, the second *that* is redundant; in the third sentence, both *that*s could be omitted.

Question: I have recently been following with some attention the postings on a local chat room and have observed a tendency to use prepositions interchangeably. For example, I have seen *of* in place of *there*. Have you noticed this tendency?

Answer: Although in some contexts I have seen the "wrong" preposition substituted for the traditional one, I have not noticed the preposition *of* used in place of the adverb *there*. If readers have seen that substitution, let me know.

One new preposition-switch that seems to be here to stay is *on* for *for*. Traditionally, waiters waited *on* tables, but people waited *for* a bus. But the preposition *on* is now used to mean "await." Waiters still wait *on* tables, but people also wait *on* buses and other things. *Webster's Third* does not list *on* with the sense of "await," in its 1993 issue, but *The American Heritage Book of English Usage* does list it in its 1996 edition, saying that it has been in use for "more than 100 years." (However, it lists only current citations of that usage.)

Another relatively new but still non-standard usage is *off* for *from*, in contexts like "I made money *off* my investment." The Usage Panel of the 1985 *American Heritage Dictionary* disapproves of that usage, saying that *off* should not "indicate a source": "I got a loan *from* – not *off* – him." The 1993 *Webster's Third* ignores the substitution of *off* for *from*.

The prepositions *with* and *to* are now being used interchangeably, following verbs like *connect*, *join*, and *communicate*. In traditional usage, when the preposition *with* followed these verbs, they connoted interaction or association. But when the preposition *to* followed, these verbs connoted adherence or attachment. A stream is "connected/joined *to* a river." A leg is connected/joined *to* a table. One joins, communicates, or connects *with* another person in a discussion. But many persons now ignore this distinction, and that seems a pity. ■

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tance of proofreading is reflected in the effect that the absence of proofreading has on readers: "Readers expect a level of competence, care, and sophistication in writing. When those elements are missing, [writers] presumably [do] not possess the necessary legal skills or fail to display consideration for [their] audience."[5]

Myth #16. Legal writing may be informal.

Reality: Whatever the legal writer's goal — to persuade, to inform — the correct tone when writing is formality without inflation. Formality and informality should be balanced. When writing, lawyers should use words they use only in polite conversation. Informal writing "suggest[s] a less respectful tone, an impression you certainly do not want to give a client or a court."[6] For example, contractions, which are warm and friendly, belong in e-mails and *Legal Writer* columns but not in briefs. Slang and colloquial and breezy writing, which indicate familiarity, don't belong in briefs either.

Myth #17. Prose in legal writing is best directed to the highest common denominator.

Reality: Many lawyers mistakenly use legalese in their writing. But legalese is "verbose and gratuitously technical, serving no purpose other than to mystify and shroud the subject matter in a veil of overblown prose."[7] The problem is that many lawyers say to themselves, "'If I don't use legalese, I won't sound professional.' . . . . 'If I change the specific phrases, the judge will rule against me.'"[8] Lawyers, judges, and clients alike favor concise, simple writing. Legalese makes writing lengthy and difficult to understand, but "[c]ourts now demand brevity, and clients demand plain English."[9]

Legal writing should be directed to smart high-school students. If they understand you, so will a more educated readership. Keep your words, sentence structure, paragraphs, and organization simple. Complex prose is weak prose. The erudite explain difficult concepts in easy-to-read language. From Harvard Law's Warren: "[T]he deepest learning is the learning that conceals learning."[10]

Myth #18. Legal writing has little to do with reading nonlegal subjects.

Reality: Writing has everything to do with reading — from finding good models, to assessing the merits of a written argument, to learning to think clearly.

Reading cases isn't the best way to learn legal writing. Frankly, some judges write poorly.[11] Some law school professors select cases under the Socratic method to make their students feel inadequate or to make them think like lawyers: "Not many readers can defend the prose of judicial opinions selected for case books — a style students instinctively assume is 'the way law looks.'"[12] Opinion writing sets the standard by which many lawyers write. According to Temple Law Professor Lindsey, "Unfortunately, court opinions influence the writing styles of students, lawyers, judges and even law professors. That [is] a distressing, or at least sobering, thought for all of us. If you are what you eat, you write what you read. Garbage in, garbage out."[13]

So what should you do if reading opinions won't teach you about good legal writing?

University of Connecticut's Professor Lindgren suggests returning to school, but "[i]f school is not the answer for most of us, what is? A few people may learn to write from their supervisors on the job, but most will have to learn the same way I am trying to — by reading style books."[14]

St. John's Professor Falkow "combat[s] the onslaught of poor legal writing in part by using non-legal examples to illustrate concepts of good legal writing."[15] She tells her students "to engage . . . in active reading, which can help them become better writers while simultaneously assuring them that models need not all derive from legal rhetoric."[16]

Only reading broadly and critically will lead a writer to study the vocabulary and rules of writing. Most great legal writers stress that reading nonlegal subjects is a prerequisite to good lawyering. This was Justice Frankfurter's advice to a 12-year-old who wanted to become a lawyer: "The best way to prepare for the law is to come to the study of law as a well-read person. Thus alone can one acquire the capacity to use the English language on paper and in speech and with the habits of clear thinking which only a truly liberal education can give."[17]

Myth #19. Outlining increases the workload. It's just one more thing to do.

Reality: Organizing before writing avoids problems. One problem is not including important information: "A gap in your logic caused by poor organization can give your opponents an opening for attack."[18] Another is repetition. The key to organization is to say it once, all in one place. Organizing before writing lets you focus on what to say and how to say it.

One form of organization is a written outline. An outline helps. It "not only provides the organization necessary to complete a complex writing task, but serves as a perpetual reminder of the 'big picture.'"[19] Organizing by outline conserves energy, especially if the case is complicated.

There are many different methods of generating an outline. The traditional method is the Roman-style outline. In

Writing has everything to do with reading — from finding good models, to assessing the merits of a written argument, to learning to think clearly.

this outline, main ideas are listed by Roman numerals, with supporting sub-points listed in the English alphabet and the sub-sub-points in Arabic numerals. The main points and sub-points are ordered according to your analysis.

For lawyers who think visually, a diagram or flowchart will work. The core idea is written in the middle of a blank page. Arrows connect the main points to the core point and sub-points to the main points.

Brainstorming works for lawyers who have many ideas but can't connect them: list all possible points randomly, and then group the points. That leads to a group of main points and supporting points.[20]

These are just a few ways to generate an outline. Experiment until you're comfortable with a way to outline.

Those who hate to outline should be flexible, but outline they should. Not outlining often means spending more time overall. If you outline, you'll have a vision before you start, you'll know what goes where, and you won't forget or repeat things.

Once you've outlined, organize. In the argument section of a persuasive brief, start with your strongest points — those on which you're most likely to win. If two points are equally strong, go first with the point that'll win the largest relief: dismissing the indictment rather than reducing the sentence, if, say, you're representing a defendant in a criminal case. Alter that pattern to arrange your points logically, to order the elements or factors listed in a statute or seminal case, or to begin with a threshold argument, like statute of limitations before the merits.

Once you've ordered your arguments, order what goes within each argument. This, too, should be outlined. One way to do that in the argument section of a persuasive brief is to CRARC — *The Legal Writer*'s patent-pending formula — which stands for Conclusion on the Issue, Rules of Law, Application of Fact to Law, Rebuttal and Refutation, and Conclusion on the Requested Relief. Start ("C") by giving your conclusion on the issue ("The trial court allowed the People to offer inadmissible hearsay."); then ("R") state the law, giving your best rules and citations first; then ("A") apply law to the facts from your fact section, giving your best facts first; then ("R") present your adversary's leading facts and legal arguments honestly and rebut them without dwelling on them, making sure not to repeat what's in your Rule section; and then ("C") conclude by stating the relief you seek ("This Court should therefore reverse the conviction.").

Myth #20. Lawyers should trust their supervisors when they're told, "Just give me a draft."

Reality: Many new lawyers believe that a supervisory lawyer's most common fib is to instruct the new lawyer to submit "only a draft." The problem here is communication, not dishonest supervisors: "[When a supervisor tells you to] 'Just give me a *quick* draft', 'Just *whip off* a draft', or 'Just dictate a *rough* draft' . . . [t]he emphasized words should trigger red lights in your mind."[21] A seasoned lawyer's draft is a less-seasoned lawyer's final product. A less-seasoned lawyer's draft provides little help to a seasoned attorney, and especially a judge, who might've forgotten that it takes years to write well. The solution: New lawyers should hand in their best work even when they're told to hand in only a draft.

Conclusion

Confess: You've fallen for some legal-writing myths. It's not too late to change. Experiment with your writing. Incorporate realities. Edit your work. And do what good lawyers do: Separate fact from fiction. ■

1. William Zinsser, On Writing Well: The Classic Guide to Writing Nonfiction 12 (25th Anniv. ed. 2001) (quoted in Richard K. Newmann, Jr., Legal Reasoning and Legal Writing: Structure, Strategy, & Style, § 6.6, at 61 (4th ed. 2001)).

2. Bryan A. Garner, *An Approach to Legal Style: Twenty Tips for the Legal Writer*, 2 Scribes J. Legal Writing 1, 34 (1991).

3. Stacey L. Gordon, *Legal Citation in Montana: Teaching Lawyers the Proper Format*, 28 Mont. Law. 7, 8 (Sept. 2002).

4. Garner, *supra* note 2, at 34.

5. Martha Faulk, Writing Tips, *The Matter of Mistakes*, 13 Persp. 27 (2004).

6. Jacquelyn E. Gentry, *The Dirty Dozen — And How to Defeat Them*, 45 Orange County Law. 14, 17 (Sept. 2003).

7. Douglas Litowitz, *Legal Writing: Its Nature, Limits, and Dangers*, 49 Mercer L. Rev. 709, 712 (1998).

8. Susan Benjamin, *Attorneys: Cause or Cure?*, 7 Scribes J. Legal Writing 47, 49 (2000).

9. Wendy B. Davis, *Consequences of Ineffective Writing*, 8 Persp. 97, 97 (2000).

10. Edward H. Warren, Spartan Education 31 (1942).

11. *See, e.g.*, Steven Stark, *Why Judges Have Nothing to Tell Lawyers About Writing*, 1 Scribes J. Legal Writing 25, 30 (1990) ("If law schools really want to improve the writing of lawyers, they should make their students study briefs, complaints, newspapers, advertisements, even direct-mail letters. But no more opinions, please. No more opinions.").

12. Terri LeClerq, Guide to Legal Writing Style xvi (2d ed. 2000).

13. John M. Lindsey, *Some Thoughts About Legal Writing*, N.Y.L.J., Oct. 27, 1992, p. 2, col. 2. Professor Lindsey overstated his case somewhat. Lawyers' and judges' writings have different functions. *See* William Domnarski, *The Opinion as Essay, the Judge as Essayist: Some Observations on Legal Writing*, 10 J. Legal Prof. 139 (1985) (arguing that judges' and lawyers' writings cannot be analyzed together). And if lawyers shouldn't emulate judicial writing styles, they shouldn't emulate law professors' styles, either. *See* Judith S. Kaye, *One Judge's View of Academic Law Review Writing*, 39 J. Legal Educ. 313, 320 (1989) (arguing that law professors "are writing for each other"). The last way to learn how to write a brief is to study the writing style of the law-review article.

14. James Lindgren, *Style Matters: A Review Essay on Legal Writing*, 92 Yale L.J. 168, 168–69 (1992) (book review).

15. Michele G. Falkow, *Pride and Prejudice: Lessons Legal Writers Can Learn From Literature*, 21 Touro L. Rev. 349, 350 (2005).

16. *Id.* at 351.

17. Felix Frankfurter, *Advice to a Young Man Interested in Going into Law*, *in* The Law as Literature 725 (Ephraim London ed. 1960).

18. Robert P. Charrow et al., Clear & Effective Legal Writing 135 (3d ed. 2001).

19. Toni M. Fine, *Legal Writers Writing: Scholarship and the Demarginalization of Legal Writing Instructors*, 5 J. Legal Writing Inst. 225, 236 (1999).

20. M.H. Sam Jacobson, *Learning Styles and Lawyering: Using Learning Theory to Organize Thinking and Writing*, 2 J. Ass'n Legal Writing Directors 27, 56 (2004).

21. Wayne Schiess, Writing for the Legal Audience 30 (2003) (quoting D. Robert White, The Official Lawyer's Handbook 109–10 (1983) (alteration in Scheiss).

Gerald Lebovits (GLebovits@aol.com), a judge of the New York City Civil Court, Housing Part, in Manhattan and an adjunct at New York Law School, has written *Advanced Judicial Opinion Writing*, from which this column is adapted. He thanks New York Law School student Sakima Kelly for assisting in researching this column.

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To the *Journal*:

In their well-written January 2006 article, "The EPA's New Clean Air Rules," Mark D. Sullivan and Christine A. Fazio are overly optimistic in their assessment of the effects for New York State of the new Clean Air Interstate Rule (CAIR) and not pessimistic enough about these effects pursuant to the Clean Air Mercury Rule (CAMR).

First there is the question of acceptance. EPA rules are notoriously vulnerable to constitutional challenges and the CAIR with its application to only selected states will be no exception (the authors themselves allude to another foreseeable conflict between the CAIR and the NYSDEC allowance programs). New Jersey, Massachusetts, Maryland, and Kansas have already managed to remove themselves from the original group of states to which the CAIR was to apply and there are similar rumblings (with at least one lawsuit) in Texas.

The insufficiency of these rules though is also substantive. Cap and trade hotspots can be much larger than just the areas "near facilities": if the dirtiest plants in Indiana, Pennsylvania, and Ohio opt to trade rather than cap, significant amounts of electric plant emissions will still be drifting eastward. This is precisely what has happened under the "highly successful Acid Rain program." By the same logic, if coal-fired plants simply moved further west, to states beyond the reach of CAIR, the contamination would still waft downwind.

With regard to the CAMR the substantive issue is one of mercury transport. Most of the atmospheric mercury deposited in New York comes from foreign sources. Even if the CAMR reductions are fully achieved, it is likely that the now familiar fish advisories would remain for our region (unless of course the rest of the world adopts equivalent mercury emission reduction policies). In view of our current confrontational and isolationist stance with regard to international environmental agreements (*i.e.*, Law of the Seas Convention, Convention on Biological Diversity, and the Climate Change Convention), the multi-national cooperation we need on mercury may take some principled negotiation.

The authors do not mention that along with the new Rules, the EPA is seeking to loosen the implementation of certain Federal Clean Air Act provisions (namely the New Source Review's Routine Maintenance Exception) which, if fully enforced, would mitigate hotspots and produce greater emissions reductions, all at a comparable cost to consumers (compared to cap and trade) (*see* U.S. Energy Administration, "Analysis of Strategies for Reducing Multiple Emissions from Power Plants: Sulfur Dioxide, Nitrogen Oxides, and Carbon Dioxide," p. 62, Table 21 <http://www.eia.doe.gov/oiaf/servicerpt/powerplants/pdf/sroiaf(2000)05.pdf>, last accessed: January 9, 2006).

Both the CAIR and CAMR are a good start but they need to be supplemented by a minimum "floor" on control technologies (as provided by New Source Review), and a renewal of U.S. participation in international environmental treaties.

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BY GERALD LEBOVITS

Legal-Writing Myths — Part II

The Legal Writer continues from last month, discussing legal-writing myths.

Myth #11. Finish early.

Reality: Start early — and edit late. Your labor will be more efficient if you start before facts and argument get cold in your mind. Starting early lets you start over if you learn new facts, develop a new argument, or realize you went down the wrong path. Then take the time and make the effort to edit until your work is due. You'll have fewer regrets afterward.

Myth #12. Obsessive-compulsives make the best legal writers.

Reality: Obsessing over what you write is time-consuming and stressful. It distracts from the main goal of legal writing: to communicate in a clear, concise, and organized manner. If you're obsessing over just one element of your writing, you won't accomplish your goal.

Not obsessing over what you write means never sweating the small stuff. It'll paralyze you. Become obsessive, if at all, only at the very end, when attention to detail is important. Then submit your work and be done with it. As Howard F. Angione, the *Journal*'s ex-Editor-in-Chief, once told me, "Writing is like children. At some point you must let go and hope for the best."

Myth #13. Good legal writers rarely need time to edit between drafts.

Reality: According to William Zinsser, "A clear sentence is no accident. Very few sentences come out right the first time, or even the third time."[1] Put your project aside a few times while you write and edit. You'll catch mistakes you didn't see earlier and make improvements you might not have thought of earlier. Read aloud: "By relying on your ear — not just on your mind's ear — for guidance, you will also find more ways to improve your phrasing."[2] Self-editing requires objectivity. If you have an editor, take advantage. Welcome suggestions gratefully, and think about them, even if you ultimately reject them. Editors, unlike writers, always consider the only one who counts: the reader.

Myth #14. No one cares how you cite — so long as your citations can be found.

Reality: Legal readers can tell from the quality of your citation whether your writing and analysis will be good. If you're sloppy about citations, you might be sloppy about other, more important things. Readers know that writers who care about citations care even more about getting the law right.

Some judges and law clerks insist they care not at all how lawyers cite, so long as lawyers give the correct volume and section numbers so that citations can be found. Judges and law clerks who insist they couldn't care less about lawyers' citing say so for one or more false reasons: as code to suggest they're so fair and smart they can see through the chaff to let only the merits affect their decision-making; because they themselves don't know the difference between good citing and bad; or to communicate their low expectations of the lawyers who appear before them.

Many judges and law clerks tolerate improper citation. But you should make the effort to cite properly, for yourself and your client. Improper citations detract from your credibility. And citing improperly won't give you the chance to persuade now and to use your citations as future references. Citing properly "dictates that you include the information your readers need to evaluate your legal argument."[3] Use citations to strengthen, not lengthen, your writing, and use pinpoint citations to refer your readers to the exact page at which your point is made.

> Organizing before writing lets you focus on what to say and how to say it.

Myth #15. Only perfectionists care about occasional typographical errors.

Reality: Because lawyers want to catch their readers' attention, "something as trivial as a typographical error can detract from the message."[4] Spell-check every time you exit your file. Proofread carefully on a hard copy as well. Proofreading reflects pride of authorship. Readers find proofreading mistakes easily — more easily than writers do. These are the same readers who pay little attention to what you write until you make a mistake. Proofreading mistakes adversely affect legal writing to a degree out of proportion to their significance. The impor-

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