NEW YORK STATE BAR ASSOCIATION

Journal

JUNE 2008
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Making Sense of New York's Corporate Opportunity Doctrine

Fiduciaries' duty of loyalty versus personal opportunity

by Jonathan Rosenberg and Kendall Burr

Also in this Issue

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A: Collier, Larson, Moore, Nichols and Weinstein. Oh, and a strong cup of coffee.

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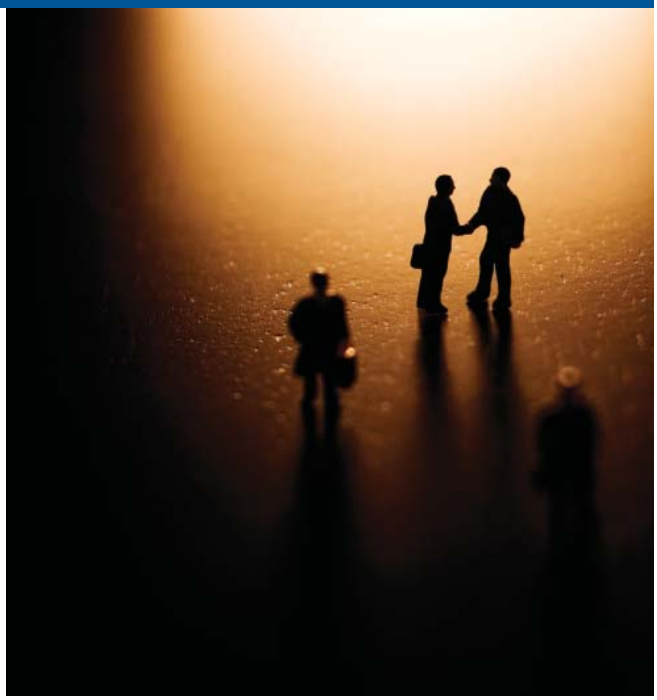

MAKING SENSE OF NEW YORK'S CORPORATE OPPORTUNITY DOCTRINE 10

BY JONATHAN ROSENBERG AND KENDALL BURR

DEPARTMENTS

The *Journal* welcomes articles from members of the legal profession on subjects of interest to New York State lawyers. Views expressed in articles or letters published are the authors' only and are not to be attributed to the *Journal*, its editors or the Association unless expressly so stated. Authors are responsible for the correctness of all citations and quotations. Contact the editor-in-chief or managing editor for submission guidelines. Material accepted by the Association may be published or made available through print, film, electronically and/or other media.

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BERNICE K. LEBER

The Road Taken

When Robert Frost stood before the branch in the road, regretting that he could not "take them both," little did he know how greatly he would affect our Bar Association in the year that lies ahead of us. As I write my first President's Message, I am humbled by the thought that I am at that fork in the road – with all of you – leading the largest voluntary bar association in the country for one year. From the many paths we could take together, choosing the most important ones is both exhilarating and daunting.

This is where you come in. Whether you practice in Kiev, Shanghai, Washington D.C., Rochester, Watervliet or New York City, your voices have – and must continue to have – importance not just to me personally but to the leadership and our staff at the State Bar Center. We look to you for guidance and support of our fundamental purpose, the voice of the New York Bar. For this reason, in March, I sent each of you an e-mail to ask you to focus on your concerns and the issues that matter to you most. About 450 of you took the time out of your busy day to respond. What better way can I continue this dialogue with you and determine which roads we should take this year than by sharing with all – all 74,000 of you – what's on your minds?

Generally, you wrote about 35 topics – ranging in breadth from the state of the legal profession, legal ethics, the challenges you face practicing law, particularly in a small or solo firm environment, the need for the State Bar to ensure there is diversity in the profession, the difficulties in practicing in our courts, the quality of our judiciary (and the lack of adequate compensation for our judges), the significance of pro bono service and work-life balance issues. You mentioned specific legal areas and issues that you would like to see the State Bar address, in the area of the securities laws, criminal laws, real estate and litigation to name a few. More than 100 of you mentioned that you work outside New York State and apply New York laws in your daily practice (not surprising given that 25% of our members live outside New York State and those numbers are growing).

Summarized below are a few of the areas. I am not mentioning you by name, on the theory that you know who you are – and in the space I have, I cannot cover all of your insights. So from time to time this year in this column, I will do so.

Regarding the state of the legal profession, many of you expressed concern over "the terror of billable hours," the "ridiculous amount of student debt many of you have," "finding time to be an excellent lawyer and do good work for my clients while still having a good personal life and being a sane person." Another wrote: "Perhaps the profession's problems can be succinctly referred to by the cliché, quantity and quality. By quantity, I mean that, other than at the large law firms, there is widespread dissatisfaction with the income earned by lawyers. . . . Most lawyers would be better off economically if they had been teachers in the public school system. . . . I am only making this comparison because lawyers have traditionally held a much higher position of prestige in society."

One contract attorney wrote: "My concerns are the overall stability of this type of work. . . . The State Bar should take notice of the increasingly large group of attorneys who are working as contract attorneys and mak[e] sure that this type of work does not get outsourced to cheaper markets." Some of you stated that "restoring a level of professionalism, i.e., competence, fidelity to the client, integrity and collegiality (or at least civility)" was the key issue of importance. One large-firm respondent concluded that "having the breadth and depth of legal talent and resources necessary to maximize options for my clients and thereby retain their confidence in me to capably represent their interests under all circumstances" affected him most in his day-to-day practice.

Many of you also wrote about the challenges you face working in a small or solo firm. Said a member from New York City: "[T]he functioning and cost to litigants and attorneys of the court system and the denial of access to the courts for a person of modest means are paramount." "I was taught in sociology class that a system of impartial dispute resolution is an essential ingredient to a secure democracy. . . . History has shown that when average people perceive that the court system is not available to them, but that it is

Bernice K. Leber can be reached at bleber@nysba.org.

merely an instrument of the state controlled by a wealthy upper class, or by the dictates from government bureaucrats themselves, then social unrest begins. . . . The state and federal court systems must expand their definition of a 'poor person' to include the working poor, who should be entitled to proceed 'in forma pauperis' (CPLR 1101) and the attorney-client privilege must be strengthened. Too many times the District Attorneys or US attorney make it a condition that the prosecuted waive the attorney-client privilege as a condition for a plea agreement. . . . Clients must be able to rely on the knowledge that the information given their lawyer, ex post facto, can never be revealed."

In sum, your letters reveal a profound concern for the profession and for your clients. Listening to you this past year around the state and taking your letters to heart, I believe that we can do the most for you by concentrating on a single theme for the upcoming year: "Helping Lawyers, Helping Clients." Our projects and initiatives will delve into issues and processes to help you practice and in so doing, help in the delivery of your legal services for clients, paying close attention to the small and solo firm practitioners among you. In setting our legislative priorities this past year, we included a review of how court rules and laws impact upon the small firm. A one-year term as President barely gives one time to complete new initiatives. Recognizing this, Kate Madigan, a great president, permitted me to share in her initiatives and programs and to then carry them out in my year, a plan that I will continue with Michael Getnick, my successor. I hope you will continue to write to me as the year progresses. Rest assured, I will be listening. ■

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Ethics and Professionalism
(program: 9:00 am–12:35 pm)
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June 2	Syracuse
June 6	Rochester
June 9	Buffalo
June 10	New York City
June 11	Westchester
June 12	Ithaca; Melville, LI
June 19	Albany

Ethics for Real Estate Lawyers
(program: 9:00 am–12:55 pm)
Fulfills NY MCLE requirement for all attorneys (4.0): 4.0 ethics and professionalism

June 2	Albany
June 10	Buffalo
June 17	New York City
June 19	Rochester
June 24	Westchester

Fundamentals of a Private Placement – Raising Money With a Private Stock Offering
(program: 6:30 pm–9:10 pm)
Fulfills NY MCLE requirement for all attorneys (3.0): 1.0 skills; 2.0 practice management and/or professional practice

June 3	New York City

Successfully Handling a 1404 Proceeding Under the SCPA
(program: 9:00 am–1:00 pm)
Fulfills NY MCLE requirement for all attorneys (4.5): 0.5 ethics and professionalism; 2.0 skills; 2.0 practice management

June 3	Westchester
June 4	Rochester
June 5	Syracuse
June 10	Albany
June 12	Buffalo; New York City
June 13	Hauppauge, LI

+Escrow Accounts (telephone seminar)
(program: 12:00 noon–1:30 pm)
Fulfills NY MCLE requirement (1.5): 1.5 ethics and professionlism

June 4	All cities

Federal Sentencing in White Collar Cases: Expanded Judicial Discretion or Business as Usual?
(program: 6:00 pm–9:00 pm)
Fulfills NY MCLE requirement for all attorneys (2.0): 2.0 professional practice

June 4	New York City

+Beyond Medicaid: Alternative Methods for Financing Long Term Care
Fulfills NY MCLE requirement (7.0): 1.0 ethics and professionalism; 6.0 practice management and/or professional practice

June 4	Hauppauge, LI
June 5	New York City
June 6	Albany; Buffalo
June 17	Tarrytown

+Tax Aspects of Real Property Transactions
(program: 9:00 am–1:00 pm)
Fulfills NY MCLE requirement (4.5): 4.5 practice management and/or professional practice

June 4	Melville, LI
June 5	Albany; New York City
June 12	Rochester

A Day in Discovery: Win Your Case Before Trial With Jim McElhaney
Fulfills NY MCLE requirement (7.0): 1.0 ethics and professionalism; 6.0 skills
IMPORTANT NOTE: NYSBA CLE seminar coupons and complimentary passes cannot be used for this program

June 6	New York City

+Law Firm Billing (telephone seminar)
(program: 12:00 noon–1:30 pm)
Fulfills NY MCLE requirement (1.5): 1.5 professional practice

June 11	All cities

+Health Information Technology (teleconference)
Fulfills NY MCLE requirement (2.0): 2.0 professional practice

June 13	All cities

+Advanced Equitable Distribution: Valuing and Dividing Professional Practices and Closely-Held Businesses
Fulfills NY MCLE requirement (4.0): 4.0 practice management and/or professional practice
(program: 9:00 am–12:35 pm)

June 13	Albany
June 20	New York City

+Financing a Law Firm (telephone seminar)
(program: 12:00 noon–1:30 pm)
Fulfills NY MCLE requirement (1.5): 1.5 professional practice

June 18	All cities

Article 81 of the Mental Hygiene Law
Fulfills NY MCLE requirement for all attorneys (7.5): 2.0 ethics and professionalism; 5.5 practice management and/or professional practice

June 24	New York City
June 26	Syracuse

Federal Rules
(program: 6:00–9:00 pm)

June 25	New York City

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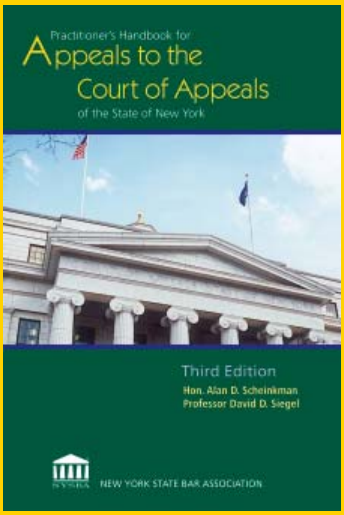

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NYSBA

Making Sense of New York's Corporate Opportunity Doctrine

By Jonathan Rosenberg and Kendall Burr

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New York, like Delaware and other states, recognizes the corporate opportunity doctrine, which derives from the duty of loyalty that fiduciaries owe corporations they serve. The doctrine forbids fiduciaries from diverting for their own benefit, without board approval, "any opportunity that should be deemed an asset of the corporation."[1] The key to the doctrine under New York law is whether the corporation had a "tangible expectancy" in the opportunity,[2] that is, an expectancy "more certain than a desire or hope."[3] Although some courts have suggested that the doctrine applies only to deprivations that "threaten the viability of the enterprise,"[4] New York courts have generally applied the doctrine more broadly. Thus, for example, fiduciaries – including those serving healthy businesses – have been found liable under the doctrine for drawing away their principal's existing customers, taking advantage of business offers made to the corporation, or purchasing property that the corporation needed or had contemplated acquiring.[5]

Fiduciaries sued under the corporate opportunity doctrine often rely on two defenses: third-party refusal-to-deal and financial inability. Both defenses go directly to the "tangible expectancy" determination. Under the former, the opportunity would be deemed fair game for the fiduciary where the third party providing that opportunity was unwilling to do business with the corporation. Under the latter, the fiduciary would not be deemed a disloyal usurper where the corporation did not have the financial wherewithal to capitalize on the opportunity. Each defense has at least surface appeal, because it tends to show that the corporation did not have a "tangible expectancy" of obtaining the business opportunity at issue. After all, what realistic expectation could a corporation have in an opportunity that (1) the third party was unwilling to give the corporation, or (2) the corporation had insufficient finances to exploit?

In late 2007, however, New York's First Department stated unequivocally, albeit in *dicta*, that neither defense is viable. It reached that conclusion in *Owen v. Hamilton*,[6] with little analysis, no mention of the "tangible expectancy" requirement, and based on a questionable characterization of First Department precedent. And as the court acknowledged, its conclusion is at odds with several Third Department cases that recognize refusal-to-deal as a valid defense. Thus, *Owen* highlights the uncertainty of the contours of New York's corporate opportunity doctrine.

This article is an attempt to restore some order. We believe that New York's fact-intensive "tangible expectancy" test requires courts to consider both whether the third party refused to deal with the corporation and whether the corporation was financially able to capitalize on the opportunity. On the other hand, neither factor should be deemed dispositive, except in rare circumstances. Rather, both factors should be considered as part of a multi-factor analysis – eight factors are identified below – in which the court would weigh the respective competing interests of the corporation and its fiduciary, consistent with the duty of loyalty.

Owen v. Hamilton

Owen involved a dispute over *Sports Reporter*, a sports-betting publication that Richard Bomze owned and decided to sell in 2001. At the time, defendant Lindsay Hamilton was the president and 51% shareholder of Starpoint Publishing Corp., which published *Winning Points*, another sports-betting publication. Hamilton proposed to Starpoint's board of directors that he and his wife purchase *Sports Reporter* and operate it out of Starpoint's office, so that the two publications could share expenses and reduce operating costs. Recognizing that the arrangement could improve Starpoint's "precarious financial state," the board approved the $450,000 purchase.[7]

Starpoint shareholder James Owen then sued Hamilton derivatively for usurping Starpoint's corporate opportunity and breaching his fiduciary duty. The trial court granted Owen's summary judgment motion on both claims. The First Department reversed and ordered that summary judgment be entered for Hamilton because he had obtained board approval for the purchase.[8] But before reaching the board-approval issue, the court briefly addressed Hamilton's refusal-to-deal and financial inability defenses.[9] Although that discussion must be considered *dicta* – because the board's approval of the transaction rendered the other defenses academic – New York courts will likely consider it in future corporate opportunity cases.

The court treated both defenses together, stating that the defense that "Starpoint itself was unable to purchase *Sports Reporter* . . . can be disposed of with dispatch."[10] It noted that some authority supports a defense that the corporation would have been unable to profit from the opportunity, citing two Third Department decisions that had recognized the third-party-refusal defense. But the court asserted that "we [in the First Department] have consistently held to the contrary."[11] It concluded that "neither Richard Bomze's unwillingness to sell *Sports Reporter* to Starpoint nor Starpoint's alleged financial inability to avail itself of the opportunity had it been offered is a valid defense to plaintiff's action."[12]

Thus, *Owen* suggests that the two defenses would be routinely rejected in the First Department. But New York precedent does not support this suggestion.

The Financial Inability Defense

Only two reported New York decisions have ruled on the financial inability defense. Each is more than 40 years old and each accepted the defense. The First Department held, in *Blaustein v. Pan American Petroleum & Transport Co.*, that the defendant did not usurp corporate opportunities, because the corporate opportunity doctrine "is not applicable if the opportunity is one which the corporation is financially unable to undertake."[13] Consistent with *Blaustein*, a Bronx County trial court in *Nigro v. Caserta* dismissed a corporate opportunity claim because, in part, there were "no factual allegations showing that the corporation had the financial means with which to avail itself of the opportunities alleged to have been diverted."[14]

First Department decisions after *Blaustein* contain *dicta* that criticized the financial inability defense. *Owen* relied on four such cases, none of which actually involved a financial inability defense.[15] *Owen* first cited *Foley v. D'Agostino*, including *Foley*'s quote from a 1941 *Harvard Law Review* Note:

> [T]he fact that the competing business undertaken presented itself in the form of a corporate opportunity which the corporation was financially unable or for other reasons unwilling to undertake should be no excuse for an officer undertaking it individually. Despite the corporation's inability or refusal to act it is entitled to the officer's undivided loyalty.[16]

The court in *Foley* quoted the Note for its critique of an "unwilling to undertake" defense. The claim in *Foley* was that the defendants – officers and directors of several affiliated companies that managed a supermarket chain – breached their fiduciary duties by setting up a rival supermarket chain. The defendants argued that they were free to establish and operate the competing business because they had previously presented the opportunity to the corporations, but their boards voted not to take it.[17]

Foley held that the complaint should not have been dismissed because the board's rejection of the opportunity did not release the fiduciaries of their duty of loyalty, and the fact finder could determine that they breached that duty by competing with their employer.[18] Thus, because the claim at issue related to employees compet-

ing with their employer, *Foley* is irrelevant to New York's corporate opportunity jurisprudence.

Two other First Department cases that *Owen* cited similarly did not discuss the financial inability defense. In *Robert N. Brown Assocs., Inc. v. Fileppo*, the defendant had redirected printing orders to his own company instead of his employer.[19] The defendant asserted an "unwilling to undertake" defense, arguing that the corporation would have rejected those orders had they been offered to it. Citing *Foley*, the court hypothesized that "even if" the defendant had offered them to the corporation, "which [was] not the case," the defendant would not have been free to take them for himself.[20]

In *Bankers Trust Co. v. Bernstein*, the court quoted *Foley* and the *Harvard Law Review* Note for the principle that "[d]espite the corporation's inability or refusal to act it is entitled to the officer's undivided loyalty."[21] But *Bankers Trust* contained no other discussion of inability defenses. Instead, the court remanded for a new trial because the trial court had improperly instructed the jury that it must find that the corporation would have obtained the opportunity "but for" the defendant's conduct.[22]

Only one of the four cases *Owen* cited, *Alexander & Alexander of New York, Inc. v. Fritzen*, contained any substantive discussion of the financial inability defense. The defendant in *Alexander* had argued that the corporation was *legally* unable to take a life insurance business opportunity because it had no license to sell life insurance.[23] The First Department, quoting *Foley* and the *Harvard Law Review*,[24] criticized both the legal and financial inability defenses, even though only the former was at issue. The court noted that it would be "imprudent" to allow fiduciaries to exploit opportunities based "solely" on their company's legal or financial inability, because information regarding any such inability is "generally within the unique knowledge of the diverting fiduciary."[25] Thus, the court reasoned, permitting a dispositive inability defense would "reduce[] the incentive for executives to seek effective solutions to corporate problems," and would "encourage employees and fiduciaries to divert corporate opportunities knowing that the diversion may not be effectively challenged."[26]

But *Alexander* stopped short of holding that the corporation's legal inability to exploit the opportunity is irrelevant. To the contrary, the court noted that although the company's legal inability to sell life insurance was not "determinative," it was "significant."[27] And relying in part on that legal incapacity, the First Department concluded that the life insurance business was *not* a corporate opportunity.[28]

Thus, all the authority on which *Owen* relied in rejecting the financial inability defense – *Foley*, *Robert N. Brown Assocs.*, *Bankers Trust* and *Alexander* – was *dicta*. And *Owen* ignored two cases, albeit significantly older, that upheld that defense. Thus, the court's back-of-the-hand treatment of the financial inability defense was inappropriate. At the very least, the court should have considered the evidence of Starpoint's financial inability as a non-determinative but relevant factor, just as the court in *Alexander* had considered the corporation's legal inability.

The Refusal-to-Deal Defense

No reported New York decision before *Owen* had suggested, much less held, that a third party's refusal to deal with the corporation would not be a valid defense to a corporate opportunity claim. To the contrary, the First Department itself had accepted the defense twice in cases that *Owen* did not cite, *Washer v. Seager*[29] and *Rafield v. Brotman*.[30]

In *Washer*, the parties were the sole stockholders, officers and directors of Sportscloth, a sports apparel manufacturer. When Seager left Sportscloth to form a competing business, Sportscloth's sole fabric supplier decided to move its business to Seager's new company. The First Department reversed the trial court's finding that Seager had usurped a corporate opportunity, holding that "[o]nce [the supplier] made its decision not to deal further with Washer or the corporation on Seager's withdrawal, there no longer existed any corporate opportunity or expectancy."[31] A New York federal court noted in 1999 that "*Washer* is still good law in New York."[32]

> The court should have considered the evidence of Starpoint's financial inability as a non-determinative but relevant factor.

In *Rafield*, a data processing company's sole client decided to phase out its relationship with the corporation and to create an in-house department to perform the data processing functions that the corporation had been providing. The plaintiff alleged that a director, who left shortly thereafter to work for the client, had usurped a corporate opportunity by taking that business with him. The trial court dismissed the claim, finding that by the time the defendant had taken the job, the client had already reached an independent decision to bring the business in-house. The First Department affirmed, concluding that because the client's decision "deprived [the corporation] of any viable prospect for continuing its business," the corporation had no "tangible expectancy" in a continuing relationship with the client.[33]

Owen cited two Third Department decisions that it characterized as providing "some authority . . . that a director cannot be liable for usurping a corporate opportunity where the corporation would have been unable to avail itself of the opportunity."[34] In *DiPace v. Figueroa*,[35] the plaintiff claimed that a director's purchase of property constituted a corporate opportunity. The Third

Department affirmed the claim's dismissal because "the sellers unequivocally aver[red] that they would not have sold to the corporation, or to [the plaintiff], but only to [the defendant] individually."[36] And in *Moser v. Devine Real Estate, Inc.*,[37] the Third Department found that because the third party "unequivocally testified" that he would not have offered an investment opportunity to the corporation, the corporation had no "tangible expectancy" in that opportunity. Citing *DiPace*, the court noted, "Typically, such evidence that the third party would not have done business with the corporation . . . is sufficient to preclude the finding that a corporate opportunity existed."[38]

In portraying *DiPace* and *Moser* as contrary to First Department precedent, *Owen* not only failed to cite *Washer* and *Rafield*, it relied solely on *Foley*, *Robert N. Brown Assocs.*, *Bankers Trust* and *Alexander*. As discussed above, those cases only tangentially support rejecting the financial inability defense. But they have no relevance to a third-party-refusal defense, because none of them referred to that defense, even in *dicta*.

Proposed Decisional Framework

New York's uncertain corporate opportunity doctrine is reflected in *Owen*'s (1) questionable characterization of New York precedent, and (2) reasoning at odds with the "tangible expectancy" requirement. The New York Court of Appeals has not taken a corporate opportunity case since 1944, when it affirmed the First Department's rejection of a corporate opportunity claim because there was no evidence of tangible expectancy.[39] That decision did not clarify how courts should evaluate tangible expectancy. *Alexander* noted the uncertainty over the applicable standard,[40] and *Owen* did not mention the tangible expectancy test or any standard at all.[41]

Courts should consider both financial inability and third-party refusal-to-deal in the "tangible expectancy" analysis. To take an extreme example, let's say a billionaire businessman serves as a director for a small, insolvent company. During the period of his service, the director learns of an opportunity to buy a business for $100 million, an amount that is multiples beyond the company's ability to pay. Perhaps on a strict duty-of-loyalty basis, the director would be criticized for not going through the motions of presenting the opportunity to the board. But breach of fiduciary duty claims require some level of causation.[42] So if there were no doubt that the corporation would not have been financially able to acquire the business, the director should not be liable. It is hard to argue that the fact finder should blind itself to that economic reality.

Similarly, there will be instances when, despite the fiduciary's best efforts, the third party remains unwilling to deal with the corporation. Let's say, for example, the third party makes that clear in no uncertain terms and the fiduciary exhausts all avenues for the corporation's getting the opportunity. If the fiduciary were thereafter to take advantage of the opportunity, the causation element arguably would not have been met for any harm the corporation was to claim in not profiting from the opportunity. At the very least, the fact finder should be able to take those circumstances into account.

On the other hand, there are good reasons why a court should not necessarily consider dispositive a company's insolvency or a third party's stated unwillingness to deal with that company. First, a bright-line rule could create perverse incentives. The law should encourage fiduciaries to be loyal, not to make a record that could insulate their disloyalty from liability. If, for example, a third party were to tell the fiduciary that it would not deal with the fiduciary's company, but would be happy to deal with the fiduciary individually, the fiduciary should be incentivized under the law to convince the third party that the fiduciary will not engage if the company he or she serves is not part of the deal. The law should also encourage the fiduciary to seek board approval; but a fiduciary would be less inclined to seek board approval if a bright-line dispositive defense were available. Second, even a third party's unequivocal expressions of refusal-to-deal can be inherently suspect. For example, the third party testifies that she would not have done business with the company had she not done the deal with the corporation's executive. That testimony is necessarily speculative and might even be inadmissible.[43] Third, even insolvent companies can sometimes acquire cash-generating businesses or obtain lucrative contracts. And sometimes that opportunity can make the difference between the insolvent company turning the corner to profitability or filing for bankruptcy. The law should incentivize fiduciaries to be the same loyal, unconflicted advocates even for the insolvent companies they serve.

The upshot of the above is that courts considering corporate opportunity claims should consider all the facts and circumstances – financial ability, third-party willingness to deal, and other facts – in conducting the tangible expectancy analysis. This is the approach articulated 66 years ago in *Turner v. American Metal*.[44] In *Turner*, New York County Justice Bernard L. Sheintag noted that in evaluating whether a corporation had a tangible expectancy in a given opportunity,

> it is safer to rely upon the particular circumstances of a case than upon abstract principles or general language used in the decisions. It is unnecessary, indeed unwise, to attempt any preciseness of definition. Nevertheless, there are certain guides which point the way[;] . . . the following circumstances, among others, have to be considered.[45]

Justice Sheintag went on to enumerate six factors he considered relevant to the tangible expectancy analy-

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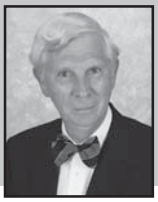

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sis.[46] Although the First Department reversed Justice Sheintag's finding that a corporate opportunity had been usurped, it did not address those factors.[47] But it quoted *Guth v. Loft*, a Delaware Supreme Court case that established a comparable four-factor test.[48]

We agree with the approach in *Turner* and *Guth*, and propose that New York courts adopt a multi-factor test to evaluate whether a fiduciary's transaction should be deemed a corporate opportunity. Below are eight factors a court would consider in making this determination. This list is not meant to address all potentially relevant evidence, but reflects the types of issues and circumstances that typically come up in corporate opportunity cases.

1. Whether the Opportunity Was Presented to the Fiduciary in His Individual or Corporate Capacity

A court should first consider how the fiduciary came to learn of the opportunity, a factor mentioned in both *Turner*[49] and *Guth*.[50] If it were presented to the fiduciary in his or her corporate capacity, this factor would weigh in favor of a corporate-opportunity finding. But if it were presented in the fiduciary's individual capacity, "[t]he burden imposed upon [the defendant] to show adherence to his fiduciary duties to [the corporation] would be thus lessened to some extent."[51] Such evidence would not be dispositive and should be considered along with all other factors.[52]

2. Whether the Corporation Understood That the Fiduciary Would Pursue Other Interests

The nature of the fiduciary relationship may also be significant. In some instances a fiduciary may be a director serving on several boards or involved in several ventures.[53] Such involvement "may negate the obligation which might otherwise be implied to offer similar opportunities to any one of [the corporations he or she represents], absent some contrary understanding."[54] Thus, courts sometimes "examine whether at the beginning of the employment or fiduciary relationship the parties understood, or it is reasonable to conclude that the parties understood, that the employee, officer or director would simultaneously pursue other interests, even ones related to or in direct competition with the business of the corporation."[55] Any such evidence would weigh against a finding that the fiduciary usurped a corporate opportunity.

3. Whether the Opportunity Would Have Been Offered to the Company

As discussed above, evidence that the third party would not have offered the opportunity to the corporation should weigh against a corporate opportunity finding. But the weight accorded this factor should depend on the type of evidence presented. For example, documented, contemporaneous evidence that the third party refused to do business with the corporation would weigh in favor of dismissal, and would be even more persuasive if the fiduciary had no involvement in creating it. But less (or in some circumstances no) weight would be appropriate if the only evidence were the third party's testimony that he or she would not have given the opportunity to the company. Such testimony would be inherently speculative and often biased, because either the third party continues to have a business relationship with the fiduciary or faces exposure for aiding and abetting a fiduciary-duty breach. Similarly, the usurper's testimony in this regard, uncorroborated by contemporaneous documentary evidence, would be accorded little weight.

Documented, contemporaneous evidence that the third party refused to do business with the corporation would weigh in favor of dismissal, and would be even more persuasive if the fiduciary had no involvement in creating it.

4. Whether the Opportunity Was Developed With Corporate Assets

This is one of the *Turner* factors.[56] Courts should treat differently an opportunity developed with corporate resources that the fiduciary swoops in to take at the 11th hour, as opposed to an opportunity that the company had not previously pursued. The weight accorded this factor depends on the type of corporate assets used to develop or pursue the opportunity. For example, the Michigan Court of Appeals, applying Delaware law, has noted that usurpation is more likely to be found "when 'hard' assets, such as cash, facilities, and contracts, are used rather than . . . 'soft' assets, such as good will, working time, and corporate information."[57] The amount of assets used when compared with the overall value of the opportunity would also affect the analysis.[58]

5. The Company's Financial Ability to Take the Opportunity

This too is a *Turner* factor.[59] As discussed above, the case law does not support *Owen*'s outright rejection of the financial inability defense, and many other states

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consider a corporation's financial ability relevant in determining whether an opportunity should belong to the company. Delaware, for example, *requires* a corporate-opportunity plaintiff to show that the company was financially capable of entering into the transaction.[60] Other jurisdictions refer to a corporation's financial ability as either conclusive or relevant.[61]

The nature of the financial inability evidence should be closely scrutinized. As noted in *Alexander*, a corporation may not be able to rebut a financial inability defense raised by a fiduciary with unique knowledge of the company's finances.[62] Thus, only objective, independently verified evidence of financial inability should weigh in the fiduciary's favor. And the court should also consider the fiduciary's role in the company's financial fortunes. Fiduciaries who view their company as a sinking ship should not be incentivized to relax their fiduciary obligations and more freely self-deal.[63]

The severity of the company's financial woes should also affect the weight given this factor. The greater the company's insolvency, the less likely it would be that it would have successfully obtained the opportunity, and the more heavily the court should weigh this factor in the defendant's favor.

6. The Investment Required to Capitalize on the Opportunity, and the Revenue Projected From the Investment

This factor is distinguished from financial inability because it turns on the nature of the opportunity itself, rather than the company's resources. For example, if a given opportunity requires a one-time purchase that clearly exceeds the funds that the corporation has or could obtain, the corporate opportunity claim would be tenuous. On the other hand, even a distressed company may be capable of making the initial investment required to take the opportunity. If, for example, an opportunity can be financed over time, or consists of a contractual relationship, the opportunity's projected revenue could facilitate the investment's funding. Courts should therefore consider whether there is a reasonable chance that the opportunity would have helped the company turn the tide.

7. The Extent to Which the Opportunity Is Consistent With the Company's Past and Current Business Model

This is another *Turner* factor.[64] If an opportunity were consistent with a company's business model, the company's shareholders would be more likely to view it as an opportunity. And the fiduciary would be more likely to recognize it as belonging to the company. In that case, this factor would weigh in favor of a corporate-opportunity finding.

On the other hand, if the opportunity were not consistent with a company's past and current business model, this factor would weigh in the fiduciary's favor. An exception may be appropriate if there were evidence that the fiduciary was aware of the corporation's intent to enter into the new business line. In *Alexander*, the court rejected the plaintiff's argument that the company intended to enter the life insurance business, in part, because there was no evidence that the defendants had been advised of that "undeclared intent."[65]

8. Whether the Opportunity Was Unique or of Special Value to the Corporation

This too is a *Turner* factor.[66] If an opportunity has some special significance or unique value to the corporation, such as property adjacent to the corporation's property, the court would more likely consider it a corporate opportunity.

Conclusion

Corporate opportunity cases are infrequent because fiduciaries ordinarily seek board approval before capitalizing on a transaction that might arguably belong to the corporation. Board approval would normally insulate the fiduciary from liability, unless the directors were not fully informed or were dominated by or beholden to the fiduciary.[67] But in those situations in which board approval either was not sought or was defective, a viable corporate opportunity claim could be brought. Courts adjudicating such claims should read *Owen* critically, and should not rely on its *dicta* or that of other New York decisions to which *Owen* cites. Rather, they should consider all the factors potentially relevant to both the corporation's interests in having loyal executives, and the fiduciaries' legitimate interests in pursuing business opportunities that do not undermine the companies they serve.

1. *Alexander & Alexander of N.Y., Inc. v. Fritzen*, 147 A.D.2d 241, 246, 542 N.Y.S.2d 530 (1st Dep't 1989).

2. *Blaustein v. Pan Am. Petroleum & Transp. Co.*, 263 A.D. 97, 128, 31 N.Y.S.2d 934 (1st Dep't 1941) ("[O]ne primary requisite for the application of the [corporate opportunity] doctrine is the existence of a presently recognizable, tangible expectancy on the part of the corporation in the property."), *aff'd*, 293 N.Y. 281, 300, 56 N.E.2d 705 (1944) ("The lack in the present case is the essential proof that at the time the properties in question were acquired . . . they were recognized or identified as properties in which Pan Am had a tangible expectancy."); *Abbott Redmont Thinlite Corp. v. Redmont*, 475 F.2d 85, 88 (2d Cir. 1973) ("[T]he central questions for determination here are whether [the plaintiff] had a 'tangible expectancy' . . . and whether [the defendant] violated his fiduciary duty by diverting that expectancy to his own profit."); *Am. Fed. Group, Ltd. v. Rothenberg*, 136 F.3d 897, 906 (2d Cir. 1998) ("The doctrine's application is limited . . . to business opportunities in which a corporation has a 'tangible expectancy.'").

3. *Alexander*, 147 A.D.2d at 247–48 (defining tangible expectancy as "something much less tenable than ownership, but, on the other hand, more certain than a desire or a hope"); *see also Abbott Redmont*, 475 F.2d at 89 ("The degree of likelihood of realization from the opportunity is . . . the key to whether an expectancy is tangible."); *Blaustein*, 293 N.Y. at 300 (stating that tangible expectancy is "a right which in its nature was inchoate").

4. *Alexander*, 147 A.D.2d at 248; *see also In re Gupta*, 38 A.D.3d 445, 446–47, 834 N.Y.S.2d 23 (1st Dep't 2007).

5. *See Burg v. Horn*, 380 F.2d 897, 899–900 (2d Cir. 1967) (citing cases).

6. 44 A.D.3d 452, 843 N.Y.S.2d 298 (1st Dep't 2007).

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7. *Id.* at 453–54.

8. *Id.* at 455–57.

9. *Id.* at 454–55.

10. *Id.* at 454.

11. *Id.*

12. *Id.* at 454–55.

13. 263 A.D. 97, 128, 31 N.Y.S.2d 934 (1st Dep't 1941).

14. 16 Misc. 2d 355, 358, 184 N.Y.S.2d 1001 (Sup. Ct., Kings Co. 1959).

15. *Foley v. D'Agostino*, 21 A.D.2d 60, 248 N.Y.S.2d 121 (1st Dep't 1964); *Robert N. Brown Assocs., Inc. v. Fileppo*, 38 A.D.2d 518, 327 N.Y.S.2d 133 (1st Dep't 1971); *Bankers Trust Co. v. Bernstein*, 169 A.D.2d 400, 563 N.Y.S.2d 821 (1st Dep't 1991); *Alexander & Alexander of N.Y., Inc. v. Fritzen*, 147 A.D.2d 241, 246, 542 N.Y.S.2d 530 (1st Dep't 1989).

16. *Foley*, 21 A.D.2d at 68 (quoting Note, *Fiduciary Duty of Officers and Directors Not to Compete With the Corporation*, 54 Harv. L. Rev. 1191, 1199 (1941)).

17. *Id.* at 67.

18. *Id.* at 66–69.

19. 38 A.D.2d at 519.

20. *Id.*

21. 169 A.D.2d 400, 401, 563 N.Y.S.2d 821 (1st Dep't 1991).

22. *Id.* at 401–02.

23. 147 A.D.2d 241, 247–49, 542 N.Y.S.2d 530 (1st Dep't 1989).

24. *Id.* at 247.

25. *Id.*

26. *Id.*

27. *Id.* at 249. *Accord Turner v. Am. Metal*, 36 N.Y.S.2d 356, 370 (Sup. Ct., N.Y. Co. 1942) (treating corporation's financial ability to "acquire and exploit the enterprise" as a relevant factor), *rev'd on other grounds*, 268 A.D. 239, 50 N.Y.S.2d 800 (1st Dep't 1944).

28. 147 A.D.2d at 249. The court permitted two fiduciary duty breach claims to go forward, but only to the extent that they did not seek damages for the alleged diversion of the life insurance business.

29. 272 A.D. 297, 71 N.Y.S.2d 46 (1st Dep't 1947).

30. 261 A.D.2d 257, 690 N.Y.S.2d 263 (1st Dep't 1999).

31. 272 A.D. at 303.

32. *Kuo v. Kuo*, 1999 WL 123379, *5 (S.D.N.Y. Mar. 4, 1999), *aff'd*, 216 F.3d 1072 (2d Cir. 2000).

33. 261 A.D.2d at 258.

34. *Owen v. Hamilton*, 44 A.D.3d 452, 454, 843 N.Y.S.2d 298 (1st Dep't 2007).

35. 223 A.D.2d 949, 637 N.Y.S.2d 222 (3d Dep't 1996).

36. *Id.* at 952.

37. 42 A.D.3d 731, 839 N.Y.S.2d 843 (3d Dep't 2007).

38. *Id.* at 735–36.

39. *Blaustein v. Pan Am. Petroleum & Transp. Co.*, 293 N.Y. 281, 300, 56 N.E.2d 705 (1944).

40. *Alexander & Alexander of N.Y., Inc. v. Fritzen*, 147 A.D.2d 241, 247–48, 542 N.Y.S.2d 530 (1st Dep't 1989) ("Various tests have been utilized to determine whether a venture should be considered a 'corporate opportunity.' . . . It appears that none of these tests alone is consistently sufficient to answer the question of what constitutes a 'corporate opportunity.' While the cases in this jurisdiction have generally announced reliance on the 'interest or tangible expectancy' test, in some instances consideration has been given to the other tests. Some cases refer to all relevant factors.").

41. *See Owen*, 44 A.D.3d 452.

42. *R.M. Newell Co. v. Rice*, 236 A.D.2d 843, 844–45, 653 N.Y.S.2d 1004 (4th Dep't 1997) (affirming dismissal where plaintiff failed to prove proximate causation, an "essential element" of its fiduciary duty claims); *Stoeckel v. Block*, 170 A.D.2d 417, 417, 566 N.Y.S.2d 625 (1st Dep't 1991) (affirming jury award of no damages where causation not established); *see also Am. Fed. Group*, 136 F.3d at 907 n. 7; *LNC Invs., Inc. v. First Fid. Bank*, 173 F.3d 454, 465–66 (2d Cir. 1999).

43. Fed. R. Evid. 701(a) (testimony admissible only if "rationally based on the perception of the witness"); *Devaney v. Chester*, 1989 WL 52375, *5 (S.D.N.Y. May 10, 1989) (stating that "speculative testimony concerning what a party would have done" is generally not admissible); *Beatty v. Michelin Tire Corp.*, No. 3:94CV989 (DJS), 1999 U.S. Dist. LEXIS 21970 at **14–15 (D. Conn. Mar. 31, 1999) (excluding testimony because it was speculative and not based on the witness's perception); *Frame v. Horizons Wine & Cheese, Ltd.*, 95 A.D.2d 514, 519, 467 N.Y.S.2d 630 (2d Dep't 1983) (same).

44. 36 N.Y.S.2d 356, 370 (Sup. Ct., N.Y. Co. 1942), *rev'd on other grounds*, 268 A.D. 239, 50 N.Y.S.2d 800 (1st Dep't 1944).

45. *Id.*

46. "1. The nature of the property involved, whether it was unique or of special value or something that could be acquired by anyone in the market. 2. Whether or not it was within the scope and line of business of the corporation. 3. The manner in which the opportunity came to the officer or director – whether in his official or in his individual capacity. 4. The financial ability and the adequacy of the facilities and resources of the corporation to acquire and exploit the enterprise. 5. The actual use of the funds and resources of the corporation in the acquisition and development of the corporation. 6. Whether or not the officer or director acted in good faith, in the interest of the corporation, or whether he was guided by his own personal advantage." *Id.*

47. *See Turner*, 268 A.D. 239.

48. 23 Del. Ch. 255, 271, 5 A.2d 503 (1939) (a transaction is a corporate opportunity if it (1) is one that "the corporation is financially able to undertake;" (2) is "in the line of the corporation's business and is of practical advantage to it;" (3) "is one in which the corporation has an interest or a reasonable expectancy"; and (4) "by embracing the opportunity, the self-interest of the officer or director will be brought into conflict with that of his corporation"); cited by *Turner*, 268 A.D. at 252. *See also Broz v. Cellular Info. Sys.*, 673 A.2d 148, 155 (Del. 1995) (in applying the *Guth* test, "[n]o one factor is dispositive and all factors must be taken into account insofar as they are applicable").

49. 36 N.Y.S.2d at 370.

50. 23 Del. Ch. at 271.

51. *Broz*, 673 A.2d at 155.

52. *Id.*

53. *See Johnston v. Greene*, 121 A.2d 919, 35 Del. Ch. 479 (1956); *Burg v. Horn*, 380 F.2d 897, 901 (2d Cir. 1967).

54. *Burg*, 380 F.2d at 901.

55. *Alexander & Alexander of N.Y., Inc. v. Fritzen*, 147 A.D.2d 241, 248, 542 N.Y.S.2d 530 (1st Dep't 1989).

56. *See Turner*, 36 N.Y.S.2d at 370.

57. *Rapistan Corp. v. Michaels*, 203 Mich. App. 301, 315, 511 N.W.2d 918 (1994).

58. *See id.* at 316 (rejecting corporate opportunity claim in part because minimal company assets used to pursue opportunity).

59. *See Turner*, 36 N.Y.S.2d at 370.

60. *See Guth*, 23 Del. Ch. at 271; *Broz*, 673 A.2d at 155–56 (remanding for consideration of financial inability defense); *Odyssey Partners, L.P. v. Fleming Cos.*, 735 A.2d 386, 412 (Del. Ch. 1999) ("ABCO was insolvent and lacked the financial capacity to acquire the Chemical Bank loan itself. Thus, there was no 'corporate opportunity' to which it was entitled."); *Yiannatsis v. Stephanis by Sterianou*, 653 A.2d 275, 277–78 (Del. 1995) (declining to follow Court of Chancery's stricter standard requiring a finding of "insolvency-in-fact" to assert financial inability, holding that Chancery Court could even consider a temporary or practical insolvency standard).

61. *See Ellzey v. Fyr-Pruf, Inc.*, 376 So. 2d 1328, 1334–35 (Miss. 1979) (holding that balance-sheet insolvency is evidence of "unquestioned financial inability [and is] *conclusive* against a finding that a business opportunity is also a corporate one") (emphasis added); *Jasper v. Appalachian Gas Co.*, 152 Ky. 68, 79, 153 S.W. 50 (1913) (dismissing corporate opportunity claim in part because corporation was financially unable to take it); *A.C. Petters Co. v. St. Cloud Enters., Inc.*, 301 Minn. 261, 267, 222 N.W.2d 83 (1974) (same); *Ostrowski v. Avery*, 243 Conn. 355, 374–75, 703 A.2d 117 (2005) (financial inability is affirmative defense to corporate opportunity claim); *Elec. Dev. Co. v. Robson*, 148 Neb. 526, 538–39, 28 N.W.2d 130 (1947) (recognizing that corporate opportunity claims are barred where corporation is financially incapable of continuing its business, but not for mere "technical insolvency"); *Nicholson v. Evans*, 642 P.2d 727, 731–32 (Utah 1982) (same); *Klinicki v. Lundgren*, 298 Or. 662, 675, 695 P.2d 906, 915 (1985) (holding that financial inability is non-dispositive but relevant factor); *Miller v. Miller*, 301 Minn. 207, 224–25, 222 N.W.2d 71 (1974) (same); *Racine v. Weisflog*, 165 Wis. 2d 184, 194, 477 N.W.2d 326 (Wis. Ct. App. 1991) (same).

62. 147 A.D.2d at 247.

63. *See id.*

64. *See Turner*, 36 N.Y.S.2d at 370.

65. *Alexander*, 147 A.D.2d at 249.

66. *See Turner*, 36 N.Y.S.2d at 370.

67. *See Marx v. Akers*, 88 N.Y.2d 189, 200, 644 N.Y.S.2d 121 (1996); *Park River Owners Corp. v. Bangser Klein Rocca & Blum, LLP*, 269 A.D.2d 313, 313, 703 N.Y.S.2d 465 (1st Dep't 2000).

BY DAVID PAUL HOROWITZ

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"Be Careful What You Wish For"

When is a witness absent from New York so that the witness's pre-trial testimony may be read at trial in lieu of live testimony from the witness, pursuant to CPLR 3117(a)(3)?[1] That was the issue for the court in *Barnes v. City of New York*,[2] where the plaintiff sought to read the sworn testimony given by the then claimant at his 50-h hearing[3] based upon the claim that the plaintiff was a resident in a New Jersey nursing home and, hence, unavailable to testify at time of trial.[4]

The Trial

The defendant, desiring the opportunity to cross-examine the plaintiff at trial, had sought, and the trial court had granted, a competency hearing, at which time the conclusions of psychiatrists retained by both sides were considered.[5] The court found the plaintiff competent to testify.[6]

Notwithstanding the finding that the plaintiff was competent to testify, plaintiff's counsel sought permission to present the plaintiff's testimony at trial from the 50-h transcript. Defense counsel argued that the plaintiff was not committed in the nursing home in New Jersey, was allowed to leave and had, in the past, left the facility. Therefore, the requirements of CPLR 3117(a)(3) were not met.[7] Further, defense counsel "argued that plaintiff's attorney was simply refusing to produce plaintiff and 'would not,' as opposed to 'could not,' produce him." Defense counsel stated that "while plaintiff had not voluntarily gone to the hospital in New Jersey, he was now voluntarily staying out of the state. The plaintiff's attorney made no attempt to dispute these statements."[8]

The court excused the plaintiff from testifying and permitted the reading of the 50-h transcript, reasoning:

> He's not committed but he is also – he was declared a danger to himself and others, I trust, by the Courts of the State of New York and for that reason he was confined to a mental institution, not released, and the mental institution that he was confined to sought to forward him to an institution in Jersey where he can get the proper treatment.[9]

The jury found for the plaintiff and awarded damages.[10]

CPLR 3117(a)(3)

A brief review of the rules governing the use of depositions is in order. CPLR 3117 is titled "Use of Depositions,"[11] and subsection (a) governs the use of deposition testimony. Use of depositions is authorized in four situations:

1. use of a deposition to impeach a witness (CPLR 3117(a)(1));[12]
2. use of the deposition of a party (CPLR 3117(a)(2));[13]
3. use of a deposition where the witness is unavailable (CPLR 3117(a)(3));[14] and
4. use of the deposition of a person authorized to practice medicine (CPLR 3117(a)(4)).[15]

When a witness is unavailable as defined in the rule, CPLR 3117(a)(3) states "the deposition of any person may be used for any purpose against any other party,"[16] provided that the party against whom the deposition is to be used "was present or represented" at the deposition or "had the notice required under these rules."[17]

Unavailability may be established in any of five ways set forth in the rule:

> (i) that the witness is dead; or
> (ii) that the witness is at a greater distance than one hundred miles from the place of trial or is out of the state, unless it appears that the absence of the witness was procured by the party offering the deposition; or
> (iii) that the witness is unable to attend or testify because of age, sickness, infirmity, or imprisonment; or
> (iv) that the party offering the deposition has been unable to procure the attendance of the witness by diligent efforts; or
> (v) upon motion or notice, that such exceptional circumstances exist as to make its use desirable, in the interest of justice and with due regard to the importance of presenting the testimony of witnesses orally in open court.[18]

Now, back to *Barnes*.

The Appeal

The First Department analyzed the requirements of CPLR 3117(a)(3):

> In order to use a party's 50-h hearing testimony in lieu of appearing and testifying at trial, a plaintiff must satisfy one of the five requirements of CPLR 3117(a)(3). At trial, plaintiff's attorney, apparently invoking CPLR 3117(a)(3)(ii), argued

that plaintiff was an unavailable witness because he had been sent from the Bronx Psychiatric Center to Lincoln Park in New Jersey. That subsection provides that a deposition of a party may be used if the court finds "that the witness is at a greater distance than one hundred miles from the place of trial or is out of the state, unless it appears that the absence of the witness was procured by the party offering the deposition."

Thus, a party may not voluntarily absent himself and then use his deposition testimony or, as here, his 50-h hearing testimony ([["By voluntarily leaving the state and refusing to return for trial, defendant procured her own absence and, therefore, failed to satisfy CPLR 3117(a)(3)(ii)"]). Before any deposition may be introduced in court, it must appear not only that the declarant is unavailable, "but also that his absence is not due to the act or neglect of the hearsay's proponent."[19]

Concluding that there was no evidence the plaintiff had been committed and that the plaintiff had not disputed the defendant's contention, let alone come forward with any proof that the plaintiff was not free to return to New York to testify, the court concluded that the plaintiff failed to meet its burden:[20]

By avoiding his obligation to testify at a trial in which he was seeking millions of dollars, plaintiff was able to frustrate the City's fundamental common-law right to cross-examine a witness ("Cross examination of adverse witnesses is a matter of right in every trial of a disputed issue of fact"). Plaintiff, of course, had good reason to avoid coming to court to testify. His strategy denied the City the opportunity to confront and test his credibility on such matters as his assertion that he had no familiarity with guns and that he did not fire at the officer, and to impeach him by way of his plea of guilty to attempted assault in the first degree (*i.e.*, by means of a deadly weapon). That deadly weapon was found at plaintiff's feet with two empty shell casings, thus corroborating the officer's account that plaintiff had fired the gun at him.

The City was also denied the opportunity to explore plaintiff's association with the Five Percenters. In addition, allowing plaintiff to escape cross-examination denied the jury the opportunity to see and hear him. [["Great deference is accorded to the factfinding function of the jury, and determinations regarding the credibility of witnesses are for the factfinders, who had the opportunity to see and hear the witness"]). With regard to the CPLR requirements for the use of depositions, it has been noted: "The tenor of all of CPLR 3117(a)(3) is that a person capable of testifying in person and subject to judicial process or a party's control so as to compel the testimony should be on display before the trier of fact and subjected to the rigors of confrontation and cross-examination."[21]

Having determined that the 50-h testimony was read to the jury in error, the question for the First Department was the appropriate remedy. The plaintiff's entire *prima facie* case depended on the 50-h transcript.[22] Merely discrediting the defendant's testimony is "contrary to that necessary to the burden of proof [and] does not satisfy that burden. Without the plaintiff's 50-h hearing testimony, there is no evidence of the plaintiff's version of the incident. Thus, the plaintiff did not make out a prima facie case and the complaint should be dismissed."[23]

What about the trial court's error in permitting the 50-h transcript to be read in lieu of the plaintiff's live testimony?

That the trial court contributed to plaintiff's shortfall in proof by erroneously allowing his counsel to read his 50-h hearing testimony does not justify a remand for a new trial. It was counsel's choice, deliberate and calculated, to withhold his client from the rigors of cross-examination – an understandable strategy, given plaintiff's unsavory background and conviction of attempted assault in the first degree for his actions in the very incident in question. In that regard, plaintiff has charted his own course and must abide by the consequences.[24]

Conclusion

All too often, we think in terms of reversible error, and think to ourselves that that is the worst thing that will happen when an evidentiary error is made by the trial court. Here, what may have seemed a clever stratagem, the trial equivalent of having one's cake and eating it too, results in dismissal, rather than reversal and remand for a new trial.

So, be careful what you wish for. ■

1. CPLR 3117(a)(3).
2. 44 A.D.3d 39, 840 N.Y.S.2d 582 (1st Dep't 2007).
3. N.Y. General Municipal Law § 50-h.
4. *Barnes*, 44 A.D.3d at 42.
5. *Id.*
6. *Id.*
7. *Id.* at 43.
8. *Id.*
9. *Id.*
10. *Id.*
11. CPLR 3117.
12. CPLR 3117(a)(1).
13. CPLR 3117(a)(2).
14. CPLR 3117(a)(3).
15. CPLR 3117(a)(4).
16. CPLR 3117(a)(3).
17. *Id.*
18. *Id.*
19. *Barnes*, 44 A.D.3d at 44–45 (citations omitted).
20. *Id.* at 45.
21. *Id.* at 46–47 (citations omitted).
22. *Id.* at 47.
23. *Id.* (citation omitted).
24. *Id.* at 47–48.

Thou Shalt Not Steal: A Primer on Music Licensing

By James A. Johnson

Understanding music licensing requires knowledge of copyright law; a copyright vests as soon as an original work of authorship is fixed in any tangible medium of expression.[1] Music licensing requires meticulous preparation, intellectual property searches and clearances, and drafting skill. The copyrights and other legal rights involved in music are unique. They must be understood in order to determine when a license is required, who has the right to grant the desired license and what type of license is appropriate. The purpose of this article is to provide a primer for general practitioners, intellectual property lawyers and entertainment attorneys on music licensing.

There are two very different and distinct sets of copyrights in music: the rights to the musical composition (the written lyrics and the accompanying music) and the rights to the sound recording of the musical composition. The sound recording is usually owned by a single record company and compositions often have complex ownership groups. Any reproduction of a musical composition or a sound recording requires the consent of the owner of that particular copyright.[2]

A copyright owner has five exclusive rights in music under the Copyright Act:[3] reproduction, adaptation, distribution, public performance and public display.

1. Reproduction is the right to reproduce the copyrighted work in copies or phonorecords.
2. Adaptation is the right to prepare derivative works based on the copyrighted work.
3. Distribution is the right to distribute copies or phonorecords of the copyrighted work to the public by sale, rental or lease.
4. Public performance is the right to publicly perform the copyrighted work including by means of a digital audio transmission.
5. Public display is the right to publicly show a copy of sheet music or lyrics by means of a film, television, motion picture or the Internet.

Uses of a Song

The intended use of a song dictates which licenses are required in the sound recording (a master use license) and the rights in the underlying composition (a mechanical license). To avoid copyright infringement one must first determine the owner of the applicable copyrights and obtain permission.

The rights granted to the licensee will almost always be in the form of a non-exclusive license. For example, a master use license should include at a minimum the specific rights granted to the licensee and reserved to the licensor, warranties, indemnification, term, termination, choice of law and jurisdiction. (See Grant of License abbreviated sample provision on p. 24.)

Digital sampling is the recording of a sound recording or portion of a sound recording by means of a computer and then using that copy in a new sound recording. The New York case of *Grand Upright Music Ltd. v. Warner Brothers Records, Inc.*[4] was the first to address directly the issue of digital sampling as copyright exploitation requiring a license. In *Newton v. Diamond*,[5] the sample at issue consisted of a six-second segment of a flutist playing three notes. A license was obtained for the sound recording but not for the composition. The district court

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Grant of License
(abbreviated sample provision)

(a) Rights Granted to Licensee. Subject to the terms and conditions of this Agreement, including without limitation, the payment of all appropriate fees to Licensor and third parties and contingent upon Licensee obtaining the music publishing and union clearances referred to in this Agreement, Licensor grants Licensee a non-exclusive, worldwide license and right to:

(1) incorporate the complete, unaltered Sound Recording within the Product.

(2) manufacture, market, promote, sell, license, and distribute copies of the Product which incorporate the Sound Recording, both directly to end users and indirectly through distributors, dealers, Resellers, agents, and other third parties; and

(3) subject to the provisions of Article 2 herein, use the full and complete name of the Artist for the credits and packaging of the Product and the distribution, exhibition, advertising, and exploitation of the Product.

(b) Rights Reserved to Licensor. Licensee acknowledges that it has no rights in the Sound Recording except those expressly granted by this Agreement. Nothing herein shall be construed as restricting Licensor's right to sell, lease, license, modify, publish, distribute, transmit, create derivatives of, publicly perform in any way the Sound Recording, in whole or in part.

(c) No License to Musical Composition. This license does not include any rights with respect to the musical composition performed in the Sound Recording. Prior to exercising any rights granted in this Agreement, Licensee shall obtain, from the owners of the copyrights in the musical work performed in the Sound Recording, all licenses that may be required for the use of that musical work in the Product. Licensee will pay all copyright fees to the music publisher of such musical.

held that the use of the three-note sample was *de minimis*, involved sheet music and was not protected by copyright. The compositional components that were taken were not separately copyrightable from the composition as a whole. *Newton* is limited to situations in which the sound recording and composition do not actually cover the same work. In other situations a digital sampler is compelled to obtain a license for the sound recording and the underlying musical composition.

A case in point is the Sixth Circuit ruling, in *Bridgeport Music, Inc. v. Dimension Films*,[6] that sampling of a copyright-protected sound recording is a per se infringement, regardless of the amount copied. All samplings of sound recordings, no matter how small, are infringements. The Sixth Circuit announced a new and bright-line rule that a defendant who samples any portion of another's sound recording on a new sound recording cannot raise that the works are not substantially similar or the use was *de minimis*. The lesson is obtain both licenses or invite a claim for copyright infringement seeking an injunction, damages for profits, attorney fees, costs and if willful, criminal prosecution.

If a recording is to be synchronized (in timed-relation) with a visual portion of an audiovisual work such as a music video, television program or motion picture, a synchronization license is required. See the abbreviated key sample provisions in synchronization licenses on pages 25 and 26.

A "synch license" authorizes the synchronization of a musical composition with an audiovisual work, but not for distribution to the public. Distribution to the public for home use (video cassettes) requires a videogram license. This license allows the licensee to make copies of the audiovisual work for public use such as at in-house corporate training or in schools, retail stores or similar public places. Neither a videogram nor a synch license grants performance rights of the music.

To glean a visual and auditory example of digital sampling, watch television, where you will hear small portions of old tunes digitally sampled and synchronized in a bevy of commercial advertising. Music enhances commercial advertising by quickly setting the mood to convey information about the product or service. The identification and memorability of the commercial message is sustained by association with a popular song. (After seeing and hearing a sufficient number of digital samples on TV, get up out of that recliner chair and reread this article.)

Performance Rights

The Constitution of the United States confers upon Congress the power "to promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."[7] This clause empowered Congress to pass copyright protections, which it did in 1790, 1909 and 1976. In 1995, Congress passed the Digital Performance Right in Sound Recording Act.[8]

The 1995 Act significantly broadened the landmark 1976 Copyright Act by creating public performance rights for sound recordings.[9] It expanded the compulsory mechanical license of physical phonorecording to include

digital phonorecords delivery. It also grants copyright holders of sound recordings the exclusive right to publicly perform their works by digital audio transmission.[10]

The Digital Millennium Copyright Act[11] that became effective in 1998 amended the 1995 Act, creating two compulsory licenses allowing record companies and their artists to collect royalty fees on webcasts of their music.

Performance licenses govern uses such as radio or television broadcasts, concert performances and outside sound in bars, restaurants and other business establishments open to the general public. In these situations the copyright owner's exclusive right to perform is implicated and a performance license is required.[12] For example, a blanket license allows a radio or TV station to perform any works in the performance rights repertory during the term of the license for a specific negotiated fee. The blanket license permits a user to perform copyrighted works of writers and publishers without worrying about infringement litigation, administrative record keeping and payment of license fees to the correct parties.

Similarly, downloadings of music on a computer are considered public performances of the underlying song for which performance royalties must be paid to the music publisher. However, the U.S. District Court for the Southern District of New York, in a case of first impression, decided that a digital download of a music file does not constitute a public performance within the meaning of § 101 of the U.S. Copyright Act. U.S. District Judge William C. Conner said downloading equates to reproduction of a copyrighted work, which is separate from the public performance right.[13] Thus, AOL and other online services do not have to pay royalties on music downloaded over the Internet.

A performance license is needed to publicly transmit a musical work over the Internet. In *Booneville International Corp. v. Peters*,[14] the Third Circuit held that the Digital Millennium Copyright Act provides the owner of a copyright sound recording the exclusive right to publicly perform the work by means of a digital audio transmission. Broadcast transmission was interpreted as being an over-the-air radio transmission by an AM/FM radio station facility operating pursuant to an FCC license. Thus, AM/FM webcasting does not meet the definition of non-subscription broadcast transmission exception under the DMCA and is therefore not excluded from the audio transmission performance copyright.

Moreover, radio stations' simultaneous transmissions of their broadcasts over the Internet, without consent of the record companies and artists that own the performance rights to the music being streamed, do not fall within the scope of the royalty-free broadcast exemption. Radio stations are not exempt from paying a performance right double royalty fee – one for the sound recording and one for the musical composition. And radio stations that simultaneously stream online over the Internet effect two separate public performance rights and may be subject to statutory damages up to $150,000 per infringement as set forth in the 1976 Copyright Act, unless they obtain a license from the holders of the copyrighted recordings for each song transmitted, before streaming their broadcasts. This license protects record companies and recording artists from loss of revenue due to pirating of musical compositions over the Internet, and it preserves the long-standing business relationship between copyright owners and broadcasters. The statutory license royalty rate is determined by the U.S. Copyright Office, and all royalty rates are scheduled for review and renewal every two years.

Performance rights societies such as ASCAP, BMI and SESAC administer the majority of performance licenses in the United States. They grant licenses, collect the license fees and pay the royalties for a particular song to the copyright owner and to the songwriter, usually on a 50/50 basis. Recently, co-publishing agreements between the songwriter and the music publisher are allocating a

Advertising Commercial Synchronization License

Agreement between _____ Music (Publisher), of _____ and (AGENCY/Sponsor) (Advertising Agency), of _____.

1. Publisher grants to Advertising Agency the limited exclusive right during the defined Term and only in the defined Territory to record the Composition entitled _____, written by _____ and solely in connection with One (1) Sixty Second (:60) commercial, with various edits, lifts and versions, in a television format (Commercial) advertising _____ hereinafter referred to as the Product.

2. This grant shall not be deemed to include the right to make any revisions in the melody, lyrics or other aspect of the fundamental character of the Composition.

3. This grant shall be exclusively limited to Product Category and Publisher agrees not to license the Composition for use in any commercial which advertises a competing product during the Term of this License.

4. This license only applies to Publisher's share of the Composition which is _____ percent (%). If the publisher does not own or control one hundred percent (%) of the Composition, Advertising Agency agrees to secure permission to use the other portion of the Composition from the music publisher which owns or controls such portion.

Television Synchronization License

Agreement between _____ Music Publisher of _____ and _____ Producer of _____.

1. The musical Composition for which this license is issued is: _____ written by _____.

2. The individual television Program for which this license is issued is: _____, Episode No. _____ (Airdate) _____.

3. The Term for which this license is issued is for the duration of the worldwide original term of copyright in and to the Composition and any and all renewals or extensions thereof that publisher may now own or control or hereafter own or control.

4. The Territory for which this license is issued is worldwide.

5. The type and number of uses of the Composition to be recorded in the soundtrack of the program are only as follows: One (1) continuous background vocal use not to exceed two (2) minutes and fifteen seconds (2:15) in duration.

greater share of the net publishing income to songwriters (about 75%). Public performance royalties are paid directly to the songwriter by the appropriate public performance society. If a client is a songwriter or music publisher, advise him or her to join one of the performance rights societies.

Music Royalty Practices Act

A New York lawyer representing a performance rights society or a client who maintains a business establishment in Michigan that plays music must be cognizant of Michigan's Music Royalty Practices Act. A performing rights society doing business in Michigan must comply with the act.[15] Briefly, the act provides for the regulation of contracts between persons publicly performing or broadcasting copyrighted nondramatic musical works.

The act applies to proprietors, meaning the owners of a retail establishment, restaurant, inn, bar, tavern, sports or entertainment facility in which the public may assemble and in which musical works are publicly and nondramatically performed, broadcast or transmitted for the enjoyment of the members of the public assembled in that place.[16] Under the act, royalties mean the fees payable by a proprietor to a performing rights society for the nondramatic public performance, broadcast or transmittal of music works.[17]

The Music Royalty Practices Act does not apply to contracts between performing rights societies and broadcasters licensed by the Federal Communications Commission.[18] A person suffering injury by a violation of this act may bring a civil action to recover actual damages and reasonable attorney fees or seek injunctive or other relief.[19]

Internet

SoundExchange is a new organization created for handling public performance rights in certain non-interactive digital and satellite transmissions of sound recordings of music over the Internet. SoundExchange collects and distributes public performance royalties for the sound recording copyright owners and for the featured and non-featured artists. It is also the principal administrator of the statutory licenses under §§ 112 and 114 of the Copyright Act.

To clarify: SoundExchange collects public performance royalties only for digital transmissions of music. ASCAP, BMI and SESAC collect the public performance license fees and royalties only for songs distributed by means other than digital transmission. The Harry Fox Agency represents music publishers and serves as a clearinghouse and a monitoring service for licensing musical compositions. It issues compulsory mechanical licenses that permit record companies and their artists to reproduce songs in various media, like a CD. Harry Fox does not license performances, except for digital downloads.

Other Rights Issues

Keep in mind that the above examples are only some of the different types of licenses in a music agreement. Copyrights and other legal rights involved in a music license transaction are complex. Consider *Parks v. LaFace Records*.[20] LaFace Records produced a song by the rap duo OutKast, titled "Rosa Parks," which contained a chorus with the words "everybody move to the back of the bus." Rosa Parks, icon of the civil rights movement of the 1950s who refused to move to the back of the bus, sued LaFace Records under the Lanham Act for misusing her name and identity.

The Sixth Circuit opined that § 43(a) of the Lanham Act[21] creates a civil cause of action for celebrities because they have an economic interest in their identities, like trademark holders. A trademark is a source or origin identifier. The primary function of trademark law is to protect consumers from confusion and deception. Federal trademark law is governed by the Lanham Act.[22]

In *Parks*, there was evidence that the title and lyrics of the song could cause confusion, and the Sixth Circuit reversed summary judgment and remanded to the district court. This permits a jury to decide the question of

Helpful Internet Web Sites for Music Licensing

www.loc.gov/copyright	- U.S. Copyright Office
www.bmi.com	- Broadcast Music International
www.ascap.com	- American Society of Composers, Authors & Publishers
www.nmpa.org	- National Music Publishers' Association/ Harry Fox
www.sesac.com	- SESAC
www.soundexchange.com	- SoundExchange
www.riaa.org	- Recording Industry Association of America
www.uspto.gov	- U.S. Patent and Trademark Office
www.kohnmusic.com	- Kohn on Music Licensing
www.governor.state.tx.us/music	- Texas Music Office
www.cmrra.ca	- Canadian Musical Reproduction Rights Agency
www.acmcountry.com	- Academy of Country Music
www.gospelmusic.org	- Gospel Music Association
www.songwriters.org	- Songwriters Guild of America

the likelihood of consumer confusion or whether the song has some artistic relevance and provides a defense. The case demonstrates the labyrinth of intellectual property rights in music, such as trademarks and publicity rights.

Conclusion

The written license agreement should accurately reflect the business deal of the parties in clear and unambiguous contract terms. Clarity, avoidance of superfluous technical jargon and memorializing the business understanding are the hallmarks of a deft intellectual property licensing attorney.

As the arts of music making and performance evolve, so does the art of music licensing. Moreover, new technology and legislative developments require the practitioner to fine-tune his or her knowledge and acumen. Avoid breaking the Seventh Commandment and keep the music soft and sweet to your ears. ■

1. 17 U.S.C. § 102(a).
2. 17 U.S.C. § 106.
3. 17 U.S.C. §§ 106, 106(4), 106(6).
4. 780 F. Supp. 182 (S.D.N.Y. 1991).
5. 204 F. Supp. 2d 1244 (C.D. Cal. 2002), *aff'd*, 349 F.3d 591 (9th Cir. 2003).
6. 383 F.3d 390 (6th Cir. 2004) *aff'd*, 410 F.3d 792 (6th Cir. 2005).
7. U.S. Const. Art. I, § 8, cl. 8.
8. 17 U.S.C. §§ 101, 106, 114, 115.
9. 17 U.S.C. § 106(6).
10. 17 U.S.C. § 114.
11. 17 U.S.C. §§ 1201–1205.
12. 17 U.S.C. § 101.
13. *U.S. v. Am. Soc'y of Composers, Authors & Publishers*, 485 F. Supp. 2d 438 (S.D.N.Y. 2007).
14. 347 F.3d 485 (3d Cir. 2003).
15. MCL 445.2101.
16. MCL 445.2102 § 2(d).
17. MCL 445.2102 § 2(e).
18. MCL 445.2108 § 8(a).
19. MCL 445.2107 § 7.
20. 66 U.S.P.Q. 2d 1735 (6th Cir. 2003).
21. Lanham Act § 43(a), 15 U.S.C. § 1125(a).
22. 15 U.S.C. §§ 1051–1127.

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Independent Contractor or Employee?

The Multiple Issues Involved in Independent Contractor Status

By Robert W. Wood

From an employer's perspective, hiring employees involves both benefits and burdens. A fundamental benefit is that you can control employees, making them do what you want to further your business goals. But, you must pay their wages, withhold taxes, give them employee benefits, be liable for any acts of negligence during their employment, and face the scrutiny of state and federal law when it comes to nondiscrimination, discipline and termination.

Independent contractors, on the other hand, are classically one-time workers who do a job for a fixed price, and who generally work for multiple companies. Axiomatically, with independent contractors, you can't control them with detailed direction, and they bring no tort, contract or tax liabilities to the employer's doorstep. That may make the dichotomy between employee and contractor, seem obvious and one that could cause no controversy.

Yet, nothing could be further from the truth. In fact, there are many subtle (and not-so-subtle) blendings of characteristics that make the spectrum of workers far more homogeneous than you might suspect. Moreover, it is often not easy to say into which category a particular worker or class of workers should go.

In part, this is due to the obvious incentives companies have to deal with independent contractors rather than employees. That has led to an epidemic of arguably bogus

independent contractors who do not necessarily function the way they are supposed to. That, in turn, produces controversy about what is and is not possible with independent contractors.

To some extent, this has undermined the circumstances in which companies lawfully and legitimately use independent contractors rather than employees. In any case, the controversies rage.

Type of Controversies

One expects worker status controversies to occur with government taxing or regulatory agencies. The taxes, administrative burdens, and federal and state employment law liabilities for employees are much greater than for independent contractors. As a result, there is a natural (and eminently understandable) tendency for businesses to treat workers as independent contractors. Much of the lawyer's or regulator's task, therefore, is in assessing what is legitimate and what is not.

With an independent contractor, of course, the employer pays gross pay with no withholding. With an employee, the employer must withhold federal, state, and sometimes even local taxes, and must remit those taxes to the proper authorities. That tax axiom is perhaps the best-known consequence of the employee-versus-contractor distinction, but it is certainly not the only one. There are workers' compensation implications, labor law issues, pension and employee benefit considerations, and a host of other issues that can ultimately hinge on this pivotal employee-versus-contractor divide.

Given all this, it is no wonder that disputes arise over fundamental characterization questions. Is the worker really an employee or a contractor? Such matters come up in very different contexts, including:

- audits from federal or state taxing agencies;
- third-party lawsuits where the worker's actions (and liabilities) are sought to be attributed to the putative employer;
- actions from labor organizations seeking to enforce worker protection measures provided to employees but not to independent contractors; and
- audits from pension authorities seeking to determine compliance with nondiscrimination, coverage and other rules governing pension and employee benefits.

It is inappropriate to dismiss any of these as unimportant. Worker status disputes can be protracted and expensive, and they can involve bet-the-company stakes. In my experience, however, companies are more apt to understand audits from (and disputes with) taxing agencies. To perhaps a lesser extent, this is even true with labor and employment agency audits. These disputes are about money, but they are also about the state's (or the federal government's) interest in ensuring that workers are being protected and treated fairly.

A number of states are ratcheting up enforcement. For example, New York recently established a joint task force to address worker misclassification.[1] The Joint Enforcement Task Force on Employee Misclassification allows state agencies charged with classification enforcement to coordinate their investigations and enforcement efforts and share relevant information. Led by the New York Department of Labor, the Task Force comprises representatives from the Workers' Compensation Board, the Workers' Compensation Inspector General's office, the Department of Taxation and Finance, the Attorney General's Office, and the New York City Comptroller's office. Coordination amongst these agencies will hopefully increase efficiency and strengthen enforcement of independent contractor characterization in the state.

A number of states are ratcheting up enforcement.

More recently, Senators Barack Obama, Dick Durbin, Edward Kennedy, and Patty Murray have launched a bill to crack down at the national level.[2] The bill, dubbed the Independent Contractor Proper Classification Act of 2007 (the "Act"), would revise procedures for worker classification, primarily focusing on § 530 of the Revenue Act of 1978.[3] Section 530 relieves an employer of employment tax liabilities stemming from a failure to treat an individual as an employee, if the employer meets three requirements: reasonable basis, substantive consistency, and reporting consistency.

An employer can meet the reasonable basis requirement if judicial precedent, IRS rulings, a past IRS audit, or industry practice supports the classification of a worker as an independent contractor.[4] An employer meets the substantive consistency requirement if it has consistently treated the workers in question as independent contractors,[5] and the reporting consistency requirement is met if the employer has not classified the workers as employees on any federal tax returns (including information returns).[6]

The proposed Act would no longer allow employers to use industry practice as a reasonable basis for not treating a worker as an employee and would prohibit employers from receiving employment tax relief for any worker whom the IRS has determined should have been classified as an employee. Under the bill, a worker would be allowed to petition for a determination of his or her status for employment tax purposes. In a kind of *Miranda* rights procedure, it would require employers pre-hiring to notify individuals classified as independent contractors of (1) their rights to seek a status determination from

the IRS, (2) their federal tax obligations as an independent contractor, and (3) the labor and employment law protections that would not apply to them.

The new legislation would also impact the IRS and Department of Labor. The IRS would be allowed to issue regulations and revenue rulings on employment status. In any case in which the IRS determines workers were misclassified, the bill would also allow the IRS to perform an employment tax audit, inform the Department of Labor, notify the worker of the possibility of a self-employment tax refund, and instruct the worker to take affirmative action to abate the violation.

The courts analyze the facts and circumstances surrounding the relationship and also assess the pattern of practice between worker and employer.

The Department of Labor would be required to identify and track complaints and enforcement actions involving misclassification of workers and to investigate those industries where worker misclassification arises frequently. Much like New York's Joint Task Force, under the new bill the Department of Labor and the IRS would be required to share and exchange information on worker misclassification cases and provide the information to relevant state agencies.

Civil Litigation[7]

Not all worker status disputes involve government agencies. Companies have a far harder time understanding the fact that these disputes also occur regularly in civil litigation. Worker status controversies can – and do – arise in civil litigation between private parties. For example, the status of a worker may be pivotal in assessing a company's liability for the worker's acts. If a delivery driver is your employee when the driver hits a pedestrian, you must pay. If the driver is a true independent contractor, the tort liability is the driver's, not the company's.

Civil litigation involving the status of workers who are contractually labeled as "independent contractors" appears to be increasing. In many of these cases, the workers themselves sue their employers expressly seeking reclassification. The workers in such a dispute may be seeking employee benefits, protection under state or federal nondiscrimination or employment rights laws, wage and hour protections, etc. Indeed, there is significant variety in such cases.

It may be startling for an employer to learn that a written contract with a worker that clearly identifies the worker as an "independent contractor" may not be respected by the courts. One could argue that a worker who signs a contract labeling the worker as an independent contractor should be estopped from later claiming he or she is an employee.

Smell Test?

The true relationship between, and the true practice of, the worker and the company will control the worker status question. The worker's true status is important. Mere words in a contract are generally not determinative.[8] In part, this may reflect the fact that worker status determinations must generally take into account the totality of the situation, not just the contract.

Indeed, the contract itself is not the be-all and end-all of the relationship. Many companies have written reasonable contracts purporting to establish independent contractor relationships, only to find that their actual practice involves many actions (and many controls over the worker) that fly in the face of the contract language. Where this occurs, anyone attempting to characterize the relationship is likely to look beyond the language of the contract, to the actual conduct of the relationship.

Moreover, some courts have discounted written contracts even more readily when the facts suggest they were "adhesion" contracts signed by unsophisticated workers with no bargaining power *viz.* the contract.[9] Although the language of the contract is relevant, the courts analyze the facts and circumstances surrounding the relationship and also assess the pattern of practice between worker and employer. The contract is only one piece of evidence a court will evaluate in assessing whether a worker is an employee or independent contractor.

Liability to Workers

Although it was not the first such case, the cornerstone of the modern era of worker status litigation is *Vizcaino v. Microsoft*.[10] In that case, a group of freelance programmers sued Microsoft claiming that, as common-law employees, they were entitled to various savings benefits under Microsoft's Savings Plus Plan (SPP) and stock-option benefits under Microsoft's Employee Stock Purchase Plan (ESPP).[11] The programmers were hired with the understanding they would *not* be eligible for benefits given to Microsoft's regular employees. They were paid through the accounts receivable department, not the payroll department. They were also paid at a higher hourly rate than comparable regular employees.

Although Microsoft may have assumed there was no risk of reclassification, in prior years the IRS had examined Microsoft's employment records and determined that Microsoft's programmers were not independent contractors but were actually employees for withholding and employment tax purposes.[12] In determining that the programmers were really employees, the IRS concluded

that Microsoft either exercised or retained the right to exercise direction over the services they performed.

Learning of the IRS rulings, the programmers sought employee benefits. Microsoft denied their claims, taking the position that they were independent contractors who were not eligible for employee benefits. Microsoft's plan administrator also reviewed and denied the claims, determining that the programmers had contractually waived all right to benefits, and that they were not regular, full-time employees.

The district court concluded that the programmers were not eligible for SPP benefits because the SPP restricted participation to individuals on Microsoft's payroll, and they were not paid through the payroll department; also, the programmers were not eligible to participate because their contract with Microsoft clearly so stated. Furthermore, they had no expectation they would receive benefits.

The Ninth Circuit reversed and remanded, holding that the programmers were eligible to receive benefits. The court also ruled that by incorporating Internal Revenue Code § 423 into the provisions of the ESPP, Microsoft manifested an objective intent to make all common-law employees, including these programmers, eligible to participate in the plan. It is important to note that Microsoft conceded that the programmers were common-law employees and contested the suit on other grounds. The court also noted that Microsoft could have easily limited participation in the SPP by using more explicit language in the plan.

Vizcaino demonstrates that employers cannot rely entirely upon the labels placed in contracts to define a worker as an independent contractor. The denomination of a worker as an independent contractor is not sufficient to establish an independent contractor relationship.[13] The fundamental truth of the relationship will control.

Domino Effect

Vizcaino also nicely shows the nearly inevitable interaction between tax controversies and other worker status inquiries. The IRS started *Vizcaino*, for the programmers made their claims on the heels of an IRS reclassification. Frequently, a later reclassification controversy emanates from a simple worker's compensation claim. Furthermore, one tax-driven dispute over worker status often comes right after another. State taxing authorities may follow federal, or vice versa. A state employment development audit may be followed by an IRS or state tax audit, or by a direct suit by workers seeking recognition as employees.

Virtually all types of employers may run the risk of such disputes. Even public agencies are not immune from private litigation over the classification of workers. In *Metropolitan Water District of Southern California v. Superior Court of Los Angeles County*,[14] the plaintiffs were

workers hired through private labor suppliers to work on long-term projects for the water district. They sought relief to compel the water district to enroll the workers into the California Public Employees Retirement System (CalPERS).

The dispute arose because the workers were labeled as "consultants" or "agency temporary employees" and were thus ineligible for benefits. The California Supreme Court held the Public Employee's Retirement Law (PERL) required the water district to enroll all common-law employees into CalPERS, with only a few statutorily defined exceptions.[15]

Class Actions by Workers Seeking Employment Status

Class actions on worker status are becoming more common. For example, in *Estrada v. FedEx Ground*,[16] the plaintiffs were parcel delivery drivers denominated as independent contractors in contracts they signed with FedEx. The plaintiffs sought to be classified as employees, and the court agreed, finding that FedEx had the right to control the drivers. The court admonished that "the label placed by the parties on their relationship is not dispositive, and subterfuges are not countenanced."[17]

It may seem to violate principles of fundamental fairness for workers to sign a contract explicitly agreeing to treatment as an independent contractor, and then to turn around and sue to be treated as an employee. On the other hand, equity also dictates finding the truth. As noted previously, the truth of the relationship between worker and company is more often defined by actions than by words in a contract. Indeed, the courts are inclined to see this issue through a lens of realism. In *Estrada*, the court stated:

> As to whether or not the parties believed they were creating an employer-employee relationship it would seem that the [drivers] thought they were either investing in a "job" or believed that they would be independent contractors, only to find out by reason of the [company's] controls that they were being treated like employees.[18]

Thus, courts will not allow employers to call a worker an "independent contractor" while subjecting the worker to the control it exercises upon a normal employee.

Private Rights of Action

Most worker classification suits are brought as claims for employee benefits under state or federal law. Having standing to sue is usually not an issue. In some cases, however, courts have been reluctant to grant private rights of action, where the statute in question does not expressly grant individuals a private right of action on a worker misclassification issue.

For example, in *McDonald v. Southern Farm Bureau Life Insurance Co.*,[19] the Eleventh Circuit upheld a district court ruling that individuals have no private right of action under FICA to seek damages from their employer resulting from the employer's misclassification of the worker. This case shows the multiplicity of reasons worker status can be critical. Beginning in 1989, and ending in 1998, Craig McDonald was employed as an insurance agent by Southern Farm Bureau Life Insurance Co., which, according to his federal class-action lawsuit, erroneously misclassified him as an independent contractor. This caused McDonald to be liable for applicable self-employment taxes.

McDonald alleged that, notwithstanding his and Southern Farm Bureau Life Insurance Co.'s signed agreement labeling him an independent contractor, he was in fact an employee. He said that the company (1) exercised substantial control over his daily activities, including mandating he keep certain hours of business; (2) provided him with an office and staff; and (3) controlled the circumstances and manner in which he sold its products.

The company moved for summary judgment, asserting that no private right of action under FICA allowed McDonald's claim. Granting the motion, the court cited *Cort v. Ash*,[20] which established a four-part test for "determining whether a private remedy is implicit in a statute not expressly providing one":[21]

- Does the statute create a federal right in favor of the plaintiff?
- Is there any indication of legislative intent, explicit or implicit, either to create such a remedy or deny one?
- Is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff?
- Is the cause of action one traditionally regulated to state law, in an area basically the concern of the states, so that it would be inappropriate to infer a cause of action based solely on federal law?[22]

The Road Less Traveled?

Plainly, worker status litigation will continue to evolve. If anything, the stakes seem likely to increase. Companies facing worker status issues should consider the larger ramifications, since one dispute may serve as a catalyst to another. This is one area where it is not an exaggeration to note the domino effect one recharacterization battle can have on others.

That, in turn, raises a fundamental precept: A fight avoided is a fight won.[23] Undeniably, the independent contractor-versus-employee line is often not crystal clear. On the other hand, it is not always unintelligibly murky. One can – and should – evaluate what workers are, and what they can reasonably be expected to be.

Some companies label workers as independent contractors who could have no reasonable chance of withstanding scrutiny as such. While this can seem expedient

– even savvy – in the short run, it rarely saves money in the long run. Even companies that are in the infancy of drafting and implementing independent contractor relationships should have realistic expectations. They should make contract language and actual practice consistent wherever possible.

Moreover, they should bear in mind the adage that only very rarely can one have one's cake and eat it too. ■

1. State of New York Executive Order No. 17, "Establishing the Joint Enforcement Task Force on Employee Misclassification," September 5, 2007. See http://www.ny.gov/governor/press/ExecutiveOrderNo17.pdf.

2. Independent Contractor Proper Classification Act of 2007, S. 2044, 110th Congress (2007).

3. Pub. L. No. 95-600, 92 Stat. 2763, *amended by*, Pub. L. No. 96-167; Pub. L. No. 96-541; Pub. L. No. 97-248; Pub. L. No. 99-514; and Pub. L. No. 104-188 ("Section 530").

4. Section 530(a)(2).

5. Section 530(a)(3).

6. Section 530(a)(1)(B).

7. The following discussion serves only as a general introduction to private worker status litigation. It is not meant to provide specific aspects of state, federal, or local laws, and it is essential for litigants and lawyers to consider such specifics.

8. *See Abillo v. Intermodal Container Serv., Inc.*, 226 Dkt. No. BC 17450 (Cal. Sup. Ct. Jan. 14, 2000), *reported in* 14 Daily Tax Rep. G-8 (Jan. 21, 2000) (the actual working relationship is more instructive than the contract language.) *See also Loomis Cabinet Co. v. OSHRC*, 20 F.3d 938, 942 (9th Cir. 1994) (finding that the economic reality test emphasizes the substance over the form of the relationship between the employer and the hired party); *Valdez v. Truss Components, Inc.*, CV 98-1310-RE (D. Or. Aug. 19, 1999) (citing *Loomis Cabinet Co.*).

9. *See S. G. Borello & Sons v. Dep't of Indus. Relations*, 48 Cal. 3d 341, 349 (Cal. 1989) (holding that cucumber farm laborers who were contractually classified as "independent contractors" were, in fact, common-law employees covered under California's Workers' Compensation Act).

10. 97 F.3d 1187 (9th Cir. 1996), *reh'g en banc granted*, 105 F.3d 1334 (9th Cir. 1997), *cert. denied*, 522 U.S. 1098 (1998).

11. *Id.*

12. Thus, Microsoft was required to pay withholding taxes and the employer's portion of Federal Insurance Contribution Act (FICA) tax.

13. *See S. G. Borello & Sons*, 48 Cal. 3d 341.

14. 32 Cal. 4th 491, 84 P.3d 966 (Cal. 2004).

15. *Id.*

16. No. BC210130, 154 Cal. App. 4th 1 (Sup. Ct., L.A. Co.), *aff'd in part, rev'd in part, and remanded with directions*, *Estrada v. FedEx Ground Package Sys., Inc.*, 154 Cal. App. 4th 1 (Cal. Ct. App. 2007).

17. *Id*. at 22 (citing *Borello*, 48 Cal. 3d at 349).

18. *Id*. at 21.

19. 291 F.3d 718 (11th Cir. 2002).

20. 422 U.S. 66 (1975).

21. 291 F.3d 718 (citing *Cort*, 422 U.S. at 78).

22. *Id.*

23. The exact origins of this phrase are unclear, although it is often uttered by masters of martial arts. Some people attribute this axiom to Bruce Lee.

2007 Insurance Law Update

Uninsured, Underinsured and Supplementary Uninsured Motorist Law – Part I

By Jonathan A. Dachs

This article will address several general areas pertinent to issues concerning coverage and claims, and will report on developments in uninsured motorist (UM), underinsured motorist (UIM) and supplementary uninsured motorist (SUM) law during 2007. This is the first of two parts; Part II will appear in a forthcoming issue of the *Journal*.

Insured Persons and Relatives

The definition of an "insured" under the SUM endorsement (and many liability policies, as well) includes a relative of the named insured and, while residents of the same household, the spouse and relatives of either the named insured or spouse. In *Korson v. Preferred Mutual Ins. Co.*,[1] the court observed that where the term "relative" is not defined in the policy, it must be construed consistently with its ordinary meaning to include persons related by "close affinity, if not consanguinity," such as a stepparent or stepchild.

Residents

In *Auerbach v. Otsego Mutual Fire Ins. Co.*,[2] the court stated that the term "household" has repeatedly been characterized as ambiguous or devoid of any fixed meaning, and that the interpretation of that term requires an inquiry into the intent of the parties and must reflect "the reasonable expectation and purpose of the ordinary business area when making an insurance contract." In *Hochhauser v. Electric Ins. Co.*,[3] the court reiterated the well-settled rule that "whether a person is a 'resident' of an insured's 'household' requires 'something more than temporary or physical presence and requires at least some degree of permanence and intention to remain.'"

The only admissible evidence in *Hochhauser* established that the plaintiff owned two homes and resided in both of them. The plaintiff's son, the insured, and his family lived in one of the two homes. The plaintiff spent weekends and holidays in the insured's home; had a key to the home; maintained her own bedroom in the home;

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in which she kept clothing and necessaries; and paid the heating, water costs and the real estate taxes for the home. The court held that the plaintiff was entitled to uninsured motorist coverage under the insured son's policy.

In *Allstate Ins. Co. v. DiBello*,[4] the court held that the carrier met its burden of demonstrating that the injured driver was not a resident of the same household as its insured, his daughter, based upon the address listed for the driver on the police report and his medical records. The court rejected the evidence presented by a deed showing that the named insured held joint title to the house in which the father resided because there was no proof that she resided there as well.

Occupants

The claimant must be an "occupant" of a particular vehicle in order to qualify for coverage under the UM or SUM coverage of that vehicle's policy. In *Kobeck v. MVAIC*,[5] the plaintiff pulled her vehicle over to the curb in response to a signal from another vehicle. The occupants of the other vehicle told the plaintiff that they needed directions and asked if she would write them down for them. The plaintiff got out of her car and approached the other vehicle, then leaned into the open passenger's window to take the pen and paper being offered. At that point, while she was leaning into the window of the other car, the male occupant of that car put his arm around her neck and grabbed her shirt, while the female occupant began to drive away. As the male pushed her away, her watch became stuck on the window and she was dragged approximately 30 feet by the moving car until she fell to the ground and the car drove off. The court held that the plaintiff would be deemed an occupant of the vehicle she had been driving only moments earlier. "Where a departure from a vehicle is occasioned by or is incident to some temporary interruption in the journey and the occupant remains in the immediate vicinity of the vehicle, and, upon completion of the objective occasioned by the brief interruption, he intends to resume his place in the vehicle, he does not cease to be a passenger."

"Accidents"

The UM/SUM endorsements provide for benefits to "insured persons" who sustain injury caused by "accidents" "arising out of the ownership, maintenance or use" of an uninsured or underinsured motor vehicle. In *Travelers Indemnity Co. v. Cruz*,[6] the court held that the collision at issue was intentional, and thus the respondents were not entitled to coverage regardless of their innocence and regardless of whether the incident was motivated by fraud or malice. Moreover, insofar as the liability insurer was entitled to disclaim coverage on the ground that the injuries were not caused by an accident, there could be no recovery for the same injuries under the UM endorsement either.[7]

Exclusions

In *GEICO v. Lang*,[8] the court held that the owner of an uninsured motorcycle could not recover underinsured motorist benefits under a policy, issued to a member of his family household, containing an exclusion for uninsured "motor vehicles" owned by the insured. Specifically, the SUM endorsement of the policy, pursuant to which the claim was made, provided that

> [t]his SUM coverage does not apply . . . (2) to bodily injury to an insured incurred while occupying a motor vehicle owned by that insured, if such motor vehicle is not insured for SUM coverage under the policy under which a claim is made, or is not a newly acquired or replacement motor vehicle covered under the terms of this policy.

The claimant argued that the motorcycle was not a "motor vehicle," pointing out that the term "motor vehicle" and "motorcycle" were separately defined in the "Other Definitions" section of the no-fault (PIP, *i.e.*, personal injury protection) endorsement, and according to those definitions a motor vehicle did not include a motorcycle. That contention was rejected by the court, which noted that

> [w]hile the term motor vehicle was not specifically defined in the SUM endorsement of the policy, unlike the language in the PIP endorsement, a motorcycle

> was not specifically excluded from its definition. Further, the term motor vehicle has been construed to include a motorcycle for purposes of uninsured motorist coverage. Specifically, the policy exclusion relied upon by GEICO has been held to be unambiguous as it applies to a motorcycle owned and occupied by the insured who is not insured for SUM coverage.[9]

Finally, as explained by the court, "[i]t is well-settled that the liability, no fault and uninsured motorist portions of a comprehensive automobile insurance policy are discrete and internally complete coverages and should be read that way. SUM coverage exists separate and apart from the policy to which it is annexed and thus can not be qualified by inapplicable provisions of the PIP portion of the policy."[10]

Timely Notice of Claim

UM, UIM and SUM endorsements require the claimant, as a condition precedent to the right to apply for benefits, to give timely notice to the insurer of an intention to make a claim. Although the mandatory UM endorsement requires such notice to be given "within ninety days or as soon as practicable," Regulation 35-D's SUM endorsement simply requires that notice be given "as soon as practicable." A failure to satisfy the notice requirement vitiates the policy.[11] In the context of SUM coverage, "the phrase 'as soon as practicable' means that the 'insured must give notice with reasonable promptness after the insured knew or should reasonably have known that the tortfeasor was underinsured.'"[12]

One of the most significant issues in the context of notice of claim in recent years has been the issue of the "no-prejudice rule." In *Argo Corp. v. Greater New York Mutual Ins. Co.*,[13] the Court of Appeals held that the general "no-prejudice" rule applicable to liability insurance policies was not abrogated by *Brandon v. Nationwide Mutual Ins. Co.*,[14] which held three years earlier that the carrier must show prejudice before disclaiming based on late notice of a lawsuit in the SUM context, and that *Brandon* should not be extended to cases where the carrier received unreasonably late notice of the claim. Insofar as the "rationale of the no-prejudice rule is clearly applicable to a late notice of lawsuit under a liability insurance policy," the Court held that a primary (liability) insurer need not demonstrate prejudice to disclaim coverage based upon a late notice of lawsuit.

> The idea behind strict compliance with the notice provision in an insurance contract was to protect the carrier against fraud or collusion.

In *Rekemeyer v. State Farm Mutual Auto. Ins. Co.*,[15] however, the Court of Appeals held that the "no-prejudice" rule should be relaxed in SUM cases, and thus "where an insured previously gives timely notice of the accident, the [SUM] carrier must establish that it is prejudiced by a late notice of SUM claim before it may properly disclaim coverage." The idea behind strict compliance with the notice provision in an insurance contract was to protect the carrier against fraud or collusion. Under the circumstances of the *Rekemeyer* case, where the plaintiff gave timely notice of the accident and made a claim for no-fault benefits soon thereafter, the Court found that notice was sufficient to promote the valid policy objective of curbing fraud or collusion. Under these circumstances, "application of a rule that contravenes general contract principles is not justified." The Court further concluded that the insurer should bear the burden of establishing prejudice "because it has the relevant information about its own claims-handling procedures, and because the alternative approach would saddle the policyholder with the task of proving a negative."

The Second Department, in *New York Central Mutual Ins. Co. v. Davalos*,[16] held that the rationale of the Court of Appeals in *Rekemeyer* was equally applicable to claims for *uninsured* motorist benefits made pursuant to an SUM endorsement as to *underinsured* motorist claims. Thus, in *Davalos*, where the insured had been given timely notice of the accident and the claimant's claim for no-fault benefits but not the uninsured motorist claim, the court held that "[s]ince the petitioner has not claimed any prejudice arising from the late notice of the SUM claim, the court correctly determined that it is not entitled to a stay of arbitration on this ground."[17]

In *Assurance Co. of America v. Delgrosso*,[18] where the insured failed to submit any notice of claim for over two years after the accident, one year and three months after he commenced a personal injury action and 11 months after he learned of the tortfeasor's policy limits, the court held that the insured's notice of claim was untimely. "[T]he insurer did not rely on the late notice of legal action defense. Rather, it relied on late notice under an SUM endorsement where the insured did not previously give any notice of the accident, thus there was no requirement for the insurer to demonstrate prejudice."[19]

In *New York Central Mutual Fire Ins. Co. v. Ward*,[20] a case involving the insured's failure to complete and return proof of claim forms supplied by the insurer, the Second Department followed the Third Department's 2006 decision in *Nationwide v. Mackey*[21] and held that "the notice of claim exception to the no-prejudice rule set forth by the court in *Rekemeyer* should now be extended to apply to proof of claim."[22] Thus, insofar as the record established that the insured substantially complied with the policy's notice and proof of claim conditions insofar as he supplied the petitioner with prompt written notice of the accident, an application for no-fault benefits, a sworn police accident report and authorizations to obtain

records, the court held that "the facts, as in *Rekemeyer*, warrant a showing of prejudice by the insurance carrier." The court determined that the insurer "demonstrated no prejudice in this matter stemming from the [insured's] failure to submit the proffered proof of claim form," and that it "did not meet this burden of showing that [the insured's] failure to comply with his contractual duties was prejudicial to it," and thus it denied the insurer's Petition to Stay Arbitration without a hearing.[23]

Notably, in *Ward*, the court also based its decision to deny the petition to stay arbitration on the fact that the policy at issue contained a provision requiring the insurer to demonstrate prejudice as a result of an alleged breach of the notice and proof of claim conditions.

In *American Transit Ins. Co. v. B.O. Astra Management Corp.*,[24] the court held that the rationale of *Brandon* applied in a non-SUM case. In this case the insurer was not only given timely notice of claim (as in *Brandon*) but was also informed that counsel had been retained. In response, the insurer stated that it would investigate the claim and provided counsel with the name of a claims adjuster. The insurer, who was also the no-fault carrier, asked the claimant to appear for an independent medical exam (IME) five weeks after the accident and followed that up with three additional requests. The insurer received notice of the lawsuit before a default judgment had been entered (unlike *Argo*)[25] and, indeed, could have prevented the default "but chose instead to allow the default judgment to be entered unopposed so that it could later avail itself of the 'no-prejudice' rule." The court held, however, that the "no-prejudice" rule did not apply. Furthermore, said the court, even if the no-prejudice rule were to apply under the facts of this case, claimant's counsel's letter to the insurer, informing it that counsel had been retained and of potential claims against it, satisfied the notice of lawsuit requirement because it served the notice requirement's functions identified in *Argo*, which allows the insurer "to be able to take an active, early role in the litigation process and in any settlement discussions and to set adequate reserves."

The First Department essentially affirmed the lower court's decision, modifying only to declare in the insured's favor and holding that "[h]aving received timely notice of claim, plaintiff's insurer was not entitled to disclaim coverage based on untimely notice of the claimant's commencement of litigation unless it was prejudiced by the late notice, and such prejudice was not shown."[26]

In *Liberty Mutual Ins. Co. v. Rapisarda*,[27] the court held that the claimant failed to provide the SUM carrier with notice of his underinsured motorist claim "as soon as practicable," and thus ruled that the court below "providently exercised its discretion in granting the petition"

to stay arbitration. Interestingly, the court did not cite *Rekemeyer* and did not discuss the issue of prejudice to the insurer.

Presently, legislation is under consideration which, if signed, would create a new requirement that insurers must demonstrate prejudice, or, possibly, "material prejudice," before they can properly or validly deny a claim based on the failure to receive timely notice. Although both houses of the state Legislature and the Governor have already expressed support for such legislation, it remains to be seen when and in what form the ultimate statutory amendment will be made.[28] The interpretation of the phrase "as soon as practicable" continued, as always, to be a hot topic.

In *Progressive Ins. Cos. v. DeWitt*,[29] the court held that a question of fact existed as to the reasonableness of delay exceeding one year in providing notice of an SUM claim where the claimant alleged that he had hoped that his symptoms would improve during that period and, therefore, he had not intended to sue the tortfeasor. Evidence existed in the record, however, suggesting that the claimant should have been aware that he had sustained a serious injury as early as two months after the accident, when he was laid off from work because he was unable to carry out the necessary tasks of his job due to his injuries. Thus, the court remitted the matter for a hearing to determine whether the notice was given "as soon as practicable."

In *Massot v. Utica First Ins. Co.*,[30] the court held that a four-month delay in giving notice was reasonable given the injured party's own testimony that she experienced no pain, considered the wound superficial and did not initially seek medical treatment for her injury. In *New York Municipal Ins. Reciprocal v. McGuirk*,[31] the claimant just discovered that the tortfeasors were underinsured at the end of July 2005, when he received a letter from their insurer detailing their policy's liability limit. There was no allegation by the petitioner that, through diligent efforts, the claimant should reasonably have discovered that information earlier. The petitioner's allegation that the claimant was aware at any earlier time that the tortfeasor's coverage "may be sufficient," was held to be "of no moment" because "the timeliness of notice in the SUM context does not turn upon the suspicions of the insured, but upon when the insured actually knew that the tortfeasor's coverage was inadequate or when such information should reasonably have been discovered." Here, the court held that the claimant's notice of his SUM claim two weeks after his discovery that the tortfeasors were underinsured was "prompt."

On the other hand, in *State Farm Mutual Auto. Ins. Co. v. Tubis*,[32] the court held that a delay between "mid to late 2003," when the claimant became aware of the tortfeasor's insurer's insolvency, and May 12, 2004, when the UM claim was asserted, was unreasonable as a matter of law. In *Tower Ins. Co. of New York v. Mike's Pipe Yard & Building Supply Corp.*,[33] the court noted that "[n]otice to a broker cannot be treated as notice to the insurer since the broker is deemed to be the agent of the insured and not the carrier."

In *Bovis Lend Lease LMB Inc. v. Garito Contracting, Inc.*,[34] the court distinguished between notice to a broker, which is insufficient to prove notice to the insurer, and notice effectuated by a claims service/broker directly to the insurer. In *Compass Construction of New York v. Empire Fire & Marine Co. of Omaha, Nebraska*,[35] the court held that oral notice to the insurer was sufficient to satisfy the notice of occurrence provision in the policy since that provision did *not* contain a *written* notice requirement.

Discovery

The UM and SUM endorsements contain provisions requiring, upon request, a statement under oath, an examination under oath, physical examinations, authorizations, and medical reports and records. If requested, the provision of each type of discovery demand is a condition precedent to recovery.

In *New York Central Mutual Fire Ins. Co. v. Serpico*,[36] the court held that the lower court "improvidently exercised its discretion" in denying that branch of the petitioner's motion directing the respondent to provide all medical authorizations, to obtain relevant medical reports and copies of relevant medical records, including reports and records pertaining to bodily injuries sustained before the subject accident occurred that were similar to those allegedly sustained in the subject accident. In *New York Central Mutual Fire Ins. Co. v. Rafailov*,[37] the court held that "[a]n unexcused and willful refusal to comply with disclosure requirements in an insurance policy is a material breach of the cooperation clause and precludes recovery on a claim." Further,

> [i]n order to establish breach of a cooperation clause, the insurer must show that the insured engaged in an unreasonable and willful pattern of refusing to answer material and relevant questions or to supply material and relevant documents. An insured's duty to cooperate is satisfied by substantial compliance, and where a delay in compliance is neither lengthy nor willful, and is accompanied by a satisfactory explanation, preclusion of a claim is inappropriate.[38]

Arbitration vs. Litigation

Under Regulation 35-D and its prescribed SUM endorsement, the insured has the choice of proceeding to court or to arbitration to resolve disputes in cases involving coverage in excess of the statutory minimums of $25,000 per person/$50,000 per accident. Cases involving 25/50 coverage must be submitted to arbitration and cannot be litigated in court. In *Williams v. Progressive Northeastern Ins. Co.*,[39] the court held that where the plaintiff was seeking UM benefits for the statutory minimum amount, arbi-

tration was mandatory. The court added that the plaintiff was not entitled to a jury trial.

National Grange Mutual Ins. Co. v. Louie[40] concerned a Connecticut resident driving a Connecticut-registered and -insured car was involved in an accident in the Bronx with an uninsured/unregistered car owned and operated by a New Jersey resident. Since the accident occurred in New York State and the insurer did business there, the claimant notified the insurer of his intention to pursue arbitration of his UM claim. The insurer sought to stay arbitration on the ground that Connecticut policy and law do not entitle him to arbitration. The First Department found that New York's arbitration requirement, which is compelled by N.Y. Insurance Law, is imposed upon auto insurers when their vehicles are operated in New York and the insurer is authorized to transact business in New York.[41] Notably, the court specifically disagreed with the Second Department which, in *State Farm Mutual Auto. Ins. Co. v. Torcivia*,[42] had ruled that since the South Carolina policy in that case did not provide for the arbitration of uninsured motorist claims, the insurer could not be compelled to arbitrate, and that "there is no requirement under the New York no-fault statute and regulations that mandates arbitration where, as here, a policy issued out of state meets the minimum financial security requirements of Insurance Law § 5107." It is also noteworthy that the *Louie* court appeared to disregard its own First Department holding, in *SAA v. Melendez*,[43] which had agreed with *Torcivia.*

Jurisdiction

In *American Transit Ins. Co. v. Hoque*,[44] the court granted the motion by a Proposed Additional Respondent insurer to dismiss a petition brought against it on the basis that the insurer

> demonstrated, without rebuttal, that it is not doing business in New York (CPLR 301), since it is a Pennsylvania company not licensed to do business in New York, it maintains no offices in New York, has no bank accounts here, has no agents operating out of or representatives soliciting business in New York and does not own or possess real property in New York.[45]

The court specifically held that the insurer was not "transacting business in New York" because driving in New York in a vehicle registered in Pennsylvania was not "purposeful activity" on the part of the insurer. Thus, New York did not have personal jurisdiction over the insurer. Interestingly, the court, on its own, distinguished its prior decision in *Preferred Mutual Ins. Co. v. Chan*,[46] wherein the court, faced with evidence that the insurer did not do business in New York (the same as in *Hoque*), directed a hearing to determine whether there was jurisdiction. There, unlike here, the driver of the offending vehicle was a New York resident. This case raised the possibility that the insurer may have been transacting business in New York by knowingly issuing policies for New York drivers.

Filing and Service

The Third Department, in *New York Central Mutual Fire Ins. Co. v. Gordon*,[47] noted that "following the 2001 amendment to CPLR 304, '[a] special proceeding is commenced by filing a petition,' not by filing an executed order to show cause."

CPLR 304 ("Method of Commencing Action or Special Proceeding") was amended effective January 1, 2008.[48] The amendment reorganizes the sentences of the pre-existing CPLR 304 into separate subdivisions, with subdivision (a) continuing the rule that an action is commenced by filing, but now cross-referencing CPLR 2102, which applies to filing of papers generally. "An action is com-

menced by filing a summons and complaint or summons with notice in accordance with rule twenty-one hundred two of this chapter." CPLR 2102(a) has, in turn, been amended to indicate that a filing in a supreme court or county court action is to be made with the county clerk.

While this essentially restates the existing law, CPLR 2102(b) notes that "[a] paper filed in accordance with the rules of the chief administrator or any local rule or practice established by the court *shall be deemed filed*." This suggests that the chief administrator of the courts may adopt rules or practices that allow for filings with clerks working in offices other than those of the clerk of the court. In such an instance, CPLR 2102(b) directs that papers "shall be transmitted to the clerk of the court." Furthermore, CPLR 2102(c) provides that "a clerk shall not refuse to accept for filing any paper presented for that purpose except where specifically directed to do so by statute or rules promulgated by the chief administrator of the courts, or order of the court."

In addition, CPLR 2001 was amended, effective August 15, 2007, to include mistakes made at the very commencement of the action or proceeding within the scope of the provision. This amendment allows any non-prejudicial "mistake, omission, defect or irregularity" to be corrected by the court without deadly consequences. Thus, the new statute explicitly includes mistakes in "the filing of a summons with notice, summons and complaint or petition to commence an action . . . including the failure to purchase or acquire an index number or other mistake in the filing process . . . provided that any applicable fees shall be paid."

It should be noted that the recommendation for this amendment, from the Chief Administrative Judge's Advisory Committee on Civil Practice, contained three cautionary notes: First, the revision of CPLR 2001 will "not excuse a complete failure to file within the statute of limitations." Second, the amendment is not addressed to mistakes in "what" is filed, only mistakes in the "method" by which a filing occurs. Third, any necessary filing fee must be paid.

CPLR 7503(c) provides, in pertinent part, that "[a]n application to stay arbitration must be made by the party served within twenty days after service upon him of the notice [of intention to arbitrate] or demand [for arbitration], or he shall be so precluded." The 20-day time limit is jurisdictional and, absent special circumstances, courts have no jurisdiction to consider an untimely application.

The Second Department noted, in *Lejbik v. Allstate Indemnity Co.*,[49] that "there is an exception to the 20-day time limitation when a stay is sought on the basis that the parties never agreed to arbitrate in the first place" (the *Matarasso* exception).[50] However, where the policy does contain an agreement to arbitrate, albeit one that is subject to a condition precedent, and the insurer's contention is that condition was not satisfied, it must move to stay within 20 days or be precluded from raising the breach of the condition precedent as a defense.[51]

In *Travelers Indemnity Co. v. Castro*,[52] the court rejected the petitioner's contention that the claimant's notices of intention to arbitrate were deceptive and intended to prevent it from contesting the issue of arbitrability. Instead, the court held that the untimeliness of a proceeding to stay arbitration resulted from neglect of the insurer's own employee, "not any deception on the part of the [insured]."

In *State Farm Ins. Cos. v. DeSarbo*,[53] after conducting communications with his SUM carrier's Saratoga and Monroe County offices, the claimant served a demand for arbitration on the insurer's home office in Bloomington, Illinois. The insurer subsequently moved to stay arbitration and the claimant contended that the application was untimely. The demand was dated February 16, 2006, and was received in the home office on February 20, 2006. After an internal transfer, being received by "claims" on March 1, 2006, the demand was forwarded to the Saratoga County office, where it was received on March 7, 2006. Thus, the demand made its way to Saratoga County before the 20-day period expired.

The insurer waited 45 days before moving for a stay, however. The court noted that "[t]he demand sent to the home office was not buried in other documents, but was a short document pertaining only to the demand for arbitration, together with a cover letter which included, in bold print, the policy number, respondent's last name and the date of loss." Earlier correspondence from the insurer's offices in Saratoga and Monroe Counties, referencing the home office in Bloomington and the affidavit of the insurer's employee articulating a time line of events, did not set forth any explanation "as to how mailing the demand to petitioner's home office, which was prominently set forth in prior correspondence, and receiving the demand in the home office before the 20 days expired," nevertheless resulted in the petitioner being so misled that it was unable to seek a stay for a month and a half. The court ultimately held that the petition to stay arbitration was untimely.

Similarly in *USAA v. DeRosa*,[54] the court held that, contrary to the insurer's contention, the demands for arbitration were not served in a manner intended to conceal their nature or to precipitate a default. Because the insurer failed to seek a stay within 20 days, the petition was denied as untimely.

Burden of Proof

In *Mercury Ins. Group v. Ocana*,[55] the petitioner made a *prima facie* showing that the offending vehicle was insured on the date of the accident via the submission of the police accident report, *inter alia*, showing the vehicle's insurance code. The burden then shifted to the claimant/respondent to establish either a lack of insurance coverage

or a timely and valid disclaimer. While it did not establish a valid disclaimer on the basis of a lack of cooperation or a matter of law, the disclaimer letter issued by the insurer was sufficient to raise a factual issue for determination at a hearing.

In *Nationwide Insurance Enterprise v. Harris*,[56] in response to proof that the offending vehicle was insured on the date of the accident through the New York Automobile Insurance Plan ("Assigned Risk"), the claimants demonstrated that the plan had assigned responsibility for providing coverage to New York Central Mutual Ins. Co., which had canceled its policy prior to the accident. They also submitted proof that, since that time, no application had been submitted to the plan for a new insurer to be assigned. The court held this evidence as sufficient to show the existence of a factual issue as to whether the offending vehicle was insured, which required a framed-issue hearing to resolve the dispute. In *Progressive Northwestern Ins. Co. v. Gjonaj*,[57] the court held that the petitioner's failure to meet its initial burden of showing that the offending vehicle was, in fact, insured on the date of the accident, mandated denial of the petition.

Arbitration Awards

In *Allstate Ins. Co. v. Duffy*,[58] the court noted,

> CPLR 7511 provides that an application to vacate an arbitration award by a party who has participated in the arbitration may only be granted upon the grounds that the rights of that party were prejudiced by corruption, fraud, or misconduct in procuring the award, partiality of the arbitrator, the arbitrator exceeded his powers or failed to make a final and definite award, or a procedural failure that was not waived.
>
> Consistent with public policy in favor of arbitration, the grounds specified in CPLR 7511 for vacating an arbitration award are few in number and narrowly applied, with the list of potential objections being exclusive.[59]

In *Allstate Ins. Co. v. Dandan*,[60] the court vacated an award made to an infant in an uninsured motorist arbitration on the ground that the award of damages was inconsistent with the arbitrator's findings and deviated from what would be considered reasonable compensation.

The petitioner alleged "partiality and misconduct" as a ground for vacating an arbitration award in *Aviles v. Allstate Ins. Co.*[61] However, the petitioner's application was supported only by a petition signed by an attorney who did not attend the arbitration hearing, and a copy of the arbitration award. No transcript of the hearing was included among the papers submitted to the court. Under these circumstances, the court held that the petitioner failed to carry his burden of establishing bias on the part of the arbitrator. Insofar as the award itself disclosed no bias, the court rejected petitioner's counsel's conclusory claim to the contrary, denied the petition, and reinstated and confirmed the award.

Service of Petition to Vacate

In *Scott v. Allstate Ins. Co.*,[62] the court held that where the "first application arising out of the arbitrable controversy" is the petitioner's application to vacate an arbitrator's award and there is no pending action, the notice of petition, petition and supporting papers must be filed and then served on the respondent "in the same manner as a summons in an action" upon the respondent, instead of merely upon respondent's counsel.

"Serious Injury" Requirement

In *Raffellini v. State Farm Mutual Auto Ins. Co.*,[63] the Court of Appeals *reversed* the decision of the Appellate Division, Second Department (reported on last year), and upheld the validity of the provision in the Regulation 35-D SUM endorsement that required proof of a "serious injury" as defined in the No-Fault Law as a condition precedent to a valid underinsured motorist claim (same as an uninsured motorist claim). In so holding, the Court rejected the plaintiff's contention that, by referencing "serious injury" in subsection (f)(1) of Ins. Law § 3420, *i.e.*, the mandatory uninsured motorist provision, but not in subsection (f)(2), the supplementary uninsured/underinsured motorist provision, the Legislature permitted insurers to condition recovery of mandatory uninsured motorist benefits on the existence of a "serious injury" but intended to preclude them from conditioning recovery of supplementary benefits on such a finding.

The Court viewed that argument as "run[ning] contrary to the interpretation of the Superintendent of Insurance expressed in Regulation 35-D." Moreover, the Court held that "the relevant statutory provision and the regulation are not contradictory" because "Insurance Law § 3420(f)(2) is silent on the issue of whether an insured can recover SUM benefits absent a serious injury and that silence does not, in this case, imply that the Legislature intended to permit such recovery." Further, "the legislative history of the relevant provisions refutes the argument that, by placing the serious injury exclusion in the mandatory benefits provision, but not the supplementary benefits provision, the Legislature intended to preclude the Superintendent from authorizing application of a serious injury exclusion for supplementary benefits."

The Court offered a lengthy analysis of the history of the drafting of the two statutory provisions, noting that, initially, both provisions appeared as two paragraphs within a single section. The second paragraph read as a continuation of the first, providing that "[a]ny *such* policy, shall at the option of the insured, *also* provide supplementary uninsured/underinsured motorist insurance," and that the Court has always viewed underinsured motorist coverage as an extension of uninsured motorist coverage. The Court concluded that the "serious injury" exclusion "can reasonably be viewed as having been intended to apply to both categories of benefits." Indeed, as the Court

stated, "[b]ased on the structure of [the predecessor statute to § 3420(f)], we cannot say that the Legislature's failure to restate the serious injury provision in the second paragraph evinced an intent to preclude application of such an exclusion to supplementary benefits."

Moreover, the two paragraphs were separated into two subsections in 1984, resulting in the placement of the serious injury exclusion in Ins. Law § 3420(f)(1) and not in Ins. Law § 3420(f)(2). The court observed that "this modification was not meant to effect a substantive change in the law – certainly, there is no reason to conclude that the Legislature split the two paragraphs into separate subsections to create a distinction between the two types of coverages that did not already exist."[64]

Collateral or "Judicial" Estoppel

In *New York Central Mutual Fire Ins. Co. v. Steiert*,[65] the court held that New York Central, the SUM carrier, was not collaterally estopped from challenging the validity of another insurer's disclaimer and was entitled to litigate that issue on the merits because it was not a party to the declaratory judgment action in which that disclaimer was unsuccessfully challenged by the claimant. The court discussed that "it was neither argued nor demonstrated that New York Central was in privity with a party to that action," and New York Central "has not afforded a full and fair opportunity to contest the determination in the declaratory judgment action."[66]

In *One Beacon Ins. Co. v. Espinoza*,[67] the court held that the claimant in the underlying personal injury action was not precluded by a jury verdict from claiming that the vehicle that struck her vehicle was unidentified because the jury had only concluded that there was no contact between the host vehicle and a vehicle owned by the defendant, Luongo. Even though the jury found that there was no accident or that there was a lack of physical contact with an (another) unidentified vehicle, the claimant was not precluded from making such a claim. Moreover, the court held that the doctrine of judicial estoppel, which precludes a party from framing his or her pleadings in a manner inconsistent with a position taken in a prior proceeding, was not applicable where the claimant did not obtain a favorable judgment as a result of the claimant's "contrary position" in the personal injury action. ■

1. 39 A.D.3d 483, 833 N.Y.S.2d 580 (2d Dep't 2007).
2. 36 A.D.3d 840, 829 N.Y.S.2d 195 (2d Dep't 2007).
3. 46 A.D.3d 174, 844 N.Y.S.2d 374 (2d Dep't 2007).
4. 40 A.D.3d 401, 835 N.Y.S.2d 576 (1st Dep't 2007).
5. 16 Misc. 3d 592, 836 N.Y.S.2d 864 (Sup. Ct., Madison Co. 2007).
6. 40 A.D.3d 362, 835 N.Y.S.2d 567 (1st Dep't 2007).
7. *See also Kobeck v. MVAIC*, 16 Misc. 3d 592, 836 N.Y.S.2d 864 (Sup. Ct., Madison Co. 2007).
8. 17 Misc. 3d 1136(A), 851 N.Y.S.2d 69 (Sup. Ct., Queens Co. 2007).
9. *Id.* (citations omitted). *See USAA Cas. Ins. Co. v. Hughes*, 35 A.D.3d 486, 825 N.Y.S.2d 531 (2d Dep't 2006); *Utica Mut. Ins. Co. v. Reid*, 22 A.D.3d 127, 799 N.Y.S.2d 509 (1st Dep't 2005); *Cohen v. Chubb Indem. Ins. Co.*, 286 AD2d 264, 729 N.Y.S.2d 105 (1st Dep't 2001); *Liberty Mut. Ins. Co. v. Panetta*, 187 A.D.2d 719, 590 N.Y.S.2d 290 (2d Dep't 1992).
10. *Lang*, 17 Misc. 3d 1136(A) (citations omitted). *See also N.Y. Cent. Mut. Fire Ins. Co. v. Gordon*, 46 A.D.3d 1296 (3d Dep't 2007).
11. *See St. James Mechanical, Inc. v. Royal & Sun Alliance*, 44 A.D.3d 1030, 845 N.Y.S.2d 83 (2d Dep't 2007).
12. *N.Y. Municipal Ins. Reciprocal v. McGuirk*, 45 A.D.3d 1166, 845 N.Y.S.2d 572 (3d Dep't 2007).
13. 4 N.Y.3d 332, 794 N.Y.S.2d 704 (2005).
14. 97 N.Y.2d 491, 743 N.Y.S.2d 53 (2002).
15. 4 N.Y.3d 468, 796 N.Y.S.2d 13 (2005).
16. 39 A.D.3d 654, 655, 835 N.Y.S.2d 247 (2d Dep't 2007).
17. *Id.* at 655 (citing and relying upon *Rekemeyer*).
18. 38 A.D.3d 649, 831 N.Y.S.2d 545 (2d Dep't 2007).
19. *Id.* (citations omitted). *See Brandon*, 97 N.Y.2d at 491; *cf. Rekemeyer*, 4 N.Y.3d at 468. *See also Progressive Ne. Ins. Co. v. Heath*, 41 A.D.3d 1321, 837 N.Y.S.2d 476 (4th Dep't 2007).
20. 38 A.D.3d 898, 833 N.Y.S.2d 182 (2d Dep't 2007).
21. 25 A.D.3d 905, 808 N.Y.S.2d 797 (3d Dep't 2006).
22. *Ward*, 38 A.D.3d at 901.
23. Contra *State Farm Mut. Auto. Ins. Co. v. Rinaldi*, 27 A.D.3d 476, 810 N.Y.S.2d 346 (2d Dep't 2006) and *Nationwide Mut. Ins. Co. v. Perlmutter*, 32 A.D.3d 947, 821 N.Y.S.2d 753 (2d Dep't 2006), where the court remanded the matter "for the carrier to have an opportunity to demonstrate prejudice, if any."
24. 12 Misc. 3d 740, 814 N.Y.S.2d 849 (Sup. Ct., N.Y. Co. 2006), *aff'd*, 39 A.D.3d 432, 835 N.Y.S.2d 106 (1st Dep't), *appeal denied*, 9 N.Y.3d 802, 840 N.Y.S.2d 762 (2007).
25. *Argo Corp. v. Greater New York Mutual Ins. Co.*, 4 N.Y.3d 332, 794 N.Y.S.2d 704 (2005).
26. 39 A.D.3d 432, 835 N.Y.S.2d 106 (1st Dep't 2007) (citing *Rekemeyer* and *Brandon*) (It is interesting to note that neither the Supreme Court nor the Appellate Division in *Am. Transit*, 12 Misc. 3d 740, cited to or relied upon any of the pre-*Brandon* decisions in non-SUM cases, in which it was held or, at the very least, implied, that a showing of prejudice was required in order for the insurer to rely upon a breach of the notice of lawsuit provisions of its liability policy. *See Aetna Ins. Co. of Hartford, Conn. v. Millard*, 25 A.D.2d 341, 269 N.Y.S.2d 588 (3d Dep't 1966), a case involving a third-party liability policy, wherein the court noted that no prejudice had resulted to the insurer from its insured's failure to timely provide it with notice of the suit brought against him; *Melhado v. Catsimatidis*, 182 A.D.2d 576, 582 N.Y.S.2d 434 (1st Dep't 1992), also involving a liability policy, where the court specifically found that the insurer was prejudiced, *i.e.*, "irreparably harmed," by the insured's failure promptly to forward the legal process served upon him; and *N.Y. Mutual Underwriters v. Kaufman*, 257 A.D.2d 850, 685 N.Y.S.2d 312 (3d Dep't 1999), involving a homeowner's policy, where the court held that in the case of a failure to comply with the requirement to provide timely notice of suit, "late notice shall be excused where no prejudice has inured to the insurer." *But see Centenniel Ins. Co. v. Hoffman*, 265 A.D.2d 629, 695 N.Y.S.2d 774 (3d Dep't 1999), where the insured did not forward the summons and complaint until 4 1/2 months later, the court held that "since a policy's notice provision operates as a condition precedent, an insurer need not demonstrate prejudice to successfully assert the defense of non-compliance."
27. 43 A.D.3d 1062, 841 N.Y.S.2d 465 (2d Dep't 2007).
28. *See* Norman H. Dachs & Jonathan A. Dachs, *Legislative Initiatives Regarding the "No-Prejudice Rule,"* N.Y.L.J., Sept. 11, 2007, p. 3, col. 1.
29. 43 A.D.3d 1356, 842 N.Y.S.2d 804 (4th Dep't 2007).
30. 36 A.D.3d 499, 828 N.Y.S.2d 342 (1st Dep't 2007).
31. 45 A.D.3d 1166, 845 N.Y.S.2d 577 (3d Dep't 2007).
32. 38 A.D.3d 670, 831 N.Y.S.2d 520 (2d Dep't 2007).
33. 35 A.D.3d 275, 827 N.Y.S.2d 36 (1st Dep't 2006). *See also Temple Constr. Corp. v. Sirius Am. Ins. Co.*, 40 A.D.3d 1109, 837 N.Y.S.2d 689 (2d Dep't 2007) ("However, a broker will be held to have acted as the insurer's agent when there is some evidence of action on the insurer's part, or facts from which a general authority to represent the insurer may be inferred.").
34. 38 A.D.3d 260, 832 N.Y.S.2d 502 (1st Dep't 2007).

35. 43 A.D.3d 1099, 842 N.Y.S.2d 554 (2d Dep't 2007).

36. 45 A.D.3d 598, 845 N.Y.S.2d 811 (2d Dep't 2007).

37. 41 A.D.3d 603, 840 N.Y.S.2d 358 (2d Dep't 2007).

38. *Id.* at 604–05.

39. 41 A.D.3d 1244, 839 N.Y.S.2d 381 (4th Dep't 2007).

40. 39 A.D.3d 293, 833 N.Y.S.2d 88 (1st Dep't 2007).

41. *See* Ins. Law § 5107.

42. 277 A.D.2d 321, 715 N.Y.S.2d 75 (2d Dep't 2000).

43. 27 A.D.3d 296, 811 N.Y.S.2d 641 (1st Dep't 2006). *See also* Norman H. Dachs & Jonathan A. Dachs, *Appellate Division: Recent Departmental Conflicts*, N.Y.L.J., July 10, 2007, p. 3, col. 1.

44. 45 A.D.3d 329, 846 N.Y.S.2d 91 (1st Dep't 2007).

45. *Id.* at 329.

46. 267 A.D.2d 181, 700 N.Y.S.2d 457 (1st Dep't 1999).

47. 46 A.D.3d 1296, 850 N.Y.S.2d 653 (3d Dep't 2007).

48. 2007 N.Y. Laws ch. 125.

49. 40 A.D.3d 644, 835 N.Y.S.2d 423 (2d Dep't 2007).

50. *Id.* at 645 (citing *In re Matarasso*, 56 N.Y.2d 264, 451 N.Y.S.2d 703 (1982)).

51. *See also State Farm Mut. Auto. Ins. Co. v. Juma*, 44 A.D.3d 963, 844 N.Y.S.2d 364 (2d Dep't 2007).

52. 40 A.D.3d 1005, 836 N.Y.S.2d 657 (2d Dep't 2007).

53. 36 A.D.3d 1193, 829 N.Y.S.2d 257 (3d Dep't 2007).

54. 36 A.D.3d 925, 830 N.Y.S.2d 716 (2d Dep't 2007).

55. 46 A.D.3d 561, 846 N.Y.S.2d 633 (2d Dep't 2007).

56. 44 A.D.3d 947, 844 N.Y.S.2d 121 (2d Dep't 2007).

57. 43 A.D.3d 1169, 841 N.Y.S.2d 794 (2d Dep't 2007).

58. 15 Misc. 3d 1116(A), 839 N.Y.S.2d 431 (Sup. Ct., Queens Co. 2007).

59. *Id.* at *3 (citations omitted).

60. 18 Misc. 3d 451, 847 N.Y.S.2d 832 (Sup. Ct., Kings Co. 2007).

61. 47 A.D.3d 710, 848 N.Y.S.2d 897 (2d Dep't 2008).

62. 45 A.D.3d 690, 846 N.Y.S.2d 248 (2d Dep't 2007).

63. 9 N.Y.3d 196, 848 N.Y.S.2d 1 (2007), *rev'g* 36 A.D.3d 92, 823 N.Y.S.2d 440 (2d Dep't 2006).

64. *See also Meegan v. Progressive Ins. Co.*, 43 A.D.3d 194, 836 N.Y.S.2d 451 (4th Dep't 2007), the Fourth Department, by a 3–2 vote, held that the plaintiff in an action to recover underinsured motorist benefits (pursuant to Ins. Law § 3420(f)(2) is required to establish a "serious injury" as defined by Ins. Law § 5102(d); *Kephart v. Safeco Ins. Co. of Am.*, 41 A.D.3d 1320, 836 N.Y.S.2d 460 (4th Dep't 2007); *Mavroudes v. Cronin & Byczek*, 45 A.D.3d 817, 847 N.Y.S.2d 591 (2d Dep't 2007). *See* Norman H. Dachs & Jonathan A. Dachs, *Appellate Division: Recent Departmental Conflicts*, N.Y.L.J., July 10, 2007, p. 3, col. 1.

65. 43 A.D.3d 1065, 842 N.Y.S.2d 494 (2d Dep't 2007).

66. *See also* Norman H. Dachs & Jonathan A. Dachs, *Issue Preclusion and UM/UIM/ SUM Cases*, N.Y.L.J., Jan. 9, 2007, p. 3, col. 1.

67. 37 A.D.3d 607, 830 N.Y.S.2d 287 (2d Dep't 2007).

BY GARY A. MUNNEKE

Gary A. Munneke (GMunneke@law.pace.edu) is a professor of law at Pace University School of Law in White Plains, where he teaches Professional Responsibility, Law Practice Management, and Torts. Professor Munneke is the Chair of the New York State Bar Association's Law Practice Management Committee, Co-Chair of the New York Fellows of the American Bar Foundation, and a member of the Board of Governors of the American Bar Association. The opinions included in this article represent the personal views of the author and do not reflect the policy of the American Bar Association or its Board of Governors.

Personal Management Skills: Getting the Most Out of Every Day

For many lawyers, management is something to be left to, well, management. According to conventional wisdom, a lawyer's job is to practice law, while managers do the managing. Lawyers believe that the high level of thought needed to practice law should not be sullied by pedestrian issues of efficiency and productivity. They assume that their innate intelligence and problem-solving ability will allow them to serve clients, fulfill professional commitments and sustain their personal lives. They pray that they will be able to keep all the balls in the air, not because they can, but because they must.

In an October 2007 *Journal* column, I posed the question, "Why Practice Management?" The column concluded that lawyers need to understand the business side of practicing law in order to survive in a competitive marketplace for legal services. What was left unsaid in that column was the idea that law practice management (LPM) has more than one meaning. In one sense, LPM involves managing the organization, or what might be called law *firm* management. Law firms, whether individual practices or multi-office mega-firms, are professional service businesses that deliver work product to clients and earn a living for the lawyer-owners. Yet, many lawyers practice outside the realm of organizational management; they delegate the administration of the office to others.

In another sense, however, LPM involves managing the delivery of legal work to clients. In this context, every lawyer is a manager, because every lawyer is ethically responsible for the legal work he or she handles, regardless of the lawyer's status in the firm. In this view, management requires the knowledge base and skill set reasonably necessary under the circumstances to get the job done. In the final sense of the term, LPM represents a group of personal management skills that are not limited to running the firm or delivering legal work. These personal skills serve those who possess them in a variety of different professional and personal settings, as well as in both legal and nonlegal activities.

What are these skills and why are they important? Although the remainder of this column looks at "what," a few preliminary words about "why" deserve attention. We have all met people who just seem to get more done than others. They are organized, prepared, and focused. This behavior cuts across all aspects of their lives. We have also known people whose work and lives seem to be perpetually in shambles, not because of some singular crisis, but because they are always in crisis. They may be intellectually gifted, but their performance always falls short of their promise. Most of us fall somewhere in the middle, neither the best nor the worst of managers. We can look at some people and recognize (thankfully) that we could be doing worse. On the other hand, we can look to others for a reminder that we could do a better job of managing our affairs. If improvement is possible, it would seem, we should strive to be better personal managers, not only because we improve the quality of our work, but also because we can enhance the quality of our lives.

As for the question, what are the personal management skills that lawyers need to possess (or develop, as the case may be), here is a short list: organization, time management, financial management, facility with technology, people skills, an ability to communicate, personal marketing skills and career skills. Although future columns will add flesh to the bones of these personal management skills, a skeletal overview may help to understand what this article is talking about.

- Organization – On a fundamental level, organization involves grouping projects in an orderly way, engineering efficient plans for accomplishing work, leveraging repetitive or recurring tasks, structuring work flow to enhance output, dividing projects into manageable components, giving work to those best positioned to do it, and saying no when a project isn't right for you. Getting organized and staying organized are two continuous battles for lawyers buffeted by competing demands in their professional and personal

Too often, lawyers are careless with money, or they delegate financial responsibilities to others without exercising proper oversight.

lives, but disorganization breeds chaos, which in turn increases stress, decreases productivity, and undermines professionalism.

- Time – Although organization and time are connected, they are not the same. Time management involves making choices about how to make the best use of the hours we have. There are 24 hours in a day – no more, no less. A lawyer who spends 10 hours per day, six days per week (or 12 hours over five days) has 60 hours to get the work done and take care of other routine office business. Surveys indicate that lawyers who work 60 hours can probably bill 40 hours to client matters, and over a 50-week year (allowing two weeks for vacation) can bill clients for roughly 2,000 hours of work per year. Time management means getting more out of the hours you have, not just spending more hours in the office.
- Technology – Over the past two decades, the technology revolution has transformed the way lawyers practice law. Some lawyers learned to harness technology early and have remained on the cutting edge of this changing environment. Other lawyers resisted technology, hoping perhaps to retire from the practice of law before it overtook them. Still others relied on experts – consultants, IT professionals, lawyer "techies" – to keep them semi-functional, if not ahead of the curve. Law firms generally have lagged behind professional offices in other fields in their use of tech applications. As younger lawyers who grew up on technology filter out of law schools and into practice, there are fewer and fewer places to hide for those who do not stay abreast of developments in e-lawyering, e-marketing, e-discovery, and e-commerce.
- Money – Lawyers can get into money trouble in a variety of ways: mismanaging their personal funds, their clients' funds, and their law firm's funds. Money management can involve accounting, budgeting, investing, billing, advising clients on financial matters, or exercising fiduciary responsibilities. In all these cases, lawyers need to possess a basic understanding of accounting principles and know how to apply these principles in a disciplined way. Too often, lawyers are careless with money, or they delegate financial responsibilities to others without exercising proper oversight. Most of us did not go to business school before law school, so developing the tools to be an effective money manager may prove challenging, but if we do not master this critical skill, it will eventually catch up with us.
- People – Law is a people business. Lawyers work with clients, judges, jurors, adversaries, witnesses, experts, partners, associates, nonlegal staff, colleagues, allied professionals, and family and friends. Our work is collaborative, and legal work is typically delivered by a team, even in the smallest organization. Lawyers sometimes thrive on the myth that they are independent agents, cowboys and cowgirls who operate outside the parameters of social intercourse and civility. These lawyers need to understand that working with

people representing disparate constituencies with differing interests and values is at the heart of being a lawyer. All lawyers need to realize that people skills are central to success in professional life. Knowing how to play the game, how to supervise, how to exercise leadership, how to give feedback, and how to say no are just a few of the things that lawyers have to do to manage people effectively.

- Communication – In law school, students learn persuasive communication skills. They learn how to take a position and make an argument using both the written and spoken word. They may not recognize that they should not interview job applicants the same way they would pick a jury, or that yelling is not the best way to inspire loyalty among subordinates. Lawyers often do not recognize that they need to know how to empathize, how to listen, how to respond to inquiries, how to mentor, and how to praise, just as much as they need to know how to formulate a winning argument. In today's world, lawyers need to understand netiquette as well as etiquette, civility as well as civil action, media relations as well as personal relations, and silence as well as repartee in order to be effective communicators.
- Marketing – According to one definition, marketing involves knowing in what business you are engaged. If you know this, then you know who your clients are, what products or services you will provide them, and how to reach them with information about what you can do for them. Marketing is much more than advertising, solicitation, or a set of rules defining when and how you can contact prospective clients. Marketing also includes developing a network or client base, rainmaking, selling yourself and/or your firm, building your own career, cross-selling services, developing an image and brand name, building loyalty among current clients who come back to you repeatedly and refer you to others in need of the services you render. Most lawyers think of marketing as an institutional activity – something the firm does to get clients. In larger firms, marketing may be viewed as an activity to be delegated to a marketing director or marketing consultant. In smaller firms, marketing may be seen as a necessary annoyance that interferes with the more important work of practicing law. Some lawyers understand instinctively that those who can get and keep a clientele can write their ticket; some lawyers never get it and never figure out why they are working for the lawyers who do.
- Career – A lawyer pursues a career in law, not just a series of jobs, but an accumulation of related experiences, which over time manifest themselves in the lawyer's professional growth and increasing mastery of the work. Law students think about their careers as they graduate from law school, and older lawyers may reminisce about their careers through the veil of retirement, but many lawyers in the midst of their careers do not think very much about where they are going, how they want to get there, and what they will need to do to position themselves in order to achieve their professional goals. In truth, career development is an ongoing activity for all lawyers, and career skills are critical to achieving success in the practice of law.

These are not the only personal management skills that lawyers need to possess, but they are clearly significant ones. It is hard to imagine a lawyer who does not apply many of these skills every day. Not surprisingly, different lawyers possess a range of aptitudes in all these areas. Some may have mastered the latest technology but can't keep a secretary for more than six months. Others may be so organized that they get twice as much done as anyone else in the office but have never brought in a client of their own. Some lawyers are skilled in multiple areas, and they are the professionals we emulate. Those who fail to develop at least some of these skills do not survive in the practice of law.

Some lawyers mistakenly believe that personal management skills are innate – one either has them or not. The reality is that these skills can all be learned and honed over time. A few lawyers may get a head start with personal charisma, or family role models, but there is nothing magic about these skills. In 1991, the ABA MacCrate Task Force described a continuum for the acquisition of professional skills and postulated that learning the skills of effective lawyering begins long before law school and extends throughout one's professional life. A lawyer should continue to grow professionally throughout his or her professional life.

In future issues of the *Journal*, this column will explore each of these professional management skills in greater depth. The Law Practice Management Committee plans to develop a series of programs to help lawyers develop and utilize these skills in their work. The Committee also plans to identify and disseminate information about resources to help lawyers help themselves, and to explore other avenues for enhancing professional skills development among members of the Association. In the end, it is each lawyer's responsibility to be the best lawyer possible, and in the end the best lawyer is not necessarily the smartest or cleverest lawyer around, but rather the most skilled. ■

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NYSBA

MEET YOUR NEW OFFICERS

President
Bernice K. Leber

Bernice K. Leber, a senior partner at Arent Fox, PLLC, New York City, took office on June 1 as president of the 72,000-member New York State Bar Association. The House of Delegates, the Association's decision- and policy-making body, elected Leber at the organization's 131st annual meeting, held this past January in Manhattan.

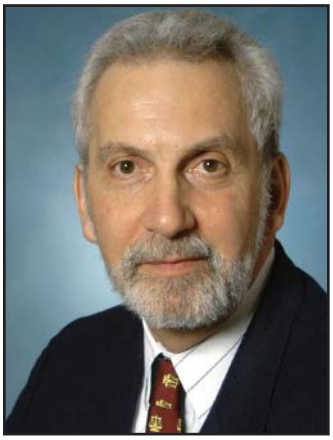
Leber received her undergraduate degree from Mount Holyoke College, *cum laude*, and earned her law degree from Columbia University School of Law.

Widely recognized for her excellence in commercial litigation, Leber's practice concentrates on the prosecution and defense of complex civil business disputes, specifically those involving securities, and financial and intellectual property.

Throughout her many years of active membership in the Association, Leber has held many leadership positions and launched a number of initiatives. Leber serves on the House of Delegates, is a member of the Executive Committee, and is a director of The New York Bar Foundation. She is a member and former chair of the Commercial & Federal Litigation Section and past chair of the Section's subcommittees on Discovery, Appellate Practice, and Federal Judiciary. She is a member of the Intellectual Property Law Section. Most recently, she chaired the Association's Task Force on Lawyer Advertising, which played a key role in the development of the new lawyer advertising regulations that took effect in 2007.

Leber serves on the NYSBA's Committees on Annual Award, Finance, and Membership. She has served on the Special Committee on Association Governance and co-chaired the Committee on Judicial Independence.

In addition to her NYSBA activities, Leber serves on the Corporate Board Selection of the Committee of the Financial Women's Association. She is a past member of the Courts of Superior Jurisdiction (1995–1998), Committee on Judicial Administration, and the Civil Courts Committee for the Association of the Bar of the City of New York. She is a former parliamentarian to the New York State Senate.



President-Elect
Michael E. Getnick

Michael E. Getnick, of Utica, a partner of Getnick, Livingston, Atkinson, Gigliotti, & Priore, LLP and of counsel to Getnick and Getnick of New York City, took office on June 1 as president-elect of the 72,000-member New York State Bar Association. The House of Delegates, the Association's decision- and policy-making body, elected Getnick at the organization's 131st annual meeting, held this past January in Manhattan. As the current president-elect, Getnick chairs the House of Delegates and the President's Committee on Access to Justice (formed to help ensure civil legal representation is available to the poor). In accordance with NYSBA bylaws, Getnick becomes president of the Association on June 1, 2009.

Getnick received his undergraduate degree from Pennsylvania State University in 1966 and earned his law degree from Cornell University in 1970.

Active in the Association, he is a member of the House of Delegates and a Fellow of The New York Bar Foundation. He is chair of the Committee on Court Operations and a member of the Membership Committee.

Getnick served as a vice president representing the Fifth Judicial District (Herkimer, Jefferson, Lewis, Oneida, Onondaga, and Oswego Counties). He is also a past member of the Nominating Committee. In 1988, he received the Association's President's Pro Bono Service Award for the Fifth Judicial District. The award recognizes lawyers for outstanding contribution of time, resources, and expertise in the provision of legal services to the poor. He is a member of the Fifth Judicial District Pro Bono Committee.

In addition to his NYSBA activities, Getnick is a member and past president of the Oneida County Bar Association (OCBA) and an ex-officio member of the Onondaga County Bar Association.

He is past chair of OCBA's Liaison Committee to the NYSBA, the Domestic Relations Committee, and the Private Attorney Involvement Committee. He is also a member of the National Institute for Trial Advocacy and the New York State Academy of Trial Lawyers.

In the community, Getnick is a member of the board of the American Heart Association Northeast Affiliate. He was the initial counsel and attorney who incorporated the Mohawk Valley Committee against Child Abuse, Inc.

Getnick is past president and member of the board of directors of the Legal Aid Society of Mid-New York and a former member and past president of the New Hartford Central School District Foundation. He was a trainer and speaker for the Mendez Anti-Drug Program for the New Hartford School District.

He formerly served as vice president of the YMCA of Utica and is past chair of the United Way's Committee for Fund Raising for Lawyers and Doctors. Getnick is a past member of the board of directors of Family Services of Greater Utica.

Secretary
C. Bruce Lawrence

C. Bruce Lawrence, of Rochester, a partner of Boylan, Brown, Code, Vigdor & Wilson, LLP, began serving his term as secretary of the Bar Association on June 1. Previously, he served as Vice President for the Seventh Judicial District.

Lawrence received his undergraduate degree from the University of Rochester and earned his law degree from Dickinson School of Law of Pennsylvania State University.

A frequent lecturer for the Association on bankruptcy and debt collection, Lawrence serves on the Bankruptcy Law Committee and as a member of the House of Delegates. He was a co-chair of the President's Committee on Access to Justice, was appointed a member of the Special Committee on Public Trust and Confidence in the Judicial System, and was a member of the Executive Committee of the Business Law Section. He has served in the House of Delegates for the American Bar Association.

Lawrence is a past president of the Monroe County Bar Association, a past chair of the Monroe County Bar Association's Bankruptcy Committee, and past chair of the New York State Council of Bar Leaders.

Lawrence has over 31 years of experience in the fields of debtor/creditor law, bank and commercial collections, business loan workouts, and commercial bankruptcy. He has frequently been listed in *The Best Lawyers in America* for his bankruptcy expertise.

Treasurer
Seymour W. James, Jr.

Seymour W. James, Jr., of New York City, Legal Aid Society of New York City, is treasurer of the Bar Association as of June 1.

James received his undergraduate degree from Brown University and earned his law degree from Boston University School of Law.

Active in the Association since 1981, James was a Vice President of the Executive Committee representing the 11th Judicial District (Queens County) and is a member of its House of Delegates. He is a member of numerous Association committees, including the Membership Committee and the Committee on Diversity and Leadership Development. He is a past member of a number of committees, including the Nominating Committee and the Special Committee on Association Governance.

James is a past president of the Queens County Bar Association and has served on a number of that association's entities, including its Judiciary Committee. He is also a member of the Macon B. Allen Black Bar Association and a former member of the board of directors of the Metropolitan Black Bar Association.

James has served as an Adjunct Professor of Law at CUNY Law School and on the faculty of the Benjamin N. Cardozo School of Law Intensive Trial Advocacy Program.

In addition to his Association activities, James is a member of the Committee on Character and Fitness for the Second Judicial Department. He is the Secretary of the Correctional Association and a member of the Board of Directors of the Osborne Association and the Queens Legal Services Corporation.

James formerly served on the board of directors of Community Action for Legal Services (now Legal Services for New York) and Bedford-Stuyvesant Community Legal Services Corporation.

ATTORNEY PROFESSIONALISM FORUM

To the Forum:

I am a third-year associate in a small law firm. The principal partner (I'll call him "Rayne Maker") has developed a large and successful practice, with white-collar crime defense being foremost among practice areas. For the past several months I have been working closely with one of our white-collar clients ("Buck Sharp"), and have had multiple contacts with him, reviewing his records and drafting documents for his signature.

A few days ago Mr. Sharp came to my office with an envelope. He presented it to me and said it was a gift in appreciation of my efforts on his behalf. In the envelope was a lot of cash – two thousand dollars, in hundred-dollar bills. You can easily imagine my surprise (and joy) counting the bills: A nice birthday present for my wife! (Or five months of student loan payments.) After the initial euphoria passed, I inquired and learned that the firm has no policy on gifts. Up to this point I have told no one about the cash.

As you may have surmised, I would not be writing to the Forum if I felt totally comfortable with receiving and keeping the gift, and not telling Mr. Maker. Are there any rules that might guide me in this?

And, would your advice be any different if Mr. Sharp had said to me: "The only gift I would like in return is your making sure Rayne Maker directs his personal attention to my case and gives it priority"?

Thank you for your help.

Sincerely,
Concerned About the Cash

Dear Concerned:

Fundamentally, this is not just an attorney professionalism question. It is generic, and might arise in other employment settings, especially in the financial services area. Alas, not all professionals hold themselves to the standards that we as attorneys must.

At the outset, there are two important technical issues that bear mentioning. They are matters concerning which you should seek specialized counsel, perhaps among your colleagues at the firm:

- Do the circumstances suggest money laundering, and what obligations might that impose on you – which could be either consistent, or in conflict, with normal client confidentiality rules – under the U.S.A. Patriot Act and other statutes? The law imposes certain reporting obligations and in some cases prohibits telling certain persons (possibly including the client here) that a report is being filed. You need to educate yourself about this and to proceed with caution.
- If you were to conclude that you can keep the money, is it a nontaxable gift or is it taxable income?

As to what to do about the cash, it is important to keep in mind your status as an employee of your firm. Your entire relationship with this client/gift giver arose from that employment, and there appears to be no legitimate basis for the payment other than the work you performed in that context. In addition, this is not a token amount of money, a relatively small personal item or a traditional seasonal gift. One thing therefore appears to be clear: you cannot keep the money without telling your employer.

The recommendation here is that you inform the client that, as appreciative as you are, you cannot accept the cash without informing your firm of the gift and the circumstances under which it was given. This allows you to offer the client your thanks, and the opportunity to take back the cash. If he indicates that he would still like to give it to you, you have left the next step to the firm's management. In either case, the client likely will appreciate your candor. If the gift is taken back, you probably have to inform your firm of what has transpired so that there will be no nasty surprises later.

Some might suggest that you should not tell the client anything, but still report to the firm. However, this approach should be avoided, because the client has the right to know that the money may not be applied as apparently intended. Perhaps more important, your firm should expect that you and all attorneys will deal with clients in good faith and provide full disclosure (unless that disclosure conflicts with statutes such as those referred to above).

If the client insists that you keep the cash, you then must pass it on to the firm with an explanation. The firm can then decide (1) whether to credit it toward the client's obligations to the firm or to treat it as a voluntary increased fee, and (2) whether to give you that amount, or a greater or lesser amount, as a bonus.

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

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

The fact that your firm has no policy on gifts is irrelevant. It may also have no policy on whether you can belch at a client lunch. Some things just do not need to be said. Only in the extremely unlikely event that the firm adopted an explicit policy allowing an employee to accept this large a gift might the result be different. As you yourself suggest, the sum of $2,000 is a big number for you, as it is for almost anyone other than the character in *Barbarians at the Gate* who asked his secretary to "get me an inch of hundreds" to pass out as holiday tips. We're not talking about a ballpoint pen with the client's logo or the like.

Your hypothetical question regarding a request that this client's work be prioritized requires further explanation. If it were no more than an unnecessary reminder to do what you have already been doing, it can probably be ignored. But if you think that the $2,000 was an inducement to get your colleagues to do anything inappropriate, such as devoting additional time and effort to this client's matters at the expense of others, you need to tell your firm that as well.

On a positive note, if you are convinced that the payment was purely a reflection of work well done, you should take that as an indication of your legal prowess and should look forward to representing this client again in the future – perhaps as a member of the firm.

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

QUESTION FOR THE NEXT ATTORNEY PROFESSIONALISM FORUM:

I am in the middle of a dilemma which is all the more disconcerting because it's mainly of my own making. It involves a personal injury action and the derivative claim of a spouse.

About a month ago, a neighbor of mine (Harry) was involved in an automobile accident in which one of his hands was injured. At first the injury didn't appear to be severe, and I was primarily involved in helping him with the no-fault application. About a week later he dropped by my office and we spoke for a few minutes. I then learned that surgery was indicated, and had him sign a retainer (after giving him a reduced fee as a neighbor). I told him that my secretary would type in the details at the top later, which she did, including the client's name, address – and that a loss of services claim would be made on behalf of his wife.

A few weeks afterwards Harry developed complications from the surgery on his hand, and it now appears that he may lose complete use of that hand. This is of course serious, especially in Harry's case, because he earns his living as an auto mechanic.

Yesterday, he was home and recovering, so I stopped by with the Summons and Complaint for him to verify. His first question to me was, "What is my wife's name doing on my lawsuit?" He then went on to tell me that he was planning on leaving his wife as soon as their son graduated from high school, in about a year. Apparently, his wife has no knowledge of these plans.

The news came as a complete shock to me. We live in a relatively small community and we are part of a tightly knit group of traveling "soccer parents." I know his wife well and had just assumed that she would be included as a plaintiff. However, I don't remember actually discussing it with Harry when he signed the blank retainer.

What do I do about the loss of services claim?

Sincerely,
Stuck in the Middle

LANGUAGE TIPS

BY GERTRUDE BLOCK

Question: In general, what is the difference between *lie* and *lay*?

Answer: My thanks to Illinois reader George Miller, who sent the question, which has often been asked in the past but not recently. The answer appears to be simple, but it is really somewhat complicated because usage has changed substantially since the question was first asked. So I can empathize with William Safire who, while discussing his recently revised dictionary, complained that words change meaning so quickly that by the time his dictionary was published, it was already out-of-date.

For the same reason, it is hard to make authoritative assertions about the correct usage of the verbs *lie* and *lay*, which are on my list of "confusing pairs." But it is probably accurate to say that careful writers and speakers, especially those who are 50 years old or older, continue to maintain the distinction between *lie* and *lay*. (I have not asked Mr. Safire, but I assume that he would deplore the loss of that distinction.) In fact, some language purists consider that awareness of the difference between *lie* and *lay* is a shibboleth indicating whether or not a person is well educated.

Traditionally, *lay* is a transitive verb, requiring an object. In the present tense, you *lay* papers on a desk; you *lay* bricks to make a wall; you *lay* down rules. The verb *lay* appears in many other phrases, but they all carry the sense of putting, placing, or setting forth.

Traditionally, *lie* was and still is an intransitive verb that does not take an object. You *lie* down if you are tired; an animal *lies* in wait; in certain cases legal actions might *lie*. Usually *lie* means "recline," as in "lie low," but it also means "to fail to perform," as in "lie down on the job." The verb *lie* also means "fail to tell the truth," a meaning of *lie* that causes no confusion. Were it not for its counterpart *lay*, the verb *lie* would probably not be a problem at all.

The difficulty is that in most people's usage *lay* has encroached on the territory of *lie* because the past tense of *lie* is *lay*, which is also the present tense of the verb *lay*. Below are the paradigms for the two verbs:

lay	laid	laid
lie	lay	lain

If you say, "Last weekend I just lay around," your grammar is impeccable, for you have used the past tense of *lie*. But if you say, "I like to lay around on weekends," you have made a grammatical error because you should use the present tense of *lie*, not the past tense of *lay*. Thus, to be correct, you should say, "I like to lie around on weekends."

But that is not what most people would say. When the large majority of the public speak or write informally, they are thinking about what they are saying, not how they are saying it. So most people ignore the rule about *lie* and *lay*. Instead they use *lay* in both contexts, saying, "Yesterday I laid down for a nap, and I'll lay down again today."

Young people have led the way in expanding *lay* and ignoring *lie*. At this southern law college one invariably hears the phrase *lay out* in contexts like, "We lay out around the pool every afternoon, but yesterday we laid out all day." (Grammatical purists would insist on, "We lie around the pool every afternoon, but yesterday we lay there all day.") The verb *lay* in contexts like this will probably soon be acceptable, and that will be bad news for only an elite few.

Question: Are the verbs *bring* and *take* synonyms? And are they interchangeable?

Answer: No, to both questions. *Bring* and *take* are semantically different. You can say, "Bring the book to my house," only if you are there to receive it. Otherwise you must say, "Take the book to my house." The request to "bring the book along to our meeting," implies that you will be at the meeting to receive it. But you would have to substitute *take* when you say, "Take the book to the meeting" if you will not be there. And you would also say, "Take the book back to the library" if you are not at the library to receive it.

The same egocentricity that causes us to capitalize the pronoun *I*, not other personal pronouns, affects the verbs *bring* and *take*. Here are some illustrations: *Bring the baby to my house.* (I'll be at home to receive her.) *Take the baby to my house.* (Nobody will be there; or somebody else will be.) *Bring your suggestions along to our meeting.* (I'll be there.) *Take your suggestions along to the meeting.* (I won't be there.)

The verbs *come* and *go* are also self-oriented. "*Come* with me; but *go* with other people." "*Come* toward me, but *go* anywhere else." You phone your spouse to say, "I'm coming home," if your spouse will be at home when you arrive." If not, you would say, "I'm going home." The expression "We must come together as a people" implies that I will join in. These illustrations may say as much about relationships as about semantics.

Potpourri:

What seemed obvious during the recent Senate hearings in which Senators questioned General David Petraeus and Ambassador Ryan Crocker about "progress" in Iraq was that the two groups were not speaking the same language. Petraeus and Crocker's definition of the words "winning," "progress," "surge," "success," and even "Al Qaeda," differed from the definition their questioners had in mind. To most Americans, "winning" means that our American military can come home. To General Petraeus and Ambassador Crocker, "winning" seems to mean "progress" toward "success." With no common agreement about the meaning of the terms under discussion, how can an intelligent appraisal of the situation be achieved? ■

Gertrude Block is lecturer emerita at the University of Florida College of Law. She is author of *Effective Legal Writing* (Foundation Press), *Legal Writing Advice: Questions and Answers* (W. S. Hein & Co.), and co-author of *Judicial Opinion Writing* (American Bar Association).

BY ELLIOTT WILCOX

Elliott Wilcox is a professional speaker and a member of the National Speakers Association. He has served as the lead trial attorney in over 140 jury trials, and teaches trial advocacy skills to hundreds of trial lawyers each year. He also publishes *Trial Tips*, the weekly trial advocacy tips newsletter <www.trialtheater.com>.

Roadmaps: Organizing Your Presentation

Have you ever been to a presentation where you listened to a speaker for an hour or more, but then walked away and asked yourself, "What the heck did he just say?"

A speaker I watched recently was entertaining, interesting, and engaging. . . . But he rambled from point to point, place to place, and story to story. There was no cohesive theme to the presentation. There was no logical order to the arrangement of his ideas. When he finished, I had absolutely *no idea* what he was talking about.

The terrible thing was this: I *wanted* to remember what he said. I *wanted* to learn the information. But his organization made it impossible for me to absorb the information.

How about you? Are you making it difficult for your audiences to understand you? Are you preventing them from walking out of the room with your information? As a lawyer, you earn your living by communicating ideas. When judges, juries, or arbitrators can't follow the flow of your ideas, your client suffers. Here are three tips to help you organize your presentations to ensure the decision maker follows your presentation and doesn't get lost.

1. You need to actually organize your presentation. What do you plan to say? What are the major points of your presentation? What do you want the audience to remember?

If you don't know yet, you're not ready to make your presentation. No matter how much you know about the subject, you can't just expect that it's all going to come together once you take the stage, grab the microphone, or rise to address the jury. Very few presenters can "wing it." And even those who can are dramatically better when they *prepare*.

Invest the time in advance to ensure you're properly prepared to present. Outline your presentation on a single page to see if the order flows smoothly. Are the main points grouped together? What are the most important ideas you want the audience to remember? Do they stand out? Until you can answer these questions, you're not organized enough to present. However, once you've actually organized your presentation, the remaining steps will be easy to follow.

2. Tell the audience where you're going. Have you ever given someone a ride and relied on them for directions? Although they knew exactly where they needed to go, did they parcel out the directions on a "need to know basis," shouting out "Turn left!" or "Turn here!" moments before you needed to turn?

How frustrated did you get? Did you miss any turns because you didn't know where you were going or weren't fast enough to follow their directions?

It's easier to travel when you know your destination in advance. That's also true for your audience. They'll have an easier time following your ideas when you tell them in advance, "Here's where we're going." Give them a roadmap for the presentation. If you're going to address three separate issues, tell your audience what the issues are and what order you'll address them in. Tell your audience what path you plan to lead them along, and it will be easier for them to follow you.

3. Point out landmarks along the way. As you lead the audience to their final destination, help the audience identify the landmarks along the journey. The landmarks in your presentation are those major points, ideas, or areas you want them to remember after you're finished. There are several different ways you can point out the landmarks for your audience:

Magic words: "First . . ." "Second . . ." "Third . . ." For example, "The *first* reason the plaintiff's case law doesn't apply to this case is . . ."

Fingers: As you address each point, raise your hand and hold up the number of fingers that correspond to the idea you're presenting.

Visual aids: Show the audience a different slide, poster, or other visual image as you reach each stage of your presentation.

Physical movement: Move to different places on the stage or in the courtroom as you discuss each major point. For example, every time you discuss "damages," you move to the far left side of the jury box.

Where are you leading the audience? To be the guide they can trust you need to know where you're taking them, tell them where you're leading them, and point out the important landmarks along the way. When you do that, your audience will reach their final destination safely, they'll know how they got there, and most importantly, they'll remember how to return to that destination, even after you've left the room. ■

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tence with a preposition whose object (noun or pronoun) appears earlier in the sentence and ending a sentence with a preposition that has no object. Eliminate the preposition at the end of the sentence when it's ungrammatical. *Incorrect example:* "Where is my briefcase at?" In this example, the preposition "at" has no object. *Correct:* "Where is my briefcase?" *Or:* "My briefcase is where?" *Preposition at end of a sentence that has an object:* "What do you need to go to court for?" "Which courtroom is she in?"

Occasionally a sentence must end with a preposition. Otherwise, the sentence will be incomprehensible. Other sentences sound tortured or stilted without a preposition at the end. Here's an example attributed to Winston Churchill, who was talking about the alleged rule not to end sentences with prepositions: "This is the kind of tedious nonsense up with which I will not put."[1] Churchill's line is brilliant, partly because it makes no sense: The preposition is in the middle — not the end — of the sentence. The sentence has lost all meaning. *Correct:* "I will not put up with this kind of tedious nonsense."

Some words that function as prepositions can also function as adverbs, or what grammarians call a phrasal verb. Verbs change in meaning when the adverb is part of the phrasal verb. In Churchill's example above, the verb "to put up with" means "to tolerate," which is different from "to put," meaning "to set" or "to place." Sentences that end with these phrasal verbs appear to end with prepositions, but they really don't. *Examples:* "to get" versus "to get up" and "get by"; "to look" versus "to look up," "to look out," and "to look over"; "to break" versus "to break down" and "to break in"; "to check" versus "to check out" and "to check up on"; "to run" versus "to run over" and "to run down"; "to shake" versus "to shake up" and "to shake down"; and "to blow" versus "to blow up," "to blow over," "to blow out," "to blow off," and "to blow away." *Used correctly in sentences:* "This evening I have four briefs to look over." "The attorney was worried that his witness would break down." "As soon as an attorney interrupted the testimony with an objection, the judge blew up."

> It's a myth that good sentences may not begin with "and" or "but."

Ending sentences with prepositions helps eliminate formality. *Ending in a preposition:* "The attorney I spoke with on the telephone was the attorney I had written to." *Eliminating the preposition at the end:* "The attorney with whom I had spoken on the telephone was the attorney to whom I had written." Both examples are correct. The first one is clearer and less formal than the second example, which needs "with whom" to make sense. Eliminating the preposition from the end of sentences will cause you to add too many "with whoms," "to whoms," and "of whiches."

The greatest emphasis in a sentence is at the end. That's where the sentence carries its weight. On a scale of one to ten, one being the lightest and ten being the heaviest, prepositions are a one: light and airy. Nouns are a five: just right. Adjectives and adverbs are an eight: heavy. Nominalizations (verbs turned into nouns) are a ten: the heaviest. *Example of ending a sentence with a noun:* "She saw the defendant once a month for a year." *Example of ending a sentence with an adjective:* "Of all the judges in New York, he's the one I like the most." *Ending a sentence with an adverb:* "The judge waited patiently." *Ending a sentence with a nominalization:* "After the judge listened to the arguments, she made a decision."

Readers want strong sentences that move them to emphatic climax. Aim to end sentences with powerful words. Ending with a preposition is often a rather weak way to conclude. But from time to time ending a sentence or clause with a preposition will give readers a reprieve from an earlier sentence that ended with a powerful noun. Vary sentence endings. Use light and heavy words to emphasize or deemphasize. Do what's right for you.[2]

3. Using serial commas. Some writers believe it's pointless to insert the last comma in a series.

Serial commas, also known as Harvard or Oxford commas, refer to the commas that separate a series of three or more words or phrases.[3] The last comma in the series — the serial comma — is optional. The goal is to be consistent. Use them always or never. But most legal-writing teachers prefer serial commas. *Examples:* "Before submitting the brief, Tom edited the brief, Marilyn printed the brief, and I prepared the appendix." "After work, Scott enjoys a drink at Reade Street, Lafayette Grill, or Brady's Pub." Don't add commas if you join all the words, phrases, or statements with "and." *Example:* "Before submitting the brief, Tom edited the brief and Marilyn printed the brief and I prepared the appendix."

Those who believe that serial commas are unnecessary contend that the "and" or "or" already separates the final two elements of a series. Others, such as newspapers and magazines, omit serial commas to save space.

Serial commas are helpful for two reasons. They reflect a natural pause in spoken English. Sound out this phrase: "Gavel, robe, and pen." You paused before the "and," didn't you? That's why you need the last comma. Serial commas also promote clarity. *Example:* "Yesterday the police arrested five criminals, two robbers and three burglars." Your reader won't know whether police arrested five or ten criminals.[4] Without a serial comma, your reader might answer "five" or "ten." If you use serial commas, your reader will answer "ten": "Yesterday

the police arrested five criminals, two robbers, and three burglars."

Serial commas are required to divide elements from sub-elements: "Juice, fruits and nuts, and dairy. Or "Juice, fruits, and nuts and dairy." Or "Juice, fruits and nuts and dairy."

Don't use a serial comma before an ampersand. Correct: "Blake, Hall & Johnson."

4. When to correctly split infinitives. H.W. Fowler, the great grammarian and stylist, once wrote the following about split infinitives: "The English-speaking world may be divided into (1) those who neither know nor care what a split infinitive is; (2) those who do not know, but care very much; (3) those who know and condemn; (4) those who know and approve; and (5) those who know and distinguish."[5]

> Your language will be flabby and conclusory if you use weak words like adverbs and adjectives.

An infinitive is the basic form of a verb: "to cry," "to eat," "to read," "to sleep." To split an infinitive is to insert a word or phrase between the component parts of the infinitive. *Example of splitting "to finish":* "She hopes to quickly finish the decision so that she can start another one." *Not splitting:* "She hopes to finish the decision quickly so that she can start another one."

George Bernard Shaw, who loved to split infinitives, once wrote the following note to the *Times* of London: "There is a busybody on your staff who devotes a lot of time to chasing split infinitives: I call for the immediate dismissal of this pedant. It is of no consequence whether he decides to go quickly or to quickly go or quickly to go. The important thing is that he should go at once."[6] The earliest example of splitting an infinitive is in Shakespeare's Sonnet 142: "Root pity in thy heart, that when it grows thy pity may deserve to pitied be." (Splitting "to be.") The most famous example of splitting an infinitive comes from *Star Trek*: "To boldly go where no man has gone before."[7] The TV show would be different had the author written "Boldly to go where no man has gone before" or "To go boldly where no man has gone before."

If you use verbs and nouns instead of adverbs and adjectives, you'll rarely need to think about whether to split infinitives. Achieve power in language by using strong words like nouns and, better, verbs. Your language will be flabby and conclusory if you use weak words like adverbs and adjectives. Think of the adverb "boldly" in the *Star Trek* example. What's "bold" to you is different from what's "bold" to me. Write with power by explaining in a non-conclusory way what makes the going bold.

Splitting some infinitives creates emphasis, secures effective word order, and avoids confusion. *Example 1:* "The clerk is instructed periodically to check the computer." *Example 2:* "The clerk is instructed to periodically check the computer." *Example 3:* "The clerk is instructed to check the computer periodically." Example 1 avoids splitting the infinitive, but it's possibly ambiguous: Is the clerk instructed periodically, or should the checking be done periodically? Example 2 splits the infinitive but makes it clear that "periodically" modifies the verb "check." Example 3 doesn't split the infinitive, but it's ambiguous: Readers might understand that "instructed" rather than "to check" is modified. If you can maneuver the words to avoid splitting the infinitive, then do so.

If you want to split the infinitive and splitting it won't hurt the writing, go ahead and split it. *Example of splitting an infinitive to avoid confusion:* "The law student decided to promptly return the library book." Changing the sentence in the following ways leads to loss of meaning: "The law student promptly decided to return the library book." "The law student decided to return the library book promptly." This example is unclear. You can't tell whether "promptly" goes with "decided" or "return": "The law student decided promptly to return the library book."

Never split an infinitive with a "not." *Incorrect:* "Try to not ever split infinitives."

In the next column, the Legal Writer will discuss more controversies. ■

1. Famous Quotations/Stories of Winston Churchill, *available at* http://www.winstonchurchill.org/i4a/pages/index.cfm?pageid=388 (last visited Apr. 20, 2008).

2. For more, see Gerald Lebovits, Legal Writer, *Do's, Don'ts, and Maybes: Legal Writing Do's — Part II*, 79 N.Y. St. B.J. 64 (June 2007).

3. For more, see Gerald Lebovits, Legal Writer, *Do's, Don'ts, and Maybes: Legal Writing Punctuation — Part II*, 80 N.Y. St. B.J. 64 (April 2008).

4. Readers might answer "none." Those arrested are alleged criminals until they're convicted.

5. Excerpt from H.W. Fowler, A Dictionary of Modern English Usage (1965), *available at* http://www-users.cs.york.ac.uk/susan/cyc/s/split.htm (last visited Apr. 20, 2008).

6. Common Usage Dilemmas, *available at* http://www.infoplease.com/cig/grammar-style/split-infinitives-boldly-go-everyone-else-goes.html (last visited Apr. 20, 2008).

7. The Phrase Finder, *available at* http://www.phrases.org.uk/meanings/385400.html (last visited Apr. 20, 2008). This lead comes from the original *Star Trek* series. The sequel, *Star Trek: The Next Generation*, improved the lead somewhat by making it gender neutral. Instead of the "man," the writers used a "one": "To boldly go where no one has gone before." The sequel retained the redundancy "before." If no one has gone there, no one has gone there "before."

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BY GERALD LEBOVITS

Do's, Don'ts, and Maybes: Usage Controversies — Part I

In the last nine of ten columns, the Legal Writer discussed legal writing's do's and don'ts. The series ends with a list of legal-writing maybes — the things about which experts disagree but about which the Legal Writer will take a position nevertheless. The answers to these maybes, or controversies, don't represent the most important aspects of legal writing. Far more important than resolving the controversies are getting law and fact right; using the right tone and format; adopting good large- and small-scale organization; and knowing your audience and the purpose of your document. But many lawyers, and all Law Review types, focus on the controversies. This two-part column resolves the controversies for the merely curious and especially the Law Review types who believe them important.

1. Starting sentences with transitions. Some legal writers believe that starting a sentence with "also," "and," "but," and "or" is bad style. They're wrong, but there's more to it than that.

Transitions link sentences, paragraphs, and ideas. The best way to move a reader forward is not to link with transitional words like "however" or "but." The best way is to use thesis paragraphs, topic sentences, and thesis sentences, and then to join sentences by ending them with a thought or word used in the beginning of the next sentence or paragraph. Sentences should go from old to new and from short to long. Sentences should end with emphasis.

A weak way to move a reader forward is with transitional words. Writers use them lazily to substitute for the hard work of connecting ideas with ideas. Worse, writers use them in the false hope that they join sentences in logical progression.

Common, weighty, legalistic transitions include "accordingly," "again," "besides," "consequently," "finally," "for example," "furthermore," "however," "indeed," "moreover," "nevertheless," "on the other hand," "otherwise," "then," "therefore," and "thus." If you must begin with transitional words, at least prefer the plain English transitions: "also," "and," "because," "but," and "or." Despite what your sixth grade teacher incorrectly told you, it's better to start sentences with "and" and "but" than with "moreover" and "however." It's a myth that good sentences may not begin with "and" or "but." Conjunctive-adverb transitions like "moreover" and "however" are weak. "Also," "and," "but," and "or" are one-syllable words that start sentences quickly. "Because" is useful in legal writing to describe cause-and-effect relationships. But don't begin sentences with "because" too often. Your writing will be boring. The same is true for all transitions. Whichever transition you use, don't overuse it.

Example of starting sentence with "And": "The attorney cross-examined the witness for five hours. And then the court took a recess." *Example of starting a sentence with "Because":* "Because the parties drafted the contract poorly, they had to resolve their differences in court." *Example of starting a sentence with "But":* "The judge wasn't impressed with his trial techniques. But she was impressed with his writing skills." *Example of starting a sentence with "Or":* "The defendant might take a plea before trial. Or the People might have to try the case and call every witness to the stand."

Notice how the above sentences are stronger without the opening transitions. *No "And":* "The attorney cross-examined the witness for five hours. Then the court took a recess." *No "Because":* "The parties drafted the contract poorly. They had to resolve their differences in court." *No "But":* "The judge wasn't impressed with his trial techniques. She was impressed with his writing skills." *No "Or":* "The defendant might take a plea before trial. The People might have to try the case and call every witness to the stand."

If you must use weighty conjunctive adverbs, don't use them at the beginning of a sentence or paragraph, a point of emphasis. And almost never use them at the end of a sentence, the point of greatest emphasis. Move the conjunction one third into the sentence. *Correct:* "The attorney, however, conceded that the defendant fled the jurisdiction. He argued, nevertheless, that the defendant should not be remanded."

2. Ending sentence with prepositions. Some readers — the purists — are offended by phrases and sentences ending with prepositions like "at," "by," "for," "in," "under." They believe that ending sentences with prepositions is informal and ungrammatical.

Readers sometimes don't recognize the difference between ending a sen-

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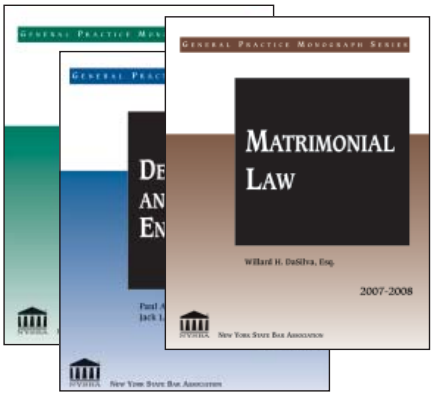

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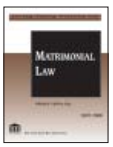

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