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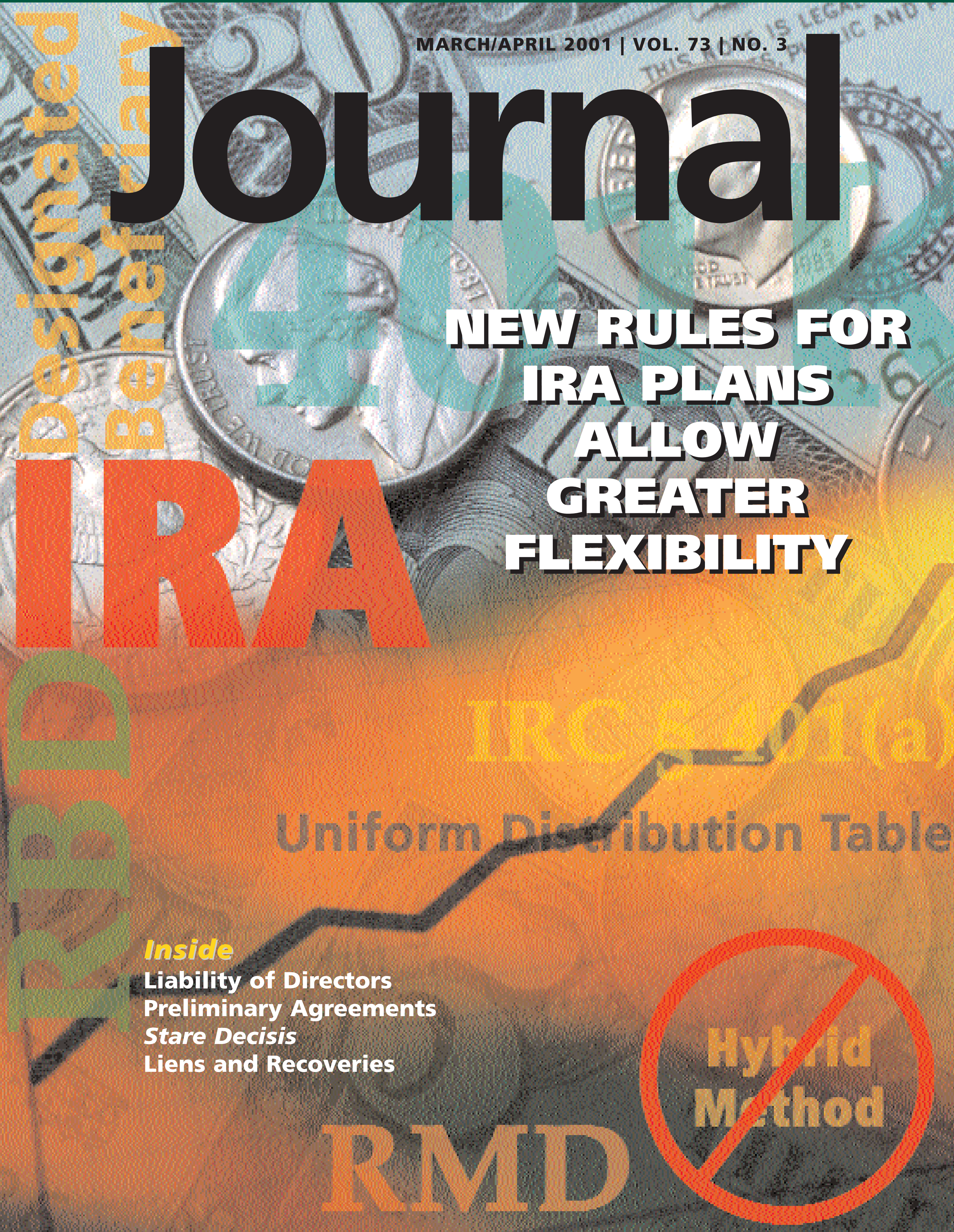
NEW RULES FOR IRA PLANS ALLOW GREATER FLEXIBILITY



Inside

Liability of Directors

Preliminary Agreements

Stare Decisis

Liens and Recoveries

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Contents

Departments

On The Cover

This month's cover illustration reflects a montage of the statutes, terms and acronyms that apply in working with the new Proposed Regulations that the Internal Revenue Service has issued for Individual Retirement Accounts and retirement plans.

Cover design by Lori Herzing

PRESIDENT'S MESSAGE

PAUL MICHAEL HASSETT

Expanding the Role Of the Courts

One of the more significant issues currently impacting the life of those of us who live in western New York involves the construction of another bridge across the Niagara River to Canada. The current bridge, the Peace Bridge, was opened in 1927 and soon will need substantial repairs in order to accommodate the increase in truck traffic which, in the summer months, can stretch all the way across the bridge and for several miles beyond. This means an hours-long wait for the truck drivers and severe congestion for automobile traffic, which is necessarily compressed into a single lane in each direction on the three-lane bridge. The Peace Bridge Authority originally proposed a twin to the existing span but after several years of planning and public hearings, some citizen groups proposed an alternative which would involve demolishing the existing bridge and erecting a modern, more visually attractive bridge. Public opinion was dramatically divided on the issue and the two proposals involved differing bridge plazas and different effects on the surrounding neighborhood so that a relatively protracted controversy arose.

As one might expect, the bridge controversy ended up in Supreme Court in a case centered on the adequacy of the Environmental Impact Statement filed by the Peace Bridge Authority. A single Supreme Court justice was thus put in the position of making a decision affecting the composition of one of the older neighborhoods of our city and the economic life of the entire Niagara frontier, the commercial development of which is in substantial part dependent upon commercial traffic across the bridge. The Court had to consider complicated questions of engineering and urban design as well. All of these issues are well beyond the educational background and general knowledge of most judges and while this case is perhaps unusual because of its particular facts and its influence on the community, it is by no means unusual in terms of its difficulty or scope. And yet individual judges, in the first instance, and appellate courts composed of a few more judges will be called upon to make decisions like this one, decisions of huge import for the lives of millions of people. I admit to a special interest in the problem since our family has spent the summer months in a cottage near Lake Erie in southern Ontario for over two decades and I travel the Peace Bridge twice a day between work and home for a few months of each year. Long traffic delays on hot summer afternoons have heightened my interest in an early solution to this problem, although I recognize that it may now be a long time before the process evolves to the point of decision and actual construction.

Our justice system, founded on the adversarial process, has been forced to meet an increasing burden in our modern society. Courts are required to decide issues of extraordinary complexity every day and the adversarial process requires attorneys to take positions at opposite poles in these controversies, each bolstering their arguments with expert witnesses, leaving the court to align itself with one side or the other or more likely somewhere in between, without benefit of its own expert advisors. Besides deciding cases of daunting complexity, the justice system has, in recent times, been asked to assume jurisdiction over problems that are not readily resolvable in a system originally designed to handle relatively straightforward matters such as basic contracts and torts. For example, the entire problem of substance addiction, unresolvable by executive action or legislative fiat, has been turned over to courts and lawyers to solve. We have been enlisted as the point force in the "war on drugs," a product of America's fascination with quick, highly visible solutions. We have been presented with the alternatives of long-term incarceration for offenders with the attendant huge cost to the correction system or, alternatively, with a never-ending cycle of recidivism. Courts and legislatures have been criticized for being too easy or too tough on drug offenders, depending on one's point of view, or for failing to solve the problem at all. Other serious social problems such as domestic violence, driving under the influence of alcohol, and parental neglect of young children are not easily resolvable in our adversary system but nonetheless are problems which have fallen into the scope of the justice system.

Family courts struggle with their own recidivistic problem—the victim of domestic violence who obtains

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an order of protection which is often ineffective in resolving the underlying conflict. Family violence and drug addiction have forced the entire system of foster care and child custody into the family court arena but the adversarial process is not readily conducive to the solution of these problems. In fact, they are not easily resolvable at all when the "best interests of the child" provides no objective or "bright-line" standard of resolution.

The inability of the traditional system to deal with many of these problems has, at least in New York State, led to what Chief Judge Kaye refers to as "problem-solving courts." In an article in the October 11, 1999 issue of *Newsweek* magazine, she described the problem in these terms:

> Judges grapple with dockets driven by drug abuse, domestic violence and family dysfunction. These are new issues for the courts, and yet judicial responses tend to be firmly rooted in the past. Not surprisingly, in many of today's cases, the traditional approach yields unsatisfying results. . . . Every legal right of the litigants is protected, all procedures followed, yet we aren't making a dent in the underlying problem.

The best-known example of a problem-solving court is the drug court, which began with a single pilot project and has now been expanded throughout the state. Drug courts provide for alternative treatment with startling results: defendants in court-ordered drug treatment have completion rates nearly twice that of those who enter treatment voluntarily. Chief Judge Kaye announced in her State of the Judiciary Address last January that the Unified Court System was instituting integrated domestic violence courts in each judicial department so that all family problems are concentrated in a single court with a single judge rather than having the same family on the docket in two and sometimes three separate courts. There is no longer any question, of course, that dedicated commercial parts have been successful in providing a forum in which New York business can be confident that its disputes will be resolved in a forum specially designed for that purpose.

Problem-solving courts, on the other hand, can and do create problems for the attorneys who practice in them. Representing a client accused of a drug infraction who is eligible for alternative treatment puts the client and attorney in a difficult situation. Admittance to a treatment program is conditioned upon admission of guilt and an attorney who believes that the client has a good chance of acquittal after trial has to consider whether acquittal is really the best option for that client. A plea of guilty to a negotiated charge followed by successful completion of the treatment program can result in dismissal of the charge but the possibility of failure in the treatment program can mean incarceration and, in some cases, place the client in a situation of a multiple-felony conviction. The client will frequently rely on the attorney's advice in order to make the choice and only hindsight can give the attorney a clear vision of the course of action best suited for the client.

Integrated domestic violence courts may also involve issues of criminality not present in the usual family court environment and the solution to the family problem may create an extra burden for one of its members and have an impact on the family's ultimate financial survival. Questions of child custody and foster care present extremely difficult choices. Each party is represented by counsel and there are frequently several mental health professionals with differing views of the appropriate solution. Problem-solving in an adversarial system can present complex issues and the traditional role of the attorney as an advocate for a single client may be seriously compromised. Likewise, this means new functions and broader involvement for judges. The changes impact on how we in the profession work individually, how the courts operate, and what resources are tapped, and in some cases necessitate modification in law, policy and other provisions.

Nonetheless the creation of these nontraditional courts and nontraditional methods of problem resolution are an acknowledgment that the traditional approach was unsuccessful in solving these tremendous societal problems. In her *Newsweek* article, Judge Kaye suggested, "Some may argue that such hands-on involvement clashes with our branch's traditional dignity and reserve. But what's the alternative? The flood of cases shows no sign of letting up. We can either bail faster or look for new ways to stem the tide." And the incentive for attorneys to accommodate themselves to these new ways is compelling. The opportunity to reverse the growing rate of substance addiction or to fashion a solution to domestic violence presents a huge opportunity to increase public trust in our system of justice and the role of our profession in administering that system. The reward—the opportunity to make a real difference in the lives of our clients, not just to achieve a good result—will mean considerable satisfaction for us as well.

Now if someone would just invent a bridge court to help speed my trips back and forth across the Niagara River this summer.

Corporate Officers and Directors Seek Indemnification From Personal Liability

BY JAMES J. COFFEY AND MOHAMED K. GABER

Even relatively unsophisticated corporate officers and directors are coming to the realization that they can be held personally liable for their actions on behalf of their employer corporation. As agents of the corporation, officers and directors are personally liable for their torts even if they are simply following orders.[1] Lawsuits brought by shareholders, employees or third parties against officers or directors, regardless of their merit, are expensive, disruptive and time consuming for both employer and the parties being sued.

Directors and officers are increasingly reluctant to work for a corporation that is unwilling to indemnify them in the event they are sued personally for their corporate acts. This article examines the importance of having a corporation indemnify its officers/directors and illustrates the advantages of indemnification agreements.

Attracting Quality Officers

Advantage The difficult task of attracting quality officers and directors is made easier by offering indemnification as part of an employer's benefit package.

Problem The business community is well aware that officers and directors are often sued personally as a result of their activities on behalf of the corporation. Juries can be unpredictable and, thus, officers and directors run the risk of financial ruin if found liable in a suit in which they are personally named.

The expense of defending even a meritless lawsuit can hold serious consequences for the party named in the action. Because of the financial risk, many capable individuals are unwilling to accept a position as an officer or director unless their employer agrees to indemnify them.

Solution/Analysis Corporations can enter into contracts with their officers/directors that provide for the corporation to indemnify an officer or director named personally in an action for any and all expenses arising from the suit. Insurance is also available to protect officers/directors from employment and environmental claims.

By using insurance, the corporation will be liable only when a claim is not covered by insurance. A 1998 study of more than 1,300 U.S. companies found that approximately 28% of the companies surveyed reported claims against their officers and directors in the prior ten years, and a 1995 study found that 42% of outside directors at Fortune 100 companies had been sued.[2] If the trend continues, it is likely that individuals who have a choice will only select employers who are willing to provide indemnification.

Employer Dissolution

Advantage Provides for the protection of the officer/director if the corporation that originally indemnified the officer/director ceases to exist because of dissolution, merger, consolidation or acquisition.

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Problem Almost all contracts contain a clause that addresses the obligations and responsibilities of "successors and assigns." This is critical in contracts entered into between individuals who do not share the corporate advantage of perpetual life.

However, corporations often voluntarily and sometimes involuntarily terminate their existence. When the corporation that has agreed to indemnify officers/directors terminates its existence, the officers/directors may be left unprotected from a lawsuit. The surviving corporation in a merger may be unwilling to indemnify the officers/directors of the merged corporation unless obligated to do so by contract.

Unless the situation is resolved contractually, officers/directors will be forced to carry an insurance policy that would protect them if they are named in a suit.

Solution/Analysis When negotiating with an corporation about the terms of the indemnification agreement, an officer/director should insist on a clause that deals effectively with this issue.

The successor in interest clause should be very specific in defining what constitutes a successor. For example, a party that purchases the bulk of the employer corporation's assets should be classified as a successor in interest.[3] Finally, the section of the indemnification agreement that deals with binding successors should contain a requirement that a successor assume any obligations associated with the agreement and that the assumption be documented in writing.[4]

Business Judgment Rule

Advantage An indemnification agreement may provide an officer/director with protection from personal liability and legal expenses when the business judgment defense rule does not.

Problem Every day officers make decisions that affect the financial health of the corporation. Directors do the same but on a less frequent basis. Naturally some of the decisions will have a negative impact on the profits of the corporation and ultimately cause financial damages to the shareholders.

A shareholder who believes that he/she has been damaged by the acts of an officer may bring an action against the officer/director individually. The business judgment rule is a common law rule accepted by most courts that has the effect of protecting officers/directors from the consequences of their honest mistakes.[5] The corporation asserting the business judgment rule may agree to advance expenses for legal costs and be responsible for any court-awarded damages. However, the shareholders who are personally suing the officer/director may go to court to obtain an injunction to prevent the corporation from indemnifying the officer/director being sued.[6]

The section of the indemnification agreement that deals with binding successors should contain a requirement that a successor assume any obligations associated with the agreement.

Officers/directors should be aware that courts often subject the business judgment rule to stringent preconditions, and not all honest decisions will be protected.[7]

> For example, the U.S. District Court for the Southern District of New York recently refused to apply the business judgment rule to a special committee's refusal to indemnify a former employee for his defense costs. The court reasoned that the purpose of the business judgment rule is to prevent shareholders from meddling in the day-to-day decisions that have been delegated to the board of directors, and that since the plaintiff was an employee and not a shareholder, the rule had no applicability.[8]

Solution/Analysis The indemnification agreement can include a clause stating that the officer/director is presumed to have acted in such a manner that he/she is entitled to indemnification by the corporation. This places the burden of proof on the shareholders suing the officer/director to demonstrate that the officer/director acted in such a way that he/she was not entitled to indemnification.

What is of critical importance to the officer/director being sued is that he/she is immediately supported by the corporation in terms of the advancement of legal fees to defend the action. An officer/director who cannot rely on an indemnification agreement to advance legal expenses may be forced to use her/his own funds and then wait perhaps several years to obtain a determination as to whether the corporation has the obligation to indemnify the individual.

Corporate Politics

Advantage Creating a corporate culture in which officers/directors can confidently make decisions on behalf of the corporation without fear that they will be undermined by corporate politics.

Problem Officers/directors are aware that corporate politics often play a role in corporate decisionmaking. A weak board of directors contemplating their future election by shareholders may be uncomfortable providing indemnification to an officer/director although it would be legally and ethically proper to do so.

> For example, if a director or officer were publicly accused of sexual harassment, a board might be tempted to determine that no expenses should be advanced to the accused, perhaps on the grounds that such a suit is not brought by "reason of the fact" that the accused was a director or officer, or because the individual could not reasonably have believed that such private conduct was in the best interest of the corporation.[9]

Solution/Analysis A directors' and officers' (D&O) policy combined with an indemnification agreement has the advantage of providing coverage to the employee and political coverage to the board. "Some policies provide that the D&O insurer will advance the cost of the defense of the claim. These provisions may require that the insured agree to repay any sums advanced for claims which are ultimately determined to be uncovered."[10]

Both the officer/director and the corporation are well served by a D&O policy and indemnification agreement that mandate the advancement of funds to defend against actions that personally name officers and directors.

Specific Coverage

Advantage Knowing specifically what expenses the employer corporation is legally obligated to pay in the event the officer/director becomes involved in litigation is of great benefit to both the officer/director and the corporation.

Problem Being involved in litigation is expensive. Employers are properly cautious about spending money that they do not have contractual or actual authority to spend. If the officer/director requesting indemnification is no longer an employee, the employer may be even less inclined to indemnify.

Even if the employer is willing to indemnify the officer/employee, the questions of what expenses are covered and when payment is to be made remain as important issues. Will an officer's/director's expenses be covered if the officer/director is only a witness and not a defendant in the proceeding? Are the expenses involved in an appeal to be included in the indemnification? These are but two of an almost unlimited list of questions that will arise in the course of litigation.

Solution/Analysis Because legitimate issues of what should be covered can arise even when the employer is willing to indemnify, it is not difficult to imagine the problems when the employer is opposed to indemnification. To avoid these problems for both employer and employee, the indemnification should specifically set forth what is covered and what is not.

> "Expenses" shall mean any expense, liability or loss, including attorneys' fees, judgments, fines, ERISA excise taxes and penalties, amounts paid or to be paid in settlement, any interest, assessments, or other charges imposed thereon, and any federal, state, local, or foreign taxes imposed as a result of the actual or deemed receipt of any payments under this Agreement, paid or incurred in connection with investigating, defending, being a witness in, or participating in (including on appeal), or preparing for any of the foregoing, any Proceeding relating to any Indemnifiable Event.[11]

A paragraph similar to the above is very helpful to both employer and employee in clarifying the responsibilities of the employer and avoiding additional litigation to determine who is responsible.

Cancellation of the D&O Policy

Advantage An indemnification agreement between the corporation and its officer/director protects the officer/director in the event that the D&O policy is terminated for any reason.

Problem Large corporations commonly carry D&O insurance. However, the parties to this contract are usually the corporation and the insurance company with the officers/directors being third-party beneficiaries. For a variety of reasons, either the insurance company or the employer may decide to terminate the coverage, leaving the employee unprotected.

For example, an insurance carrier may rescind a policy if the policyholder misrepresented a material fact, even if the misrepresentation was innocent.[12] In fact, the officer/director may be totally unaware that he/she no longer has coverage. This lack of awareness effectively prevents officers/directors from seeking alternative coverage and leaves them exposed if they are personally served.

Solution/Analysis Unlike the insurance contract, the officer/director is one of the parties to the indemnification agreement. These agreements, like most properly drafted agreements, will contain a clause that prohibits any change in the agreement unless both parties agree in writing to the change.

Thus, if the indemnification agreement required the employer to maintain a D&O policy to protect its officers and directors, the employer could not change or modify the policy without the written consent of the officer/director. Indeed, none of the advantages accruing to the officer/director under the terms of the indemnification contract could be changed without the permission of the officer/director.

Employers who include D&O insurance in their indemnification agreements will be hesitant about canceling the insurance without notice to the officer/director because of breach of contract.

Advancement of Funds for Legal Fees

Advantage The advancement of legal fees and expenses reduces the financial burden and stress of offi-

CONTINUED ON PAGE 12

CONTINUED FROM PAGE 10

cers/directors who have been personally named in an action as a result of their activities on behalf of the corporation. Also, it encourages a spirit of cooperation among the parties named in the lawsuit.

Problem The officer/director personally named in a lawsuit must respond to the complaint within a limited period of time and in almost all cases will require the assistance of counsel. Attorneys representing defendants often require substantial retainers before accepting a case.

Within a short period of time, it is likely that either the officer/director or her/his employer will be required to make the first of a series of payments for attorneys' fees and related expenses. If the officer/director is being sued as a result of a decision that, in retrospect, was not profitable for the corporation, the corporation may be hesitant to advance legal expenses unless required to do so by contract.

The agreement should serve as a valuable tool that heightens the awareness of the employer to its obligations in the event one of its employees is sued personally and named in an action.

The employer corporation may have insurance that covers legal expenses but insurance coverage always carries with it a degree of uncertainty.

> The claims department of most insurers concluded that it was in the insurers' best interest to advance defense costs to individual directors and officers when failure to do so meant that the director or officer could not afford to mount a competent defense. Eventually this practical consideration led to policy provisions that gave the insurer the option to advance defense costs. This option, of course, did the individual director or officer little good when the insurer, for whatever reason, decided not to exercise it.[13]

Solution/Analysis The worst-case scenario for any corporation is to have its officers/directors believe that the corporation is unwilling to support them in defending an action that stems from actions that officers/directors took on behalf of the corporation. An "every man for himself" attitude among the defendants, which may include the corporation, helps no one but the plaintiffs who are bringing the action.

An indemnification agreement between the corporation and its officers/directors that contains a clause requiring the corporation to advance expenses to the officers/directors will be very beneficial. A clause mandating the advancement of legal expenses will reduce the chance that the officers/directors will not cooperate with the corporation and each other in defending the suit. In addition, it will relieve the corporation of having to make a potentially uncomfortable decision, *i.e.*, paying for the defense of an officer/director whose decisions were financially damaging for the corporation.

Caution "Historically most states have prohibited the indemnification of judgments and amounts paid to settle derivative suits."[14] However some states, including New York, permit indemnification for costs associated with derivative suits subject to court approval.[15]

Changes to Corporate Charter and By-Laws

Advantage An indemnification agreement between a corporation and its officers/directors, unlike the bylaws of the corporation, requires the consent of the officers and directors before it may be modified.

Problem Corporations may feel uncomfortable entering into an indemnification agreement with their officers/directors. This discomfort may stem from a tradition of not having entered into this type of agreement or a simple desire not to become obligated.

A corporation seeking to assuage the concerns of its officers/directors regarding personal liability may point out to the concerned officer/director that protection concerning this issue is contained in the corporate charter or by-laws. The problem with this type of protection is that it can be changed without the consent of the parties being protected. By the time the litigation is brought, the officer/director frequently is no longer associated with the corporation where the incident occurred. The officer/director may be totally unaware that any changes have been made to the by-laws or corporate charter and, as a result, the individual may be laboring under the false impression that he/she is protected.

Solution/Analysis The best way that officers/directors can protect themselves from this is to require the corporate employer to enter into an indemnification agreement. The agreement, unlike the corporate charter or by-laws, cannot be changed without the consent of the parties. Also, the indemnification agreement could be customized to fit the particular needs of the officers/directors in ways that the charter or by-laws could not.

If the employer corporation refused to consent to entering into an indemnification agreement and tells the officers/directors that the wording in the by-laws or corporate charter is sufficient protection, at a minimum the officers/directors have uncovered the corporate culture on this issue.

Protection for Work With Subsidiaries

Advantage A properly drawn indemnification agreement may provide protection for officers/directors that cannot be covered adequately by D&O insurance because they are active in a variety of subsidiaries in different capacities.

Problem A common way of protecting officers and directors from individual liability is to have the corporation purchase D&O insurance that will provide coverage if the officers/directors are personally named in an action. However, insurance policies naturally must specify who and what is covered under the policy.

An officer/director may be required to assume a function in a newly formed or acquired subsidiary that is not included in the insurance coverage. As a result, if the officer/director is named in an action and the subsidiary is not listed as a covered party in the insurance policy, the officer/director will be forced to look to the parent corporation for indemnification.

Solution/Analysis The existence of a D&O policy does not guarantee that a named officer/director will be entitled to coverage. To protect officers/directors from any gaps in the insurance coverage, the indemnification agreement should contain specific language protecting the officers/directors if they are personally named in an action that resulted from their activities on behalf of a subsidiary not covered under the insurance policy. The language in the indemnification agreement should be broad, providing coverage "by reason of the fact that he is or was a director, officer, employee or agent of the company or is or was serving at the request of the company as a director, officer, employee or agent of another corporation, partnership, joint venture, trust, or other enterprise."[16]

Corporations are often required to react very quickly to opportunities and, as a result, insurance coverage for officers/directors of the newly acquired subsidiary may often lag behind the acquisition process. A corporation may acquire a limited partnership, a limited liability company or another corporation, and the officers/directors of the parent company may hold various positions in the acquired entities.

It is not realistic to expect an officer/director to investigate the exact nature and extent of the insurance coverage of the subsidiaries he/she has been assigned to work for. If the officer/director is named personally in an action and neither the insurance company nor the employer has a legal obligation to indemnify, he/she will be forced to rely on the good will of the employer for protection. In this age of rapid corporate changes, relying on the good will of past or present employers is a dubious proposition at best.

CONTINUED ON PAGE 14

CONTINUED FROM PAGE 13

Statutory Restrictions on Indemnification

Advantage The process of negotiating the indemnification agreement with the corporate employer will bring to light the statutory limits of indemnification and enable officers/directors to make additional agreements to protect themselves.

Problem Employer corporations are limited in what they can do to protect their officers/directors from personal liability. A corporation that is willing to indemnify its officers/directors who have been personally named in an action may discover that its shareholders may have obtained a court order preventing them from taking the desired action. The lack of knowledge on the part of both the employee and employer can have disastrous consequences.

Solution/Analysis "The New York statute provides that a corporation must pay indemnification if the director or officer is successful 'on the merits, or otherwise' in the defense of a criminal action or proceeding."[17] Corporations are not required but are permitted under the law to indemnify officers and directors even if the officers are not successful in court, if they acted in good faith or in criminal cases, where they were unaware their acts were illegal.[18]

"The New York statute permits corporations to purchase insurance to protect officers and directors not only in instances in which the statute permits indemnification, but also in instances in which they may not otherwise be indemnified under the statute."[19] The attorney advising the officer/director presumably will point out the statutory and case law limits of indemnification. In addition, the attorney may suggest that D&O insurance is advisable as well as tailoring the agreement to maximize protection under the state law.

"In other words, the corporation may purchase insurance coverage under circumstances where the permissive indemnification statutes would prohibit indemnification. Consequently, insurance can fill the gap between the directors' and officers' total liability and the amount of corporate indemnification." Without the indemnification agreement, it is unlikely that the limitations of indemnification will be uncovered and compensated for.

Conclusion

No agreement can provide corporate officers/directors with fail-safe type protection against personal liability. If the acts of the officers/directors are egregious enough, statutory or case law may prohibit even a willing employer from protecting the director from personal liability. However, a carefully drawn indemnification agreement can provide protection and peace of mind to officers/directors who are being abandoned by their corporations for political or other self-serving reasons.

It should also be recognized that prudent behavior by the officers/directors is probably the best protection against being personally named in an action. The existence of the agreement should benefit the corporation by empowering its officers/directors so they do not confuse prudence with inaction. Finally, the agreement should serve as a valuable tool that heightens the awareness of the employer to its obligations in the event one of its employees is sued personally and named in an action.

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1. 14a N.Y. Jur. 2d, *Business Relationships*, § 763 (1996).
2. Chew, P.K., Director's and Officer's Liability, Practising Law Institute, § 1.1 (1999) (hereinafter "Chew").
3. Model Agreements & Checklists on CD ROM, Director and Officer Indemnification and Insurance Agreements, § 14 (*Indemnification*), § 15 (*Binding Effect*) (Business Laws, Inc., Sept. 1998), (hereinafter "Model Agreements & Checklists").
4. Beatty, J.F. and Samuelson, S.S., Business Law for a New Century, p. 839 (1996).
5. *Id.*
6. Olson, J.F. and Hatch, J.O., III, Director and Officer Liability, § 1.04 (West 1999) (hereinafter "Olson and Hatch").
7. *Id.* § 1.03.
8. *Id.* § 10.03.
9. Directors' and Officers' Liability Insurance: Deskbooks 93 (David E. Bordon, et al., eds., ABA 1998).
10. *See* Model Agreements & Checklists, *supra* n. 3 (*Certain Definitions*).
11. Directors' and Officers' Liability Insurance: Deskbooks *supra* n. 9 at p. 14.
12. Olson and Hatch, *supra* n. 6 at § 10.07(3).
13. Johnson, A.A., Corporate Officer's and Director's Liability Litigation Reporter, Vol. 14, p. 17 (Andrews Publication Inc., 1999).
14. *Id.*
15. Olson and Hatch, *supra* n. 6 at appendices 8-4-3.
16. *Id.* § 5.04(3).
17. *Id.* § 5.04(4).
18. *Id.* § 5.04(6).
19. Chew, *supra* n. 2 at § 8:3.2.

Federal Courts in New York Provide Framework for Enforcing Preliminary Agreements

By Stephen L. Brodsky

When will an "agreement to agree" be enforceable, and when can you require another party to negotiate with you? New York's federal courts provide a framework for enforcing preliminary agreements that answers both of these questions.

This body of law recognizes that parties at times may intend to commit themselves to a transaction based on a preliminary statement of their agreement even though they intend to sign a final written instrument in the future. In other cases, parties may intend to commit themselves to negotiate a deal and prevent each other from leaving or obstructing the negotiations arbitrarily and in bad faith. In today's fast-paced world, where no one wants to wait until all of the paperwork is done and negotiations are always high-stakes, the enforceability of preliminary agreements is particularly relevant.

Ordinarily, preliminary manifestations of assent do not create binding obligations.[1] Parties who agree to a deal while expecting to negotiate further and to execute additional writings most often agree to non-binding proposals or statements of intent. In *Teachers Insurance & Annuity Assoc. v. Tribune Co.*, however, Judge Leval recognized two kinds of preliminary agreements that are binding and enforceable.[2] The first, which has been referred to as a "fully binding preliminary agreement," is completely enforceable as any contract. The second, termed a "binding preliminary commitment," obligates parties to negotiate in good faith the open and unresolved issues in their agreement.[3] The Second Circuit has categorized these two approaches as "Type I" and "Type II" preliminary agreements respectively.[4]

Parties enter into a Type I "fully binding preliminary agreement" when they agree on all aspects of their negotiation—including that they are bound—even though they contemplate later executing a complete writing that embodies their agreement.[5] This kind of preliminary agreement fully binds the parties to perform their contractual obligations. Although the parties intend to express their agreement more completely in a subsequent writing, they have already formed a contract.[6] Accordingly, even if the parties never execute the later writing, they may still enforce their preliminary agreement as any other contract.[7] They may bring an action for specific performance of the agreement or for damages for its breach. The subsequent writing that the parties desire is merely a formality and is effectively irrelevant.[8]

Parties enter into Type II "binding preliminary commitment" when they agree on certain "major"[9] terms of their agreement while agreeing to negotiate other terms of their agreement that remain open and unresolved.[10] The parties recognize those open issues and commit themselves to negotiate them in good faith within the scope of their preliminary agreement. Parties to this kind of preliminary agreement may not compel performance of the expected contractual obligations, as they are not yet obligated to perform them, but may compel each other to continue negotiations in good faith and to refrain from taking actions that contravene the negotiations.[11] If the parties fail to reach a final agreement after a good faith effort, there is no further obligation upon either.[12]

Policy Considerations

Enforcing these kinds of "agreements to agree" in the appropriate circumstances is beneficial for the marketplace.[13] A fully binding preliminary agreement allows parties to commit to a transaction even when they desire more formal documentation. A binding preliminary commitment prevents parties from arbitrarily abandoning negotiations over an anticipated transaction, and therefore provides an assurance that a deal will falter only over a genuine disagreement.[14]

Continued on page 18

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CONTINUED FROM PAGE 16

Without such an agreement, parties may spend enormous sums negotiating every detail of contract wording without knowing whether they have an agreement, and if so, on what terms.[15] Because contract law aims to "gratify, not defeat expectations,"[16] courts should enforce and preserve agreements that were intended to be binding and in the manner the parties had intended them to be.

Of course, if parties do not intend to be bound prior to executing a complete written contract, their prior agreement is unenforceable.[17] A contract requires mutual intent to be bound—an agreement to enter into a binding contract.[18] Even if parties reach agreement on all disputed terms, if they do not intend to be bound by a statement of their understanding, they have simply agreed to a non-binding proposal or letter of intent.[19] Neither party is obligated to execute the transaction or even to continue negotiating.[20] Courts will not lightly impose binding obligations based on preliminary manifestations of assent. They safeguard a party's right to negotiate free of binding obligations[21] and will accordingly seek to avoid locking parties into "surprise contractual obligations" that were never intended.[22]

The Second Circuit's framework for preliminary agreements, however, provides guidance on when preliminary agreements may be partially or fully binding. Parties should therefore be mindful of the indicia of enforceability that courts consider and guide their conduct accordingly. Although New York's state courts have not formally adopted the Second Circuit's classifications and terminology, state rulings appear consistent with the underlying federal analysis.[23]

Party Intent Governs

Whether a preliminary agreement is binding and enforceable depends upon the intent of the parties.[24] A court will discern party intent, as it would when examining any other contract, from the parties' words and conduct.[25]

The Second Circuit has articulated a four-factor test to determine whether parties have entered into a Type I "fully binding preliminary agreement." The test considers: (1) the language of the agreement, and whether the agreement contains a reservation not to be bound in the absence of a later writing; (2) whether there has been partial performance of the agreement; (3) whether all of the agreement's terms have been agreed upon; and (4) whether the agreement at issue is the kind usually committed to writing.[26] No single factor is dispositive.[27]

The Second Circuit has set forth a similar test to determine whether parties have reached a Type II "preliminary commitment." It also considers the context of the parties' negotiations.[28]

The Agreement's Language The language of the agreement is the first and most critical determinant of party intent.[29] An express reservation in the agreement that neither party is bound absent the execution of a later writing, understandably, demonstrates very strongly that the parties did not intend to be bound by the agreement.[30] The presence[31] or the absence[32] of such a reservation, however, is not decisive, because parties may express their intent not to be bound in many ways.[33]

Courts do acknowledge conventional expressions of intent.[34] Signature lines demonstrate that the parties intended to be bound only upon signing the agreement.[35] Nonetheless, a court will balance the import of signature lines with the language of the agreement.[36] Clauses calling for immediate performance connote a presently binding agreement,[37] while those providing for performance only upon the execution of a later writing indicate the opposite.[38] Merger clauses,[39] statements indicating that open terms are formalities,[40] or provisions that the parties are bound even in the absence of a later instrument[41] are additional strong evidence of a Type I enforceable preliminary agreement. A "handshake" on a proposed deal is not accorded particular significance if the weight of the proof demonstrates that the parties did not intend to make a contract.[42]

Parties to a Type II preliminary commitment must convey, orally or in writing, that they have agreed on the "major terms" of their agreement but have left open certain other terms that they commit themselves to negotiate in good faith.[43] If the parties merely express a generalized intent to negotiate with each other, leaving open terms of too-fundamental importance, a court will most likely view their agreement as a non-binding and unenforceable proposal or letter of intent.[44]

Partial Performance Partial performance of the parties' agreement is the second indication of a fully binding agreement.[45] The partial performance, however, must consist of one party conferring something of value on the other party which the other party has accepted.[46] Mere preparatory acts by one party in anticipation of the agreement are insufficient.[47] A court may also discount even substantial partial performance if the parties had, on balance, demonstrated their intent not to be presently bound to each other.[48]

Terms Left to Negotiate The third benchmark looks to the extent to which the parties have fully agreed upon the terms of their understanding. Provisions stating that the parties have agreed on all aspects of their agreement or merger clauses are, accordingly, highly demonstrative. Yet, parties may bind each other to an agreement even if they have failed to resolve or have omitted cer-

CONTINUED ON PAGE 20

State Law on Preliminary Agreements

New York's state courts apply the same general principles regarding preliminary agreements, but they do not employ the Second Circuit's specific framework of analysis.

Although the New York State Court of Appeals has not formally recognized "binding preliminary commitments," it has recognized a claim for breach of a good faith commitment to negotiate in an exclusive bargaining agreement.[1]

But, where the parties' intent to negotiate is too general and the obligations too fragmentary, the agreement is still an unenforceable "agreement to agree."[2] The state courts follow the same fundamental rules as the federal courts. An enforceable contract must have a "meeting of the minds" regarding the material terms of the transaction.[3]

However, where parties express an intent not to be bound by an agreement until all of the terms are reduced to a signed writing between them, no binding agreement is formed before then.[4]

1. *See Goodstein Constr. Corp. v. City of New York*, 80 N.Y.2d 366, 590 N.Y.S.2d 425 (1992). *See also SNC, Ltd. v. Kamine Eng'g and Mechanical Contr. Co., Inc.*, 238 A.D.2d 146, 655 N.Y.S.2d 47 (1997) (1st Dep't 1997) (citing *Goodstein*). *But see Simone v. N.V. Floresta, Inc.*, 1999 WL 429504 at *9 fn. 3 (S.D.N.Y. June 18, 1999) (calling the concept of a Type II binding preliminary commitment only a "creature of the federal courts" which has not yet been adopted by the New York Court of Appeals).
2. *Yans Video, Inc. v. Hong Kong TV Video Programs, Inc.*, 133 A.D.2d 575, 520 N.Y.S.2d 143 (1st Dep't 1987).
3. *Henri Assocs. v. Saxony Carpet Co., Inc.*, 249 A.D.2d 63, 671 N.Y.S.2d 46 (1st Dep't 1998).
4. *Sheck v. Francis*, 26 N.Y.2d 466, 311 N.Y.S.2d 841 (1970); *Dratfield v. Gibson Greetings, Inc.*, 269 A.D.2d 294, 703 N.Y.S.2d 147 (1st Dep't 2000); *LaRuffa v. Fleet Bank, N.A.*, 260 A.D.2d 299, 689 N.Y.S.2d 59 (1st Dep't 1999).

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tain terms of their understanding. Industry custom and practice[49] or a prior course of dealing between the parties[50] may establish and fix those terms.

The nature and import of any terms that the parties have left unresolved in their agreement understandably affects whether the agreement is enforceable.[51] Whether a Type I binding preliminary agreement has been reached (in view of an agreement upon its terms) appears to be governed by the same principles for contract formation generally—the parties must agree on all of the "essential" or "material" terms of their agreement.[52]

Although New York federal courts typically refer to the terms necessary for contract formation as the "essential" terms of the agreement, some have referred to them as the "material" terms of an agreement, using the parlance of the state courts. The analysis is the same.[53] A court will employ a flexible analysis to determine whether the parties have agreed on the necessary aspects of their agreement, assessing the significance of open terms and drawing upon the subject matter, complexity, and purpose of the agreement,[54] as well as the relation of the parties.[55] A court will, in fact, look through the form of the agreement to its substance when making its determination.[56]

To create a Type II binding preliminary commitment, the parties must agree on certain "major" terms while committing themselves to negotiate in good faith certain remaining open terms of their agreement.[57] One valid question is whether an agreement's "major" terms are the same as its "essential" or "material" terms.[58] Certain federal decisions have equated the terms, and held that a Type II preliminary commitment is enforceable as long as the parties have agreed on the "material" terms of their agreement.[59] A second valid question is the kind of terms that parties may leave open for later negotiation. Decisions conflict on the issue.[60] The critical point, however, is that the parties agree on the significant terms of their agreement and indicate their intent and their commitment to each other to negotiate remaining open issues.[61] A court will not enforce an agreement that is vague and non-definitive or that provides no indication of the parties' intent as to open terms.[62]

Type of Contract at Issue The final factor a court will consider is whether the agreement is the kind that is ordinarily embodied in a writing. Generally, the greater the complexity and magnitude of the dealings envisioned by an agreement, the more likely it is that the agreement would be embodied in a signed complete writing.[63]

Remedies and Enforcement

A binding Type I preliminary agreement is fully binding and enforceable. If the parties have reached a binding preliminary agreement[64] and one party has breached it, the other may enforce the agreement, as any other contract, by an action for damages or specific performance.[65]

However, if the preliminary agreement is premised on certain conditions precedent, a party will not be able to enforce it unless the conditions have occurred. A contract will not arise unless and until those conditions are fulfilled.[66]

As noted, a Type II preliminary commitment may be executed to "prevent a party from arbitrarily renounc-

CONTINUED ON PAGE 22

Continued from page 20

ing a deal, abandoning negotiations, or insisting on conditions that do not conform to the parties' preliminary understanding."[67] A party to a Type II preliminary commitment may enforce such an agreement by seeking equitable relief, *i.e.*, an injunction or specific performance concerning the negotiations, and perhaps, reliance damages.[68]

However, a party cannot recover expectation or "benefit of the bargain" damages, because the agreement simply does not guarantee that the parties will conclude a final contract.[69] Even with good faith efforts on both sides, the deal contemplated by the agreement may still not close, and attributing lost profits to the other party's bad faith abandonment of negotiations is too speculative.[70] One party's failure to negotiate in good faith is not a but-for cause of the other's lost profits.[71]

The enforceability of a Type II preliminary commitment often turns on whether the parties have sufficiently shown that they have committed themselves to good faith negotiations over the open terms of their agreement.[72] If the parties fail to expressly convey their intent to be bound, a court will presume that they merely expressed a general intent to negotiate while remaining uncommitted and free from binding obligations.[73]

A final issue, which New York's federal courts appear to have rarely addressed, is whether a clause in an otherwise non-binding preliminary agreement can be enforceable. One held that a right of first-refusal provision in a non-binding letter of intent was not enforceable, while another, applying non-New York law, upheld a forum selection clause in such an agreement.[74]

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1. *Adjustrite Systems v. GAB Business Services*, 145 F.3d 543, 548 (2d Cir. 1998); *Shann v. Dunk*, 84 F.3d 73, 77 (2d Cir. 1996); *R.G. Group, Inc. v. Horn & Hardart Co.*, 751 F.2d 69, 74 (2d Cir. 1984) ("Under New York law, if parties do not intend to be bound by an agreement until it is in writing and signed, then there is no contract until that event occurs"); *Space Imaging Europe, Ltd. v. Space Imaging L.P.*, 38 F. Supp. 2d 326, 333 (S.D.N.Y. 1999). *Accord Scheck v. Francis*, 26 N.Y.2d 466, 469-70, 311 N.Y.S.2d 841, 843 (1970); *La Ruffa v. Fleet Bank, N.A.*, 260 A.D.2d 299, 689 N.Y.S.2d 59 (1st Dep't 1999).
2. 670 F. Supp. 491 (S.D.N.Y. 1987).
3. *Id.* at 498.
4. *Shann*, 84 F.3d at 77 (first categorizing the agreements in this manner). *See also Adjustrite*, 145 F.3d at 548; *Rappaport v. Buske*, 2000 WL 1224828 *4 (S.D.N.Y. Aug. 29, 2000); *Gorodensky v. Mitsubishi Pulp Sales Inc.*, 92 F. Supp. 2d 249, 254 (S.D.N.Y. 2000); *Simone v. N.V. Floresta, Inc.*, 1999 WL 429504 at *9 (S.D.N.Y. June 18, 1999); *Space Imaging,* 38 F. Supp. 2d at 333.
5. *Adjustrite*, 145 F.3d at 548; *Rappaport*, 2000 WL 1224828 at *4; *Gorodensky*, 92 F. Supp. 2d at 254; *Tribune*, 670 F. Supp. at 498.
6. *Adjustrite*, 145 F.3d at 548; *Rappaport*, 2000 WL 1224828 at *4; *Gorodensky*, 92 F. Supp. 2d at 254; *Tribune*, 670 F. Supp. at 498. *See also V'Soske v. Barwick,* 404 F.2d 495, 499 (2d Cir. 1968) ("the mere fact that the parties contemplate memorializing their agreement in a formal document does not prevent their informal agreement from taking effect prior to that event").
7. *Adjustrite*, 145 F.3d at 548; *Rappaport*, 2000 WL 1224828 at *4; *Gorodensky*, 92 F. Supp. 2d at 254; *Tribune*, 670 F. Supp. at 498.
8. *Adjustrite*, 145 F.3d at 548; *Rappaport*, 2000 WL 1224828 at *4; *Gorodensky*, 92 F. Supp. 2d at 254; *Tribune*, 670 F. Supp. at 498. *See also Scholastic Inc. v. Harris,* 80 F. Supp. 2d 139, 147 (S.D.N.Y. 1999) ("Although the parties also agreed to negotiate in good faith to create the details to facilitate the implementation of the agreed upon terms, the inability to agree further does not vitiate that which was already agreed."); *Cauff, Lippman & Co. v. Apogee Finance Group, Inc.,* 807 F. Supp. 1007, 1021 (S.D.N.Y. 1992).
9. Which terms constitute the "major terms" of the agreement is important and the subject of some confusion in the courts. *See infra*.
10. *Adjustrite*, 145 F.3d at 548; *Rappaport*, 2000 WL 1224828 at *4; *Gorodensky*, 92 F. Supp. 2d at 254; *Tribune*, 670 F. Supp. at 498. *See also Shann*, 84 F.3d at 77 (stating agreement on "certain important terms").
11. *Adjustrite*, 145 F.3d at 548 (a party to the agreement "has no right to demand performance of the transaction"); *Shann*, 84 F.3d at 77; *Rappaport*, 2000 WL 1224828 at *4; *Gorodensky*, 92 F. Supp. 2d at 254; *Simone*, 1999 WL 429504 at *9 fn. 3; *Pan American World Airways, Inc. v. Eclipse Holdings, Inc.*, 1998 WL 205313 (S.D.N.Y. Apr. 27, 1998); *Tribune*, 670 F. Supp. at 498; *Media Sport & Arts v. Kinney Shoe Corp.*, 1997 WL 473968 (S.D.N.Y. Aug. 20, 1997) (finding question of fact whether preliminary binding commitment was executed such that one's party's actions during negotiations contravened it); *Imtrac Indus., Inc. v. Glassexport Co. Ltd.*, 1996 WL 39294 at *9 (S.D.N.Y. Feb. 2, 1996) (remedy for breach of Type II agreement is specific performance, not damages).
12. *Adjustrite*, 145 F.3d at 548; *Rappaport*, 2000 WL 1224828 at *4; *Simone*, 1999 WL 429504 at *9 fn. 3; *Tribune,* 670 F. Supp. at 498.
13. *Tribune*, 670 F. Supp. at 498; *P.A. Bergner & Co. v. Martinez*, 823 F. Supp. 151, 156 (S.D.N.Y. 1993).
14. *P.A. Bergner*, 823 F. Supp. at 156.
15. *Tribune*, 670 F. Supp. at 499; *P.A. Bergner*, 823 F. Supp. at 156.
16. *Tribune*, 670 F. Supp. at 498. *See also Adjustrite*, 145 F.3d at 548; *Rappaport*, 2000 WL 1224828 at *4.
17. *Adjustrite*, 145 F.3d at 548; *R.G. Group*, 751 F.2d at 74 ("Under New York law, if parties do not intend to be bound by an agreement until it is in writing and signed, then there is no contract until that event occurs."); *Rappaport*, 2000 WL 1224828 at *4. *Accord Scheck*, 26 N.Y.2d 466; *La Ruffa v. Fleet Bank*, 260 A.D.2d 299, 689 N.Y.S.2d 59 (1st Dep't 1999); *Brause v. Goldman,* 10 A.D.2d 328, 199 N.Y.S.2d 606, 611 (1st Dep't 1960), *aff'd*, 9 N.Y.2d 620, 210 N.Y.S.2d 225 (1961).
18. *Winston v. Mediafare Entertainment Corp.*, 777 F.2d 78, 80 (2d Cir. 1985); *Aniero Concrete Co., Inc. v. New York City Constr. Auth.*, 2000 WL 863208 (S.D.N.Y. June 27, 2000) ("there must be an overall agreement to enter into a binding contract"); *Universal Reinsurance Co., Ltd.*, 1999 WL 771357 at *4 (Sept. 29, 1999); *Tribune*, 670 F. Supp. at 497 ("more is needed than agreement on each detail, which is

overall agreement (or offer and acceptance) to enter into the binding contract").

19. *Adjustrite*, 145 F.3d at 548 ("if the preliminary writing was not intended to be binding on the parties at all, the writing is a mere proposal, and neither party has an obligation to negotiate further."); *Prudential Ins. Co. of America v. Hilton Hotels Corp.*, 1996 WL 340002 (S.D.N.Y. June 19, 1996) ("a contract cannot be created absent a mutual assent of the parties"); *P.A. Bergner*, 823 F. Supp. at 156 ("even an 'agreement to agree' . . . must meet the requirements necessary for formation of a binding contract").
20. *Adjustrite*, 145 F.3d at 548. *Rappaport*, 2000 WL 1224828 at *4; *Simone*, 1999 WL 429504 at *9 fn. 3; *Accord Brause*, 10 A.D.2d 328.
21. *Winston v. Mediafare Entertainment Corp.*, 777 F.2d 78 (2d Cir. 1985); *Tribune*, 670 F. Supp. at 497.
22. *Adjustrite*, 145 F.3d at 548; *Rappaport*, 2000 WL 1224828 at *4; *Gorodensky*, 92 F. Supp. 2d at 254; *Tribune*, 670 F. Supp. at 497.
23. *See* sidebar.
24. *Adjustrite*, 145 F.3d at 548; *Winston v. Medicafare Entertainment Corp.*, 777 F.2d 78, 80 (2d Cir. 1985); *R.G. Group*, 751 F.2d at 74; *Tribune,* 670 F. Supp. at 498.
25. *Winston*, 777 F.2d at 80. *See also Adjustrite,* 145 F.3d at 548-49. Subjective evidence of intent is generally not considered. *Rule v. Brine, Inc.*, 85 F.3d 1002, 1010 (2d Cir. 1996).
26. *Adjustrite*, 145 F.3d at 548 (applying factors to written proposal that called for negotiation and execution of formal sales agreement); *Winston v. Mediafare Entertainment Corp.*, 777 F.2d 78, 80 (2d Cir. 1985) (applying factors to oral preliminary manifestation of assent). In *Consar Corp. v. Marine Midland Bank*, 996 F.2d 568 (2d Cir. 1993), the Second Circuit had suggested a list of 16 factors.
27. *Ciaramella v. Reader's Digest Ass'n*, 131 F.3d 320, 323 (2d Cir. 1997); *Gottlieb v. Simon,* 1998 WL 684839 at *3 (S.D.N.Y. Sept. 30, 1998); *P.A. Bergner*, 823 F. Supp. at 156.
28. *Adjustrite*, 145 F.3d at 549 fn. 6 (listing the factors as: "(1) the language of the agreement; (2) the context of the negotiations; (3) the existence of open terms; (4) partial performance; and (5) the necessity of putting the agreement in final form, as indicated by the customary form of such transactions") (citing *Arcadian Phosphates, Inc. v. Arcadian Corp*., 884 F.2d 69, 72 (2d Cir. 1989)). *See also R.G. Group*, 751 F.2d at 75-76.
29. *Arcadian Phosphates, Inc. v. Arcadian Corp.*, 884 F.2d 69, 72 (2d Cir. 1989) (in the event there is a writing showing the parties did not intend to be bound, a court "need look no further than the first factor"). *See also Adjustrite*, 145 F.3d at 549 (the first factor is "the most important"); *Rappaport*, 2000 WL 1224828 at *5; *Gottlieb,* 1998 WL 684839 at *2.
30. *RKG Holdings, Inc. v. Simon*, 182 F.3d 901 (2d Cir. 1999); *R.G. Group*, 751 F.2d at 75.
31. *See, e.g., NAP, Inc. v. FRAJAC*, 104 F.3d 350 (2d Cir. 1996) (unpublished disposition) (text statement in letter that "the terms contained herein shall not be effective until the Agreement is fully executed" is "not strong enough to counter other indicia of an intent to be bound" including other text, no open material terms, and extensive performance); *I.R.V. Merchandising Corp. v. Jay Ward Prods., Inc.,* 856 F. Supp. 168 (S.D.N.Y. 1994) (finding issues of fact despite language in memorandum contemplating drafting later contract); *P.A. Bergner & Co., v. Martinez*, 823 F. Supp. 151, 156 (S.D.N.Y. 1993) ("intention to enter into [agreement] if and when it received the approval of the Bankruptcy Court" did not foreclose possibility of a prior oral "agreement to agree").
32. *Adjustrite*, 145 F.3d at 550 fn. 7; *Media Sport,* 1997 WL 473968; *Tribune,* 670 F. Supp. at 499.
33. *See, e.g., Arcadian,* 145 F.3d at 549 (non-binding agreement was contingent "upon execution of other contracts; *Winston v. Mediafare Entertainment Corp.,* 777 F.2d 78, 80 (2d Cir. 1985) (correspondence referred to "proposed agreement"); *R.G. Group*, 751 F.2d at 76 (agreement stated "when duly executed"); *Reprosystem, B.V. v. SCM Corp.*, 727 F.2d 257, 262 (2d Cir.), *cert. denied*, 469 U.S. 828 (1984) (stating that "when executed and delivered, this [agreement] will be a valid and binding agreement"); *Spencer Trask Secs., Inc. v. Financial Web.com, Inc.*, 2000 WL 1239101 (S.D.N.Y. Aug., 31, 2000) phrase "Please let me know if my understanding of our agreement is in any way incorrect" interpreted as an express reservation not to be bound); *I.R.V. Merchandising Corp., v. Jay Ward Prods, Inc*., 856 F. Supp. 168 (S.D.N.Y. 1994) (parties to pay "[w]hen we receive our lawyers' go ahead per a contract to be signed. . . .").
34. *See, e.g., Ward v. Pricellular Corp.,* 1991 WL 64043 at *7 (S.D.N.Y. Apr. 16, 1991) ("agreement in principle" or "subject to execution of definitive Formal Agreements describes non-binding agreement"); *Henchman's Leasing Corp. v. Condren*, 1989 WL 11440 (Feb. 8, 1989) (recognizing the use of the words "agreement in principle" to describe when parties have "reached a common understanding on fundamental terms of a proposed contract but have not resolved all details and have not made a legally binding commitment.").
35. *See, e.g., Lightwave Technologies, Inc. v. Corning Glass Works*, 725 F. Supp. 198, 200 (S.D.N.Y. 1989) *Accord Jevremov v. Crisci*, 129 A.D.2d 174, 177, 517 N.Y.S.2d 496, 498 (1st Dep't 1987).
36. *See, e.g., Adjustrite*, 145 F.3d at 550 (noting that although document contained signature line for acceptance of offer, it nowhere stated that it became a binding agreement upon signature); *Grupo Sistemas Integrales De Telecomunicacion v. AT&T Communications, Inc*., 1994 U.S. Dist. LEXIS 11896 (S.D.N.Y. Aug. 19, 1994); *Tribune*, 670 F. Supp. at 499 *Accord Drago v. Credit Life Ins. Co.*, 210 A.D.2d 579, 620 N.Y.S.2d 154 (3d Dep't 1994).
37. *I.R.V. Merchandising Corp., v. Jay Ward Prods, Inc.,* 856 F. Supp. 168 (S.D.N.Y. 1994) (one party's encouragement to other to contact prospective licensees).
38. *See Silverite Constr. Co. Inc. v. Montefiore Med. Center,* 239 A.D.2d 336, 657 N.Y.S.2d 196 (2nd Dep't 1997) (plaintiff would begin construction only after formal contract); *Oursler v. Women's Interart Center, Inc.,* 170 A.D.2d 407, 566 N.Y.S.2d 295, 297 (1st Dep't 1991) (defendant filmmaker willing to proceed only after a signed agreement).
39. *Scholastic Inc. v. Harris*, 80 F. Supp. 2d 139 (S.D.N.Y. 1999) (clause that agreement "constitutes the entire agreement between [us]" and that it "shall remain a complete and mutually binding agreement" evidenced present intent to be bound even if negotiations on drafting more detailed agreement failed).
40. *See Keis Distribs., Inc. v. Northern Distrib. Co.*, 226 A.D.2d 967, 968-69, 641 N.Y.S.2d 417, 419-20 (3d Dep't 1996) writing directed plaintiff "to accept this offer by signing below" and suggested retaining counsel to work out the "wording of the final details").
41. *Adjustrite*, 145 F.3d at 548; *Tribune,* 670 F. Supp. at 498. *See, e.g., Scholastic Inc.*, 80 F. Supp. 2d 139 (joint venture agreement that referenced parties' intention to "enter into a long form agreement" but stated that until such agreement was negotiated and executed the agreement was "complete and mutually binding" held enforceable).

42. *See Ciaramella*, 131 F.3d at 325 (statement "[w]e have a deal" was not explicit waiver of signature requirement); *R.G. Group Inc.*, 751 F.2d at 73 (summary judgment appropriate despite party believing it entered into a "handshake deal"); *Cleveland Wrecking Co. v. Hercules Constr. Corp.*, 23 F. Supp. 2d 287, 293 (E.D.N.Y. 1998) ("handshake" of no particular significance); *Mellencamp v. Riva Music Ltd.*, 698 F. Supp. 1154, 1168 (S.D.N.Y. 1988) ("wholly ephemeral assertions" that handshake evinces firm agreement in some circles are "inadequate as a matter of law"); *Davidson Pipe Co., v. Laventhol & Horwath*, 1986 WL 2201 at *5 (S.D.N.Y. Feb. 11, 1986) (oral statement "we have a deal" insufficient to bind parties who reserved right to be bound by executed written contract).
43. *Cleveland Wrecking*, 23 F. Supp. 2d at 297. *See, e.g., Media Sport & Arts v. Kinney Shoe Corp.*, 1997 WL 473968 at *12 (S.D.N.Y. Aug. 20, 1997) (question of fact based on language); *P.A. Bergner*, 823 F. Supp. at 158; *Tribune*, 670 F. Supp. at 499; *Teachers Ins. & Annuity Ass'n of America v. Butler*, 626 F. Supp. 1229 (S.D.N.Y. 1986).
44. *See Gordensky v. Mitsubishi Pulp Sales Inc.*, 92 F. Supp. 2d 249, 255 (S.D.N.Y. 2000) (letter states that party "is prepared to enter into a commercial agreement" and "it is our intent to enter into a contract."); *Prudential Ins. Co. of America v. Hilton Hotels Corp.*, 1996 WL 340002 at *8 (S.D.N.Y. June 19, 1996); *Tribune*, 670 F. Supp. at 497.
45. *R.G. Group*, 751 F.2d at 75-76. *Viacom Int'l Inc. v. Tandem Prods., Inc.*, 368 F. Supp. 1264, 1270 (S.D.N.Y. 1974), *aff'd*, 526 F. 2d 593 (2d Cir. 1975) (partial performance "is strong circumstantial proof that the minds of the parties had met on the essential elements, and that they were not waiting for a formal written instrument."). *Accord Metro-Goldwyn-Mayer, Inc. v. Scheider*, 40 N.Y.2d 1069, 1070-71, 392 N.Y.S.2d 252, 253 (1976).
46. *Cleveland Wrecking Co. v. Hercules Construction Corp.*, 23 F. Supp. 2d 287, 296 (E.D.N.Y. 1998) (where one party's performance did not confer a benefit on the other, it did not constitute partial performance).
47. *R.G. Group*, 751 F.2d at 75 (forming a partnership in order to facilitate the transaction is not partial performance); *Rappaport*, 2000 WL 1224828 at *6 (requesting vacation time); *Universal Reinsurance*, 1999 WL 771357 at *6 (renting office space).
48. *Adjustrite*, 145 F.3d at 550; *Arcadian*, 884 F.2d at 72-72.
49. Hutner v. Greene, 734 F.2d 896, 900 (2d Cir. 1984). *See also Simone*, 1999 WL 429504 at *8 (noting that some unresolved terms in real estate transaction can be resolved by "local custom"). *Accord Cooper Square Realty, Inc. v. A.R.S. Management Ltd.*, 181 A.D.2d 551, 581 N.Y.S.2d 50, 51 (1st Dep't 1992).
50. *Cleveland Wrecking Co.*, 23 F. Supp. 2d at 294. *See Eli Attia Architects v. Safra*, 1996 WL 480721 at *4 (S.D.N.Y. Aug. 23, 1996).
51. *Adjustrite*, 145 F.3d at 550 (noting that preliminary agreement "did not include . . . many of the terms usually found in an employment contract, such as a description of the employee's duties and responsibilities and termination, non-competition, and proprietary information provisions.").
52. *Adjustrite*, 145 F.3d at 548; *Shann*, 84 F.3d at 77 (agreement on "essential terms"); *Durante Bros. & Sons, Inc. v. Flushing Nat'l Bank*, 755 F.2d 239, 252 (2d Cir.), *cert. denied*, 473 U.S. 906 (1985); *Brookhaven Housing Coalition v. Solomon*, 583 F.2d 584, 593 (2d Cir. 1978); *Rappaport*, 2000 WL 1224828 *4; *Michael Coppel Promotions v. Bolton*, 982 F. Supp. 950, 953 (S.D.N.Y. 1997).
53. *Shann*, 84 F.3d at 77-78 n. 3 (recognizing that New York federal courts refer to the terms necessary for contract formation as "essential terms," while New York state courts commonly refer to the same terms as the "material terms" of a contract, yet recognizing trend in New York state courts to comport with federal terminology of "essential terms"). *But see In re Windsor Plumbing Supply Co.*, 170 B.R. 503, 523 n. 5 (Bankr. E.D.N.Y. 1994) ("A material term is any term properly bearing upon the subject matter of the contract. Essential terms are those items whose agreement is prerequisite to the formation of a contract."). *Joseph Martin, Jr. Delicatessen, Inc. v. Schumacher*, 52 N.Y.2d 105, 109, 436 N.Y.S.2d 247, 249 (1981) (agreement unenforceable if "material term" is left for future negotiations); *Chan v. Bay Ridge Park Hill Realty Co.*, 213 A.D.2d 467, 623 N.Y.S.2d 896 (2d Dep't 1995) (enforceable agreement if agreement on "essential terms").
54. *See, e.g., Shann*, 84 F.3d at 77-78 (2d Cir. 1996) (terms of employment contract and non-compete agreement had "no importance," were a "fiction" and not part of the "guts of the deal"); *Ginett v. Computer Task Group, Inc.*, 962 F.2d 1085, 1099 (2d Cir. 1992) (contract's non-compete clause was not essential); *Lande v. Radiology Specialists*, 806 F. Supp. 1084, 1092 n. 11 (S.D.N.Y. 1992) (disputed contract provision was not essential).
55. *Shann v. Dunk*, 84 F.3d 73, 77-78 (2d Cir. 1996). *Accord Cobble Hill Nursing Home, Inc. v. Henry & Warren Corp.*, 74 N.Y.2d 475, 548 N.Y.S.2d 920, 923 (1989).
56. *Shann*, 84 F.3d at 77-78. *See supra* n. 54.
57. *Adjustrite*, 145 F.3d at 548, *Rappaport*, 2000 WL 1224828 at *4; *Spencer Trask Secs., Inc. v. Financial Web.com, Inc.*, 2000 WL 1239101 at *2 (S.D.N.Y. Aug. 31, 2000); *P.A. Bergner*, 823 F. Supp. at 158; *Tribune*, 670 F. Supp. 499.
58. In an unpublished disposition, *NAP, Inc. v. FRAJAC*, 104 F.3d 350 (2d Cir. 1996), the Second Circuit stated that a "[b]inding commitment to negotiate in good faith towards a contract may be created by preliminary agreement on *major terms*, even though *important terms* of the ultimate contract remain open." (emphasis added).
59. *Ward*, 1991 WL 64043 at *6 ("where material terms have been agreed upon, an obligation to negotiate in good faith unresolved non-material terms may be enforced"); *Henchman's Leasing Corp. v. Condren*, 1989 WL 11440 at *4.
60. *Compare Shann*, 84 F.3d at 77 ("Type II is where the parties recognize the existence of open terms, even major ones, but, having agreed on certain important terms, agree to bind themselves to negotiate in good faith to work out the terms remaining open."); *Media Sports & Arts v. Kinney Shoe Corp.*, 1997 WL 473968 at *8 (S.D.N.Y. Aug. 20, 1997) (same). *But see Ward*, 1991 WL 64043 at *6 (only "non-material" terms may be left open). *See also Imtrac*, 1996 WL 39294 at *8 fn. 6 (as to the nature of the open terms, the question is "how many and how minor.").
61. *Ward*, 1991 WL 64043 at *6 ("Whether a provision in a preliminary agreement obligating the parties to negotiate in good faith is enforceable depends on the materiality of the terms remaining to be negotiated and the degree to which the content of the remaining terms can be discerned from the preliminary agreement.").
62. *See Cleveland Wrecking*, 23 F. Supp. 2d at 294 (parties gave no indication of intent to bind themselves to negotiate a specific unanticipated occurrence); *Imtrac Indus., Inc. v. Glassexport Co. Ltd.*, 1996 WL 39294 at 9 (S.D.N.Y. Feb. 2, 1996) (writing not binding, where it "set[ ] forth no concrete terms or obligations; both in form and substance"); *Candid Prods., Inc. v. Int'l Skating Union*, 530 F. Supp. 1330 (S.D.N.Y. 1982) (agreement "to negotiate in good faith"

the contract renewal unenforceable where all material terms were left open). *See also Tribune*, 670 F. Supp. at 497 (agreement which "leaves open terms of too fundamental importance" is "incapable of sustaining binding legal obligation); *Prudential,* 1996 WL 340002 at *8 (noting too many terms left open); *Imtrac*, 1996 WL 39294 at *8 (agreement too "fragmentary" is not binding); *Lieberman v. Good Stuff Corp.*, 1995 WL 600864 at *3 (S.D.N.Y. Oct. 11, 1995) (letter left open material terms). *Accord Martin, Jr. Delicatessen Inc. v. Schumacher*, 52 N.Y.2d 105, 436 N.Y.S.2d 247 (1981) (provision that lease may be renewed "at annual rentals to be agreed upon" unenforceable).

63. *Gottlieb v. Simon,* 1998 WL 684839 at *3 (S.D.N.Y. Sept. 30, 1998) (observing that corporate buyout, employment agreement and acquisition agreements indicated need for a completed writing). *See also Adjustrite,* 145 F.3d at 551 (transaction required "a formal contract complete with representations and warranties and the other standard provisions usually found in sophisticated formal contracts."); *Winston*, 777 F.2d at 83 (involving a $62,500 transaction); *R.G. Group.*, 751 F.2d at 77 (initial investment of $2 million). *See also Spencer Trask Secs., Inc. v. Financial Web.com, Inc.*, 2000 WL 1239101 (S.D.N.Y. Aug. 31, 2000) (any settlement agreement for more than a "trifling amount" should be in writing) (citation omitted).

64. *See Adjustrite*, 145 F.3d at 550 (affirming grant of summary judgment where three of the four factors indicated parties did not intend to be bound until formal documents were executed); *Arcadian*, 884 F.2d at 72-73 (affirming grant of summary judgment dismissing breach of contract action even though there was "considerable partial performance"); *Winston*, 777 F.2d at 83; *Gottlieb,* 1998 WL 68439 at *2.

65. *Adjustrite*, 145 F.3d at 548; *Rappaport*, 2000 WL 1224828 at *4; *Gorodensky*, 92 F. Supp. 2d at 254; *Tribune*, 670 F. Supp. at 498. *See Scholastic,* 80 F. Supp. 2d at 147 (binding preliminary agreement for joint venture despite intent to execute long form agreement); *Michael Coppel Productions*, 982 F. Supp. at 953 (oral contract upheld); *Krauth v. Executive Telecard, Ltd.*, 890 F. Supp. 269 (S.D.N.Y. 1995) (finding binding preliminary agreement reached, but declining to award injunction and specific performance under the facts presented).

66. *Aniero Concrete Co., Inc. v. New York City Constr. Auth.*, 2000 WL 863208 (S.D.N.Y. June 27, 2000) (preliminary agreement unenforceable due to failure of condition precedent); *Cleveland Wrecking Co.*, 23 F. Supp. 2d at 299 (parties not bound by preliminary oral agreement because condition precedent, approval from third party for use of access point, did not occur).

67. *Adjustrite*, 145 F.3d at 548; *Rappaport*, 2000 WL 1224828 at *4; *Pan Am Corp. v. Delta Air Lines, Inc.*, 175 B.R. 438, 502 (S.D.N.Y. 1994); *P.A. Bergner*, 823 F. Supp. at 156; *Tribune*, 670 F. Supp. at 498. *See, e.g., Media Sport*, 1997 WL 473968 at *13 (question of fact whether party "cut off the negotiations" and asserted in bad faith that "an impasse existed" without giving the other a chance to offer an acceptable solution).

68. *Pan American World Airways, Inc. v. Eclipse Holdings, Inc.*, 1998 WL 205313 at *8 (S.D.N.Y. Apr. 27, 1998) (finding that one party did not reasonably rely on promises in negotiations, declining to award damages for expenses in reliance); *Media Sport & Arts v. Kinney Shoe Corp.*, 1997 WL 473968 (S.D.N.Y. Aug. 20, 1997) (finding question of fact whether Type II preliminary binding commitment was executed such that one's party's actions during negotiations contravened it); *Imtrac Indus., Inc. v. Glassexport Co. Ltd.*, 1996 WL 39294 at *9 (S.D.N.Y. Feb. 2. 1996) (proper remedy for breach of a Type II agreement is specific performance, *i.e.*, "good-faith negotiation of a conclusive contract," not damages); *Space Imaging Europe, Ltd. v. Space Imaging L.P.*, 1988 WL 190356 (S.D.N.Y. Apr. 21, 1998) (preliminary injunction in context of letter of intent);. *But see Teachers Ins. & Annuity Assoc. of America v. Ormesa Geothermal,* 791 F. Supp. 401 (S.D.N.Y. 1991) (holding that lending commitment letter was preliminary commitment to negotiate in good faith remaining terms, that borrower breached it by insisting on pretextual conditions to abandon deal, and awarding lost interest income to lender). The subject of reliance damages is discussed in *Goodstein Constr. Corp. v. New York*, 80 N.Y.2d 366, 590 N.Y.S.2d 425 (1992).

69. *Gordodensky*, 92 F. Supp. 2d at 254 (finding that the remedy of lost future profits is unavailable for breach of a duty to negotiate in good faith); *Imtrac Indus., Inc. v. Glassexport Company Ltd.,* 1996 WL 39294 at *9 (S.D.N.Y. Feb. 2, 1996) (an expectation damages award "presupposes the culmination of the contemplated definitive contract, such that a repudiation of the preliminary agreement essentially amounts to a breach of the contract in its final form."); *Inside Out Prods., Inc. v. Scholastic Inc.*, 1995 WL 375927 (S.D.N.Y. June 23, 1995) ("it cannot be known what agreement would have been reached") (citation omitted); *Tribune*, 670 F. Supp. at 498. *Accord Goodstein Constr. Corp. v. New York*, 80 N.Y.2d 366, 375, 590 N.Y.S.2d 425 (1992).

70. *Arcadian*, 884 F.2d at 74 n.2; *In Re 131 Liquidating Corp.*, 44 F. Supp. 2d 552, (S.D.N.Y. 1999) (denying expectancy damages); 1 Farnsworth Contracts § 3.26a at 314 (an "award based on [the expectation interest] would give the injured party the 'benefit of the bargain' that was not reached. But if no agreement was reached and . . . it cannot even be known what agreement would have been reached, there is no way to measure the lost expectation"); *Goodstein*, 80 N.Y.2d 366, 590 N.Y.S.2d 425 (1992).

71. *Arcadian,* 884 F.2d at 74 n.2; *Teachers Ins. & Annuity Assoc. of America v. Ormesa Geothermal,* 791 F. Supp. 401 (S.D.N.Y. 1991) (action by lender against prospective borrower for breach of commitment letter); *Gorodensky*, 92 F. Supp. 2d at 255 n.2; *Inside Out*, 1995 WL 375927 at *2 (expectation damages are "totally speculative"). *Accord Goodstein Constr. Corp. v. New York*, 80 N.Y.2d 366, 372, 590 N.Y.S.2d 425, 428 (1992) (holding that reliance damages can be awarded for breach of good faith commitment within an exclusive bargaining agreement, and declining award expectation damages).

72. *P.A. Bergner*, 823 F. Supp. at 158; *Tribune*, 670 F. Supp. at 499; *Media Sport*, 1997 WL 473968 at 12; *Cleveland Wrecking*, 23 F. Supp. 2d at 296.

73. *Prudential Ins. Co. of America v. Hilton Hotels Corp.*, 1996 WL 340002 (S.D.N.Y. June 19, 1996) (holding agreement unenforceable); *Roberts v. Atlantic Recording Corp.*, 1995 WL 386552 (S.D.N.Y. June 29, 1995) (commitment to negotiate is too vague); *Ogden Martin Systems of Tulsa, Inc. v. Tri-Continental Leasing Corp.,* 734 F. Supp. 1057, 1067 (S.D.N.Y. 1990); *Candid Productions, Inc. v. International Skating Union,* 530 F. Supp. 1330, 1334 (S.D.N.Y. 1982) (good-faith negotiation clauses were held so vague and indefinite that they were unenforceable).

74. *Space Imaging*, 38 F. Supp. 2d at 334-37 (no proof that parties' intent not to be bound did not similarly apply to the provision). *Compare Lexington Inv. Co. v. Southwest Stainless, Inc.*, 697 F. Supp. 139 (S.D.N.Y. 1988) (applying Texas law and transferring action on forum selection clause in letter of intent containing non-binding provision).

New Rules Offer Greater Flexibility And Simpler Distribution Patterns For IRAs and Pension Plans

By Susan B. Slater-Jansen and Avery E. Neumark

After 13 years of following a set of complicated and confusing pension distribution rules, the Internal Revenue Service has published new Proposed Regulations[1] that greatly simplify those issued in 1987[2] but never made "final."

This article focuses on how the new Proposed Regulations affect owners of Individual Retirement Accounts, but the rules generally apply also to participants in qualified employer-sponsored retirement plans,[3] subject to rules and options within those plans. Similar rules are promised "in the near future" for deferred compensation plans covering employees of governmental and non-profit organizations.[4]

The proposed effective date is January 1, 2002. For 2001, however, IRA owners have the option to rely on either the new Proposed Regulations or the 1987 version when determining required distributions for calendar year 2001.[5] (See the box on page 31 for details on the implementation schedule.)

The most dramatic changes allow a significantly slower pace for required distributions from most of these accounts during an owner's lifetime, substantially greater flexibility in determining who should receive the funds after the owner's death, and potentially large tax savings as a result of these changes.

To "improve compliance" with the rules, however, IRA custodians will be required to report, both to the owner and to the Internal Revenue Service, the amount of the distribution that is required in each calendar year.[6]

Required Distributions During Lifetime

The single most dramatic change for almost all living account owners is that the pace of their annual Required Minimum Distributions will now be universally governed by the assumption that they have chosen an after-death beneficiary who is ten years their junior. The only exception involves owners who chose as their Designated Beneficiary a spouse who is ten years their junior; they will continue to be able to use a life expectancy based on their actual ages.

Until now, unless account owners had a much-younger spouse, they had one of four measuring methods: their own life expectancy,[7] a life expectancy figure based on their age and the actual age of the person they were choosing[8] as their Designated Beneficiary provided that the person was less than ten years younger, a life expectancy based on calculations that applied when a Designated Beneficiary was ten years or more younger, or a so-called "hybrid" method.[9]

Under these old rules, an account owner aged 70 who had no Designated Beneficiary was assumed to have a life expectancy of 16 years, and if the account balance was $160,000 on December 31, the Required Minimum Distribution in the next year was $10,000. If the owner had named a Designated Beneficiary aged 67 and the joint life expectancy option was used, their assumed

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Some Basic Terms Used in IRAs and Retirement Plans

The following terms apply when working with the minimum distribution rules[1] for Individual Retirement Accounts (IRAs) and various types of employment-related retirement plans.[2]

Required Minimum Distribution (RMD) This is the minimum amount that must be withdrawn from an IRA each year beginning with the year the account owner reaches age 70½.[3] The first year's withdrawal may be delayed, however, until April 1 of the following year (see Required Beginning Date).

Each year's RMD is determined by dividing the owner's aggregate account balances as of December 31 of the previous calendar year[4] by the Applicable Divisor (see below), a figure based on life expectancy tables.

Except for the extension to April 1 that is allowed for the first distribution, each year's RMD must be made by December 31 of that distribution year. Postponing the first required distribution until the following April 1 does not affect the need to take a distribution for the second distribution year. The RMD for the second year must still be taken by December 31 of that year. However, the first-year December 31 account balance, which is used in calculating the second-year distribution, can be reduced by the amount withdrawn to satisfy the first-year RMD.[5]

The penalty for not taking an RMD can be 50% of the difference between the RMD and any lesser amount actually distributed.[6]

Any distribution in excess of the amount required for the first year, when taken in the second year on or before April 1, can be credited toward the distribution required by December 31 of the second year.[7] Otherwise, distributions greater than the required minimum cannot be used to reduce the RMD in subsequent years.[8]

Required Beginning Date (RBD) This is the April 1 deadline for taking the first Required Minimum Distribution, even though the distribution is actually due in the previous calendar year. The rules effectively provide an automatic one-time extension to allow extra time for financial planning.

Applicable Divisor This is a number that reflects the anticipated distribution period, the number of years in which distributions will be made from an account.

During the account owner's lifetime, the Applicable Divisor is the figure taken from the Uniform Distribution Table corresponding to the owner's age in the applicable distribution year. The only exception applies when the account owner's sole Designated Beneficiary is a spouse more than ten years younger. In this case, the Applicable Divisor is taken from the Joint Life and Last Survivor Expectancy Table which provides for a longer distribution period.[9]

For the year following the year of the owner's death, the Applicable Divisor is based upon the life expectancy of the oldest Designated Beneficiary calculated using the beneficiary's attained age in that year. That Applicable Divisor is reduced by one for each subsequent year.[10]

Designated Beneficiary This must be a living person. Otherwise, the account will be treated as having no Designated Beneficiary.[11] In effect, any designee other than a living person has a life expectancy of zero, thereby precluding any option to spread distributions over a designated life expectancy. However, if a trust is designated and certain conditions are met,

CONTINUED ON PAGE 28

joint life expectancy was 22 years, and the Required Minimum Distribution for the next year was $7,273. If the Designated Beneficiary was 60 or less and the joint life expectancy option was used, the Required Minimum Distribution was $6,107.

Under the new Proposed Regulations, regardless of whether the owner has a Designated Beneficiary and regardless of the age of any Designated Beneficiary (except for a spouse more than ten years the owner's junior), the joint life expectancy of the owner and a 70-year-old Designated Beneficiary is assumed to be 26.2 years. The Required Minimum Distribution from a $160,000 account in the owner's 70th year is thus universally $6,107.

The new universality in determining minimum distributions is made possible by the use of a Uniform Distribution Table[10] (see page 38) provided in the new Proposed Regulations. It is actually a duplicate of the Minimum Distribution Incidental Benefit Table[11] that previously applied when a non-spousal Designated Beneficiary was more than ten years younger than the owner.[12] The $6,107 Required Minimum Distribution that would now apply to an account owner aged 70 would have been available in the past only if the owner had a non-spousal beneficiary either exactly age 60 or some younger age.

The advantages of the new system also apply to account owners who wish both a charity and an individ-

CONTINUED FROM PAGE 27

the beneficiaries of the trust may be treated as Designated Beneficiaries.[12]

Before the account holder's death, all except those who designate a spouse more than ten years younger as the sole beneficiary use the Uniform Distribution Table to obtain the Applicable Divisor, without regard for the age of a Designated Beneficiary.

After the account holder's death, the beneficiary designations may be subject to adjustments until December 31 of the year following the year of account holder's death. These adjustments might include removal of a beneficiary by timely and voluntary disclaimer to allow a younger contingent beneficiary's life expectancy to be considered. For an account with multiple beneficiaries, these adjustment might also include division of the account into separate accounts for each beneficiary to limit the impact that the oldest beneficiary would have on the pace of distributions. This could be especially helpful when an entity with no life expectancy, *i.e.*, a charity, is named along with living beneficiaries on a single account. The terms of the beneficiary designations will determine whether such adjustments are available. As was true under the old rules, beneficiary designations can take on the scope and complexity of the designations used in a will or trust.

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1. REG-130477-00, 1/17/2001, Fed. Reg. Vol. 66, no. 11, p. 3928 (*amending* Required Distributions from Retirement Plans Prop. Reg. §§ 1.401(a)(9), 1.403(b)-2, 1.408-8, 54.4974-2).
2. These include Government Deferred Compensation Plans under IRC § 457, as well as IRC § 403(b) retirement accounts including Tax-Deferred or Tax-Sheltered Annuities ("TDAs" or "TSAs") and Qualified Retirement Plans including 401(k)s and other Profit-Sharing Plans. The RMD rules for IRAs and retirement plans are nearly the same. For brevity, this summary references IRAs only but footnotes note differences applicable to retirement plans.
3. Retirement plan account holders can wait until the calendar year they retire if it is later than the year they reach age 70½. Persons who own 5% or more of the employer sponsoring the retirement plan cannot wait until retirement.
4. For IRAs, it is always December 31. Prop. Reg. § 1.408-8, A-6. If a retirement plan does not follow a calendar year, the valuation date is the end of the plan's fiscal year ending in the prior calendar year. Prop. Reg. § 1.401(a)(9)-5, A-3.
5. Prop. Reg. § 1.401(a)(9)-5, A-3(c)(2).
6. Prop. Reg. § 54.4974-2, A-1.
7. Prop. Reg. § 1.401(a)(9)-5, A-3(c)(2).
8. Prop. Reg. § 1.401(a)(9)-5, A-2.
9. Prop. Reg. § 1.401(a)(9)-5, A-4(b).
10. Single life expectancies are found in the table at Reg. § 1.72-9, Table V, § 1.401(a)(9)-5, A-6.
11. Prop. Reg. § 1.401(a) (9)-4, A-3.
12. Prop. Reg. § 1.401(a) (9)-4, A-5.

ual to receive the remaining funds after their deaths, and to those who do not identify a Designated Beneficiary and either name a charity as the beneficiary or allow the funds to be payable to their estates at death. Because neither a charity nor an estate has a life expectancy, even a dual designation of a charity and an individual meant that an owner did not have a Designated Beneficiary. The owner's Required Minimum Distribution was thus governed solely by the owner's life expectancy.[13] Now even these individuals can take the smaller Required Minimum Distributions formerly available only to owners who had a "real-life" beneficiary ten years younger.

In succeeding years, the new computation of the Required Minimum Distribution uses the Applicable Divisor for the owner's age in the Uniform Distribution Table, regardless of whether there is still a Designated Beneficiary or whether the Designated Beneficiary has been changed to anyone other than a spouse more than ten years the owner's junior.

Effect on Married Couples Among the major beneficiaries of the change are husbands and wives whose age difference is less than ten years. All were previously required to use the rules that applied to non-spousal Designated Beneficiaries, a rule that prevented many from keeping more of the principal intact so it could grow at tax-deferred rates and leave more for the potentially greater financial needs of the surviving spouse. (See **Example 1,** page 29.)

When the age difference between a husband and wife is more than ten years, the Required Minimum Distribution is based on their birthdays in each successive calendar year, using the Applicable Divisor found in the Joint Life and Last Survivor Table[14] (relevant excerpts are printed here on page 36). The new Proposed Regulations require a spouse to be alive the entire year in order to use this exception.[15] (See **Example 2,** page 29.)

Quandaries Eliminated in Choosing Method The new rules also eliminate the need to consider choosing

Rules for Computing Required Distributions

Example 1 Effect on married couples of the new rules for calculating life expectancies:

Roseann's IRA account balance on December 31 in the year before she reached age 70½ was $1 million. Her birthday is July 6th, so she will actually reach her 71st birthday in the year she reaches age 70½. Roseann's Designated Beneficiary is her husband, Kevin, who will be 73 in that same year.

Under the old rules, Roseann's Applicable Divisor for her first RMD would have been 19 and her first RMD would have been $1 million ÷ 19 = $52,632.

Using the Uniform Distribution Table that now applies, her Applicable Divisor is 25.3, even if she does not have a Designated Beneficiary. Her first RMD is $1 million ÷ 25.3 = $39,526.

Example 2 Applicable Divisor when spouses' age difference is more than ten years:

On his Required Beginning Date, Donald, a widower, named his children as Designated Beneficiaries of his IRA. After taking three Required Minimum Distributions using the Uniform Distribution Table, at age 74 he marries Daisy, age 44.

The next year he names Daisy as his Designated Beneficiary. Donald is now 75, Daisy is 45, and their joint life expectancy from the Joint Life and Last Survivor Table is 38.1 (compared with 21.8 from the Uniform Distribution Table). The following year, their joint life expectancy is 37.1.

The net result is that Donald's Required Minimum Distribution each year is less, and more assets will remain in the account over a much longer period.

Example 3 Effect of ability to fix the Designated Beneficiary after death:

Alice, a widow, designates a charity to receive $100,000 of her 401(k) death benefit, and her son, Regis, to receive the balance.

Alice would be treated as not having a Designated Beneficiary unless distribution of the $100,000 to charity is made before December 31 of the year following the year of her death. If the charitable distribution is made, Regis will be her Designated Beneficiary.

Example 4 Applicable Divisor when there is ultimately no Designated Beneficiary:

Jane died at age 76 without naming a Designated Beneficiary to receive her 401(k) death benefit, and the plan document did not provide a Default Designated Beneficiary. Her life expectancy in the year of her death was 11.9 years.

The Applicable Divisor that her estate must use in the year after her death is 10.9 years. In subsequent years, it will be 9.9, 8.9, 7.9 years, etc.

Example 5 Applicable Divisor when a non-spouse is ultimate Designated Beneficiary:

Steven died at age 80. His wife, Jean, his primary Designated Beneficiary, died two years earlier. Steven had named as his contingent Designated Beneficiary a qualifying trust for the benefit of his children.

Steven had not taken his Required Minimum Distribution in the year of his death. His children will have to withdraw his RMD prior to December 31 of that year using 17.6 as the Applicable Divisor, as provided in the Uniform Distribution Table for a person age 80. As long as a copy of the trust is delivered to the IRA custodian by December 31 of the year following Steven's death, the RMD to the children that year will be based on the Applicable Divisor in the Single Life Expectancy Table for the age of the oldest child who is a Designated Beneficiary. The Applicable Divisor will decrease by one in each subsequent year until the benefit is fully distributed.

the "recalculation" method that was formerly an option. Those who selected it, instead of the "term certain" method that froze the Applicable Divisor at the owner's life expectancy on the Required Beginning Date, faced the prospect that after their deaths any Designated Beneficiary other than a spouse would face a premature heavy tax burden.[16] Unless the spouse survived the owner, the entire account balance had to be distributed in the year following the death of the owner, and income taxes were due immediately on all the proceeds.

The motivation for the recalculation method, however, was the dilemma faced by those who chose the "term certain" method—if they lived more years than expected, their accounts would be depleted at the end of the "term certain."

In effect, the consistent use of the Uniform Distribution Table provides every owner with the advantages of the "recalculation" (the Applicable Divisor changes with each advancing year to reflect the owners' revised

CONTINUED ON PAGE 31

Examples of Rollover Rules

Example 6 John has named his wife Myra as beneficiary of his IRA. Myra has her own IRA and has designated her husband, John, as her beneficiary. John dies first at age 73 and Myra has already reached her own Required Beginning Date.

After taking the Required Minimum Distribution for the year of John's death based on their life expectancies from the Uniform Distribution Table (using their ages in the year of his death), she can place the balance of her husband's IRA funds in a new rollover-spousal IRA, name a new Designated Beneficiary, and the distributions will be based on the Applicable Divisor in the Uniform Distribution Table for her age. Each year Myra must take separate distributions from the rollover-spousal IRA and from the IRA she owned before her husband died.

On Myra's death, the Designated Beneficiary of the rollover-spousal IRA will be treated as a non-spouse beneficiary, even if it is her new husband. If she has named her new husband the Designated Beneficiary of her own original IRA, however, at her death he will be the sole spousal Designated Beneficiary of that account.

Suppose, however, that Myra was 58 at her husband's death.

She must take the minimum distribution that her husband would have been required to take in the year he died, but she can then place the remaining funds in a rollover-spousal IRA of her own. She may not make further withdrawals from her spousal-rollover IRA until she reaches 59½. When she reaches her Required Beginning Date, she must take separate distributions each year from the rollover-spousal IRA and her own IRA; she will not be allowed to withdraw an amount from one equal to the total distribution required from both.

If she leaves the funds in her husband's IRA account and does not elect to treat it as her own, the normal rules for a surviving spouse Designated Beneficiary will apply (*i.e.*, she must start her Required Minimum Distributions in the year after her husband's death).

If she elects to treat her husband's IRA as her own, if the IRA or plan document permits (many plans do not allow this), she may take no further withdrawals until she reaches age 59½ (or she would generally be subject to "early distribution" penalties. Nothing would need to be withdrawn until she reaches 59½. Most plans would not allow her to treat it as her own.

If she wants to name her children as beneficiaries, the best strategy will likely be to start new rollover IRAs for each of her children. In this way, the Applicable Divisor will be taken from the Uniform Distribution Table during her life. At her death, it will be based on each child's age in the year after her death.

Example 7 Douglas designated Cynthia, his surviving spouse, as sole Designated Beneficiary of his 401(k) plan. Douglas was 73 and Cynthia was 70 when he died.

On December 31 of the year before Douglas's death, his account balance was $470,000 after the distribution was made for that year. In the year of his death, the Applicable Divisor from the Uniform Table was 23.5. The minimum distribution to Cynthia in the year of his death was $470,000 ÷ 23.5 = $20,000.

At the end of the year in which Douglas died, the account balance, after the deduction of the $20,000 distribution and the posting of interest and dividends for the year, was $482,900.

Cynthia elects not to place the funds in a rollover-spousal account. In the year after her husband's death, Cynthia is 71 and the Applicable Divisor from the Single Life Expectancy Table is 15.3. The required distribution is $482,900 ÷ 15.3 = $31,562. Assuming that interest and dividends on the $482,900 during the year had yielded $33,802, the year-end balance in the account is $485,140.

The next year, at age 72, Cynthia dies. Douglas had designated their grandson, Ray, as his contingent beneficiary. In the year of Cynthia's death, the Applicable Divisor used to calculate the minimum distribution to Ray is 14.6, the same figure that would have applied to a person age 72 if Cynthia had lived. Thus the minimum distribution is $485,140 ÷ 14.6 = $33,229.

In the first year after Cynthia's death, the Applicable Divisor will be 13.6. In later years it will be 12.6, 11.6, etc.

If, instead, Cynthia had elected to place the funds in a rollover-spousal IRA, the Required Minimum Distribution in the year of Steven's death would still have been $20,000. She would have to withdraw the amount before she could place it in a spousal-rollover IRA.

Assume that Cynthia then named her grandson, Ray, as her Designated Beneficiary. The next year, at age 72, the Applicable Divisor is 24.4, using the Uniform Distribution Table, and the Required Minimum Distribution is $485,140 ÷ 24.4 = $19,883. After the distribution, the account balance, assuming 7% interest, is $499,217.

If she dies at age 73, Ray must take out the amount that would have had to be distributed to her if she had lived, using the Applicable Divisor from the Uniform Distribution Table: $499,217 ÷ 23.5 = $21,243. Assuming 7% interest, the account balance would then be $512,919.

The next year, the Applicable Divisor would be 12.9, calculated using the Single Life Expectancy Table for Cynthia's age at death, 13.9, minus one. The Required Minimum Distribution to Ray in that year would thus be $512,919 ÷ 12.9 = $39,761. In each subsequent year, the Applicable Divisor would be one less than it was the previous year, until all the funds were exhausted.

CONTINUED FROM PAGE 29

actuarial life expectancy), without the potential tax disadvantages that formerly arose at death.

Choosing the Designated Beneficiary

In the past, the size of the Required Minimum Distribution based on the age of the owner and the Designated Beneficiary could not be adjusted after the Required Beginning Date. Before the Required Beginning Date, an account owner could periodically change the chosen Designated Beneficiary, but the deadline for a final decision was the Required Beginning Date. From that point onward, distributions were based on the age of the Designated Beneficiary on the Required Beginning Date. The choice of the actual beneficiary or beneficiaries could still be changed at some later point during life, but the pace of distributions based on the age of the Designated Beneficiary on the Required Beginning Date could not be changed.

At death, the distribution pattern based on the age of the Designated Beneficiary was locked in—it was either a required minimum based on the age of the oldest of the last individual(s) named if the Required Beginning Date had not arrived, or an amount based on the age of the Designated Beneficiary named no later than the Required Beginning Date.

The lack of any opportunity to adjust the designation after the Required Beginning Date often led to large income tax burdens for the Designated Beneficiary. It also meant the loss of the ability to keep the funds in a tax-sheltered account where they could grow and permit greater distributions subject to lower income taxes in future years when the Designated Beneficiary was retired and in a lower income tax bracket.

Under the new Proposed Regulations, the final identification of the Designated Beneficiary does not need to be made until December 31 of the year following the year of the owner's death. The executor of the owner's estate cannot name a Designated Beneficiary if the owner's account (or plan documents) made no provision for one, but if the owner did name a Designated Beneficiary and/or a contingent Designated Beneficiary, the persons named have options that were formerly unavailable.

Among those who may use this flexibility are sons and daughters who are financially secure themselves and would prefer to see a parent's funds go to their children. The son or daughter can decline to be the beneficiary, stepping aside in favor of a child identifiable under the plan documents as a contingent beneficiary. The account owner's grandchild would then become the Designated Beneficiary (assuming that this approach does not create problems with the generation-skipping tax rules). Distributions would proceed at a slower rate based on the age of the grandchild in the year following the year of the owner's death (see the charts on pages 32 and 33).

In other cases, one or more individuals named as Designated Beneficiaries may wish to be cashed out for the amounts due to them, leaving the funds that remain to be distributed to one or more other individuals who were also named as Designated Beneficiaries. Those who are not cashed out will become the official Designated Beneficiary of the remaining funds and required distributions will begin in the year after the owner's death. The pace of required distributions will now be

CONTINUED ON PAGE 34

Implementation Dates

The anticipated effective date for the new Proposed Regulations is January 1, 2002, for owners of IRAs and for plan participants.

Owners of IRAs may use the new rules for distributions required after January 1, 2001,[1] but the new rules were not available for use in calculating distributions for 2000, even if the actual distributions could be delayed because April 1, 2001, was the Required Beginning Date.

Participants in qualified plans may be able to use the new Proposed Regulations for distributions required after January 1, 2001, but their ability to do so depends on whether the plan adopts a Model Amendment that was published with the new Proposed Regulations.[2] The Internal Revenue Service will not issue determination letters with respect to the adoption of the Model Amendment, however. Any plans that are now being amended to conform to other Internal Revenue Service requirements should separately adopt the Model Amendment (it is one paragraph long).

A public hearing on the changes is to be held June 1, 2001, in Washington. Anyone who wishes to speak must submit written comments and an outline of the topics and the time to be devoted to each topic. A signed original and eight copies of the document must be submitted by to the Internal Revenue Service by May 11, 2001.

IRA owners and other beneficiaries who rely on the new Proposed Regulations before they are made final will not be penalized.[3]

1. Prop. Reg. § 1.401(a)(9)-1, A-2.
2. Preamble to Proposed Regs.
3. *Id.*

Owner Dies Before Required Beginning Date[1]

	Distribution Pattern	Applicable Divisor
Spouse Is Sole Designated Beneficiary	The first of the RMDs* must be made by the later of: (1) December 31 of the calendar year following the year when the owner died, or (2) December 31 of the year when the owner would have been 70½.[2] ——— The spouse may select one or more Designated Beneficiaries to receive any funds remaining at her/his death.[3] If the spouse dies before the first date for RMDs, the spouse is treated as the owner and the appropriate rule in the next three boxes is used.[4]	Select from the Single Life Expectancy Table, using the surviving spouse's actual age in the first year. In subsequent years, use the surviving spouse's age in that year.[5] ——— After the spouse dies, use the Single Life Expectancy Table and choose the spouse's age at death for the first distribution. In each subsequent year, reduce the figure by 1.[6]
Non-Spouse Is Sole Designated Beneficiary	The first of the RMDs* must be made by December 31 of the year following the year of the owner's death.[7] ——— The Designated Beneficiary can name one or more Designated Beneficiaries to receive any remaining benefits when he/she dies.	Select from the Single Life Expectancy Table, using the Designated Beneficiary's age in the first year. In subsequent years, deduct 1 from the figure used in the previous year.[8]
Multiple Designated Beneficiaries	The first of the RMDs* must be made by December 31 of the year following the year of the owner's death,[9] even if the spouse is one of the beneficiaries.[10] (Until the deadline, the beneficiaries have the option to place the funds into separate accounts, dividing all income, gains, losses and expenses on a pro rata basis.#)	Select from the Single Life Expectancy Table, using the age of the oldest Designated Beneficiary in the first year.[11] (If separate accounts have been created, each account uses the age of the account's beneficiary.[12]) In subsequent years, deduct 1 from the figure used in the previous year.[13]
No Designated Beneficiary	The funds must be paid to the owner's estate, a charity or non-qualifying trust using the Five-Year Rule.[14]	

*—A plan may specify, however, that the Five-Year Rule applies.
#—The title for each sub-IRA must retain the name of the deceased IRA owner (*e.g.*, Metropolis Bank as Custodian for Clark Kent, deceased IRA, fbo Lois Lane).

1. These rules apply even if the decedent had begun receiving installments before the RBD. Prop. Reg. § 1.401(a)(9)-2, A-6(a).
2. Prop. Reg. § 1.401(a)(9)-3, A-1(a), A-3(b).
3. Prop. Reg. § 1.401(a)(9)-5, A-7(d).
4. Prop. Reg. § 1.401(a)(9)-4, A-4(b).
5. Prop. Reg. § 1.401(a)(9)-5, A-5(a)(1), A-5(c)(2).
6. Prop. Reg. § 1.401(a)(9)-5, A-5(c)(2).
7. Prop. Reg. § 1.401(a)(9)-3, A-1(a), A-3(a).
8. Prop. Reg. § 1.401(a)(9)-5, A-5(b), A-5(c)(1).
9. Prop. Reg. § 1.401(a)(9)-3, A-1(a), A-3(a).
10. Prop. Reg. § 1.401(a)(9)-5, A-7.
11. Prop. Reg. § 1.401(a)(9)-5, A-7(a).
12. Prop. Reg. § 1.401(a)(9)-8, A-2.
13. Prop. Reg. § 1.401(b)(9)-5, A-5(b), A-5(c)(1).
14. Prop. Reg. § 1.401(a)(9)-3, A-1(a), A-2; Prop. Reg. § 1.401(a)(9)-4, A-3.

Owner Dies On or After Required Beginning Date

If not already made before death, a distribution must be made from the account for the amount that would have been required for the year in which the owner died.[1]

	Distribution Pattern	Applicable Divisor
Spouse Is Sole Designated Beneficiary	The first of the RMDs* must be made by December 31 of the year following the year of the owner's death.[2] ——— The spouse can name one or more Designated Beneficiaries to receive the remaining benefits when he/she dies. If there is a remarriage and the new husband or wife is named, that person will not be treated as a spouse for this account; the rules below for a non-spouse will apply.	Select from the Single Life Expectancy Table, using the surviving spouse's age in the first year. In subsequent years, use the spouse's age in that year.[3] ——— After the spouse dies, use the Single Life Expectancy Table and choose the spouse's age at death for the first distribution. In each subsequent year, reduce the figure by 1.[4]
Non-Spouse Is Sole Designated Beneficiary	The first of the RMDs* must be made by December 31 of the year following the year of the owner's death.[5] ——— The Designated Beneficiary can name one or more Designated Beneficiaries to receive any remaining benefits when he/she dies.	Select from the Single Life Expectancy Table, using the Designated Beneficiary's age in the first year. In subsequent years, deduct 1 from the age used the previous year.[6]
Multiple Designated Beneficiaries	The first of the RMDs* must be made by December 31 of the year following the year of the owner's death.[7] (Until the deadline, the beneficiaries have the option to place the funds into separate accounts, dividing all income, gains, losses and expenses on a pro rata basis.#)	Select from the Single Life Expectancy Table, using the age of the oldest Designated Beneficiary in the first year. In subsequent years, deduct 1 from the figure used in the previous year.[8] (If the beneficiaries have divided the accounts, the rules are not clear but they appear to indicate that each account uses the age of the oldest Designated Beneficiary as if the accounts had not been divided.)
No Designated Beneficiary	The first of the RMDs,* must be made by December 31 of the year following the year of the owner's death.[9] The likely recipient(s) will be the estate, a charity, a non-qualified trust or an individual who was not named as a Designated Beneficiary or Contingent Designated Beneficiary and could not succeed to the role after a disclaimer by a Designated Beneficiary.	Select from the Single Life Expectancy Table. In the first year, use the age the owner was or would have been on her/his birthday in the calendar year of death. In subsequent years, deduct 1 from the figure used in the previous year.[10]

*—A plan may specify, however, that the Five-Year Rule applies.
#—The title for each sub-IRA must retain the name of the deceased IRA owner (*e.g.*, Metropolis Bank as Custodian for Clark Kent, deceased IRA, fbo Lois Lane).

1. Prop. Reg. § 1.401(a)(9)-5, A-4(a)(1).
2. Prop. Reg. § 1.401(a)(9)-5, A-5(a).
3. Prop. Reg. § 1.401(a)(9)-5, A-5(a)(1), A-5(c)(2).
4. Prop. Reg. § 1.401(a)(9)-5, A-5(c)(2).
5. Prop. Reg. § 1.401(a)(9)-5, A-5(a).
6. Prop. Reg. § 1.401(a)(9)-5, A-5(a)(1), A-5(c)(1).
7. Prop. Reg. § 1.401(a)(9)-5, A-5(a).
8. Prop. Reg. § 1.401(a)(9)-5, A-5(a)(1), A-5(c)(1).
9. Prop. Reg. § 1.401(a)(9)-5, A-5(a).
10. Prop. Reg. § 1.401(a)(9)-5, A-5(a)(2), A-5(c)(1).

Importance of Backup DB

To avoid the possibility that a Designated Beneficiary's death could leave an account with no Designated Beneficiary,[1] account owners should always name a contingent Designated Beneficiary.

In addition, now that the choice of a Designated Beneficiary and any contingent Designated Beneficiary is not locked in at the Required Beginning Date for an account, owners need to be alert to the ability to name other potential Designated Beneficiaries if their circumstances change.

It may also be prudent for an owner's Power of Attorney to specifically give the agent authority to change a Designated Beneficiary or name a contingent Designated Beneficiary if conditions change after the owner has become incapacitated.

1. The Proposed Regulations note that the fact that an owner's "interest under the plan passes to a certain individual under applicable state law does not make the individual a designated beneficiary unless the individual is designated as a beneficiary." Prop. Reg. § 1.401(a)(9)-4, A-1.

CONTINUED FROM PAGE 31

governed by the age in the year following the owner's death of either the final Designated Beneficiary or the oldest Designated Beneficiary if multiple individuals were named and the accounts have not been split up (see the charts on pages 32 and 33).

Another benefit of this flexibility occurs when the owner has named an entity such as a charity to receive a portion of the funds and an individual to receive the rest. In the past, because the charity did not have a life expectancy, there could be no Designated Beneficiary at all. Now, if the funds are paid to the charity before December 31 of the year following the owner's death, the individual chosen to receive the balance can become the Designated Beneficiary as long as that designation is in place by that December 31 deadline.[17] (See **Example 3,** page 29.)

Trusts as Designated Beneficiary The new rules are also likely to make it more practical for a trust to be a Designated Beneficiary. To qualify, the trust must:[18]

(a) be a valid trust under state law, or would be, except that it has no assets until the death of the IRA owner or plan participant;

(b) be irrevocable upon the death of the IRA owner or plan participant;

(c) provide that the beneficiaries of the trust must be identifiable and be individuals (a charitable trust or a trust such as a charitable remainder trust that has split interests does not qualify);

(d) provide the IRA custodian or plan trustee with a copy of the trust *or* a list of all primary, contingent and remainder beneficiaries with a description of the condition of their entitlements;

(e) supply a certified copy of any changes to the beneficiary of the trust and the IRA custodian or plan trustee; and

(f) give the IRA custodian or plan trustee a full copy of the trust if one is demanded (*i.e.*, if the custodian or trustee is not satisfied with option (d) to provide a list of beneficiaries and their entitlements).

After the death of the IRA owner or plan participant, a copy of the final version of the trust (including all amendments to it) *or* a certified list of all trust beneficiaries (primary beneficiaries, contingent beneficiaries and remainderpersons) and a description of their entitlement to benefits must be supplied to the IRA custodian or plan trustee by December 31 of the year following the year of the death of the IRA owner or plan participant.[19]

If the rules that apply to a spouse as the sole Designated Beneficiary are to apply to a trust, the spouse must be able to withdraw from the trust all distributions that the trustees take from the IRA or the plan.[20] Otherwise the ages of any contingent Designated Beneficiaries will be surveyed, and the age of the oldest Designated Beneficiary will be used to choose the Applicable Divisor.

Even if the spouse is the sole Designated Beneficiary of a trust, however, it appears that the rule for the starting date of required distributions will be the one for a "non-spouse" Designated Beneficiary, unless the trustees of the trust are required to distribute all withdrawals from the IRA directly to the spouse.[21] In other words, unless the exception applies, distributions must begin by December 31 of the year following the year of the owner's death; distributions cannot wait until the owner would have turned 70½ (see the charts on pages 32 and 33).

The new Proposed Regulations make clear that both *inter vivos* trusts, whether revocable or irrevocable, and testamentary trusts can qualify as Designated Beneficiaries.[22]

Distribution Rules After Death

When an owner dies before what would have been the Required Beginning Date for minimum distributions, the new rules for distributing the funds depend on which of four possible scenarios applies: the owner's spouse is the Designated Beneficiary, a non-spouse is the Designated Beneficiary, multiple individuals (including possibly the spouse) are Designated Beneficiaries, or there is no Designated Beneficiary. The results in each of these circumstances appear in the chart on page 32.

If the owner dies on or after the Required Beginning Date, any distribution that would have been required in the year of death must be made before determining how much will be available for any beneficiaries. (In the rare case where the owner actually died on the April 1 Required Beginning Date, the distribution due that day would also be required if it had not already been made.)

Beginning with the year after the owner's death, the distribution pattern for someone who has died on or after a Required Beginning Date will again depend on whether the spouse is the sole Designated Beneficiary, a non-spouse is the Designated Beneficiary, multiple individuals (including possibly the spouse) are Designated Beneficiaries, or there is no Designated Beneficiary. The applicable results appear in the chart on page 33. (See also **Examples 4** and **5,** page 29.)

Rollover-Spousal IRAs

Only a surviving spouse can roll over the funds available from a decedent's IRA account or qualified plan into another an IRA of her/his own.

Instead of following the rules for Spouse as the Sole Designated Beneficiary shown in the charts on pages 32 and 33, a surviving spouse has the option to place the inherited balance into her/his own rollover-spousal account and choose her/his own Designated Beneficiary. If the decedent was making Required Minimum Distributions, the spouse cannot make the rollover until the distribution for the year of death has been made, even if the amount can be paid from another IRA that is not being rolled over.[23] (See **Examples 6** and **7,** page 30.)

The advantage of the rollover approach is that the spouse gets to use the Uniform Distribution Table when computing the distribution rate, not the Single Life Expectancy Table. The result is a larger Applicable Divisor and a slower required pace for distributions. For an individual 72 years old, for example, the Applicable Divisor from the Uniform Distribution Table would be 24.4. vs. 13.2 from the Single Life Expectancy Table.

The only restriction is that if this individual remarries, at her/his death the new husband or wife will not qualify on this account for the treatment accorded a spousal Designated Beneficiary. Instead, the rules for a non-spouse Designated Beneficiary will apply.

If the spouse who decides on a rollover was not 70½ when the original owner died, distributions from the rollover-spousal IRA are not required until this surviving spouse reaches her/his Required Beginning Date. If the spouse has reached 70½ by the time of the owner's death, distributions to the spouse must begin in the year following the year of the owner's death.

The new Proposed Regulations specify that a spouse may implement a rollover only if he/she is an outright Designated Beneficiary of the decedent's account, not the beneficiary of a trust (unless he/she is able to take the entire distribution from the trust).[24]

If a surviving spouse has both a personal IRA account and a rollover-spousal IRA account, the annual total of the Required Minimum Distributions from the two cannot be aggregated and taken from just one account; the correct amount for each account must be taken from that account.[25] If, however, the surviving spouse has several personal accounts and several rollover-spousal accounts, the total Required Minimum Distributions from the personal accounts can be aggregated and paid from one or more of these accounts, and the total Required Minimum Distributions from the rollover-spousal accounts can be aggregated and paid from one or more of these accounts.[26]

Reporting Requirements

Custodians of IRAs are now to be treated as IRA trustees to the extent that each year they must report to the Internal Revenue Service and to the IRA owner the amount that had to be distributed from the IRA for the calendar year.[27] This is a major change because, under the old Proposed Regulations, most IRA custodians were not required to perform these calculations for IRA owners.

The Preamble to the new Proposed Regulations provides that IRA custodians must also advise IRA owners that they do not have to take a distribution from a particular IRA but may aggregate all IRAs owned by the same individual and take their minimum required distribution from one or more of them.[28]

Publications on the Web

The full text of the new Proposed Regulations is available from the Federal Register files accessible through the Government Printing Office site on the Internet. Go to www.access.gpo.gov. and click on GPO Access. Then click on Federal Register. Scroll down to Issue Date. Choose the On Date option and enter 1/17/2001, then type Retirement Plans in the Search Terms box. Select Retirement Plans from the list that appears and follow instructions for downloading.

Also helpful is IRS Publication 590, *Individual Retirement Arrangements*. It is available from www.irs.ustreas.gov. Take the Publications option and follow instructions for downloading.

A private site, http//www.benefitslink.com, also provides informative material, including a summary of some corrections to what was published in the Federal Register.

Joint Life and Last Survivor Table

Ages	70	71	72	73	74	75
35	47.5	47.5	47.5	47.5	47.5	47.4
36	46.6	46.6	46.6	46.5	46.5	46.5
37	45.7	45.6	45.6	45.6	45.6	45.5
38	44.7	44.7	44.7	44.6	44.6	44.6
39	43.8	43.8	43.7	43.7	43.7	43.6
40	42.9	42.8	42.8	42.8	42.7	42.7
41	41.9	41.9	41.9	41.8	41.8	41.8
42	41.0	40.9	40.9	40.9	40.8	40.8
43	40.1	40.1	40.0	40.0	39.9	39.9
44	39.2	39.1	39.1	39.0	39.0	39.0
45	38.3	38.2	38.2	38.1	38.1	38.1
46	37.4	37.3	37.3	37.2	37.2	37.1
47	36.5	36.5	36.4	36.3	36.3	36.2
48	35.7	35.6	35.5	35.4	35.4	35.3
49	34.8	34.7	34.6	34.6	34.5	34.5
50	34.0	33.9	33.8	33.7	33.6	33.6
51	33.1	33.0	32.9	32.8	32.8	32.7
52	32.3	32.2	32.1	32.0	31.9	31.8
53	31.5	31.4	31.2	31.1	31.1	31.0
54	30.7	30.5	30.4	30.3	30.2	30.1
55	29.9	29.7	29.6	29.5	29.4	29.3
56	29.1	29.0	28.8	28.7	28.6	28.5
57	28.4	28.2	28.1	27.9	27.8	27.7
58	27.6	27.5	27.3	27.1	27.0	26.9
59	26.9	26.7	26.5	26.4	26.2	26.1
60	26.2	26.0	25.8	25.6	25.5	25.3
61	25.6	25.3	25.1	24.9	24.7	24.6
62	24.9	24.7	24.4	24.2	24.0	23.8
63	24.3	24.0	23.8	23.5	23.3	23.1
64	23.7	23.4	23.1	22.9	22.7	22.4
65	23.1	22.8	22.5	22.2	22.0	21.8
66	22.5	22.2	21.9	21.6	21.4	21.1
67	22.0	21.7	21.3	21.0	20.8	20.5
68	21.5	21.2	20.8	20.5	20.2	19.9
69	21.1	20.7	20.3	20.0	19.6	19.3
70	20.6	20.2	19.8	19.4	19.1	18.8
71	20.2	19.8	19.4	19.0	18.6	18.3
72	19.8	19.4	18.9	18.5	18.2	17.8
73	19.4	19.0	18.5	18.1	17.7	17.3
74	19.1	18.6	18.2	17.7	17.3	16.9
75	18.8	18.3	17.8	17.3	16.9	16.5
76	18.5	18.0	17.5	17.0	16.5	16.1
77	18.3	17.7	17.2	16.7	16.2	15.8
78	18.0	17.5	16.9	16.4	15.9	15.4
79	17.8	17.2	16.7	16.1	15.6	15.1
80	17.6	17.0	16.4	15.9	15.4	14.9

The biggest beneficiary of this change is likely to be the Internal Revenue Service. In the past, it was almost impossible for the IRS to know when participants were not taking their Required Minimum Distributions, or if they were taking the correct amounts.

Rules Not Being Changed

TEFRA 242(b) Elections under § 242(b) of the Tax Equity and Fiscal Responsibility Act of 1982 for qualified plan account balances may remain in effect unless a distribution is taken that does not comply with the election. In the year after the distribution, the full amount of distributions that would have been required if the election had not been in place must be distributed.[29]

There are few changes with respect to annuities from defined benefit plans. One of the more important rules in the new Proposed Regulations is that when an annuity contract is purchased after the Required Beginning Date, "the first payment interval must begin on or before the purchase date and the payment required for one payment interval must be made no later than the end of such payment interval."[30]

Conclusions

Although the new Proposed Regulations are still very detailed, a number of questions and inconsistencies will require corrections, IRS Rulings and Notices. Nevertheless, the result is that senior citizens, probably the population least qualified to understand the complexities of the old Minimum Distribution Rules (and therefore most likely to be penalized for mistakes) should have a much simpler time now.

This is especially true because IRA custodians and plan trustees must now compute the distributions for IRA owners and plan participants. The downside to this requirement is that the Internal Revenue Service, which really had no way of policing the rules for Required Minimum Distributions in the past, will now need only to add up the Required Minimum Distribution reports forwarded by the custodians and trustees.

The new rules also have certain unexpected consequences. Owners who take the lower Required Minimum Distributions may have substantially larger balances in their plans or IRA accounts at death than they would have had under the prior rules. The funds (unless passing to a spouse or charity) may be subject to larger estate taxes at the death of the owner because of the greater accumulated value. In addition, the ultimate recipients of the funds will be required to pay income tax on the amounts received (although in filing their tax returns they will be able to take an "income in respect of a decedent" deduction reflecting the amount of the estate tax that was paid on the funds received).

Single Life Expectancy Table

Age	Divisor	Age	Divisor	Age	Divisor	Age	Divisor	Age	Divisor	Age	Divisor
5	76.6	24	58.0	43	39.6	62	22.5	80	9.5	98	3.0
6	75.6	25	57.0	44	38.7	63	21.6	81	8.9	99	2.8
7	74.7	26	56.0	45	37.7	64	20.8	82	8.4	100	2.7
8	73.7	27	55.1	46	36.8	65	20.0	83	7.9	101	2.5
9	72.7	28	54.1	47	35.9	66	19.2	84	7.4	102	2.3
10	71.7	29	53.1	48	34.9	67	18.4	85	6.9	103	2.1
11	70.7	30	52.2	49	34.0	68	17.6	86	6.5	104	1.9
12	69.7	31	51.2	50	33.1	69	16.8	87	6.1	105	1.8
13	68.8	32	50.2	51	32.2	70	16.0	88	5.7	106	1.6
14	67.8	33	49.3	52	31.3	71	15.3	89	5.3	107	1.4
15	66.8	34	48.3	53	30.4	72	14.6	90	5.0	108	1.3
16	65.8	35	47.3	54	29.5	73	13.9	91	4.7	109	1.1
17	64.8	36	46.4	55	28.6	74	13.2	92	4.4	110	1.0
18	63.9	37	45.4	56	27.7	75	12.9	93	4.1	111	.9
19	62.9	38	44.4	57	26.8	76	11.9	94	3.9	112	.8
20	61.9	39	43.5	58	25.9	77	11.2	95	3.7	113	.7
21	60.9	40	42.5	59	25.0	78	10.6	96	3.4	14	.6
22	59.9	41	41.5	60	24.2	79	10.0	97	3.2	115	.5
23	59.0	42	40.6	61	23.3						

Because the new rules permit a much longer payout than the old ones did, in many cases, it will be highly beneficial for the beneficiaries to keep the funds in the plans for as long as possible, taking only their Required Minimum Distributions and permitting the remaining funds to grow on a tax-deferred basis.

If all, or virtually all, of a decedent's assets are in IRAs or qualified plans and her/his assets exceed the current $675,000 threshold for estate taxes, beneficiaries may face a significant tax burden. If they must withdraw funds from the plans to pay estate taxes, they will also owe income taxes on the withdrawn funds (even after they take the deduction for "income in respect of a decedent"). If the beneficiaries are in high income tax brackets, the net result may be the need to withdraw almost $2 from a plan for every $1 needed to pay estate taxes.

Owners of IRA accounts and participants in retirement plans who will leave potentially larger balances to beneficiaries other than a surviving spouse or a charity must now confirm the sufficiency of their liquid assets (other than from the IRAs or plans) to pay estate taxes. If not sufficient, other estate planning techniques, such as life insurance held outside of the taxable estate, may be useful to provide liquidity. Draftspersons should also examine estate tax allocation clauses in participants' wills and living trusts to ensure that estate taxes are allocated against non-plan assets, if possible, so that these large balances can stay intact for the beneficiaries for the longest time possible.

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1. The new Proposed Regulations were published in the Federal Register on January 17, 2001, with the designation REG-130477-00 and REG-130481-00. They are designated as § 1.401(a)(9)-0 through § 1.401(a)(9)-8 for qualified plans, § 1.403(b)-2 for annuity contracts, § 1.408-8 for Individual Retirement Accounts, and § 54.4974-2 for the excise tax on accumulations in qualified retirement plans.

   In this article, sections from the new Proposed Regulations are identified as "Prop. Reg. § __", while sections from the 1987 Proposed Regulations are identified as "1987 P.R. § __."
2. 1987 P.R. § 1.401(a)(9)-2, Q&A 4(a)(2).
3. The document covers proposed regulations "relating to required minimum distributions from qualified plans, individual retirement plans, deferred compensation plans under section 457, and section 403(b) annuity contracts, custodial accounts, and retirement income accounts." In the background commentary, the document specifically identifies its scope as containing "proposed amendments to the Income Tax Regulations (26 CFR Part 1) and to the Pension Excise Tax Regulations (26 CFR Part 54) under sections 401, 403, 408, and 4974 of the Internal Revenue Code."

   The background discussion also notes that "whenever the term *employee* is used, it is intended to include not only an employee but also an IRA owner." Federal Register, Vol. 66, No. 11, January 17, 2001, pp. 3928-3929.
4. Federal Register, Vol. 66, No. 11, January 17, 2001, p. 3929. These plans are covered under IRC § 457(d).

Uniform Distribution Table

Age	Divisor
70	26.2
71	25.3
72	24.4
73	23.5
74	22.7
75	21.8
76	20.9
77	20.1
78	19.2
79	18.4
80	17.6
81	16.8
82	16.0
83	15.3
84	14.5
85	13.8
86	13.1
87	12.4
88	11.8
89	11.1
90	10.5
91	9.9
92	9.4
93	8.8
94	8.3
95	7.8
96	7.3
97	6.9
98	6.5
99	6.1
100	5.7
101	5.3
102	5.0
103	4.7
104	4.4
105	4.1
106	3.8
107	3.6
108	3.3
109	3.1
110	2.8
111	2.6
112	2.4
113	2.2
114	2.0
115	1.8

5. "If, and to the extent, future guidance is more restrictive than the guidance in these proposed regulations, the future guidance will be issued without retroactive effect." Federal Register, Vol. 66, No. 11, January 17, 2001, p. 3934.
6. Federal Register, Vol. 66, No. 11, January 17, 2001, p. 3933.
7. As found in the Single Life Expectancy Table, published as Table V in Treas. Reg. § 1.72-9.
8. As found in the Minimum Distribution Incidental Benefit Table, published in 1987 P.R. § 1.401(a)(9)-2, A-4.
9. This option used the "recalculation" method for the owner and a "term certain" for the Designated Beneficiary. It was typically appropriate when the owner was concerned that the Designated Beneficiary might die first. It locked in a payout stream that would not be accelerated due to the death of the Designated Beneficiary and, after the owner's subsequent death, heirs were not required to take an immediate total distribution.
10. Prop. Reg. § 1.401(a)(9)-5, A-3(d).
11. 1987 P.R. § 1-1401(a)(9)-2, A-4.
12. The figure is also the same that would have applied if the Designated Beneficiary was exactly ten years younger than the owner, although technically it would have come from the Ordinary Joint Life and Last Survivor Expectancy Table (Table VI from Treas. Reg. § 1.72-9). The figure in that table for an owner age 70 and a Designated Beneficiary age 60 is 26.2 years, the same as the figure in the Minimum Distribution Incidental Benefit Table (1987 P.R. § 1.401(a)(a)-2) for an account owner aged 70 with a Designated Beneficiary more than ten years younger.
13. 1987 P.R. § 1.401(a)(9)-1, A-D-2A(b).
14. Table VI of Treas. Reg. § 1.72-9.
15. Prop. Reg. § 1.401(a)(9)-5, A-4(b).
16. Only the life of a Designated Beneficiary who was a spouse could also be recalculated annually; for others it was fixed on the Required Beginning Date at either the person's life expectancy if he/she was less than ten years younger than the owner, or the figure assigned to anyone who was ten years younger. The owner's life expectancy was reduced to zero in the year after the owner's death, and the effect on the distribution pattern was that the entire remaining benefit had to be distributed to any Designated Beneficiary other than a spouse by December 31 of the year following the owner's death. Only a spouse whose life expectancy had also been being recalculated annually could continue annual distributions, with payments then based solely on the spouse's life expectancy. The spouse also had the option to place the remaining amount in a rollover-spousal IRA with a new Designated Beneficiary.
17. Prop. Reg. § 1.401(a)(9)-4, A-4(a).
18. Prop. Reg. § 1.401(a)(9)-4, A-5(a), A-6.
19. Prop. Reg. § 1.401(a)(9)-4, A-6(b).
20. Prop. Reg. § 1.401(a)(9)-5, A-7(c), Example 1(iii) and IRC § 401(a)(9)(B)(iv).
21. Prop. Reg. § 1.401(a)(9)-5, A-7(c)(23), Example 3.
22. Prop. Reg. § 1.401(a)(9)-4, A-5(b)(2), Preamble.
23. Prop. Reg. § 1.401(a)(9)-8, A-5.
24. *Id*.
25. Prop. Reg. § 1.401(a)(9)-8, A-9.
26. Prop. Reg. § 1.408-8, A-9.
27. Prop. Reg. § 1.408-8, A-10.
28. Prop. Reg. § 1.408-8, Q&A-10.
29. Prop. Reg. § 1401(a)(9)-8, A-13, A-16.
30. Prop. Reg. § 1.401(a)(9)-6, A-1(d)(2).

Stare Decisis Provides Stability To the Legal System, But Applying It May Involve a Love-Hate Relationship

BY HARRY STEINBERG

Precedent. It is the lifeblood of the litigation process. We cannot live without it and, all too often, we find that we cannot live with it.

Typical of the love-hate relationship that both litigators and judges have with precedent is Justice Brandeis' two views of it, first taking the negative view that the "doctrine of *stare decisis* does not command that we err again when we have occasion to pass upon a different statute."[1] And just a scant 20 years later taking the seemingly more agreeable view, even while dissenting, that *stare decisis* is "usually wise policy, because in most matters it is more important that the rule be settled than that it be settled right,"[2] a concept also recognized by our Court of Appeals.[3]

Stare decisis can also be frustrating because all too often there seems to be authority that squarely supports two diametrically opposed propositions, giving life to the adage, "The devil can cite Scripture for his purpose."[4]

Like most legal rules, *stare decisis* can be defined quite simply: "The doctrine of precedent, under which it is necessary for a court to follow earlier judicial decisions when the same points arise again in litigation."[5]

But like most legal rules, its application is not quite as simple as its definition. The Court of Appeals defined *stare decisis* as follows:

> The doctrine of stare decisis provides that once a court has decided a legal issue, subsequent appeals presenting similar facts should be decided in conformity with earlier decisions. Its purpose is to promote efficiency and provide guidance and consistency in future cases by recognizing that legal questions once settled should not be reexamined every time they are presented.[6]

Some courts have stated the rule of *stare decisis* as an inviolate principle, unequivocally stating that "the established precedent prevails unless there is a compelling reason to depart from it."[7]

But the courts have also recognized that applying the doctrine of *stare decisis* involves a constant struggle between firmly adhering to the past and recognizing that times change and the law must change with the times. This view was reflected in Judge Cardozo's dictum that "[p]recedent drawn from the days of travel by stagecoach does not fit the conditions of travel today."[8]

The courts seem to be most acutely aware of changing times when confronted by a firmly embedded rule that no longer seems to be in accord with what the rule should be. For example, in abandoning the long-established "fellow-servant rule,"[9] the Court of Appeals said, in language somewhat less elegant than Cardozo's:

> While the longevity of a rule of law requires that its reexamination be given careful scrutiny, it does not demand that its effect be given permanence. The continued vitality of a rule of law should depend heavily upon the continued practicality and the demands of justice, rather than on mere tradition.[10]

However, while the courts do not view *stare decisis* as wedding them permanently to a past result, "the mere existence of strong arguments to support a different result is not sufficient, in and of itself, to compel the court to overturn judicial precedent. . . . In the end there must be a compelling reason to change the established rule."[11]

Yet we continue to look to the past—for that is what we do—every time we cite precedent. And judges and lawyers alike do so almost mechanically, often without giving a great deal of thought to just what the precise holding of the cited case is and whether the case is truly binding precedent for the proposition for which we—or our adversaries—are citing it. This article explores how the doctrine of *stare decisis* operates, when and how it is properly applied, and how to overcome, or sidestep, the formidable barrier it can present.

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Finding the Holding

In determining whether a case is actually *stare decisis* on a particular issue, counsel must look carefully at the precise issues that the case actually addresses. As the Court of Appeals explained: "Law is made not 'by what was said, but by what was decided, and what was said is not evidence of what was decided, unless it relates to the question presented for decision.'"[12] In other words, a case "is precedent only as to those questions presented, considered and squarely decided."[13]

For example, where a court dismissed an indictment, its statement that it would also have ordered a new trial because of errors made at trial was dictum and was not entitled to any binding effect because the statement was "neither essential to, nor supportive of its determination and was purely gratuitous."[14] Thus, anything a court says that goes beyond the issue presented for decision is not entitled to *stare decisis* effect.

The key rule governing the application of* stare decisis *is that it applies only to issues actually addressed and directly relevant to the issue decided and that it does not apply to dictum.

The reverse is also true. The failure of the Court of Appeals to address an issue does not mean that it rejected the argument because "[p]rinciples of law are established by what is decided by a court, not by what a court fails to reach."[15] Thus, what a court does *not* say is also not entitled to *stare decisis* effect.

One application of the rule that dictum does not carry the force of *stare decisis* was stated by the Court of Appeals as follows: "Affirmance by this Court without opinion does not mean that we adopted the opinion of the court below."[16] An affirmance without opinion "indicates that it is concurring only in the result reached by the lower court and not the reason given in the opinion of the lower court."[17] And an affirmance that does not address an issue "is not necessarily to be considered an adoption of the reasons stated by the lower court, at least where there are other grounds for affirmance."[18] For this reason, "denial of leave to appeal is 'not equivalent to an affirmance and has no precedential value.'"[19]

Thus, the key rule governing the application of *stare decisis* is that it applies only to issues actually addressed and directly relevant to the issue decided and that it does not apply to dictum—things a court says or does not say[20]—although a court's dictum obviously has some persuasive force.[21]

Legal Versus Factual Holdings

Another rule that governs the application of *stare decisis* is that the doctrine applies only to legal principles and not to factual findings[22] or to legal issues not raised or reached in a prior proceeding.[23] One way this rule applies is that a court may give different interpretations to identical provisions of a will based upon credibility determinations, or to tax assessments for different years.[24]

In one of the few lengthy judicial discussions of the rule and role of *stare decisis*, Chief Judge Breitel explained that a court departing from *stare decisis* must approach its task with the "humbling assumption, often true, that no particular court as it is then constituted possesses a wisdom surpassing that of its predecessors. Without this assumption there is judicial anarchy."[25]

Having recognized the critical role of *stare decisis*, Judge Breitel then proceeded to parse out the different degrees of respect to which *stare decisis* is entitled in different spheres of the law. For example, when addressing constitutional questions, a court will adhere to the established rule unless "convinced of prior error."[26] This is so because of the difficulty involved in amending a constitution.[27] By contrast, statutory provisions "are entitled to great stability" because frequent changes in the interpretation given to statutory language would mean that the courts were acting as legislators[28] and because statutes can be amended by the legislature with far less difficulty than is required for a constitutional amendment.[29] But statutes that are so broadly written as to suggest that the legislature has invited judicial interpretation are not entitled to such deference.[30]

Tort cases, especially personal injury cases, are another area where the courts will be less reluctant to shed the shackles of *stare decisis* "to achieve the ends of justice in a more modern context" and in accord with the "reasonable expectations of members of society."[31]

Judge-made rules are also entitled to less deference when it come to *stare decisis*. As the Court of Appeals explained: "The fellow-servant rule originated as a matter of decisional law, and it remains subject to judicial re-examination."[32]

However, in property and contracts cases the rule of *stare decisis* plays a more important role because society needs to know the prevailing rule and rely upon its stability.[33] The same is true of cases deciding tax issues, because taxpayers are likely to rely on a court's decision in planning their affairs.[34]

And while the closeness of a decision should play no role at all in determining the *stare decisis* effect of a decision,[35] the manner in which the rule was stated is entitled to some consideration. "[A] precedent is less binding if it is *ipse dixit*, a conclusory assertion of result, perhaps supported by generalized platitudes" than it would be "if it is the result of reasoned and painstaking analysis."[36]

The Hierarchy of *Stare Decisis*

Also important is the rule that the decision of the highest court is the decision that is to be given *stare decisis* effect.[37]

"The ultimate principle," Judge Breitel wrote, "is that a court is an institution and not merely a collection of individuals. Just as a higher court commands superiority over a lower court not because it is wiser or better but because it is institutionally higher."[38]

And while it is obvious to most that the hierarchical order of the courts governs the application of *stare decisis*, at least one court found it necessary to explain to an appellant that the Appellate Division "has no power" to address a claim that the Court of Appeals erred.[39] For this reason, once a decision of the Appellate Division has been affirmed by the Court of Appeals "that court, not this one, should pass on the continued validity" of the Appellate Division's opinion.[40]

Put differently, a trial court is bound by the decisions of the court to which an appeal from the trial court would be taken.[41] Thus, a Civil Court judge in New York County concluded that she was bound by a determination of the Appellate Term, First Department, notwithstanding that the Appellate Division, Second Department, in considering the same statute, had come to a conclusion that was diametrically opposed to the conclusion of the Appellate Term.[42]

Unappealed decisions of the trial courts do not have *stare decisis* effect on appellate courts.[43] However, the doctrine of *stare decisis* bars courts of coordinate jurisdiction from ruling "on a matter already reviewed by another judge of equal authority."[44]

Sometimes, the doctrine of *stare decisis* can come into play indirectly. For example, where the Appellate Division dismisses an appeal because no appeal lies from a judgment entered on default, the doctrine of *stare decisis* bars the Supreme Court from finding that there had been no default.[45] Likewise, the Supreme Court cannot undo a judgment of the Civil Court that had been affirmed by the Appellate Term and from which the Appellate Division had denied leave to appeal.[46]

Trial courts are, of course, bound to follow the law as stated not only by the Appellate Division in which they are situated, but absent authority from their own judicial department, are bound to follow the law as stated by *any* Appellate Division. The Appellate Division, Second Department, stated the rule as follows:

> The Appellate Division is a single statewide court divided into departments for administrative convenience [citations omitted] and, therefore, the doctrine of *stare decisis* requires trial courts in this department to follow precedents set by the Appellate Division of another department until the Court of Appeals or this court pronounces a contrary rule.[47]

This rule does not bind one Appellate Division to follow another because "[w]hile we should accept the decisions of sister departments as persuasive . . . we are free to reach a contrary result."[48] However, where an appeal is transferred from one department to another, the department receiving the appeal should apply the rule of the department from which the appeal originated.[49]

Federal-State Dichotomy

The doctrine of *stare decisis* as applied to the effect of decisions of state courts on federal courts and vice versa, is not a two-way street. Decisions of state courts on a state statute are binding on the federal courts, but a federal court decision on a state law matter not involving a federal question is not binding on state courts.[50] This was recognized by the Court of Appeals for the Second Circuit which, in certifying an appeal which hinged on the interpretation of Insurance Law §§ 3425(a)(7) and 3425(e) to the New York Court of Appeals, explained:

> Interpretation of the statute by a federal court would not provide authoritative guidance. Were we to simply decide the issue, insurers that conformed their . . . practices to our interpretation would run the risk of an eventual determination based on New York court rulings that their practices have not satisfied the Insurance Law's requirements, with potentially harsh consequences.[51]

On federal questions, the decisions of the U.S. Supreme Court are entitled to full and binding *stare decisis* effect on state courts.[52] But as the Court of Appeals explained, "the interpretation of a Federal constitutional question by lower federal courts may serve as useful and persuasive authority for our Court while not binding on us."[53]

Thus, "[w]here 'there is neither a decision of the Supreme Court nor uniformity of the lower Federal courts, a State court required to interpret a Federal statute is not bound to follow the decision of the Federal courts or precluded from exercising its own judgment.'"[54] And "where there is a conflict between decisional law of the [New York] Court of Appeals and that of an intermediate Federal appellate court, the ruling of the Court of Appeals should be followed."[55] This applies even to a "decision of the Federal Circuit Court of Appeals within the territorial boundaries of which it sits."[56]

Where the case cited contains little or no factual discussion to support its legal conclusion, that case is a poor candidate for the powerful mantle of stare decisis.

Attacking *Stare Decisis*

In challenging a case cited by an adversary, the first line of attack should be an effort to show that the cited case is factually different from the case at issue, because, as noted above, *stare decisis* applies only to legal conclusions, not to factual ones.[57] For Judge Cardozo the key to *stare decisis* was the factual setting which the rule relied upon: "Precedents will be misleading if separated from the statutes they interpret. Opinions get their color and significance from the subject of the controversy."[58]

Another means of challenging a citation is to demonstrate that the legal conclusion cited was not necessary to the resolution of that case.[59]

A case cited by an adversary can also be challenged by showing that the court deciding that case is not "superior" to the court in which the case at issue is pending, so that the cited case is, at most, persuasive authority but not binding precedent.[60]

And where the cited case contains little or no factual discussion to support its legal conclusion, that case is a poor candidate for the powerful mantle of *stare decisis*.[61]

Finally, the most difficult argument to make is the one pointed out by Chief Judge Cardozo—that the case was decided in the long-gone days of stagecoach travel and should no longer be considered *stare decisis* in the day of jet travel.[62]

Conclusion

Whether in the day of stagecoach travel or jet travel, the doctrine of *stare decisis* serves the important function of providing the stability that our judicial system—and our society—needs.

This principle must be recognized both by counsel citing a case and counsel trying to avoid or overcome a cited case. And while the doctrine of *stare decisis* itself is not in need of change, it must be applied consistently, tempered with the recognition that the law it is intended to govern must, by its nature, continue to change so that our society can continue to grow and adapt.

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1. *Di Santo v. Pennsylvania*, 273 U.S. 34, 42 (1927), *overruled in part*, *California v. Thompson*, 313 U.S. 109 (1941).
2. *Burnet v. Coronado Oil & Gas*, 285 U.S. 393, 406 (1932) (Brandeis, J., dissenting), *overruled in part*, *Helvering v. Bankline Oil Co*., 303 U.S. 362 (1938).
3. *In re Estate of Eckart*, 39 N.Y.2d 493, 500, 384 N.Y.S.2d 429, 432 (1976) ("In cases involving the transfer of property especially, where it can reasonably be assumed that settled rules are necessary and necessarily relied upon, stability and adherence to precedent are generally more important than a better or even 'correct' rule of law").
4. William Shakespeare, *The Merchant of Venice*, Act I, Sc. iii, L. 95. The rest of Antonio's speech, which might have been directed at those who miscite cases, the subject for another article, reads:

   An evil soul providing holy witness
   Is like a villain with a smiling cheek,
   A goodly apple with a rotten heart.
   O what a goodly outside falsehood hath.

   Id. *See also* T.R. Newman and S.J. Ahmuty, *Conflicting Precedents*, N.Y.L.J., December 6, 2000, p. 3.
5. Black's Law Dictionary (7th ed. 1999), p. 1414.
6. *People v. Bing*, 76 N.Y.2d 331, 338-39, 559 N.Y.S.2d 474, 477 (1990).
7. *Battle v. State*, 257 A.D.2d 745, 746, 682 N.Y.S.2d 726, 727 (3d Dep't 1999).
8. *McPherson v. Buick Motor Co*., 217 N.Y. 382, 391 (1916).
9. The "fellow-servant rule" was first stated in an 1837 English case which held that an employer was immune from suit under the principles of *respondeat superior* for injuries to an employee which results from the negligence of a fellow employee. *Buckley v. City of New York*, 56 N.Y.2d 300, 303, 452 N.Y.S.2d 331, 332 (1982). Notwithstanding the 145-year life of the rule, the Court of Appeals concluded that, in cases in which workers' compensation does not apply, "[t]he fellow servant rule serves no continuing valid purpose in New York . . . and we must thus conclude that the fellow-servant rule is no longer to be followed in New York." *Id*. at 305, 452 N.Y.S.2d at 333.
10. *Id*. at 305, 452 N.Y.S.2d at 333.
11. *Dufel v. Green*, 198 A.D.2d 640, 640, 603 N.Y.S.2d 624, 625 (3d Dep't 1993), *aff'd* 84 N.Y.2d 795, 622 N.Y.S.2d 900 (1995).
12. *People v. Bourne*, 139 A.D.2d 210, 216, 531 N.Y.S.2d 899, 902 (1st Dep't 1988), *quoting People ex rel. Metropolitan Street Railway v. State Board of Commissioners*, 174 N.Y. 417, 447 (1903).
13. *Bourne*, 139 A.D.2d at 216, 531 N.Y.S.2d at 902-03. *See also Williams v. AGK Communications, Inc*., 143 Misc. 2d 845, 848, 542 N.Y.S.2d 122, 124 (Sup. Ct., Onandaga Co. 1989) ("A binding precedent is not created by a court's decision unless the subject matter is clearly and squarely dealt with and the principle established is well defined").
14. *People v. Palumbo*, 79 A.D.2d 518, 519, 433 N.Y.S.2d 770, 771 (1st Dep't 1980), *aff'd* 53 N.Y.2d 894, 440 N.Y.S.2d 633 (1981).
15. *Thomas Crimmins Contracting Co. v. City of New York*, 138 A.D.2d 138, 148, 530 N.Y.S.2d 779, 785 (1st Dep't 1988), *aff'd,* 74 N.Y.2d 166, 544 N.Y.S.2d 580 (1989).
16. *Adrico Realty Corp. v. City of New York*, 250 N.Y. 29, 44 (1928).
17. *Tepper v. Tannenbaum*, 65 A.D.2d 359, 360, 411 N.Y.S.2d 588, 590 (1st Dep't 1978); *Estate of Eckart*, 39 N.Y.2d 493, 502, 384 N.Y.S.2d 429, 434 (1976) ("our affirmance in

Cairo, without opinion, does not constitute an indorsement of that rationale").

18. *People v. Rosano*, 69 A.D.2d 643, 654, 419 N.Y.S.2d 543, 549 (2d Dep't 1979), *aff'd* 50 N.Y.2d 1013, 431 N.Y.S.2d 683 (1980).
19. *Giblin v. Nassau Co. Med. Ctr.*, 61 N.Y.2d 67, 76 n*, 471 N.Y.S.2d 563, 567 n* (1984), *quoting Panico v. Young*, 46 N.Y.2d 847, 847, 414 N.Y.S.2d 313, 313 (1979).
20. *Kaswan v. Mannings*, 198 A.D.2d 170, 171, 604 N.Y.S.2d 71, 72 (1st Dep't 1993); *Gameways, Inc. v. Department of Consumer Affairs*, 101 A.D.2d 888, 888, 476 N.Y.S.2d 202, 203 (2d Dep't 1984).
21. *Adirondack Trust Co. v. Farone*, 245 A.D.2d 840, 842, 666 N.Y.S.2d 352, 352 (3d Dep't 1997) ("While dictum in Court of Appeals decision carries considerable weight, it is not controlling."); *Bourne*, 139 A.D.2d at 216, 531 N.Y.S.2d at 903.
22. *Liberty Health Care Management Group, Inc. v. Fahey*, 257 A.D.2d 964, 965, 684 N.Y.S.2d 638, 639 (3d Dep't 1998); *Killeen v. Crosson*, 218 A.D.2d 217, 220, 638 N.Y.S.2d 531, 531 (4th Dep't 1996).
23. *Hop Wah v. Coughlin*, 160 A.D.2d 1054, 1055, 553 N.Y.S.2d 886, 887 (3d Dep't 1990); *Smith v. Andrews*, 122 A.D.2d 310, 504 N.Y.S.2d 286 (3d Dep't 1986).
24. *In re Estate of Wetsel*, 154 A.D.2d 802, 803-04, 546 N.Y.S.2d 243, 245 (3d Dep't 1989); *Liberty Healthcare Management*, 257 A.D.2d at 965, 684 N.Y.S.2d at 639 ("nor are we persuaded that the doctrine of stare decisis . . . bars the instant proceeding since the propriety of the 1995 assessment involved the resolution of a factual issue").
25. *People v. Hobson*, 39 N.Y.2d 479, 488, 384 N.Y.S.2d 419, 425 (1976).
26. *Id*. at 488-89, 384 N.Y.S.2d at 425.
27. *Id*. at 488, 384 N.Y.S.2d at 425.
28. *Id*. at 489, 384 N.Y.S.2d at 426; *Higby v. Mahoney*, 48 N.Y.2d 15, 19, 421 N.Y.S.2d 35, 37 (1979) (where "courts are interpreting legislative intention . . . a sequential contradiction is a grossly arrogated legislative power").
29. *Hobson*, 39 N.Y.2d 489, 384 N.Y.S.2d at 426; *Higby*, 48 N.Y.2d at 18, 421 N.Y.S.2d at 36.
30. *Hobson*, 39 N.Y.2d at 489-90, 384 N.Y.S.2d at 426.
31. *Id*. at 489, 384 N.Y.S.2d at 425. *See also Estate of Eckart*, 39 N.Y.2d 493, 499, 384 N.Y.S.2d 429, 432 (1976) ("When courts themselves have originated the rule, as for instance a common-law rule of tort, the courts will more readily re-examine it and, if necessary, set it aside.").
32. *Buckley v. City of New York*, 56 N.Y.2d 300, 305, 452 N.Y.S.2d 331, 333 (1982).
33. *Hobson*, 39 N.Y.2d at 489-90, 384 N.Y.S.2d at 425-26; *Eastern Consolidated Properties, Inc. v. Adelaide Realty Corp*. 95 N.Y.2d 785, 788, 710 N.Y.S.2d 840, 841 (2000) (Kaye, C.J., concurring) ("persons entering into contract and property transactions are guided by court decisions and tailor their agreements to conform to the law. Because 'settled rules are necessary and necessarily relied upon, stability and adherence to precedent are generally more important than a better or even "correct" rule of law.'").
34. *City of Buffalo v. Cargill, Inc.*, 44 N.Y.2d 7, 18, 403 N.Y.S.2d 473, 479 (1978).
35. *Hobson*, 39 N.Y.2d at 490, 384 N.Y.S.2d at 426, *citing Semanchuck v. Fifth Avenue & 37th Street Corp.*, 290 N.Y. 412, 420 (1943).
36. *Hobson*, 39 N.Y.2d at 384 N.Y.S.2d at 426.
37. *Meyer v. Somlo*, 105 A.D.2d 1007, 1008, 482 N.Y.S.2d 156, 157 (3d Dep't 1984).
38. *Hobson*, 39 N.Y.2d at 491, 384 N.Y.S.2d at 427.
39. *Babigian v. Wachtler*, 181 A.D.2d 640, 640, 582 N.Y.S.2d 14, 15 (1st Dep't 1992).
40. *Carnesi v. State*, 140 A.D.2d 912, 913, 529 N.Y.S.2d 214, 215 (3d Dep't 1988).
41. *81 Franklin Co. v. Gianaccini*, 149 Misc. 2d 124, 128, 563 N.Y.S.2d 977, 980 (Civ. Ct., N.Y. Co. 1990).
42. *Id*. at 128, 563 N.Y.S.2d at 980-81.
43. *In re Claims of Bull*, 235 A.D.2d 722, 724, 652 N.Y.S.2d 809, 811 (3d Dep't 1997).
44. *Belcher Co. of New York, Inc. v. City of New York*, 157 A.D.2d 585, 586, 550 N.Y.S.2d 331, 332 (1st Dep't 1990); *Kleinberg v. American Mayflower Life Ins. Co.*, 106 A.D.2d 268, 268, 482 N.Y.S.2d 282, 284 (1st Dep't 1984).
45. *Ross Bicycles, Inc. v. Citibank, N.A.*, 149 A.D.2d 330, 330-31, 539 N.Y.S.2d 906, 907 (1st Dep't 1989).
46. *Branciforte v. Spanish Naturopath Society, Inc.*, 217 A.D.2d 619, 629 N.Y.S.2d 465 (2d Dep't 1995).
47. *Mountain View Coach Lines, Inc. v. Storms*, 102 A.D.2d 663, 664, 476 N.Y.S.2d 918, 919-20 (2d Dep't 1984); *People v. Shakur*, 215 A.D.2d 184, 185, 627 N.Y.S.2d 341, 342 (1st Dep't 1995); *People v. Brisotti*, 169 Misc. 2d 672, 652 N.Y.S.2d 206 (App. Term 1st Dep't 1996).
48. *Mountain View Coach Lines*, 102 A.D.2d at 665, 476 N.Y.S.2d at 920.
49. *Miano v. Hehn*, 206 A.D.2d 957, 959, 614 N.Y.S.2d 829, 830 (4th Dep't 1994).
50. *Hartnett v. New York City Transit Authority*, 200 A.D.2d 27, 32, 612 N.Y.S.2d 613, 616 (2d Dep't 1994), *aff'd* 86 N.Y.2d 438, 633 N.Y.S.2d 758 (1995); *Alorna Coat Corp. v. Lumbermens Mut. Cas. Corp.*, 167 A.D.2d 329, 330, 562 N.Y.S.2d 80, 80 (1st Dep't 1990).
51. *Rosner v. Metropolitan Property & Liab. Ins. Co.*, 236 F.3d 96, 103 (2d Cir. 2000).
52. *Fletcher v. Kidder, Peabody & Co.*, 81 N.Y.2d 623, 632-33, 601 N.Y.S.2d 686, 689-90, *cert. denied* 510 U.S. 993 (1993).
53. *People v. Kin Kan*, 78 N.Y.2d 54, 60, 571 N.Y.S.2d 436, 439 (1991).
54. *Podraza v. Carriero*, 212 A.D.2d 331, 338, 630 N.Y.S.2d 163, 168 (4th Dep't 1995), *quoting 423 South Salina Street, Inc.*, 68 N.Y.2d 474, 489, 510 N.Y.S.2d 507, 514-15 (1986), *cert. denied* 481 U.S. 1008 (1987).
55. *People v. Brown*, 235 A.D.2d 344, 344-45, 653 N.Y.S.2d 544, 544 (1st Dep't 1997). *See also Boyd v. Constantine*, 180 A.D.2d 186, 189, 586 N.Y.S.2d 439, 441 (4th Dep't 1992), *rev'd. on other grounds*, 81 N.Y.2d 189, 597 N.Y.S.2d 605 (1993).
56. *Flanagan v. Prudential-Bache Secs., Inc.*, 67 N.Y.2d 500, 506, 504 N.Y.S.2d 82, 85, *cert. denied* 479 U.S. 931 (1986).
57. *See supra* text accompanying notes 22-23.
58. *Cott v. Erie R.R. Co.*, 231 N.Y. 67, 73, *cert. denied* 267 U.S. 636 (1921).
59. *See supra* text accompanying notes 12-13.
60. *See supra* text accompanying notes 38-41.
61. *See supra* text accompanying note 36.
62. *See supra* text accompanying note 47.

Early Assessment of Potential Liens Is Critical to Assure That Recovery Meets Client's Expectations

By Elizabeth E. Little

Liens are the uninvited guests at the negotiating table. But once they are seated they won't leave simply for the asking. Therefore, before an offer is accepted—or even before a demand is made—a plaintiff's attorney in an automobile accident case needs to examine the case for these potential deal-breakers, which can reduce a client's recovery to an unacceptable level.

If liens are not discovered before an initial demand is made, the amount sought may be inappropriate, and may later prove insufficient to meet the client's needs or expectations. The information is also vital to the second stage of negotiations with the defendant, deciding whether to recommend acceptance of a settlement offer. Finally, counsel must act promptly to deal with them successfully.

Without timely negotiation of a lien, the plaintiffs' bargaining position when attempting to reduce it may be lost. In the end, the lien may be all that stands between the client and the defendant's offer, and a lienor who knows that a case has been settled may also know that there is enough to satisfy the lien in full. This can provide little room for plaintiff's counsel to negotiate.

This article provides guidance in the area by outlining many of the common lien issues that arise in a motor vehicle accident cases.

The "Basic" No-Fault Lien

A no-fault lien comes into being when a covered party receives no-fault benefits from his or her carrier and the defendant is not covered by the required financial security, or is otherwise not entitled to no-fault benefits.

The first question to ask is whether this particular defendant was a covered person as that term is defined in the Insurance Law.[1] This initial inquiry is necessary because the Insurance Law provides that a no-fault lien cannot arise if the case involves a covered plaintiff and a covered defendant,[2] but also states that if the defendant is not a covered person, the no-fault carrier "has a lien against any recovery to the extent of benefits paid or payable by it to the covered person."[3]

Some common non-covered persons include a defendant who is driving an uninsured vehicle, an automobile manufacturer, the bar in a dram shop case, or, in certain cases, a municipality.[4] In the past, a defendant who resided in another state was often deemed a non-covered person and the no-fault carrier thus could assert a lien against the plaintiff's recovery. For the most part, this is no longer the case. If a defendant is an out-of-state resident, the plaintiff should determine (1) whether the defendant's insurance company is an authorized insurer, and (2) whether the defendant's insurance provides liability coverage in excess of that required by Vehicle and Traffic Law § 311(4). If both of these questions are answered affirmatively, then the defendant is a covered person and the no-fault carrier may not assert a lien on the settlement.[5] If either prong is missing, the defendant is not covered and the lien can arise. If it does, counsel must understand both its theory and its practical implications.

Although the effect of a no-fault lien on real-life situations can present puzzles for all involved, the idea behind it is straightforward: to prevent a double recovery by the plaintiff.[6] What constitutes a double recovery is, of course, clearer after a verdict than after a settlement. In the former the finder of fact will state the breakdown between pecuniary losses—covered by no-fault and thus subject to a lien—and compensation for pain and suffering, which is not. In the settlement context there may be no clear distinction. In this situation the carrier who has not consented to the settlement thus may be

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granted a hearing to determine the sum to which its lien may attach.[7] Given the obvious risk to a plaintiff's recovery, counsel should endeavor to avoid this situation.

The no-fault lien is often overlooked when formulating a demand, because most cases involve both a covered plaintiff and a covered defendant. However, in cases where the defendant is not a covered person, counsel should obtain an updated total of no-fault benefits paid before engaging in negotiations, and also determine the total dollar amount of claims the carrier has not yet processed. Armed with this information, counsel can—and must—discuss the lien with the carrier. This effort often results in an agreement by the carrier to reduce the lien in order to encourage the plaintiff to accept the settlement, because this assures the carrier of at least some repayment. Under no-fault regulations, the no-fault carrier's consent to the settlement means that it must then continue to pay the remaining benefits due to the plaintiff. In any event, in cases where the settlement will not exceed $50,000, the plaintiff must either receive the written consent of the no-fault carrier before accepting a settlement, or procure a court order allowing him or her to do so.[8]

Other No-Fault Liens

In addition to inquiring into a potential no-fault lien based on payment of basic coverage amounts, counsel should also determine whether the plaintiff has any additional no-fault coverage. One of the most common is Additional Personal Injury Protection (APIP). When the plaintiff receives APIP benefits, the carrier generally possesses a subrogation claim against the amounts paid by the defendant that is equal to the amount of APIP paid to the plaintiff. It is important to understand that the subrogation right enjoyed by the carrier is derived from the insurance contract,[9] and thus, unlike the basic no-fault lien, is viable even in situations where both the plaintiff and the defendant are covered persons.

The potential for an APIP lien can be difficult to assess if a demand is made early in the litigation, because counsel may have to guess whether basic Personal Injury Protection coverage will be exhausted and the additional coverage reached. However, when an APIP lien is anticipated, it should be factored into the demand so that a sufficient ceiling is established. At the time of settlement, this lien may be negotiated with the APIP carrier.

A frequent issue that arises in APIP cases is whether settlement with the defendant prejudices the APIP carrier's subrogation right.[10] A general release given to the defendant has been found to prejudice the rights of the insurer and to constitute a breach of contract.[11] A practical dilemma can thus arise at the time of settlement. The defendant will often not accept a release that contains a reservation of rights in favor of the plaintiff's insurance carrier. For its part, the APIP carrier has no incentive to approve the settlement without this reservation of rights and often either refuses the approval or simply fails to respond to the request for approval. These circumstances mean that a plaintiff who wants to accept the defendant's offer is unable to do so without prejudicing the rights of the APIP carrier. As a result, a settling plaintiff will, in most situations, be cut off from APIP coverage. There are instances, however, in which the no-fault carrier pays no attention to settlement, and pays the APIP benefits anyway. The appropriate course of action should be explored on a case-by-case basis or, perhaps more accurately, a carrier-by-carrier basis.

Another potential no-fault insurance issue that should be considered during settlement negotiations is the $25,000 Optional Basic Economic Loss (OBEL)[12] coverage. However, if this endorsement exists in a given policy, any payments made under it is an extension of basic economic loss coverage rather than a separate additional category of insurance. Therefore it will not become the basis for a lien. Nevertheless, it is still important to keep any such payments in mind. Because OBEL is an extension of basic economic loss, the plaintiff who elects to go to trial will need to prove economic damages in excess of $75,000, not $50,000, before being eligible to collect money from the defendant on an economic loss claim. The client should be advised of this factor before a settlement offer is refused.

Work-Related Injuries—Compensation Liens

If a motor vehicle accident occurs while the injured party was on the job, additional circumstances must be considered before a demand is made or an offer of settlement is evaluated. The principal concern is whether the worker will be faced with repaying the carrier who provides the workers' compensation insurance. Often, however, this lien is subject to reduction, and in some cases, outright elimination.

The first task for counsel is to determine the total amount of workers' compensation benefits paid to date. Unless the compensation paid exceeds $50,000, it is usually not an issue. Compensation paid in lieu of no-fault will not become the subject of a separate lien[13] if the parties to the accident are all "covered persons" under no-fault. However, before the issue is closed, counsel should check to see whether wages were paid to the plaintiff/claimant for more than three years after the collision. Because no-fault wages are paid for the first three years after the accident only, the compensation carrier will have a lien for any compensation paid beyond the three-year limit.[14] As noted, the compensation carrier will also have a lien on any payment that exceeds $50,000.[15]

The compensation lien also is subject to the provisions established in section 29 of the Workers' Compensation Law and the case of *Kelly v. State Insurance Fund*,[16] under which the lien is reduced in recognition of the benefit enjoyed by the carrier when the claimant recovers from a third party. Pursuant to *Kelly*, when a workers' compensation claimant "recovers damages in a third-party action, the compensation carrier's equitable share of litigation costs incurred by the claimant may be apportioned on the basis of the total benefit that the carrier derives from the claimant's recovery."[17] Costs and disbursements of the action are added to the attorney's fee, and this total represents the "litigation costs." The litigation costs are then divided by the total amount of the settlement. The resulting percentage is deemed to the costs of attaining the recovery. The amount of workers' compensation benefits paid is then multiplied by this percentage to determine the extent to which the carrier's lien should be reduced.

Once a settlement is paid to the claimant, the workers' compensation carrier will take a "holiday." This is a period of time during which the carrier is not required to make compensation payments to the plaintiff/claimant. The duration of this holiday is determined by the workers' compensation judge, and in general equals the amount of time it would take the carrier to make payments if net proceeds received by the plaintiff/claimant were paid out in installments by the workers' compensation carrier.

Because this holiday means that the carrier will be relieved from making payments in the future, it serves to further reduce the compensation lien. The carrier must reduce its lien by the present value of the future benefits that it will not have to pay because of the settlement. If the plaintiff/claimant and the workers' compensation carrier cannot agree on the amount of lien reduction, the court before whom the third-party action was initiated can make an order apportioning the costs to the recovery. If no action was initiated, then a "court of competent jurisdiction" can make the order.[18]

Equity Considerations As is apparent from the foregoing, the principal consideration in lien reduction is equity. This concept, as well as the carrier's self interest, can sometimes lead to a waiver of the lien in its entirety. A carrier can be persuaded to abandon its lien entirely if a settlement is offered in a case where it believes that the plaintiff/claimant's chances of success at trial are slim. This is so because the carrier is often wiser to accept a known "holiday" based on the settlement rather than to risk losing any benefit at all by forcing the plaintiff/claimant to go to trial with a weak case.

This is especially true when the carrier has an obligation to make continued compensation payments to the plaintiff/claimant. If the plaintiff/claimant were to lose at trial, the carrier loses twice. With no recovery, there are no proceeds against which the carrier can assert a lien and no funds that would entitle the carrier to take a holiday from making its weekly compensation payments to the plaintiff/claimant.

On the other hand, if the case yields a substantial recovery, the plaintiff/claimant could effectively lose his or her entitlement to future workers' compensation. Applying the same equity concept, the carrier must pay the claimant an amount equal to the value of the carrier's anticipated savings—computed through use of the same *Kelly* formula that determines a lien offset—if the recovery exceeds the value of waiving the compensation lien.[19]

Of equal importance to the compensation lien itself is the carrier's approval of the settlement, or a court's authorization to settle absent that approval. One or the other must occur before the offer is accepted. If not, the plaintiff/claimant's entitlement to future compensation benefits is jeopardized,[20] and it would make no difference that the defendant's full policy was offered; it thus is critical to obtain approval or authorization prior to acceptance of a settlement.[21] It is possible that approval can be obtained after the fact, that is, in a case where a settlement is inadvertently accepted prior to approval. Nevertheless, the possibility of retroactive approval should not be relied upon. Planning that is based on the leniency of the workers' compensation case manager or the court, *nunc pro tunc*,[22] clearly is not the best way to protect a client's rights.

Special Funds Cases When obtaining the carrier's approval, counsel should inquire whether the case involves the Special Disability Fund, better known as Special Funds. This is a state agency that exists to deal with cases involving workers who have disabilities above and beyond the accident-caused compensation injury.[23]

After the workers' compensation carrier pays 260 weeks of disability benefits, Special Funds starts reimbursing the carrier for all of the benefits paid.[24] This often becomes an issue when negotiating with the carrier to waive the lien. Special Funds will not want to bear the burden of reimbursing a carrier that has taken less of a credit from the settlement proceeds than it thinks the carrier should have, thereby shortening the compensation carrier's holiday and advancing the time when Special Funds would have to pick up payments to the injured worker.

It is a good idea to speak to the Special Funds case administrator directly instead of negotiating through the compensation carrier, because Special Funds can become the real party in interest. Although the approval of the compensation carrier is all that is required for the plaintiff/claimant to settle the case, Special Funds can still cause a settlement to derail, because it will require the compensation carrier to obtain the Fund's approval as a condition for continued reimbursement. If that approval is not forthcoming, the carrier may be unwilling to give its own approval to the claimant.

Derivative Claims Another issue concerns derivative claims in the personal injury action. If the plaintiff/claimant has a spouse who is also a party to the action, and the settlement is divided between the plaintiff/claimant's main claim and the spouses' derivative claim, then the amount used by the compensation judge to determine the length of the carrier's holiday will be less than if the entire claim was paid to the plaintiff/claimant.

In many cases it may be helpful to the plaintiff for the carrier to have a shorter holiday, because the compensation carrier will resume paying benefits sooner. In other cases, however, a longer holiday is desirable because the carrier may be required to contribute more *Kelly* money to the settlement. Before a division of funds is proposed to the defendant, counsel should "run the numbers" to see which alternative best serves the client. Given the dichotomy of a shorter holiday versus a larger *Kelly* payment, the insurance carrier usually has no pressing reason to become involved in the division of funds between the two plaintiffs, and their attorney can often dictate the breakdown.

Medicare & Medicaid Liens

When the client is either 65 years old or in need of public assistance, the Medicare or Medicaid programs can become players in the settlement process. In the ordinary case, neither should be involved as direct payors of medical benefits to persons injured in an automobile accident, because no-fault should cover them all, up to the policy limits. However, there are several cases where Medicare or Medicaid has paid benefits. This is especially common with an older client who has received Medicare benefits in the past and whose doctors inadvertently send the client's bills to Medicare. Counsel must be prepared to deal with these liens before making a demand or accepting an offer.

Medicare may be entitled to a lien on funds paid for injuries related to the motor vehicle case.[25] In most situations the client or counsel will receive a notice from Medicare regarding its lien, and the total amount must be confirmed. Because of the slow speed at which most Medicare offices are able to respond, it is advisable to start the process of confirming the total several months before the demand is made or the settlement offer is evaluated. This is done by contacting the Medicare office that sent a notice and any other Medicare office in the geographical area where the plaintiff has been treated.

Potential Lien Checklist

1. Is one or more of the defendants a non-covered party?

If so, a.) have we negotiated the no-fault lien?

b.) do we have approval to settle if the settlement is under $50,000?

2. Does the plaintiff have APIP or other additional insurance?

Did the client use the additional insurance?

If so, has the carrier's lien been negotiated?

Did we get the permission of the carrier to settle?

If not, has situation been discussed with client?

3. Was this an on-the-job injury?

How much workers' compensation benefits were paid out?

What is the amount of benefits above $50,000 paid out by the compensation carrier?

Has the amount of benefits paid over $50,000 been negotiated with the carrier?

For how many years were wages paid out? (Past the three-year threshold?)

Has this lien been negotiated?

Has the compensation carrier or court approved the settlement?

Was the settlement divided between the husband and wife?

What is the amount of the lien after reduction?

Is there any *Kelly* fee?

4. Did the client receive Medicare?

If so, what is the Medicare lien?

Part A ____________

Part B ____________

Do we know that this is the total lien amount from each Medicare office?

Has the settlement been divided between the husband and wife?

What is the total lien amount?

5. Has the client received Medicaid or other state/county benefits?

Did the client receive benefits from more than one county?

What is the amount of the lien?

Can/Has this lien be/been negotiated?

6. Did the client's private health insurance pay for any accident-related medical costs?

Does the health insurance contract create a lien, subrogation or refund right?

7. Are there any lawsuits or collection efforts pending against the plaintiff?

Have they been negotiated?

What if no notice arrives? There is currently a debate over whether the plaintiff's attorney should put Medicare on notice of its potential lien if this is the case.[26] The danger of not notifying Medicare is that if it discovers that it paid for medical expenses that should have been covered by a third party, it may bring an action against the beneficiary or the attorney who has received a third-party payment.[27] The defendant will often "help" the plaintiff's attorney make this decision because the defendant too is on the hook for any lien—because the federal government has the power to collect the amount of the lien directly from the defendant.[28]

It is a good idea to request itemization of the benefits that are the basis of the lien.

Assuming that the decision is made to notify Medicare, every office in the geographical area where the plaintiff has been treated should be contacted. Counsel should inquire whether Medicare has a Part A or Part B lien on the settlement proceeds of the lawsuit, and the total amount of the lien for both parts should be determined. Medicare will perform a calculation to fix its lien. Unfortunately for a plaintiff, this calculation is statutory and there is little room for negotiation.

Medicaid is the other large government program that can pay medical benefits to an injured client, and though it is frequently confused in the public mind with Medicare, it is entirely distinct. Pursuant to Social Services Law §§ 104-b(1), 366(4)(h)(1), 367-a(2)(b) and 42 U.S.C. § 1396k(a)(1)(A), Medicaid has a lien on the total amount of public assistance and care furnished on and after the date when the injuries occurred, and will send a lien notice to the plaintiff. Counsel then will be dealing with state or local agencies, because Medicaid is administered by the New York State Department of Health and the New York City Human Resources Administration. Local county governments can be administrators as well, and possess the power to pursue liens.

Before the case is settled, any updated Medicaid lien notices should be reviewed to determine the full amount of the lien. It is a good idea to request itemization of the benefits that are the basis of the lien. In the case of a 104-b lien, careful attention should be paid to the date the services were rendered to confirm that the benefits were paid on or after the date of the injury, not before. In addition, with this type of lien counsel should verify that the assistance and care were paid for the plaintiff's sole benefit. For example, funds paid to an adult plaintiff under the former Aid to Dependent Children program, now titled Temporary Assistance for Needy Families, is assistance provided for the maintenance and care of the children. The state can recover the amount of assistance provided for the adult plaintiff's sole benefit, but it may not recover the funds provided for the children.[29]

The state may also go after the funds directly, pursuant to Social Services Law § 104(1). This statute allows the state to bring an action against a plaintiff "discovered to have real or personal property." The state can attempt to collect aid paid to a plaintiff during the ten years that preceded the accident. Counsel should be sure to make the client aware of this possibility. If clients are not so informed, they could consent to a settlement that is insufficient to meet their needs after Medicaid has been reimbursed.

If an action is brought by the state, it is not limited to reimbursement for care furnished on or after the date of injury, and it may attempt to recover funds paid to dependents of the plaintiff, such as children, based on an assignment signed by the plaintiff. As unpleasant as it may appear to a plaintiff or his counsel, the state may be able to collect the entire settlement of an aid recipient.[30] The client thus should also be asked if he or she has received any other benefits from the Medicaid program that may be subject to a lien. If so, then the amount of benefits paid and the item for which the benefits were extended should be determined. Once again, these benefits should not be paid in a typical situation because no-fault insurance should cover most of the plaintiff's needs. However, this situation does arise.

Funds for Supplemental Needs Trusts At one time it was unclear whether counsel could avoid satisfying a Medicaid lien by establishing a Supplemental Needs Trust (SNT) with the settlement proceeds pursuant to EPTL § 7-1.12. No longer. Pursuant to the Court of Appeals determination in *Cricchio v. Pennisi*,[31] the state is entitled to satisfy its lien before the SNT is funded. In the later case of *Calvanese v. Calvanese*,[32] the Court determined that all of the settlement proceeds are available to satisfy the state's lien, not just those funds designated as compensation for medical expenses.

The only potential relief for a plaintiff who has a large lien, or whose entire settlement is at risk of being subsumed by a Medicare lien, is the officer of the local Medicaid agency handling the case. The state has the power to fix the amount of the lien and to release and discharge it.[33] This statutory authority allows the state to reduce the amount of the lien. If the local agency official is reluctant to reduce the lien, it is possible to seek assistance from the Department of Health. In some situations the department can put pressure on the local agency official to reduce the lien.

Whether an infant's settlement is subject to recoupment by the state was addressed directly by the Court of

Appeals in 1976 when it decided *Baker v. Sterling*.[34] In *Baker,* the Court determined that only settlement proceeds related to a compromise of the infant's claim for past medical expenses, in excess of the infant's reasonable requirements, were subject to the statutory Medicaid lien.[35] This being the case, settlements that fairly could be characterized as compensation for pain and suffering alone were interpreted by many as not being subject to the lien. However, this safe harbor for infants came under attack. The First, Second and Third Departments all decided cases in favor of state's lien rights against persons under 21 years of age.[36]

The final answer came with the Court of Appeals revisiting the issue in *Gold v. United Health Services Hospitals Inc.*,[37] the case decided by the Second Department (the appeal from a Third Department case, *Santiago v. Craigbrand Realty Corp.*[38] was also decided in the same decision). Asserting that the relevant statutory scheme had changed since *Baker* was decided, and referring to its discussions of those statutes in *Cricchio* and *Calvanese*, the Court held that Social Services Law § 104(2) will not act as a bar to Medicaid's recoupment provisions. The entire settlement or judgment recovered by an infant will thus be subject to Medicaid's lien.

As a final note on these governmental liens, an attorney who represents not only the injured party but also a spouse or parent with a viable derivative action should consider whether this is an appropriate case for a division of settlement proceeds between the two claims; this can limit the funds against which Medicare or Medicaid can assert a lien. Given these recent developments in the law, this may be an attractive—and perhaps the only—way to limit recoupment by a determined state Department of Health.

Private Health Insurers' Liens

If the plaintiff's no-fault benefits were discontinued before the settlement, counsel should determine whether the plaintiff's private medical insurance paid for any accident-related medical benefits. If so, the medical insurance contract should be reviewed to determine if the insurance company reserved to itself any lien right, reimbursement right or subrogation right with regard to a third-party settlement.

A number of health insurers have attempted to intervene in personal injury suits by their insureds in order to recoup benefits paid as a result of the injuries sustained, at both the pre-trial and settlement phase.[39] Although all four Departments of the Appellate Division have denied a health insurer's right to intervene, it is far from true that the claims of health insurers can be ignored.

Any review of the law in this area must begin with *Teichman v. Community Hospital of Western Suffolk*,[40] an infant's medical malpractice action in which the infant's health insurance company sought to intervene. The medical payments in issue ($169,302) were not significant in light of the recovery ($4.5 million), but plaintiff's counsel, who had been notified of the insurer's position regarding its claim to reimbursement some three years earlier, wrote to the insurer a few days after the case was settled and asserted that it had no lien. Before the infant's compromise order was signed, counsel moved to "vacate" the insurer's claim. The ultimate result was that the Court of Appeals allowed the health insurance company to intervene to protect its rights.

The Court of Appeals determined that although the health insurance company had no contractual lien or equitable lien (because no specific property was identified as a fund that might serve as security for an obligation flowing to it from its insured), it might be entitled to a contractually based refund. It thus allowed intervention upon its finding that the settlement may have included compensation for medical expenses, which the health insurer could recoup. The Court noted that this would prevent a double recovery by the plaintiff and did not offend CPLR 4545, because that section does not apply to settlements. It thus remanded the case to the trial court, presumably for a determination as to whether any component of the settlement was for medical expenses and thus subject to the health insurer's contractual refund claim.

Following *Teichman*, the four Departments of the Appellate Division weighed in with a series of cases that amplified on the holding. In *Independent Health Association v. Grabenstatter*, the Fourth Department had before it an action brought by a health insurance company against the plaintiff (and the plaintiff's attorney) following a settlement.[41] That action was dismissed, with *Teichman* serving as authority.[42] In *Humbach v. Goldstein*,[43] *Berry v. St. Peter's Hospital of the City of Albany*[44] and *Halloran v. Don's 47 West 44th St. Restaurant Corp.*[45] the other Departments refused to allow intervention in a pending action.

In *Humbach* the Second Department found that by its terms the insurance contract did not create a lien until a settlement or satisfied judgment was reached, and thus the health insurance company's attempt to intervene on a contractual basis was premature. Addressing any theory based on equitable subrogation, it stated that if the case went to verdict, CPLR 4545 would bar the insurer's right to recover. The decision also voiced concern that intervention in a pending action would transform simple personal injury actions into "complicated, unmanageable, multiparty litigation."[46] Notwithstanding the result, the *Humbach* decision clearly does not interpret *Teichman* as barring a contractual claim in the pretrial settlement context.

In *Berry*, the Third Department rejected the health insurers' attempt at intervention on public policy grounds and because of the potential for prejudice to the plaintiff. In the *Berry* case it appears that the carriers' medical expenses of $2.5 million would have exhausted the available liability policies. The *Berry* court held that an insurer cannot take proceeds where an insured has not been made whole, and in the case before it that possibility was a real one. The court further stated that if a loss must go unsatisfied, it should be the insurer who bears such a loss, as it is the insurer who has been paid to assume the risk. In a similar vein, the First Department found in *Halloran* that intervention was premature and would be "inappropriate since it would likely have the consequence of placing [the insurer's] interests in impermissible conflict with those of its insured."[47]

Intervention was allowed by a trial court in *Nossoughi v. Federated Department Stores, Inc.*[48] based on the insurer's right of equitable subrogation. However, with a reference to the concerns expressed in *Humbach* the participation of the carrier's counsel was sharply limited, and counsel could do no more than receive all notices in the pretrial phase, and participate at trial only at the discretion of the trial judge. Interestingly, the court also held that under *Teichman* no settlement could be made without the insurer's consent.

As should be apparent, the case law has not established any hard-and-fast rules regarding when a health insurance company will be allowed to intervene and/or recoup medical expenses in a third-party action.

As a practical matter, then, counsel should first determine if accident-related medical expenses have been paid by a private health insurer. If so, the health insurance contract should be reviewed. If the contract appears to create a lien by identifying a specific fund to which a lien might attach, or grants a right of subrogation, the totality of the recovery should be reviewed to determine whether enforcement of the lien or subrogation right will prevent the plaintiff from being made whole. This potential lien or subrogation right may also affect the wording of the settlement agreement, as lack of clarity regarding the composition of the settlement could lead to a hearing on the vitality of the health insurer's claim. Indeed, even if the language purports to exclude medical expenses the stipulation may not be found binding on the health insurance carrier.[49] This should be fully discussed with each client who could be affected by an insurance company's attempt to recoup funds.

Finally, the file should be reviewed to see whether any notices of lawsuits have been filed or collection actions started by unpaid medical providers. This situation often arises when no-fault benefits are discontinued and the plaintiff has no other health insurance available. Although there is no requirement that these lawsuits or collection efforts be handled before the case is settled (providing that no judgment has been filed and a lien thus created), this is the time when the plaintiff is in the best position to negotiate these outstanding bills.

Conclusion

Although issues not discussed in this article can certainly arise in exceptional cases, it is likely that plaintiff's counsel will have to deal with one or more of the liens mentioned here at one time or another. If these potential liens are assessed before a demand is made or a settlement offer is reviewed, counsel will be in a much better position to evaluate the case intelligently and advise the client; the late discovery of an undetected lien can be disconcerting, to say the least. Given the number and variety of liens that might attach to a plaintiff's recovery, a routine, but thorough, check is advisable for all cases.

1. Pursuant to Insurance Law § 5102(j) a covered person means

    > any pedestrian injured through the use or operation of, or any owner, operator or occupant of, a motor vehicle which has in effect the financial security required by article six or eight of the vehicle and traffic law or which is referred to in subdivision two of section three hundred twenty-one of such law; or any other person entitled to first party benefits.

2. Insurance Law § 5104(a).
3. Insurance Law § 5104(b).
4. Uninsured Automobiles: *City of Poughkeepsie v. Garlepp*, 158 A.D.2d 120, 558 N.Y.S.2d 663 (3d Dep't 1990); Auto Manufacturer: *Acevedo v. G.E.I.C.O.*, 87 A.D.2d 600, 448 N.Y.S.2d 50 (2d Dep't), *lv. denied* 57 N.Y.2d 605 (1982); Dram Shop: *Dymond v. Dunn*, 148 A.D.2d 56, 543 N.Y.S.2d 230 (3d Dep't 1989); Municipality: *Lang v. City of New York*, 98 A.D.2d 792, 469 N.Y.S.2d 971 (2d Dep't 1983).
5. *Nationwide Ins. Co. v. Morigerato*, 215 A.D.2d 994, 627 N.Y.S.2d 123 (3d Dep't 1995); *Aetna Life & Cas. Co. v. Allstate Ins. Co.*, 207 A.D.2d 984, 616 N.Y.S.2d 838 (4th Dep't 1994).
6. *Aetna Life & Cas. Co. v. Nelson*, 67 N.Y.2d 169, 176, 501 N.Y.S.2d 313 (1986).
7. *Dymond v. Dunn,* 148 A.D.2d 56, 543 N.Y.S.2d 230 (3d Dep't 1989).
8. Insurance Law § 5104(b).
9. Prior to collection of benefits, the carrier requires the plaintiff to sign an N-F11 form wherein the plaintiff guarantees the carrier its subrogration rights and to do nothing to prejudice those rights.
10. 11 N.Y.C.R.R. § 65-1.3(c)

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

See also 11 N.Y.C.R.R. Appendix 13-A, the N.Y.S. Form N-F11.

11. *Weinberg v. Transamerica Ins. Co.*, 62 N.Y.2d 379, 477 N.Y.S.2d 99 (1984).
12. 11 N.Y.C.R.R. § 65-1.2, Insurance Law § 5102(a)(5).
13. *Dietrick v. Kemper Ins. Co.*, 76 N.Y.2d 248, 557 N.Y.S.2d 301 (1990).
14. *Johnson v. Buffalo & Erie County Private Indus. Council*, 84 N.Y.2d 13, 17, 613 N.Y.S.2d 861 (1994).
15. The compensation carrier does not have a lien on a recovery procured from an uninsured motorist benefits endorsement. The carrier's lien is limited to funds recovered from third-party defendant. *Shutter v. Phillips Display Components Co.*, 90 N.Y.2d 703, 665 N.Y.S.2d 379 (1997).
16. 60 N.Y.2d 131, 468 N.Y.S.2d 850 (1983).
17. *Id*. at 135.
18. *Id*. at 136.
19. *Id*. at 138–140.
20. Workers' Compensation Law § 29(5); *Johnson v. Buffalo & Erie County Private Indus. Council*, 84 N.Y.2d 13, 613 N.Y.S.2d 861 (1994).
21. *Johnson*, 84 N.Y.2d 13.
22. A *nunc pro tunc* order may be obtained when a settlement is reasonable, the delay in applying for the order or approval was not caused by fault or neglect and the insurance carrier was not prejudiced for the delay. Workers' Compensation Law § 29(5); *Gilson v. National Union Fire Ins. Co.*, 246 A.D.2d 897, 668 N.Y.S.2d 287 (3d Dep't 1998).
23. New York established a Second Injury Fund also called Special Disability Fund to lessen the potential burden on employers who hired or retained people with disabilities. When the "pre-existing handicap . . . increase[s] the compensation liability above that which the employer would have incurred as a result of the subsequent injury alone" Special Funds will be involved in the case. *Saletta v. Allegheny Ludlum Steel Corp.*, 62 A.D.2d 360, 404 N.Y.S.2d 896 (3d Dep't 1978).
24. The amount of time before Special Funds steps in and starts reimbursement recently changed. In the past Special Funds commenced reimbursement after 104 weeks of paying benefits. The cut-off date for the new timetable is August 1, 1994. Workers' Compensation Law § 15(8)(d).
25. 42 U.S.C. 1395y(b)(2) This is Medicare's secondary payer program. Medicare is precluded from paying for a beneficiary's medical expenses when payment "has been made or can reasonably be expected to be made . . . under an automobile or liability insurance policy or plan (including a self-insured plan) or under no-fault insurance." If Medicare makes a payment that should have been paid by no-fault or the defendant's liability carrier, Medicare is entitled to reimbursement for that payment from settlement funds.

    Medicare also has the right to bring an action against the third party who is responsible for making payment. 42 U.S.C. § 1395y(b)(2)(B)(ii).
26. An article and a responsive letter appearing in the publication *Trial* discuss the attorney's responsibilities with regard to reimbursing Medicare claims: Sally Hart, Esq., *Recovery powers under Medicare's Secondary Payer Program*, Trial (September 1997), and a letter from Mark A. Cameli, Esq., published in *Trial* (June 1998).
27. 42 C.F.R. § 411.24(g); *see United States v. Sosnowski*, 822 F. Supp. 570 (W.D. Wis. 1993).
28. 42 C.F.R. § 411.24; *Liss v. Brigham Park Cooperative Apts. Sec. No. 3, Inc.*, 264 A.D.2d 717, 694 N.Y.S.2d 742 (2d Dep't 1999).
29. *Borsman v. Mannix*, 46 A.D.2d 885, 361 N.Y.S.2d 694 (2d Dep't 1974); *Miller v. Smythe*, 79 Misc. 2d 945, 361 N.Y.S.2d 804 (1974). As the Medicaid recipient's assignee, DSS can immediately pursue its claims against the responsible third party. *Cricchio v. Pennisi*, 90 N.Y.2d 296, 660 N.Y.S.2d 679 (1997); Social Services Law § 366(4)(h)(1); 42 U.S.C. § 1396(k).
30. *Hoke v. Ortiz*, 83 N.Y.2d 323, 610 N.Y.S.2d 455 (1994), *cert. denied*, 513 U.S. 865 (1994).
31. 90 N.Y.2d 296, 660 N.Y.S.2d 679 (1997).
32. 93 N.Y.2d 111, 688 N.Y.S.2d 479 (1999).
33. Social Services Law § 104-b(1), (7).
34. 39 N.Y.2d 397, 384 N.Y.S.2d 128 (1976).
35. *See, e.g., Applegrad v. Maimonides Medical Center*, 213 A.D.2d 438, 624 N.Y.S.2d 904 (2d Dep't 1995) *citing Baker v. Sterling*, 39 N.Y.2d 397, 384 N.Y.S.2d 128 (1976).
36. *Santiago v. Craigbrand Realty Corp.*, 268 A.D.2d 28, 706 N.Y.S.2d 87 (1st Dep't 2000); *Carpenter v. Saltone Corp.*, __A.D.2d__, 716 N.Y.S.2d 86 (2d Dep't 2000); *Gold v. United Health Servs. Hosps.*, 261 A.D.2d 67, 701 N.Y.S.2d 123 (3d Dep't 1999), *appeal granted*, 95 N.Y.2d 754, 711 N.Y.S.2d 833 (2000).
37. N.Y.L.J. p. 19, col. 1 (Feb. 16, 2001).
38. 268 A.D.2d 28, 706 N.Y.S.2d 87 (1st Dep't), *appeal granted*, 273 A.D.2d 952, 713 N.Y.S.2d 468 (1st Dep't 2000).
39. *See, e.g., Teichman v. Community Hosp. of Western Suffolk*, 87 N.Y.2d 514, 640 N.Y.S.2d 472 (1996); *Berry v. St. Peter's Hosp.*, 250 A.D.2d 63, 678 N.Y.S.2d 674 (3d Dep't 1998); *Humbach v. Goldstein*, 229 A.D.2d 64, 653 N.Y.S.2d 950 (2d Dep't 1997), *lv. dismissed*, 91 N.Y.2d 921, 669 N.Y.S.2d 263 (1998).
40. 87 N.Y.2d 514, 640 N.Y.S.2d 472 (1996).
41. 254 A.D.2d 722, 678 N.Y.S.2d 220 (4th Dep't 1998), *lv. denied*, 93 N.Y.2d 804, 689 N.Y.S.2d 17 (1999).
42. In *Independent Health Association v. Grabenstatter* the Court dismissed a health insurance company's complaint against its insured and the insured's attorney for reimbursement from the settlement proceeds. The Court held that the health insurance contract was limited to reimbursement for identified health care expenses and since the insurance company did not establish that the settlement included reimbursement for such expenses, the company had no lien.
43. 229 A.D.2d 64, 653 N.Y.S.2d 950 (2d Dep't 1997), *lv. dismissed*, 91 N.Y.2d 921, 669 N.Y.S.2d 263 (1998).
44. 250 A.D.2d 63, 678 N.Y.S.2d 674 (3d Dep't 1998).
45. 225 A.D.2d 206, 680 N.Y.S.2d 227 (1st Dep't 1998).
46. 250 A.D.2d at 68, 678 N.Y.S.2d at 952. *See also McGuire v. Long Island Jewish-Hillside Med. Ctr.*, 237 A.D.2d 417, 654 N.Y.S.2d 420 (2d Dep't 1997); *Pell v. Malibu Resorts Int'l Ltd.*, 248 A.D.2d 605, 669 N.Y.S.2d 939 (2d Dep't 1998).
47. 255 A.D.2d 206, 680 N.Y.S.2d 227 (1st Dep't 1998) citing *Berry v. Lucent*, 250 A.D.2d 63, 678 N.Y.S.2d. 674; *Humbach v. Goldstein*, 229 A.D.2d 64.
48. 175 Misc. 2d 585, 669 N.Y.S.2d 479 (Sup. Ct., N.Y. Co. 1998).
49. *Aetna Cas. & Sur. Co. v. Jackowe,* 96 A.D.2d 37, 468 N.Y.S.2d 153 (2d Dep't 1983).

Lawyer's Bookshelf

Successful Partnering Between Inside and Outside Counsel, West Group and American Corporate Counsel Association, 4 volumes, 6032 pages, 4 diskettes of forms, $350. Reviewed by James C. Moore.

In their extraordinarily comprehensive, diverse and detailed exploration of the legal and strategic relationships between American businesses and their law firms, Robert Haig and more than 200 of the nation's most prominent general counsel and retained counsel have provided a masterful guide to many of the issues which those parties confront each day. Their work should serve as an invaluable resource for the entire profession.

In *Successful Partnering Between Inside and Outside Counsel*, the authors explore in 80 chapters—many with exemplars of forms, letters and brochures, as well as checklists—a broad spectrum of subjects ranging from the routine but vitally important ("Fee Arrangements," "Budgeting and Controlling Costs"), to the more exotic but less frequently seen subjects ("Arbitration of International Commercial Disputes" and "Use of Jury Consultants"). In between, the authors address, with helpful analysis and suggestions, a vast array of subjects that concern corporate counsel almost every day (*e.g.*, "Legal Research Management," "Technology," "Trial Preparation and Presentation" and "Law Department Management").

In a relatively brief review of a massive work such as this, it is difficult to accurately convey the scope of the subjects addressed or the depth of the authors' subject analysis. Nevertheless, even a fleeting look at a handful of the chapters will provide a sense of its usefulness.

In their essay, "Marketing to Potential Corporate Clients," authors Louis Briskman, James Quinn and Peter Antonucci consider such well-established marketing devices as the firm brochure, the "beauty contest" and firm seminars and newsletters. Whether such devices are effective, how they can be made more responsive to the needs of the client, and how law firms can improve their performance are issues the authors consider with candor and the benefit of considerable experience. These authors also provide useful suggestions about analyzing the legal needs of the business client and encouraging the use of additional skills from the law firm. In addition, this excellent essay contains helpful thoughts about law firm Web sites and how law firms can successfully respond to RFPs. Indeed, so valuable are the insights and suggestions contained in this chapter that it should find a welcome and productive place in most law firms as a stand-alone pamphlet.

One of the most troubling issues confronting the legal profession at this time is the fact that, on a relative basis, minorities are inadequately represented in its ranks. In their chapter entitled "Diversity," authors Marion Cowell, Jr. and W. Randy Eaddy address this important subject. Noting that several businesses now insist that their legal service providers do more than pay lip service to the concept of a diverse work force, the authors begin by articulating what they characterize as the "diversity principle"—a set of attitudes based on respect, together with an understanding that the differences between people do not matter for certain purposes. Once an organization commits to the diversity principle, the authors suggest, it can then determine which groups it will seek to bring within the scope of its plan. The authors take care to distinguish affirmative action from diversity programs and discourage the setting of number goals as a simplistic and ultimately unproductive response to the diversity issue. They also candidly admit the existence of several practical obstacles to compliance with their concept of diversity. They emphasize that a diversity program within a law firm or law department is an ongoing, unending commitment requiring the full support of senior managers. They also argue, however, that a diversity program is good for business. They conclude by suggesting specific actions that can be taken or avoided to enhance chances that such a program will succeed.

Addressing a subject that frequently provokes hand-wringing and cries of dismay from corporate counsel—as well as occasional laments from the bench and media—authors William J. O'Brien, Kenneth I. Gluckman and Stephen J. Ott have prepared an informative, practical and useful essay entitled "Discovery and Information Gathering." The authors contend that an important first step in managing this process is to understand that the goals of all discovery are essentially the same: to provide accurate information in a timely manner, to establish reasonable boundaries for the discovery process, to protect proprietary information, and to achieve these objectives in a cost-effective manner. They also enumerate and comment upon various discovery devices (including the unusual "apex" deposition) and suggest appropriate occasions and approaches for seeking judicial intervention to obtain protective orders. The chapter also discusses how to respond reasonably to requests for multiple depositions of key employees. The authors stress the importance of actively managing the discovery process so that the ultimate goal—successful completion of the lawsuit—will be achieved at reasonable expense and so that the interests of all of the parties will be fairly addressed.

One of the unique features of this treatise is that it concludes with several chapters devoted to case studies of the way that specific businesses have addressed legal issues and how they have worked with outside counsel to implement their philosophies. Some of the issues considered include the outsourcing of some legal functions, broad attempts to reform or change certain legal principles, and accelerated deal-making. Among the most interesting of these chapters is "Case Study—the Wal-Mart Approach to Litigation," written by Robert Rhoads, Ronald Williams, Jon Comstock and Ann Cato.

After noting that Wal-Mart is a defendant in approximately 99% of the cases in which it is involved, the authors identify the fundamentals of the company's litigation strategy: integrity, quality, breakneck speed, prevention and economy. They describe the way this philosophy is conveyed to retained counsel and how compliance with it is monitored. They stress the importance in every case of requiring opposing counsel to demonstrate that Wal-Mart did something wrong (the "What Did We Do Wrong" philosophy) before they will consider any settlement payment or before mediation will be considered. Reporting requirements, fee arrangements and the importance of understanding Wal-Mart's preference for venue in federal courts are also discussed. And, in a candid admission of a prior tactical mistake, the authors report that Wal-Mart is far more circumspect about filing appeals from adverse verdicts than it had been in the past.

Two of this work's greatest virtues are the depth of analysis provided by the authors and the quality of their writing. One can readily imagine a law firm or law department using these volumes to train its lawyers over an extended period, or as a resource for gaining a greater understanding of one or more of the issues discussed in this exceptional treatise.

JAMES C. MOORE is a partner with Harter Secrest & Emery LLP in Rochester and a past president of the NYSBA. He expresses appreciation to Jeanne Boyle, Leslie DesMarteau and Scott Malouf for their assistance in preparing this review.

Protect and Defend, by Richard North Patterson, published by Alfred A. Knopf, 2000, 550 pages, $26.95. Reviewed by Ellin M. Mulholland.

From the inauguration of a new President, narrowly elected, to a Senate divided 50-50, it is tremendously challenging to read *Protect and Defend* and remember that it is a novel, not the fascinating inside story of political news that we read each morning in our daily newspapers. For 549 pages, Richard North Patterson holds his readers in his thrall, intrigues them and, finally, makes them ponder.

The book derives its title from the presidential oath of office, "I will faithfully execute the Office of President of the United States and will to the best of my ability, preserve, protect and defend the Constitution of the United States." The novel's centerpiece is the new President's nomination of a federal judge who, if confirmed, will become the first female chief justice of the U.S. Supreme Court. In the course of the story, the candidate for chief justice, a federal District Court judge, Caroline Masters, participates in a decision involving the constitutionality of a Protection of Life Act requiring the consent of at least one parent for an abortion of a viable fetus of a minor. Pursuant to the Act, consent must be based on a doctor's informed medical judgment that an abortion is necessary as defined by the law.

In the story, a young girl, l5 years of age, 5½ months pregnant, has been denied permission by her parents for the abortion she wants. The unborn child is hydrocephalic, its head swollen with water, a condition that tends to impede development of the brain. The girl, Mary Ann Tierney, fears that if she is forced to deliver such a child, she will risk the ability to bear and deliver other children.

Webster defined a novel as "an invented prose narrative that is usually long and complex and deals with human experience through a connected series of events." As such, *Protect and Defend* is a novel in every sense of the word—superbly written, engrossing and deeply researched. Certainly, it deals with the human experience of a President, his aides, members of the Senate, the House of Representatives, judges, a trial lawyer and the Tierney family.

Would that the author sought to preserve, protect and defend human life in his novel as passionately, as powerfully and as effectively as he defended the mandate of Sarah Dash, the lawyer who undertook representation of Mary Ann Tierney in her quest to have the Protection of Life Act declared unconstitutional and so to abort her child. "Now Sarah's mandate was clear: to ensure that any woman brave or desperate enough to come for an abortion could have one." [p. 6]

Abortion, late-term abortion, parental consent, the politics of choice are recurrent themes of *Protect and Defend*. Those who espouse pro-choice are seen as standing on principle, as supporting reason over belief. Those who view abortion as the taking of life are seen as coming from a tradition of

> unyielding rules, a paradoxical mixture of mysticism and literal belief; the repression of women; the suppression of dissent, whether philosophical or scientific. Though she thought better of Martin Tierney, he embodied for her the two-thousand-year divide between the religious and the rational which has created so much misery. [p. 119]

Protect and Defend will have wide appeal:

• To lawyers, particularly trial lawyers, and all those captivated by the preparation for and intricacies of trials, who will enjoy examples of direct and cross-examination so real that they might be transcripts of an actual case tried by masters.

• To judges and those who aspire to the bench, who will meet judges, both inspired and inspiring, and judges who are venal, vain and self-seeking.

• To those who participate in and whose lives are influenced by the political process, who will come to realize how mighty are those in government, how much good, and conversely how much evil, they can do, and the enormous power that money has on the shaping of government and the laws that regulate our lives.

• To students and teachers of ethics, legal and medical, who will read not only about Mary Ann Tierney's desired late-term abortion, but also about the early abortions of other women, for different reasons, none of which is portrayed as morally questionable. They will read about the abortion performed to protect someone aspiring to high office and the abortion performed because an unmarried young woman was of delicate mental health due to drug and alcohol abuse. There is also the sympathy-evoking example of the victim of incest, denied an abortion, who gave birth to a retarded and blind child. Truly, *Protect and Defend* presents great ethical problems worthy of study, debate, teaching and consideration of the intent of the framers of the Constitution.

• To women, who will recognize that it is time for an extraordinary woman and lawyer to become chief justice of the U.S. Supreme Court, who will rejoice that in this book the vice president of the United States is a woman, who will appreciate that the author of *Protect and Defend* makes the 29-year-old trial attorney, Sarah Dash, a heroine in her profession.

• To every reader of *Protect and Defend*, who must find within its pages reason and inspiration to use all of his/her moral and intellectual energies to protect and defend, above all to preserve the Constitution of the United States and the sanctity of every human life, and who must ponder whether this novel, despite its appeal, achieves this goal.

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Correction

The final citation in the *Warrant of Arrest* form printed on page 31 of the February issue was incorrectly listed as Executive Law § 271-a. It should have read: Executive Law §§ 221-a, p.

Language Tips

By Gertrude Block*

Question: Professor Joseph Wilson of McGill University questions the U.S. Supreme Court's interpretation of the following statement: "[We] not only reverse the judgment below but direct divestiture without delay."

In *United States v. El Paso Natural Gas Co.*, 376 U.S. 651 (1964), the Court stated that the phrase "without delay" modified the noun "divestiture." Professor Wilson noted that a law journal article (65 *Antitrust Law Journal* 825, 826, 1997) concurred with that interpretation. But, he asked, could not *without delay* refer to the issuance of the order—that the order be issued without delay?

Answer: That interpretation would be strained at best. In English, the language closest to the modificand is considered its modifier. Here the noun *divestiture* is followed immediately by the phrase *without delay*. If the Court had intended the phrase *without delay* to modify the verb *order*, the sentence would have read: "[We] not only reverse the judgment below but direct the District Court, without delay, to order divestiture."

But Professor Wilson's query raises a more interesting question: what does *delay* mean, as it is used by the Supreme Court in that opinion? And the answer is that it is widely misinterpreted. The phrase *without delay* comes from the Latin words *sine die*. But that phrase, which has come down from the medieval courts, has nothing to do with delay. It is a truncated version of a longer Latin phrase that translates to the English "without the necessity of returning at a later day."

This phrase is only one of many that lawyers and judges glibly use without being aware of their meaning. In a New Jersey poll, judges and lawyers were asked to define the language *Know by all these Presents*, which is still widely used in legal documents. Most admitted that they did not know, and many who thought they did know believed it meant gifts. But the word *presents*, in this formula, has nothing to do with gifts. It is all that is left of a Latin 15th-century will-writing formula *presens scriptum*, which meant "present writing." This formula was abbreviated for convenience to *presens*, and ultimately misspelled *presents* because no one remembered its origin.

The legal tautology *without let and hindrance* is another illustration of the tendency of the legal profession to rely on "tried and true" language that no longer has the intended meaning but has survived centuries of litigation. As every tennis player knows, *let* describes a ball that is impeded by the net. So it is an unneeded repetition of the word *hindrance* in the legal phrase. But the legal profession respects precedent, redundant or not.

Legal drafters seem to believe that precedent is fostered by using language "exactly the same way" that it has always been used. Therefore tautologies abound, especially in will-writing, as the language from medieval documents is repeated through the centuries: *to have and to hold*, *last will and testament*, *seized and possessed*, *mind and memory*, *fit and proper, force and effect*. A now-deceased colleague used to decry these and other redundancies in his estates classes, but his disapproval seems to have had little effect on his students who now practice law in this area.

Question: Increasingly, I notice in the local press what I believe to be the misspelling of the adverbs *incidentally* and *fundamentally.* Is this traditional spelling now out-of-date? The spellings *fundamently* and *incidently* are so frequent now, that my old-fashioned spelling may be incorrect.

Answer: Your "old-fashioned" spelling is still correct. The misspellings you note seem to be the result of the disappearance of the good old grammar instruction in elementary school, as well as the tendency of many people to ignore the printed word and turn to TV and radio speech for information. Unfortunately, the print media now employs journalists who have grown up listening and watching, and they too misspell more words than previously.

Many of the *-ly* adverbs are now misspelled because the writer has forgotten or never realized that they derive from the adjective form of the word in question. Thus *accidentally* is spelled as if it came from the noun *accident*, not the adjective *accidental.*

From the Mailbag:

New York City attorney Howard Steinberg writes regarding my response, in the November/December 2000 "Language Tips" to the question whether *elided* or *elided over* was proper. I answered (correctly) that the adverb *over* was redundant, the verb *elide* itself including the sense of omitting, eliminating, or suppressing. But as Mr. Steinberg correctly pointed out, the choice of neither *elided* or *elided over* was proper, for the correct verb to describe the action was *ignored*, which is not the meaning of *elided.*

Gertrude Block is the writing specialist and a lecturer emeritus at Holland Law Center, University of Florida, Gainesville, FL 32611, and a consultant on language matters. She is the author of *Effective Legal Writing*, fifth edition (Foundation Press, July 1999), and co-author of *Judicial Opinion Writing Manual* (West Group for ABA, 1991).

The author welcomes the submission of questions to be answered in this column. Readers who do not object to their names being mentioned should state so in their letters. E-mail: Block@law.ufl.edu

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O'Mara, Timothy M.
Palmer, Thomas A.
Pfalzgraf, David R.
Webb, Paul V., Jr.

Ninth District
Aydelott, Judith A.
Berman, Henry S.
Galloway, Frances C.
Gardella, Richard M.
Giordano, A. Robert
Golden, Richard Britt
Headley, Frank M., Jr.
Herold, Hon. J. Radley
Klein, David M.
Kranis, Michael D.
Longo, Joseph F.
Manley, Mary Ellen
Miklitsch, Catherine M.
* Miller, Henry G.
Mosenson, Steven H.
O'Keeffe, Richard J.
* Ostertag, Robert L.
Scherer, John K.
Steinman, Lester D.
Stewart, H. Malcolm, III
Walker, Hon. Sam D.
Wolf, John A.

Tenth District
Abrams, Robert
Asarch, Hon. Joel K.
†* Bracken, John P.
Capell, Philip J.
Corcoran, Robert W.
Filiberto, Hon. Patricia M.
Fishberg, Gerard
Futter, Jeffrey L.
Gutleber, Edward J.
Karson, Scott M.
Levin, A. Thomas
Meng, M. Kathryn
Mihalick, Andrew J.
O'Brien, Eugene J.
†* Pruzansky, Joshua M.
Purcell, A. Craig
Roach, George L.
Rothkopf, Leslie
Spellman, Thomas J., Jr.
Walsh, Owen B.

Eleventh District
Bohner, Robert J.
Darche, Gary M.
Dietz, John R.
DiGirolomo, Lucille S.
Glover, Catherine R.
James, Seymour W., Jr.
Nashak, George J., Jr.
Wimpfheimer, Steven

Twelfth District
Bailey, Lawrence R., Jr.
Friedberg, Alan B.
Kessler, Muriel S.
Kessler, Steven L.
Millon, Steven E.
†* Pfeifer, Maxwell S.
Schwartz, Roy J.
Torres, Austin

Out-of-State
Chakansky, Michael I.
* Walsh, Lawrence E.

Res Ipsa Jocatur

Defending the Lowly[1] Footnote[2]

By Paul F. McAloon

Recently, I learned the bad news that the Appellate Division, Fourth Department[3] has adopted not one, but two rules barring the use of footnotes in briefs.[4] Although these rules have been in effect for more than three years,[5] other departments have not followed the trail blazed in Buffalo. I speak out here in the hope that none will.

The Fourth Department was not always so hostile to footnotes, making use of them in its own decisions from time[6] to time,[7] and once citing a Court of Appeals footnote as authority for a ruling of its own.[8] The court even considered an argument, albeit unfavorably, that had been raised by an appellant in a footnote.[9] It may be that the court's new policy reflects typographical considerations rather than philosophical or aesthetic ones,[10] but whatever the reason, the consequences are regrettable.

Among writers in all fields, attitudes toward footnotes are mixed. The device has been much maligned,[11] but it also has strong advocates.[12] Footnotes are essential in works of historical scholarship,[13] and they even appear occasionally in works of fiction.[14] Ahab's obsessions, or at least those of his creator, could not be contained within the body of the text, but gave rise to multiple footnotes.[15]

Still, even some who use footnotes successfully are ambivalent about them. J.D. Salinger footnoted several of his stories, but referred to the device as an "aesthetic evil."[16] There is no greater display of footnotes as an art form than Edward Gibbon's *History of the Decline and Fall of the Roman Empire*, but Gibbon had intended that all of his notes be at the end of the multi-volume work, and he regretted the prominence they received by being moved to the bottom of the pages where they appeared.[17]

What then are the legitimate uses of footnotes in a brief? They can convey information that is dense and dull, but essential.[18] They can explicate subtleties in an argument, while leaving its core unobstructed.[19]

They can also be fun.[20] Appellate writing is a solitary occupation, and the prospective audience for its product is distressingly small. It is a craft with rigid conventions that require the exercise of restraint and precision. If not abused, the footnote can be a pleasant relief for writer and reader alike. As with a distinctive spice, the use of footnotes should be sparing, but not forbidden.[21]

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1. Context is everything. Although the content of footnotes often soars intellectually, their placement and name connote baseness, a closeness to the ground, a position and body part often denigrated. Would they not be accorded far greater respect if they were placed above the text and referred to as superscript? Cf. Price et al., Effective Legal Research § 10.6 [Headnote or syllabus] at 143 (Little, Brown and Co. 4th Ed. 1979).
2. Ironically, due to the layout used in this publication, what would otherwise be footnotes have the appearance of endnotes.
3. The Fourth Department sits in Buffalo, often referred to as the Blizzard Capital of the United States. Like the footnote, Buffalo has been much maligned. The city was host to the 1901 Pan-American Exposition which was marred by the assassination of President William McKinley by Leon Czolgosz, an anarchist, on September 6, 1901. While it still snows too much in Buffalo, the city is the proud home of the Buffalo Bills, Buffalo chicken wings, the second largest historic district in America, and five buildings designed by Frank Lloyd Wright.
4. 22 N.Y.C.R.R. §§ 1000.4(f)(2), 1000.4(f)(6) both state, "A brief shall contain no footnotes."
5. Filed February 26, 1997, effective March 1, 1997.
6. November 18, 1992: *Treichler v. Niagara-Wheatfield Central School District*, 184 A.D.2d 1, 590 N.Y.S.2d 954 (4th Dep't 1992).
7. March 11, 1994: *Davidson Pipe Supply Co., Inc. v. Wyoming County Industrial Development Agency*, 196 A.D.2d 240, 609 N.Y.S.2d 982 (4th Dep't 1994).
8. *Tyler v. Oaks*, 231 A.D.2d 966, 648 N.Y.S.2d 392 (4th Dep't 1996) citing *Watergate II Apartments v. Buffalo Sewer Authority*, 46 N.Y.2d 52, 57, fn. 1, 412 N.Y.S.2d 821, 823, fn. 1 (1978).
9. *People v. Le*, 226 A.D.2d 1108, 642 N.Y.S.2d 828 (4th Dep't 1996).
10. 22 N.Y.C.R.R. § 1000.4(f)(2) specifies type size and mandates that text be double-spaced. The "no footnote" provision may have been adopted to close a potential loophole in those requirements.
11. A. Mikva, *Goodbye to Footnotes*, 56 Univ. of Colo. L. Rev. 647 (1984-1985) ("I consider footnotes in judicial opinions an abomination.").
12. H. M. Levy, How to Handle an Appeal § 7.3.3 (Use of Footnotes) at 173 (PLI 2nd Ed. 1982) ("Footnotes can be persuasive and should be used except under certain circumstances.").
13. A. Grafton, The Footnote*: A Curious History (Harvard Univ. Press 1997).
14. W. C. Booth, The Rhetoric of Fiction at 171 (The Univ. of Chicago Press (Pb.) 1961).
15. H. Melville, Moby Dick at 139, 168, 219, 229, 237, 268, 274, 307, 318, 319, 326, 336, 354-355, 369, 373, 414, 425, 457, 509 (Dell 1959).
16. J.D. Salinger, Franny and Zooey at 52 (Bantam Books 1964); J.D. Salinger, Raise High the Roof Beam, Carpenters and Seymour—an Introduction at 100, 117-118, 126, 139-140 (Bantam Books 1965).
17. A. Grafton, *supra* n. 14 at 1-4, 102-103, 224.
18. I recently prepared a brief addressing two lawsuits, joined for trial, arising from the same accident and involving overlapping parties. The facts of the case were dramatic, and their impact would have been greatly diminished by the interruptive page of text needed to identify the status of the parties. However, that status had implications with respect to the relief to be granted. By putting the procedural information in a footnote, I made it available, but not intrusive.
19. A lawyer's credibility can be enhanced by an occasional display of erudition, provided it does not become pedantic.
20. Aside, *The Common Law Origins of the Infield Fly Rule*, 123 Univ. of Penn. L. Rev. 1474 (1975).
21. I. S. Rombauer, M. R. Becker, Joy of Cooking at 575 (Bobbs-Merrill 1975).
22. In an appeal challenging the credibility of a police officer's claim that he smelled marijuana from 60 feet away, Mr. McAloon put his philosophy into practice by including a footnote that cited *Cyrano de Bergerac*, N. Gogol's *The Nose*, Nathaniel West's *Miss Lonelyhearts* and L.H. Sigourney's *The Camel's Nose.*