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Torts, Insurance & Compensation Law Section Journal

A publication of the Torts, Insurance & Compensation Law Section
of the New York State Bar Association

SOCIAL MEDIA

- Do Employers Have the Right to Demand Social Media Passwords from Job Applicants and Employees?
- Ethical Rules Relating to Social Media Investigation and Discovery

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A View from the Chair

Among other things, the *TICL Journal* traditionally serves as a source of practical tips and provides analysis of developing trends; this issue is no exception. More importantly, however, the *Journal* is a vehicle that allows practitioners to facilitate discussion, share content with a colleague, or simply learn something new and perhaps apply it in their everyday practice. In my opinion, though, one of the *Journal*'s greatest benefits is that it provides members of our learned profession with the opportunity to deliver information in a medium with which all lawyers are intimately familiar—the written word. On these pages are captured advocacy, counsel, time, effort and insight that is welcomed and appreciated.

This issue of the *Journal* also is a chance to catch up; that is, to re-cap some highlights of the past year and level-set for the remainder of 2013 in advance of what lies ahead. In May, TICL was recognized as a Section Diversity Champion for its collective efforts on the diversity and inclusion front. The Section historically has placed, and continues to place, considerable emphasis on a number of opportunities for minority attorneys including mentoring, leadership development, CLE scholarship, NYSBA event sponsorship, and a host of other initiatives that specifically are aimed at fostering diversity within our membership and within our Executive Committee ranks. As part of the venture, TICL Section leadership has committed to the NYSBA Section Mentor Program in order to assist with attorney involvement and professional growth in NYSBA Sections, and to help pave the way for future leaders. TICL also co-sponsored the Commercial and Federal Litigation Section's Smooth Moves event in the Spring, and provided two full tuition scholarships to eligible and diverse candidates wishing to attend the Young Lawyers Section Trial Academy.

Our Annual CLE was held in Annapolis, Maryland, in August and included a comprehensive program that drew speakers from the bench, the bar and industry. The attendees were treated to the hospitality of the capital city, in the company of David Schraver, the President of our Association. The event was capped off by a memorable twilight cruise of the Chesapeake Bay that put a fantastic finishing touch on a noteworthy meeting. Moreover, the Law School for Insurance Professionals enjoyed another successful run this year in venues throughout the state. Our new website is up and running, coinciding with the launch of the new NYSBA platform, and is as user-friendly as ever. The portal provides meaningful content and an outstanding electronic gateway to all things TICL.

As we set about the work of 2014, the Annual Meeting program is in development in partnership with the Trial Lawyers Section, which will include the ever-popular dinner and all-day CLE that are trademarks of the yearly gathering of our members from around the state. Additionally, plans already are under way for an unforgettable annual CLE in 2014, so please stay tuned. As we begin to close the books on 2013, and look forward to 2014, the Section's financial position remains strong, and we are well-positioned to continue to provide the value-added member benefits on which the Section prides itself.

In conclusion, my thanks to those who make it all work, every day, all year long. A special note of thanks to the contributors to this issue of the *Journal*, the collective steady hands of Lyn Curtis, the NYSBA staff and David Glazer, for putting it all together and making it look effortless.

Most importantly, and on behalf of the entire TICL Section Executive Committee, our thanks to you, our members, for supporting not only the largest volunteer state bar association in the country, but the greatest one.

Robert F. McCarthy

Do Employers Have the Right to Demand Social Media Passwords from Job Applicants and Employees? If So, Is It Good Practice—and How May the Accessed Information Be Used?

By Denine K. Carr

I. Introduction

With more than one billion people worldwide active on Facebook, it should not be a surprise that many employers are using Facebook as a tool to vet job applicants and check up on current employees. The question is whether requiring an employee to provide her Facebook or other social network password account information to a prospective or current employer is legal. If legal, the question becomes whether it's good practice, and in what manner an employer may legally use the accessed information.

II. State Legislation to Prohibit Employer Access

Public sentiment appears to disfavor allowing employers and schools the ability to access social media content that social media users consider private. Since 2012, many states have been proposing and enacting legislation that would prohibit employer access to employee social media sites. Six states enacted legislation in 2012 alone that makes it illegal for current or prospective employers and schools to force employees and students to provide access to their social network accounts. See http://www.ncsl.org/issues-research/telecom/employer-access-to-social-media-passwords.aspx. California, Michigan, Delaware and New Jersey laws apply to employers and academic institutions, while Illinois and Maryland laws currently apply to employers only. Pending legislation in 2013 would amend the Illinois and Maryland laws to apply to schools as well.

Fourteen states, including New York, introduced legislation in 2012 that would restrict employers from requesting access to social networking usernames and passwords of applicants, students or employees. As of May 31, 2013, similar legislation has been introduced or is pending in at least 36 states, including New York, and legislation has been passed in seven states so far this year. See http://www.ncsl.org/issues-research/telecom/employer-access-to-social-media-passwords-2013.aspx. New York's 2013 proposed legislation would prohibit an employer from requesting that an employee or applicant disclose any means for accessing an electronic personal account or service.

III. Status of Pending Federal Legislation

In addition to the legislation that more than half of the states have either proposed or enacted that prohibits employer and academic institutions from requesting employee passwords to social media accounts, in April 2012, the Social Networking Online Protection Act (SNOPA), a bill addressing this subject, was introduced in Congress. SNOPA would apply to schools and universities as well as employers, and would protect e-mail as well as social media. Similarly, one month later, in May 2012, federal legislation known as the Password Protection Act of 2012 was introduced in Congress which would have made it illegal for employers to force current or potential employees to provide employers access to their social network accounts. This legislation would have prohibited employers from discriminating or retaliating against prospective or current employees if an employee refused to provide access to password protected accounts. Both bills died when Congress adjourned at the year's end, but SNOPA, the more comprehensive bill, was reintroduced in February 2013 and is currently awaiting action. The Password Protection Act of 2013 was referred to committee in May 2013, but it has not been sent to the House or Senate.

If federal legislation is passed and/or New York State passes legislation prohibiting employers from requiring prospective or current employees to provide their passwords to social media accounts, whether an employer may be allowed to access employees' or prospective employees' social media content will no longer be an issue.

IV. Existing Legislation: The Stored Communications Act

As we await the status of the pending New York State and federal legislation, what guidance exists regarding an employer's rights?

The most common cause of action for social media and related claims has been via The Stored Communications Act, 18 U.S.C. § 2701, *et seq*. (SCA) (part of the Wiretap Act) that prohibits the knowing or intentional unauthorized access to "a facility through which an electronic communication services is provided." In the cases that address unauthorized access to a password protected e-mail account or social networking group, federal district courts in the Southern District of New York and New Jersey have held that the employers in question violated the SCA.

A. Employer's Request for Employees' Social Medial Passwords Is Unauthorized

Despite the fact that employees provided their employer with their social media passwords when requested, a jury found that the employer's access was unauthorized

and violated the SCA, and a federal district court in New Jersey upheld the jury's verdict. In the case of *Pietrylo v. Hillstone Restaurant Group*, 2009 U.S. Dist. LEXIS 88702 (D.N.J. 2009), the issue was whether a jury properly found that the defendant violated the SCA when it repeatedly accessed plaintiffs' MySpace chat room accounts after requesting their login information. One plaintiff testified that she felt she had to give her password to defendant because it was her employer and that she would not have given her password if the person who requested it from her had not been a manager. She testified that she would not have given her information to co-workers and that she believed she "probably would have gotten in trouble" if she had not given it to her manager. *Id.* at *8. The court found that the jury could have reasonably inferred that the plaintiff's authorization was coerced or "provided under pressure."

When deciding whether the jury's findings were reasonable, the court took into consideration the fact that the MySpace site clearly stated that it was intended to be private and was only accessible to invited members. The *Pietrylo* court found that the jury could have reasonably inferred that defendant's managers acted with knowledge or intent when they accessed MySpace repeatedly and that the managers knew they were not authorized to access the contents using the "manner and means" they did to obtain the passwords. *Id.* at *9. One of the managers testified that he knew that a plaintiff was "very uneasy" with the fact that she had given him and the rest of the managers her password and that she was worried about the consequences of having provided this information. Based upon these facts, the court found there was sufficient evidence for the jury to find that defendant unlawfully accessed plaintiffs' social media site five separate times, that the access was without authorization and was not by mistake or accident. *Id.* at *11.

B. Application of *Pietrylo*

Employers who ask their employees for social media passwords do so at their own risk. Although it does not appear that an employment policy related to the use of social media was an issue the jury addressed in *Pietrylo*, it is likely that such a policy would not have made any difference, given that the MySpace policy stated that the site was intended to be private and only accessible to invited members.

Facebook's Statement of Rights and Responsibilities requires its users to agree that they will not solicit login information or access an account belonging to someone else. It also requires its users to agree not to share their passwords or let anyone else access their accounts or "do anything else that might jeopardize the security" of their accounts. http://www.facebook.com/legal/terms. If an employer's social media policy states that the employer has a right to access employees' social media content when an employee uses the employer's computer system to access the sites, a jury could find that this policy alone does not provide an employer with authorized access because the social media site states that it is private and/or that passwords are not to be shared. A jury could find that an employee still has a reasonable expectation of privacy to her social media sites and that the employer's access was unauthorized. Employers should be very wary of accessing their employees' social media sites even if their policies give them the right to do so.

C. Employer's Access to Employee's Personal E-Mail Accounts Unauthorized

Similarly, in *Pure Power Boot Camp, Inc. v. Warrior Fitness Boot Camp*, LLC, 587 F. Supp. 2d 548, 552 (S.D.N.Y. 2008), the District Court for the Southern District of New York addressed the issue of whether an employer accessed defendant's third party server e-mails without authorization. In that case, plaintiff sought an injunction and claimed breach of restrictive covenant, alleging among other things that defendant stole trade secrets and proprietary information while still employed by plaintiff. After defendant left plaintiff's employment to set up a competing business, plaintiff accessed defendant's personal (non-work) e-mail service providers: Gmail, Hotmail, and defendant's new business e-mail account. Plaintiff was able to access defendant's e-mail accounts because the password to defendant's Hotmail account was saved to defendant's work computer. Plaintiff gained access to defendant's Gmail account by using the same user name and password as his Hotmail account and plaintiff made a "lucky guess" at defendant's new work mail password, which was the same password he used for his personal accounts. Defendant sought to preclude the e-mails from evidence and compel their return.

Plaintiff had an employee handbook that addressed its e-mail policy and limited its employees' expectation of privacy in company e-mails, granting the company full access to review all e-mail sent via *the company system*. *Id.* at 559. The court was clear that this was "not a situation in which an employer [was] attempting to use e-mails obtained from the employer's own computers or systems," noting that the e-mails at issue were "**stored and accessed directly from accounts maintained by outside electronic communication service providers**" (emphasis added). *Id.* at 554. The court found that plaintiff accessed three separate electronic communication services, obtaining defendant's e-mails while they were in storage on those service providers' systems, and stated that either of those actions, if done without authorization, would be a violation of the SCA. *Id.* at 556.

Plaintiff argued that it was authorized to access defendant's e-mails since defendant was on notice by way of plaintiff's e-mail policy that plaintiff might view his e-mails, and even if he had no expectation of privacy, by leaving his username and password on plaintiff's computers, he gave implied consent.

The court found that defendant had a subjective belief that his personal e-mail accounts, stored on third-party computer systems, protected by passwords, would be private, and further found that this expectation was reasonable, since plaintiff's policy did not suggest it could extend beyond plaintiff's own systems and beyond the employment relationship. *Id.* at 561. With regard to the issue of implied consent, the court found that defendant did not provide implied consent to search his Hotmail account simply by leaving his password on the company computer "absent clear knowledge of the extent of what could be searched and the opportunity to refuse or withdraw his consent." *Id.* at 561. Because it found that defendant's access to plaintiff's e-mails accounts was unauthorized, the court therefore found defendant violated the SCA.

The same reasoning that the *Pure Power Boot Camp* court, *supra,* applied to e-mail accounts is also applicable to social media accounts. Employers should be very careful before deciding to access employee social media sites that employees may have accessed on employer computer systems. The social media sites are stored and accessed directly from accounts maintained by outside electronic communication service providers, much like the e-mail accounts that the Pure Power Boot Camp, Inc. plaintiff accessed. The user name and password may be stored on the employer's computer system and, as a result, would be easy to access. The question is whether the employee has an expectation of privacy, and if so, whether the employee authorized access to the account. A sound social media policy is helpful, but does not address the larger issue of whether an employer policy that gives the employer the right to access social media sites used by employees during work hours on the employer's computer system constitutes consent. Based upon the decisions in *Pietrylo* and *Pure Power Boot Camp*, arguably, the employer's access would be unauthorized.

V. Another Perspective

And if the possibility of being found to have violated the SCA is not enough to dissuade employers, consider the following from Jeanne Meister, who posts a blog on www.forbes.com. She says that employees who are the best and the brightest will not agree to give up their privacy, and the companies demanding password access to social media sites will lose talented employees. Meister points out that employers requiring social media passwords is bad public relations, suggesting that job hunters will spread the word of the requirement, which will result in fewer applicants. She also points out that a majority of college students and young professionals already "friend" their colleagues and superiors on Facebook. Meister says, "Enlightened recruiters at companies know that building personal and professional networks is a sign of a high-performing professional, not an infantile practice that puts the company at risk." Finally, she points out that requiring social media passwords is a losing battle, since job seekers/employees will simply come up with another way to deal with the issue by, for example, by setting up two accounts: one that's "scrubbed" under their own name and another that uses a pseudonym. See http://www.forbes.com/sites/jeannemeister/2012/04/09/facebook-and-the-job-interview-what-employers-should-be-doing/.

Nicole Black, an attorney, author and blogger, has also weighed in on this subject. She argues that the practice of requiring employees to provide their social media passwords to their employers is not only a privacy violation of the employees, but a violation of the privacy rights of the third parties with whom the employees have communicated via social media sites. Black points out that many social media users limit public access to their social media profiles for the very purpose of maintaining more privacy. She does not believe employers should engage in the practice of requiring social media passwords, since that practice undermines the privacy rights of "innocent, unsuspecting third parties who happen to be friends with, and correspond with, job applicants." See http://nylawblog.typepad.com/suigeneris/2012/08/states-pass-laws-that-ban-requesting-passwords.html.

Gary Saunders, a blogger for CoVerica, a nationwide insurance agency, recommends against employers asking employees for user names and passwords to their social media accounts and opines that managers should not become online "friends" with employees, nor should employers have a social media "policeman" at the company who monitors comments/complaints that employees make online. http://www.coverica.com/social-media-employee-policy/. Saunders' advice is based upon various court and National Labor Relations Board (NLRB) rulings that have found employee online complaints and comments were protected activity, as discussed in VI.B. below.

In her March 5, 2013 article entitled "SNOPA and the PPA: Do You Know What it Means for You?," which was published in the Barry University Law School law review, Angela Goodrum argues that social media networks are fraught with fraudulent information; that is, information posted may not be accurate because it may have been posted by someone who created a fake profile and is holding himself out to be another person. Ms. Goodrum refers to the quarterly report filed by Facebook to the Securities Exchange Commission which reports that it estimates that over 14 million user accounts may be fraudulent. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2245911. Accordingly, employers who access their employees' social media sites may obtain false and inaccurate information, which may be negative and misleading.

VI. What to Do with the Information Once You've Accessed It

A. Gathering the Information and Using It

If an employer makes the decision to access applicants' or employees' social media sites to aid in its hiring decisions and/or to determine whether its employees are

posting derogatory and potentially defamatory statements about it online, in what manner is it allowed to use this information? The difficulty with using social media in making a hiring/firing decision is that information which may be otherwise unavailable to an employer is now accessible, yet employers may not legally use certain information to make hiring/firing decisions (e.g., information about a disability, sexual orientation, age, etc.). Further, off-duty conduct such as political activity is protected by New York Labor Law § 201-d and may not be used to make employment-based decisions. When vetting job applicants online, employers should: 1) limit inquiries to publicly available information; 2) know the legal limitations; and 3) consider only information that relates to legitimate business needs. To ensure that hiring/firing decisions are not made on the basis of protected information about which it would be illegal to base a decision, when conducting an investigation, it is advisable to delegate a person who is not a part of the decision-making process and who will maintain the privacy of ("scrub") the information that cannot legally be considered. This "neutral" will then be able to disseminate only information that may legally be considered by the hiring/firing decision makers.

B. Beware of Running Afoul of the NLRA

If an employer is ready to fire an employee for posting online comments complaining about working conditions or a supervisor, the posting will likely be considered concerted activity if other employees participate in making similar complaints. An employee who posts information about the terms and conditions of his employment is covered by § 7 of the National Labor Relations Act (NLRA) regardless of whether the employer is unionized. Concerted activity includes: 1) two or more employees addressing their employer about improving their working conditions and pay; 2) an employee speaking to his employer on behalf of himself and one or more co-workers about improving workplace conditions; and 3) two or more employees discussing pay or other work-related issues with each other. An employee's speech is not protected, however, if it is openly disloyal, including situations where the employee: 1) breached protected confidentiality, 2) maliciously or recklessly made false statement, or 3) disparaged the employer's products.

C. Ensuring an Employer's Social Media Policy Does Not Violate the NLRA

More often than not, it appears that employment social media policies reviewed by the NLRB violate § 7 of the NLRA because they: 1) tend to restrict employees from discussing protected subjects, 2) may be so vague that employees could interpret the policy to prohibit their posting about subjects involving their working conditions, 3) may discourage employees from "friending" or communicating with their co-workers, and/or 4) may prohibit social media complaining. The NLRB reviews not only whether a social media policy is used to suppress § 7 rights, but also whether the existence of an overly broad social media policy in and of itself can interfere with § 7 rights.

On May 30, 2012, Acting General Counsel for the NLRB issued a report that addressed the application of the NLRA to social media. The Acting General Counsel's opinions and advice memoranda are not binding on the NLRB or any court, but are guidance nonetheless. The report reviews six employer policies that were construed in part as overbroad and violating the NLRA, but the Acting General Counsel determined that the last policy he reviewed was entirely lawful. That policy serves as a good sample social media policy. The report may be viewed at www.jdsupra.com/legalnews/nlrb-report-of-the-acting-general-counse-61410.

D. Retaliation

If an employee does violate an employer's social media policy or use of the company network, retaliation against the employee as a result of making a complaint against the employer is illegal, and may include covert monitoring of an employee's personal Internet use at work. *Zakrzewska v. The New School*, 543 F. Supp. 2d 185, 187 (S.D.N.Y. 2008).

VII. Conclusion

Employers who choose to ask employees or applicants for their social media passwords run the risk of violating the Stored Communications Act as well as state and/or federal anti-discrimination laws if they use the accessed information improperly. While it is a good idea to maintain a social media policy in the workplace, a good policy does not necessitate accessing employees' social media accounts. Moreover, requiring that applicants/employees provide their social media passwords may result in decreased morale in the workplace, as employees feel a sense of distrust and loss of privacy, and may turn away good potential employees. The best advice? Don't ask your employees or applicants for social media passwords.

Denine K. Carr, Esq., is of counsel to Connors & Corcoran, PLLC and has a sole practice which has a focus in the area of employment law. Denine received her B.A. from the University of Iowa and her law degree from Loyola University of Chicago Law School. Denine is active in the Greater Rochester Association for Women Attorneys, serving on various committees, and is a past President. Denine has also served as Co-Chair of the Monroe County Bar Association's Disability, Labor & Employment Committee. She is a member of the New York State Bar Association and was a member of its Gender Equity Task Force and Committee on Women and the Law.

Ethical Rules Relating to Social Media Investigation and Discovery

By Odette J. Belton

It is almost impossible to visit a website these days that does not have a link to a social media site such as Facebook or Twitter. In fact, judging by the 1.06 billion monthly active users (MAU) on Facebook[1] and Twitter's forty percent jump in MAU between the second and fourth quarters of 2012,[2] you would be hard pressed to find someone who did not have a Facebook or Twitter account or who has not been otherwise exposed to social media platforms. With the proliferation of commentary, photos, videos and other information made accessible in the public domain through social media, it is inevitable that issues would arise concerning the investigation and discoverability of these sites. Courts have delved into these very deep waters, and as will be discussed below, certain patterns have emerged.

I. An Introduction to Popular Social Media Sites

Facebook and Twitter are household names. Other popular sites include, LinkedIn, Instagram, Youtube and Pinterest. Launched in February 2004, Facebook features a personal profile where you can add and categorize your friends and join common-interest user groups, post pictures and videos, play games and even send and receive email through your personal @facebook.com email address. Twitter was launched in July 2006 and allows its users to send and read text-based messages (maximum of 140 characters or less), send links to articles, and post pictures and videos. It has been described as texting over the Internet. LinkedIn has over 200 million members[3] and it was launched in May 2003. Its users can upload their CV, share articles, endorse skill sets, and network with a myriad of professional connections worldwide. Instagram has 90 million MAU[4] and it was launched in October 2010. This platform is primarily a photo-sharing vehicle where a user can upload pictures to his or her Instagram profile. These photos can also be accessed through various other social media sites (e.g., Facebook and Twitter). Youtube has 800 million MAU[5] and it was launched in February 2005 as a video-sharing platform. Sold in 2006, it is now a subsidiary of Google Inc. Pinterest is the third most popular social network site on the web behind Facebook and Twitter.[6] Launched in March 2010, this platform is a pinboard-style photo sharing website. You can create themes based on hobbies, events etc., browse other users' "pinboards" and "like" their pictures. MySpace has 21 million users.[7] Launched in August 2003, this social media platform started out as a music-based site. Other social media sites' popularity assisted the decline of this platform from 2008 onward. A new "revamped" MySpace was launched in January 2013.

II. Ethical Rules Relating to Social Media Investigation and Discovery

Various state legal associations have issued ethical "Opinions" on the rules relating to social media investigation and discovery. "Deception" as a previously acceptable investigative means does not translate easily (or at all) into the realm of social networking.[8] The new age of social media has also ushered in a move away from a complete prohibition against contacting users of social networking sites for evidence gathering.[9]

"[J]udging by the…monthly active users…, you would be hard pressed to find someone who did not have a Facebook or Twitter account or who has not been otherwise exposed to social media platforms."

New York

The New York County Lawyers' Association Committee on Professional Ethics Formal Opinion No. 737 states that "*deception" is permissible*, in limited circumstances, to investigate civil rights or intellectual property rights violations which are currently taking place or imminent.[10] Lawyers are permitted to undertake pretrial search of aprospective juror's social networking site, as long as there is no contact or communication (e.g., no "friending" or "tweeting"). Also permitted during evidentiary and deliberation phases of a trial, but only to "…publically available Twitter, Facebook or other social networking site…."[11] Attorneys can use social media websites for juror research provided no communication occurs between the parties. Deception is not permitted to gain access to a juror's website…and third parties working on behalf of the attorney must also comport with the Rules of Professional Conduct. Improper jury conduct must be reported to the court.[12] "It would be inconsistent with this policy to flatly prohibit lawyers from engaging in any and all contact with users of social networking sites." A lawyer or her agent are allowed to "friend request" an unrepresented person's social networking website without disclosing reasons for doing so, provided she uses her "real name and profile." The committee is aware of other opinions which permit limited deception, but differentiates by stating that "…the utility and ethical grounding of these limited exceptions…[are] inapplicable to social networking websites…non-deceptive means of communication ordinarily are available to obtain information on [a]

social networking page…trickery cannot be justified as a necessary last resort." Lawyers should use "informal discovery," utilizing truthfulness instead of deceit to obtain information from "unrepresented" parties.[13] "A lawyer representing a client in pending litigation may access the public pages of another party's social networking website (such as Facebook or MySpace) for the purpose of obtaining possible impeachment material for use in the litigation." The distinction here is that the pages in question are accessible to all social media network members, and is therefore akin to obtaining information on said party "…in publicly accessible online or print media, or through a subscription research service such as Nexis or Factiva…." The lawyer is prohibited from "friending" the other party or directing a third person to do so, where that party is represented.[14]

New Jersey

Two New Jersey defense attorneys allegedly "caused" a paralegal to "friend" the plaintiff in a personal injury case in order to access information on plaintiff's Facebook page. The New Jersey Office of Attorney Ethics (OAE) charged that the lawyers used the action as a "ruse and a subterfuge" to gain access to non-public portions of the plaintiff's Facebook page. The OAE alleged violation of the Rules of Professional Conduct regarding communications with parties represented by counsel, failure to supervise a non-lawyer assistant among other charges.[15] "No New Jersey ethics opinion specifically addresses friending people for litigation purposes." D. Vanarelli. (2012, Sept. 5) *Ethics Complaint Filed Against New Jersey Attorneys Who "Friended" Plaintiff So They Could Access Private Information On His Facebook Page*. (Blog commentary). Retrieved from www.dvanarelli.com/blog/?p=9396.

Pennsylvania

In March 2009, the Philadelphia Bar Association's Professional Guidance Committee found that friending for the purpose of litigation would "…violate the equivalents to RPC 8.4(c) and 4.1 for a lawyer to have a third party seek to friend a witness whose testimony was helpful to an adverse party." Lawyers are held to a higher ethical standard and the fact that the witness' Facebook or MySpace pages make her susceptible to varying deceptions does not excuse the lawyer's deception here. The committee also differentiated between the use of videotaping a plaintiff in a personal injury matter as an investigative tool by stating that the lawyer does not have to "ask to enter a private area" to make the video.[16]

Colorado

In *People v. Pautler*, 47 P. 3d 1175 (Colo. 2002) the District Attorney misrepresented himself as a defense attorney in order to keep a murder suspect talking/confessing to him over the phone regarding the gruesome murder of three women. The Supreme Court held that there are never any exceptions that would permit "deception." "Even noble motive does not warrant departure from the [R]ules of Professional Conduct…"

Oregon

In *In Re Gatti*, 8P3d 966 (Ore. 2000), the Supreme Court also held that no deception is permissible (not even carve outs for civil rights or government investigations). However, Oregon's Rules of Professional Conduct has since been changed to include under Rule 8.4 an exception permitting "covert activity" by a lawyer who in good faith believes unlawful activity has taken place or is about to take place.

Iowa

Iowa retains the old Rule 8.4, but has adopted the same exception as Oregon.

California

Plaintiff's attorney in a wrongful discharge action sends a "friend" request to two high-ranking company employees who are dissatisfied with defendant employer and likely to make disparaging remarks on social media page. Plaintiff's attorney uses only his name, concerned that those employees won't be as forthcoming in depositions. California Rule of Professional Conduct 2-100 like ABA Rule 4.2 bars *ex parte* contact with represented parties. The committee held that sites like Facebook enable users to place limitations on those that view their information. Therefore, the attorney violated RPC when he made the friend request (*ex parte* communication) to the represented party and further violated rule against deception by not revealing to represented party the purpose of the request (applicable to both represented or not, party or non-party).[17]

A. The ethical implications of obtaining evidence via social media has given rise to a robust discussion as evidenced by the following articles:

i. See C. J. Buckner, *Ethical Informal Discovery of Social Media*, Los Angeles County Bar Ass'n County Bar Update, Vol. 31 No. 5 (May, 2011)—the *Stored Communications Act* 18 U.S.C. §2701 (SCA) and the *Electronic Communications Privacy Act* 18 U.S.C. §2510 may preclude formal discovery directed at social media providers. California law in general does not permit lawyers to practice deception in the practice of discovery of social media, so much so that same could be subject to both civil and criminal misdemeanor ramifications in addition to professional reprisals for breaching the Rules of Professional Conduct. "Lawyers must proceed with caution when conducting informal discovery of social networking sites, restricting such efforts to truthful requests to nonparties to avoid ethical perils."

1. Under the SCA— electronic communication service providers are prohibited from "knowingly divulging" to any person or entity the contents of a communication while in electronic storage by that service without the consent of the owner of said information.

ii. See W. L. Patrick, *What Are "Friends" For?*—Ethics Hotliner—Keeping an Eye on Ethics (December, 2011)—the legal profession had advanced beyond simply "googling" a party's name as a method of evidence gathering, but what about "false friending"? There is growing consensus that the use of "deception" violates the lawyer's duty of candor.

iii. See M. Lynch and L. Batchoo, *Litigation: The risks and opportunities of social media: Growing case law allowing for the discovery of social media content has significant implications for litigation strategy*, InsideCounsel.com (September 20, 2012)—most states have a broad approach to discovery, but over the past few years social media has drastically changed the scope of such discovery. See *EEOC vs. Simply Storage Mgmt.,* 270 F.R.D. 430, which is often relied on as the standard for discovery of social media information, where the court held that social media is not "off limits" simply because it was not made available for public view or designated as "private." It's important early on in a case to determine whether social media will be useful in a case, which includes evaluating if such information would "support" claims or defenses depending on the party seeking the information.

iv. See D. Thayer and N. Keosseian, *Avoiding Minefields Associated with Discoverability of Social Media,* ABA Pretrial Practice & Discovery Committee (2011)—Five years ago, courts were "struggling" with the discoverability of emails and other electronically stored information (ESI). "A patchwork of decisions from across the United States (and some from Canada) make up the law—if it can be called that yet—on the discoverability of social media."

B. New York Rules of Professional Conduct (RPC)—the law regarding discoverability of social media is still being developed, so in the absence of clear guidance it is prudent to follow the rules of professional conduct in the same manner as one would with regard to more established law regarding ESI:

i. Rule 3.4—Fairness to Opposing Party and Counsel—lawyer shall not suppress evidence, conceal or knowingly fail to disclose that which a lawyer is legally required to reveal.

1. See *Lester v. Allied Concrete Co.,* Record No. 120074—court found "spoliation" of Facebook evidence where an attorney directed plaintiff to "clean-up" her Facebook page just before the defense made a discovery request seeking production of screen print copies from same. But in a 2013 released opinion the court upheld the lower court's decision regarding damages, reasoning that the lower court had taken significant steps to mitigate the effect of the misconduct by plaintiff and her attorney.

ii. Rule 3.5—Maintaining and preserving the impartiality of tribunals and jurors—*ex parte* communication with a juror is prohibited and could occur where a lawyer or his agent "friends" same on Facebook or other contact through various social media platforms.

iii. Rule 4.1—Truthfulness in statements to others—"…a lawyer shall not knowingly make a false statement of fact or law to a third person."

iv. Rule 4.2—Communications with represented parties—(a) "…a lawyer shall not communicate or cause another to communicate…"

1. The "no contact" rule may be violated where a party "friends" another party, for example, as it requires a response from the represented party, thus violating the no-contact rule.

v. Rule 4.3—Communicating with unrepresented persons—"…a lawyer shall not state or imply that the lawyer is disinterested…[where] the unrepresented person misunderstands the lawyer's role in the matter, the lawyer shall make reasonable efforts to correct the misunderstanding" (see *id*. *People v. Paulter*).

vi. Rule 4.4—Respect for rights of third persons—(a) "…a lawyer shall not use means that have no substantial purpose other than to embarrass or harm a third person or use methods of obtaining evidence that violate the legal rights of such a person…"

vii. Rule 5.1—imposition of ethical obligations on lawyers for the actions of attorneys they supervise.

viii. Rule 5.3—imposition of ethical obligations on lawyers for the actions of non-lawyers they supervise.

1. Agents of lawyers cannot be directed to violate the RPC.

ix. Rule 8.4—Misconduct—(a) must not violate RPC, (b) no illegal conduct, (c) no dishonesty, fraud, deceit or misrepresentation, (d) no engagement in conduct that is prejudicial to the administration of justice,…(h) no engagement in other conduct that adversely reflects on the lawyer's fitness as a lawyer.

C. Civil Practice Law and Rules (CPLR)—rules governing disclosure under the CPLR can encompass discovery of social media information, but note that New York State case law has erred more on the side of the party seeking discovery being able to prove that it is not simply a "fishing expedition" and will yield information helpful in either the "defense" against claims or "support" of same in the case.

i. CPLR 3101—full disclosure of all non-privileged matter which is "material and necessary" to the defense or prosecution of an action.

1. "[M]aterial and necessary" standard is one of "needful" not "indispensible."—"[A]ny facts bearing on the controversy which will assist preparation for trial by sharpening the issues and reducing delay and prolixity. The test is one of usefulness and reason. [*Romano v. Steelcase*, 30 Misc. 3d 426 (N.Y. Sup. Ct. 2010) quoting *Allen v. Crowell Collier Publ. Co.*, 21 NY2d 403 etc.]"

ii. CPLR 3103—Protective Orders

1. Some courts have denied protective orders and simply denied discovery demands "without prejudice" in favor of future service that is more "narrowly tailored."

iii. CPLR 3104—Supervision of disclosure

1. Use of "in-camera" inspection to have the court make a determination as the relevancy of materials sought from social media sites.

III. Discovery Demands and Social Media

There is still a dearth of case law on the issue of discovery of social media as mentioned above; however, there are several cases, which, most notably out of New York courts, have begun to fill in the gaps.

Romano v. Steelcase, 30 Misc. 3d 426 (N.Y. Sup. Ct. 2010)—personal injury action where plaintiff claimed "loss of enjoyment of life." Court granted defendant's motion for an order permitting access to plaintiff's current and historical Facebook and MySpace pages and accounts, including deleted pages and related information. Where a plaintiff puts his or her physical condition into controversy, including a claim for the loss of enjoyment of life, the plaintiff may not shield disclosure of material necessary for the defense.

Patterson v. Turner Constr. Co., 88 A.D.3d 617 (App. Div. 1st, 2011)—personal injury case where plaintiff claims loss of enjoyment of life in addition to other claims. "… [W]e reverse and remand for a more specific identification of plaintiff's Facebook information that is relevant, in that it contradicts or conflicts with plaintiff's alleged restrictions, disabilities, and losses, and other claims." And the court further reasons, that "…postings on plaintiff's online Facebook account, if relevant, are not shielded from discovery merely because plaintiff used the service's privacy settings to restrict access (*Romano v. Steelcase Inc.*).

Davids v. Novartis, 857 F. Supp. 2d 267 (U.S. Dist. 2012)—court ordered that although plaintiff's publicly available social media information was discoverable, the defense had failed to show that the private data sought had any relevancy to the matters at issue in the lawsuit.

Loporcaro v. New York City, 35 Misc. 3d 1209A—personal injury action where defendant sought access to plaintiff's "postings" on Facebook among other things to refute plaintiff's claim of being permanently disabled. Plaintiff claims "postings" are discoverable because of claims in his BOP and his EBT testimony regarding "loss of enjoyment of life." Court reasons that CPLR 3101(d)(1) entitles each party to "full disclosure of all matter material and necessary in the prosecution or defense of an action, regardless of the burden of proof" (see "material and necessary" test in *Allen v. Crowell-Collier Pub. Co.*, N.Y.2d 403), and further that "[w]hen a person creates a Facebook account, he or she may be found to have consented to the possibility that personal information might be shared with others, notwithstanding his or her privacy settings, as there is no guarantee that the pictures and information posted thereon, whether personal or not, will not be further broadcast and made available to other members of the public.…" The court permitted access to some portions of the plaintiff's Facebook account including deleted materials.

Kregg v. Maldonado, 98 A.D. 3d 1289 (App. Div. 4th Dept. 2012)—personal injury case where defendant motor car company's motion to compel plaintiff's disclosure of computer records regarding social media after learning that family of injured party had established Facebook and MySpace accounts and made Internet postings on his behalf. Plaintiff objected, contending that it was a "fishing expedition," and the court agreed, reasoning that CPLR 3101 (a) provides for full disclosure of all matter material and necessary to prosecution or defense in a matter, regardless of burden of proof, but that where discovery

demands are "overbroad" it is appropriate to vacate the entire demand rather than prune it (quoting *Board of Mgrs. Of the Park Regent Condominium v. Park Regent Assoc.*, 78 A.D.3d 752). [T]here is no contention that the information in the social media accounts contradicts plaintiff's claims for the diminution of the injured party's enjoyment of life…**[T]he proper means by which to obtain disclosure of any relevant information contained in the social media accounts is a narrowly-tailored discovery request seeking only that social-media-based information that relates to the claimed injuries arising from the accident."** [Emphasis mine] The court unanimously reversed the lower court's decision and vacated the demand without prejudice to service a more narrowly tailored disclosure request.

McCann v. Harleysville Ins. Co. of NY, 78 A.D.3d 1524 (App. Div. 4th Dept. 2010)—defendant appealed the denial of its motion to compel disclosure of information, including authorization for plaintiff's Facebook account in this personal injury action. Court held that the defendant essentially sought a "fishing expedition" and failed to establish a factual predicate with regard to the relevancy of the evidence. Lower court order was amended to vacate the protective order so that the defense was not precluded from seeking disclosure of plaintiff's Facebook at a future date.

Abrams v. Pecile, 83 A.D.3d 527 (App. Div. 1st Dept. 2011)—court refused to permit discovery of plaintiff's social networking accounts because defense failed to show that doing so would result in the discovery of evidence relevant to the defense of the lawsuit.

D'Agostino v. YRC, Inc., N.Y.L.J. (Sup. Ct. Orange Co., 2012)—In this personal injury action, defendants sought an order compelling disclosure of plaintiff's Facebook account posting which pre-dated the accident which is the subject of this action. Plaintiff sought recovery of daamges based on psychological and emotional damages. In fact, based on plaintiff's own deposition testimony, her psychological and emotional stressors predated the accident, which she'd revealed in posts on Facebook and other social media platforms. The court granted the motion. "Plaintiff claims depression and emotional and mental injuries in this lawsuit, but now wants to prevent the defendants from ascertaining the extent that these conditions existed prior to the accident…[plaintiff] cannot now claim an expectation of privacy when she shared her feelings online, testified that she did so, and now makes claims for related injuries in this action."

Richards v. Hertz Corp., 100 A.D.3d 728 (App. Div. 2d Dept. 2012)—personal injury case where court denies defendants' motion to preclude plaintiffs from offering evidence on the issue of damages, but grants plaintiffs' cross motion for a protective order (CPLR 3103) striking a demand for authorizations to their Facebook profiles. Following deposition where plaintiff testified that her injuries impaired her ability to play sports, defense lawyers discovered photos of plaintiff on skis on her public Facebook profile. Court ordered that plaintiff send to defendant "every photo on Facebook" which supported plaintiff participating in a sporting activity. Defense had demonstrated that plaintiff's Facebook profile contained photos that were probative of the issue of the extent of her alleged injuries and it was reasonable to believe that other portions of her profile may contain further relevant evidence. Supreme Court to conduct an "in-camera" inspection of all status reports, emails, photos, Facebook profile since DOA.

Tapp v. New York State Urban Development Corporation, 102 A.D.3d 620 (App. Div. 1st Dept., 2013)—The court denied defendant's motion for discovery of the plaintiff's Facebook account reasoning that it would not permit a "fishing expedition." "To warrant discovery, defendants must establish a factual predicate for their request by identifying relevant information in plaintiff's Facebook account—that is, information that 'contradicts or conflicts with plaintiff's alleged restrictions, disabilities and losses, and other claims.'"

Winchell v. Lopiccolo, 2012 N.Y. Misc. Lexis 5318 (N.Y. Sup. Ct. 2012—personal injury action where defendant sought access to plaintiff's Facebook page for the purpose of discovering what it reveals about plaintiff's cognitive functioning as she'd claimed loss of same. Court reasoned that although there is a dearth of law on this emerging issue of electronic/digital information discovery, digital fishing expeditions are just as objectionable as their "analog antecedents." Party demanding access must show that disclosure of relevant evidence is reasonably calculated to lead to the discovery of information that bears on the claims (e.g., disproving/challenging). "Hope" is not enough, and court found request for "unrestricted access" overbroad. Denied motion without prejudice to service a more "narrowly tailored" discovery demand.

Bianco v. North Fork Bancorp Inc., 2012 WL 5199007 (Oct. 10, 2012)—a personal injury case where defendant sought access to plaintiff's Facebook account (the "complete Facebook record") for an in-camera inspection. Defendant argued for discovery based on plaintiff's claim of injuries in BOP and EBT statements as to impact of said injuries on plaintiff's quality of life. Court ordered in-camera review to be supervised by Special Referee, in accordance with CPLR 3104.

Leduc v. Roma (2009 CarswellOnt 843 (Feb. 20, 2009)—an Ontario, Canada personal injury case where defendant requested production of plaintiff's Facebook pages, including private pages. Plaintiff also claimed loss of enjoyment of life. Court permitted access to private pages, stating that "[t]o permit a party claiming very substantial damages for loss of enjoyment of life to hide behind self-

set privacy controls on a website, the primary purpose of which is to enable people to share information about how they lead their social lives, risks depriving the opposite party of access to material that may be relevant to ensuring a fair trial (quoted from *Romano v. Steelcase*).

Niesig v. Team I, 76 N.Y.2d 363, 372, 559 N.Y.S.2d 527, 530 (1990)—("[T]he Appellate Division's blanket rule closes off avenues of informal discovery of information that may serve both the litigants and the entire justice system by uncovering relevant facts, thus promoting the expeditious resolution of disputes.").

EEOC v. Simply Storage Mgmt., 270 F.R.D. 430—EEOC claim filed on behalf of 2 complainants against their employer to hold it responsible for sexual harassment by a supervisor. Discovery demands included 1) photos and video from Facebook or MySpace. "The court agrees with the EEOC that broad discovery of the claimants' SNS could reveal private information that may embarrass them. Other courts have observed, however, that this is the inevitable result of alleging these sorts of injuries. Further, the court finds that this concern is outweighed by the fact that the production here would be of information that the claimants have already shared with at least one other person through private messages or a larger number of people through postings. As one judge observed, 'Facebook is not used as a means by which account holders carry on monologues with themselves.'" Leduc, 2009 CanLII 6838, at p. 31." A protective order was ordered by the court to limit the disclosure.

Coates v. Mystic Blue Cruises, Inc., 11 C 1986 (Aug. 9, 2012 N.D. Ill.)—harassment lawsuit where defendant-employer sought discovery of Facebook posts and tweets where plaintiff's comments allegedly undercut claim for emotional damages. Court permitted a "redacted" form for impeachment purposes.

Reid v. Ingerman Smith LLP et al., CV 2012-0307 (ILG) (MDG) (E.D.N.Y. 2012)—harassment case where defendants sought access to plaintiff's social media accounts to contradict plaintiff's claims of mental anguish. With some limitations, court ordered plaintiff to disclose communications or photos depicting an expression of emotion, feeling, or mental state reasoning that even if plaintiff only permitted "friends" to view her Facebook profile, there is no guarantee that they wouldn't share her personal information with others.

Keller v. National Farmers Union Property & Casualty, CV 12 72 M DLC JCL (D.Montana 2013)—personal injury case where defendant sought printout of all of plaintiff's social media website pages, and court said that discovery of "relevant" material found in social networking evidence is not off limits simply because it's designated as "private." Court denied request for discovery in this instance because it did not want to permit access "carte blanche."

Fawcett v. Altieri, 2013 N.Y. Misc. Lexis 82 (N.Y. Sup. Ct. 2013)—altercation at a tennis match resulting in personal injuries where defendant sought access to plaintiff's social media accounts. It wasn't clear when the plaintiff's social media accounts had been "made private," but this was mentioned by the court and thus the court devised a two-prong approach: (1) "material and necessary" test; and (2) whether or not it would violate the account holder's right to privacy. Ultimately, the court directed the parties to conduct depositions before it could appropriately determine whether or not production should be compelled.

McMillen v. Hummingbird Speedway, Inc., No. 113-2010 (Pa. Com. Pl. September 9, 2010)—"Where there is an indication that a person's social network sites contain information relevant to the prosecution or defense of a lawsuit…access to those sites should be freely granted."

The pattern in more recent case law on this issue has seen courts granting "limited" access to the content of an account holder's social media information. However, there have been some cases that have deviated from this.

Bass v. Miss Porter's School, No. 08-1807 (D. Conn. Oct. 27, 2009)—"[A] Connecticut court ordered the plaintiff, a student who had been expelled from a private high school, to produce all available data from Facebook, which included over 750 pages of material."

Ledbetter v. Wal-Mart Stores Inc., No. 06-1958 (D. Colo. Apr. 21, 2009)—a personal injury case where the court required plaintiff to produce all information contained on her Facebook, MySpace, and Meetup.com accounts. On January 11, 2010 the court ordered the case dismissed with prejudice (see 2010 Order).

Barnes v. CUS Nashville, LLC, No. 09-764 (M.D. Tenn. June 3, 2010)—a Tennessee magistrate offered to "friend" a plaintiff on Facebook to conduct an "in-camera" review of photos and comments. Order issued on May 25, 2011 dismissing all of plaintiff's claims against CUS with prejudice and stricken from the Court's dockets (see 2011 Order).

Purvis v. Comm'r of Soc. Sec., No. 09-5318 (D.N.J. Feb. 23, 2011)—a New Jersey judge conducted his own research on plaintiff's Facebook page and determined that plaintiff's claim of an inability to find a job wasn't credible.

Bishop v. Minichiello, 2009 BCSC 358, paras. 1, 4, 57 (Can. B.C.S.C.)—a British Columbia judge ordered a plaintiff in a personal-injury case to turn over the contents of her hard drive to make a determination of how much time the plaintiff spent on Facebook. This case is on appeal from the Supreme Court of British Columbia order.

IV. Construction of Discovery Demands and Securing Records from Social Media Sites

A. On the topic of constructing discovery demands, several themes arise from the analysis provided above:

i. Publicly available information on a social media website is "always" discoverable (see *id*. *Davids v. Novartis*).

ii. Private information *may* be discoverable

1. Consider the "material and necessary" test

   a. Must show that disclosure will result in relevant evidence or lead to discovery of information bearing on the claim.

2. "Narrowly tailored" and no "fishing expeditions"—see *Id. Winchell v. Lopiccolo.*

3. In-camera review to be supervised by Special Referee, in accordance with CPLR 3104 (many courts will permit a producing party to review private postings and disclose what he/she thinks is relevant; however, if you would prefer not to rely on opposing counsel's judgment, this is an alternative to be considered).

4. Informal discovery demands (must still adhere to ethical standards)—basically apply old rules to new technology (see *id*. *Stored Communications Act and internet service* providers).

5. The use of "[d]eception" is not permitted (refer to NY state opinions above).

iii. Subpoenas for Internet Service Providers (ISP).

1. See P. Flucke, M. Lackey, A. Lamut and M. Geagan, *Stored Communications Act and internet service providers*, lexology.com (June 28, 2012)—in 2012, U.S. District courts have handed down divergent decisions: In *In re Bittorrent Adult Film Copyright Infringement Cases*, 2012 WL 1570765 (E.D.N.Y. May 1, 2012) the court quashed subpoenas directed at "non-party ISPs" where plaintiffs sought to obtain names, addresses, home telephone numbers and email addresses of the subscribers who had allegedly illegally downloaded copyright materials. The court found that while the plaintiffs' claim was valid, they'd failed to demonstrate that the information sought was reasonably likely to identify the subscribers who'd infringed because of the widespread use of wireless routers etc. On the other side of the spectrum, "under almost identical facts," in *Patrick Collins Inc. v. Does 1-39,* 2012 WL 1432224 (D. Md. April 23, 2012), the court denied defendant's motion to quash subpoenas to certain ISPs and granted leave for plaintiff to file third-party subpoenas on the ISPs to discover the identities of the defendants, further reasoning that identification was necessary in order for plaintiff to enforce its copyright. The court distinguished the decision by stating that the subpoenas were directed towards the ISPs and not the Doe Defendants, and was therefore not burdensome to the defendants.

2. *People v. Harris*, 36 Misc. 3d 613 (Crim. Ct. N.Y. Co. 2012) and *People v. Harris*, 36 Misc. 3d 868 (Crim. Ct. N.Y. Co. 2012)—Both of these decisions addressed efforts to quash a subpoena issued by the New York County District Attorney which sought information from the defendant's "Twitter" account. In the first case, the defendant, and in the second case, Twitter, sought standing for the defendant to challenge the subpoena, but the court rejected both challenges reasoning that an individual does not have standing to challenge a subpoena against a third-party. Twitter argued that the subpoena created on "undue burden" on it, but the court denied the argument that the "burden" could create standing.

3. Method of obtaining information sought from social-media sites (*id., Avoiding Minefields*).

   a. Simply ask the ISP for the information sought (the worst it can say is no);

   b. If denied, ask the account holder for authorization to obtain the information sought;

   c. If denied, file a motion to compel.

V. Conclusion

The law concerning the investigation and discoverability of information from social media is still a work in progress. What is clear is that in general the courts, when confronted with a request for access to social media information, will exam the relevancy of the information being sought and reject efforts at a "fishing expedition." So while the law continues to develop, our profession's ethical rules and personal standards must at base shape our conduct.

Endnotes

1. *Tam, Donna,* Facebook by the numbers: 1.06 billion monthly active users as of December 31, 2012—The social network shells out a bunch of numbers during its earnings call, including new totals for users and how much money it's made off of them, cnet.com January 30, 2013.
2. *McCue, TJ,* Twitter Ranked Fastest Growing Social Platform In The World, Forbes.com January 29, 2013.
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4. *Lynley, Matthew,* Now We Know How Many Active Users Instagram Really Has, wsj.com, January 17, 2013.
5. youtube.com/t/press_statistics.
6. *Palis, Courteney,* Pinterest Traffic Growth Soars to New Heights: Experian Report, huffingtonpost.com, April 6, 2012.
7. See *Evans, Mark,* Could MySpace Become Cool Again?—forbes.com, May 23, 2012.
8. New York County Lawyers' Association Opinion No. 737 (May, 2007).
9. See NYCB Formal Opinion 2010-2 at #4 below—juror investigation and represented parties excluded.
10. *Id.*
11. New York County Lawyers' Association Committee on Professional Ethics Formal Opinion No. 743 (May, 2011).
12. New York City Bar Formal Opinion, 2012-2 Jury Research and Social Media.
13. New York City Bar Formal Opinion, 2010-2 Obtaining Evidence from Social Networking Websites.
14. New York State Bar Association Committee on Professional Ethics Opinion #843 (September 10, 2010).
15. See M. Gallagher, *Hostile Use of 'Friend' Request Puts Lawyers in Ethics Trouble,* N.J. Law Journal (Aug. 30, 2012).
16. The Philadelphia Bar Association's Professional Guidance Committee (see Opinion 2009-02).
17. See San Diego County Bar Association Legal Ethics Opinion 2011-2 (May 24, 2011).

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Insurance Recovery After Hurricane Sandy: Correcting the Improper Depreciation of Intangibles Under Property Insurance Policies

By Don Wood and John Wood

Summary

In light of the billions of dollars of insured losses suffered by property owners in the New York area, this is a timely article addressing a significant issue involving the insurance claims process. This article concerns the depreciation of partial losses of insured property. Depreciation is one of the factors that lead to differences between the estimates of a loss prepared by a contractor estimating a job for the policyholder and an adjuster estimating the same job for an insurance company. This subject is of critical importance to all professionals in the insurance industry—from adjusters to contractors, litigators, and policyholders—because the method used to calculate depreciation could lead to drastically different estimates of the value of the loss, and therefore widely divergent settlement expectations. This article lays out and defends a method that is most beneficial to the policyholder, and criticizes the intellectual foundations provided for alternative methods that should otherwise be rejected because they happen to disadvantage the policyholder.

The bottom line is that the cost of intangible items like labor and supervision should never be depreciated. The trend in the insurance industry to apply depreciation to intangible items such as labor for partial repairs defies this general principle of insurance law, as well as common sense. The trend is not a harmless shortcut. Depreciating intangibles and applying blanket depreciation rates inappropriately discounts as much as two-thirds of the items covered under the policy, significantly undermining the value of the settlement and leading to an underpayment of the insured.

There are a variety of methods of applying depreciation, or not allowing it at all in different states. Both state law and the policy must be consulted to settle a loss. Best practices should be adjusted in favor of the policyholder in light of the arguments made in this article.

If the insurance policy is a Replacement Cost Value (RCV) policy, the lowering of the estimate by the depreciated amount on the initial settlement can be a setback even if it can be recovered on completion of the work, since it forces the policyholder to come out of pocket for the amount withheld and then seek reimbursement. There is no question but that many policyholders cannot come up with the difference, which means the RCV policy is effectively settled as an ACV only policy. Excessive depreciation becomes a hindrance to indemnification.

But if the insurance policy is an Actual Cash Value (ACV) only policy, it is even more crucial to apply depreciation properly or the policyholder will never be fully indemnified. If depreciation is applied too severely, the insured may never be able to complete repairs, defeating the purpose of indemnity.

The Meaning of "Depreciation"

Depreciation means the loss in value of real or personal property over time as a result of physical deterioration from age, wear and tear from use, or economic obsolescence. The loss in value due to physical depreciation is deducted from the estimated replacement cost (RCV) of insured property in determining its actual cash value (ACV). This much is clear. What is less clear is the method by which the amount of depreciation is to be calculated. Proper application of depreciation is one of the most confusing parts of calculating a settlement on an insured property loss. Readers should be aware that this form of depreciation is distinct from financial asset remaining life calculations used for tax and accounting, and it is inappropriate to apply the latter form of depreciation in the context of property insurance. Depreciation as we are using it here is distinctly an insurance settlement term.

The Broad Evidence Rule

The manner of applying depreciation to an insured property settlement is the subject of significant potential misunderstanding. It is applied differently by different carriers in different states, and sometimes by different managers and adjusters within the same company and location. A common method of calculating the settlement amount is to subtract Depreciation from Replacement Cost to determine Actual Cash Value of the replaced property. But this is not the only method, and it may not be the best way in every instance. Market Value has also been considered in case of total losses. But now, the Broad Evidence Rule is the most commonly used method for all losses in most states. This rule is a departure from the principle that the traditional actual cash value measurement (replacement cost less depreciation) is the only measure of value at the time of the loss. The Broad Evidence Rule requires consideration of every standard of value that has a bearing on the property—its age, its likely profit, its tax value, etc.—in order to determine the value that will provide complete indemnification and no more.

Contracts of Adhesion are Construed Against the Drafter

The means of calculating depreciation should be the method that is most favorable to the insured. This was the position taken in *The Fire, Casualty & Surety Bulletin* (1992). That is a result of certain legal doctrines. Insurance policies are so-called "contracts of adhesion," which means they are contracts offered intact to the property owner by the insurance carrier under circumstances requiring the owner to accept or reject the contract in total without having an opportunity to negotiate over the wording. As a matter of contract law doctrine, contracts of adhesion are construed strictly against the party that writes them; in this situation, they would be construed strictly against the insurer. Therefore, insurance policies are interpreted in the light most favorable to the policyholder. In general, this should benefit the property owner in situations where the insurance policy is unclear. The uncertainty in the context of determining depreciation under an insurance policy means that depreciation should be calculated according to the method most favorable to the policyholder.

Repairs for Partial Losses Are Never Depreciated

Repairs to property in situations of partial loss are never depreciated. I was taught this principle as part of my extensive training as an insurance adjuster, and it is also case law in multiple jurisdictions, including Florida (*Am. Reliance Ins. Co. v. Perez*, 689 So. 2d 290 (Fla. 3d DCA 1997)); New York *(Eshan Realty Corp. v. Stuyvesant Insurance Co. of New York*, 202 N.Y.S.2d 899, *aff'd,* 12 A.D.2d 818, 210 N.Y.S.2d 256 (1961), *aff'd,* 11 N.Y.2d 707 (1962)); and Kansas (*Thomas v. Am. Family Mut. Ins. Co*., 233 Kan. 775 (1983)). However, over time, depreciation has evolved into a practice whereby some estimators arbitrarily depreciate structures or assemblies that are totally damaged, as well as apply depreciation if just a portion is being repaired.

Partial Versus Complete Loss

How do you determine what is a "partial" versus "complete" loss of insured property? Is a roof an entire component system, or is it a collection of thousands of individual shingles? If a portion of the roof is replaced, should those shingles have depreciation applied to calculate the insurance settlement? What if the entire roof is damaged? What if the entire house is damaged? What should be depreciated?

Repair Versus Replace

Where do you draw the line? If a portion of an interior room's sheetrock ceiling is replaced and the entire room painted, is the room to be depreciated since it was a repair and not a replacement? If an entire sheet of 4x8 sheetrock is replaced, would it be depreciated since it was in entire sheet, but if a 2x2 portion is replaced, would it be calculated without depreciation, since it is a repair? Would it change if you calculated depreciation on the room instead of an item? The questions prompted by the attempt to depreciate insured items proliferate, almost beyond reason.

Different Component Should Mean Different Depreciation Rates

When depreciation is applied, it is not appropriate to apply the same depreciation rate to different components within the same structure, since they have different lifespans.

The questions from the foregoing sections reveal that the calculation of depreciation is rife with decision-points that will, in aggregate, significantly influence the estimate amount. When these decisions are made in an unprincipled manner by adjusters in the field the results will be arbitrary, inconsistent, and likely to the detriment of the insured. This is true in both the insurance industry and in the courts, where the battle over depreciation is engaged regularly.

Some states require that total losses, especially total fire losses, be paid without any depreciation at all. The point here is that in those cases where depreciation is applied as a policy provision should be done so on an item-by-item basis. Furthermore, the depreciation should apply to materials only. That argument will be made clearly below.

When to Determine Actual Cash Value

Some courts have held that the actual cash value is the value immediately before the loss occurred. This would allow insurance adjusters to apply a depreciation rate for determining actual cash value based on the time of the loss. The time of the loss determines the age of the components. This means the value of the physical property would be determined on the date of the loss. However, especially in the context of catastrophic losses, the value of the repair labor should be calculated based on the price at the time proper repairs would have been made had they been made at a reasonable time after the loss. This would align depreciation rates with the reality of the insurance company's handling of the insurance claim, since the cost of repairs will vary drastically depending on when they are performed. Repairs cannot be made immediately at the time of the loss. They are made shortly thereafter.

Repair Costs Are Time-Sensitive

So the physical components age for depreciation purposes is determined at the time of the loss. Repairs can

only be made after the loss, and therefore the labor portion of repairs should be calculated based on market prices after the time of the loss. In situations of catastrophic loss, the cost of material and labor both escalate dramatically after the loss date due to increased overhead, shortages of material and labor, delays, and difficult work conditions. These elevated costs must be borne by the contractors and the insured when repairing or replacing the property, not the costs of material and labor the day before the loss occurred. The time of loss affects the rate of depreciation that is applied to the settlement. The actual cash value should be calculated based on replacement cost at the time of replacement, which is shortly after the loss, not an arbitrary price set before the trigger for coverage manifested. To do otherwise puts an impossible burden on the insured to replace their property with insufficient funds in a time of labor and material shortages. The reasonable time after the loss in which the repairs could be accomplished should be the time period to determine the costs of these items. Of course, replacement parts and the extent of labor are based on the scope of damages as a result of the loss on the loss date, so that date remains important for the calculation of costs. The loss date sets the age of the structure's materials, but it should not be the tether for values of material and labor. Those are set by market fluctuations immediately after the loss.

To repeat, the value of the property should be calculated based on the price of material and labor at the time proper repairs would have been made had they been made at a reasonable time after the loss. This means estimators must determine several categories of costs, all of which fluctuate by region, time, and conditions. Material cost is one category. Another is labor cost.

Other Costs Must Be Added

The category of "soft costs," such as General Conditions must be considered, which includes Direct Costs attributable to the repairs or rebuilding such as permits, inspections, architect fees, engineering fees, debris removal, access, and safety. Additionally, the other categories of Overhead, Profit, and Taxes must be considered.

General Contractor Overhead and Profit

In America's economy, contractors make a profit to stay in business. The only contractors who do not need to make a profit work for the government. Insurance losses include a calculation for profits. Subcontractor's overhead and profit are built into their bids or their unit costs. That is not true for a General Contractor. Usually an estimated rate of 10% of the entire cost of the job is added for Overhead and 10% for Profit for a General Contractor. The "rule of thumb" for including a General Contractor's additional Overhead and Profit is to add the amount to the entire estimate if there are three trades or more, or if the type of work would normally require the skill and time of a general contractor. This applies whether or not the policyholder does the work himself.

I would add that it would also apply if the insured were unable to supervise and coordinate the work himself. For instance, even if it is just a roof replacement, if the insured is a surgeon working long hours, he cannot leave work to supervise crews, receive deliveries, or verify proper installation. He would have to hire someone to care for the supervision, coordination, and security of his interests. The same would be true of a single mom working a job she could not leave. It would be true of anyone who did not possess the requisite skill to oversee construction. In all those cases, indemnity requires that a line item for Direct Cost of Supervision be added, or the services of a General Contractor be obtained in order to complete the job, even if it involves less than three trades.

Direct Costs and Line Items

Direct Cost is a term understood by builders and contractors, but usually is a mystery to an adjuster who has never served as a superintendent on a job. If an item is a "Direct Cost" attributable to the repair or rebuilding, it should be added into the estimate as a line item, not included in the General Contractor's Overhead. Overhead, on the other hand, cannot be reduced to a line item or assigned to only one project. Onsite supervision is a line item. Portable toilets and dumpsters are each a line item, being assigned to a jobsite. A temporary fence or field office is a line item. Overhead pertains to things that continue when the General Contractor is between jobs, or that are not attributable to the job, such as cell phones, offices, secretary labor, office supplies, vehicles, insurance, etc. Direct Cost items are each a separate line item in the estimate, and not paid for out of Overhead. Neither adjusters nor contractors should misunderstand Direct Costs.

Replacement Costs Include Sales Taxes

The basis of calculations of insurance losses always starts with Replacement Cost Value, which includes state sales tax. Taxes are calculated on Materials, Labor, or both, Materials and Labor, or on the entire Total including Overhead and Profit, depending on the type of loss and how the contractor engages to do the work. States have their own rules that vary greatly. Estimators should become familiar with local rates and emergency bulletins in order to properly estimate a loss.

Cost Evaluation Concepts

In considering a total loss versus a partial loss, there are frequently differences in how depreciation is calculated to arrive at a number for actual cash value. Total loss of a structure is sometimes measured by comparable

costs of total structures in the area at the time of the loss. This is a market value approach. Real estate comparable values or a professional appraisal would be examples of total loss comparisons. So would a calculation based on a dollar per square foot basis. These are conceptual cost evaluations that would have to be modified by property distinctions such as elevated structures, pools and accessories, grade of construction and many other factors. Sometimes the actual cash value of a total loss is higher than the replacement cost of building a comparable structure, due to unique factors of construction or market demand. The Broad Evidence Rule of considering all the factors that affect depreciation and actual cash value is important for adjusters to keep in mind. The indemnification of the policyholder that is in the policyholder's best interest is the important factor.

Market value as a means of determining depreciation is impossible on a partial loss since there is no ready market for debris or for damaged components that are still attached to undamaged components. Some adjusters calculate depreciation as a percentage of the replacement cost room by room, by construction categories, or sometimes applied to the entire structure (as most flood adjusters and some insurance carriers do). On all partial loss settlements, I believe the only appropriate means of applying depreciation is on a line-by-line item basis. This also serves the purpose of separating the damaged and undamaged portions of the property.

Costs Vary According to Region

Since the actual cash value of the loss must be determined at the time of the loss, that means the current material costs and current labor costs must be determined and applied to the scope of damages. Material costs will vary for the geographic location and conditions. Many materials are found in one locale and not in another—especially roofing, which is highly localized by style and type. Material costs escalate due to shortages and delivery problems.

Depreciation Should Not Apply to Intangibles Such as Labor

Labor costs are found for each region as well. After a catastrophe, labor will fluctuate upward due to availability and extra travel, housing, overtime, and food for crews working away from their home area. Large fluctuations in material and labor do not usually occur during normal claims settlement, but do occur in almost every catastrophe. Depreciation is physical deterioration. Insurance companies and courts have erred in including labor in depreciation calculations. Labor is involved in both tear off and replacement of the physical items. Only physical items are subject to wear and tear, obsolescence, or deterioration by exposure to elements. Labor is an intangible, not subject to wear and tear, but may actually increase while the cost of the physical item decreases due to lower manufacturing costs.

Insurance companies and courts have both argued whether labor and material should be depreciated when the policy calls for an Actual Cash Value settlement, as means of arriving at a proper cost. They have further argued whether the labor to remove damaged items should be depreciated. Some courts have ruled yes and some no. To further add to the confusion, some have argued to not apply depreciation to labor when it is to remove an item, but to apply depreciation to labor when it is to install the replacement item.

The arguments that involve depreciating labor in any form just don't make sense. They are arbitrary. Depreciation can be appropriately applied only to tangible items. Labor is intangible. Therefore, depreciation should not be applied to labor in either removal or installation phases.

Depreciation is the physical deterioration of a tangible item. This position is bolstered by the traditional common law in New York (*McAnarney v. Newark Fire Ins. Co.*, 247 N.Y. 176, 159 N.E. 902 (1928); Florida (*Sperling v. Liberty Mutual Ins. Co.*, 281 So.2d 297 (Fla. 1973), *Glens Falls Ins. Co. v. Gulf Breeze Cottages, Inc.*, 38 So.2d 828 (Fla. 1949)) and possibly other jurisdictions.

It is inconsistent to state that labor to remove an item from its position where it was previously installed as a part of a structure should not be depreciated, but labor to install a new item in its place should be depreciated. This was the unfortunate holding of an erroneously reasoned Oklahoma court case.

Example: Debris Removal

It is an error to state that the difference in treatment between repair and removal is due to the fact that the policy includes Debris Removal in its coverage. Picture the craftsman removing sheetrock or framing or roofing materials. He disassembles the components and sets them on the ground. For the roofer, he lays it down and it may slide off the roof to the ground. The Xactimate definition of removal is to take the item off and set it down. This is disassembly, not Debris Removal.

Next, the item previously removed has to be carried to the dumpster or trash truck. That is probably in the category of "Daily Labor," or "Daily Cleanup." But once the rubble is assembled into a pile and swept or carried to the dumpster and placed inside, it is then undeniably, "Debris." The cost of the rental of the dumpster or trash truck and the cost of hauling the dumpster to the approved waste site and paying the dump fees is Debris Removal. It is this latter operation—removing the debris from the Loss Site and conveying it to an approved dump location—that qualifies as Debris Removal. It is a separate

and subsequent operation from the removal of the item from where it was previously installed.

In any case, neither removal nor Debris Removal are depreciable. They are intangible labor operations. Decades ago, as a staff property adjuster for a national carrier, I was trained not to depreciate either labor or Debris Removal. This should remain the rule.

Materials and Labor Prices Are Not Linked

Recall that the ACV is determined as of the Date of Loss (DOL). What was the value of the material item on the DOL? You can find out its age and calculate its lifespan using industry charts from manufacturers. What was the value of the labor on the DOL? Federal labor and wage tables, local bid practices—all can be consulted to find labor and wage rates for the time period of the required repairs. While materials generally go down in value with time, with some exceptions, labor generally goes up due to a variety of pressures. They are not linked. It is inappropriate to use the same rate of depreciation on two components of an item—material and labor—particularly when the value of one is going down and the other is going up.

When and How to Apply Depreciation

I was taught years ago that depreciation, when it was applied, must be done on a line-by-line, item-by-item basis. At the very least, it should be applied to categories of items, based on the lifespan of that category of material, rather than applied like a blanket to the entire loss.

I obtained charts of the average lifespans of materials. A few sample pages from the National Association of Home Builders is attached. Material lifespans shown in the attachment were derived from reports by product manufacturers. Nowhere in any of the lists of materials is any labor item mentioned with its appropriate lifespan! Only physical, tangible items are listed.

Rates of depreciation are different for each of the various types of materials in the estimates I produced. Sheetrock, Paint, Wood Trim, Windows, Carpet—they all have different lifespans, and therefore once I knew their approximate age, I could figure how much of their useful lifespan to deduct.

I have heard some adjusters use the example of depreciating a refrigerator and its loss of value over the years in talking about depreciating a roof. It is a nonsensical comparison. The refrigerator was assembled in a factory under controlled conditions. It only had to be set in place and connected. It would be proper to depreciate a refrigerator's material and labor as one unit, since it came pre-assembled. I have never seen anyone assemble a refrigerator onsite.

The roof components, on the other had, have to be assembled on the job, custom fit into place, individually installed into a whole unit, and properly completed over a period of days. The roof does not come pre-assembled. That would be impossible considering the variety of houses, businesses, and types of roofing, and types of jobsite conditions.

The crew does not come with the roof. The roof installation costs are obtained separately by a bid or referral process and their pricing is individualized by the job type, supply and demand, and job conditions.

There is no comparison between depreciating a refrigerator and depreciating a roof. The same is true of nearly all site-built structure components.

Material may become obsolete. An example would be organic shingles. They are not generally available. Labor does not become obsolete. If it did, it would go up, not down, due to its scarcity. Labor is always priced at current availability.

Material may suffer from wear and tear from use. This is common on floor coverings and paint finishes. Labor, on the other hand, does not suffer from wear and tear. It is intangible and temporary. It does not stick around to be abused. It has to be priced after the Date of Loss.

Material may deteriorate. It is normal for the organic compounds in roofing to evaporate or break down due to heat and sunlight. The labor is not there to be affected by the weather conditions. Once the material was installed, like Elvis, the labor is gone from the building. If it is needed again in the future, it would come with a new current price.

So, depreciation should be applied only to physical items. This is the historic and usual use of depreciation in the insurance industry.

Determining Replacement Costs

Replacement Costs are composed of:

- Material Direct Costs
- Labor Direct Costs
- Soft Costs
- Overhead
- Profit
- Taxes

These are all included in a determination of Replacement Costs. Of all these items, the only portion subject to depreciation is the Material Direct Costs.

Conclusion

If depreciation can only be applied to physical tangible items, then only about 1/3 of a loss estimate is even subject to depreciation.

Xactimate includes an option to select "Depreciate Material Only." It is there because it has been the option for much of insurance claim settlement history. I believe selecting that option is the most appropriate choice in every case where the policy calls for depreciation. Depreciation should not be applied to any other component of a loss, and especially not intangible items.

Furthermore, in all partial losses, the only appropriate depreciation is line item depreciation based on the age of the item in question.

If the writers of the policies meant to depreciate an intangible item, they should define it as such. The courts likewise should consistently avoid applying market value depreciation to a combination of tangible and intangible items that are affected differently by obsolescence, wear and tear, and deterioration.

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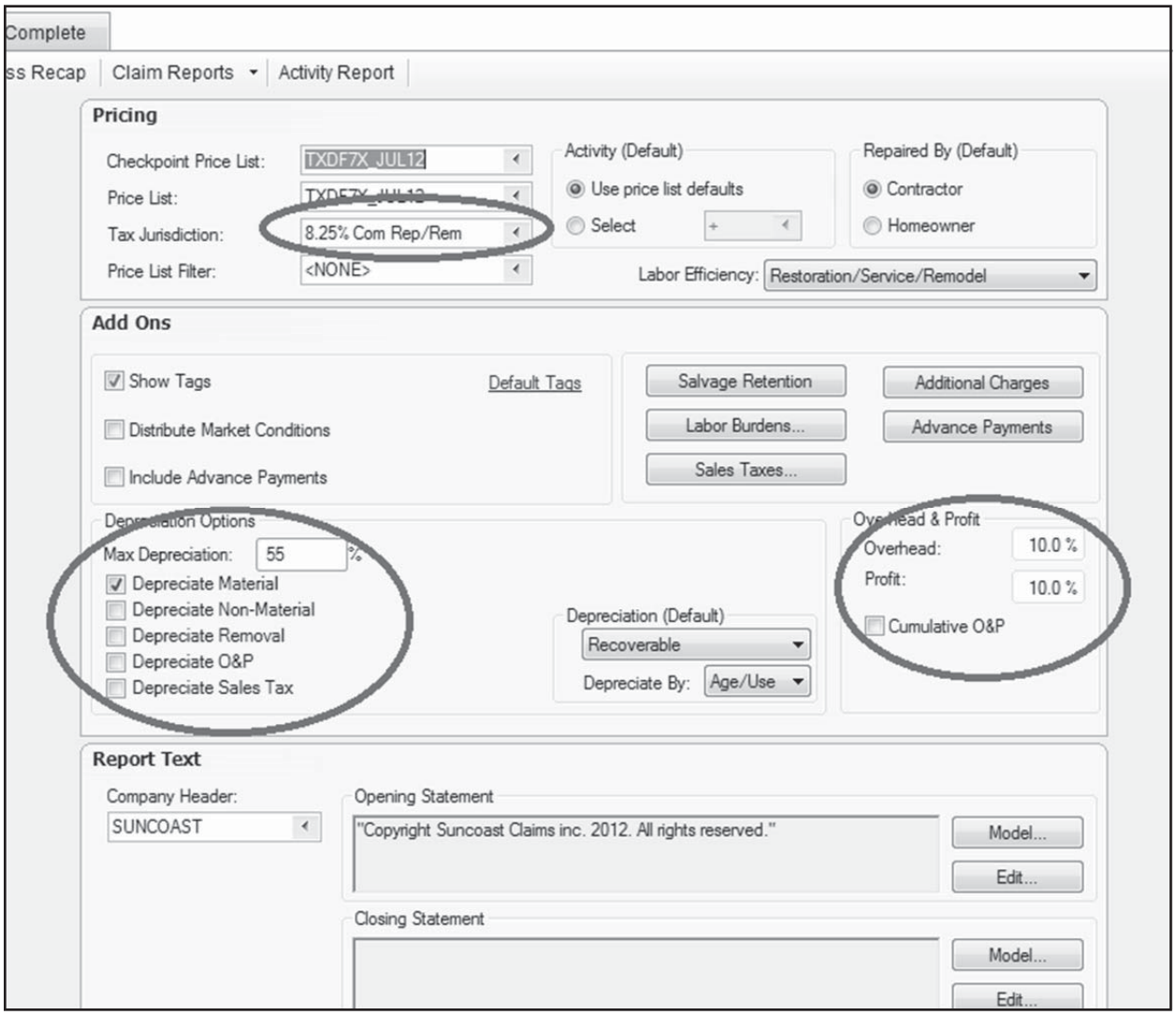
Xactimate Screen Shot



National Association of Home Builders /
Bank of America Home Equity

STUDY OF

LIFE EXPECTANCY OF HOME COMPONENTS

NAHB
National Association of Home Builders

Bank of America

FEBRUARY 2007

Table 1:
Life Expectancy of Different Products/Items/Materials in the Home

Life in Years Comments
16. INSULATION & INFILTRATION BARRIERS Insulation Material Cellulose Fiberglass Foam Insulation Type Batts/Rolls House Wrap Loose Fill 100+ Lifetime Lifetime Lifetime Lifetime Lifetime Source: DuPont, National Fiber, Johns Manville, RHH Foam Systems, No. American Insulation Manufacturer Association
17. JOBSITE EQUIPMENT Ladders Lifetime Lifts 8-10 Source: Putnam Rolling Ladder Co., Genie Industries
18. MOLDING & MILLWORK Custom Millwork Stair Parts Stairs, Circular & Spiral Stairs, Prebuilt Stairs, Attic Lifetime Lifetime Lifetime Lifetime Lifetime Source: York Spiral StairAzek, Authentic Pine Floors, Century Architectural Specialties, StairWorld, National AZZHardwood Flooring & Moulding
19. PAINTS, CAULKS, & ADHESIVES Adhesives Roofing 7 Paints & Stains Paint, Exterior 15+ Paint, Interior 15+ Depends on whether or not it is washable paint. Source: The Sherwin-Williams Co., Slate Savers, Tamko Roofing Products, Dutch Boy Paints
Life in Years Comments
20. PANELS Hardboard 30 25-30 Particleboard 60 Plywood 60 Softwood 30 Underlayment, Flooring 25 Oriented-Strand Board Wall Panels Lifetime Source: Georgia Pacific Corp., NGS Materials, Weyerhaeuser, James Hardie Building Products

21. ROOFING

Material Aluminium Roof Coating 3-7 Fiber Cement 25 Asphalt 20 Modified Bitumen 20

Copper Simulated Slate 50 Wood 30

Lifetime

Clay/Concrete Slate 50+ Coal and Tar 30

Source: Gardner-Gibson, Maxitile, National Roofing Contractors Association, GAF Material Corp., Asphalt Roofing Manufacturer's Association, Johns Manville, Metal Roof Specialties, Nycore, Authentic roof, 208 Shake&Shingle, The Northern Roof Tile Sales Co., Universal Marble & Granite, Slate Savers, Koppers, Northern Elastomeric, EcoStar, Metals USA, GAF Material Corp.

Lifetime

Life in Years

Comments

22. SIDING & ACCESSORIES

Material Brick

Engineered Wood Fiber Cement Manufactured Stone Stone

Stucco Vinyl

Lifetime Lifetime Lifetime Lifetime Lifetime 50-100 Lifetime

Related Accessories Soffits/Fascias Trim 25

Shutters Wood/Exterior 20 Wood/Interior 15+

Aluminium/Interior

10+ Sun can cause the strings to break.

50 This time period applies for fascia in fiber-cement only.

Gutters and Downspouts Copper 50+ Aluminium 20 Galvanized Steel 20 Downspouts (Aluminum) 30 Downspouts (Copper) 100

Source: Boral Bricks, APA, GAF Material Corp., James Hardie Building Products, Boulder Creek Stone and Brick, Owens Corning, Genstone Enterprises, El Rey Stucco, Heartland Building Products, Azek, James Hardie Building Products, Blinds.com, Vixen Hill Mfg. Co., Yost Mfg. & Supply, Berger Building Products, Guttersupply.com, (Rain Trade Corp. division)

23. SITE & LANDSCAPING

Asphalt Driveway Polyvinyl Fences Clay Paving Underground PVC Piping 25 Valves 20 Sprinklers

Controllers

Tennis Court Fast-Dry Green

20 Usually made obsolete by advances in technology. 15 Lifespan given for areas not prone to lighting strikes.

Lifetime

15-20 Lifetime Lifetime

Life in Years Comments
23. SITE & LANDSCAPING (Continued)
Asphalt with Acrylic Coating
Asphalt with Acrylic Cushion Coating
American Red Clay Fast-Dry with Subsurface
Irrigation Red or Green
Swimming pool
General Concrete Shell Interior Finish/Plaster Interior Finish/Pebble-tec Interior Finish/Tile Cleaning Equipment Decking Waterline Tile
12-15 Age before requiring major work. Requires recoating every 5-7 years.
12-15 Age before requiring major work. Requires recoating every 5-7 years.
Lifetime Lifetime Maintenance: average 10 minutes a day per court.
Lifetime 25+ 10-15 25-35 15-25 7-10 15 10
Source: Paddock Pools, Patios & Spas, Boral Bricks, Accurate Tennis, Aquatic Technology, Huyser, Digger Specialties, Inc., Aquatech Pools—Society of Professional Builders, Inyo Pool Products, Omega Pool Structures, Inc.
24. WALLS, CEILINGS, & FINISHES
Accoustical Ceiling Ceiling Suspension Ceramic Tile Standard Gypsum
Lifetime Moisture or movement can affect lifespan. Lifetime Lifetime Lifetime
Source: Interceramicusa, United States Gypsum Co., Messmers Inc., DAP
25. WINDOWS, SKYLIGHTS, & GLASS
Glass & Glazing Materials Window Glazing 10+
Windows Aluminum/Aluminus Clad
15-20 Wood 30+
Some parts of the window may have to be replaced, so lifespan may vary.
Source: Polygal, Gallina USA, LLC, Allied Window

[Note: This report should be used as a general guideline only. None of the information in this report should be interpreted as a representation, warranty or guarantee regarding the life expectancy or performance of any individual product or product line. Readers should not make buying decisions and/or product selections based solely on the information contained in this report.]

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Tips for Writing a Good Coverage Letter and Avoiding Common Pitfalls

By Dan D. Kohane and Elizabeth A. Fitzpatrick

Writing a coverage letter that can withstand judicial scrutiny and the strict application by the courts of Insurance Law § 3420 can mean the difference between preserving the right to rely upon a policy exclusion or breach of a policy condition and an implied waiver of such right. In New York, unlike many other jurisdictions, Insurance Law § 3420, when applicable, mandates that an insurer timely jump through many hoops, and seemingly minor deviations from the statute, and the courts' interpretations of its requirements, will result in a harsh penalty, to wit, an insurer, who otherwise had a perfectly legitimate coverage defense, will be deemed to have waived the defense and will owe coverage that otherwise would not have been available to the insured.

We will discuss the governing statute, the courts' interpretation of its requirements and finally, the New York Court of Appeals' *K2 Investment* decision and its impact on an insurer's obligations. Along the way, we will visit the issue of the applicability of § 3420 to claims between insurers.

The Reservation of Rights Letter

For those of you who have heard us lecture on this topic, you know that we often begin our discussion by advising that you NOT write another reservation of rights letter in New York, provided that the claim is one governed by Insurance Law § 3420, a statement that often is met with incredulous looks, if not outright disbelief. We are quick to explain our reasoning and to recommend the language your coverage letter should include. It is to some extent a matter of semantics.

Under established New York law, reservations of rights letters are of limited value in most situations, as a result of the governing statute discussed above, New York Insurance Law § 3420. The statute imposes onerous standards on insurers seeking to disclaim coverage and identifies several requirements necessary for proper disclaimer and denial of coverage letters. Unlike most jurisdictions, where insurers are able to protect themselves by issuing Reservation of Rights letters, New York generally finds such communications to be ineffective to protect an insurer's rights to later deny coverage and are not generally favored by the courts.

New York Insurance Law § 3420(d)(2) is the operative statutory provision. A "deeming statute," it imposes requirements that are grafted onto casualty policies issued in New York and requires strict compliance to avoid dire consequences. As will be discussed in greater detail below, New York's highest court has made it clear, time and time again, that Reservation of Rights letters are not a substitute for the statutorily required disclaimer letter.

Liability insurance carriers that fail to issue disclaimer letters promptly and properly, where claim is made under a policy issued or delivered in New York State involving an accident that occurs in New York and seeking recovery for bodily injury or wrongful death, will lose their right to rely upon exclusions and breaches of policy conditions.

Statutory Scheme

Insurance Law § 3420(d)(2) provides, with important terms highlighted, what we call the *statutory scheme* for coverage denials:

> If under a liability policy **issued or delivered in this state**, an insurer shall **disclaim liability or deny coverage** for **death or bodily injury** arising out of a motor vehicle accident or **any other type of accident occurring within this state**, it shall give **written notice as soon as is reasonably possible** of such **disclaimer of liability or denial of coverage** to the **insured and the injured person or any other claimant**.

That section creates a *statutory scheme* that applies to disclaimers when all of the following circumstances exist:

- The policy was issued or delivered in the State of New York;
- The accident occurred in the State of New York; and
- The claim involves bodily injury or wrongful death.

The purpose is to "protect the insured, the injured party, and 'any other interested party who has a real stake in the outcome' from prejudice resulting from a belated denial of coverage." *Admiral Ins. Co. v. State Farm Fire*, 86 A.D.3d 486, 488 (N.Y. App. Div. 2011).

If the *statutory scheme* does not apply, the courts resort to common law and require insurers to deny coverage in a *reasonable time* under the circumstances.

The *statutory scheme* does not apply to property damage claims, nor to claims that arise out of non-New York accidents. Likewise, it does not apply to "personal or advertising" injury claims (e.g., libel, slander, defamation), unless there is a bodily injury component alleged. Under New York law, "emotional distress," even with physical injury, is considered bodily injury so the statute may ap-

ply where such a claim is made. Accordingly, if there is a claim for emotional distress arising out of a defamation claim, the statutory scheme is triggered.

What the statute does not instruct, but the case law clearly teaches, is that a failure to strictly comply with these requirements renders a disclaimer invalid and ineffective and results in a loss of most coverage defenses, assuming the claim would otherwise fall within the coverage grant. The statute does not speak of "reservations of rights" and the courts have held that a reservation of rights letter is not a substitute for a disclaimer letter. *Hartford Ins. Co. v. Cnty. of Nassau*, 46 N.Y.2d 1028 (1979). A reservation of rights does not toll the time which an insurer would otherwise be obligated to issue a statutory compliant disclaimer of coverage, a concept often misunderstood.

As noted above, the claim must initially fall within the grant of coverage before adherence with the strict requirements of the statute will apply, i.e. the statute does not create coverage where none existed. For example, if an insurer is placed on notice of an accident or claim, but there was no policy in force for the purported insured at the time—or there was no occurrence—the failure to disclaim will not create coverage. However, if the claim initially falls within the grant of coverage and the basis for disclaimer or denial of coverage is the applicability of an exclusion or a breach of policy condition (notice or cooperation, for example), a failure to deny coverage "as soon as reasonably possible" by sending out a letter to the insured, the injured person and those who may be "other claimants" (e.g., potential cross-claimants), will invalidate the denial.

Who Must Be Notified?

The statute and the courts' interpretation of the law makes abundantly clear that the insured, the injured person and those who may be "other claimants" (e.g., potential cross-claimants) must be notified of the disclaimer or partial disclaimer. A failure to do so will invalidate the denial. The statute has been construed to mean that an insurer must give prompt written notice of disclaimer of liability or denial of coverage not only to the insured but also to any party that has *a claim against the insured arising under the policy*. *See e.g., Hartford Acc. & Indemn. Co. v. J.J. Wicks, Inc.*, 104 A.D.2d 289, 293 (N.Y. App. Div. 1984), *appeal dismissed,* 65 N.Y.2d 691 (1985); *Bovis Lend Lease LMB, Inc. v. Royal Surplus Lines Ins. Co.*, 27 A.D.3d 84, 90-91 (N.Y. App. Div. 2005). A failure to give such notice renders the disclaimer under the *statutory scheme* ineffective. *Hartford Ins. Co. v. Nassau Cnty.*, 46 N.Y.2d 1028, 1030 (1979).

While a failure to provide notice of the carrier's coverage position to the injured party and others who qualify as "any other claimant" as soon as reasonably possible will result in nullification of the denial, only those who do not receive proper notice of a coverage denial have standing to challenge and potentially overturn that denial.

When Is Notice Required?

Under Insurance Law § 3420(d)(2), "written notice as soon as is reasonably possible of such disclaimer of liability or denial of coverage" has been interpreted as obligating an insurer to issue an otherwise compliant disclaimer within 30 days of the date the insurer knew or should have known of the grounds to deny. Although the timeliness of such a disclaimer generally presents a question of fact, where the basis for the disclaimer was, or should have been, readily apparent before the onset of the delay, any explanation by the insurer for its delay will be insufficient as a matter of law. If an investigation is necessary before a denial of coverage is concluded, insurers have a duty to "expedite" the disclaimer process and the courts will evaluate whether the insurer acted promptly. It is the burden of the insurer to explain or justify the reasonableness of the delay. *Felice v. Chubb & Son Inc.*, 67 A.D.3d 861 (N.Y. App. Div. 2009).

What Events Trigger an Insurer's Obligation?

Notice of an accident, occurrence or suit implicate the insurer 's obligation to consider and advise of their position, whether notice is received from the insured, a claimant or a potential cross-claimant. Under New York law, specifically Insurance Law § 3420(a)(3), written notice given by or on behalf of the injured party or any other claimant is deemed to be notice by the insured.

Who Bears the Burden?

The insurer bears the burden to explain the reasonableness of any delay in disclaiming coverage. *See Moore v. Ewing*, 9 A.D.3d 484, 488 (N.Y. App. Div. 2004). The reasonableness of any delay is computed from the time that the insurer becomes sufficiently aware, or should have become so aware, of the facts which would support a disclaimer. *See Pawley Interior Contr., Inc. v. Harleysville Ins. Cos.*, 11 A.D.3d 595 (N.Y. App. Div. 2004). Although the timeliness of such a disclaimer generally presents a question of fact, *see Continental Cas. Co. v. Stradford,* 11 N.Y.3d 443, 449 (2008), where the basis for the disclaimer was, or should have been, readily apparent before the onset of the delay, any explanation by the insurer for its delay will be insufficient as a matter of law. *See First Fin. Ins. Co. v. Jetco Contr. Corp.,* 1 N.Y.3d 64, 69 (2003); *West 16th St. Tenants Corp. v. Public Serv. Mut. Ins. Co.*, 290 A.D.2d 278, 279 (N.Y. App. Div. 2002), *lv. denied*, 98 N.Y.2d 605 (2002).

Where the basis is not readily apparent, an unsatisfactory explanation will render the delay unreasonable as a matter of law. *See Bovis Lend Lease LMB, Inc. v. Royal Surplus Lines Ins. Co.,* 27 A.D.3d 84, 88 (N.Y. App. Div. 2005) (citing *First Fin. Ins. Co. v. Jetco Contr. Corp.*, 1 N.Y.3d at 69 (2003)). If the delay allegedly results from a need to investigate the facts underlying the proposed disclaimer, the insurer must demonstrate the necessity of conducting a thorough and diligent investigation. *See Quincy Mut. Fire Ins. Co. v. Uribe*, 45 A.D.3d 661 (N.Y. App. Div. 2007); *Schul-*

man v. Indian Harbor Ins. Co., 40 A.D.3d 957 (N.Y. App. Div. 2007).

However, as noted, where no coverage is available in the first instance, a delayed disclaimer will not create coverage. See for example, *Hunter Roberts Const. Group, LLC v. Arch Ins. Co.*, 75 A.D.3d 404, 408-09 (N.Y. App. Div. 2010) (where the court noted: "Insofar as Arch's denial of coverage was based upon lack of coverage as an additional insured pursuant to the additional insured endorsement, a timely disclaimer was unnecessary (*see Markevics v. Liberty Mut. Ins. Co.*, 97 N.Y.2d 646, 648, 735 N.Y.S.2d 865, 761 N.E.2d 557 [2001]; *Perkins v. Allstate Ins. Co.*, 51 A.D.3d 647, 649, 858 N.Y.S.2d 238 [2008])").

What Information Must Be Included in a Partial Declination and Must the Right to Independent Counsel Be Included?

Under the *statutory scheme*, specificity for grounds for disclaimer must be included, particularly if the reason for denial is a breach of policy condition or policy exclusion. It is preferable to include the policy language upon which the insurer is relying in the disclaimer letter. If there are multiple policies, for example, a primary and excess or umbrella policy, be sure to cite to both.

In *Elacqua v. Physician's Reciprocal Insurers*, 21 A.D.3d 702 (N.Y. App. Div. 2005), *lv. dismissed*, 6 N.Y.3d 844 (2006), the Third Department held that where an insurer may face liability based upon some of the grounds for recovery asserted but not upon others, the insurer has an obligation to inform the insured of its right to be represented by an attorney of his or her own choosing at the expense of the insurer. In a second decision, three years later, the same intermediate appellate court held *that an insurer's failure to meet its "affirmative obligation" to so inform the insured is further a deceptive trade practice under New York's General Business Law, § 349*. *Elacqua v. Physicians' Reciprocal Insurers*, 52 A.D.3d 886 (N.Y. App. Div. 2008) (emphasis added). No other courts have yet so held. Many insurers have decided to so advise insureds, even in parts of the state outside of the Third Department.

What Specific Statutory or Regulatory Language Must Be Included in the Coverage Letter?

There is no special language that need be included either by statute or regulation. Often, insurers include Fair Claims Settlement language that is required in first party property damage denials by regulation (11 NYCRR Part 216), but that language is not necessary in third party disclaimers.

> Should you wish to take this matter up with the New York State Insurance Department, you may file with the department either on its website at www.ins.state.ny.us/complhow.htm or you may write to or visit the Consumer Services Bureau, New York State Insurance Department, at: 25 Beaver Street, New York, NY 10004; One Commerce Plaza, Albany, NY 12257; 200 Old Country Road, Suite 340, Mineola, NY 11501; or Walter J. Mahoney Office Building, 65 Court Street, Buffalo, NY 14202.

N.B. The New York State Insurance Department and the New York State Banking Department merged effective October 3, 2011, into the New York State Department of Financial Services. However, the regulatory language still references the New York State Insurance Department, an agency that no longer exists.

May an Insurer Reserve the Right to Seek Reimbursement of Defense or Indemnity Payments?

While this issue has not reached the highest state court, generally, federal courts interpreting New York law have opined that where "coverage is disputed and a liability policy includes the payment of defense costs, 'insurers are required to make contemporaneous interim advances of defense expenses…subject to recoupment in the event it is ultimately determined no coverage was afforded.'" *Axis Reinsurance Co. v. Bennett*, No. 07 Civ. 7924, 2008 WL 2600034 (S.D.N.Y. June 27, 2008) (quoting *National Union Fire Ins. Co. of Pittsburgh, PA. v. Ambassador Group, Inc.*, 157 A.D.2d 293, 299 (N.Y. App. Div. 1990)).

In *Gotham Ins. Co. v. GLNX, Inc.*, No. 92 Civ. 6415, 1993 WL 312243 (S.D.N.Y.1993), an insurer sued for a declaratory judgment that it was not obligated to defend or indemnify an insured in an underlying lawsuit, and sought reimbursement for defense costs it had incurred. After finding that the insurer was entitled to summary judgment that it had no obligation to defend, the court also declared that the insurer was entitled to recover defense costs. *Id.*

The court relied on the fact that the insurer had sent the insured a letter explicitly stating that it reserved its right to seek reimbursement in the event of a determination that it had no duty to defend. Because the insured offered no evidence that it refused to consent to this reservation, the court found this reservation valid and issued a declaration that the insurer was entitled to reimbursement of defense costs. *Id.*; *see also One Beacon Ins. Co. v. Freundschuh*, No. 08–CV–823, 2011 WL 3739427 (W.D.N.Y. Aug. 24, 2011) (granting summary judgment to an insurer seeking a declaration that the insurer had no obligation to defend the insured in an underlying action, and determining that the insurer was entitled to a judgment that it could recoup fees from the underlying action). *See also Max Specialty Ins. Co. v. WSG Investors, LLC*, 09-CV-5237 CBA JMA, 2012 WL 3150579 (E.D.N.Y. Apr. 20, 2012), *report and recommendation adopted*, 09-CV-05237 CBA JMA, 2012 WL 3150577 (E.D.N.Y Aug. 2, 2012) where the carrier explicitly

cited its intent to recoup fees in its reservation of rights and the court found the insurer was entitled to recovery.

While it is unclear whether a right to recoupment would be lost if not specifically reserved in a letter to the insured, it appears that in every case where recoupment was permitted, the insurer specifically reserved the right and the court so noted.

What Are the Consequences of Not Issuing a Proper Reservation of Rights Letter (*e.g.*, Estoppel, Waiver, Procedural Bad Faith)?

Under the *statutory scheme*, a failure to timely and properly issue a disclaimer letter leads to a waiver of policy defenses and a loss of the right to rely upon policy exclusions and breaches of policy conditions. This can be fatal to the protection of an insurer's rights and does not require that the insured demonstrate that he, she or it was prejudiced. As indicated, and as described below, the *statutory scheme* requires that copies of the letter be sent to the injured party or any other claimant, including potential cross claimants. A failure to do so will lead, again, to a loss of the insurer's right to rely on those policy defenses.

In *Zappone v. Home Ins. Co.*, 55 N.Y.2d 131, 136-37 (1982), the Court of Appeals spoke of three kinds of disclaimers: (1) a breach of a policy condition, (2) an exclusion, and (3) a situation where coverage is not available because the risk is not within the grant of coverage. The high court made it clear that under the *statutory scheme,* a failure to timely disclaim would be fatal to the carrier in the first two instances. However, in the third, when the claim did not fall within the grant, coverage would not be created where none existed. *See also 1812 Quentin Road, LLC v. 1812 Quentin Road Condominium*, 94 A.D.3d 1070 (N.Y. App. Div. 2012) (reiterating that no disclaimer is required where there is no coverage in the first instance).

In *Max Specialty Ins. Co. v. WSG Investors, LLC*, 09-CV-5237 CBA JMA, 2012 WL 3150579 (E.D.N.Y Apr. 20, 2012), *report and recommendation adopted*, 09-CV-05237 CBA JMA, 2012 WL 3150577 (E.D.N.Y Aug. 2, 2012), the court noted that the terms used by an insurance policy are not necessarily determinative on the question of whether a lack of coverage is due to an exclusion or a lack of inclusion. Rather, the distinction comes from a practical examination of what the policy terms amount to. Applying this analysis, the court found no disclaimer was required.

A failure to raise particular exclusionary language or a breach of a policy condition within the time so prescribed will result in a waiver of the insurer's right to raise that ground for disclaimer later. A reservation of rights letter does not preserve the insurer's right to do so and the courts have held that such a letter is not a substitute for a disclaimer. It is well settled that an insurance carrier may not disclaim liability if it fails to give the insured timely notice of disclaimer as soon as is reasonably possible after it first learns of the accident or grounds for disclaimer of liability. *State Farm Ins. Co. v. Brosnan*, 220 A.D.2d 599 (N.Y. App. Div. 1995).

With regard to disclaimer outside of the *statutory scheme*, an insured must demonstrate prejudice before it can create coverage by estoppel. *See Kamyr, Inc. v. St. Paul Surplus Lines Ins. Co.*, 152 A.D.2d 62, 66 (N.Y. App. Div. 1989); *Interested Underwriters at Lloyd's v. H.D.I. III Assoc.*, 213 A.D.2d 246, 247 (N.Y. App. Div. 1995).

Under What Circumstances Does the Issuance of a Partial Denial Require Independent Counsel (and if Independent Counsel Is Required, Must the Insurer So Notify the Insured)?

Under the holding of the New York State Court of Appeals in *Public Service Mutual v. Goldfarb,* independent counsel is not required in every case where an insurer sends out a partial disclaimer or reservation of rights:

> Independent counsel is only necessary in cases where the defense attorney's duty to the insured would require that he defeat liability on any ground and his duty to the insurer would require that he defeat liability only upon grounds which would render the insurer liable. When such a conflict is apparent, the insured must be free to choose his own counsel whose reasonable fee is to be paid by the insurer. On the other hand, where multiple claims present no conflict—for example, where the insurance contract provides liability coverage only for personal injuries and the claim against the insured seeks recovery for property damage as well as for personal injuries—no threat of divided loyalty is present and there is no need for the retention of separate counsel. This is so because in such a situation the question of insurance coverage is not intertwined with the question of the insured's liability.

Pub. Serv. Mut. Ins. Co. v. Goldfarb, 53 N.Y.2d 392, 401 (1981).

Are There Any Other Notable Cases or Issues Regarding Partial Declinations?

Specificity

In addition to strict adherence to the timing of disclaimers of coverage and the obligation to provide notice to the injured party and any other claimant, New York courts also require insurers to apprise the necessary parties of the grounds for disclaimer with a high degree of specificity. This is illustrated by a decision from New York's Court of Appeals, entitled *General Accident v. Ciruc-*

ci, 46 N.Y.2d 862 (1979). New York courts afford an injured party the independent right to provide notice of an accident for which coverage is sought to an insurer. Here, the injured party exercised this right. The insurer, deeming the notice afforded by the injured party to be untimely, disclaimed coverage. Their disclaimer, however, did not specifically refer to late notice by the injured party as a basis for denial, but rather referred only to the insured's failure to timely report the accident. This defect, the court found, was fatal. Thus, the court invalidated the disclaimer and the insurer was obligated to afford coverage.

Does §3420 Apply Between Insurers?

Where an insurer, on behalf of its insured, tenders to another insurer, does the disclaiming insurer have an obligation to comply with the statutory requirements of Insurance Law § 3420 discussed above and does the tendering insurer have standing to raise the deficiencies? Where the tender is made on behalf of the insured rather than in a subsequent equitable subrogation or contribution suit between insurers, an insurer is so obligated. *JT Magen v. Hartford Fire Ins. Co.*, 64 A.D.3d 266 (N.Y. App. Div. 2009). Those within the class of persons entitled to the protections of Insurance Law § 3420(d) may properly raise an insurer's non-compliance with the statute.

In *Industry City Mgmt. v. Atlantic Mutual Ins. Co.*, 64 A.D.3d 433 (N.Y. App. Div. 2009), the court held that a letter written to Atlantic Mutual on Industry's behalf by its own insurer's claims administrator constituted timely notice to Atlantic Mutual within the meaning of Insurance Law § 3420 and, as such, the insurer was obligated to issue a timely disclaimer of coverage. The disclaimer was not issued until seven months later and, thus, the court held that it was untimely and therefore ineffective.

In *New York State Ins. Fund v. Mount Vernon Fire Ins. Co.*, 2010 WL 1239088 (2d Cir. 2010), the 2d Circuit, applying New York law, distinguished an intra-insurer dispute from one where an insurer's claim against another is premised upon the concept of equitable subrogation and thus, concluded that NYSIF was entitled to the protections of Insurance Law § 3420 as "any other claimant."

Who May Commence an Action to Challenge the Insurer's Position?

New York distinguishes between a Declaratory Judgment Action (that may be commenced only by the insurer and those who claim insured status) and a "Direct Action." The latter action, created by the New York State Insurance Law, can be commenced by an injured party who has taken judgment against an insured or purported insured but *only* after judgment has been secured.

In 2004, New York State's highest court determined that an injured claimant does not have standing and therefore does not have the right to commence an action, declaratory or otherwise, to challenge a liability insurer's decision to deny coverage, *Lang v. Hanover Ins. Co.*, 3 N.Y.3d 350, 356 (2004), until after it has obtained a judgment against the insured. The New York Insurance Law, § 3420(a)(2) allows a claimant who has obtained judgment against an insured, and therefore becomes a judgment creditor of the insured, to present that judgment to the insurer and the insured for payment. If the insurer refuses to pay the judgment, the judgment creditor is then entitled to bring a direct action against the carrier, at which time coverage defenses can be litigated.

The Court of Appeals, in *Lang,* decided that this was the only remedy the claimant had to challenge a coverage denial. The insured or the insurer each have the right to commence a declaratory judgment action at any time after a denial, even before the underlying lawsuit is resolved. There is also a limited right carved out under the recent amendments to Insurance Law §3420 imposing a prejudice requirement on an insurer seeking to disclaim coverage that allows the injured party to challenge an insurer's denial based upon late notice only once 60 days have passed from the insurer's issuance of the coverage letter.

A New Landscape—An Insurer's Obligations After the K2 Investment Decision

The New York Court of Appeals Adopts Draconian Penalty for Wrongfully Refusing to Defend in *K2 Investment Group, LLC v. American Guar. & Liab. Ins. Co.*[1]

On June 11, 2013, the New York Court of Appeals fundamentally altered the liability insurance coverage playing field in one of the most significant and far-reaching decisions in recent memory. An insurer which wrongfully fails to defend an insured will lose its right to rely upon policy exclusions when litigating indemnity obligations.

What Is the Penalty to Be Assessed to a Liability Insurer for Wrongfully Denying the Obligation to Defend an Insured? It Has Been Axiomatic That an Insurer's Obligation to Defend an Insured Is Not Based on the Responsibility to Indemnify. On the Contrary, the Duty to Defend Is Measured by the Allegations in the Complaint Juxtaposed Against the Policy Provisions

> The duty to defend arises whenever the allegations in a complaint against the insured fall within the scope of the risks undertaken by the insurer, regardless of how false or groundless those allegations might be (*Goldberg v. Lumber Mut. Cas. Ins. Co.*, 297 N.Y. 148, 154, 77 N.E.2d 131). The duty is not contingent on the insurer's ultimate duty to indemnify should the insured be found liable, nor is it material that the complaint against the insured asserts additional claims which fall outside

> the policy's general coverage or within its exclusory provisions. Rather, the duty of the insurer to defend the insured rests solely on whether the complaint alleges any facts or grounds which bring the action within the protection purchased.

Seaboard Sur. Co. v. Gillette Co., 64 N.Y.2d 304, 310 [1984].

So then, what is the penalty for a failure of the insurer to understand that defense obligation when it ought to have done so? That question was asked of the Court of Appeals almost 30 years ago. In *Servidone Const. Corp. v. Sec. Ins. Co. of Hartford* (64 N.Y.2d 419, 423-25 [1985]), the high court made it clear that the breach of the obligation to defend does not create coverage where none otherwise existed. Rather, the indemnity obligations under the policy define the coverage, and the failure to defend would not modify the insurance product to expand it beyond its accepted terms.

In *Servidone,* the insurer withdrew from the defense of a case, wrongfully, and the insured, concerned about an adverse verdict, settled the underlying claim for $50,000. When it sought to recover the $50,000 from the insurer, the Court of Appeals made it clear that the insured was only entitled to be reimbursed for that portion of the settlement that was covered by the policy:

> **We Agree With the Dissent That an Insurer's Breach of Duty to Defend Does Not Create Coverage and That, Even in Cases of Negotiated Settlements, There Can be No Duty to Indemnify Unless There is First a Covered Loss**
>
> (*Servidone Const. Corp. v Sec. Ins. Co. of Hartford*, 64 NY2d 419, 423-25 [1985]).

It has remained the standard for 28 years of insurance jurisprudence that the duty to indemnify requires a covered loss. That was, until June 11th.

A unanimous Court of Appeals, without even a passing nod of farewell to *Servidone,* decided *K2 Investment Group, LLC v. American Guar. & Liab. Ins. Co.* (2013 NY Slip Op 04270 [06/11/2013]) and altered the well-worn paradigm.

The facts are worthy of review. Plaintiffs were limited liability companies that made multiple loans totaling approximately $3 million to Goldan. Daniels, an attorney, was a member of Goldan, and was an insured of American Guarantee ("American"). Daniels was sued for legal malpractice when it was claimed that as K2's attorney he failed to record mortgages and obtain title insurance.

Daniels then notified his E&O carrier, American, of the malpractice claims against him, and thereafter forwarded a copy of the complaint. In response, American denied defense and indemnity for the reason, among others, that the allegations against Daniels were not based on the rendering or failing to render legal services for others.

After this disclaimer, plaintiff made a settlement demand on Daniels for $450,000— significantly less than the $2 million limit of American's policy. Daniels transmitted the demand to American which rejected it by reason of two exclusions in the policy. The first exclusion was based on the insured's capacity or status as an officer, director, etc., of a business enterprise. The second exclusion referenced by the carrier removed coverage for any claim arising out of the alleged acts or omissions of the insured for any business enterprise in which he had a controlling interest.

Daniels, soon thereafter, defaulted in the malpractice action, and judgments totaling over $3,000,000 were entered against him. Daniels then assigned to plaintiffs all his claims against defendant, including bad faith claims.

In the instant action, plaintiff sought the policy limits for the judgment and extra-contractual coverage for bad faith.

American opposed the claim by arguing that the allegations against Daniels arose out of his "capacity or status" as a member and owner (and thus, presumably, at least a "manager") of Goldan. Therefore, any of the claims against him logically arose from his "acts or omissions" on Goldan's behalf.

The Appellate Division, First Department, found the exclusions relied upon by American were inapplicable to the malpractice claim on which the default judgment against Daniels was based. In a strong dissent, two Justices at the Appellate Division found that there was an issue whether or not the exclusions applied (91 A.D.3d 401).

The Court of Appeals took an entirely different approach. *To wit*, it found that by breaching its duty to defend Daniels, American lost its right to rely on these exclusions in litigation over its indemnity obligation. Significantly, the high court seemed unconcerned that by so ruling, it no longer required that the coverage be afforded only for what was bargained.

The ruling, simply stated, takes a judicial eraser to policy exclusions and eschews its words in *Servidone:* ***The duty to indemnify requires a covered loss.***

In support of its position, the high court noted that in *Lang v. Hanover* (3 N.Y.3d 350 [2005]) it stated*:*

> [A]n insurance company that disclaims in a situation where coverage may be arguable is well advised to seek a declaratory judgment concerning the duty to defend or indemnify the purported insured. If it disclaims and declines to defend in the underlying lawsuit without doing so, it

> takes the risk that the injured party will obtain a judgment against the purported insured and then seek payment… Under those circumstances, having chosen not to participate in the underlying lawsuit, ***the insurance carrier may litigate only the validity of its disclaimer*** and cannot challenge the liability or damages determination underlying the judgment.
>
> The court then went on to hold here, that **if the disclaimer is *found bad*, the insurance company must indemnify its insured for the resulting judgment, even if policy exclusions would otherwise have negated the duty to indemnify.**

However, the Court in *Lang* never suggested that exclusions would be written out of the policy. Notably, that decision specifically recognized that the insurer *may litigate the validity of its disclaimer*. While the Court's ruling appeared to hold that it would disallow a subsequent challenge to the underlying liability or damage determination, it did not prevent an insurer from standing on policy exclusions or breaches of policy conditions to preclude its obligation to indemnify.

The *K2* decision implicitly modifies *Lang* as well. If the unanimous Court means what it says, *Servidone* is no more and the Court no longer requires that the indemnity obligation is measured by the policy terms.

The Court summarized and further justified its decision with these words:

> This rule will give insurers an incentive to defend the cases they are bound by law to defend, and thus to give insureds the full benefit of their bargain. It would be unfair to insureds, and would promote unnecessary and wasteful litigation, if an insurer, having wrongfully abandoned its insured's defense, could then require the insured to litigate the effect of policy exclusions on the duty to indemnify.

The Outcome Is Unmistakable, the Court of Appeals Has Held That the Failure to Properly Defend Results in the Draconian Penalty of Forfeiture

So what, if anything, does all of this mean going forward?

In the future, insurers will have to think very differently about denying a defense to an insured. As discussed below, the consequences may be very, very expensive.

In one sense, the decision is troubling as it signals the Court's willingness to void what may be perfectly acceptable policy defenses. In the instant case, it is noted that the carrier, American, had already lost its coverage argument at the Appellate Division level. Thus, if the Court did not wish to wade into this thicket, it could have simply found the exclusion relied upon by American to have been inapplicable, thereby affirming the Appellate Court, and resolving the matter with little to no fanfare.

That, as noted above, is not what the Court elected to do. The broader point, and one to be concerned with here, is whether a carrier will lose an otherwise enforceable exclusion simply because it chose to deny a potential indemnity obligation. Of course, New York courts have long held that a carrier does not have an obligation to defend a case if the insurer is able to demonstrate that it can never be charged with an obligation to indemnify. (*City of New York v. Ins. Corp.*, 305 A.D.2d 443 [2d Dept., 2003]; *see also, Pagano v. Allstate Ins. Co.*, 5 A.D.3d 576 [2d Dept., 2004]; *Dumblewski v. ITT Hartford Ins. Co.*, 213 A.D.2d 823 [3d Dept., 1995]). That long line of cases may also be in jeopardy.

Given the breadth of the duty to defend in New York, should a carrier now err, almost invariably, on the side of caution to protect against the potential loss of coverage defenses and immediately commence a declaratory judgment action to seek exculpation?

Recall the curious decision of *Hartford v. Cook* as the bellwether case for the lengths to which the defense obligation has been stretched (*see Auto. Ins. Co. of Hartford v. Cook*, 7 N.Y.3d 131 [2006]). In *Hartford v. Cook*, the insured shot and killed his business associate as the decedent was menacingly approaching him. Fearing for his safety, the insured shot decedent in the stomach in hopes of injuring to the point where the insured would avoid being attacked. The insured argued that although he intentionally shot decedent, the event was an "occurrence" under his insurance policy, as he did not intend to kill the man. In agreeing, the Court of Appeals held that the insured could have negligently caused the man's death and, accordingly, a defense under the policy should have been provided.

The breadth of *Hartford v. Cook* was further expanded by the Third Department's holding in *Merchant's Insurance Company v. Weaver* (31 A.D.3d 945 [3d Dept. 2006]) where the carrier was required to defend its insured even though the insured had intentionally fired a flare gun into the face of the injured party. Because there was an allegation of negligence, the Third Department found that the duty to defend had been triggered. In *New York Cent. Mut. Fire Ins. Co. v. Wood* (36 A.D.3d 1048), the Third Department refused to apply the intentional act exclusion where the insured knowingly and intentionally drove his vehicle into a tent in the middle of the night to retaliate against people he knew were staying at the campsite. In support of his argument for coverage, the insured stated that he did not know the tent was occupied at the time he drove into it. Accordingly, the Court held that the insured's actions may have simply been reckless, and as such, outside the scope of the intentional act exclusion.

As noted above, the carrier who gambles on its duty to defend and loses may very well face costly consequences.

A final thought. The Court offers a very curious and troubling bit of dicta in this final comment:

> [W]e do not necessarily reject (though we do not necessarily endorse) the decision of the Appellate Division in *Hough v. USAA Cas. Ins. Co.* (93 A.D.3d 405 [1st Dept. 2012]). There, the court held that an insurer's "disclaimer of its duty to defend its insured in the underlying action does not bar it from asserting that its insured injured plaintiff intentionally." The *Hough* decision could arguably be justified on the ground that insurance for one's own intentional wrongdoing is contrary to public policy (*see Messersmith v. American Fid. Co.*, 232 NY 161, 165 [1921]).

In the *Hough* case, the First Department held that a liability insurer would not lose its right to be free from indemnity obligations because it failed to deny coverage based on the lack of an **occurrence**. It has long been the rule that an insurer cannot waive itself into coverage that never existed in the first place, that was not within the grant of coverage. *Zappone v. Home Ins. Co.*, 55 N.Y.2d 131, 138-39 [1982]. We can only hope that the Court is not suggesting that a denial based upon a grant of coverage would lead to a loss of the right to deny coverage, a rule that would be contrary well-established New York law.

Crafting the Coverage Position Letter

With this background, there are certain rules that apply to crafting and sending a coverage position letter in New York, particularly relevant when considering New York incidents that result in bodily injury or wrongful death and involve New York policies.

1. Keep your eyes on the calendar. Remember the requirement to send out a disclaimer or partial disclaimer letter within the 30-day common law time period.
2. When drafting the letter, follow the "Coverage Formula":

   [What's in]—[What's Out] x [Compliance with Policy Conditions]
   [WI]—[WO] x [CPC]

   - Discuss whether there is an accident, occurrence or loss during the policy period [What's In] (or first made during the policy period if there is a claims made policy);
   - Consider each exclusion [What's Out] and detail the applicable ones in the letter;
   - Evaluate whether there has been compliance with policy conditions of notice and cooperation [CPC].
3. Avoid "reservation of rights" language, instead use "partial" or "complete" disclaimer language. For example, instead of saying
   - "We reserve our rights to deny coverage later if we find that this was an assault and therefore excluded and will, in the meantime, provide you with a defense…" use:
   - "As the incident appears to be the result of an assault, we advise you that there is no coverage because an assault does not constitute an "occurrence" and is otherwise excluded by exclusion "a." However, because of the allegations in the complaint, we recognize our separate and distinct obligation to provide you with a defense.
4. Make certain that a copy of the letter is sent to the claimant or his or her attorney and any other party that may assert a cross-claim against your insured (including co-defendants).

Endnote

1. On September 3, 2013, the Court of Appeals granted reargument, which is quite rare. Apparently, the last chapter of *K2* is yet to be written.

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The New Wave of Food Labeling Litigation: Primary Defenses and Practical Considerations

By Andrew J. Scholz, Matthew R. Shindell, and Matthew D. Cabral

Counsel for food and beverage manufacturers know these are particularly trying times for the food industry. For years now it has faced the challenge of producing competitive products in a disproportionate global marketplace during a historic domestic economic downturn. As if this challenge was not enough, the American food manufacturer must now face a barrage of lawsuits from a growing number of creative and well-funded trial lawyers who see food and beverage manufacturers as their next big target.

If garnering more and more attention from America's trial lawyers is not bad enough, the industry must also deal with an aggressive regulatory regime, including the Food and Drug Administration, which has ramped up scrutiny of the industry under the latest administration.[1] Indeed, even municipal leadership, such as New York City's Mayor Bloomberg, has gotten into the act by imposing all sorts of requirements on the food and restaurant industry. Meanwhile, the frequency of litigation against the same manufacturers is increasing at a blistering pace.[2]

Remarkably, only a small portion of this litigation is focused on manufacturing defect claims allegedly resulting in consumer injuries or even death (*e.g.*, salmonella outbreaks). Instead, the bulk of the litigation is focused on alleged "false advertising" associated with food labeling. These plaintiffs are often represented by the same well-funded trial lawyers who took on Big Tobacco. The prevailing litigation tactic is to bring false-advertising claims as class actions in state courts under the umbrella of loosely interpreted state consumer protection statutes and common law theories of negligent misrepresentation, fraud, and breach of warranties.

What is their beef and why are they bringing these claims? Are they claiming, for example, that consumers are in some sort of significant health danger akin to lung claims associated with smoking tobacco, neurological impairments from eating lead paint, or mesothelioma from inhaling asbestos fibers? No. Instead, their claim is essentially that the health benefits touted on the food labels and packaging (*e.g.*, labeling statements and pictures indicating "all natural," "low sodium," "100% pure," "heart healthy," "cholesterol free"[3]) are misleading to consumers and, in some cases, induce the consumer to buy a slightly more expensive version of a product. The damage claims based on such liability theories are murky, at best. Consequently, and not surprisingly, if a claim does induce some sort class settlement, the trial lawyers are the primary beneficiaries.

The targeted products and manufacturers are often household names, such as Campbell's Soup, Cheerios, Hershey's, and Snapple. The manufacturers have defended these claims aggressively, both on procedural and substantive grounds, by immediately removing the cases to federal court and then moving to dismiss the claims on the pleadings. This article analyzes the judicial decisions interpreting the primary defenses taken by the manufacturers. We then suggest some proven, cost-effective strategies to defeat or minimize such claims going forward.

Preemption

One of the primary defenses to a false labeling claim is that the claim is preempted by federal laws and regulations, such as the Federal Meat Inspection Act (FMIA), the Poultry Products Inspection Act (PPIA), the federal Food, Drug, and Cosmetic Act (FDCA), the Nutritional Labeling and Educational Act (NLEA), and various regulations promulgated by the Food and Drug Administration (FDA) and the U.S. Department of Agriculture (USDA). These laws provide nationwide standards for food labels, including image and wording requirements. As such, manufacturers correctly argue that any state-law claim challenging such labels should be preempted.[4]

Notably, federal preemption is an extremely complex area that cannot be fairly covered in this article. Indeed, given the complexity of the issue, courts in various jurisdictions have contradicted one another in applying preemption jurisprudence to food labeling cases. Consequently, we will only outline the general themes that are developing in the case law.

For example, courts generally find no federal preemption where the information on the label being challenged is not directly governed by federal statutes or regulations.[5] Similarly, courts typically find no preemption where plaintiffs, on the basis of state consumer protection statutes, allege that the manufactures' labels violate specific FDA regulations.[6] On the other hand, courts find preemption where there are specific federal regulations governing a food label and that label is compliant with regulations.[7] In sum, the strength of a preemption defense depends in part on the type of label being challenged, whether or not that label is directly governed by statute or regulations and, if so, whether that label is in compliance with those regulations.

Primary Jurisdiction

Even where preemption is not dispositive, manufacturers have argued with some success that the court should stay the litigation where the relevant regulatory body (*e.g.*, the FDA) is currently considering the specific labeling issues being challenged by the plaintiffs.[8] For example, some courts have stayed class actions since the FDA was considering the word "natural" in the context of foods and beverages.[9] Consequently, this defense argument can significantly delay a claim.

Standing

For some time courts have held that there is no private cause of action under the FDCA or similar statutes. Generally, plaintiffs cannot file suit alleging a food company's products are misbranded or fail to comply with specific FDCA statutes or regulations.[10] However, as we have been discussing, plaintiffs, in ever-increasing numbers, have been finding other mechanisms to challenge food labels. The most common approach is to challenge on the basis of alleged consumer fraud. Most states have some form of consumer fraud, unfair trade practice, or unfair competition law, which typically prohibits deceptive or misleading trade practices in connection with the sale or advertisement of consumer goods. Such statutes are attractive to food labeling plaintiffs, at least in part, because they often have only minimal standing requirements.

In particular, two states, California and New Jersey, have seen an explosion of food labeling-related class actions. California's Unlawful Competition Law (UCL)[11] prohibits unlawful, unfair, and fraudulent practices.[12] The law also prohibits violations of California's false-advertising statute.[13] That statute has been broadly construed to "borrow" violations of other laws as unlawful practices, which are then treated as independently actionable.[14] New Jersey's Consumer Fraud Act (NJCFA) is similarly attractive to plaintiffs because the New Jersey Supreme Court has held that courts should construe the state's class action rules liberally with respect to consumer fraud class actions.[15]

The California Supreme Court has rendered a number of encouraging decisions for food labeling plaintiffs, which effectively relax the standing requirements under the UCL. The court in *In re Tobacco II Litigation*[16] held that only the class representative needed to establish standing, not all of the absent class members. Additionally, in *Kwikset Corp. v. Superior Ct. of Orange County,*[17] the court held that merely purchasing a product because of a defective label would be enough to establish "injury in fact" for purposes of standing.[18]

Federal courts have interpreted California law to grant standing in most circumstances. In a case alleging that defendant Sioux Honey Association Cooperative violated state law by marketing its "Sue Bee Clover Honey" as "honey" even though the product contains no pollen, the U.S. District Court for the Northern District of California dismissed Sioux Honey's argument that the plaintiff lacked standing, holding that "California law recognizes an injury when a product is mislabeled in violation of the law and consumers rely on that labeling in purchasing the product or paying more than they otherwise would have."[19]

The same court has also held that a plaintiff may even have standing in circumstances where he never actually used the product at issue. In the matter of *Anderson v. Jamba Juice Co.*, the court denied a motion to dismiss a proposed class action alleging that Jamba Juice's "all natural" do-it-yourself smoothie kits contain synthetic ingredients, holding that the plaintiff can bring claims based on products he never purchased. In that case, the plaintiff alleged that he actually purchased only two of the five kits at issue in the case. Nevertheless, the court determined that the class representative had standing to bring claims regarding smoothie kit flavors that he did not buy because the products were sufficiently similar and the labels contained the same alleged misrepresentation.

California's loose standing rules notwithstanding, standing remains an important defense to consider, particularly in other jurisdictions. For instance, in New Jersey, another state that has seen a dramatic spike in food labeling-related class actions, defendants enjoy more success obtaining dismissal of such claims on the basis of lack of standing. Take, for example, the case of *Hemy v. Perdue Farms, Inc.*,[20] in which the plaintiffs claimed that the defendant inhumanely raised and slaughtered its chickens, yet advertised that its raising of chickens was humane. Specifically, the plaintiffs brought a class action suit challenging the defendant's advertising practices relating to its Perdue and Harvestland chicken products. The defendant argued that the plaintiffs lacked standing to challenge the Perdue brand products as opposed to the Harvestland products because the plaintiffs never purchased the Perdue brand products. The District Court agreed and dismissed the plaintiffs' class complaints against the defendant with respect to its Perdue brand products.

Failure to State a Claim

A routine motion filed in federal cases is a 12(b)(6) motion that the complaint fails to sufficiently state a claim, particularly given the new *Iqbal/Twombly* pleading standards. In fact, one of the early food label decisions addressing a 12(b)(6) motion was *Pelman v. McDonald's Corp*.[21] There, two families sued McDonald's under the guise of New York's consumer protection statute and alleged that McDonald's advertising campaigns, such as "McDonald's can be part of any balanced diet and lifestyle," constituted deceptive advertising.[22] The District

Court dismissed the complaint, but the Second Circuit reversed, thereby permitting the plaintiffs to supplement their pleadings.[23] Ultimately, however, the plaintiffs agreed to voluntarily dismiss the claim after they lost a class certification motion and after McDonald's changed its advertising campaign.

Following *Pelman*, Courts have granted 12(b)(6) motions involving food labeling claims. For example, in *Rooney v. Cumberland Packing Corp.*,[24] the plaintiffs alleged that "Sugar in the Raw" was misleading consumers under California's consumer protection laws because, they claimed, consumers believe that the product is not refined sugar. The District Court dismissed the claim, finding, among other things, that the defendant's packing did not state anywhere that the sugar was "unprocessed" or "unrefined." Although the procedural context for the decision came on a 12(b)(6) motion, the court was persuaded by the defendant's submission of color reproductions of the defendant's advertisements and materials, which the court took judicial notice of. The court also cited to the fact that the defendant's trademark has been in use without contest for over four decades.

Similarly, in *Verzani v. Costco Wholesale Corp*.[25] the plaintiff alleged the defendant engaged in deceptive practices by failing to disclose on its label of Shrimp Tray with Cocktail Sauce the actual weight of the shrimp. The plaintiff's motion to amend the complaint was ultimately denied because the court agreed with the defendants that a reasonable consumer would not believe that the net weight disclosed on the label refers only to the shrimp.

Unfortunately, not all motions are successful and the threat of filing a 12(b)(6) motion has done little to slow down the filing of food labeling claims. However, it is essential that all defendants in this form of litigation examine a plaintiff's complaint closely to ensure it complies with the pleading requirements outlined in *Iqbal/Twombly*.

Damages

This is also a key defense to any claim because it is difficult for plaintiffs to show that they actually suffered any measurable or cognizable harm from the alleged "deceptive" label. Notwithstanding the hurdles, plaintiffs have creatively espoused various damages theories because, clearly, if they can survive a dispositive motion on any one theory, damages can quickly add up given that the claims are typically brought as class actions.

The recent decision in *In re Cheerios Marketing and Sales Practice Litigation*[26] illustrates the point. In that case, the proposed class plaintiffs alleged that General Mills' "Cheerios" labels were deceptive in that the labels suggested that eating Cheerios helps lower cholesterol. The District Court of New Jersey refused to dismiss the claim at the pleading stage and directed limited discovery as to whether the plaintiffs suffered any cognizable harm. Plaintiffs' damages theories were "return of purchase price refunds," "benefit of the bargain" damages, and "disgorgement of profits." After taking depositions of various proposed class plaintiffs, General Mills moved for summary judgment.

The District Court found that the plaintiffs could not recover under any of the damages theories they advanced. Specifically as to the return of the purchase price theory, the court found that plaintiffs could not show that the product was "essentially worthless." As for the benefit of the bargain theory, the court found that plaintiffs could not show that plaintiffs were induced by the labeling when purchasing the product and, moreover, they could not show an actual difference in value between the product promised and the one they received. Finally, the plaintiffs could not recover a disgorgement of profits because they could not show that General Mills was unjustly enriched.

Similarly, in *Hemy v. Perdue Farms, Inc.*,[27] the New Jersey District Court dismissed the plaintiff's complaint with leave to re-plead as to damages. The court held that the plaintiff must specifically allege a loss that is "quantifiable or otherwise measurable." Like the *In re Cheerios Marketing and Sales Practice Litigation*, plaintiffs were required to establish more than conclusory allegations that they would not have purchased the products had they known that the chickens were, in their view, inhumanely treated. Instead, the plaintiffs were required to allege proven lost value, such as by showing that there were comparable chicken products without the alleged false label and that those products were less money.

Accordingly, the defendant that cannot get out of a claim at the outset should aggressively pursue a damages defense by first demanding detailed fact and expert discovery on damages and then by moving for summary judgment.

What's Working and What's Not

For the foreseeable future, trial lawyers have chosen their next target and, so long as the food industry puts out products with labels describing the health-related contents of their products, there will be continued lawsuits filed against them. The food industry is, as a result, in this fight together. While, on one hand, aggressive litigation tactics are undoubtedly expensive, the aggressiveness is paying off by slowly but surely establishing binding legal precedent throughout the country that will help traditional and newly targeted defendants in the future. In such future cases, such as the cases targeting new labels or non-traditional defendants, it is critical for defendants to immediately identify the best defenses to the claim and to aggressively pursue them through early motion practice and, if necessary, through targeted discovery.

Endnotes

1. *See* Sarah Roller and Raqiyyah Pippins, "Marketing Nutrition & Health-Related Benefits of Food & Beverage Products: Enforcement, Litigation & Liability Issues," 65 Food Drug L.J. 447 (2010).
2. *See, e.g.*, Stephanie Strom, "Lawyers from Suits Against Big Tobacco Target Food Makers," New York Times (Aug. 18, 2012) (available at www.nytimes.com/2012/08/19/business/lawyers-of-big-tobacco-lawsuits-take-aim-at-food-industry.html); and "Food Labeling Lawsuits Fill Up Court Dockets," Rockland County Times Web site (Oct. 18, 2012) (available at http://www.rocklandtimes.com/2012/10/18/food-labeling-lawsuits-fill-up-court-dockets/).
3. *Cox v. General Mills, Inc.*, 3:12 CV 06377 (N.D.Ca.) (steamers not "all natural"); *Kosta v. Del Monte Corp*., 12 CV 1722 (N.D.Ca.) ("natural" label misleading since preservatives added); *Sovocool v. Coca Cola,* 12 CV 2064 (N.D. Ca) (orange juice purportedly not "pure, natural orange juice" as labeled); *Trammal v. Barbara's Bakery, Inc.,* No. 12 CV 2664 (N.D. Ca.) ("all natural" misleading); *Lanavaz v. Twinings North America, Inc.,* No. 12 CV 2646 (N.D. Ca.) (antioxidant claims in tea misleading); *Wilson v. Frito-Lay North America, Inc.,* 12 CV 1586 (N.D. Ca) 12 CV 1586 (trans fat labeling misleading); *Anderson v. Starbucks,* No BC485458 (Cal. Super. Ct., L.A. Co.) (Starbucks beverage dyed with insect extract); *Hawkins v. General Mills,* 12 CV 3306 (C.D.Ca.) ("Greek" yogurt falsely labeled).
4. *See* 21 U.S.C. § 343-1(a)(1)–(5) (express preemption clauses).
5. *Holk v. Snapple,* 575 F.3d 329 (3d Cir. 2009) ("all natural" claim)*; Khasin v. The Hershey Company,* 5:12-cv-01862, 2012 U.S. Dist. LEXIS 161300 (N.D. Cal. Nov. 9, 2012) (N.D.Ca.); *Chacanaca,*752 F. Supp. 2d 1111, 1118 (N.D.Ca. 2010) (no preemption "[u]ntil the agency brings 'front of the box' symbols and photographs into its regulatory ambit"); *Wright v. General Mills Inc.,* 2009 WL 3247148, at *3 (S.D. Cal. Sept. 30, 2009) (no preemption since "FDA has deferred taking regulatory action"); *Fellner v. Tri Union,* 539 F.3d 237, 255 (unregulated food warning claim not preempted).
6. *Ackerman v. Coca-Cola Co.,* No. CV-09-0395, 2010 WL 2925955 (E.D. N.Y. July 21, 2010); *Mason v. Coca-Cola Co.,* 2010 WL 2674445, at *3 (D.N.J. June 30, 2010) (allegedly false statement of ingredients related to Diet Coke Plus); *Chavez v. Blue Sky Natural Beverage Co.,* 268 F.R.D. 365, 371-72 (N.D. Cal. 2010) (allegedly false statement of origin); *Vermont Pure Holdings, Ltd. v. Nestle Waters,* 2006 WL 839486, at *5-6 (D. Mass. March 28, 2006) (alleged violation of spring water source regulation); *Smajlaj v. Campell Soup,* 782 F. Supp.2d 84 (2011).
7. *Turek v. General Mills., Inc.,* 2011 U.S. App. LEXIS 20959 (7th Cir. 2011) (fiber statements); *Pom Wonderful LLC v. Coca Cola,* 679 F.3d 1170 (9th Cir. 2012) (juice label); *Carrea v. Dryer's Grand Ice Cream,* No. 11-15263 (April 5, 2012); *Lateef v. Pharmavite,* 12-cv-05611 (N.D.Il. Oct. 24, 2012) (dismissing class action complaint related to food supplement label since directly governed by FDA regulations); *Peviani v. Hostess Brands,*2010 WL 4553510, at *6 (C.D. Cal. Nov. 3, 2010) (trans fat label claims directly preempted); *Henderson v. Gruma Corp.,* CV 10-04173, 2011 WL 1362188, at *13 (C.D. Cal. Apr. 11, 2011) (trans-fat/cholesterol statements).
8. *See, e.g., Astiana v. Hain Celestial Group, Inc.,* 2012 WL 5873585 (N.D.Ca.); *Syntek Semiconductor Co., Ltd. v. Microchip Tech., Inc.,* 307 F.3d 775, 780 (9th Cir. 2002).
9. *See Coyle v. Hornell Brewing Co.,* Civ. No. 08-02797, 2010 U.S. Dist. LEXIS 59467 (D.N.J. June 15, 2010); *Holk v. Snapple Beverage Co.,* Civil Action No. 07-3018, 2010 U.S. Dist. LEXIS 81596 (D.N.J. Aug. 10, 2010); *Ries v. Hornell Brewing Co.,* Case No. 10-1139-JF, 2010 U.S. Dist. LEXIS 86384 (N.D. Cal. July 23, 2010).
10. *See Murphy v. Cuomo*, 913 F. Supp. 671, 679 (N.D.N.Y 1996).
11. Cal. Bus. & Prof. Code § 17200.
12. *See In Re Tobacco II Cases*, 46 Cal. 4th 298, 311 (2009).
13. Cal. Bus. & Prof. Code § 17500.
14. *See Farmers Ins. Exch. v. Superior Court*, 2 Cal. 4th 377, 383 (1992).
15. *See Strawn v. Canuso*, 140 N.J. 43, 68 (1995).
16. 46 Cal. 4th 298 (2009).
17. 51 Cal. 4th 310 (2011).
18. In *Kwikset*, the plaintiff had purchased door locks, which were not in any way defective, but were labeled "Made in the USA" even though some components were made elsewhere.
19. *See Brod v. Sioux Honey Ass'n Coop.*, 2012 U.S. Dist. LEXIS 129391 (N.D. Cal. Sept. 11, 2012). Notably, the court did dismiss the case on other grounds, finding that California's consumer protection laws, which essentially prohibit a product from being labeled as honey if it contains no pollen, were preempted by federal law mandating that foods not otherwise defined by federal law should be labeled with their common or usual names. Because there is no specific regulation pertaining to honey, the court determined that federal law required Sioux Honey's product to be labeled as "honey" in clear conflict with the state statute.
20. 2011 U.S. Dist. LEXIS 137923 (D.N.J. Nov. 30, 2011).
21. 237 F.Supp. 512 (S.D.N.Y. 2003).
22. *Id.* at 527-28.
23. 396 F.3d 508 (2d Cir. 2005).
24. 12 CV 0033 (S.D.Ca. April 16, 2012).
25. 2010 U.S. Dist. LEXIS 107699 (S.D.N.Y. 2010).
26. MDL Docket No. 2094, 2012 U.S Dist. LEXIS 128325 (Sept. 10, 2012).
27. 3:11-cv-00888 (D.N.J.).

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The Right of Publicity: Show Me the Money

By James A. Johnson

Now that the 2013 NCAA basketball season is over and the star players have moved on to the professional ranks, merchandisers will be scrambling to secure the endorsements of the best of the best to enhance pecuniary profits from their goods and services. What follows here is to ensure that the picture or images of the players' jump shot, in combination with merchandisers and the National Collegiate Athletic Association, is as clear and as pure as newly fallen snow.

In 2009, former UCLA basketball star Ed O'Bannon filed a lawsuit against the NCAA and the Collegiate Licensing Company. The basis of the lawsuit was for their failure to compensate him *during and after his collegiate athletic career* for the use of his name, image and likeness on trading cards, DVDs, video games and other materials.[1] Subsequently, the *O'Bannon* lawsuit was consolidated with a lawsuit brought by former University of Nebraska quarterback, Sam Keller, to form what is now styled In Re: NCAA Student-Athlete Name and Likeness Litigation.[2]

In the consolidated lawsuit, commonly referred to as *O'Bannon*, the plaintiffs allege that the NCAA and its business partners made agreements that unreasonably restrain trade in violation of the Sherman Act and that the NCAA deprives former student-athletes of their right of publicity.[3] Keller and O'Bannon contend that the NCAA through these agreements prevents student-athletes from entering the licensing market and negotiating a price in exchange for their right of publicity. In addition, the plaintiffs contend that the NCAA's profits from these agreements constitute unjust enrichment. To prevail on their Section I Antitrust claim Keller and O'Bannon must show that (1) there was an agreement; (2) the agreement unreasonably restrains trade under a rule of reason analysis; and (3) the restraint affects interstate commerce.[4] The court has determined that there exists a relevant and sufficient market to support a Sherman Act claim. But see *Agnew v. National Collegiate Athletics Association* where the Seventh Circuit affirmed a decision by a district court to dismiss a claim for failure to identify a relevant market in which the NCAA allegedly committed violations of the Sherman Act.[5]

At the core of the plaintiffs' unjust enrichment claim is the required signing at the beginning of each year, by each student-athlete, of form 08-3a. This form authorizes the NCAA to use the athlete's name or picture to promote NCAA Championships, other NCAA events and programs. A student-athlete cannot participate in intercollegiate athletics until he or she has signed this form. O'Bannon and Keller claim this agreement restricts and precludes the student-athletes' ability to use his or her name, image or likeness for commercial purposes, *particularly after graduation*. Moreover, the plaintiffs dispute that the signing of form 08-3a by each student-athlete gives the NCAA a right of publicity for commercial purposes.

If the plaintiffs prevail in their lawsuit any right of publicity agreements between the NCAA and current student-athletes would be null and void. College sports are big business and have become a billion dollar industry. The following explains in detail what the use of the student-athletes' name, image and likeness is all about. ***Enter the Right of Publicity.***

Distinction of Rights

The Genesis of the Legal Right of Publicity Is Rooted in and Intertwined with the Right of Privacy

The right of publicity is a protectable property interest in one's name, identity or persona. Every person, celebrity or non-celebrity, has a right of publicity that is the right to own, protect and commercially exploit one's identity. The genesis of the legal right of publicity is rooted in and intertwined with the right of privacy.[6]

The right of privacy protects against intrusions upon one's seclusion or solitude to obtain private facts for public disclosure that would be highly offensive, false or embarrassing to a reasonable person. In short, this is a right to be left alone. However, privacy and publicity rights become entwined when an appropriation of another's name or likeness for one's own benefit occurs without permission.[7] Notwithstanding, the right of privacy is distinguishable because it is a personal right, non-assignable and terminates at death.

The purpose of this article is to provide guidance and an advance starting point for general practitioners, intellectual property lawyers and entertainment attorneys. An additional purpose is to push the edge of the jurisprudential envelope forward and to inspire scholarship.

To further illustrate the difference and similarity between privacy and publicity rights, a photograph in an advertisement that causes injury to the plaintiff's feelings and dignity, resulting in mental or physical damages, implicates the right of privacy. Failing the elements of mental or physical injury invokes the right of publicity. It is the legal right to exploit for commercial purposes one's own name, character traits, likeness[8] or other indicia of identity. Depending on state law a caricature,[9] popular phrase ("Here's Johnny"),[10] sound-alike voice,[11] name in a car commercial,[12] animatronic likeness[13] and statistics of professional baseball players,[14] without consent, have

all been held to come within the ambit of publicity rights, constituting infringement.

Proprietary Interest

An individual has the right to control, direct and commercially use his or her name, voice, signature, likeness or photograph. Publicity rights may include the right to assign, transfer, license, devise and to enforce the same against third parties. Today, nineteen states have publicity statutes,[15] which differ widely and at least a half dozen more, by common law. Thirteen states do not recognize the right of publicity.[16] It is the commercial value together with the commercial exploitation, without prior consent, that triggers a cause of action. The unauthorized use, in a commercial context, engenders money damages or equitable relief by way of an injunction or both. Moreover, as to a celebrity, subject to exemptions, the post-mortem right of publicity extends after death to 70 years in California[17] and 100 years in both Oklahoma[18] and Indiana.[19] New York, with one of the most developed jurisprudence in this area, excludes protection for the persona of deceased celebrities.[20]

Pendent Jurisdiction

Unlike other fields of intellectual property law, there is no federal statute or federal common law governing rights of publicity. Nevertheless, federal claims of unfair competition and false advertisement or false endorsement under the Lanham Act,[21] together with a state claim of publicity, can be asserted in federal court under pendent jurisdiction. A prevailing party, in appropriate circumstances, can collect treble damages, costs and attorney fees on Lanham Act claims, in establishing unfair competition, dilution or the likelihood of public confusion.[22]

Monetary relief in establishing liability for infringement of one's right of publicity is measured by the commercial value of the person's name, likeness or persona. In the absence of actual loss of money as a result of the defendant's unauthorized use, the "going rate" for compensatory damages is the appropriate measure of damages. And where the defendant's activities are also a willful disregard of the plaintiff's rights, punitive damages are warranted.[23]

Constitutional Protection

Reporting newsworthy events or newsworthiness, with nonconsensual use of a name or photo in a magazine, is afforded First Amendment guarantees of freedom of speech and the press.[24] There is no violation of publicity rights. It is this newsworthy dimension or article of public interest that provides constitutional protection, even for a newspaper selling promotional posters of NFL Quarterback Joe Montana's four Super Bowl Championships.[25] The posters were reproductions of actual newspaper pages of the newspaper. The California Court of Appeals opined that the posters depicted newsworthy events and the newspaper had a right to promote itself with them.

The plaintiff Tony Twist,[26] a former professional "enforcer" hockey player, sued the creator of a comic series who used the name Anthony "Tony Twist" Twistelli, as a Mafia fictional character. Twist claimed association with the comic book thug damaged the endorsement value of his name. The Missouri Supreme Court adopted a predominant purpose test. The court held that the use and identity of Twist's name was predominantly a ploy to sell comic books rather than an artistic or literary expression. The court opined that under these circumstances free speech must give way to the right of publicity. However, because of improper jury instructions, the verdict of $24.5 million in the plaintiff's favor was set aside. A second trial in 2004 resulted in a $15 million jury verdict. On June 20, 2006 in a 3-0 opinion, a three-judge panel of the Eastern District Appeals Court upheld the $15 million jury verdict against the comic book creator Todd McFarlane and his company, Todd McFarlane Productions Inc.

Similarly, a publisher of an artist's work depicting Tiger Woods' likeness, entitled " The Masters of Augusta," is afforded First Amendment protection based on "fine art,"[27] despite the fact that 5,250 copies of the print had been sold. The court found that the art print was not a mere poster or item of sports merchandise, but rather an artistic creation seeking to express a message. Further, the right of publicity does not extend to prohibit depictions of a person's life story in a television miniseries,[28] book[29] or film.[30]

In *Gionfriddo v. Major League Baseball*,[31] the First Amendment protected Major League Baseball's use of names and statistics of four former players on the defendant's websites, media guides, and programs for All-Star and World Series games. The California Court of Appeal held that those uses were of substantial public interest and not commercial speech.

New York's highest court extended such rights to a magazine that used a 14-year-old girl's picture, without her consent, to illustrate a magazine column of teenage sex and drinking. The New York Court of Appeals ruled that publishers cannot be held liable, so long as the photograph bears a genuine relationship to a newsworthy article and is not an advertisement in disguise.[32] Despite the fact that the plaintiff's photo was used in a substantially fictionalized way, it may by implication make the plaintiff the subject of the article.

The New York ruling begs the question, would the result have been different if a high-profile celebrity's picture was used without permission? And, should any and all purported newsworthiness provide a safe haven

for authors and publishers? If Section 50 of the Civil Rights Law provides a criminal misdemeanor penalty and Section 51, civil damages, then when do they really become actionable? Moreover, how is it that celebrities may prevent the use of their visual and audio images, yet cannot stop authors from writing about them? The courts do not draw a clear path between commercial exploitation and protected expression. In this morass, questions abound and answers elude.

Consider further, the Ninth Circuit's reversal of $1.5 million in compensatory damages and $1.5 million in punitives in *Hoffman v. Capital Cities/ABC, Inc*.[33] The Ninth Circuit disagreed with the district court's conclusion that the magazine article with a digitally altered photograph of Dustin Hoffman, together with a fashion spread, was pure advertisement and commercial speech. The court opined that the fashion article's purpose was not to propose a commercial transaction.[34] Since fully protected by the First Amendment, the court went on to state that *Los Angeles Magazine* could not be subjected to liability unless, under *New York Times v. Sullivan*,[35] the magazine intended to mislead its readers, thus raising the burden of proof to clear and convincing evidence that the magazine acted with constitutional "actual malice." Oh, my Tootsie! Is it now time for a uniform federal statute governing the rights of publicity?

Two central issues in any right of publicity statute are (1) To whom does the right of publicity extend, to any person or just celebrities? And what elements of personality are protected such as name, signature and voice? (2) Is a post-mortem property right provided? Not only do the publicity statutes in 19 states vary widely, but also the post-mortem protection. For example: Kentucky, 50 years; Ohio, 60 years; Tennessee, 10 years with a potential perpetual right, so long as there is no nonuse for two consecutive years. New York does not recognize a post-mortem right of publicity. California in 2007 amended its statute to include deceased personalities. It provides a cause of action for the unauthorized use of a deceased personality's name, voice, signature, photograph or likeness for commercial purposes within 70 years of the personality's death.[36]

In *Cobb v. Time, Inc*.,[37] Randall "Tex" Cobb, a former professional boxer, sued *Sports Illustrated* for an article describing his alleged participation in drug use and a fixed boxing match. The Sixth Circuit affirmed summary judgment of the district court based on the actual malice standard because Cobb was a public figure.

Right to Use Persona

To keep the jump shot and other indicia of identity "pure," to avoid a violation of the right of publicity, is to secure the individual's consent. Most professional athletes, as part of their employment in individual contracts and through the relevant collective bargaining agreements, give their consent to the team and league to broadcast their pictures, attributes and use their names for promotional purposes. Absent expressed or implied consent, the most effective way is to obtain a release, endorsement agreement or a license. The appropriate instrument should transfer, in whole or in part, specific rights setting forth, at a minimum, scope, term, representations, warranties, fees, choice of law and a morals clause. A morals clause permits a team, league, product developer or licensee to terminate the player or the agreement for engaging in criminal conduct or acts involving moral turpitude.

Conclusion

The first Amendment requires that the right to be protected from unauthorized publicity be balanced against the public interest in the dissemination of news and information. This is congruent with the democratic processes under the constitutional guarantees of freedom of speech and of the press. Not all commercial unauthorized uses of identity violate the right of publicity. Violations turn on how the identities are used in a commercial context. Is the use solely to promote, sell or endorse products and services or is it a fair use? The ultimate answer is based on the facts and circumstances of each case. In particular, is it fair that student-athletes be required to sign form 08-3a in order to participate in collegiate athletics? Stay tuned.

Fame is valued. The right of publicity protects the athlete's proprietary interest in the commercial value of his or her identity from exploitation by others.[38] Therein lies the question that the court has to determine in the *O'Bannon* case. Advertising is the quintessential commercial speech and a violation of the right of publicity is a tort that quintessentially consists of advertising. The crux of the right of publicity is the commercial value of human identity. In order to lawfully and properly exploit this legitimate proprietary interest, it is just like the game itself—one must know the rules.

On September 27, 2013, Electronic Arts and Collegiate Licensing Co., the other defendants in the *O'Bannon* case, have tentatively settled their roles and are prepared to pay $40 million to compensate college athletes. This proposed settlement is subject to court approval and an acceptable distribution plan. This leaves the NCAA as the lone defendant in the *O'Bannon* lawsuit.

The *O'Bannon* case is set for trial in 2014. It is very possible that the NCAA's guiding principle of preserving amateurism will engender a call from the striped-shirt people on the basketball floor and the football field: **FOUL!** If that happens there will be significant changes in the NCAA landscape.

Endnotes

1. O'Bannon v. Nat'l Collegiate Athletics Ass'n, No. C 09-3329 CW, 2009 WL 4899217 (N.D. Cal. Dec. 11, 2009).
2. In Re Student-Athlete Name & Likeness Licensing Litig., No. CW, 2010 WL 5644656 (N.D. Cal. Dec. 17, 2010).
3. *Id.*
4. 15 U.S.C. Ch.1 § 1 et seq.
5. Agnew v. Nat'l Collegiate Athletics Ass'n, 683 F. 3d (7th Cir. 2012).
6. Robertson v. Rochester Folding Box Co., 171 N.Y. 538, 64 N.E. 442 (1902) (rejected the common law right of publicity which led to the enactment of the New York privacy law, codified in the New York Civil Rights Law, 1903, N.Y. Civ. Rights, §§50-51); Pavesich v. New England Life Ins. Co., 50 S.E. 68 (Ga. 1905) (first state to recognize a personal privacy right against unauthorized commercial exploitation); Pallas v. Crowley Milner and Co., 322 Mich 411, 33 N.W. 2d 911(1948) (Supreme Court of Michigan recognizes a right of publicity where invasion of privacy was pleaded in preventing the nonconsensual use of a model's photograph in a local department store advertisement. The plaintiff was not a nationally known celebrity. Michigan recognizes publicity rights through a derivative privacy right at common law); Janda v. Riley-Meggs Industries, Inc., 764 F. Supp 1223 (E. D. Mich 1991), Haelan Laboratories v. Topps Chewing Gum is the seminal case that coined the term right of publicity, 202 F. 2d 866 (2d Cir. 1953), cert. denied, 346 U.S. 816 (1953).
7. Original Appalachian Artworks, Inc. v. Topps Chewing Gum, Inc., 642 F. Supp. 1031 (1986) (demonstrates the labyrinth of intellectual property rights in publicity issues such as copyright infringement and trademark dilution).
8. Newcombe v. Coors, 157 F.3d 686 (9th Cir. 1998) (Don Newcombe's stance and windup of the Brooklyn Dodgers, displayed in a drawing in Sports Illustrated created a triable issue of fact whether Newcombe is readily identifiable as the pitcher in the beer advertisement. It is interesting to note that Don Newcombe (Cy Young Award, MVP and Rookie of the Year) is the only player in major league history to have won all three awards).
9. Titan Sports, Inc. v. Comics World Corp., 870 F. 2d 85 (2d Cir. 1989).
10. Carson v. Here's Johnny Portable Toilets, Inc., 698 F. 2d 831 (6th Cir. 1983).
11. Midler v. Ford Motor Co. 849 F. 2d 460 (9th Cir. 1986), Waits v. Frito Lay, Inc., 978 F.2d 1093 (9th Cir. 1992).
12. Abdul-Jabbar v. General Motors Corp., 85 F. 3d 407 (9th Cir. 1996).
13. Wendt v. Host International Inc., 125 F. 3d 806 (9th Cir. 1997); White v. Samsung Electronics America Inc., 971 F. 2d 395 (9th Cir. 1992); 989 F. 2d 1512 (9th Cir. 1993).
14. Uhlaender v. Hendricksen, 316 F. Supp. 1277 (Minn. 1970).
15. California: Cal. Civ. Code §3344; Florida: Fla. Stat. Ann. §540.08; Illinois: 765 Ill. Comp. Stat. §1075/30; Indiana; Ind. Code 32-36-1-1; Kentucky: Ky. Rev. Stat. Ann. §391.170; Massachusetts: Mass. Gen. L. Ann., ch 214, §3; Nebraska: Neb Stat. §§20-201-20-211 and 25-840.01; Nevada: Nev. Stat. §§597.77-597.810; New York: N.Y. Civ. Rights L. §§50-51 N. Y. Gen. Bus. L. §397; Ohio: Ohio Rev. Code Ann. §2741.04; Oklahoma: 21 Okla. Stat. §§839.1-839.3, 12 Okla. §§1448-1449; Rhode Island: R.I. Gen Laws §9-1-28; Tennessee: Tenn. Code Ann. §§47-25-1101-47-25-1108; Utah: Utah Code Ann. §§45-3-1; Virginia: Va. Code Ann. §8.01-40, 18.2-216; Washington: Wash. Rev. Code §§63.60.030-63.60.037; Wisconsin: Wis. Stat. Ann. §§895.50; in Texas the tort of misappropriation protects a person's persona and the unauthorized use of one's name, image or likeness. Brown v. Ames, 201 F. 3d 654 (5th Cir. 2000), post-mortem right of publicity: Tex. Prop.Code §§26.001-26.015.
16. Alaska, Arizona, Connecticut, Idaho, Louisiana, Mississippi, New Hampshire, New Mexico, North Dakota, Oregon, South Carolina, Vermont and Wyoming.
17. Cal. Civ. Code §3344.1(g).
18. Okla. Stat. Ann. Tit. 12 §§1448 et seq. (West 1993).
19. Ind. Code Ann. §32-13-1 et seq. (West Supp. 1999).
20. Stephano v. News Group Publications, 64 N.Y. 2d 174, 474 N.E. 2d 580 (1984).
21. Lanham Act §43(a), 15 U.S.C. §1125(a).
22. 35(a), 15 U.S.C. §1117(a).
23. Frazier v. South Florida Cruises, Inc., 19 U.S.P.Q. 2d (BNA) 1470 (E.D. Pa. 1991) (defendant placed a full-page unauthorized advertisement in Ring Magazine inviting the public to cruise with former world heavyweight champion, Smokin' Joe Frazier); Cecil Fielder, 3-time MLB All-Star in 2003, won over $400,000 against a design firm for using his name without permission in commercial ads.
24. Neff v. Time, Inc., 406 F. Supp. 858 (W.D. Pa. 1976); *see* Joe Dickerson & Assoc. v. Ditmar, 34 P. 3d 995 (Colo. 2001) (Colorado Sup. Ct. recognizes the tort of invasion of privacy by appropriation of name or likeness subject to First Amendment privilege where the use involves publication of matters that are newsworthy or of legitimate public concern).
25. Montana v. San Jose Mercury News Inc., 34 Cal. App. 4th 790 (1995); *see, e.g.*, Hogan v. Hearst, 945 S.W.2d 246 (Tex. App. 1997) (exemplifying the breadth of the newsworthy exception in negating a claim of invasion of privacy based on disclosure of highly embarrassing facts, obtained from a public record); Peckham v. Boston Herald, Inc., 719 N.E. 2d 888 (Mass. App. Ct. 1999) (defense summary judgment on basis of newsworthiness to a statutory private facts claim).
26. Doe v. TCI Cablevision, 110 S.W. 2d 363 (Mo. 2003).
27. ETW Corp. v. Jireh Publishing, Inc., 332 F. 3d 915 (6th Cir. 2003); *see* Comedy III Productions, Inc. v. Saderup, Inc., P. 3d 797 (Cal. 2001) (a T-shirt artist's realistic drawing of the Three Stooges was not sufficiently transformative to defeat a claim of California's publicity rights statute).
28. Ruffin-Steinbeck v. Depasse, 82 F. Supp. 2d 723 (E.D. Mich. 2000).
29. Matthews v. Wozencraft, 15 F. 3d 432 (5th Cir. 1994) (applying Texas law).
30. Seale v. Gramercy Pictures, 949 F. Supp. 331 (E.D. Pa. 1996) (applying Pennsylvania law).
31. 114 Cal. Rpt. 2d 307 (Ct. App. 2001).
32. Messenger v. Gruner & Jahr Printing and Publishing, 28 Media L. Rep. (BNA) 1491 (S.D.N.Y. 2000), 94 N.Y 2d 436 (2000).
33. 255 F. 3d 1180 (9th Cir. 2001).
34. *Id.* at 1184–86.
35. 376 U.S. 254 (1964).
36. Cal. Civ. Code §3344.1.
37. 278 F. 3d 629 (6th Cir. 2002).
38. O'Brien v. Pabst Sales, Co. 124 F. 2d 167, 170 (5th Cir. 1941) (famed Heisman Quarterback and Philadelphia Eagle opened the door to the professional athlete's right of publicity).

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The Adequacy of Expert Disclosure in Motion Practice

By David A. Glazer

At the heart of every products liability case is the liability expert. Inevitably, the adequacy of the expert disclosure will be brought up in either a motion for summary judgment or a motion *in limine*. To ensure that a case is decided on the merits, it is imperative that the expert exchanges are done properly.

In the state of New York, expert disclosure is governed by a CPLR 3101(d) and in the federal court under FRCP 26(a)(2). In federal court, disclosure is further modified by the Federal Rules of Evidence § 702.

CPLR 3101(d)

CPLR 3101 governs disclosure of material in litigation, with subsection (d) directed at disclosure of relevant expert witness information and materials.

CPLR 3101(d)(1)(i) specifically states:

> Upon request, each party shall identify each person whom the party expects to call as an expert witness at trial and shall disclose in reasonable detail the subject matter on which each expert is expected to testify, the substance of the facts and opinions on which each expert is expected to testify, the qualifications of each expert witness and a summary of the grounds for each expert's opinion. However, where a party for good cause shown retains an expert an insufficient period of time before the commencement of trial to give appropriate notice thereof, the party shall not thereupon be precluded from introducing the expert's testimony at the trial solely on grounds of noncompliance with this paragraph. In that instance, upon motion of any party, made before or at trial, or on its own initiative, the court may make whatever order may be just. In an action for medical, dental or podiatric malpractice, a party, in responding to a request, may omit the names of medical, dental or podiatric experts but shall be required to disclose all other information concerning such experts otherwise required by this paragraph.

Section 3101(d) also requires that a party seeking discovery of section 3101 materials (i.e., reports, expert's documents, etc.) show that it has "substantial need" of the materials in the preparation of the case, and that it is unable "without undue hardship" to obtain the information by other means. CPLR 3101(d)(2).

Identity of Expert Witnesses

Notably, CPLR 3101(d)(1) carves out several exceptions to the disclosure requirements of the rule for malpractice suits only. For example, a party need not disclose the name of or revealing information regarding expert witness in a medical malpractice suit. However, where a plaintiff brings claims involving both medical malpractice and products liability against a defendant, he must disclose only the identity of the expert witness who will be testifying in support of the products liability claim.[1]

Expert Witness Qualifications

"Practical experience" may qualify a witness to testify in a products liability case based upon allegations of defective design, even though the witness "was not a *designer* of and had never participated in *constructing*" the kind of product at issue.[2]

Time for Disclosure

While CPLR 3101(d) does not provide a time frame or require expert disclosure at any particular time as a practical matter, disclosure needs to be made early enough to avoid prejudice to the other side. In a case where a motion for summary judgment is being contemplated, that time frame has been interpreted to mean by the filing of the note of issue.

Violations of Disclosure—State Court

In *Mankowski v. Two Park Co.*, the Second Department held that it was proper for the Supreme Court to preclude the use of an expert or the expert's affidavit to oppose a motion for summary judgment since the plaintiff failed to timely respond to the defendant's discovery demands.[3] Throughout the years, the Second Department made similar rulings.[4]

In *Pellechia v. Partner Aviation Enterprises, Inc.*, the plaintiff allegedly sustained injuries when he slipped and fell while disembarking from defendant's charter jet.[5] The Second Department affirmed the Supreme Court's granting of summary judgment for the defendant on the grounds that the defendant made out a prima facie showing for summary judgment and the plaintiff was unable to raise a triable issue of fact. The Second Department upheld the Supreme Court's decision to disallow

the plaintiff's expert affidavit "because the plaintiff never complied with any of the disclosure requirement of CPLR 3101(d)(1)(i), and only first identified his expert witness in opposition to the defendant's summary judgment motion, after the plaintiff filed the note of issue and certificate of readiness." The Court also held that: (1) the expert did not demonstrate that he was qualified to render an opinion and (2) the affidavit was "speculative and conclusory, and was not based on accepted industry standards…."[6]

In *Ehrenberg v. Starbucks Coffee Company*,[7] the plaintiff sued Starbucks Coffee Company when a cup of hot tea spilled on him, claiming that the accident was the result of a dangerous and defective condition on the premises. Starbucks moved for summary judgment, which was denied by the Supreme Court. On appeal, the Second Department reversed on the grounds that the Supreme Court improperly considered the affidavit of the plaintiff's expert that was submitted in opposition to the motion. The Second Department held that the Supreme Court should not have considered the affidavit "since that expert witness was not identified by the plaintiffs until after the note of issue and certificate of readiness were filed, attesting to the completion of discovery, and the plaintiffs offered no valid excuse for the delay." As a result, the Court granted summary judgment to Starbucks.[8]

In the first case, *Tomaino v. 209 E. 84th Street Corporation*, the plaintiff slipped and fell down a flight of steps and sued the owner of the premises.[9] The defendant moved for summary judgment on the grounds that the plaintiff was unable to state exactly where she fell and the exact cause of her fall, but the Supreme Court denied the motion. On appeal, the First Department affirmed the denial of the defendant's motion for summary judgment and to preclude plaintiffs' expert testimony. It held that the Supreme Court properly did not exclude the plaintiff's expert's affidavit and testimony because "[p]laintiffs established good cause for the untimely disclosure, which does not appear to have surprised or prejudiced defendant."[10]

In *Harrington v. City of New York*, the First Department affirmed the Supreme Court's order which granted defendants' motion for summary judgment and denied plaintiff's cross motion for partial summary judgment. The First Department held that even if the defendant's were negligent, "such negligence was not a substantial cause of the events producing the injury" and that the plaintiff "failed to establish prima facie entitlement to summary judgment in her favor on liability." However, the court also stated that "the motion court properly declined to consider the [plaintiff's] expert's affirmation because plaintiff failed to timely disclose his identity."[11] In making this statement, the court cited to a Second Department case, *Wartski v. C.W. Post Campus of Long Is. Univ.*, which held that "[t]he plaintiff's expert affidavit should not have been considered in determining the motion since the expert was not identified by the plaintiff until after the note of issue and certificate of readiness were filed attesting to the completion of discovery, and the plaintiff offered no valid excuse for her delay in identifying the expert."[12] However, the First Department also made clear that even if the expert's affidavit were allowed, that it was insufficient to raise an issue of fact.[13]

FRCP 26(a)(2)

Expert Disclosure is federal court is more detailed. It is governed by FRCP 26(a)(2) which states:

> (2) Disclosure of Expert Testimony.
>
> (A) In General. In addition to the disclosures required by Rule 26(a)(1), a party must disclose to the other parties the identity of any witness it may use at trial to present evidence under Federal Rule of Evidence 702, 703, or 705.
>
> (B) Witnesses Who Must Provide a Written Report. Unless otherwise stipulated or ordered by the court, this disclosure must be accompanied by a written report—prepared and signed by the witness—if the witness is one retained or specially employed to provide expert testimony in the case or one whose duties as the party's employee regularly involve giving expert testimony. The report must contain:
>
> (i) a complete statement of all opinions the witness will express and the basis and reasons for them;
>
> (ii) the facts or data considered by the witness in forming them;
>
> (iii) any exhibits that will be used to summarize or support them;
>
> (iv) the witness's qualifications, including a list of all publications authored in the previous 10 years;
>
> (v) a list of all other cases in which, during the previous 4 years, the witness testified as an expert at trial or by deposition; and
>
> (vi) a statement of the compensation to be paid for the study and testimony in the case.
>
> (C) Witnesses Who Do Not Provide a Written Report. Unless otherwise stipulated or ordered by the court, if the wit-

ness is not required to provide a written report, this disclosure must state:

(i) the subject matter on which the witness is expected to present evidence under Federal Rule of Evidence 702, 703, or 705; and

(ii) a summary of the facts and opinions to which the witness is expected to testify.

(D) Time to Disclose Expert Testimony. A party must make these disclosures at the times and in the sequence that the court orders. Absent a stipulation or a court order, the disclosures must be made:

(i) at least 90 days before the date set for trial or for the case to be ready for trial; or

(ii) if the evidence is intended solely to contradict or rebut evidence on the same subject matter identified by another party under Rule 26(a)(2)(B) or (C), within 30 days after the other party's disclosure.

(E) Supplementing the Disclosure. The parties must supplement these disclosures when required under Rule 26(e).

As is evident from the statute, there is a lot more information that must be disclosed in federal court. In federal court, parties must exchange the report, the facts and data used to form the expert opinion and exhibits that the expert will rely upon to for that opinion.

Violations of Disclosure—Federal Court

In general, a motion seeking to preclude expert testimony on grounds of an improper disclosure is to be made under FRCP 37(c)(1) which states:

(1) *Failure to Disclose or Supplement.* If a party fails to provide information or identify a witness as required by Rule 26(a) or (e), the party is not allowed to use that information or witness to supply evidence on a motion, at a hearing, or at a trial, unless the failure was substantially justified or is harmless. In addition to or instead of this sanction, the court, on motion and after giving an opportunity to be heard:

(A) may order payment of the reasonable expenses, including attorney's fees, caused by the failure;

(B) may inform the jury of the party's failure; and

(C) may impose other appropriate sanctions, including any of the orders listed in Rule 37(b)(2)(A)(i)-(vi).

Thus, the standard to impose sanctions for a late or incomplete disclosure is whether or not the improper disclosure was either harmless or justifiable.

In *Wills v. Amerada Hess Corp.*, the plaintiff disclosed expert's report concerning causation of seaman's injury pursuant to FRCP 26(a)(2), but did not disclose reports of two other experts except in response to defendants' motion for summary judgment, exclusion of two proposed expert witnesses as untimely disclosed was proper; plaintiff's manner of identifying experts appeared intended to delay completion of pre-trial process and it was questionable whether substance of proposed experts' testimony would be sufficient to allow plaintiff to survive summary judgment.[14]

Conversely, in *Commercial Data Servers, Inc. v. IBM*, the plaintiff computer systems company's submission, with its response to defendant competitor's summary judgment motion, of expert witness affidavit that was inconsistent with its corresponding FRCP 26 reports such that submission was, in essence, new and untimely expert report, was harmless and did not warrant excluding consideration of experts' evidence under FRCP 37 sanction provisions.[15]

Perhaps as important is that objections to an improper expert disclosure must be made timely or the court will deny the requested relief. In *Rupolo v. Oshkosh Truck Corp.*, the court held that preclusion of admission of defendant's expert's testimony as sanction under FRCP 37(c)(1) was inappropriate, even though defendant's FRCP 26(a)(2) disclosure concerning expert was inadequate, because plaintiffs waited more than one and half years before objecting on this basis and did not seek more complete disclosure, expert's testimony was crucial to defendant's case on issue of causation, and any prejudice to plaintiff was due to its delay before objecting to report.[16]

Federal Rules of Evidence 702

Fed. R. Evid. 702 governs testimony by expert witnesses. It states:

A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if:

(a) the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue;

(b) the testimony is based on sufficient facts or data;

(c) the testimony is the product of reliable principles and methods; and

(d) the expert has reliably applied the principles and methods to the facts of the case.

Under the *Daubert*[17] standard, a witness must first be shown to be sufficiently qualified by "knowledge, skill, experience, training, or education," pursuant to Fed. R. Evid. 702. In a products liability action, an expert may be qualified as an expert, even though he may not be the "best qualified" expert, or have direct "specialization" in a field, if his expertise in similar areas is sufficient to assist the trier of fact understand the issues.[18]

As with all other types of claims, the testimony of expert witnesses in products liability suits may be precluded if the witness is unqualified, has no expertise, or if his methodology is clearly unreliable.[19] In the alternative, a court may limit the type and use of an expert witness's testimony to contain it within the scope of the witness's expertise.[20]

Federal Rules of Evidence 104(a)

Fed. R. Evid. 104(a) provides that "The court must decide any preliminary question about whether a witness is qualified, a privilege exists, or evidence is admissible. In so deciding, the court is not bound by evidence rules, except those on privilege." This Rule is applied in the context of *Daubert*[21] determinations, as described below.

A court is not required to hold a 104(a) hearing to determine the admissibility of expert witness testimony where it conducts a thorough review of the record, including the witness's deposition transcript.[22] A court may also forgo the full 104(a) hearing where the witness's testimony is so blatantly unreasonable that a hearing would be useless.[23] While there is no requirement that a court hold a 104(a) hearing, the court must have a proper and reviewable foundation for making its admissibility findings.[24]

Admissibility of Expert Testimony Under *Daubert* and *Frye*

The threshold standard for admissibility of novel scientific evidence in New York State is derived from *Frye v. United States*.[25] The *Frye* rule requires that innovative scientific evidence be based on "a principle or procedure [which] has 'gained general acceptance' in its special field." "[T]he particular procedure need not be 'unanimously endorsed' by the scientific community but must be 'generally accepted as reliable.'"[26] The proponent of a scientific procedure "is required to show the generally accepted reliability of such procedure in the relevant scientific community through judicial opinions, scientific or legal writings, or expert opinion other than that of the proffered expert."[27]

The *Frye* rule as applied in New York differs from the more liberal federal standard established by the United States Supreme Court in *Daubert v. Merrell Dow Pharms.*[28] In *Daubert*, the Court rejected the *Frye* rule in favor of a "reliability standard" derived from the Federal Rules of Evidence Rule 702. Under the *Daubert* standard, the court makes "a preliminary assessment of whether the reasoning or methodology underlying the testimony is scientifically valid."[29] In contrast, under *Frye*, the court does not determine whether a scientific technique is reliable but, instead, "whether there [is a] consensus in the scientific community as to its reliability."[30] The *Daubert* test essentially requires federal trial judges to play the role of a "gatekeeper," insuring that the fact-finding process does not become distorted by "expertise that is *fausse* and science that is junky."[31]

Under the *Daubert* standard, a witness must first be shown to be sufficiently qualified by "knowledge, skill, experience, training, or education," pursuant to Fed. R. Evid. 702. Second, the Federal Rules of Evidence require that the judge "ensure that any and all scientific testimony or evidence admitted is not only relevant, but [also] reliable." *Daubert*, 509 U.S. at 589. "[T]he trial judge must determine at the outset, pursuant to Rule 104(a), whether the expert is proposing to testify to (1) scientific knowledge that (2) will assist the trier of fact to understand or determine a fact in issue." *Id*. at 592-593.

Although *Daubert* was decided in the context of scientific knowledge, the test has since been extended to the kind of "technical or other specialized knowledge" often at issue in products liability cases.[32]

New York

There is some disagreement in New York courts as to whether the *Daubert* or *Frye* standard is generally applicable. After the *Daubert* decision was rendered, some New York courts continued to use the stricter "general acceptance" test of *Frye* in cases where the issue was the reliability and admissibility of novel scientific evidence.[33] However, where the evidence is not scientific or novel, some courts have held that the *Frye* analysis is not applicable.[34] "Nevertheless, whenever directly confronted with the issue, appellate courts have consistently rejected the idea that *Daubert* should be the controlling standard in New York rather than *Frye*."[35]

In products liability cases where the testimony is based upon recognized technical or other specialized knowledge, courts have applied the liberal *Daubert* test.[36] However, where there is a question as to whether the witness's testimony is supported by accepted scientific methods, as where the expert's conclusions are novel, courts have applied the stricter *Frye* standard.[37]

Endnotes

1. *See, e.g., Travis v. Wormer*, 524 N.Y.S.2d 913 (App. Div. 4th Dep't 1988) (plaintiff must disclose identity of medical expert to defendant drug manufacturer sued in strict products liability and breach of warranty notwithstanding other pending claim of medical malpractice against codefendants).
2. *See Caprara v. Chrysler Corp.*, 52 N.Y.2d 114 (1981) (emphasis in original).
3. *Mankowski v. Two Park Co.*, 225 A.D.2d 673, 639 N.Y.S.2d 847 (2d Dept. 1996).
4. *See Vailes v. Nassau County Police Activity League, Inc., Roosevelt Unit*, 72 A.D.3d 804 (2d Dept. 2010); *Yax v. Development Team, Inc.*, 67 A.D.3d 1003 (2d Dept. 2009); *Gerardi v. Verizon N.Y., Inc.*, 66 A.D.3d 960 (3d Dept. 2009); *Wartski v. C.W. Post Campus of Long Is. Univ.*, 63 A.D.3d 916 (2d Dept. 2009); *King v. Gregruss Mgt. Corp.*, 57 A.D.3d 851 (2d Dept. 2008); *McArthur v. Muhammad*, 16 A.D.3d 630 (2d Dept. 2005); *Ortega v. New York City Tr. Auth.*, 262 A.D.2d 470 (2d Dept. 1999).
5. 80 A.D.3d 740, 916 N.Y.S.2d 130 (2d Dept. 2011).
6. *Id.*
7. 82 A.D.3d 829, 918 N.Y.S.2d 556 (2d Dept. 2011).
8. *Id.*
9. 72 A.D.3d 460, 900 N.Y.S.2d 245 (1st Dept. 2010).
10. *Id.* (internal citations omitted).
11. *Id.*
12. 63 A.D.3d 916, 917, 882 N.Y.S.2d 192 (2d Dept. 2009).
13. *Harrington*, 79 A.D.3d 545.
14. *Wills v. Amerada Hess Corp.* (2004, CA2 NY) 379 F3d 32, 2004 AMC 2082, 64 Fed Rules Evid Serv 1153, cert den (2005) 546 US 822, 126 S Ct 355, 163 L Ed 2d 64.
15. *Commercial Data Servers, Inc. v. IBM* (2003, SD NY) 262 F Supp 2d 50, 2003-1 CCH Trade Cases P 74022.
16. Rupolo v. Oshkosh Truck Corp. (2010, ED NY) 749 F Supp 2d 31.
17. *Daubert v. Merrell Dow Pharms.*, 509 U.S. 579 (1993).
18. *Pineda v. Ford Motor Co.*, 520 F.3d 237 (3d Cir. 2008); *see also McCloud v. Goodyear Dunlop Tires N. Am., Ltd.*, 479 F. Supp. 2d 882 (C.D.Ill. 2007) (witnesses qualified to testify as experts where they qualified as experts to the field of tires in general, although they did not specialize in the particular subset of motorcycle tires at issue).
19. *Smith v. Goodyear Tire & Rubber Co.*, 495 F.3d 224 (5th Cir. 2007); *Khoury v. Philips Med. Sys*, 615 F.3d 888 (8th Cir. 2010).
20. *See Schaff v. Caterpillar, Inc.*, 286 F. Supp. 2d 1070 (D.N.D. 2003).
21. *Daubert v. Merrell Dow Pharms.*, 509 U.S. 579 (1993).
22. *Anderson v. Raymond Corp.*, 340 F.3d 520 (8th Cir. 2003) (no abuse of discretion where court did not hold 104(a) hearing for admissibility of an engineer's testimony in a product liability case).
23. *In re "Agent Orange" Prod. Liab. Litig.*, 611 F. Supp. 1223, 1246 (E.D.N.Y. 1985) (no need for 104(a) hearing in products liability suit where the witness relied on litigants' checklists to reach a conclusion, a process that "no reputable physician" would use).
24. *See In re Paoli R. Yard PCB Litigation*, 916 F.2d 829, 854 (3d Cir. 1999).
25. *Frye v. United States*, 293 F. 1013 (D.C. Cir. 1923).
26. *People v. Wesley*, 83 N.Y.2d 417, 422 (1994).
27. *Cameron v. Knapp*, 137 Misc. 2d 373, 375 (Sup. Ct, NY County 1987).
28. *Daubert v. Merrell Dow Pharms.*, 509 U.S. 579 (1993).
29. *Id.*
30. *Wesley*, 83 N.Y.2d at 439 (Kaye, J, concurring).
31. *Kumho Tire Co, Ltd. V. Charmichael*, 526 U.S. 137, 159 (1999) (Scalia, J., concurring).
32. *Kumho Tire, Ltd.*, 526 U.S. at 159; *see also, Clay v. Ford Motor Co.*, 215 F.3d 663 (6th Cir. 2000).
33. *Wahl v. American Honda Motor Co.*, 693 N.Y.S.2d 875, 877 (Sup. Ct. Suffolk County, 1999).
34. *See People v. Wernick*, 89 N.Y.2d 111 (1996); *Wesley*, 83 N.Y.2d at 417.
35. *Matter of Seventh Jud. Dist. Asbestos Litig.*, 797 N.Y.S.2d 743, 751 (2005).
36. *See, e.g., Wahl*, 693 N.Y.S.2d at 878 (permitting engineer's expert witness testimony under the *Daubert* standard).
37. *See Selig v. Pfizer, Inc.*, 13 N.Y.S.2d 898, 902-903 (Sup. Ct. NY County, 2000) (applying the *Frye* standard and precluding testimony not generally accepted in the scientific community).

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The Prehearing Conference Statement: Necessary or Sheer Redundancy?

By Moya M. O'Connor

On March 13, 2007, the New York Workers' Compensation Board passed a series of reforms that included obliterating claimants' ability to receive payments for the rest of their lives. This was a major success for insurance carriers because the reform stipulated that claimants who the Board determined were permanently partially disabled and had a date of accident after March 13, 2007 would be subject to caps for their weekly payments. The caps would set forth a certain number of weeks that a claimant would be able to receive workers' compensation payments, and the number of weeks would be based on the claimant's permanent disability rating and loss in wage earning capacity as a result of the accident. Once the number of weeks passed, the carrier would no longer have to provide the claimant with weekly payments or treatment. Only claimants who were classified as permanently totally disabled could receive workers' compensation benefits for the rest of their lives no matter when the date of accident occurred. This aspect of the reforms was a victory in the eyes of insurance carriers because once a claimant was deemed permanently partially disabled, carriers could curb their exposure in workers' compensation claims. However, the aspects of the Workers' Compensation Law that favor insurance carriers are far and few between.

For instance, the March 13, 2007 reforms incorporated the agenda for the Workers' Compensation Board to be more lax when it came to determining what constitutes prima facie medical evidence for a work related injury. Prior to the 2007 reforms, the Board required initial medical reports to indicate a work related history, diagnoses, causal relationship to the work related history, and a degree of disability. The 2007 reform determined that a claimant only had to present a medical report that indicated an injury, and it was up to the carrier to develop whether the claimant's injury was causally related to the claimant's work. Thus, this change lessened the burden placed on the claimant to present justifiable medical evidence of a work related accident, and as insurance carriers took a step forward with the caps, they took two steps backwards with more of a burden to prove whether or not a claim was compensable.

The intent of this reform was to reinforce that the Workers' Compensation Law is to be construed in favor of the claimant. However, how far should we take this intent? When does the intent to protect the claimant cross the line of prejudicing the carrier?

One of the largest controversies in Workers' Compensation Law falls under Section 300.38 that governs controverted claims. A controverted claim is a claim that an insurance carrier contests and wants set for trial. In order for an insurance carrier to controvert a claim, the carrier must file a C-7 form that sets forth a summary of the facts of the claim, the carrier's defenses, and the witnesses the carrier plans to present at trial. A carrier may assert the following defenses of a claim: Accident or occupational disease arising in and out of employment, causal relationship, notice, employer/employee relationship, jurisdiction, and statute of limitations. The C-7 must be filed within 25 days from when the claim is indexed by the Workers' Compensation Board. If the carrier fails to file the form within the 25 days, the carrier waives its right to use accident or occupational disease arising in and out of employment and employer/employee relationship as defenses.

However, even if the carrier timely files the C-7, the carrier is still required to file a Prehearing Conference Statement that requests the same information as the C-7. Once the C-7 is filed, the Board schedules a Prehearing Conference where a Law Judge determines whether the case should be set for trial after hearing from both the carrier and the claimant. The carrier is required to file a PH 16.2 Prehearing Conference Statement that again requires the carrier to set forth the facts, all defenses, and the witnesses that will be called when the case is set for trial. The claimant is required to file the Prehearing Conference Statement as well; however, the carrier must file its statement 10 days before the Prehearing Conference while the claimant may file his or her statement before or at the Prehearing Conference.

The prejudice arises against the carrier if it does not file the Prehearing Conference Statement within the 10 days allotted. All of the carrier's defenses are waived. In turn, the carrier can no longer develop the allegations through a trial and is left only to get an Independent Medical Examination contesting causal relationship. If the carrier can show due diligence and good cause for the late filing, the lateness is excused. However, the lateness is excused at the discretion of the Law Judge. Thus, a carrier may be excused from the late filing depending on whether or not the Law Judge had a good or bad day.

Where is the fairness in this penalty? In the interest of justice, the carrier should have a right to present its case and fulfill its burden of proving that the claimant's case is not compensable. However, due to an inadvertence, a claimant has the potential to collect workers' compensation benefits and receive treatment. Sure, a carrier may always appeal a Law Judge's determination; however, why should the carrier have to incur such an expense for untimely filing a form that serves no purpose?

Is the answer that carriers should be more responsible and watch their deadlines, or would it be more efficient for the Workers' Compensation Board to create a penalty that is more fair and justifiable for all the parties involved? Rather, should the Workers' Compensation Board simply do away with the Prehearing Conference Statement completely? Clearly, as the March 13, 2007 reforms reflect, the Board is open to change, so time will tell if the Board will make a practical change and get rid of the Prehearing Conference Statement and its stringent penalties.

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How Does a Brain Injury Qualify as a Grave Injury?

By Allison Marley

The Brain

Probably the least understood organ in the human body is the brain. Presently, however, under New York State's Workers' Compensation Law, courts are required to assess the nature and level of brain injury suffered in light of the "Grave Injury" threshold. The courts' recent analysis of this issue will be discussed in the passages below.

Exclusive Remedy and Third-Party Indemnification/Contribution Claims

In 1996, the legislature amended Section 11 of the Workers' Compensation Law which made Workers' Compensation an exclusive remedy to recover compensation for injuries arising out of and in the course of a worker's employment, without regard to fault or cause of the injury. This no-fault system provides a limited amount of automatic benefits to the injured employee in return for the elimination of tort liability against the employer. As long as the employer maintained appropriate insurance coverage, neither the employee nor any other party may seek to recover damages from the employer.

However, the statutory amendment provided two narrow exceptions to the bar against employer liability. An employer may be held liable to a third party for indemnification or contribution if (1) there is a written contract that provides for indemnification or contribution, or (2) the employee, while engaged in conduct within the scope of his employment, suffers a grave injury.[1]

The legislature narrowly defined "grave injury" to include injuries that were catastrophic in nature and the phrase encompasses only those injuries which are specifically enumerated in the statute.[2] "Grave injury" is defined as injuries that result in:

> death, permanent and total loss of use or amputation of an arm, leg, hand or foot, loss of multiple fingers, loss of multiple toes, paraplegia or quadriplegia, total and permanent blindness, total and permanent deafness, loss of nose, loss of ear, permanent and severe facial disfigurement, loss of an index finger or an acquired injury to the brain caused by an external physical force resulting in permanent total disability.[3]

Since this reform, there has been much dispute as to when a brain injury may constitute a grave injury. To qualify, the brain injury must be "caused by an external physical force resulting in *permanent total disability.*"[4]

What Is a Permanent Total Disability?

The Dispute

The Appellate Division was initially divided as to the definition of a permanent total disability resulting from a brain injury. The Third and Fourth Departments had held that a permanent total disability meant only that the injured party was totality disabled from employment.[5] However, the Second Department determined that the disability analysis focused on the injured employee's ability to engage in daily life activities, essentially requiring an almost vegetative state.[6]

The Underlying Cases

The Court of Appeals presumably resolved the dispute in *Rubeis v. Aqua Club, Inc*. where it discussed three consolidated cases—two from the Second Department and one from the Fourth Department.

In *Rubeis v. Aqua Club, Inc*. the trial judge charged the jury with the following definition of permanent total disability for a brain injury:

> [i]n order to prove a grave injury…the medical evidence must indicate that… plaintiff is unable to return to any employment. You may consider plaintiff's ability to obtain other employment and should also consider his ability to perform the usual and customary tasks of ordinary day-to-day living, such as whether he is physically independent and ambulatory, in determining whether or not plaintiff suffered a grave injury.[7]

Applying this standard, the jury found that plaintiff had sustained a grave injury.[8] The trial court then denied the employer's motion to set aside the verdict. The Second Department, however, reversed the trial court's decision and dismissed the third-party complaint, holding that plaintiff did not sustain a grave injury because he was still able to perform his day-to-day activities and, therefore, did not qualify as having a permanent total disability.[9] Similarly, the Second Department held in *Largo-Chicaiza v. Westchester Scaffold Equipment Corp*., that because the plaintiff was able to engage in his day-to-day functions, he did not sustain a permanent total disability.[10]

On the other hand, in *Knauer v. Anderson*, the trial court's jury instruction defined a permanent total disability as an injury that permanently and totally disables a plaintiff from employment and it did not require that plaintiff lack all capacity to perform daily activities.[11] The Fourth Department agreed with the trial court and affirmed.[12]

The Resolution

After reviewing the purpose and intent of the statutory scheme and analyzing the other examples of grave injuries, the Court of Appeals rejected the total disability standard set forth by the Second Department, which would essentially require the employee to be in a vegetative state, finding it to produce a result which was too harsh and not in line with the Legislative intent.[13] Instead, the court partially adopted the standard set forth in the Third and Fourth Departments. It found that the term "disability" within the context of Workers' Compensation Law generally referred to a person's inability to work.[14] The court then went a step further and adopted the test of whether a person is employable "in any capacity" on the basis that it "sets a more objectively ascertainable test than equivalent, or competitive, employment."[15] Thus, pursuant to *Rubeis*, the test to determine whether the brain injury category of a grave injury is met is whether the injured employee is unemployable in any capacity.[16]

After *Rubeis*

Since the decision in *Rubeis*, courts have still struggled with the issue of whether an injured party is unemployable in any capacity.

The courts have considered many factors when analyzing whether an injured party has sustained a permanent total disability resulting from a brain injury. In 2010, the Third Department held, in *Miranda v. Norstar Building Corporation*, that a plaintiff's eligibility for Social Security disability benefits or a determination by the Workers' Compensation Board that he or she is permanently and totally disabled is sufficient to raise questions of fact as to whether a grave injury occurred, but are not dispositive on the issue.[17] Another court considered a plaintiff's ability to sit for lengthy depositions and provide coherent answers as a factor in determining whether a plaintiff was employable in any capacity; however, it did not rise to the level of proving that the plaintiff did not sustain a grave injury.[18]

It has also been held that an employer satisfies its initial burden of proving that the plaintiff did not sustain a grave injury with the submission of an affidavit from a vocational rehabilitation specialist who opines that, with a reasonable degree of certainty, the plaintiff is well suited for jobs that were unskilled, low-stress, and required simple instruction.[19] The same court also held that submission of an affidavit from a vocational rehabilitation expert stating that the plaintiff was permanently and totally disabled from all employment is sufficient to create an issue of fact.[20]

However, in most of the cases the courts rely on the medical evidence presented, as required by the statute.[21] While it is not required for the moving party to show that the plaintiff is in a completely vegetative state, the courts consider such factors as a plaintiff's lack of orientation to time and place, court-ordered guardianship, required 24-hour-a-day supervision and nursing home care, and inability to provide any testimony relating to the event.[22]

Those factors are extreme compared to most cases and so the courts are often required to consider much more subtle factors when determining if a plaintiff is employable. Recently, one court determined that the medical evidence showing a plaintiff's anxiety and depression, impairment of short-term memory, frequent headaches, problems with daily living, and the requirement of outpatient cognitive rehabilitation and supportive psychotherapy was sufficient to create an issue of fact to defeat a motion for summary judgment.[23]

Additionally, while appellate courts have not specifically addressed the issue, it appears that the permanent total disability must result directly from the brain injury.[24] This is consistent with the language set forth in the statute which specifically states, in part, that a grave injury means "…an acquired injury to the brain caused by an external physical force resulting in permanent total disability."[25] In *Dechnik v. Fortunato*, the Second Department's decision affirmed the trial court's decision to grant summary judgment in favor of the employer, stating that the plaintiff did not sustain a grave injury.[26] The employer's brief on appeal reveals that the third-party plaintiff attempted to rely on the plaintiff's employment limitations relating to his back pain and visual impairments.[27] The employer argued, and apparently the Appellate Division agreed, that while the plaintiff may be disabled as a result from his other injuries, he is not disabled *due to* a brain injury, which is required pursuant to Workers' Compensation Law § 11.[28] One trial court has specifically stated that although the plaintiff may be totally and permanently disabled from injuries to the cervical spine, extremities, and shoulder, the aspect of the statute that references a "permanent total disability" is only applicable to brain injuries caused by an external physical force.[29] Thus, limitations on employment caused by injuries to other parts of the body must be separated from those related to the brain injury.[30]

Conclusion

While the courts consider these factors discussed above, they are still no closer to providing a clear line as to what qualifies as an "acquired injury to the brain caused by an external physical force resulting in permanent total disability." For any party to succeed on a motion for summary judgment it appears that the plaintiff must fall into one of the extremes of either having returned to some form of employment or be in a vegetative state. It also appears that, based upon the decisions following *Rubeis*, if there are *any* conflicting medical opinions as to the injured employee's ability to return to some type of employment, summary judgment will not be granted to either party.

Endnotes

1. Workers' Compensation Law § 11.
2. *Fleming*, 10 NY3d at 301; *Schuler v. Kings Plaza Shopping Center and Marina, Inc.*, 294 AD2d 556 (2d Dept 2002).
3. Workers' Comp. Law § 11.
4. *Id.* (emphasis added).
5. *Knauer v. Anderson*, 2 AD3d 1314 (4th Dept 2003); *Way v. Grantling*, 289 AD2d 790 (3d Dept 2001).
6. *Largo-Chicaiza v. Westchester Scaffold Equipment Corp.*, 5 AD3d 355 (2d Dept 2004); *Rubeis v. Aqua Club, Inc.*, 305 AD2d 656 (2d Dept 2003); *Schuler*, 294 AD2d 556.
7. *Rubeis*, 3 NY3d at 413.
8. *Rubeis*, 305 AD2d at 657.
9. *Id.* at 657-658.
10. *Id.*
11. *Id.*
12. *Knauer*, 2 AD3d 1314.
13. *Id.* at 416-417.
14. *Id.* at 417.
15. *Id.*
16. *Id.* at 413.
17. *Miranda v. Norstart Building Corporation*, 79 AD3d 42 (3d Dept 2010).
18. *Carlsen v. Rockefeller Center North, Inc.*, 2010 WL 5646983 (NY. Co. Sup. Ct. 2010).
19. *Fernandez v. City of New York*, 31 Misc3d 1208(A), *6 (Sup. Ct. 2011).
20. *Id.*
21. Workers' Compensation Law § 11; *Rubies*, 3 NY3d at 413-418; *Way*, 289 AD2d at 793; *Galindo v. Dorchester Tower Condo.*, 56 AD3d 285 (1st Dept 2008).
22. *Tzic v. Kasampas*, 93 AD3d 438, 440 (1st Dept 2012).
23. *Paredes v. 1668 Realty Associates LLC*, 34 Misc3d 1240(A) (NY Sup. Ct. 2012).
24. Workers' Compensation § 11.
25. *Id.*
26. *Dechnik v. Fortunato*, 58 AD3d 793 (2d Dept 2009).
27. *Dechnik v. Fortunato*, 2008 WL 6691216.
28. *Id.*
29. *Eldoh v. Astoria Generating Co., L.P.*, 24 Misc3d 1214(A) (Sup. Ct. 2007).
30. *Id.*

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Ethical Boundaries in Settlement Discussions

By Eileen E. Buholtz

I. Pre-trial Conferences and Settlement Conferences

A. History and Origin of Pre-Trial and Settlement Conferences

Settlement conferences date back to early 20th century efforts by municipal courts to apply Scandinavian conciliation techniques to local cases to produce harmony among the parties consistent with communitarian values. At some point in the 1920s efficiency became a rationale for settlements; settlements relieved congested court dockets. Settlement conferences were originally voluntary but eventually have become mandatory. Menkel-Meadow, *Essay: For and Against Settlement: Uses and Abuses of the Mandatory Settlement Conference*, 33 UCLA Law Rev. 485, 490-493.

A parallel but separate move to aid judicial administration is the development of the pre-trial conference to streamline trials: issues are narrowed, and evidence and rulings are made on preliminary motions. These conferences derived from English and Scottish practices of the early 19th century that provided for oral presentation of preliminary matters in open court. Menkel-Meadow, *Essay: For and Against Settlement: Uses and Abuses of the Mandatory Settlement Conference*, 33 UCLA Law Rev. 485, 490-493.

In 1938, Rule 16 of the Federal Rules of Civil Procedure was promulgated and in its first version explicitly excluded the use of the pre-trial conference for settlement purposes. But given the ever increasing pressure on the courts by the ever increasing number of cases, Rule 16 changed. Rule 16 as it currently stands encourages judges to put more time into the management of the front end of cases and explicitly encourages, if not requires, judicial involvement in settlement discussions at two points: immediately after the complaint is filed and just before trial. Menkel-Meadow, *Essay: For and Against Settlement: Uses and Abuses of the Mandatory Settlement Conference*, 33 UCLA Law Rev. 485, 490-493.

"Mandatory settlement conference" is an oxymoron. It involves fundamental conceptions of our adversary system as distinguished from more judicially activated inquisitorial systems. Menkel-Meadow, *Essay: For and Against Settlement: Uses and Abuses of the Mandatory Settlement Conference*, 33 UCLA Law Rev. 485, 490-493.

Use of magistrates and court mediators relieves the tension caused by having the judges (the adjudicators and decisions makers) settle and manage the cases. Menkel-Meadow, *Essay: For and Against Settlement: Uses and Abuses of the Mandatory Settlement Conference*, 33 UCLA Law Rev. 485, 490-493.

There is a range in judges' styles in handling settlement conferences from those who do nothing more than set a trial date to those who are actively involved in bringing the parties together to those who use coercive techniques to get the parties to settle. Among those who are actively involved, some express opinions and offer suggestions on the issues of liability and damages; some find a common ground for the parties from whatever point each starts at; and some use a formula approach, the simplest being splitting the difference between the two starting positions.

B. Pre-Trial Conferences. Settlement Can Be Discussed at Any Court-Mandated Conference

Rule 16 of the Federal Rules of Civil Procedure reads as follows:

> Pretrial Conferences; Scheduling; Management
>
> (a) Purposes of a Pretrial Conference. In any action, the court may order the attorneys and any unrepresented parties to appear for one or more pretrial conferences for such purposes as:
>
> (1) expediting disposition of the action;
>
> (2) establishing early and continuing control so that the case will not be protracted because of lack of management;
>
> (3) discouraging wasteful pretrial activities;
>
> (4) improving the quality of the trial through more thorough preparation; and
>
> (5) *facilitating settlement*.
>
> …
>
> (c) Attendance and Matters for Consideration at a Pretrial Conference.
>
> …
>
> (2) *Matters for Consideration.* At any pretrial conference, the court may consider and take appropriate action on the following matters:
>
> …

(P) *facilitating in other ways the just, speedy, and inexpensive disposition of the action*.

II. Types of Settlement Conferences

Settlement discussions take place in a variety of settings:

A. Informal conversations between/among counsel.

B. Privately arranged mediation with a privately paid mediator.

C. Any type of conference with the court. In federal court, any conference can be treated as a settlement conference, so one must be prepared. In New York State Supreme Court, settlement discussions are expressly expected in all actions at the preliminary conference (22 NYCRR §20212(c)(5)) and the pre-voir-dire conference (22 NYCRR §202.33(b)); in medical, dental and podiatric malpractice actions at the settlement conference after the note of issue has been filed (22 NYCRR §202.56(c)); and in commercial cases at the settlement and pre-trial conferences after the note of issue has been filed (22 NYCRR §202.70).

D. Mandatory settlement conferences and court-ordered mandatory mandatory mediation. Because one or both parties may not want to participate, the federal courts and some state courts have adopted the requirement that parties to a mandatory mediation participate in good faith. *In re A.T. Reynolds & Sons, Inc.*, 452 B.R.374, 381-384 (S.D.N.Y. 2011).

III. Confidentiality of the Settlement Process

Rule 408 of the Federal Rules of Evidence makes settlement discussions confidential:

> Compromise Offers and Negotiations
>
> (a) Prohibited Uses. Evidence of the following is not admissible—on behalf of any party—either to prove or disprove the validity or amount of a disputed claim or to impeach by a prior inconsistent statement or a contradiction:
>
> (1) furnishing, promising, or offering—or accepting, promising to accept, or offering to accept—a valuable consideration in compromising or attempting to compromise the claim; and
>
> (2) conduct or a statement made during compromise negotiations about the claim—except when offered in a criminal case and when the negotiations related to a claim by a public office in the exercise of its regulatory, investigative, or enforcement authority.
>
> (b) Exceptions. The court may admit this evidence for another purpose, such as proving a witness's bias or prejudice, negating a contention of undue delay, or proving an effort to obstruct a criminal investigation or prosecution.

Confidentiality encourages the parties to be candid with the mediator by making them comfortable that their positions, willingness to settle, weaknesses of their case, etc. will not prematurely influence the trial judge. See, e.g., Alternate Dispute Resolution Act, 28 U.S.C. §652(d) (each district court shall, by local rule, provide for the confidentiality of the mediation process and prohibit disclosure of confidential mediation communications); *Clark v. Stapleton Corp.*, 957 F.2d 745, 746 (10th Cir. 1992); *Fields-D'Arpino v. Restaurant Assocs., Inc.*, 39 F. Supp. 2d 412, 417 (S.D.N.Y. 1999); *Hand v. Walnut Valley Sailing Club*, No. 10-1296-SAC, 2011 U.S. Dist. LEXIS 80465, 9-19, 12-15 (D. Kan. July 20, 2011).

But there is a caveat: Settlement negotiations between a plaintiff and settling defendants in a patent dispute were held discoverable by a non-settling defendant because plaintiff's expert relied on the testimony of plaintiff's executive about plaintiff's reasons for entering into the settlement agreements with the settling defendants. This decision does not limit its holding to intellectual property litigation. *In re MSTG*, 675 F.3d 1137 (Fed. Cir. 2012).

The federal courts are divided as to whether there is a settlement privilege under Fed. R. Evid. 501. No privilege: *In re MSTG*, 675 F.3d 1137 (Fed. Cir. 2012); *In re General Motors Corp. Engine Interchange Litigation*, 594 F.2d 1106 (7th Cir. 1979); *Matsushita Electric Indus. Co. v. Mediatek, Inc.*, No. C-05-3148, 2007 U.S. Dist. LEXIS 27437 (N.D. Cal. Mar. 30, 2007); *In re Subpoena Issued to Commodity Futures Trading Comm'n*, 370 F. Supp. 2d 201 (D.D.C. 2005). Privilege: *Goodyear Tire & Rubber Co. v. Chiles Power Supply, Inc.*, 332 F.3d 976, 979-83 (6th Cir. 2003); *California v. Kinder Morgan Energy Partners, L.P.*, No. 07-1883, 2010 WL 39888448 (S.D. Cal. Oct. 12 2010); *Software Tree LLC v. Red Hat, Inc.*, No. 6:09-CV-097, 2010 WL 2788202 (E.D. Tex. June 24. 2010).

The Eighth Circuit views Rule 408 as sufficiently broad to encompass certain work product, internal memos, and other materials created specifically for the purpose of conciliation, even if not communicated to other party, in addition to actual offers of settlement. *EEOC v. UMB Bank Fin. Corp.*, 558 F3d 784 (8th Cir. 2009).

CPLR 4547 similarly makes settlement discussions confidential:

> Evidence of (a) furnishing, or offering or promising to furnish, or (b) accepting, or offering or promising to accept, any valuable consideration in compromising or attempting to compromise a claim which is disputed as to either validity or amount of damages, shall be inadmissible as proof of liability for or invalidity of the claim or the amount of damages. Evidence of any conduct or statement made during compromise negotiations shall also be inadmissible. The provisions of this section shall not require the exclusion of any evidence, which is otherwise discoverable, solely because such evidence was presented during the course of compromise negotiations. Furthermore, the exclusion established by this section shall not limit the admissibility of such evidence when it is offered for another purpose, such as proving bias or prejudice of a witness, negating a contention of undue delay or proof of an effort to obstruct a criminal investigation or prosecution.

In New York, where a communication is intended to be disclosed to third persons for the purpose of negotiating a settlement of litigation it is not privileged. *See, e.g., Hernandez v. Brookdale Mills, Inc.*, 201 A.D. 325 (1st Dep't 1922) (affidavit from witness to attorney or use in negotiation with party in other litigation was admissible); *Timmermann v. State*, 48 Misc. 2d 678 (Ct. Cl. 1965) (letter of negotiation from attorney to adverse party); *Brown v. Ingersoll*, 226 N.Y.S.2d 479 (Sup. Ct. Monroe County 1962). *See generally* 8 Wigmore, Evidence §2325 (McNaughton rev. 1961).

Since, however, there is a strong policy in favor of negotiated settlements, perhaps revelations of a client's communications made between attorneys in the course of an attempt to settle a case should be deemed privileged even if the client was aware of the negotiation. 9-4503 New York Civil Practice: CPLR P 4503.18. *Cf. In re Grand Jury Subpoena Duces Tecum etc*., 406 F. Supp. 381 (S.D.N.Y. 1975) (matters disclosed during joint conference between attorney and client and co-defendants or potential co-defendants and their independently retained attorneys are privileged when a joint defense was contemplated because of the expectation of confidentiality but not privileged when disclosures occurred in the presence of a third party not demonstrated to be interested in a joint defense; even when corporate co-defendant commenced separate action against individual co-defendants, joint conference materials remained privileged against disclosure in a third-party proceeding other than the private litigation between former co-defendants). *See also Magnaleasing, Inc. v. Staten Island Mall*, 76 F.R.D. 559 (S.D.N.Y. 1977) (communications among the attorneys for co-defendants are privileged only if the communications are designed to further a joint or common defense) (citing Weinstein, Korn & Miller.). On the related problem of the exchange of information between attorneys representing clients with common interests see Note, *Waiver of Attorney-Client Privilege on Inter-Attorney Exchange of Information*, 63 Yale L. J. 1030 (1954).

IV. Learn the Court's Procedures

Different courts require different tasks to be done before the conference. Some courts require a settlement memorandum or position paper be submitted. Some courts require the client or a representative from the insurer insuring the defendant be present at the conference. Some courts issue letters that set forth the requirements; some issue orders such as in *Easterbrook v. Life Ins. Co. of N. America*, No. CV-06-956-PHX-MHM, 2007 U.S. Dist. LEXIS 17990, 1-12 (D. Ariz. 2007) (attached hereto as exhibit A). Submit the paperwork that is required to avoid sanctions. *Nick v. Morgan Foods, Inc.*, 99 F. Supp. 2d 1056, 1057 (E.D. Mo. 2000), aff'd 270 F. 3d 590 (8th Cir. 2001).

V. Know Your Case Factually and Legally

An attorney who lacks knowledge of the facts of a case at a scheduling conference is "substantially unprepared" to participate in a scheduling or other pre-trial conference and is subject to sanctions. Fed. Rule Civ. Proc. 16(f). The New York commercial-part rules also require that counsel who appear at conferences must have knowledge of the case. 22 NYCRR §202.70, rule 1.

Preparation includes familiarity with the facts of the case sufficient to permit meaningful discussion with the court and opposing counsel. *Flaherty v. Dayton Elec. Mfg. Co.*, 109 F.R.D. 617 (D. Mass. 1986) (magistrate's decision). In *Flaherty*, plaintiff's attorney attended the scheduling conference and explained that "this is a products liability case involving a bench grinder manufactured by Dayton Electric" and briefly described what a bench grinder was. He stated that the plaintiff injured his hand because the safety guard failed while plaintiff was operating the grinder at work. Plaintiff's attorney could not describe the injury other than to say that it was a hand injury involving one or two fingers and that he thought that plaintiff had reached an end result in treatment. Plaintiff's attorney could not say whether plaintiff received anything from his employer's workers' compensation carrier and could not name the workers' compensation carrier. Plaintiff's attorney did not know the extent of plaintiff's lost wage claim other than that he thought plaintiff had returned to work. Plaintiff' attorney could not say whether he intended to sue a corporation not named in the complaint but against whom the complaint alleged a cause of action. The magistrate held that plaintiff's attorney was "substantially unprepared" because "one of the primary purposes of the scheduling conference is to explore the

possibilities of settlement early in the litigation, as the notice of scheduling conference noted." The magistrate ordered plaintiff's attorney personally to pay defendant's attorney $110 being the amount of time at $100 per hour that defendant's attorney spent preparing for and attending the conference.

VI. Understand Your Client

Is your client a risk taker or risk averse? Some research concludes that when a defendant-client expects to pay out, he is more likely to pursue risk, for example, to go to trial and take his chances rather than settling, and a plaintiff client who expects to gain money will tend to be risk adverse, that is, accept an offer rather than risk losing all. However, my empirical experience in litigating cases for thirty years has demonstrated the opposite: that plaintiffs are more likely to roll the dice and go to trial and that defendants are more willing to settle.

Double-check your client's position. Beware of the client or claim representative who exhibits an extreme emotional reaction to the case and takes a "scorched earth" or "millions-for-defense-but-not-a-penny for tribute" attitude, especially early in the case. The individual client who is overly insistent on the merits of his case frequently is compensating for his own wrongdoing by deflecting scrutiny away from himself and towards the opponent. The client's employee or the insurer's claim representative who is overly zealous may be out of line with the company's philosophy. The attorney who blindly follows those instructions risks being blamed later on for that course of action; when the case gets to trial, the individual client will change 180 degrees and the supervisors of the employee or claim representative will countermand the aggressive stance previously taken by the subordinate employee. After the fact, the individual client will wonder why the attorney led him down the aggressive path and the supervisors will wonder about the attorney's judgment in handling files.

VII. Inform Your Client of the Settlement Conference and Obtain Settlement Authority from Your Client Before the Conference

Sanctions can be imposed for failure to obtain settlement authority. A represented party must authorize at least one of its attorneys to make stipulations and admissions about all matters that can reasonably be anticipated for discussion at a pre-trial conference. Fed. R. Civ. P. Rule 16(c)(1). On motion or on its own, a district court may issue any just orders if a party or its attorney is "substantially unprepared to participate—or does not participate in good faith—in the conference." Fed. R. Civ. P. Rule 16((f)(1)(B).

Identify the client who holds the right to control settlement decisions. Where there is coverage and the insurer controls the litigation, the insurer is the "client" for purposes of extending settlement authority. But in a reservation-of-rights case, the insured has the ultimate decision regarding settlement. *See, e.g., Carrier Express v. Home Indem. Co*., 860 F. Supp. 1465 (N.D. Ala. 1994). In *Carrier Express*, the insurer defended the insured under a reservation of rights. Early in the case, the insured directed its carrier-retained counsel to tender the policy limits in response to a settlement offer but counsel refused. The case ultimately settled for more than the policy limit and the insured paid the balance. A jury in the subsequent bad-faith action by insured against the carrier found in favor of the insured and awarded the insured punitive as well as compensatory damages. Vis-à-vis the carrier-retained attorney, the district court stated that although retained by the insurer, the attorney was ethically bound to represent only the insured's interest in the underlying litigation. Therefore, it was the insured who made the ultimate choice regarding settlement.

But in contrast, the federal district court in *State Farm & Cas. Co. v. Myrick*, 611 F. Supp. 2d 1287, 1298-1299 (M.D. Ala. 2009), noted that there was no dispute that the carrier hired competent defense counsel who understood that only the insureds were his clients. The clients retained the right to decide on settlement and authorized the settlement of the case. The insurer, which had issued a reservation of rights, refused to settle and its refusal was found to be justified given its reservation of rights.

With regard to uncovered claims, the insured is the client. The insurer has no duty to consider uncovered claims, such as a punitive damages claim, in responding to plaintiff's settlement demand. *St. Paul Fire & Marine Ins. Co. v. Convalescent Servs*., 193 F.3d 340, 345 (5th Cir. Tex. 1999). Therefore, the insured controls the grant of settlement authority.

Defendant's attorney is obliged to advise insured that he has a right to contribute money towards settlement where the damages clearly exceed the insured's coverage. *Kaudern v. Allstate Ins. Co*., 277 F. Supp. 83, 90 (D.N.J. 1967).

Have sufficient settlement authority for the conference. Courts and court mediators may impose sanctions for lack of good faith if counsel has "insufficient" settlement authority. An extreme example, in which the attorney was spared on appeal, is *In re A.T. Reynolds & Sons, Inc*., 452 B.R. 374, 384-385 (S.D.N.Y. 2011), in which the Southern District of New York reversed sanctions and a contempt finding imposed by a bankruptcy court judge on the creditor's attorney for failure to have "sufficient authority" at a court-ordered mediation. The bankruptcy judge sanctioned the attorney, who had appeared with an employee from his client-creditor, on several grounds: for having insufficient authority to settle the case for an amount greater than the amount in controversy, for failure to be able to discuss any theory of legal liability including issues that did not affect the creditor, and for

failure to enter in to "creative solutions" that were not defined. The bankruptcy court had taken particular umbrage at the creditor's attorney and the creditor's employee calling a more senior person at the creditor to discuss issues. On appeal, the district court reversed the sanctions and contempt because the the bankruptcy court applied an unworkable and overly stringent standard for measuring sufficient settlement authority. The district court held that settlement authority is met by sending a person who has authority to settle for the anticipated amount in controversy and who is prepared to negotiate all issues that can be reasonably expected to arise.

Defense counsel should notify the court before the conference if there will be no offer. *Kyeame v. Buchheit*, 1:07-CV-1239, 2011 U.S. Dist. LEXIS 120106, 4-5 (M.D. Pa. 2011). Defense counsel notified the mediator four days before the mediation that defendant would be making no offer, thereby letting the court know that the settlement conference would be a futile act. The mediation/conference was canceled. Plaintiff's attorney's motion for sanctions based on defendant's failure to mediate in good faith was denied.

Plaintiffs who didn't speak English participated sufficiently via their attorney who translated for them the dialog of private mediation. Defendant sought sanctions afterwards because the mediator could not speak directly with plaintiffs. The Eastern District of California denied defendant's motion. There is no requirement that the mediator be able to speak directly to plaintiffs. If defendant felt it was that important for the mediator to speak directly with plaintiffs, defendant should have arranged for a translator to be at the mediation. *U.S. EEOC v. ABM Industries*, 1:07-cv-01428-LJO –JLT, 2010 U.S. Dist. LEXIS 24570, 11-12 (E.D. Cal. 2010).

VIII. At the Conference

Make sure you appear at the conference. On motion or on its own, the district court may issue any just orders if a party or its attorney fails to appear at a scheduling or other pre-trial conference or fails to obey a scheduling or other pre-trial order. Fed. R. Civ. P. Rule 16(f)(1)(A) and (C). The Eastern District of California levied a $2,500 monetary sanction against an attorney who failed to provide a required dismissal of an action after his client was paid in full, failed to respond to the court's inquiries about the status of the case, and failed to appear for a status conference that the court scheduled because the attorney had ignored the court's other efforts. *Waterbury v. Veneman*, No. CV-F-02-6162 LJO, 2006 U.S. Dist. LEXIS 82206 (E.D. Cal. 2006).

The Ninth Circuit affirmed the sanctions against an attorney who failed to appear at a settlement conference where the other attorney received the court's notice, the post office did not return the notice to the offending attorney, and the offending attorney when called by the court clerk said that the date had slipped by him. *Ayers v. Richmond*, 895 F.2d 1267 (9th Cir. 1990).

Bring your client's contact information (and claim number) to the conference/mediation, and bring your client or carrier claim representative if required. More likely than not, the judge or the court-appointed mediator will require that the carrier's claim representative physically appear at the conference. Fed. R. Civ. P. Rule 16(c)(1) states that if appropriate, the court may require that a party or its representative be present or reasonably available by other means to consider possible settlement.

Representatives include insurer's claim representatives. A claim representative's failure to appear in response to a court directive to appear can result in criminal contempt. In *Matter of Novak*, 932 F.2d 1397 (11th Cir. Ga. 1991) the district court faxed the claim representative an order directing him to appear for a settlement conference and so informed the carrier-retained attorney representing the insured. The claim representative authorized the attorney to make a higher offer and did not appear at the conference. The district court issued an order directing the claim representative to show cause why he should not be held in criminal contempt. The claim representative challenged the court's jurisdiction over him. The district court held him in criminal attempt and the Eleventh Circuit affirmed. The Eleventh Circuit held that although the order to appear was invalid because it was unauthorized by statute, rule or the district court's inherent power, the order was valid until vacated and the claim representative willfully disobeyed the order.

The Eastern District of Missouri issued sanctions against defendants for failing to participate in court-ordered mediation. Defense counsel failed to provide its pre-mediation brief for the mediator and defendant failed to send a representative with settlement authority. Defendant sent only a person with little knowledge of the litigation. Plaintiff made two offers but defendant made no counteroffers because of lack of settlement authority. *Nick v. Morgan Foods, Inc*., 99 F. Supp. 2d 1056, 1057 (E.D. Mo. 2000), *aff'd*, 270 F. 3d 590 (8th Cir. 2001).

Plaintiff's attorney was sanctioned for abruptly terminating a court-ordered mediation. Defendants had made a serious offer to plaintiff, who rejected it out of hand and said that if defendants did not make a serious offer within five minutes, plaintiff would leave. Plaintiff's attorney did not allow the mediator to explain the reasoning behind the offer and unilaterally terminated the mediation. *U.S. EEOC v. ABM Industries*, 1:07-cv-01428-LJO –JLT, 2010 U.S. Dist. LEXIS 24570, 11-12 (E.D. Cal. 2010).

Negotiate with confidence. Experienced opposing counsel and the judge may take advantage of an attorney who lacks confidence. Correspondingly, do not be forced into settling. Rule 2.6 of the Model Code of Judicial Conduct states that a judge shall accord to all who have

a legal interest in a proceeding and to their attorneys the right to be heard according to law, and that a judge may encourage parties and their lawyers to settle matters but shall not act in a manner that coerces any party into settlement.

Ex parte communications with the judge during the settlement conference are permitted. Although ex parte communications with the judge are forbidden as a general matter, it is customary during settlement conferences for the judge to confer with each side separately. This exception to the ban on ex parte communications is generally assumed but is sometimes made explicit in federal court court-specific rules and scheduling orders. In New York, judges are prohibited from ex parte communications except (in pertinent part) that a judge, with the consent of the parties, may confer separately with the parties and their lawyers on agreed-upon matters. 22 NYCRR §100.3(B)(6)(d).

You have no obligation to tell opposing counsel the attorney's limit of authority, but the attorney cannot lie about it to the judge. Under Rule 1.6 (confidentiality of information) of the New York Rules of Professional Conduct, the limits of the client's settlement authority and the terms that a lawyer would recommend to client are confidential client information that cannot be disclosed without the client's express consent. ABA Standing Committee on Ethics and Professional Responsibility, Formal Opinion 93-370 (1993). The attorney has no implied authority by virtue of his representing the client to disclose the limit on the attorney's settlement authority. This information should not be disclosed to a judge, a mediator, or opposing counsel without the client's informed consent.

The attorney cannot make false statements to a judge about the limit of the attorney's settlement authority. See Code of Prof'l Conduct Rules 3.3 (candor towards the tribunal) and 8.4(c) (misconduct). The judge is not supposed to ask what the limit of the attorney's settlement authority is, but if the judge does ask, the appropriate response is to decline to answer the judge's question. N.Y. Rules of Prof'l Conduct Rules 3.3 and 8.4(c).

The attorney can, however, make false statements to opposing counsel about the limit of the attorney's settlement authority. N.Y. Rules of Prof'l Conduct Rule 4.1, comment 2: "Under generally accepted conventions in negotiation, certain types of statements ordinarily are not taken as statements of material fact. Estimates of price or value placed on the subject of a transaction and a party's intentions as to an acceptable settlement of a claim are ordinarily in this category, and so is the existence of an undisclosed principal except where nondisclosure of the principal would constitute fraud. Lawyers should be mindful of their obligations under applicable law to avoid criminal and tortious misrepresentation."

ABA Formal Ethics Opinion 06-439 acknowledges that it is not unusual for lawyers to be "less than entirely forthcoming" with opposing counsel during settlement negotiations, and gives examples of what are not false statements of material fact or law under Model Rule 4.1 [see N.Y. Rules of Prof'l Conduct Rule 4.1]:

- "puffing," posturing and other statements upon which parties to negotiations are ordinarily not expected to rely.
- Exaggerating the client's negotiation goals.
- Downplaying the client's willingness to compromise.

But statements that are false statements of material fact or law under Rule 4.1 are:

- When a lawyer representing an employer in labor negotiations states to union lawyers that adding a particular employee benefit would cost the company an additional $100 per employee, when the lawyer knows it will actually cost $20.
- When defense counsel declares that documentary evidence will be submitted at trial in support of a defense when the lawyer knows that such documents do not exist.
- When either side in a criminal case tells the other during a plea negotiation that he knows of an eyewitness to the facts in question when he knows that is not the case.

False statements that have led to discipline or voiding of settlements. Plaintiff's attorney was disciplined for settling a personal injury case without disclosing that the plaintiff had died. *Kentucky Bar Ass'n v. Geisler,* 938 S.W.2d 578 (Ky. 1997); *In re Warner*, 851 So. 2d 1029 (La. 2003); *Toledo Bar Ass'n v. Fell*, 364 N.E.2d 872 (Ohio 1977).

Defendant's attorney was disciplined for stating to opposing counsel that his client's insurance coverage was only $200,000 when he knew that the limits were $1 million. *In re McGrath*, 96 A.D.2d 267 (1st Dep't 1983).

Settlement was voided because of defense counsel's failure to disclose material facts adverse to his client's position relating to the plaintiff's medical condition. *See, e.g., Spaulding v. Zimmerman*, 116 N.W.2d 704 (Minn. 1962) which was a case involving a crash injury to the chest of a 20-year-old minor plaintiff. Defendant's examining doctor discovered an aortic aneurysm caused by the accident which plaintiff's treating physicians had missed. The aneurysm was a serious condition given the plaintiff's young age. Defense counsel, knowing of the aneurysm but not disclosing it to the court or plaintiff's attorney, settled the case for $6,500 and the court approved it as an infant compromise. Two years later, plaintiff's physician

found the aneurysm during a routine physical, re-read the films taken immediately after the accident, and related the aneurysm to the accident. The court set aside the settlement because it was an infant compromise. Had plaintiff been an adult, the court would have relegated plaintiff to malpractice actions against his attorney and physicians.

Attorneys and litigants cannot be forced to settle. Rule 2.6 of the ABA Model Code of Judicial Conduct states that a judge shall accord to all who have a legal interest in a proceeding and to their attorneys the right to be heard according to law, and that a judge may encourage parties and their lawyers to settle matters but shall not act in a manner that coerces any party into settlement. New York's Code of Judicial Conduct states that a judge shall accord to every person who has a legal interest in a proceeding, or that person's lawyer, the right to be heard according to law. 22 NYCRR §100.3.

IX. Make a Record of the Settlement

Make a record of the settlement and its terms. Write down the settlement with all of its terms and have it signed by the plaintiff personally and by defense counsel, or place the agreement and its terms on the record and memorialize it with a so-ordered from the judge. The judge should elicit an acknowledgement by all parties, especially plaintiff, that the parties understand the terms of the settlement and agree to them. *See, e.g., Quinones v. Police Dep't of N.Y.*, 10 Civ. 6195 (JGK) (JLC), 2012 U.S. Dist. LEXIS 51697, 9-20 (S.D.N.Y. Apr. 12 2012) (magistrate decision) in which the judge's colloquy with the plaintiff bound plaintiff to the settlement.

Make sure all represented parties have the advice of their counsel in signing the agreement or release. A represented party who signed a stipulation of settlement without its attorney's advice was entitled to reprieve from the terms of the settlement. *National Labor Relations Board v. Autotronics, Inc.*, 596 F. 2d 322 (8th Cir. 1979). The Eighth Circuit in *Autotronics* held that the NLRB's attorney acted unethically in obtaining the signature of the corporation's president to a stipulation which the NLRB then attempted to enforce. Enforcement was denied.

Settlements that are subject to a client's approval are not final until approved. When a municipality or governmental agency settles a case, actual authority to settle is required, and the settlement is not final until the appropriate board or body approves the settlement. Thus, neither side can enforce the settlement until the approval is obtained. *See, e.g., Morgan v. South Bend Community School Corp.*, 797 F.2d 471 (7th Cir. Ind. 1986) (plaintiff was not entitled to enforcement of a written settlement agreement that was expressly subject to approval by the school board); *Heuser v. Kephart*, 215 F.3d 1186, 1191-1192 (10th Cir N.M. 2000) (plaintiff was permitted to disavow the settlement because the City and County that were required to approve the settlement had not yet approved it).

X. If the Client Did Not Attend the Conference, Report Back Immediately to the Client

The attorney must convey all settlement offers to the client, no matter when made. *Kaudern v. Allstate Ins. Co.*, 277 F. Supp. 83, 90 (D.N.J. 1967); N.Y. Rules of Prof'l Conduct Rule 1.4, comment 2; N.Y. Rules of Prof'l Conduct Rule 1.4(a)(1)(iii); 22 NYCRR §1210.1 (Statement of Client's Rights).

XI. Other Issues

Keep your and your client's hands off your opponent's file when you are alone in a room with your opponent's file during court conferences. In *Lipin v. Bender*, 193 A.D.2d 424 (1st Dep't 1993), plaintiff's suit was dismissed with prejudice because plaintiff, who was working for her attorney as a paralegal, attended a discovery hearing and when no one was looking reviewed the opposing attorney's internal counsel memorandums, informed her attorney, and made copies of them. Plaintiff's attorney then took advantage of that information and scheduled a "settlement conference." The First Department affirmed dismissal of plaintiff's suit with prejudice. *See also Furnish v. Merlo*, 1994 U.S. Dist. LEXIS 8455, 24-26, 128 Lab. Cas. (CCH) ¶ 57,755 (D. Or. 1994) (plaintiff who was a former manager of the defendant, whom she was suing for discrimination, and her attorney were sanctioned because plaintiff had copied a number of confidential documents from her personnel file that was maintained by her employer and then turned them over to her attorney for use in litigation).

Be reasonable in billing for travel time for and attendance at settlement conferences. A creditor applied to a bankruptcy court for reimbursement of expenses and attorney fees relating to mutual obligations under a pre-petition credit agreement with a Chapter 11 debtor. Out-of-town counsel for the creditor billed 211 hours for non-working travel time for various hearings and conferences. Although the creditor had local counsel in the venue, the out-of-town firm sent one and sometimes two attorneys even for events in which the creditor did not actively participate. The court held the billings to be unreasonable and disallowed them. *In re Latshaw Drilling*, LLC, 481 B.R. 765, 816 (Bankr. N.D. Okla. 2012).

Settlement conferences on appeals. Settlement conferences may be held regarding appeals. Rule 33 of the Federal Rules of Appellate Procedure provides that the court may order settlement conferences to address any matter that may aid in the disposition of the matter including simplification of issues and settlement of the matter. In the New York State Second and Third Departments, settlement conferences may be ordered. 22 NYCRR §670.4

(Second Department), §730.2 (Appellate Terms in the Second Department), and §800.24-b (Third Department).

High-low agreements are ethical; Mary Carter agreements are not. A "Mary Carter" agreement occurs when a defendant settles with plaintiff in secret, capping defendant's liability, but remains in the suit through trial as if there was no settlement, and the defendant receives an offset on his settlement based on plaintiff's recovery against the non-settling co-defendants. See *Booth v. Mary Carter Paint Co.*, 202 So.2d 8 (Fla. Ct. App. 2d 1967). Most jurisdictions hold these agreements to be unethical and against public policy because Mary Carter settlements hide a motive for the settling defendant to give testimony against a co-defendant.

High-low agreements, however, are ethical and enforceable. In a high-low agreement, the parties agree that the defendant will pay an amount to be determined by the trier of fact but that the amount will be between a high "ceiling" and a low "floor" but agree that those parameters are not disclosed to the trier of fact. As long as there is no sham amount used to hide what is really a Mary Carter agreement, most jurisdictions allow high-low agreements.

A client's personal attorney who may be called as a fact witness at trial may nevertheless participate in pre-trial proceedings. The prohibition against the attorney acting as an advocate applies only to trials. It does not automatically disqualify the attorney from all pre-trial activities such as strategy sessions, pre-trial hearings, pre-trial conferences, settlement conferences, or motion practice. Disqualification would be appropriate in the pre-trial setting if the activity includes obtaining evidence which if admitted at trial would reveal the attorney's dual role. *Lowe v. Experian*, 328 F. 2d 1122 (D. Kan. 2004) (the attorney in question had drafted the trust that was issue.)

Hearing-impaired clients may be entitled to an ALS interpreter ordered by the judge and paid for by the court system. *Patrick v. U.S. Postal Service*, No. CV-10-0650-PHX-ECV, 2010 U.S. Dist. LEXIS 128677 (D. Ariz. Nov. 23 2010).

Do not use a crystal ball, even a toy one, during settlement conferences. *Dodds v. American Broadcasting Co.*, 145 F.3d 1053, 1061-1062 (9th Cir. 1998). Judge Dodds sued ABC for defamation arising out a report that ABC aired to the effect that Judge Dodds used a crystal ball during settlement conferences. The judge sued ABC claiming that the report was false. The Ninth Circuit dismissed some of the claims and granted defendant summary judgment on the rest. The judge admitted using a toy crystal ball in one settlement conference for "levity." One of the show's producers took advantage of an open door to the judge's chambers and forced his way inside to where the crystal ball sat in plain view. Many sources told ABC that they were personally aware of the judge's use of the crystal ball as described by litigants who appeared on the show.

Eileen Buholtz concentrates her practice in trial and appellate litigation involving construction site accidents, products liability, premises liability, auto liability, disability and life, title insurance, New York class actions, and toxic torts. She has lectured and written on N.Y. Labor Law, automobile liability, including the no-fault threshold and the seat belt defense, uninsured/underinsured coverage, trial and discovery practice, ethics in preparing for and trying the civil lawsuit and in the insurance defense tri-partite relationship, contractual and statutory liens and claims on settlements and judgments, architects' and engineers' liability, construing the insurance contract, post-judgment interest, and insurance fraud.

Nominations for Officers

Nominations for the offices of Chairperson, Vice-Chairperson, Secretary, Treasurer, and members to be elected to the Executive Committee may be submitted to TICL Section Chair Robert McCarthy (robert.mcarthy@rocketmail.com) and TICL Section Liaison Patricia Johnson (pjohnson@nysba.org) as soon as possible or made at the Annual Meeting of the Section on January 30, 2014.

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