New York State Law Digest

REPORTING IMPORTANT OPINIONS OF THE COURT OF APPEALS AND IN SPECIAL SITUATIONS OF OTHER COURTS

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WAIVER OF EMPLOYEE'S RIGHT TO BRING CLASS ACTION

U.S. SUPREME COURT ENABLES PARTY TO ARBITRATION AGREEMENT TO WAIVE RIGHT TO BRING CLASS ACTION, AND EVEN RIGHT TO COLLECTIVIZE THE ARBITRATION

This the U.S. Supreme Court definitively does in *American Exp. Co. v. Italian Colors Rest.*, 133 S.Ct. 2304, handed down on June 20, 2013. There were several prior "*Amex*" cases and yet other decisions that serve as background to the recent Second Circuit decision in *Sutherland v. Ernst & Young LLP*, 726 F.3d 290 (Aug. 9, 2013). Those decisions, and of course the *Italian Colors* case as well, are noted in *Sutherland*, around which we build this note.

Those interested in this controversial issue can secure a quality education on the subject from the *Sutherland* opinion, including a review of the relevant caselaw and the back-and-forth travels of several cases as they tried to re-track themselves to implement *Italian Colors*. Before that decision, many courts had reached results that had to be reconsidered in light of it.

This concerns the federal class action under the hyperactive Rule 23 of the Federal Rules of Civil Procedure. New York also has a class action provision, of course. Indeed, it has a whole CPLR article on the subject: Article 9, consisting of nine sections, adopted in 1975. The federal activity was the inspiration for Article 9, but it appears that only the legislature was inspired. By contrast with the federal history, in any event, and with developments in other states, the New York courts did not run very far with this new ball. (See Siegel, New York Practice 5th Ed. § 139.)

Sutherland involves the especially difficult question of whether parties who commit themselves to arbitration forfeit thereby any right to pursue a class action to which their dispute might otherwise lend itself. More particularly, the overarching issue in *Sutherland* is whether the parties to an arbitration agreement – most notably employees making an agreement with their employers – can include in their contract a stipulation waiving the right to bring a class action to resolve their dispute, and whether the courts will enforce it. The answer is that the employees can, and the courts will.

That is so, in any event, of the claims under the federal Fair Labor Standards Act (FLSA), which were among the claims involved in *Italian Colors* and now again in *Sutherland*.

Also involved, however, were claims under New York's Labor Law, which, for New York lawyers, makes a footnote in the *Sutherland* case a key one. The court says in the note (note 1) that it need not address the New York claims because

> in light of our conclusion that [the] FLSA claim must proceed collectively in arbitration pursuant to the Federal Arbitration Act, so too must her NYLL claims.

We may note that this part of the court's holding will at least avoid the potential conflict of having different forums address and conclude differently on the same issues.

Looking at the broader picture, however, the traditional argument alleged by the one in the underdog position – e.g., employees in wage disputes with their employers, credit card holders in disputes with the card companies, etc. – is that if they are deprived of the right to bring a class action on their claims, they will be effectively divested of their claims altogether for reasons of simple economics. Restricted to seeking just a one-on-one resolution in arbitration – this argument continues – they in essence lose their claims then and there because the cost of pursuing the claim alone will generally exceed the value of the claim itself.

That argument has often been made in such cases, and was made to the U.S. Supreme Court in *Italian Colors*, but did not persuade the majority. The court divided along the usual partisan lines, with Justice Scalia writing the opinion for the majority and Justice Kagan writing the opinion for the dissenting minority.

On the issue of whether the *Italian Colors* decision applies only to efforts to collectivize the claims in court, in a regular class action, or applies as well to any attempt to collectivize them within the arbitration itself, the court in *Sutherland* says that even the parties themselves acknowledge that their arbitration agreement

> bars both civil lawsuits and 'any class or collective proceedings in the arbitration'.

This flies in the face of what little New York law there is on the subject, such as that applied by the First Department in its 2011 decision in *JetBlue Airways Corp. v. Stephenson* (SPR 244:4). *JetBlue* holds, in a dispute between pilots and their airline, that whether each pilot's case must be arbitrated individually, or all may be arbitrated in one, is for the arbitrator to decide. Presumably that conclusion will still obtain, at least in a case involving only state law claims.

On the federal side, however, the arbitrator is given no such broad discretion. Provisions like those involved in the U.S. Supreme Court's *Italian Colors* decision – and in the *Sutherland* case that we're doing here – remove the parties' right to "collectivize" their dispute, either within the arbitration itself or through a class action in court, thus disabling them from securing the economic support that such devices might provide and without which an individual party might not be able to pursue a claim at all, no matter how meritorious.

If there is nothing on the scene of a federal nature, such as the FLSA was in *Italian Colors*, would a New York arbitrator be free of that restriction? Can it be that this contract-based claim is of such a nature that it invokes the contracts clause of the federal constitution and applies to state proceedings as well as federal, including those that have no specific federal subject matter?

Much remains to be resolved here, but from the *Italian Colors* case one must note that on the federal side, the contract-controlling party has been allowed to prevent the collectivization of the decisional process, thus forcing the weaker party to face the unhappy choice between the economic disadvantage of a one-on-one battle – or an outright forfeiture of the claim.

OTHER DECISIONS

"VANDALISM" COVERAGE

In Defining Malice, Held Necessary for "Vandalism" Coverage in Insurance Policy, Court Uses Same Standard That Supports Punitive Damages

That's in essence the answer furnished by the New York Court of Appeals to questions certified to it by the Second Circuit in *Georgitsi Realty, LLC v. Penn-Star Ins. Co.*, ... N.Y.3d ...., ... N.Y.S.2d ..... 2013 WL 5637757 (Oct. 17, 2013; 6-1 opinion).

P owned an apartment building in Brooklyn, insured by the defendant (D) against "vandalism", among other things. A neighbor, excavating its lot next door for an underground garage, caused damage to P's building and P tried to stop it with a cease and desist order from the city buildings department and then with a temporary restraining order from a state court. Both were apparently ignored and P turned to its insurer, D, under the policy's "vandalism" coverage.

The case was removed to and heard in federal court, reaching the Second Circuit, which certified two questions. In answering the first one, the New York Court of Appeals held that for vandalism protection under the policy the damage need not result from acts "directed specifically at the covered property". Here the acts of the wrongdoing neighbor were not aimed at P's property at all. The damage resulted unintentionally as the neighbor did work on its own property, only incidentally damaging P's property, but the Court holds that sufficient to invoke the coverage; direct injury is not necessary. "Vandalism", holds the Court,

> need not imply a specific intent to accomplish any particular result; vandals may act simply out of a love of excitement, or an unfocused desire to do harm or, ... out of a desire to enrich oneself without caring about the consequences to others.

Hence the Court concludes in an opinion by Judge Smith, that

> [w]here damage naturally and foreseeably results from an act of vandalism, a vandalism clause in an insurance policy should cover it.

That disposed of the first question. The second one put by the Second Circuit appeared the more difficult, but also ends up with an answer favorable to P.

The second question asked what "state of mind" is required of the wrongdoer to qualify it as a vandal under the policy. The Court's answer is that it's the same state of mind "required to award punitive damages against the alleged vandal". And that, holds the Court after reviewing and quoting from some of its earlier cases, including its *Marinaccio* decision of a few months ago (Digest 641), means

> such a conscious and deliberate disregard of the interests of others that [the conduct in question] may be called willful or wanton.

Judge Abdus-Salaam stresses in her partial dissent that there must also be evidence "that the vandal intended to damage or destroy property, be it the covered property or otherwise".

The "destroy" part is probably applicable here in any event, even as used in the dissent, because the destruction occurred as part of a construction project. But that's for the federal courts to determine after they get the New York answer back.

ARBITRATION

Mere "Indirect" Benefit Person Derives from Agreement He Did Not Sign Doesn't Suffice to Bind Him to Its Arbitration Clause

The basic rule is that since an obligation to arbitrate arises from the agreement of the parties, a person not a party to the agreement can't be subject to its arbitration clause. Some exceptions do exist to this rule, but they're not easy to apply. The Court of Appeals was asked to apply one in its recent *Belzberg v. Verus Investment Holdings Inc.*, ... N.Y.3d ...., ... N.Y.S.2d ...., 2013 WL 5637775 (Oct. 17, 2013), but the Court

finds no exception applicable; it relieves the nonsignatory of the obligation to arbitrate that the appellate division had imposed on him.

The exception at issue in *Belzberg* was the so-called "direct benefits estoppel theory", which holds the nonsignatory obliged to arbitrate where – citing and quoting from some federal decisions – he

> "knowingly exploits" the benefits of an agreement containing an arbitration clause, and receives benefits flowing directly from the agreement.

Guess what word causes the difficulty! Right on: the word "directly".

In an opinion by Judge Rivera, the Court struggles with earlier cases on the issue, meeting some in which the "direct" benefit was found (and the nonparty subjected to the arbitration clause) and some in which whatever benefit existed was found too indirect (and the nonparty therefore relieved of any obligation to arbitrate).

The facts of the present case show the perplexity of the realm. The appellate division had found the requisite directness in *Belzberg*, while the Court of Appeals finds it lacking.

The facts in such cases are usually convoluted, a tradition kept intact by *Belzberg*.

Mr. Belzberg and his friend Khan, the factotum of the Verus company, tried to arrange, through various other persons as well, a merger between F and C, Canadian corporations, which generated a Canadian tax that Canada sought to collect from one of the parties, J. J had an agreement with Verus which contained the arbitration clause. In a dispute over liability for the taxes, J sought arbitration against Verus. Verus then sought to add the other parties through "third-party arbitration", and they of course sought to avoid the arbitration because they weren't parties to the agreement that contained the arbitration clause.

It was argued that Belzberg, one of those resisting the arbitration – and who was not a party to the agreement that contained the clause – had nevertheless derived benefits that flowed directly from it, i.e., the J/Verus agreement. The argument does not convince the Court of Appeals, which finds that whatever the benefits Belzberg arguably derived, they were too indirect. The Court says that

> [a] benefit is indirect where the nonsignatory exploits the contractual relation of the parties, but not the agreement itself[,]

at this point citing cases, mainly federal, that go this way and that on their facts. From the cases the Court distills the conclusion that Belzberg in this case "did not receive the type of direct benefit ... encompassed by this estoppel theory".

The reader may find helpful a review of the cited cases, but in all candor we doubt it. In a wonderful understatement, the Court observes that "it can be difficult to distinguish between direct and indirect benefits".

We're reminded once again of the long-suffering Dr. Johnson after patiently sitting through a violinist's recital in 18th Century London, and even offering a kind word to the performer who, flattered, allowed that the piece he had just played was indeed difficult. The doctor couldn't let that pass. "Difficult do you call it, sir? I wish it were impossible!"

NURSING HOME REGULATION

Court Upholds Statute Requiring Commissioner's Approval for Transfer of Facility's Assets When Transfer Would Exceed 3% of Annual Revenue

The statute is § 2808(5)(c) of the Public Health Law. It requires the permission of the State Commissioner of Health if a proposed transfer of a nursing facility's assets exceeds 3% of the most recent annual revenue produced by its patient care services. Both lower courts found this unconstitutional on its face, but are overruled by the Court of Appeals, which sustains the statute in *Brightonian Nursing Home v. Daines*, ... N.Y.3d ...., ... N.Y.S.2d ...., 2013 WL 5610135 (Oct. 15, 2013).

The case reviews the present status of administrative power and the point at which the judiciary may be called on to intercede. In a unanimous opinion written by Chief Judge Lippman, the Court says that the lower courts here "erred in concluding that the subject statute was offensive to substantive due process". We have reached such a point in this field, the Court concludes, that

> [e]conomic regulation will violate an individual's substantive due process property interest only in those situations ... where there is absolutely no reasonable relationship to be perceived between the regulation and the achievement of a legitimate governmental purpose.

Citing cases met along this trail, the Court concludes that decisions finding "absolutely" no such relationship are "vanishingly rare in modern jurisprudence", and that the *Brightonian* case is not one of the rare ones.

Citing and quoting from its 2004 *Bower* decision (Digest 536), the Court says that to be "actionable" a regulation must be

> arbitrary in the constitutional sense – which is to say "so outrageously arbitrary as to constitute a gross abuse of governmental authority".

This one does not reach that point.

Conceding the government's power to regulate the sensitive business of nursing homes, the plaintiffs here – nursing home operators – argued that this enactment passed that mark by targeting even "facilities that are not financially distressed". Justifying use of such a threshold, the Court holds that with it the legislature has merely

> put in place a mechanism that would ... identify contemplated withdrawals sufficiently substantial to be of legitimate regulatory concern.

In language that is likely to be cited frequently in future regulatory disputes, the Court says that

> [t]he Legislature's prescription of means, particularly in the arena of economic regulation, is entitled to judicial deference so long as those means are in a very broad sense reasonably related to the achievement of a permissible regulatory end.

The plaintiffs argued that only those facilities with negative equity positions can be restricted in the way the present statute contemplates. The Court responds, however, that "[e]ven facilities with technically positive equity positions are not insusceptible" to the consequences of "substantial" asset withdrawal. It finds the setting of 3% as the threshold for measuring substantiality a reasonable legislative decision.

The Court also notes that the statute requires the health commissioner to act on a facility's application within 60 days of submission, which, in the usual case, at worst delaying the proposed transfer for a short time rather than absolutely barring it.

WORKERS' COMPENSATION

When Death of Worker Results from Both Work-Related and Non-Work-Related Causes, Computed Death Benefit under WCL Does Not Have to Be Reduced to Reflect the "Non-Related" Part

That would be an apportionment, for which the employer (R) argued in this case, but the Court of Appeals finds nothing in any of the relevant Workers' Compensation Law provisions – and the Court sifted through many – suggesting a need to apportion. If the work-related injury is any part of the cause, the Workers' Compensation benefits calculated for it are set by that law and are not to be diminished by any part that might be attributable to the non-work-related injury. *Hroncich v. Con Edison*, ... N.Y.3d ...., ... N.Y.S.2d ...., 2013 WL 5610258 (Oct. 15, 2013).

Mr. H was a plumber's helper for Con Ed, working there from 1958 until his retirement in 1993, when he was diagnosed with asbestosis, classified as permanently partially disabled, and awarded the applicable level of retirement benefits.

Six years later, in 1999, he was diagnosed with thyroid cancer, which was unrelated to his work. The cancer eventually "progressed" to his lungs and in 2007 he was admitted to the hospital "on an emergency basis" and died a month later. His death was the result of both the asbestosis (covered by workers' compensation) and the cancer (uncovered). The question – and the only one we address in this Digest – is whether an apportionment is called for, reducing the death benefits prescribed by the WCL in the ratio by which the later cancer contributed to the death.

Employer R argued that it is, but the Court, in an opinion by Judge Read, holds that it is not, overruling some appellate division cases that appeared to hold to the contrary, and incidentally avoiding (may we suggest) the inevitable lot of expert (and inevitably inconsistent) testimony that a rule of apportionment would generate.

R of course argued that without apportionment the deceased employee's survivors would be getting a "windfall" at R's expense. R cited the basic language of workers' compensation, embodied in WCL § 10(1), which requires every employer to cover "disability or death from injury arising out of and in the course of the employment". This argument by R, says the Court,

> implicitly endorses apportionment by suggesting that non-work-related causes should be factored out of any award. This reads quite a bit into what appears to be simply a general statement of the principle underlying workers' compensation.

Any redress for the objections raised by R here, and by employers generally in like situations, "is properly made to the legislature, not the courts".

The two-judge concurrence, written by Judge Pickett, agrees that under the WCL some appellate divisions have held that a decedent's work-related injury "need not be the sole or even the most direct cause of death"; it just has to be a "contributing factor". But the concurrence says that the Court of Appeals has yet to consider the issue, and in its view apportionment should not be used for either causation or damages. (The majority were applying it here only to the damages issues, finding the causation aspect not before it.)

The concurrence would also leave to the legislature whether any adjustment should be made in this situation.

HANDGUN PERMITS

Mere Residence in New York Suffices for Handgun License; Domicile Not Required

Many New York decisions, including a number from the Court of Appeals, have examined the difference between residence and domicile, among them the Court's 1984 *Antone* decision (Digest 301), which said that whether a mere "residence" has been established

> turns on whether [one] has a significant connection with some locality in the State as the result of living there for some length of time during the course of a year.

To establish a “domicile”, on the other hand, said *Antone*,

> requires a physical presence in the [place] and an intention to make the [place] a permanent home.

Quoting this language from *Antone*, the Court says in *Osterweil v. Bartlett*, ... N.Y.3d ...., ... N.Y.S.2d ...., 2013 WL 5610272 (Oct. 15, 2013), that this makes a key feature of domicile an “intent to remain ... for the foreseeable future”. (Sometimes it’s helpful to conceptualize the domicile concept with a negative: living in a place with no specific present intention of leaving it in the future.)

In *Osterweil*, the gun applicant had been domiciled in New York but moved to Louisiana. He kept his former residence in New York, however, to use for vacation purposes. In an opinion by Judge Pigott applying the statute that governs the issuance of handgun licenses, Penal Law § 400.00(3)(a), the Court finds that a mere residence is a permissible basis for issuance of the license; that outright domicile is not required.

The Court traces the background of the statute to and through the Roosevelt administration of 1931, when gun applications were more strictly administered in New York City than in upstate counties, prompting city residents to circumvent the city’s supervision by getting their gun licenses upstate. In the Court’s words this

> indicates that the residence language was introduced to prevent New York City residents from obtaining handgun permits in counties where, at the time, investigations of applicants were much less thorough than in the City.

And because the statute is found not to insist on domicile, and thus to enable the applicant to qualify based on what had become his mere part-time “residence”, the Court finds no need to dispose of any of the constitutional issues raised, including, of course, Second Amendment questions.

The case had begun in a federal court, where the applicant had brought an injunction action to require the state issuing officer (a state judge in this case) to grant the application. The case then went up to the Second Circuit, which found the statute ambiguous and certified the case to the New York Court of Appeals for decision.

The decision is that domicile is not necessary, and that this Louisiana domiciliary may apply for the license as a mere part-time “resident” of the state.