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Lawyers as Whistleblowers Under the Dodd-Frank Wall Street Reform Act

Ethical Conflicts Under the Rules of Professional Conduct and SEC Rules

By Barry R. Temkin and Ben Moskovits

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CONTENTS

JULY/AUGUST 2012

LAWYERS AS WHISTLEBLOWERS UNDER THE DODD-FRANK WALL STREET REFORM ACT

Ethical Conflicts Under the Rules of Professional Conduct and SEC Rules

BY BARRY R. TEMKIN AND BEN MOSKOVITS

10

DEPARTMENTS

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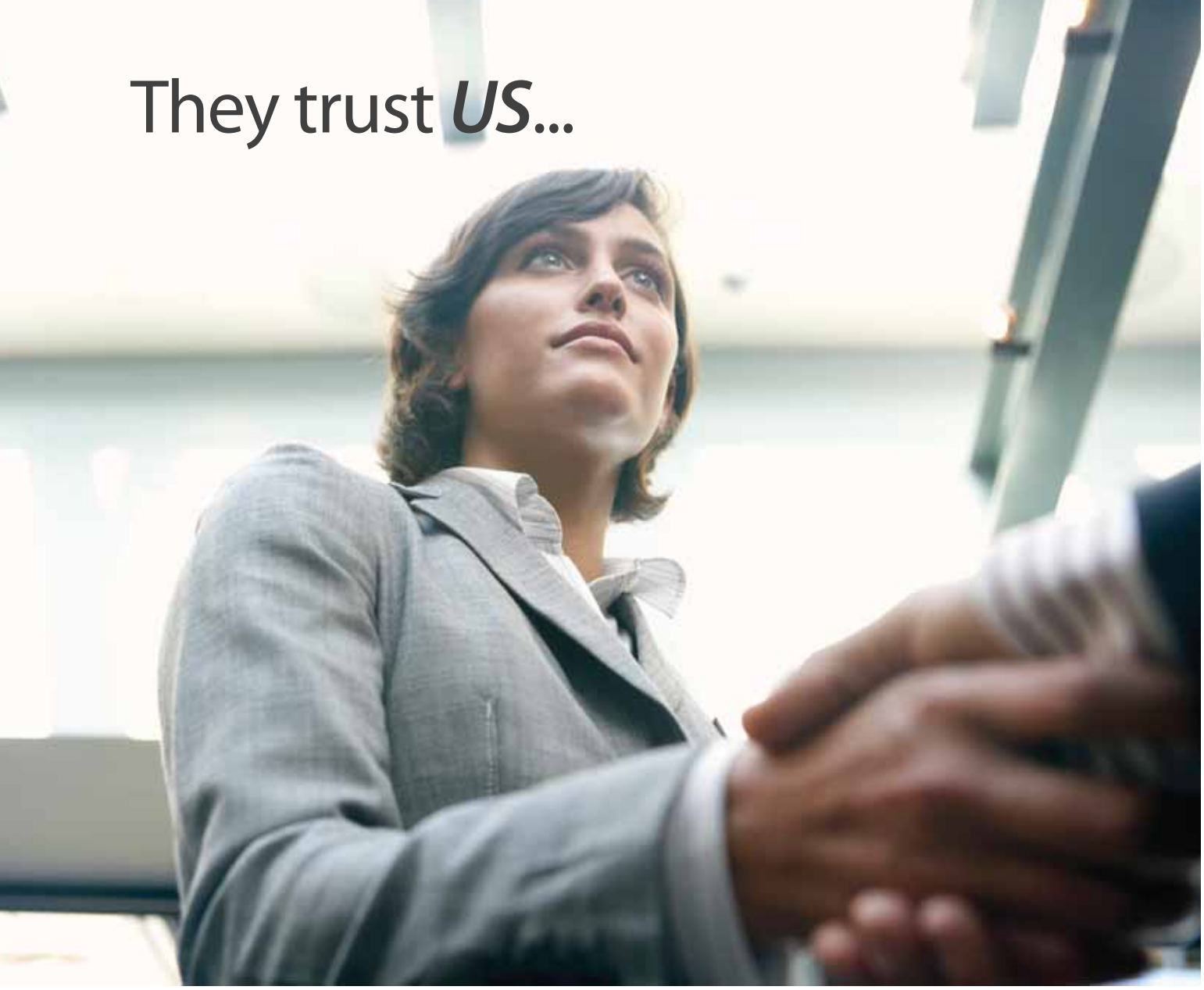

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Reaching for the Next Level

In keeping with our Association's long-standing commitment to diversity, we recently wrapped up the President's Section Diversity Challenge, initiated by our Immediate Past President, Vincent E. Doyle III. We were thrilled with the enthusiastic and positive response we received from the Sections, and we announced the results of the Challenge at our Section Leaders Conference in May. This year, we will once again reaffirm our strong commitment to enhancing diversity and promoting even more meaningful inclusion and participation by attorneys who reflect the diversity of our communities throughout New York State. We have chosen a new theme as we build upon past efforts: "Reaching for the Next Level."

Thanks to Vince and the many other past State Bar Presidents who have done so much to enhance our diversity over the years, we have an excellent foundation for future diversity initiatives. The President's Section Diversity Challenge is a terrific example of this ongoing work. In fact, we were thrilled to learn recently that the Challenge has been selected for an ABA Partnership Award, which recognizes bar association projects that work to enhance the participation and advancement of attorneys of color and other underrepresented populations.

Our 25 Sections, made up of volunteer attorneys and assisted by State Bar staff, consistently produce high-quality publications and CLE programs, host valuable networking events and provide many other opportunities for attorneys to connect with their colleagues. They are also continuously striving to improve their work by making their membership more diverse and inclusive. The President's Section Diversity Challenge encouraged the Sections to appoint a diversity team, implement new and additional diversity initiatives, execute their plans and evaluate their results. The Challenge was co-sponsored by the State Bar's Committee on Membership and the Committee on Diversity and Inclusion. With the support of those Committees, as well as the State Bar's Membership Department and the Department of Section Services, the Challenge was designed to help the Sections enhance diversity in their membership, leadership and programs, and to establish a framework for our ongoing diversity efforts.

Section leaders truly embraced the Challenge, and their work has been outstanding. We recently announced the results, and our 10 first-place "Diversity Champions" shared some best practices that aided in their success. One very striking observation is the incredibly wide variety of strategies the different Sections have employed. The Torts, Insurance and Compensation Law (TICL), Environmental Law, Entertainment, Arts and Sports Law, Dispute Resolution, and Commercial and Federal Litigation Sections all hosted diversity receptions, CLE programs and other events, many of which were co-sponsored by multiple Sections as well as minority bar associations throughout the state. Two great examples are TICL's "Strength by Association" seminar series, which encouraged bar association participation and mentoring to improve diversity, and the Commercial and Federal Litigation Section's ongoing "Smooth Moves for Litigators of Color" program. In April, the Smooth Moves program focused on pursuing a career as general counsel, with a panel titled "Views from the Corner Office: Diverse General Counsels Discuss How to Get There, and How to Win Their Business." The Environmental Law, Labor and Employment Law, Corporate Counsel, Trial Lawyers, Health Law, Commercial and Federal Litigation and Young Lawyers Sections all implemented or continued fellowships and scholarships offered to law students and young attorneys of color. For example, the Commercial and Federal Litigation Section's annual fellowship program places minority law students with Commercial Division judges for a summer internship. Many Sections also worked on improving the diversity of their speaker panels and increasing their membership outreach and recruitment of diverse attorneys.

One consistent theme that we heard again and again in discussing the results of the Challenge was that the Sections welcomed this opportunity to focus on diversity because they recognize that our work is better when it is informed by a wide variety of perspectives. In order to build upon this progress, Membership Committee

SEYMOUR W. JAMES, JR., can be reached at sjames@nysba.org.

Co-chairs Sherry Levin Wallach and Glenn Lau-Kee have agreed to continue to chair this initiative as we shift our theme to "Reaching for the Next Level."

Diversity is a dynamic goal and an ongoing priority for our Association. To have a lasting impact, we must achieve true inclusiveness, with active participation by our newly recruited members and leadership that represents a wide variety of backgrounds and experiences. As we continue to focus on enhancing diversity, we must measure our progress and demonstrate quantitative improvement. In the coming year, we will work to show the impact of our continued efforts in this area, track the involvement of our members to determine where we have been most successful, and focus our energy to promote broader inclusion.

I would like to thank our Sections for all they have done to make the Challenge a success and I look forward to all that we will continue to achieve in the coming year. Together we can build upon this successful initiative and take the Bar Association to the next level. ■

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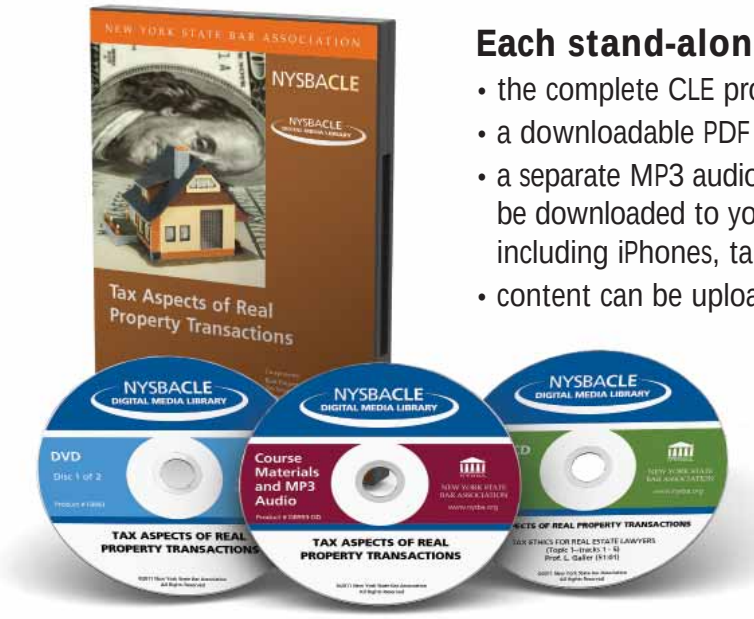

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Lawyers as Whistleblowers Under the Dodd-Frank Wall Street Reform Act

Ethical Conflicts Under the Rules of Professional Conduct and SEC Rules

By Barry R. Temkin and Ben Moskovits

Barry R. Temkin is a partner at Mound Cotton Wollan & Greengrass and Chair of the New York County Lawyers' Association Professional Ethics Committee. **Ben Moskovits,** a graduate of Benjamin N. Cardozo School of Law, is a Vice President at Morgan Stanley Smith Barney, LLC in New York. The authors thank Daniel Markewich and Michael Stone for reviewing and commenting on an earlier draft of this article, and Aaron F. Fishbein, Christopher Amore, and Julie Fleishman for their assistance in the drafting and research for this article. The views expressed in this article are solely those of the authors, as are the mistakes, and do not reflect the views of Mound Cotton Wollan & Greengrass or Morgan Stanley Smith Barney, LLC.

Introduction

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank), which seeks to regulate the financial markets in order to prevent a recurrence of the financial crisis of 2008–2009. Section 922 of Dodd-Frank added new section 21F to the Securities Exchange Act of 1934 (Exchange Act), creating a whistleblower bounty program under which individuals who voluntarily provide original information leading to successful Securities and Exchange Commission (SEC or the Commission) enforcement actions may receive bounty payments based on penalties assessed against respondents. Whistleblowers who report wrongdoing to the U.S. Commodity Futures Trading Commission (CFTC) may also recover under the Dodd-Frank whistleblower provisions.

The exact amount awarded will be determined by the SEC and will be paid by a new Investor Protection Fund funded by monetary sanctions. Section 21F of the Exchange Act also creates a new private right of action for whistleblowers against retaliating employers. Whistleblowers can bring their claims in federal court seeking reinstatement, double back pay with interest, and attorney fees.

As discussed below, the general rule is that whistleblowers who voluntarily furnish original information to the SEC or CFTC that results in a successful prosecution netting monetary penalties in excess of $1 million are entitled, with some exceptions, to bounties of 10% to 30% of the amount recovered in the government enforcement actions. Lawyers, whether in-house or outside, are generally ineligible for Dodd-Frank whistleblower bounties. However, the rules promulgated under Dodd-Frank offer exceptions. To the extent that a lawyer possesses confidential information that may be disclosed to the SEC pursuant to its regulations or state ethics rules, the Commission's rules appear to permit paying bounties to attorney-whistleblowers. Under SEC regulations promulgated under the Sarbanes-Oxley Act (SOX), a lawyer may disclose to the Commission confidential client information to prevent "a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors."[1] In addition, SEC regulations promulgated under Dodd-Frank permit attorneys to blow the whistle, disclose client confidences and collect bounties to the extent permitted by state ethics rules.

The SEC rules governing attorney conduct differ in some significant respects from the controlling ethics laws in effect in some jurisdictions, notably New York, the District of Columbia, and California, and, in addition, are not entirely consistent with the confidentiality provisions of the ABA Model Rules of Professional Conduct (which, in any event, are merely model rules, and not enforceable through professional discipline). Most state ethics codes include some form of exception to their general confidentiality rules and permit reporting out by attorneys where client fraud has been perpetrated with the assistance of the attorney. Therefore, an attorney whose services have been used to perpetrate client fraud would be permitted to take remedial action in most jurisdictions. In the event of known client perjury, the attorney's duty to take remedial action is even stronger. Several jurisdictions even *require* lawyers to report out fraudulent, criminal, or illegal client conduct.[2] What is prohibited under the rules of every jurisdiction is the general disclosure of confidential information relating to a material violation of the securities laws, or client fraud committed without the assistance of the attorney, disclosures that are permitted by SOX and, through incorporation of the SOX rules, the Commission's whistleblower rules.

While the SEC may have authority to determine the qualifications of lawyers who practice before it, it does not grant plenary law licenses, and, therefore, it is unclear that the minimum confidentiality standards it sets provide a definitive safe harbor for New York or California lawyers to rely upon when revealing secrets and confidences of their clients to beckoning regulators and prosecutors. Thus, for example, a New York lawyer that adheres to SEC (or even ABA) guidelines in reporting client fraud to regulators in hope of receiving a Dodd-Frank bounty could run afoul of state Rules of Professional Conduct, and, at least theoretically, subject himself or herself to professional discipline.

As a result, the SEC's whistleblower regulations potentially encroach on state regulation of attorney ethics and could unintentionally but insidiously erode confidential attorney-client communications. Moreover, as mentioned above, some (but not all) of this confidential information is arguably protected from disclosure by state ethics rules.

Aside from the potential discrepancy among SEC, ABA, and state codes regulating attorney conduct, the prospect of a corporate attorney under any circumstances claiming a whistleblower bounty could give rise to a potential personal conflict of interest. A lawyer for a corporation is a fiduciary and must exercise independent professional judgment on the client's behalf. This professional judgment includes determining whether there is evidence of a material violation of law, whether the legal violation poses a threat to the company, whether to report the wrongdoing to the board of directors or chief legal officer of the entity, whether to commence an investigation, whether to bring in outside counsel, etc. The lawyer must skillfully navigate a web of internal personal and political relationships, and objectively analyze the company's legal obligations while simultaneously minding the lawyer's own professional responsibilities. These complex and potentially disparate considerations are sufficiently challenging to the most diligent and experienced corporate counsel without adding the additional temptation of a substantial personal monetary bounty. The prospect that lawyers may personally benefit by reporting out alleged corporate misconduct could cloud their professional judgment. Such bounties could also cause a conflict of interest between the lawyer's personal interests and those of the client within the meaning of the professional conflict rule, ABA Model Rule of Professional Conduct 1.7 and its parallel in state codes of ethics. Further, as a personal conflict, it may not be waivable by the impacted client, and, as discussed below, the potential for an attorney bounty inevitably complicates an already complex relationship between corporate lawyer and client.

The Dodd-Frank Whistleblower Rules

To be eligible for an award under Dodd-Frank whistleblower rules, the whistleblower must provide original information. To qualify as original, information must not become known to the SEC from any source other than the whistleblower and must be the whistleblower's independent information or the product of the whistleblower's own analysis. Therefore, information obtained solely from an allegation made in a hearing, government report, or other publicly available document would not qualify for a Dodd-Frank bounty.

Additionally, SEC Rule 21F-3 and CFTC Rule 165.5 state that awards will be paid to whistleblowers who voluntarily provide "original information" that "leads to the successful enforcement by the [SEC] of a federal court or administrative action" or "leads to the successful resolution of a covered [CFTC] judicial or administrative action or successful enforcement of a related action." Information provided in response to a subpoena or information request does not qualify as voluntary.

A whistleblower becomes eligible to receive an award if the SEC collects more than $1 million in monetary sanctions. The reward to be given to the whistleblower must fall within 10% to 30% of the aggregate amount recovered, which includes disgorgement, penalties, and interest. Once the SEC surpasses the $1 million threshold necessary to enable the whistleblower to recover, the basis of the sanction may also include fines and penalties assessed and collected by the Department of Justice, self-regulatory organizations, and state attorneys general.

CONTINUED ON PAGE 14

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Continued from Page 12

While the SEC has discretion as to what percentage within the range to award, there are some guidelines. The SEC must consider: (1) the significance of the information provided relative to the success of the SEC's action; (2) the degree of assistance provided by the whistleblower in the SEC's action; and (3) the SEC's interest in deterring securities law violations by rewarding whistleblowers.

To be eligible for an award under Dodd-Frank whistleblower rules, the whistleblower must provide original information.

Dodd-Frank defines which individuals may qualify as whistleblowers. The law does not require that an award recipient be a U.S. national, but rather allows foreigners to be eligible whistleblowers as well. Certain individuals, however, are not eligible to collect an award, such as employees of securities regulators and auditors. Additionally, individuals convicted of a criminal violation related to the underlying securities violations that were disclosed by the whistleblower are also barred from receiving awards. Thus, whether an individual implicated in the underlying conduct can obtain a whistleblower reward will depend, in part, on whether the individual is ultimately convicted on related criminal charges.

Attorney as Whistleblower

Under SEC and CFTC rules, attorneys generally cannot be whistleblowers because the new rules exclude from the definition of "original information" most material that lawyers, in-house or private, are likely to gain in the course of their professional representation of clients. The categories excluded from whistleblower bounty include: (1) confidential communications subject to the attorney-client privilege; (2) information that came from the legal representation of a client; (3) information that came from persons in a compliance, legal, audit, supervisory or governance role for the entity; and (4) information from the entity's legal, compliance, audit, or related functions for dealing with violations, unless the entity did not disclose the information to the SEC or CFTC within a reasonable time or acted in bad faith.[3] The new rules deny whistleblower status to attorneys whose knowledge originated as a result of the "legal representation of a client," even if that knowledge did not come from a privileged communication or a client confidence or even from the client at all. Most of a practicing attorney's knowledge about a client would come from legal representation, so this is a very broad exclusion.

There are exceptions to the SEC's and CFTC's general rule against attorneys acting as whistleblowers. Attorney whistleblowers may use attorney-client communications and information obtained as a result of legal representation of a client when such disclosure is permitted by SEC Rule 205.3(d)(2), which was promulgated pursuant to SOX.[4] This provision allows attorneys practicing before the SEC in the representation of an issuer to reveal confidential information related to the representation in some circumstances. These circumstances occur when the attorney reasonably believes disclosure is necessary (1) to prevent the issuer from committing a material violation of securities laws which is likely to cause substantial financial injury to the interests or property of the issuer or investors; (2) to rectify the consequences of a material violation of securities laws in which the attorney's services have been used; or (3) to prevent the issuer from committing or suborning perjury in an SEC proceeding.[5] In addition, SEC rules permit disclosing client confidences to regulators, when the issuer fails to act reasonably in response to a complaint or acts in bad faith. Finally, the SEC permits reporting out where permissible under state ethics rules.

The CFTC considers attorney-client privileged communications and information obtained as a result of legal representation of clients to be derived from "independent knowledge" (and therefore would allow an attorney to be a whistleblower) if the disclosure is permitted "by the applicable federal or state attorney conduct rules."[6]

Under SEC Rule 205, the disclosure of client confidences outside the organization is permitted as a last resort, not a first step. The rule requires lawyers practicing before the Commission to report evidence of material violations of the securities laws to the company's chief legal officer (CLO), who is required to investigate the claim and report back to the lawyer who originally made the report. In the event that the CLO finds credible evidence of a material violation, the CLO must report the wrongdoing up the proverbial corporate ladder including, if necessary, to the audit committee, qualified legal compliance committee or full board of directors. If all else fails, and if necessary to prevent further harm to the corporation or to investors, the CLO is authorized to disclose client confidences outside the company. The junior reporting lawyer may report disclosures outside the organization if the CLO fails to act.

Thus, under SEC Rule 205, a lawyer must first report corporate wrongdoing up the corporate ladder. If that fails, the lawyer may, if necessary, report outside the organization to regulators, i.e., reporting out. Reporting up the corporate ladder is mandatory. Reporting out is *permissive* under Rule 205.[7] However, a lawyer may be subject to discipline by the SEC for failing to correct or

Continued on Page 16

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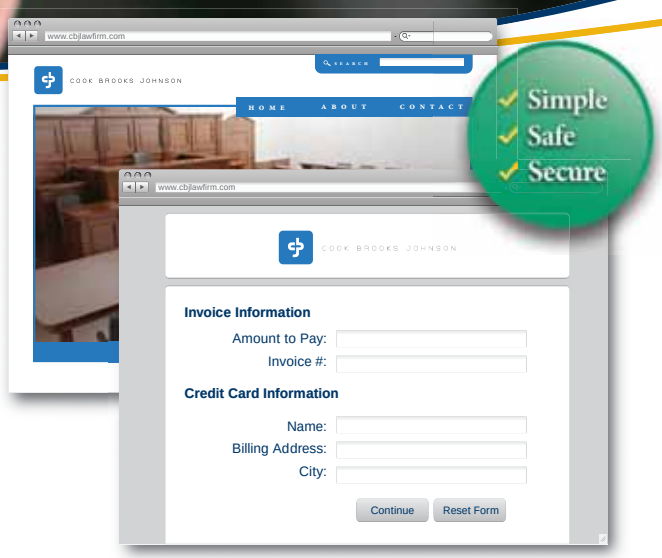

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Continued from Page 14

prevent the wrongdoing of a client in which the lawyer was complicit.[8]

SEC/CFTC rules are not entirely consistent with the ABA Model Rules of Professional Conduct. The ABA rules, in turn, do not entirely agree with the rules of various states, such as (notably) New York, California, Washington State, or the District of Columbia. Lawyers practicing before the SEC and CFTC should be mindful of both federal and state rules, because most cases are intensely fact-specific.

Comparison With ABA and State Ethics Rules

The ABA Model Rules require lawyers to maintain the confidentiality of information learned by the lawyer in the course of the representation.[9] However, ABA Model Rule 1.6 permits disclosure of confidential information in six circumstances: (1) to prevent death or substantial bodily harm; (2) to prevent crime or fraud "that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services"; (3) to prevent or rectify financial injury from client crime/fraud "in furtherance of which the client has used the lawyer's services"; (4) to obtain advice about the lawyer's own compliance with the ethics rules; (5) for the lawyer to defend himself or herself against a claim relating to the representation; and (6) to comply with law or a court order. Exceptions (2) and (3) to Model Rule 1.6(b) were added in 2003 in the wake of the Enron and Worldcom financial scandals.[10] The ABA Model Rules, unlike the former Canons and Code, do not require mandatory reporting out of client fraud.[11]

The New York Rules of Professional Conduct (RPC) are different from their ABA counterparts. The New York Rules prevent a lawyer from disclosing client confidential material, but provide exceptions: (1) to prevent reasonably certain death or substantial bodily harm; (2) to prevent a client from committing a crime; (3) to withdraw a lawyer's opinion or representation that was based on inaccurate information or which is being used to further a crime or fraud; (4) to get legal advice about the lawyer's own conduct; (5) for the lawyer to defend himself or herself; (6) to collect a fee; and (7) when permitted to reveal confidences under the RPC, such as to comply with law or a court order.[12]

In some respects the New York exceptions to RPC 1.6 are broader than their ABA counterparts, since a lawyer may disclose client confidences "to prevent a crime," whereas the Model Rules have no direct correlating provision. While Model Rule 1.6(b) permits disclosure of client confidential material to prevent or rectify client fraud, this may be done only in situations in which the client has used the lawyer's services to perpetrate the fraud.[13] The District of Columbia's crime-fraud exception similarly applies only where the crime or fraud is perpetrated by means of the attorney's services.[14]

The exception in New York RPC 1.6(b)(2), which permits (but does not require) the lawyer to reveal confidences "to prevent the client from committing a crime," is not consonant with the "material violation" of the securities laws described in SEC Rule 205. A material violation of federal securities laws can be civil or criminal. A *criminal* material violation of the securities law is probably permissively discloseable outside the company pursuant to both the New York and SEC rules, whereas a civil violation caused by the same facts may be reportable by a New York lawyer only if another exception under RPC 1.6(b) applies.[15] SEC rules would permit disclosure to the Commission of client confidential information establishing a civil material violation of federal securities laws. Thus, a New York lawyer who reports out client confidences under the authority of SEC Rule 205 would, under some circumstances, violate state ethics rules.

A comparison of ethics rules in certain other jurisdictions further complicates the analysis. For example, while New York lawyers are *permitted* to report out client confidences to prevent a crime, New Jersey lawyers are *required* to do so. According to New Jersey RPC 1.6:

> (b) A lawyer *shall* reveal [confidential] information to the proper authorities, as soon as, and to the extent the lawyer reasonably believes necessary, to prevent the client or another person:
> (1) from committing a criminal, illegal or fraudulent act that the lawyer reasonably believes is likely to result in death or substantial bodily harm or substantial injury to the financial interest or property of another;
> (2) from committing a criminal, illegal or fraudulent act that the lawyer reasonably believes is likely to perpetrate a fraud upon a tribunal.
> (c) If a lawyer reveals information pursuant to RPC 1.6(b), the lawyer also may reveal the information to the person threatened to the extent the lawyer reasonably believes is necessary to protect that person from death, substantial bodily harm, substantial financial injury, or substantial property loss.
> (d) A lawyer *may* reveal such information to the extent the lawyer reasonably believes necessary:
> (1) to rectify the consequences of a client's criminal, illegal or fraudulent act in the furtherance of which the lawyer's services had been used;
> (2) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, or to establish a defense to a criminal charge, civil claim or disciplinary complaint against the lawyer based upon the conduct in which the client was involved; or
> (3) to comply with other law.[16]

Thus, unlike in New York (or under the ABA Model Rules), a New Jersey lawyer may be subject to professional discipline for failing to report client confidences reasonably necessary to prevent a client's

crime or fraud that is likely to result in substantial injury to the financial interest or property of another, regardless of whether the lawyer's services were used to further the fraud. New Jersey's rule is even more aggressive than the SEC's, in that the latter first requires reporting up the ladder, and only secondarily permits reporting out. Because New Jersey RPC 1.6 contemplates reporting out a "criminal, illegal or fraudulent act" that causes financial injury, it would seem to apply only to those securities law violations that rise to fraud or illegality. With that qualification, the New Jersey formulation is not coextensive with, and, in fact, is at once both more permissive and more restrictive than the SEC rule, since a material violation of the securities laws, per SEC Rule 205, may not rise to the level of fraud or illegality. For example, the unregistered sale of securities might be a material violation of the securities laws but not amount to fraud. It might, however, be considered an "illegal" act within the meaning of New Jersey RPC 1.6.[17] Moreover, New Jersey's rules, unlike the ABA Model Rules, and those of New York, require reporting out of client fraud or crime regardless of whether the lawyer's services were used to implement the fraud.[18]

> While New York lawyers are *permitted* to report out client confidences to prevent a crime, New Jersey lawyers are *required* to do so.

Not all securities violations rise to the level of a crime. Lawyers have been prosecuted for registration and record-keeping violations that do not amount to fraud or a crime. For example, in *In re Isselman*, a general counsel improperly failed to correct his client's misperception of foreign law.[19] In *In re Drummond*, the SEC successfully prosecuted the general counsel of Google for failing to report that a grant of stock options would cause the company to cross a reporting threshold.[20] In both *Isselman* and *Drummond*, general counsels were prosecuted for securities law violations. However, it is arguable that the lawyers' conduct in these cases, even if violations of securities law, did not rise to the level of crime or fraud for the purpose of state ethics rules. These are the types of technical violations that illustrate the disconnect between the SEC conduct rules under Sarbanes-Oxley on the one hand and state rules of professional conduct on the other. Moreover, these prosecutions show that these discrepancies are not merely theoretical but can have real, career-ending consequences.[21]

Other exceptions in state ethics rules may apply. For example, New York RPC 1.6(b) permits a lawyer to reveal client confidences "to withdraw a written or oral opinion or representation previously given by the lawyer and reasonably believed by the lawyer still to be relied upon by a third person," where the lawyer's opinion was incorrect or being used to perpetrate a fraud or crime. This New York exception, in turn, is different from the ABA Model Rules, which merely require the use of the attorney's services to perpetrate the fraud, and do not require an opinion or representation by the lawyer in order to trigger the exception permitting disclosure. And that's just comparing New York and New Jersey rules with those of the ABA and SEC. Other jurisdictions have differing approaches and are too numerous to recount in this article.

California's ethics rules are broader, and bar disclosure of client confidential information, even in cases of fraud. The California Business and Professions Code provides that attorneys must "maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client."[22] This broad, sweeping provision does not include the nuanced exceptions of the ABA or New York formulations and places California squarely at variance with SEC Rule 205. California lawyers, in particular, must exercise extreme caution before considering disclosures of client confidential information.

According to one law review survey, 41 states permit and four require lawyers to disclose confidential information to prevent a client's ongoing criminal or fraudulent act.[23] Thus, significant conflicts exist among the SEC, ABA, and various state formulations providing exceptions to the confidentiality provisions.

Model Rule 1.6 and its state counterparts speak only to reporting out; they do not govern up-the-ladder reporting by corporate lawyers. Up-the-ladder reporting – as required by SEC Rule 205 – is governed by ABA Model Rule 1.13 and its state counterparts. These provisions generally require up-the-ladder reporting by corporate lawyers who discover corporate wrongdoing; but, other than the Model Rule's formulation, the state variations all stand in contrast to the SEC's provision and do not include an independent basis for permissive reporting out.

Up-the-Ladder Reporting

Under ABA Model Rule 1.13, a corporate lawyer with knowledge of wrongdoing that poses a substantial risk of injury to the organization must report the violation up the corporate ladder. If a corporate lawyer knows that

an officer or employee of the organization has engaged in illegal conduct related to the representation which is likely to result in substantial injury to the organization, he or she "shall proceed as is reasonably necessary in the best interest of the organization."[24] Up-the-ladder reporting, including to the board of directors, is ethically mandated: "Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer *shall* refer the matter to higher authority in the organization, including, if warranted by the circumstances, to the highest authority that can act on behalf of the organization as determined by applicable law."[25]

An attorney considering whether to become a Dodd-Frank whistleblower must determine whether it is ethical to do so. But which rules apply?

Outside disclosure of client confidences is permitted, but not mandated, under the Model Rules. If the corporation's board fails to address in a timely and appropriate manner an action, or a refusal to act, that is clearly a violation of law. If the lawyer reasonably believes that the violation is "reasonably certain to result in substantial injury to the organization," then the lawyer may (but is not obligated to) report outside the corporation "whether or not Rule 1.6 permits such disclosure," but only to the extent necessary to prevent substantial injury to the organization. Thus, the ABA formulation, which was influenced by the passage of the Sarbanes-Oxley Act of 2002 and the proposed SEC rules thereunder, permits a corporate lawyer to report out evidence of corporate wrongdoing.

New York RPC 1.13, on the other hand, contains no further exception to RPC 1.6, and does not, in and of itself, permit reporting out. According to New York RPC 1.13:

> If, despite the lawyer's efforts in accordance with paragraph (b), the highest authority that can act on behalf of the organization insists upon action, or a refusal to act, that is clearly in violation of law and is likely to result in a substantial injury to the organization, the lawyer may reveal confidential information *only if permitted by Rule 1.6*, and may resign in accordance with Rule 1.16.[26]

Moreover, in New York, up-the-ladder reporting is not presumptively required under its Rule 1.6. California's rule is similar to New York's. Thus, there is a disconnect between the ABA/SEC rule and state rules, since the former permits reporting out by corporate lawyers under different circumstances from the latter.

Just to illustrate the complexity of this, New Jersey takes yet another approach, permitting (but not requiring) reporting out where the corporate board fails to remedy reported wrongdoing and the disclosure of client confidences is in the company's best interests:

> (c) When the organization's highest authority insists upon action, or refuses to take action, that is clearly a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization, the lawyer may take further remedial action that the lawyer reasonably believes to be in the best interest of the organization. Such action may include revealing information otherwise protected by RPC 1.6 only if the lawyer reasonably believes that:
> (1) the highest authority in the organization has acted to further the personal or financial interests of members of that authority which are in conflict with the interests of the organization; and
> (2) revealing the information is necessary in the best interest of the organization.[27]

Of course, RPC 1.13 must be read together with RPC 1.6. For example, if the corporate wrongdoing constitutes a crime as well as a material violation of securities laws, then any distinction among the three rules is irrelevant, as it would be permissively reportable under SEC, New York, and ABA formulations. And, as mentioned, participation in a crime or fraud must be reported by New Jersey lawyers, if preventable, regardless of whether the lawyer's services have been utilized to further the scheme.[28] Thus, a lawyer confronted with client misconduct must analyze and balance potentially conflicting ethical considerations.

State Versus Federal Rules: Prior Cases Resolving Conflicting Rules

An attorney considering whether to become a Dodd-Frank whistleblower must determine whether it is ethical to do so. But which rules apply? Clearly, the CFTC and SEC have authority to regulate the conduct of attorneys who practice before them, and those agencies can discipline lawyers who act unprofessionally. The U.S. Supreme Court has long held, for example, that the U.S. Patent and Trademark Office may grant licenses to non-lawyers to practice before it and that a state may not proscribe or regulate such practice as unauthorized practice of law.[29]

But federal agencies do not grant plenary law licenses, and lawyers must also comply with state ethics rules. And, as we have seen, state ethics rules are inconsistent with SEC regulations. Moreover, the Supreme Court has not given the federal government the right to interfere with attorney-client confidential communications, which are protected by state law.[30]

Which rules govern in the event of a conflict? SEC Rule 205, which was promulgated pursuant to the authority of the Sarbanes-Oxley Act of 2002, proclaims its supremacy over state ethics rules. According to SOX, "[w]here the standards of a state or other United States jurisdiction where an attorney is admitted or practices conflict with these standards, these standards shall govern."[31] The "predominant effect of the conduct" is the standard under Model Rule 8.5(b) for conflict purposes. A predominant effect in a state jurisdiction would favor state ethics rules under RPC 8.5. A predominant effect on federal law might yield a different result, depending on the facts.

Some scholars (and regulators) have argued that federal law reigns supreme, and that regulations promulgated under SOX preempt inconsistent state regulations. For example, in their 2004 article Professors Cramton, Cohen and Koniak argue that the SEC has been too lenient on securities lawyers, and that it should step up its regulation of big firm securities lawyers. Their article posits that "the SEC had authority to, and did in fact, draft rules that preempt state ethics rules that prohibit or restrict disclosure of material violations of law,"[32] opining that the legislative history of Sarbanes-Oxley suggests that Congress intended to regulate the legal profession and, specifically, reporting up the corporate ladder. Asserting that other federal agencies have the right to control and regulate practice before them, Cramton, Cohen, and Koniak argue that "[t]here is no basis for singling out the securities bar, among all lawyers engaged in federal practice areas, as being entitled to immunity from federal regulation."[33]

The problem with their pro-preemption argument is that it erroneously conflates a federal agency's right to restrict or permit lawyers or non-lawyers to practice in a federal forum, which may be regulated by the relevant federal agency, with its authority to create a parallel set of conflicting in-state lawyer confidentiality rules, an area of regulation that has long been exercised by the states. It is one thing for the federal government to say who can appear before the Internal Revenue Service or the Patent and Trademark Office; it is usurpation of a different order for federal agencies to define permissive circumstances under which a state-licensed lawyer may reveal client confidences to the federal government, irrespective of state ethics rules. States have no interest in preventing non-lawyers from prosecuting patent applications. But they do have an interest in protecting the confidentiality of their citizens' communications with lawyers. Cramton, Cohen, and Koniak, who believe that securities lawyers need to be reined in by the SEC, elide over this important distinction.

It feels disquieting, and is perhaps unconstitutional, for the federal government to arrogate to itself the power to purport to regulate state attorney ethics. While the concept of a federal law license has been floated, it is still in the pipe-dream phase. It is one thing for the SEC to bar a lawyer for unprofessional conduct in an SEC proceeding; it is quite another for the federal government to seek to regulate attorney-client confidential communications. The Constitution does not give the federal government the right to license or regulate the practice of law.

Moreover, federal prosecutors under the McDade Amendment are subject to state ethics rules. The McDade Amendment provides that "an attorney for the Government shall be subject to State laws and rules, and local Federal court rules, governing attorneys in each State where such attorney engages in that attorney's duties, to the same extent and in the same manner as other attorneys in that State."[34] State ethics rules bind federal lawyers, including SEC staff attorneys. It would be anomalous for SEC lawyers, who must obey state ethics rules, to argue that private practitioners, who are licensed by the state, must defer to SEC ethics rules, when such conduct may affect the rights of clients.

Indeed, no court has found that state ethics rules governing lawyers' communications with their clients are preempted by SEC regulations. After all, the states, not the federal government, issue plenary law licenses. Moreover, state ethics regulators have not been unanimous in deferring to federal regulation of attorney conduct. For example, the organized bar in California refused to take a backseat to the SEC, warning that "portions of [Rule 205] seemingly conflict with our statutory duty to protect

confidential client information."[35] The California bar wrote in response to SEC regulations under SOX that "[a]n attorney faced with choosing between potentially irreparable harm to a client's interests arising from disclosure of a confidence or the cost of a good faith, well founded objection to the SEC's rules is virtually duty-bound to select the latter."[36]

Similarly, in response to the implementation of Rule 205, the Washington State Bar Association issued a Formal Ethics Opinion advising Washington attorneys to "not reveal [client] confidences and secrets unless authorized to do so under the RPCs."[37] The Washington opinion also noted that because of the "current lack of case law on the pre-emption issue, a Washington attorney cannot as a defense against an RPC violation fairly claim to be complying in 'good faith' with the SEC Regulations, as that term is used in [Rule 205]."[38]

By contrast, North Carolina took a more deferential approach to the SEC Rule. In a 2005 Formal Ethics Opinion, the North Carolina bar commented that there is a presumption that Rule 205 is a valid exercise of the SEC's authority and, therefore, "a North Carolina attorney may, without violating the North Carolina [RPCs], disclose confidential information as permitted by Rule 205 although such disclosure would not otherwise be permitted by the NC Rule."[39]

In some jurisdictions, the dispute over federal preemption may be more theoretical than practical. ABA Model Rule 1.6(b)(6) permits disclosure of client confidential material "where permitted by law or court order." New York RPC 1.6(b)(6) similarly permits disclosure "to comply with other law or court order."[40] While not compelling, it could be argued that a disclosure permitted by the federal securities laws is a disclosure made "to comply with other law" within the meaning of RPC 1.6. In other jurisdictions, however, notably California and Washington State, a lawyer who discloses client confidential information to the SEC may well run afoul of state ethics laws.[41]

Since the Dodd-Frank whistleblower provisions went into effect on August 12, 2011, there has been little authority directly interpreting its provisions, particularly with respect to the interplay of state and federal attorney ethics rules. However, the limited authority on these rules has not by any means assumed federal preemption of state ethics rules.

Some guidance, at least by analogy, is provided by a recent federal opinion in a qui tam whistleblower case brought and decided under the False Claims Act. The plaintiffs in *United States ex rel. Fair Laboratory Practices Associates v. Quest Diagnostics Inc.* brought a qui tam action claiming that the defendant diagnostic laboratory engaged in kickbacks by underpricing some services in order to garner other, federally paid-for and more lucrative business.[42] The plaintiffs had excellent intelligence about the defendant's illegal conduct, since its principal, a lawyer named Mark Bibi, had served for five years as general counsel for the defendant's predecessor. Armed with an expert affidavit from legal ethics guru Steven Gillers, the defendant claimed that Bibi had breached his ethical duty of confidentiality to his former client by using confidential information to bring the qui tam claim. Bibi and his co-plaintiffs demurred, arguing that state ethics rules permitted the revelation in order to prevent or rectify client fraud. The district court rejected the plaintiffs' arguments, disqualified Bibi and dismissed the qui tam case in its entirety. The court reasoned that state ethics rules did apply, at least in the case before it; Bibi's disclosures vastly surpassed what was necessary to remedy the fraud; and the revelation of client confidences infected the entire prosecution. The court wrote that if a state ethics rule is "inconsistent with or antithetical to federal interests, a federal court interpreting that rule must do so in a way that balances the varying *federal* interests at stake."[43] According to the court, "Counsel for [the relators] are privy to [the defendant's] . . . confidential information and are in a position to use that information to give present or subsequent clients an unfair, and unethical, advantage."[44] The federal interest in preventing kickbacks, on the facts of that case, was outweighed by the state interest in protecting client confidences.

Other federal courts have applied a totality of the circumstances analysis to weigh the conflicting interests presented by attorney-whistleblower claims. For example, the Ninth Circuit Court of Appeals, in *Van Asdale v. International Game Technology*, upheld the right of terminated in-house lawyers to bring a retaliation suit under the whistleblower provisions of the Sarbanes-Oxley Act.[45] In that case, the plaintiffs were in-house intellectual property lawyers for a publicly traded slot machine distributor. In the course of due diligence for a

proposed merger, the in-house lawyers for the acquiring company (a brother and sister team) learned that a patent infringement claim was the major asset of the acquired company. Following the merger, the lawyers learned that the patent was probably invalid due to prior art, and that high-ranking company officers may have been aware of this fact. As a result, investors were potentially misled by public disclosures about the value of the merger. Shortly after the corporate IP lawyers brought this matter to the attention of the company's president, they were fired.

The sacked lawyers brought a wrongful discharge claim under SOX, which prevents retaliation against any person alleging discrimination based on conduct protected under the act.[46] The reporting of securities fraud was protected conduct. The defendant corporation moved to dismiss, arguing that the plaintiff-lawyers could not prove their case without revealing protected client confidences and waiving privileges. The Ninth Circuit rejected this argument, reasoning that the court could permit the case to proceed while taking precautions to limit the disclosure of confidential information. The court wrote that "concerns about the disclosure of client confidences in suits by in-house counsel" did not, without more, require dismissal of the case, observing that the district court could take protective measures by which it could balance the terminated lawyers' claim against the company's right to preserve the confidentiality of attorney-client protected material.[47] The court further noted that nothing in the Sarbanes-Oxley Act "indicates that in-house attorneys are not also protected from retaliation under this section, even though Congress plainly considered the role attorneys might play in reporting possible securities fraud."[48] Without announcing any broad, bright-line rules, the Ninth Circuit held that the plaintiffs had adduced sufficient evidence to reverse a grant of summary judgment in favor of the employer. Thus, under the *Van Asdale* standard, a whistle-blowing lawyer may bring a retaliation claim under SOX, and concerns about disclosure of confidential information can be accommodated by balancing the plaintiff's need to bring the claim against the client's confidentiality concern.

What do these authorities portend for the future of Dodd-Frank whistleblower claims? The message of *Van Asdale* is that a terminated lawyer with a valid federal retaliation claim will garner some sympathy from the courts, which will try to fashion a way to permit the claim while minimizing disclosure of confidential information. On the other hand, the court's holding in *Fair Laboratory* suggests that a lawyer who affirmatively and aggressively seeks to exploit confidential information for personal benefit is likely to be subjected to a higher standard. Under either standard, both federal courts were receptive to arguments based on lawyers' ethical obligations under state law, and balanced the state and federal interests. Neither case presented the perfect storm posed by the disconnect between SEC Rule 205 and state ethics rules. But neither case held that state ethics rules were federally preempted. Accordingly, it is unlikely that a federal court would plainly find that the SEC regulations promulgated under Dodd-Frank that explicitly pay homage to the various state ethics rules preempt or override those same rules.

Conflict of Interest Rules

In addition, a personal conflict is posed by the Dodd-Frank whistleblower bounties for corporate lawyers. A lawyer confronted with potential corporate wrongdoing must make some difficult, gut-wrenching decisions. A corporate lawyer, whether in-house or in private practice, must decide whether to report wrongdoing up the corporate ladder. In so doing, the lawyer may be ending the career of his or her principal contact within the organization. The whistleblowing lawyer may have to go over the head of the principal contact, including, potentially, the corporation's general counsel. The lawyer must decide whether the potential violation is material, and, in some states, whether it amounts to a crime. The lawyer must evaluate and consider varying requirements under SEC and state ethics rules. The reporting lawyer may get fired, and end up bringing a retaliation claim.

A lawyer whistleblower faces a once-in-a-lifetime ethical dilemma, a potentially career-ending conflict; a misjudgment could result in a malpractice claim or professional discipline.

These complex and potentially inconsistent considerations call for the exercise of objective, dispassionate professional judgment. A lawyer whistleblower faces a once-in-a-lifetime ethical dilemma, a potentially career-ending conflict. A misjudgment in either direction could result in a malpractice claim or professional discipline. A lawyer who blows the whistle prematurely could harm the client and be professionally responsible for the precipitous disclosure of client confidences. A lawyer who fails to report up the ladder credible evidence of corporate wrongdoing could be prosecuted by securities regulators, subject to professional discipline by the SEC, and subject to reciprocal discipline by state bar counsel.[49]

Under these delicate circumstances, the last thing lawyers need is a financial incentive to cloud their

professional judgment. Yet Dodd-Frank provides lawyers with potential bounties that range from $100,000 to literally millions of dollars in larger cases. Since lawyers are fallible, imperfect people, these bounties could tend to place their personal interests in potential conflict with those of their clients, thereby clouding lawyers' professional judgment.

ABA Model Rule 1.7 provides some guidance in the event of a conflict raised by such personal interests. According to that rule, a lawyer may not ethically represent a client, absent a valid waiver, if "there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person *or by a personal interest of the lawyer*."[50] New York's formulation provides:

> (a) Except as provided in paragraph (b), a lawyer shall not represent a client if a reasonable lawyer would conclude that either:
> (1) the representation will involve the lawyer in representing differing interests; or
> (2) there is a significant risk that the lawyer's professional judgment on behalf of a client will be adversely affected by the lawyer's own financial, business, property or other personal interests.[51]

A lawyer's professional judgment may be clouded by the prospect of a bounty award.

In either formulation, a lawyer must obtain a valid written waiver under Rule 1.7(b) in the event of a "significant risk" that the lawyer's professional judgment or representation will be adversely affected by the lawyer's personal interest. This raises three difficult and potentially unanswerable questions. First, wouldn't just about any lawyer's professional judgment be affected by a potential six- or seven-figure bounty award? Second, how would a lawyer obtain a conflict waiver under these circumstances? Third, would a written waiver be enforceable?

In the first instance, almost any lawyer's professional judgment is likely to be affected, consciously or otherwise, by the prospect of a significant bounty payment. While all lawyers undoubtedly value their professional licenses, at some point a million-dollar bounty can be tempting.

Second, it is difficult to imagine a whistleblower simultaneously deciding whether to report wrongdoing up the corporate ladder while asking the client for informed consent to the conflict waiver. Almost by definition, the would-be whistleblower would be acknowledging a defect or weakness in professional judgment by requesting the waiver. By the very act of requesting the waiver, the lawyer would implicitly be informing the client of his intention to profit from a future whistleblower claim. Let's imagine such a hypothetical conversation. It might go something like this:

> Lawyer: I wish to inform you that I have uncovered credible evidence of a material violation of the federal securities laws that I am obligated to report up the ladder, over your head, to the full board of directors.
> Client: That's terrible. We should investigate this matter promptly.
> Lawyer: That's not all. In the event that the full board does not act promptly or decisively to remedy the wrongdoing, I may seek to file a whistleblower claim under the Dodd-Frank Act, for which I may be entitled to a bounty of 10% to 30% of the penalty that the SEC may exact against the company. Based on what I know so far, I anticipate that this case could result in a $30 million fine. My share would be approximately $3 million to $10 million. While this could affect my professional judgment, I don't believe it will, and I want you to agree to permit me to continue as the company's lawyer.
> Client: Wait a minute. Are you telling me you might, under some circumstances, report confidential information to regulators?
> Lawyer: Yes. But I can still represent the company diligently.
> Client: How can I trust you to continue as the company's lawyer if you may seek to blow the whistle on our company for your personal profit and implicate me and everyone else you have worked with?
> Lawyer: I represent the company, not you. I have to comply with my ethical obligations under SEC Rule 205.
> Client: You are fired.
> Lawyer: You can't fire me. I am protected from retaliation by Dodd-Frank.
> Client: I am not firing you for reporting up or reporting out. I am firing you because you have a personal conflict of interest and can no longer give me or the company objective, disinterested advice.

In the foregoing hypothetical example, the lawyer advises the client that he must report wrongdoing up the corporate ladder, and possibly out to regulators. The lawyer simultaneously requests a waiver in order to permit ongoing representation. The client discharges the lawyer because she has reason to question the lawyer's professional judgment, not because of protected activity under Dodd-Frank. But the client needn't discharge the lawyer to get to the same point. The client can merely decline to consent to the waiver. Under those circumstances (and a slight tweak of the hypothetical), the lawyer must withdraw from the representation, because the client refuses to waive a conceded conflict. In the event of an in-house corporate lawyer, this could, depending on the facts, require the lawyer to withdraw, i.e., quit his or her job.

How is a court to sort this out? An in-house corporate lawyer who is wrongly discharged under Dodd-Frank may bring a retaliation case, and such a lawyer is likely to cite *Van Asdale* in support. On the other hand, Dodd-Frank does not explicitly or implicitly preempt or supersede state ethics rules, and a lawyer with a conflict of interest may not be able to obtain a valid waiver. Such a lawyer may need to voluntarily resign under RPC 1.16.

Lawyers whose representation conflicts with their personal interests are not new. Consider, for example, the decision of the Second Circuit Court of Appeals in *United States v. Schwarz*, which upended an on-the-record conflict waiver conducted in open court in a criminal prosecution.[52] In the Abner Louima police brutality scandal of the 1990s, NYPD Officer Justin Volpe pleaded guilty to sexually assaulting Louima with a broomstick in a Brooklyn police precinct bathroom. While swearing that Volpe had an accomplice who held him down during the attack, Louima couldn't make a definitive identification. The government prosecuted Police Officer Charles Schwarz, Volpe's partner, as the accomplice, based largely on circumstantial evidence. However, substantial evidence placed other police officers in the vicinity of the precinct bathroom at the time of the assault. Those officers were also high-ranking members of the Patrolmen's Benevolent Association (PBA), the police officers' union.

Prior to trial, Steven Worth, Schwarz's lawyer, signed a $10 million two-year contract with the PBA. One potential strategy would have been for Schwarz to argue that he wasn't the accomplice and to point the finger at one of several other police officers, each of whom had positions of power and influence with the PBA. Worth and Schwarz elected not to pursue that strategy. Upon learning of the potential conflict, the district judge held a formal, on-the-record, conflict waiver hearing at which Schwarz was fully apprised in open court of his attorney's potential conflict. Schwarz waived the conflict, and proceeded to be convicted at a trial in which he denied being Volpe's accomplice, yet refused to point the finger at any other (PBA delegate) cop.

The Second Circuit reversed, holding that Worth's conflict was unwaivable as a matter of law, and that no rational person in Schwarz's situation would have waived that conflict or pursued that defense. The court wrote that Worth's representation of Schwarz "was in conflict not only with his ethical obligation to the PBA as his client, but also with his own substantial self-interest in the two-year, $10 million retainer agreement his newly formed firm had entered into with the PBA." As a result, the court announced the following test:

> An actual or potential conflict cannot be waived if, in the circumstances of the case, the conflict is of such a serious nature that no rational defendant would knowingly and intelligently desire that attorney's representation. Under such circumstances, the attorney must be disqualified, regardless of whether the defendant is willing to waive his right to conflict-free counsel.[53]

Thus, not all conflicts are waivable, particularly when they involve a conflict with the lawyer's personal interest. Given Worth's $10 million contract with the PBA, and the restrictions that deal imposed on his representation of Schwarz on the facts of the Louima case, "no rational defendant" would knowingly have desired his representation. In short, a conflict with the lawyer's personal interests can be profound and, in some circumstances, unwaivable.

It does not require much imagination to apply the *Schwarz* ruling to potential conflicts under Dodd-Frank. A prospective whistleblower may hope to claim close to a $10 million bounty by reporting a securities fraud of $30 million or more. Such a lawyer's professional judgment may be clouded by the prospect of a bounty award, which could tilt the lawyer in favor of reporting out a violation that otherwise perhaps should be reported up the ladder.

In fact, precipitous reporting out could violate state ethics rules, and corporate lawyers may find themselves in a conflict situation because of the potential of a whistleblower bounty. Such a conflict can tend to cloud a lawyer's professional judgment, and furthermore, it may be unwaivable.

Conclusion

Securities lawyers confronted with evidence of corporate wrongdoing are faced with conflicting ethical and fiduciary responsibilities. Would-be whistleblowers are well advised to consider the varying and potentially conflicting obligations of SEC and state ethics regulations.

Lawyers who report out corporate wrongdoing may run afoul of state ethics regulations and could, at least theoretically, be subject to state discipline. State ethics rules are inconsistent with each other and with SEC Rules.

Courts faced with conflicts between state and federal ethics rules are unlikely to apply a blanket preemption analysis; indeed, they cannot. If precedent is a guide, federal courts will apply a fact-specific totality-of-the-circumstances analysis in balancing state and federal interests in evaluating the validity of whistleblower claims under Dodd-Frank implicating state attorney ethics rules. Indeed, the McDade Amendment indicates that federal lawyers must adhere to state ethics rules. It is highly unlikely that lawyers can ethically disregard state ethics rules. Moreover, lawyers should be mindful of the potential that their professional judgment could be influenced by the prospect of collecting a bounty from the government under the Dodd-Frank Act. ■

1. 17 C.F.R. § 205.3(d)(2)(i).

2. *See* Roger Cramton, George Cohen & Susan Koniak, *Legal and Ethical Duties of Lawyers After Sarbanes Oxley*, 49 Vill. L. Rev. 725, 782 (2004).

3. SEC Rule 21F-4(b)(iv)–(v), 17 C.F.R. § 240.21F-4(b)(4)(iv)–(v).

4. 15 U.S.C. § 7245, 17 C.F.R. § 205.3(d)(2).

5. SEC Rule 205.3(d)(2), 17 C.F.R. § 205.3(d)(2), states:

> An attorney appearing and practicing before the Commission in the representation of an issuer may reveal to the Commission, without the issuer's consent, confidential information related to the representation to the extent the attorney reasonably believes necessary:
>
> (i) To prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors;
>
> (ii) To prevent the issuer, in a Commission investigation or administrative proceeding from committing perjury, proscribed in 18 U.S.C. 1621; suborning perjury, proscribed in 18 U.S.C. 1622; or committing any act proscribed in 18 U.S.C. 1001 that is likely to perpetrate a fraud upon the Commission; or
>
> (iii) To rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney's services were used.

6. CFTC Rule 165.2(g)(2)–(3), 17 C.F.R. § 165.2(g)(2)–(3).

7. Cramton, Cohen & Koniak, *supra* note 2, at 791.

8. *See In re Don Hershman*, Securities Act Release No. 9180 (Feb. 2, 2011).

9. *See* Model Rules of Prof'l Conduct R. 1.6.

10. New York City Bar, Report of the Task Force on the Lawyers Role in Corp. Governance 80 (2006) (Task Force Report).

11. *Id.* at 76–80.

12. N.Y. Rules of Prof'l Conduct R. 1.6(b).

13. Model Rules of Prof'l Conduct R. 1.6(b).

14. Lynne Bernabei & Alan Kabat, *The SEC Properly Expanded Protection for Attorney Whistleblowers*, Nat'l L.J., Aug. 9, 2011, http://www.law.com/jsp/nlj/PubArticlePrinterFriendlyNLJ.jsp?id=1202510464836.

15. *But see* Task Force Report, *supra* note 10, at 12.

16. N.J. Rules of Prof'l Conduct R. 1.6(b)–(d).

17. *See* Task Force Report, *supra* note 10, at 47 (citing *In re Isselman*, Securities Act Release No. 50428 (Sept. 23, 2004)).

18. California, on the other hand, requires a lawyer to remonstrate with the client before revealing confidences and prevents prosecution of the lawyer for not revealing client confidences. *See* Stephen Gillers, Roy D. Simon Jr. & Andrew M. Perlman, Regulation of Lawyers 82 (Aspen 2010).

19. *In re Isselman*, Securities Act Release No. 50428 (Sept. 23, 2004).

20. *In re Drummond*, Securities Act Release No. 8523 (Jan. 13, 2005).

21. *See also In re Weiss*, Securities Act Release No. 52875 (Dec. 2, 2005) (bond counsel prosecuted by SEC under negligence standard for failing to exercise reasonable prudence in advising school board about tax-exempt status).

22. Cal. Bus. & Prof. Code 6068 (e).

23. *See* Cramton, Cohen & Koniak, *supra* note 2, at 782.

24. Model Rule of Prof'l Conduct R. 1.13.

25. *Id.*

26. N.Y. Rules of Prof'l Conduct R. 1.13.

27. N.J. Rules of Prof'l Conduct R. 1.13.

28. *See* N.J. Rules of Prof'l Conduct R. 1.6.

29. *See Sperry v. State of Florida*, 373 U.S. 379 (1963).

30. *See, e.g., Swidler & Berlin v. United States*, 524 U.S. 399 (1998).

31. Sarbanes-Oxley Act, 15 U.S.C. §§ 7245 *et seq.*

32. *See* Cramton, Cohen & Koniak, *supra* note 2, at 788.

33. *Id.* at 795.

34. 28 U.S.C. § 530B (2004); *see* Lisa G. Lerman & Philip G. Schrag, Ethical Problems in the Practice of Law 716–17 (Aspen 2008).

35. *See* Ethics Alert, Ethics Hotliner, Corporations Committee of the Business Law Section and Committee on Professional Responsibility and Conduct, California State Bar, http://www.calbar.ca.gov/portals/0/documents/SEC-ethics-alert.pdf.

36. Letter from the Corporations Committee, Business Law Section of the State Bar of California to Giovanni P. Prezioso, General Counsel of the SEC (Aug. 13, 2003) at 6, *available at* http://www.dwalliance.com/sbar/SEC.PDF.

37. Wash. State Bar Assoc., Interim Formal Ethic Opinion re: *The Effect of the SEC's Sarbanes-Oxley Regulations on Washington Attorneys' Obligations Under the RPCs*, http://www.ethicsandlawyering.com/Issues/files/WashOpinion.pdf.

38. *Id.*

39. N.C. State Bar, Formal Ethics Op. 9 (2005).

40. N.Y. Rules of Prof'l Conduct R. 1.6(b)(6).

41. *See* Cramton, Cohen & Koniak, *supra* note 2, at 807 ("California lawyers are therefore at some risk if they seek to take advantage of Section 205.6(c).").

42. No. 5393, 2011 WL 1330542 (S.D.N.Y. Apr. 5, 2011).

43. *Id.* at *6 (quoting *Grievance Committee for the S.D.N.Y. v. Simels*, 48 F.3d 640, 646 (2d Cir. 1995)).

44. *Id.* at *13.

45. 577 F.3d 989 (9th Cir. 2009).

46. *See id.* at 996 (citing 15 U.S.C. § 7245).

47. *Id.* at 995 (quoting *Kachmar v. SunGard Data Sys.*, 109 F.3d 173, 181 (3d Cir. 1997)).

48. 577 F.3d at 996 (citations omitted).

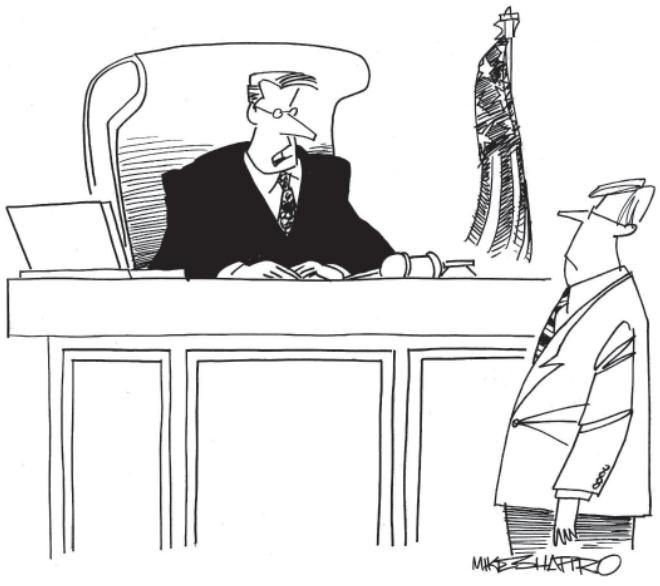
49. *See, e.g.*, Task Force Report, *supra* note 10, at 46 (collecting 74 SEC enforcement actions against lawyers).

50. Model Rules of Prof'l Conduct R. 1.7(a) (emphasis added).

51. N.Y. Rules of Prof'l Conduct R. 1.7.

52. 283 F.3d 76 (2d Cir. 2002).

53. *Id.* at 95–96 (citations omitted).



"Hey, I'm all about being reasonable."

BY DAVID PAUL HOROWITZ

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Electronic Odds & Ends

Introduction

Having devoted the last two columns to a recent trilogy of significant First Department electronic disclosure cases, I thought I would close out the topic with a look at a number of recent appellate and trial level decisions from the world of electronic disclosure.

Social Networking Evidence

In *Johnson v. Ingalls*,[1] the plaintiff was injured when she either jumped or fell from a vehicle operated by the defendant. The plaintiff appealed a verdict for the defendant, contending, *inter alia*, that the trial court erred in admitting into evidence photographs obtained from the plaintiff's Facebook account, a contention the Third Department rejected:

> We further reject plaintiff's contention that certain photographs obtained from her Facebook account were unduly prejudicial and improperly admitted into evidence. After an in camera review, Supreme Court excluded the majority of the photographs that defendants proffered as unduly prejudicial, cumulative or insufficiently probative, but permitted use of approximately 20 photos during plaintiff's cross-examination. Plaintiff claimed that, as a result of her injury, she suffered severe anxiety, vertigo, constant migraines and pain for a period of about two years, that her anxiety prevented her from going out or socializing with friends, and that she required antidepressant medication. The photos admitted were taken over a 1 1/2-year period beginning shortly after the accident. They depicted plaintiff attending parties, socializing and vacationing with friends, dancing, drinking beer in an inverted position referred to in testimony as a "keg stand," and otherwise appearing to be active, socially engaged and happy. They further revealed that plaintiff consumed alcohol during this period, contrary to medical advice and her reports to her physicians. The discretion of trial courts in rendering evidentiary rulings is broad. The photographs had probative value with regard to plaintiff's claimed injuries, their evidentiary value was properly balanced against their potential for prejudice, and we find no abuse of discretion.[2]

When the plaintiff took the keg stand, I mean witness stand, the cross-examination must have been uncomfortable, to say the least. *Johnson* serves as a useful reminder that the most damaging wounds in litigation are often those that are self-inflicted. What is surprising is that the plaintiff did not withdraw at least some of the damage claims highlighted by the appellate court, which might have obviated the relevance of some of the photos ultimately admitted, particularly in light of the careful balancing test the trial court appears to have applied.

Johnson also shows the potential value of social media material for cross-examination, whether directly addressing a claim or defense, or on a collateral issue. Care must be taken, however, to establish a proper foundation for the matter to be discoverable, before the issue of admissibility is addressed. Accordingly, the First Department denied "access to plaintiff's social networking accounts, [where] no showing has been made that 'the method of discovery sought will result in the disclosure of relevant evidence or is reasonably calculated to lead to the discovery of information bearing on the claims.'"[3]

Johnson serves as a useful reminder that the most damaging wounds in litigation are often those that are self-inflicted.

The importance of the nature and extent of the *in camera* review by the trial court cannot be understated. In another personal injury action, *Patterson v. Turner*, the plaintiff alleged physical and psychological injuries, and the defendant sought disclosure of all Facebook records created by the plaintiff after the date of the occurrence, including deleted and archived records.[4] The First Department remanded for further *in camera* review by the trial court:

> Plaintiff claims damages for physical and psychological injuries, including the inability to work, anxiety, post-traumatic stress disorder, and the loss of enjoyment of life. Although the motion court's in camera review established that at least some of the discovery sought

> "will result in the disclosure of relevant evidence or is reasonably calculated to lead to the discovery of information bearing on the claims," it is possible that not all Facebook communications are related to the events that gave rise to plaintiff's cause of action. Accordingly, we reverse and remand for a more specific identification of plaintiff's Facebook information that is relevant, in that it contradicts or conflicts with plaintiff's alleged restrictions, disabilities, and losses, and other claims.[5]

The First Department also reviewed, and rejected, the plaintiff's argument that the privacy settings selected by the plaintiff dictated whether the Facebook records were discoverable: "The postings on plaintiff's online Facebook account, if relevant, are not shielded from discovery merely because plaintiff used the service's privacy settings to restrict access, just as relevant matter from a personal diary is discoverable."[6]

In *Patterson*, the First Department cited the Fourth Department's *Faragiano v. Town of Concord*.[7] In *Faragiano*, which involved a plaintiff's written diary, the court explained that the trial court, in evaluating whether to order the diary's disclosure,

> abused its discretion in granting that part of plaintiffs' cross motion seeking to compel the Town to disclose the unredacted diary of a former employee of the Town without first reviewing the diary in camera. The court previously had ordered disclosure of the diary, with "any privileged, or personal, non-work related entries that have nothing to do with the occurrence herein to be redacted." A redacted diary was provided and, in now seeking disclosure of the unredacted diary, plaintiffs have raised valid questions concerning the nature of the redactions. We conclude that the court should have reviewed the diary in camera "to determine whether full disclosure is required and to minimize the intrusion into [the] privacy" of the Town's former employee. We therefore modify the order by denying that part of plaintiffs' cross motion seeking to compel the Town to disclose the unredacted diary of a former employee of the Town, and we remit the matter to Supreme Court, Erie County, to determine that part of the cross motion following an in camera review of the diary.[8]

A recent Fourth Department decision makes clear that a party's failure to establish a proper foundation for the disclosure of social-media matter will not, in and of itself, preclude that party from making a subsequent application for disclosure, supported by a proper foundation.[9]

Spoliation of ESI

In *915 Broadway*,[10] one of the first cases applying *Voom HD Holdings, LLC v. EchoStar Satellite, LLC*,[11] a trial court imposed the most stringent sanction available, the striking of a party's pleading, here the plaintiff's amended complaint, for the spoliation of ESI:

> Paul Hastings seeks dismissal of the amended complaint, in light of 915 Broadway's complete failure to preserve key evidence relevant to Paul Hastings' claims and defenses in this action. I agree that dismissal is the only remedy capable of addressing the prejudice imposed upon on [sic] Paul Hastings as a result of 915 Broadway's conduct, as no other remedy can rectify the gaps in the evidentiary record resulting from 915 Broadway's own misconduct. If the amended complaint is not dismissed, Paul Hastings will have to defend itself against 915 Broadway's claims without the benefit of a full and complete record. Dismissal is warranted not only because 915 Broadway's intentional and reckless destruction of electronic evidence has been so widespread that it precludes Paul Hastings from fairly litigating its claims and defenses, but also because the destruction persisted months after Paul Hastings raised its concerns about 915 Broadway's preservation efforts, and the incompleteness of the evidentiary record in this case.[12]

The trial court explained when striking a pleading is an appropriate remedy:

> Generally, dismissal of a cause of action is warranted where the destroyed evidence is key to the innocent party's claims or defenses. However, [i]t is fundamentally unfair to require [a party] to come forward with evidence that the destroyed [documents] are key evidence . . . , where [the party] has no way of knowing what records were destroyed. That is exactly why there are sanctions for spoliation. [The party] will never know what was in the records . . . which is why [the spoliating party] should have preserved the records.[13]

The trial court recited the relevant conduct of the plaintiff:

> Likewise, here, Paul Hastings cannot know exactly what documents were destroyed because of 915 Broadway's misconduct. However, it is clear that the following intentional, willful and/or grossly negligent destruction of evidence by 915 Broadway has tainted the record in this case: (1) Poretsky's intentional deletion of relevant electronic files after the duty to preserve arose, and until December 2010; (2) the failure of 915 Broadway to investigate the ways in which emails were stored and retained by its principals, or to make any effort to ensure that the custodians were complying with their preservation duties; (3) the complete failure of six of 915 Broadway's custodians to suspend the automatic-deletion functions associated with their electronic files, even after receipt of the Litigation Hold; (4) the complete failure of all of 915 Broadway's custodians to suspend the regular destruction of backup tapes or create electronic images of their data; and (5) the replacement of email servers in January 2011

> associated with two key witnesses, which rendered impossible any potential recovery of destroyed emails, even though Paul Hastings had raised its concerns to me about 915 Broadway's preservation and production efforts months earlier.[14]

The trial court concluded that the plaintiff's conduct warranted dismissal: "These failures resulted in the destruction of relevant electronic documents, which has prevented Paul Hastings from defending the causes of action asserted against it. It is fundamentally unfair to require Paul Hastings to defend itself in a vacuum."[15]

In addition to dismissing the plaintiff's complaint, the trial court awarded the defendant's request for attorney fees and the costs incurred in making the motion, holding there was "ample authority for granting this relief," citing, *inter alia*, the First Department's decision in *Ahroner v. Israel Discount Bank of New York*.[16]

Trade Secrets & Electronic Disclosure

In *MSCI Inc. v. Financial Engineering Associates, Inc.*,[17] an action for misappropriation of trade secrets, disclosure centered on computer source codes and their components and sequencing. The trial court reviewed letter briefs on the issue of

> "whether the plaintiff has to affirmatively identify its trade secrets at this juncture or is it sufficient to identify the components [of the source codes] not claimed to be trade secrets." The court had previously made a ruling on the issue, early in the discovery process. The issue arose at a discovery conference and was not briefed. That ruling is the subject of the letters.[18]

After examining the positions advanced by the parties, the trial court held:

> Here, plaintiffs' misappropriation claim alleges a number of different trade secrets beyond its compilation theory. Plaintiffs who have brought this action, bear the burden of proving their allegations. Merely providing defendants with plaintiffs' "reference library" to establish what portions of their source code are in the public domain shifts the burden to defendants to clarify plaintiffs' claim. Additionally, the disclosure does not enlighten either defendants or the court as to what sequencing of publicly known components or licensed components, are trade secrets. Hence, it is insufficient.
>
> Moreover, it would be unfair to allow plaintiffs to discover Axioma's trade secrets prior to revealing their own. Should defendants remain in the dark as to the explicit portions of the source codes that plaintiffs deem to be trade secrets misappropriated by defendants, plaintiffs, once privy to Axioma's source codes, could tailor their theory of misappropriation to Axioma's work.
>
> Indeed, Axioma's work could be misappropriated. For this reason, plaintiffs are precluded from seeking further discovery from defendants until they identify, with reasonable particularity, which of the component parts or sequencing of their source code are not (1) publicly available information, (2) commonly-used algorithms, or (3) third-party licensing. Plaintiffs shall further supplement its "paths not taken" response to defendants' interrogatory requests.[19]

The trial court concluded with mention of the potential costs involved: "The court is not insensitive to the costs of its order. However, discovery in this age of electronically stored information and, thus litigation, has become an exceedingly expensive venture. This is even more the case, when the subject of the action is computer software and programming."[20]

Conclusion

Attorneys and their clients are long past the point in time when ignorance was a viable defense for failing to follow e-discovery obligations. While there will certainly be refinements and adjustments made to e-discovery rules over time, a relatively settled landscape now appears to stretch into the foreseeable future. With e-discovery assuming its rightful place as a component of, rather than a driving force behind, litigation, this column will turn to some "old school" disclosure and evidentiary issues in the months ahead. So, a Happy Fourth to all, and see you in September. ■

Attorneys and their clients are long past the point in time when ignorance was a viable defense for failing to follow e-discovery obligations.

1. 95 A.D.3d 1398 (3d Dep't 2012).
2. *Id.* (citations omitted).
3. *Abrams v. Pecile*, 83 A.D.3d 527 (1st Dep't 2011) (citations omitted).
4. *Patterson v. Turner Constr. Co.*, 88 A.D.3d 617 (1st Dep't 2011).
5. *Id.* (citations omitted).
6. *Id.* (citation omitted).
7. 294 A.D.2d 893 (4th Dep't 2002).
8. *Id.* at 894 (citation omitted).
9. *McCann v. Harleysville Ins. Co. of N.Y.*, 78 A.D.3d 1524 (4th Dep't 2010).
10. *915 Broadway Assocs. LLC v. Paul, Hastings, Janofsky & Walker*, 34 Misc. 3d 1229(A) (Sup. Ct., N.Y. Co. 2012).
11. 93 A.D.3d 33 (1st Dep't 2012).
12. *915 Broadway Assocs. LLC*, 34 Misc. 3d 1229(A).
13. *Id.* (citations omitted).
14. *Id.*
15. *Id.*
16. 79 A.D.3d 481 (1st Dep't 2010).
17. 2012 N.Y. Slip Op. 22110, 2012 WL 1382438 (Sup. Ct., N.Y. Co. 2012).
18. *Id.*
19. *Id.* (citations and parentheticals omitted).
20. *Id.*

Your Client's Insurer Is in Receivership – Now What?

By David Axinn

Introduction

To properly assess a client's case, it is critical to determine whether there is an insurance policy that covers the loss or indemnifies the defendant for litigation costs. The existence of such a policy often determines the outcome of the dispute. But what if the insurance company that issued the policy is insolvent, and what if that insurer is now in receivership proceedings in New York? Does your client stand a chance of recovery under the policy, and if so, after what period of time? There are no simple answers to these questions, but the lawyer in this situation should be armed with a few basic principles.

The Superintendent as Receiver

Distressed or insolvent companies in New York are placed in receivership under the supervision of the New York state courts and the administration of the New York Superintendent of Financial Services as receiver (Receiver).[1] The Superintendent is given "broad fiduciary powers to manage the affairs of distressed domestic insurers and to marshal and disburse their assets."[2] The Receiver currently administers approximately 36 liquidation and four rehabilitation proceedings and also handles a number of ancillary estates and conservations relating to receivership proceedings located in other states.

The Superintendent's role as Receiver is legally and functionally distinct from his job as the chief regulator of the Department of Financial Services (Department) under N.Y. Financial Services Law § 202.[3] The Receiver relies on a dedicated staff of agents, deputies and others who do not assist in his regulatory duties as head of the Department.[4] This dedicated staff is collectively known as the New York Liquidation Bureau (Liquidation Bureau or Bureau). The Liquidation Bureau has no independent corporate form or identity, but is merely an office that handles the Superintendent's receivership duties and certain other functions under the direction of a special deputy superintendent. Unlike the Department, the Bureau receives no funding or appropriations in the state's budget;[5] the Bureau is funded from assessments imposed on the assets of the estates it manages and on the state's three insurance security funds.[6]

Because the Receiver is authorized to handle only non-state funds, he is often described as acting in a

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private capacity in discharging his receivership duties.[7] This is certainly the case; the Receiver can sue and be sued in a private capacity and the Bureau is organized in many respects as a private entity.[8] However, it may be an overstatement to equate the Bureau entirely with a private actor. For instance, the Bureau processes and pays claims on behalf of the three state security funds mentioned above, each of which is a state entity managed jointly by the Superintendent and the Department of Taxation and Finance. Nor can the dual nature of the Superintendent as head of both the Department and the Bureau be ignored. The Superintendent is appointed by the Governor, upon advice and consent of the Senate,[9] and only a strict constructionist could argue that his alter ego, the Receiver, stands outside the realm of politics and public policy.[10] The Bureau is best understood as a state entity that is not an agency and that stands outside the state's budgetary processes.

The Receiver does not act alone, but shares his authority with the courts. The Receiver's powers derive directly from N.Y. Insurance Law Article 74 and, as such, he has an independent source of authority;[11] yet, the Receiver is powerless to take action on behalf of an insurance company unless and until he has first been appointed to act as Receiver by a competent court.[12] Further, once appointed, the Receiver's actions with regard to an estate are subject to judicial review, although only certain of his decisions must be approved by the courts prior to taking action.[13]

The Receiver and courts have worked out a balance of authority in which each has a distinct role in carrying out the receivership's purposes. In the parlance of receiverships, it can be said that "the Receiver proposes and the court disposes." The Receiver carries out the executive function, determining how to administer estates in the best interests of creditors. The court, in turn, is generally passive and cannot direct the administration of the estate, but it is charged with adjudicating the claims of creditors and reviewing the Receiver's decisions to ensure that he has reasonably exercised his discretion.[14]

Section 202(c) of the Financial Services Law provides that the Superintendent's actions and decisions under the Insurance Law are committed to his "sound discretion." Such was the understanding prior to the enactment of the Financial Services Law, but it remains to be seen whether by making this understanding express, the provision has any effect on the balance of power between the Superintendent as Receiver and the courts.

Insurance Law Article 74

The general practitioner may be tempted to compare an Article 74 receivership to a bankruptcy proceeding under the United States Bankruptcy Code, but this can be misleading. Although many of the doctrines in bankruptcy have analogs in an Article 74 receivership, the two proceedings have evolved on separate tracks, are supervised by different sovereigns and, in some respects, serve different public policies. In large part, New York has an insurance receivership statute because of the special role of the insurance industry in protecting the public from personal and business hardships associated with insurance losses. Insurance is a safety net and policyholders are not the same as general creditors in a bankruptcy. The state has an important interest in minimizing the economic impact associated with an insurer's failure and has designed the statute to ensure an orderly and fair disposition of the insurer's assets. For similar reasons, Insurance Law Article 76 and the Workers' Compensation Law have designated the Superintendent as administrator of three of the state's insurance security funds, which, as discussed below, provide an additional protection to New Yorkers against hardships associated with the insolvency of an insurance carrier.[15]

Article 74 describes a carefully detailed scheme for the administration of insurance receiverships. As stated by the Court of Appeals in *In re Knickerbocker*, Article 74 "is intended to and does furnish a comprehensive economical, and efficient method for the winding up of the affairs of such insurance companies by the Superintendent of Insurance."[16] Furthermore, the provisions of Article 74 "are exclusive in their operation and furnish a complete procedure for the protection of the rights of all parties interested."[17] There is no formal statement of purpose of Article 74, but the case law suggests that fair and equitable treatment of all creditors and maximization of creditor distributions through efficient administration and recovery of estate assets are among the top priorities of the statute.

Article 74 is a "comprehensive" statute, but there are areas where the text is silent or that require interpretation. Where the statute is not clear, it is important to remember that Article 74 is founded on equitable principles and "the dominant purpose of [Article 74] is the preservation and enhancement of that company's assets to the end that the interests of all its creditors, policyholders, stockholders and the public will be subserved."[18] Thus, when questions arise concerning the statute's interpretation, "equitable" principles should be applied.

Liquidation Versus Rehabilitation

Article 74 sets forth two types of domestic receiverships – rehabilitations and liquidations – each with its own rules and practices. Each proceeding serves different public policy goals.

Liquidation

Most receiverships managed by the Receiver are liquidations, which consist of estates that are so deeply insolvent or otherwise distressed that they cannot be returned to the marketplace or reorganized. In a liquidation proceeding, the Receiver is required "to

take possession of the property of such insurer and to liquidate the business of the same."[19] The term *liquidation* is not defined in the statute, but may be thought of as the orderly process of monetizing an estate's assets and making distributions to creditors with allowed claims against the estate.

> The Receiver proposes and the court disposes.

Unlike a rehabilitation proceeding in which the insurer may continue to operate, the order of liquidation usually dissolves the corporate existence of the insurer, including its licenses to write new or renewal insurance policies.[20] The entry of a liquidation order terminates most of the insurer's business and contractual relationships with third parties. Under Insurance Law § 7405(b), "the rights and liabilities of any such insurer and of its creditors, policyholders, shareholders, members" are fixed upon entry of the liquidation order.[21] This generally means that unless the liquidator or the liquidation court specifies otherwise, upon the entry of the liquidation order all contracts, including policies, are canceled going forward.

Allowance and Priority

All claims in liquidation, other than the administrative expenses of the Receiver, must be presented to the Receiver and approved or "allowed" by the court before the claimant can receive a distribution in a liquidation proceeding. Under Insurance Law § 7433(b), persons who appear on the books and records of the insurer as policyholders or claimants at the time of the liquidation order will automatically be deemed to have submitted a timely claim with the liquidator.[22] Prior to the 1989 amendment that added the "books and records" rule, claimants were required to submit their claims to the liquidator in the form of a proof of claim within four months of the liquidation order. Since the adoption of § 7433, the four-month rule is generally no longer followed. Instead, claimants are free to submit claims in the proceeding. If and when the liquidator seeks to cut off the presentment of new claims, the current practice is to seek a court order imposing a bar date.

Once a claim has been reviewed, the Receiver recommends to the court whether to allow, disallow or partially allow the claim.[23] As noted above, the Receiver merely proposes allowances, and it is the court's function to formally approve or allow the claim. In order for a claim to be allowed, it must be absolute, which generally means that the underlying loss must have been paid to the injured party or have been reduced to a judgment. Contingent claims, claims that require additional evidence or events to occur in order to ripen into paid or liquidated claims, cannot be allowed by the court.[24] An example of a contingent claim may be a claim submitted by an insured that has been named in a lawsuit, but has not been subject to a judgment fixing damages. Under the statute, such claims are preserved in the proceeding and submitted for allowance once they become absolute.

Creditors sometimes argue that the Receiver is an interested party in an allowance proceeding or that he has a motive to either reduce claims allowances or maximize reinsurance. Neither is the case. As a fiduciary, the Receiver is a disinterested administrator whose function is to adjust the claim under governing law. This does not mean that the Receiver is unable to negotiate claims or take adverse positions when he disagrees with a claimant as to the controlling law or facts. In the event that a claim is disputed, most receivership courts establish adjudication procedures by which disputed claims are referred to a referee to hear the claim and report to the court.

Once the court has allowed a creditor's client's claim, there is still no guarantee that the creditor will receive a distribution. Insurance Law Article 74 contains a detailed distribution scheme that determines the priority in which creditors receive payment.[25] Unlike the priority scheme of the Bankruptcy Code, however, the Article 74 scheme is designed to protect policyholders. Once the "actual and necessary" administrative expenses of the Receiver have been paid as Class One claims,[26] the next highest class – Class Two claims – consists of claims made under insurance policies and claims of security funds.[27]

Claims of the federal government are designated as Class Three.[28] Notwithstanding a federal statute that requires that the United States be paid first in an insolvency distribution,[29] the Supreme Court held in *United States v. Fabe*[30] that federal law does not preempt a state's priority scheme with regard to the state's regulation of the "business of insurance," under § 2(b) of the McCarran-Ferguson Act, 15 U.S.C. § 1012(b). *Fabe* held that distributions to policyholders fall within the "business of insurance," and therefore receive a higher priority than federal claims under state liquidation statutes. After the claims of policyholders, however, the claims of other creditors do not fall within the business of insurance. This means that the federal priority statute takes effect below Class Two, placing the federal government above all remaining creditors.[31] General creditors receive a Class Six priority and claims of shareholders are Class Nine, the lowest priority.

Distributions to Holders of Allowed Claims

Once a claim has been allowed in a liquidation proceeding, it is eligible to receive a distribution. Because estates in liquidation are almost always insolvent, distributions will be expressed as a percentage of an allowed claim and will rarely amount to a 100% payment.

Article 74's liquidation scheme provides that no priority class may receive a distribution from the estate

until every claim in each higher class has received full payment for its allowed claims. Thus, if the estate's assets are insufficient to reach your client's priority class, the client will not receive a distribution. Even if your client's allowed claim falls within a class that is "in the money," the client may have to wait a considerable amount of time before receiving payment. Before making a distribution, the Receiver is required to "assure the proper recognition of priorities and a reasonable balance between the expeditious completion of the liquidation and the protection of unliquidated and undetermined claims."[32] The Receiver must therefore properly reserve for developing claims prior to making any distribution payments to creditors with allowed claims.

Striking this balance can be quite difficult in cases with long-term (long-tail) liabilities developing over decades, such as asbestos claims. In such cases, the Receiver may make only small interim distributions on allowed claims as funds are collected on behalf of the estate. The Receiver may also petition the court for a "bar date," which cuts off creditors' ability to present claims in the receivership so that the liabilities of the receivership can be determined with more precision.

Security Fund Coverage

After considering the obstacles to receiving payment in a liquidation, your client may be surprised to learn that he or she is entitled to a prompt and full payment through submission of his or her claim to a New York security fund or the guaranty association of another state. Depending on the residence of your client and the location of the risk that is covered by the policy, your client's claim may be covered by one of the four New York security funds.[33] The New York Property/Casualty Insurance Security Fund, for instance, provides a statutory benefit up to $1 million[34] per claim under certain types of property and casualty policies owned by New York residents or insuring New York-based risks.[35]

In addition, each of security funds requires that the insurer in receivership has been authorized, meaning licensed,[36] to write the insurance policies in New York and that the court make a finding of insolvency, or in the case of the life insurance guaranty fund, a finding of impairment. In practice, the security funds have historically been triggered only by the liquidation of a domestic insurer. It is an academic, but lingering, question, however, whether a finding of insolvency alone without a liquidation order could trigger any of the New York security funds.

Rehabilitation

If your client has a claim against an insurer in rehabilitation, a different set of laws and procedures may apply. The purpose of a rehabilitation is not necessarily to monetize and distribute the estate's assets, but "to take such steps toward the removal of the causes and conditions which have made such proceeding necessary."[37] In general, the rehabilitator does not dissolve the insurer's corporate existence,[38] but continues to operate the company in a limited manner. In some cases, the rehabilitator continues to employ key personnel who ran the company prior to rehabilitation using the same office space.

The goal of rehabilitation can be viewed from different perspectives. In theory, the objective is to remove the "causes and conditions" of the proceeding and return the company to the marketplace as a solvent insurer. This may include taking steps such as replacing management, attracting new capital investments or selling non-productive assets. In many cases, however, insurers enter rehabilitation in such an impaired condition that returning the company to the marketplace is impracticable. In such

cases, the rehabilitator may consider a plan to restructure (e.g., cancel and reissue) the insurer's debt so that its obligations can be run off in an orderly fashion outside of receivership. In those cases, the goal is not necessarily to return the insurer to the marketplace, but to reorder the insurer's debt in a manner that maximizes returns for all creditors and avoids the costs and delays associated with a protracted liquidation proceeding.

Last, the Receiver must be mindful of the possibility that a rehabilitation may later be converted to a liquidation if "at any time the superintendent deems further efforts to rehabilitate such insurer would be futile."[42] If the proceedings are converted, prior settlements that are in excess of the amount that would have been paid in liquidation may raise objections from creditors. In certain cases, such payments could risk being characterized as preferential – i.e, payments made with the intent to provide the recipients greater amounts than they would have received in liquidation – and be subject to clawback by the court.[43]

> The Receiver is required to "assure the proper recognition of priorities and a reasonable balance between the expeditious completion of the liquidation and the protection of unliquidated and undetermined claims."

For the rehabilitation to come to an end, the Receiver must submit a rehabilitation plan to the court explaining how all the claims have been or will be settled and that the "the purposes of the proceeding have been fully accomplished."[39] Under the so-called "best interests of creditors test," for the rehabilitation plan to be approved by the court, the rehabilitator must demonstrate that creditors have consented to the plan or that the plan provides creditors with a return that is at least as favorable as they would have received in liquidation.[40]

During the rehabilitation, the company may continue to pay claims, enter into contracts and seek financing to restore the company to solvency. The Receiver enjoys a greater degree of flexibility with regard to settling and paying claims in rehabilitation than in liquidation. Unlike liquidation, which requires a formalized mechanism for allowance and payment of claims, in rehabilitation, the Receiver may compromise and settle claims in the same manner as a "live" insurance company and the Receiver's settlements are judged under a standard similar to the business judgment rule.[41] This can result in a faster payment of claims in a manner that more closely resembles the settlement practices of a solvent insurer.

There are some limitations to this flexibility, however. Given that the insurer in rehabilitation is usually financially impaired or de facto insolvent, the rehabilitator must carefully supervise claims payments and husband the estate's assets to ensure there are sufficient funds to pay creditors fairly. There is no priority scheme of payment in rehabilitation as in liquidation, but the safer practice is to ensure that payments in rehabilitation are generally consistent with the class and priority that a creditor would receive in liquidation. Care must also be taken to ensure that there are sufficient assets to pay claims at the end of the rehabilitation in the same manner as at the beginning, and in the same percentage amounts, although such percentages need not be identical for each class of creditor as is the case in liquidation.

The Receivership Stay

A final word about the impact of judicial stays in receivership: If your client has a claim directly against an insurer in receivership, the claim is likely to be subject to a judicial stay imposed by the receivership court barring the commencement or continuation of legal proceedings against the insurer. The initial order placing the insurer in receivership typically enjoins the commencement of all actions against the estate or the Receiver.[44] Depending on the estate and the type of receivership, the receivership order will also temporarily enjoin so-called third-party proceedings in which the insurer is obligated to defend an insured.[45] Other stays to prevent interference with the receivership or waste of assets may be granted under Insurance Law § 7419.

The granting of a stay enjoining litigation in a New York state court, however, does not necessarily stay proceedings in other state and federal courts. State and federal courts have come to differing conclusions concerning whether a New York stay should be recognized, based on principles of abstention and comity.[46]

When the New York stay is challenged in the court of another state, an important consideration is whether the foreign state is a "reciprocal state"[47] under the Uniform Insurers Liquidation Act (UILA). The UILA has been adopted in almost all states; it was adopted in New York in 1940 and codified in Insurance Law §§ 7408–7415.[48] The reciprocity language of the UILA provides that when a receivership is pending in a foreign state, "no action or proceeding in the nature of an attachment, garnishment, or execution shall be commenced or maintained in the courts of this state."[49] Under the UILA's reciprocity provision, New York courts are supposed to honor the

receivership stays of receiverships pending in reciprocal states and vice versa.

In recent years, some courts have narrowly construed UILA provisions calling for reciprocity of stay enforcement. In *Hawthorne Savings v. Reliance Ins. Co. of Illinois*,[50] the U.S. Court of Appeals for the Ninth Circuit held that it would not recognize the first-party stay of a reciprocal state liquidation proceeding involving the insurer Reliance Insurance Co. of Illinois. The lawsuit, commenced in California state court, alleged breach of contract against Reliance for failing to defend and indemnify an insured. The action was removed to federal court and, on appeal, the Ninth Circuit refused to recognize the first-party stay of Pennsylvania, reasoning that the UILA recognition of foreign stays extends only to in rem cases that seek to enforce or collect a judgment and do not prevent in personam actions against the insurer for the purpose of obtaining a judgment that fixes the amount of claim.[51]

However, parties who lift the stay and obtain a judgment against the Receiver in a foreign court may find they've secured a Pyrrhic victory. A claimant that obtains such a judgment does not cut to the front of the line of creditors, but must still submit the claim in the receivership proceeding in order to be paid. Section 7433(d)(3) expressly rejects the enforceability of post-receivership judgments taken against insured parties, stating that such judgments are not "considered in the proceeding as evidence of liability or of the amount of damages." Post-receivership judgments against the insurer are similarly not enforceable in the proceeding due to the first-party stay.

Pre-receivership judgments against either the insurer or the insured, provided they are not obtained by default, inquest or collusion,[52] may be entitled to limited enforcement. In *Callon Petroleum Co. v. New York State Dep't of Insurance as Rehabilitator of Frontier Insurance Co.*,[53] the Appellate Division, First Department held that pre-receivership judgment taken against Frontier, a New York domestic insurer in rehabilitation, is entitled to receive full faith and credit and res judicata effect in New York courts. The pre-rehabilitation judgment against Frontier had been taken in the United States District Court in Louisiana in the short window of time between the filing of the petition in New York Supreme Court to place Frontier in rehabilitation and the entry of the order of rehabilitation.

Just as with a post-receivership judgment creditor, a holder of a pre-receivership judgment – even one that is entitled to full faith and credit under the U.S. Constitution – must still submit the claim in the receivership proceeding. This may result in delays and, depending on the financial condition of the insurer, a significant discount off the amount of the judgment.

In a liquidation proceeding, the pre-receivership judgment is subject to the priority scheme of Article 74 and will receive the same treatment as any other claim in the same class. In a rehabilitation, the situation is less clear, but most often will result in the pre-receivership judgment receiving the same treatment as other, similarly situated claims. As explained in a later decision of the Appellate Division, Third Department in *In re Callon*,[54] once the pre-receivership judgment holder has submitted a claim in the proceeding, it "should be entitled to some payment for its established claim and, if the matter proceeds to liquidation, petitioner will be entitled to such compensation as is available to judgment creditors." This is hardly a mandate for immediate payment of pre-receivership judgment creditors, but as the Third Department stated, the rehabilitator "is required to discharge its statutory duty by taking some affirmative action with respect to petitioner's claim."[55]

Conclusion

Recovering on an insurance claim in a receivership proceeding is often neither simple nor fast, but there is usually a light at the end of the tunnel. The good news is that the management that drove the insurance company into receivership has been replaced by a statutory Receiver, who administers the estate on a fiduciary basis without profit motive, and who relies on a staff of experienced professionals to assist in his duties. Whereas prior management settled claims on behalf of individual creditors with an eye toward profits, the Receiver is charged with pursuing economic fairness for all creditors. The Receiver, however, pays special attention to the economic hardship of policyholders who have losses on policies and are in need of a defense or indemnity. At the same time, the Receiver keeps an eye on the estate as a whole to ensure that there are sufficient assets to pay all creditors what is "justly owing" under law.[56] The Receiver is charged with performing this delicate balancing act and ensuring that the estate is managed without preferences or inequitable treatment. ■

1. Financial Services Law § 301. Prior to the passage of the Financial Services Law in March 2011, this function was exercised by the Superintendent of Insurance.
2. *Dinallo v. DiNapoli*, 9 N.Y.3d 94, 97 (2007).
3. *Id.* at 97.
4. N.Y. Insurance Law §§ 7409(c), 7422 (Ins. Law).
5. Ins. Law §§ 7403 and 7434(a)(1) authorize the Receiver to charge administrative fees to insurers in rehabilitation and liquidation; *Dinallo*, 9 N.Y.3d at 102 ("The State has no interest in those assets and thus they do not constitute "money[s] of the state." Nor do assets of a distressed insurer constitute "money[s] under [state] control").
6. The Bureau also carries out the claims-handling function for three statutory security funds, known as the Property/Casualty Insurance Security Fund, the Public Motor Vehicle Security Fund and the Workers' Compensation Security Fund. The security funds directly fund the Bureau for its claims handling work on their behalf.
7. For additional information on the legal status of the New York Liquidation Bureau, see *Dinallo*, 9 N.Y.3d 94.
8. *In re Ideal*, 140 A.D.2d 62, 68 (1st Dep't 1988).
9. Financial Services Law § 201 (Fin. Servs. Law).

10. Notably, the Receiver and his employees view themselves as bound by the Public Officers Law.

11. *See In re Lawyers Mortgage Co.*, 293 N.Y. 159, 162 (1944).

12. Ins. Law §§ 7402–7407, 7409–7410. Although the court is not specified in Article 74, receivership proceedings are generally commenced in New York Supreme Court.

13. In some cases judicial approval is required prior to the action and in others approval may be sought later in the proceeding. *See, e.g.*, Ins. Law § 7428.

14. *See e.g., In re Liquidation of Consolidated Mut. Ins. Co.*, 60 N.Y.2d 1, 8 (1983) ("the superintendent's determination does not run 'counter to the clear wording of a statutory provision.' He is, moreover, vested by sections 10 and 21 of the Insurance Law with 'broad power to interpret, clarify, and implement the legislative policy' embodied in that law") (citations omitted); *Lawyers Mortgage*, 293 N.Y. at 162; *Mills v. Florida Asset Fin. Corp.*, 31 A.D.3d 849, 850 (3d Dep't 2006) ("courts will generally defer to the rehabilitator's business judgment and disapprove the rehabilitator's actions only when they are shown to be arbitrary, capricious or an abuse of discretion"); *In re Nat'l Surety Co.*, 248 A.D. 111 (1st Dep't), *aff'd*, 272 N.Y. 613 (1936); *Consol. Ed. Co. v. Ins. Dep't of the State of N.Y.*, 140 Misc. 2d 969, 976 (Sup. Ct., N.Y Co. 1988).

15. The Superintendent is the statutory administrator of the Property / Casualty insurance Security Fund and the Public Motor Vehicles Liability Security Fund under Ins. Law § 7601(e) and the Workers' Compensation Security Fund under Workers' Compensation Law §§ 109-A–109-e. In addition, the Superintendent is designated as ex-officio chairman of the Life Insurance Company Guaranty Corporation of New York under Ins. Law § 7707(d).

16. *In re Knickerbocker Agency (Holz)*, 4 N.Y.2d 245, 250 (1958) (quotations omitted).

17. *Id.* (citation omitted).

18. *Id.* at 253; *see Dinallo v. DiNapoli*, 9 N.Y.3d 94, 97 (2007) ("This statutory scheme was devised for the protection of creditors, policyholders and the general public by furnishing a comprehensive mechanism for collecting the assets of a distressed insurer and paying its creditors"); *Corcoran v. Frank B. Hall & Co.*, 149 A.D.2d 165, 171 (1st Dep't 1989) ("the pre-eminent purpose of article 74 is to insure equitable treatment for its creditors and to avoid preferences and upon the liquidation of an insurer")(citations omitted); *G.C. Murphy Co. v. Reserve Ins. Co.*, 54 N.Y.2d 69, 81 (1981) ("By enacting the Uniform Insurers Liquidation Act, our Legislature has determined that such occasional instances of adversity are outweighed by the paramount interest of the various States in seeing that insurance companies domiciled within their respective boundaries are liquidated in a uniform, orderly and equitable manner without interference from external tribunals"); see also the Appellate Division decision in *Knickerbocker*, 4.A.D.2d 71, 73 (1st Dep't 1957) (the "pre-eminent purpose" of Article 74 "is to insure equitable treatment for its creditors and to avoid preferences . . . upon the liquidation of an insurer by providing that any matter affecting the assets available for distribution be the subject of a single integrated administration") (citations omitted).

19. Ins. Law § 7405(a). Notably, the statute directs the Superintendent to liquidate the "business" of the insurer as opposed to "property," recognizing that converting a business to a pool of liquid assets that can be distributed to creditors is a complicated process.

"First off I'd like to address the rumor that I'm not really running things around here."

20. Ins. Law § 7416.

21. Ins. Law § 7405(b).

22. Ins. Law § 7433(b)(2).

23. Ins. Law § 7433.

24. Ins. Law § 7433(c). See Liquidation of Integrity, 193 N.J. 86 (NJ 2007).

25. Ins. Law § 7434(a)(1).

26. Ins. Law § 7434(a)(1)(i).

27. Ins. Law § 7434(a)(1)(ii).

28. Ins. Law § 7434(a)(1)(iii).

29. 31 U.S.C. § 3713.

30. 508 U.S. 491 (1993).

31. *Id.* at 508.

32. Ins. Law § 7434(a).

33. Those funds are: The New York Property / Casualty Insurance Security Fund; the Public Motor Vehicle Liability Security Fund; The Life Insurance Company Guaranty Corporation and The Workers' Compensation Security Fund.

34. Ins. Law § 7603(a)(2). *See Paramount Commc'ns Inc. v. Gibraltar Cas. Co.*, 199 A.D.2d 90 (1st Dep't 1993), *aff'd*, 90 N.Y.2d 507 (1997) (discussion of $1 million limit in connection with excess insurance policies).

35. Ins. Law § 7602(g).

36. Ins. Law § 107(a)(10).

37. Ins. Law § 7403(a); *In re Allcity Ins. Co.*, 66 A.D.2d 531, 535 (1st Dep't 1979) ("Rehabilitation is distinguished from liquidation in that it is directed toward preservation, whenever possible, of the business of an insurance company threatened with insolvency.")(citations omitted); *In re Nat'l Surety Co.*, 239 A.D. 490 (1st Dep't 1933).

38. Ins. Law § 7416.

39. Ins. Law § 7403(d).

40. *Neblett v. Carpenter*, 305 U.S. 297 (1938); *Foster v. Mut. Fire, Marine & Inland Ins. Co.*, 614 A.2d 1086, 1093–94 (Pa. Super. Ct. 1992).

41. *See Mills v. Florida Asset Financing Corp.*, 31 A.D.3d 849, 850 (3d Dep't 2006) ("courts will generally defer to the rehabilitator's business judgment and disapprove the rehabilitator's actions only when they are shown to be arbitrary, capricious or an abuse of discretion").

42. Ins. Law § 7403(c). Note the statute requires the "Superintendent" as opposed to the Receiver to make the determination of futility. This distinction is significant because the Superintendent is a State officer entitled to the protections of the Public Officers Law and his determinations are reviewable only within a CPLR article 78 proceeding.

43. Ins. Law § 7425.

44. Ins. Law § 7419(b) authorizes the receivership court to grant such injunctions and orders as it deems necessary "to prevent interference with the superintendent or the proceeding."

45. Such third-party stays enjoining prosecution of suits against an insured are typically granted for 180-day periods, though further extensions are routinely granted when, for instance, the in-take of a new insurance receivership requires additional time to properly identify the third-party claims and assign counsel.

46. *See, e.g., Twin City Bank v. Mut. Fire Marine & Inland Ins. Co.*, 646 F. Supp. 1139, 1141–42 (S.D.N.Y. 1986), *aff'd*, 817 F.2d 713 (2d Cir. 1987).

47. "Reciprocal State" is defined under Ins. Law § 7408(a)(6).

48. Ins. Law § 7408(a), (b)(6).

49. Ins. Law § 7414.

50. 421 F.3d 835, 854 (9th Cir. 2005), *amended*, 433 F.3d 1089 (9th Cir. 2006).

51. *Id.* Indeed, the Ninth Circuit has taken a broad approach that "the [UILA's] language suggests that 'an action or proceeding may be maintained unless it is in the nature of an attachment, garnishment, or execution." *Id.* at 855.

52. Ins. Law § 7433(d)(3).

53. 27 A.D.3d 274 (1st Dep't 2006).

54. 53 A.D.3d 845 (3d Dep't 2008).

55. *Id.* at 846.

56. Ins. Law § 7433(a)(1).

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Gun Law, Policy, and Politics

By Robert J. Spitzer

Late in 2011, the U.S. House of Representatives passed a bill that would dramatically alter gun laws throughout the country if enacted into law. Approved in the House by a vote of 272-154, the bill's passage had long been assured, as more than 240 House members had co-sponsored the bill, which was backed by the National Rifle Association. (However, passage of the bill in the Senate in 2012 was considered unlikely because a similar version of the bill had failed to win approval in that chamber.) Titled the National Right-to-Carry Reciprocity Act, this bill would require any state or jurisdiction that issues concealed-carry gun permits to recognize and honor the permits granted by any other state. The practical effect of this bill would be to set as a de facto national standard the gun-carry standards of the state with the least restrictive regulations. This would result in dramatic changes in most states, because state gun-carry laws vary widely, and states make their gun-carry licenses available to residents of other states.

To illustrate: 35 states have "shall issue" carry laws that allow applicants to obtain a concealed-carry gun license unless they are barred from doing – if, for example, they have a felony record. That is, a gun license can be obtained in a manner similar to obtaining a driver's license, where the presumption is that the applicant can obtain the license unless the applicant fails to meet some knowledge-based standard (e.g., a driver's test) or is otherwise disqualified. Ten states have "may issue" laws, where the applicant must justify the desire to carry a gun, and the state has discretion as to whether to grant the license. Four states allow their residents to carry concealed weapons without a permit. Only one state, Illinois (plus the District of Columbia), does not issue concealed-carry permits. Under the new law, the least restrictive state provision would have to be accepted by the 49 other states that have some kind of concealed-carry law. One state, Utah, allows civilian concealed-gun carrying on its college campuses, regardless of the preferences of the campus. Under the new federal law, all concealed-carry states would have to recognize the Utah standard, even though half of the states have laws specifically barring on-campus gun carrying. Most states require concealed-carry applicants to complete a training course to obtain a permit (New Mexico, for example, requires 16 hours), but 10 states require no training. Under the new law, those who obtained gun permits in states where no training is required would be able to carry their guns in the other 40 states.[1]

These examples illustrate why a variety of organizations, in addition to pro-gun-control organizations, oppose this measure, including the American Bar Association and the International Association of Chiefs of Police. Philadelphia Police Commissioner Charles Ramsey testified before Congress that among his objections to the bill was it did not include the establishment of a national database that police could consult to determine if an out-of-state gun-carry permit in the possession of an individual carrying a loaded gun was valid. In fact, an amendment to the bill to require states to maintain databases of permit holders was defeated.[2] While the policy significance of this bill is apparent, what is arguably even more significant is that it exemplifies how far the national gun policy debate has shifted in favor of gun rights organizations.

At a time when crime in virtually every category is at historic lows, when police are better trained, more

professional, and more respected than ever, and when overall rates of civilian gun possession continue to decline, it might seem puzzling, even bizarre, that gun rights organizations would not only press so frantically for, but meet apparent success in, a protracted effort to extend gun carrying ever more into the general population.

This article will first examine key political forces that have turned gun policy in an ever-more gun-friendly direction within the last decade. It will then examine the Supreme Court's landmark and controversial decision in which it created a new, Second Amendment right of civilian gun possession, arguing that its verdict was based on historical analysis largely detached from historical reality. It then offers a brief conclusion.

Gun Policy and Politics

The Second Bush Presidency

During the 2000 presidential campaign, the National Rifle Association's first vice president and Iowa State Republican Party Chair, Kayne Robinson, was caught on videotape as saying that the election of George W. Bush would mean that the NRA would have "'a president where we work out of their office.'"[3] Many interest groups offer similar assertions in the heat of a campaign in order to persuade their members that the election of their preferred candidate represents a boon to the organization's goals and interests. Yet in this instance, this private NRA brag would prove to be entirely accurate.

The second Bush presidency proved itself to be, in policy terms, the most gun-friendly presidency in history, even more than the Ronald Reagan and George H.W. Bush administrations, both of which won enthusiastic endorsement from the NRA. That, in itself, is unexceptional, insofar as every administration pursues policies in line with some interests and opposes others; further, no candidate can capture the White House without an extensive web of interest group support. What is remarkable about Bush and gun control, however, is the extent to which the administration put itself out, not only in its political stands on the issue but in the administration's policy toward law-related matters pertaining to the gun issue, where the administration adhered to the NRA line with near-total devotion. Aside from the implementation of gun-friendly policies in statutes and in courts, the second Bush presidency's gun adherence is significant for two other reasons: first, Bush's 2000 election victory helped to cow national Democrats on the issue; second, the administration's pro-gun positions helped legitimize pro-gun ideology in American political discourse and public opinion.[4]

Many Democrats in 2000, headed by presidential nominee Al Gore, campaigned on a strongly pro-gun-control platform. Control foes, spearheaded by the NRA, campaigned vigorously to defeat Gore. Despite these efforts, the key battleground states of Pennsylvania, Michigan, Wisconsin, Iowa, Washington State, and New Mexico were all won by Gore. Three states that went to Bush for which the NRA claimed credit – Arkansas, Tennessee, and West Virginia – were all critical to Bush's win. Yet of the three, only West Virginia had voted Democratic with any regularity up until the 2000 elections (since then, West Virginia has supported Republican presidential candidates). While the gun issue may have helped Bush in these three states (and may have been decisive in West Virginia), it is difficult to conclude that the issue worked more to Bush's benefit than to Gore's.[5] Still, a win is a win, and the NRA claimed its share of credit, as would any interest group so deeply vested in the race. This loss prompted considerable soul searching in the Democratic Party, with the result that the national party largely backed away from its generally pro-control positions on guns,[6] believing the issue to be too contentious. In addition, the Democrats' conscious decision to embrace more centrist and "Blue-Dog" Democrats to recapture control of Congress also impelled them to back away from a pro-control agenda. While there is good reason to believe that the NRA had little ability to inflict damage on pro-control Democrats, by and large Democrats chose to focus their political energies on other issues and policies.[7]

Bush's Pro-Gun Policies

Shortly after taking office, Bush Attorney General John Ashcroft moved to codify and legitimize the NRA's view of the Second Amendment. In one of his first legal pronouncements, Ashcroft outlined his views on the meaning of the right to bear arms in a letter sent on May 17, 2001, to NRA Executive Director James Jay Baker shortly before the NRA's annual convention. Ashcroft's letter said: "[L]et me state unequivocally my view that the text and the original intent of the Second Amendment clearly protect the right of individuals to keep and bear firearms."[8] The letter embraced the argument that the amendment endorsed an individual right to own guns, aside and apart from citizen service in a militia – a position Ashcroft had embraced as a United States senator. As a formal issuance from the nation's chief law enforcement officer, the letter was notable not only because it argued that the individualist view "is not a novel position,"[9] but because it contradicted the existing position that the Justice Department had taken in a then-pending Fifth Circuit Court of Appeals case, *United States v. Emerson*,[10] and was sent to a group, the NRA, that had filed an opposing friend of the court brief in the very same case.

The letter was remarkable for several reasons: (1) it represented an offhanded, informal, and political means to articulate and inaugurate what proved to be an abrupt and total about-face in decades of Justice Department policy on the meaning of the Second Amendment; (2) the letter's arguments contradicted more than a century of

federal court rulings that had uniformly rejected the view embraced by Ashcroft; (3) the evidence and sources cited in the letter to support Ashcroft's claim did no such thing; and (4) the letter failed to cite the most important sources explaining what the right to bear arms does mean.[11] Yet it represented the initial political and legal charge to reinterpret the Second Amendment – an effort that met with success in 2008.

Other elements of the NRA's political agenda were successfully advanced by the Bush administration. Limits were placed on gun data record-keeping, as well as law enforcement access to such records, even in the face of the 9/11 attacks, when captured documents revealed that terrorist leaders advised operatives to exploit America's weak gun laws and easy gun availability. Federal funding for gun buyback programs was eliminated. The assault weapons ban, enacted after a bitter struggle in 1994, was allowed to lapse in 2004. And in 2005, Congress enacted the centerpiece of the NRA's political agenda: federal liability protection for the gun industry. The Protection of Lawful Commerce in Arms Act extended to gun manufacturers, distributors, dealers, and importers unique legal protection against civil suits.[12]

The Supreme Court Weighs In

In 2008, responding in part to a rising tide of writing in support of an "individualist" view of the Second Amendment, buttressed substantially by gun rights groups,[13] and because the more conservative court was sympathetic to this view (embraced by the Bush Administration) the Supreme Court reversed course on Second Amendment jurisprudence in the landmark case of *D.C. v. Heller*.[14] In *Heller*, the Court majority set two firsts: for the first time in history, a federal court overturned a gun regulation as a violation of the Second Amendment, and it adopted the individualist interpretation of the amendment,[15] reversing course on its prior rulings, all of which supported some version of the militia-based interpretation of the amendment.[16]

Heller arose as a challenge to the District of Columbia's strict gun law, first enacted in 1976 (and drafted, ironically, with the assistance of the NRA), which banned the new registration of handguns, banned handgun carrying, and required that firearms in the home be kept unloaded and locked. Police officers and security guards were exempted. The law was challenged as a violation of the Second Amendment. The nation's capital is governed directly by the federal government, so the Court's past refusal to incorporate the Second Amendment (that is, apply it to the states through the Fourteenth Amendment) did not keep the case from proceeding, as the entire Bill of Rights has always applied to actions of the federal government.

On appeal from the District of Columbia Circuit,[17] the Supreme Court ruled 5-4 against the D.C. law, striking it down as inconsistent with the Court majority's individualist reading of the Second Amendment. Writing for the majority, Justice Antonin Scalia concluded that the amendment now protected a personal right of civilians to own handguns to protect themselves in their homes. This right is by no means unlimited, however. Scalia noted that

> nothing in our opinion should be taken to cast doubt on longstanding prohibitions on the possession of firearms by felons and the mentally ill, or laws forbidding the carrying of firearms in sensitive places such as schools and government buildings, or laws imposing conditions and qualifications on the commercial sale of arms.[18]

In addition to lending support for long-standing gun regulations, the Court also suggested that certain types of especially powerful weapons might also be subject to regulation and that laws regarding the safe storage of firearms would also be allowable. As for the Court's past reading of the Second Amendment as militia-based, the majority decision rejected the idea that the first half of the Second Amendment referencing a "well regulated militia" explained the second half of the sentence (referencing the right to bear arms), arguing instead that the first half of the sentence in effect merely offered an example of the right mentioned in the second half of the sentence. Most of the text of this lengthy opinion dealt with the history of the right to bear arms. The decision did not overturn *United States v. Miller*,[19] which analyzed the Second Amendment as a militia-based right, but it dealt with *Miller* by saying instead that *Miller* was only about "the type of weapon" at issue in the case. "Beyond that," Scalia concluded, "the opinion [i.e., *Miller*] provided no explanation of the content"[20] of the Second Amendment.

The four dissenting Justices filed two opinions, authored by Justices John Paul Stevens and Stephen Breyer. Stevens disputed Scalia's historical analysis, arguing in a similarly lengthy historical analysis that the amendment was indeed a militia-based right, and that the Supreme Court had said so in *Miller* and the 1886 case of *Presser v. Illinois*.[21] (Scalia argued that the prior court rulings either supported, or were not inconsistent with, the individualist view.) Stevens wrote that "[t]he text of the [Second] amendment, its history, and our decision in *United States v. Miller* . . . provide a clear answer"[22] to the meaning of the amendment, which was that the amendment "was adopted to protect the right of the people of each of the several States to maintain a well-regulated militia."[23] *Miller*, said Stevens, "protects the right to keep and bear arms for certain military purposes,"[24] noting that this was how *Miller* had been interpreted by hundreds of federal judges in dozens of cases. Breyer's dissent argued that, even if the individualist interpretation were correct, D.C.'s strict gun law was still allowable as a legitimate effort to control crime. In all, the *Heller* decision is notable for carving out a new, individual right to own guns, even if the right is

subject to limitations and regulation; for its heavy reliance on history; and for the fierce controversy it engendered. In the aftermath of *Heller*, scores of legal challenges were mounted against gun laws around the country.

The Supreme Court completed its establishment of this new right two years later in *McDonald v. Chicago*,[25] where the Court, by the same 5-4 vote, applied or "incorporated" the Second Amendment to the states. *McDonald* arose from a Second Amendment-based challenge to Chicago's strict gun law that essentially banned handguns and any other gun not already registered with the city (Chicago's law was very similar to the D.C. law struck down by *Heller*). The majority opinion, written by Justice Samuel Alito, did two primary things. First, it affirmed the qualified *Heller* individual right, saying that "the right to keep and bear arms is not 'a right to keep and carry any weapon whatsoever in any manner whatsoever and for whatever purpose,'"[26] adding that the ruling was not to cast doubt on "longstanding [gun] regulatory measures"[27] such as those cited in *Heller*. Second, the opinion incorporated or applied the Second Amendment to the states, while cautioning that "incorporation does not imperil every law regulating firearms."[28] The means by which the Court chose to effect incorporation was through the Fourteenth Amendment's "due process" clause, which had been the basis for past incorporation decisions regarding parts of the Bill of Rights. It rejected the argument that it should use the Fourteenth Amendment's "privileges or immunities" clause (a much-discussed but controversial method that was discarded by the Court in the 19th century)[29] and rejected the idea of "total incorporation," a theory arguing that the entire Bill of Rights should be applied to the states as a whole. *McDonald* produced five opinions: three in the majority and two in the minority. While the majority argued that this individual right to guns was a "fundamental" right "necessary to our system of ordered liberty"[30] (the standard for incorporation), Justice John Paul Stevens's dissent argued that guns "destabilize ordered liberty."[31] He and the dissenters continued to argue that *Heller* was wrongly decided, and that incorporation itself was not warranted in this case. As for the Chicago law, the Court did not strike it down, but sent it back to the lower court for review in the light of its new ruling. In the first two years following *Heller*, more than 260 challenges to gun laws around the country have been brought; to date, however, virtually all have failed.[32]

History

The *Heller* and *McDonald* rulings established, as a matter of law, an individual rights interpretation of the Second Amendment. But while judges can change the law, they cannot change history, and the historical record largely contradicts the bases for these two recent rulings.

The Militia-Based Understanding

The militia-based understanding of the Second Amendment is that found in most standard historical texts on the Bill of Rights. From classic 19th-century analyses, such as those of St. George Tucker, Joseph Story, and Thomas M. Cooley, to modern treatments, the verdict is the same.[33] In his classic book on the Bill of Rights, Irving Brant writes: "The Second Amendment, popularly misread, comes to life chiefly on the parade floats of rifle associations and in the propaganda of mail-order houses selling pistols to teenage gangsters."[34] Similar, if less sarcastic, sentiments are found in other standard works,[35] and "[s]tandard legal reference works used by lawyers and judges parallel this perspective."[36] The fact that standard historical treatments of the amendment have long accepted the militia-based view lends credence to the criticism that the *Heller* ruling played fast and loose with history. As one legal historian noted, Scalia's *Heller* opinion "is at best confused" and presents "an historical argument that is limited and wrongheaded."[37] To cite but one example, Scalia's majority opinion states that "there is no evidence whatsoever to support a military reading of 'keep arms,'"[38] adding that "we find no evidence that it [i.e. the phrase "keep and bear arms"] bore a military meaning."[39] The historical consensus, however, is the reverse. Contrary to Scalia's categorical assertion, not only is there evidence that the Second Amendment phrase had a military meaning, but most colonial and military historians say as much. For example, the Pulitzer Prize-winning historian Garry Wills has written that the phrase "'Bear arms' refers to military service . . . 'arms' means military service in general . . . ." The historical evidence of the military usage of bearing arms, Wills says, is "overwhelming": "History, philology, and logic furnish no solid basis for thinking the Second Amendment has anything to do with the private ownership of guns."[40]

As the conservative federal judge Richard A. Posner noted, "professional historians were on Stevens's side" in *Heller*. According to Posner, Scalia's distortion of history is an example of "'law office history,'" meaning that it

> In *Heller*, for the first time in history, a federal court overturned a gun regulation as a violation of the Second Amendment, and it adopted the individualist interpretation of the amendment, reversing course on its prior rulings.

is the product of lawyers "tendentiously dabbling in history, rather than . . . disinterested historians." Scalia's decision "is evidence of the ability of well-staffed courts to produce snow jobs."[41] Other commentators, notably prominent conservatives, accused Scalia of unwarranted judicial activism (a criticism usually reserved for liberals) as well as distortion of history, arguing that an accurate "originalist" reading of the Second Amendment leads to the militia-based understanding of the amendment, not the individualist view.[42]

The "Individualist" View

The *Heller* decision embraced the individualist view – that is, that the Second Amendment was meant to bestow on every American citizen a right to have guns for personal self-defense, aside from the militia principle. This view suffers from several problems.

The first problem is that the individualist view often relies for its arguments on quotations pulled out of context.[43] The historical issue of the bearing of arms *as it pertained to the Constitution and the Bill of Rights* always came back to military service and the balance of power between the states and the federal government, as seen in the records of the Constitutional Convention and of the First Congress when the Bill of Rights was formulated. In *Heller*, Scalia dismisses the First Congress's deliberations and debate over the Second Amendment by saying that it is of "dubious interpretive worth."[44] Second, the definition of the citizen militias at the center of this debate has always been men roughly between the ages of 17 and 45.[45] That is, it has always excluded a majority of the country's adult citizens – men over 45, the infirm, and women. Therefore, it was not a right enjoyed by all citizens, unlike such Bill of Rights protections as free speech, religious freedom, or right to counsel.

Scalia argued in *Heller* that the reference to "the people" in the Second Amendment has the same meaning as it does in other parts of the Bill of Rights, as in "the right of the people [to] peaceably assemble" in the First Amendment or the "right of the people to be secure in their persons, houses, papers and effects" in the Fourth Amendment. Because all citizens are considered to have such First and Fourth Amendment protections, why shouldn't the Second Amendment be read as meaning that all citizens have a right to bear arms? Scalia referenced a 1990 Supreme Court case, *United States v. Verdugo-Urquidez*,[46] for support.[47] This claim is false on four grounds. First, militia service, from colonial times on, always pertained only to those capable and eligible to serve in a militia – that is, as noted above, healthy young-to-middle-aged men (excluding the infirm, old men, and nearly all women). Second, the courts (especially in the *Presser* case) and federal law up until *Heller* clearly defined and interpreted the Second Amendment as having this specific meaning. Third, no evidence suggests that the authors of the Bill of Rights attempted, or succeeded, in imposing a single, uniform definition of "the people" in the document; the Bill of Rights was the product of many hands and many ideas, a fact reflected in the variety of ideas, interests, and concerns addressed in the first 10 amendments. Fourth, and most important, the *Verdugo-Urquidez* case has nothing to do with interpreting the Second Amendment. In fact, the case deals with the Fourth Amendment issue of whether an illegal alien from Mexico was entitled to constitutional protection regarding searches (the court ruled that non–U.S. citizens were not "people" as the term is used in the Fourth Amendment). In the majority decision, Chief Justice William H. Rehnquist discussed what was meant by the phrase "the people," given that the phrase appears not only in several parts of the Bill of Rights, but also in the Constitution's preamble, in order to determine its applicability to a noncitizen. Rehnquist speculated that the phrase "seems to have been a term of art" that probably pertains to people who have developed a connection with the national community.[48] Rehnquist's speculations about whether the meaning of "the people" could be extended to a noncitizen, and his two passing mentions of the Second Amendment in that discussion, shed no light, much less legal meaning, on this amendment.

Third, Scalia's central claim that the individualist view reflects an originalist reading of the Second Amendment is contradicted by the fact that the individualist view is of modern origin. It first appeared in print in a law review article published by a law student in 1960.[49] Prior to 1960, the militia or collective view of the Second Amendment was the basis for understanding and analyzing the Second Amendment in 13 law journal articles published from 1874 to 1959.[50]

Self-Defense

The overriding goal and purpose of *Heller* is to establish a Second Amendment-based personal right of civilians to own guns for self-protection. Scalia wrote, "[I]ndividual self-defense . . . was the *central component*" of the Second Amendment.[51] As others have noted, Scalia reached this conclusion by "dismembering"[52] the Second Amendment by essentially ignoring or removing the first half of the amendment referring to a well-regulated militia. Scalia does this in part by intermixing the defense needs of early Americans (against Native Americans or predators, for example) with modern personal self-defense against robberies, assaults, rapes, home intrusions, or other life-threatening circumstances. Yet, by design and interpretation, the Second Amendment has to do not with these very real modern-day threats but with the threats posed by armies and militias.

This does not mean that the law affords no legal protection to individuals who engage in personal self-defense – far from it. U.S. and British common law has recognized and legally sanctioned personal self-defense for hundreds of years, prior to and independent of

the Second Amendment. But it arises from the area of criminal law, not constitutional law,[53] a fact that Scalia largely ignores. A standard, long-accepted definition of self-defense from common law reads:

> A man may repel force by force in the defense of his person, habitation, or property, against one or many who manifestly intend and endeavor, by violence or surprise, to commit a known felony on either. In such a case he is not obliged to retreat, but may pursue his adversary until he find himself out of danger; and if, in a conflict between them, he happen to kill, such killing is justifiable. The right of self-defense in cases of this kind is founded on the law of nature; and is not, nor can be, superseded by any law of society.[54]

Even in the light of *Heller* and *McDonald*, the Second Amendment is superfluous to legal protection for personal defense or defense of the home. Indeed, as defined in the common law tradition, the self-defense principle supersedes even constitutional guidelines.

A "Right of Revolution"?

At least twice, Scalia's opinion in *Heller* links the right to bear arms with citizen resistance to tyranny.[55] Given the decision's individualist view of the Second Amendment, it implies that citizens, armed and acting independent of the government (not as part of a government-organized and regulated militia), somehow may use force against tyranny – government tyranny. This assertion harkens to a so-called "right of revolution," which, though not expressly endorsed by *Heller,* has been an important component of how many supporters of the individualist view have interpreted the Second Amendment. Proponents of a right of revolution (also called "insurrectionism") have argued that the amendment provides citizens the right to threaten to or to use force against their own government to keep the country's rulers responsive to the citizens' concerns.[56] Although these theories pose interesting intellectual questions about the relationship between citizens and the state, they do not translate into meaningful policies for modern America.

Most citizens recognize the importance of using democratic institutions and values to voice their opinions by participating in elections, juries, expressions of public opinion, and participation in interest groups rather than by pointing guns (whether by threat or deed) at congressional leaders or the White House. Few Americans approve of those few groups in United States that actively pursue something resembling a right of revolution – the Ku Klux Klan, the skinheads, the Branch Davidians, Los Angeles rioters, those responsible for bombing the federal office building in Oklahoma City in April 1995, or elements of the modern so-called Patriot Movement. As the legal scholar Roscoe Pound noted, a

> legal right of the citizen to wage war on the government is something that cannot be admitted . . . . In the urban industrial society of today a general right to bear efficient arms so as to be enabled to resist oppression by the government would mean that gangs could exercise an extra-legal rule which would defeat the whole Bill of Rights.[57]

In any event, any so-called right of revolution is carried out against the government, which means against that government's constitution as well – including the Bill of Rights and the Second Amendment. In short, one cannot carry out a right of revolution against the government and at the same time claim protections within it. This was well understood by the country's Founders. In 1794 the government, through its militias, moved to suppress the Whiskey Rebellion, an uprising that was denounced by Federalists and Anti-Federalists alike. As the historian Saul Cornell noted, in the 1790s there was "widespread agreement that the example of the American Revolution did not support the rebels' actions" because Americans at the start of the Revolution "did not enjoy the benefits of representative government," whereas those who fomented the Whiskey Rebellion "were represented under the Constitution."[58] The Constitution makes this point forcefully. Congress is given the powers "[t]o provide for calling forth the Militia to execute the Laws of the Union, *suppress Insurrections* and repel Invasions" (emphasis added) in Article I, Section 8; to suspend habeas corpus "in Cases of Rebellion or Invasion" in Section 9; and to protect individual states "against domestic Violence" if requested to do so by a state legislature or governor in Article IV, Section 4. Further, the Constitution defines *treason* in Article III, Section 3: "Treason against the United States, shall consist only in levying War against them." In other words, the Constitution specifically and explicitly gives the national government the power to suppress by force anything even vaguely resembling revolution. Such revolt or revolution is by constitutional definition an act of treason against the United States. The militias are thus to be used to suppress, not cause, revolution or insurrection. These powers were further detailed and expanded in the Calling Forth Act of 1792 (1 Stat. 264), which gives the president broad powers to use state militias to enforce both state and federal laws in instances where the law is ignored or in cases of open insurrection. This act was passed by the Second Congress shortly after the passage of the Bill of Rights.[59] In current law, these powers are further elaborated in the U.S. Code sections on insurrection (10 U.S.C. §§ 331–334).

Gun rights groups like the NRA have been leading exponents of this "insurrectionist" view of the Second Amendment,[60] and the link between guns and freedom has become an ever-more entrenched component of the individualist view of the Second Amendment. For example, Sharron Angle, the 2010 Republican nominee for the U.S. Senate from Nevada, said during her campaign, "[O]ur Founding Fathers, they put that Second Amendment in there for a good reason and that was for the people to protect themselves against a tyrannical

government. . . . [I]f this Congress keeps going the way it is, people are really looking toward those Second Amendment remedies . . . ."[61] Angle lost her Senate race, but her assertion that the Second Amendment gives people the right to use violence against Congress if they disagree with its decisions embodies a fanciful and dangerous idea that bears no relationship to the intention or purposes of the Second Amendment.

Some have argued that traditionally oppressed groups, such as women and African Americans, should aggressively claim for themselves a right to bear arms.[62] Blacks in particular have been subject to race-based violence for hundreds of years and were unquestionably denied arms as a manifestation of racial oppression. An article by the legal scholar Carl Bogus presents substantial evidence that southern state leaders supported inclusion of the Second Amendment to ensure that they could use their state militias to suppress slave revolts.[63] Yet the key handicap for blacks and other oppressed groups has not been the denial of Second Amendment rights but the denial of *all* basic Bill of Rights freedoms, not to mention denial of the basic common law principle of self-defense.

Conclusion

By the end of the Bill Clinton presidency in the 1990s, it seemed as though the forces supporting stronger gun laws had all but won the upper hand – or at least had logged significant victories on the battlefield of gun politics. While its most significant achievements, including enactment of the Brady law in 1993 (requiring background checks for handgun purchasers) and the assault weapons ban in 1994, came early in Clinton's administration, the public continued to support stronger gun laws by wide margins. In addition, continued gun violence, capped by the horrific Columbine High School shootings in 1999, and the pro-gun-control Million Mom March in Washington, D.C., in 2000, seemed to intensify public outrage at the pattern of easily accessed firearms and poorly regulated gun ownership. Yet by the end of the second Bush presidency, that tide had reversed course. In the super-charged environment of gun politics, the nation's conservative turn had included sweeping political victories for those seeking to not only halt, but reverse, decades of gun laws. That effort was capped by the Supreme Court's embrace of a newly created constitutional right to own guns for personal self-protection.

At the least, these changes reflect two important political lessons. The first is that the maelstrom of interest group politics does not necessarily produce democratic outcomes. Policy victors in the interest arena prevail by greater political force, not the broad winds of popular preference. Second, policies that are the product of these forces may bear no resemblance to any rational weighing of policy alternatives. As the gun issue demonstrates, the courts are no less immune to the temptations of counter-factual analysis when heated in the super-charged environment of interest politics than are the political branches of government. ■

Gun rights groups have been leading exponents of the "insurrectionist" view, and the link between guns and freedom has become an ever-more entrenched component of the individualist view of the Second Amendment.

1. John Crewdson, *Concealed NYC Guns Backed by 243 in U.S. House*, Bloomberg News, Sept. 12, 2011.
2. Editorial, *Packing Heat Everywhere*, N.Y. Times, Sept. 19, 2011, at A26; *House Approves Bill Making Travel Easier for Gun Owners*, N.Y. Times, Nov. 17, 2011, at A16.
3. James Dao, *National Rifle Association Unleashes Attack on Gore*, N.Y. Times, May 21, 2000.
4. For more on the gun issue and public opinion, *see* Robert J. Spitzer, The Politics of Gun Control 116–18 (5th ed. 2012).
5. E.J. Dionne, Jr., *Guns and Votes*, Wash. Post, Feb. 13, 2001, at A21.
6. Noam Scheiber, *Gun Shy*, New Republic, Jan. 29, 2001, pp. 15–16.
7. Spitzer, *supra* note 4, at 116–18.
8. Letter from John Ashcroft, U.S. Attorney General, to James Jay Baker, Executive Dir., Nat'l Rifle Ass'n, May 17, 2001.
9. *Id.*
10. 270 F.3d 203 (5th Cir. 2001).
11. *See* Robert J. Spitzer, *Gun Rights for Terrorists? Gun Control and the Bush Presidency*, *in* Transformed by Crisis: The Presidency of George W. Bush and American Politics 150–55 (2004).
12. Spitzer, *supra* note 4, at 156–59.
13. NRA lawyer Stephen P. Halbrook alone has written four books and dozens of law journal articles on gun control and the Second Amendment. *See* Carl T. Bogus, *The Hidden History of the Second Amendment*, 31 U.C. Davis L. Rev. 309, 318 (1998). The National Rifle Association and other gun rights groups have provided extensive support for this writing; *see, e.g.*, Scott Heller, *The Right to Bear Arms*, Chron. Higher Educ., July 21, 1995, at A12.
14. 554 U.S. 570 (2008).
15. In the case of *U.S. v. Emerson*, a lower federal court accepted the individualist interpretation of the Second Amendment, but did not use it to strike down the gun restriction that gave rise to the challenge. 270 F.3d 203 (5th Cir. 2001).
16. Robert J. Spitzer, The Right to Bear Arms ch. 2 (2001).
17. *Parker v. Dist. of Columbia*, 478 F.3d 370 (D.C. Cir. 2007). The appeals court accepted the individualist view in a 2-1 ruling against the D.C. law.
18. *Heller*, 554 U.S. at 626–27.
19. 307 U.S. 174 (1939). The *Miller* case was the last Supreme Court case to address the meaning of the Second Amendment.
20. *Heller*, 554 U.S. at 622.
21. 116 U.S. 252 (1886).

22. *Heller*, 554 U.S. at 637.

23. *Id.*

24. *Id.*

25. 130 S. Ct. 3020 (2010).

26. *Id.* at 3047.

27. *Id.*

28. *Id.*

29. *Slaughter-House Cases*, 83 U.S. 36 (1872). Only Justice Clarence Thomas supported using the "privileges or immunities" clause as the basis for incorporation. For more on incorporation and the Second Amendment, *see* Robert J. Spitzer, *Why Gun Ruling Is a Teachable Moment*, CNN Opinion, June 29, 2010, *at* http://www.cnn.com/2010/OPINION/06/29/spitzer.guns.supreme.court/index.html?iref=storysearch.

30. *McDonald*, 130 S. Ct. at 3042.

31. *Id.* at 3108.

32. Paul Helmke, *Future of Gun Laws After* McDonald, The Huffington Post, July 12, 2010, *at* http://www.huffingtonpost.com/paul-helmke/future-of-guns-laws-after_b_643453.html.

33. Saul Cornell, *St. George Tucker and the Second Amendment*, 47 Wm. & Mary L. Rev. 1123 (2006). Tucker viewed the Second Amendment as a civic right and a right belonging to the states. He also addressed personal self-defense, but not as coming from the Second Amendment. Joseph Story, Commentaries on the Constitution 708 (Durham, N.C.: Carolina Academic Press 1987; first published 1833); Thomas M. Cooley, General Principles of Constitutional Law 298–99 (1898). Cooley's book did not include discussion of the important *Presser* case until the subsequent (fourth) edition of this book, published in 1931, which buttressed the standard interpretation found in the writings of other constitutional scholars. Both Story and Cooley describe the broader, more general nature of keeping and bearing arms arising from the old-style unorganized militias and musters of the pre-Civil War era.

34. Irving Brant, The Bill of Rights 486 (1965).

35. Robert A. Rutland, The Birth of the Bill of Rights 229 (1955).

36. Robert J. Spitzer, *Lost and Found: Researching the Second Amendment*, 76 Chi.-Kent L. Rev. 349, 368 n.105 (2000). ("In 1975, the American Bar Association endorsed the understanding that the Second Amendment is connected with militia service.").

37. Paul Finkelman, District of Columbia v. Heller*: It Really Was About a Well Regulated Militia*, 59 Syracuse L. Rev. 267, 267 (2008).

38. *D.C. v. Heller*, 554 U.S. 570, 591 (2008).

39. *Id.* at 591.

40. Garry Wills, A Necessary Evil 257, 258, 259 (1999).

41. Richard A. Posner, *In Defense of Looseness*, New Republic, Aug. 27, 2008. For more on "law office history" and the Second Amendment, *see* Robert J. Spitzer, Saving the Constitution from Lawyers ch. 5 (2008).

42. Posner, *supra* note 41; J. Harvie Wilkinson III, *Of Guns, Abortions, and the Unraveling Rule of Law*, 95 Va. L. Rev. 253 (2009); Douglas Kmiec, *Guns and the Supreme Court: Dead Wrong*, Tidings Online, July 11, 2008, *at* http://www.the-tidings.com/2008/071108/kmiec_text.htm. Doug Kmiec, *What the Heller? Is Only the Supreme Court's Liberty Enhanced?*, Slate Magazine, July 8, 2008.

43. For example, Stephen Halbrook in *The Founders' Second Amendment* (2008) quotes Patrick Henry as saying during the Virginia ratifying convention "that every man be armed" as evidence that the country's founders favored "the ideal of an armed populace." This quote would seem to support the view that at least some early leaders advocated general popular armament aside from militia purposes. Yet here is the full quote from the original debates:

> May we not discipline and arm them [the states], as well as Congress, if the power be concurrent? so that our militia shall have two sets of arms, double sets of regimentals, &c.; and thus, at a very great cost, we shall be doubly armed. The great object is, *that every man be armed.* But can the people afford to pay for double sets of arms, &c.? Every one who is able may have a gun. But we have learned, by experience, that, necessary as it is to have arms, and though our Assembly has, by a succession of laws for many years, endeavored to have the militia completely armed, it is still far from being the case (emphasis added).

Jonathan Elliot, 3 Elliot's Debates, on the Adoption of the Federal Constitution 386 (1937). It is perfectly obvious that Henry's comments are in the context of a discussion of the militia and of the power balance between the states and Congress.

44. *D.C. v. Heller*, 554 U.S. 570, 571 (2008).

45. *See* 10 U.S.C. § 311. Current code lists the lower age as 17, but in colonial times, the age range was of necessity wider.

46. 494 U.S. 259 (1990).

47. *Heller*, 554 U.S. at 580.

48. *Verdugo-Urquidez*, 494 U.S. at 265.

49. Stuart R. Hays, *The Right to Bear Arms, a Study in Judicial Misinterpretation*, 2 Wm. & Mary L. Rev. 381 (1960).

50. *See* Robert J. Spitzer, *Lost and Found: Researching the Second Amendment*, 76 Chi.-Kent L. Rev. 349–401 (2000); Spitzer, *supra* note 36; Spitzer, *supra* note 16, at 72.

51. *Heller*, 554 U.S. at 599 (emphasis in original).

52. David Thomas Konig, *The Second Amendment and the Right to Bear Arms After* D.C. v. Heller*: Why the Second Amendment Has a Preamble: Original Public Meaning and the Political Culture of Written Constitutions in Revolutionary America*, 56 UCLA L. Rev. 1295, 1297 (2009).

53. *See* Joel Samaha, Criminal Law ch. 6 (1993).

54. Am. Law Inst., 1 Model Penal Code and Commentaries 380–81 (1985). *See also* definition of self-defense in Black's Law Dictionary 947 (1991).

55. *Heller*, 554 U.S. at 661, 662.

56. Robert E. Shalhope says the Second Amendment protects weapons possession for Americans in part "for the purpose of keeping their rulers sensitive to the rights of the people." Would this make, say, Lee Harvey Oswald, John Wilkes Booth, and David Koresh true democrats? *See* Robert E. Shalhope, *The Ideological Origins of the Second Amendment*, 69 J. of Am. Hist. 614 (1982); Wayne LaPierre, Guns, Crime, and Freedom 19–20 (1994); Glenn H. Reynolds, *The Right to Keep and Bear Arms under the Tennessee Constitution*, 61 Tenn. L. Rev. 647, 668–69 (1994).

57. Roscoe Pound, The Development of Constitutional Guarantees of Liberty 90–91 (1957).

58. Saul Cornell, Whose Right to Bear Arms Did the Second Amendment Protect? 19–20 (2000). *See also* Saul Cornell, A Well Regulated Militia (2006). Stuart R. Hays goes so far as to cite with approval the Civil War as an instance of "the right to revolt when the laws of the government began to oppress." Whatever one thinks of that conflict, the effort of southern states to break away from the Union was not within the bounds of the Constitution but an attack on the document and was a threat to the Union's continued existence. Hays, *supra* note 49, p. 382.

59. The Calling Forth Act states as its purpose "[t]o provide for calling forth the Militia to execute the laws of the Union, suppress insurrections and repel invasions." Section 1 of the act says "in case of an insurrection in any state, against the government thereof, it shall be lawful for the President of the United States, on application of the legislature of such state, or of the executive (when the legislature cannot be convened) to call forth such number of the militia of any other state or states, as may be applied for, or as he may judge sufficient to suppress such insurrection." Section 2 says "That whenever the laws of the United States shall be opposed or the execution thereof obstructed, in any state, by combinations too powerful to be suppressed by the ordinary course of judicial proceedings . . . it shall be lawful for the President of the United States to call forth the militia of such state to suppress such combinations, and to cause the laws to be duly executed. And if the militia of a state . . . shall refuse, or be insufficient to suppress the same, it shall be lawful for the President, if the legislature of the United States be not in session, to call forth and employ such numbers of the militia of any other state or states most convenient thereto."

60. *See* Joshua Horwitz & Casey Anderson, Guns, Democracy, and the Insurrectionist Idea (2009).

61. Greg Sargent, *Sharron Angle Floated Possibility of Armed Insurrection*, Wash. Post, June 15, 2010.

62. In his *McDonald* concurring opinion, Justice Clarence Thomas raises this very argument. *See also* Robert J. Cottrol & Raymond T. Diamond, *The Second Amendment: Toward an Afro-Americanist Reconsideration*, 80 Georgetown L.J. 309–61 (1991); Stefan B. Tahmassebi, *Gun Control and Racism*, 2 Geo. Mason U. Civ. Rts. L.J. 67–99 (1991).

63. Bogus, *supra* note 13. *See also* Carl T. Bogus, *Race, Riots, and Guns*, 66 S. Cal. L. Rev. 1365–88 (1993).

BY HENRY G. MILLER

Tort Reform and the KKK Manifesto

Henry G. Miller (hmiller@cgmlaw.com) is the senior member of Clark, Gagliardi & Miller, P.C., in White Plains. He is a Past President of the New York State Bar Association and is the author of *On Trial: Lessons From a Life in the Courtroom.* He earned his undergraduate and law degrees from St. John's University.

Kris K. Krulman (KKK), the president of the Killmen Tobacco Co., perhaps the most powerful CEO in America, was deeply mourned by the corporate world when he died in 1979. The pallbearers were leaders of the John Birch Society. Krulman's estate, valued in the billions, gave rise to endless lawsuits. *The New York Times* called the litigation America's *Jarndyce v. Jarndyce*, spawning more lawsuits than even Charles Dickens could imagine. Hundreds of lawyers built their careers on the estate's endless disputes. This was indeed ironic since Cruel Krulman, as he was known, absolutely detested lawsuits. But most of all, he detested the lawyers who brought them.

Confession

Recently, while working on the case, I came upon a highly secret document hidden in the mountains of KKK files stored in the Catacomb Caves Storage Facility. The importance of this 1978 document cannot be overstated. It is the summary of Krulman's campaign to end lawsuits. It is his manifesto. It reveals his detestation of consumer litigation – "jackpot justice" he called it. Krulman was truly the Father of Tort Reform.

This hidden document was stamped: "Confidential." "Secret." "Never to be Published." All who went into the Catacomb Caves Facility had to sign a pledge of secrecy. I signed that pledge.

Nevertheless, I have decided to publish this document, which I took without authorization. I consulted with experts before making this decision. Some counseled caution. Others supported disclosure, arguing there is such a public interest in this secret document that it must be published.

In any event, I don't care. The public should know. No more Wiki-Secrets. I risk all to bring it to you – the consequences be damned. This is the Pentagon Papers revisited. I am proud to share KKK's "Manifesto" with you.

The Confidential KKK Manifesto for Tort Reform

To: My Brother CEOs of Major Corporations Dedicated to Ending Frivolous Lawsuits

From: KKK

Re: How to Kill Those Damn Lawsuits and the Detestable Lawyers Who Bring Them

Malignant Lawsuits

Enough is enough. Lawsuits are spreading faster than cancer. Anybody, no matter how unimportant, can sue a major American company. Unbelievably, these people can get lawyers even though they don't have any money. They've got this thing called a contingency fee, which the lawyers boastfully call "the little guy's key to the courthouse." This is what comes of silly ideas about all people being equal.

Lawsuits are even worse than regulation. We can control the governmental agencies that supposedly regulate us by packing them with our people, and those who can't wait to become our people when their term ends.

But these lawsuits are uncontrollable and do real harm. Think of asbestos, a damn valuable product. Sure, some got lung cancer and something called mesothelioma and it killed people. But isn't that the price of progress? They even savaged an executive because of a secret memo he wrote, which read, "The less we say about these health problems with asbestos to our customers and employees, the better." That's just common sense. You don't want to start a panic, do you?

The government can't get asbestos off the market. But those damn lawsuits will. That's why we have to kill these lawsuits before they kill us, and there'll be no products left for anybody to sell. Beware of do-gooders crying about the public interest and whining about more safety rules.

Safety concerns are becoming the bugaboo of our society. Remember when some bad tires exploded and killed a few people? Lawsuits uncovered the defect. Nobody would have known anything about it except for what the lawyers learned in "discovery." No secret is safe from those damn lawsuits. It was a shame. Those tires were a profitable product.

And remember when two million women used those IUDs for birth control? A very convenient device. Sure, some had miscarriages, pelvic infections, and, yes, some even died. But the majority didn't. The FDA was no problem but, once again, the lawsuits, not the regulators, are getting them off the market and another profitable product will be lost to industry.

Mark my words, before you know it, people will be suing for all sorts of things – cribs, cars, toys, cigarettes. And there'll be no end to it, like plane passengers looking for deep pockets to sue just because the manufacturer ignored warnings that the planes were going to crash. Picky. Picky. Picky. Next they'll want to sue when some corporate executive makes a pass and grabs one of the girls in the office. They'll take the fun out of life. The same in the drug field. An ingenious American company comes up with a product that takes care of morning sickness in pregnant women. It solves an old problem. A great advance. So a few women have children with birth defects like no arms. But there's a risk to everything. You can't stop progress for a few people who like to bellyache and bring frivolous lawsuits. Mark my words, the day will come when enemy soldiers will sue the manufacturers of the weapons our soldiers use.[1]

Now our drug companies make a lot of their drugs overseas where they don't have inspections. It's beautiful – no inspections, a lot cheaper. Sure, every now and then there'll be a problem like when they didn't use the right animal part to make heparin and some people died. But you got to look at the big picture – the money saved by the drug companies.

Smokers are now even thinking about suing my beloved Killmen Tobacco Co. as well as other tobacco companies, complaining that we hid bad medical studies and had advertising campaigns to cover up the perils of smoking, saying things like: "Have a treat, not a treatment." What were we supposed to do? Publish studies that admit tobacco kills people? Sure, there are studies that say smoking is bad, but I call them "junk science." Scientists on our payroll say the evidence is not clear. Keep the waters muddy. People addicted to cigarettes will grasp at any excuse to keep smoking.

We don't need consumer safety commissions telling the auto companies you can't have accelerators that get stuck, telling companies they can't pollute, telling construction companies they have to make the workplace safe. We don't need inspectors going into our animal farms and taking pictures documenting unsafe conditions that cause infections in people, or telling the oil companies they have to pay for oil spills. We don't need these environmental zealots warning us about the danger of an oil spill in the pristine Alaskan wilderness.

How do we expect to compete with the rest of the world? Safety is expensive. You have to hire inspectors and safety experts. I know there are people out of work who would love to have those jobs. But people without jobs are not our problem, are they? People have to take care of themselves. We're becoming a nation of spoiled weaklings.

Enough is enough.

What Are We to Do? Tort Reform

What to do? That's easy. Stop these lawsuits. First, we come up with a catchy name. You can't say: People can't sue. You can't say: Eliminate juries. That sounds un-American. You can't say "Tobacco Companies Against Litigation." That's stupid. Say, "Citizens Against Lawsuit Abuse." "Working People Against Frivolous Lawsuits." (While I wouldn't want you to quote me, I've always admired the Nazis in Germany calling their party the National Socialist Party. Clever of the Fascists to call their party "Socialist.")

So what should we call our campaign, our crusade to protect defenseless corporations? Words are important. We have to be clever.

Lawyers call these supposed wrongs "torts." Needless to say, it rhymes with courts. No we can't say: Protect the tobacco companies. So we say: Tort Reform. That's a great word: Reform. Like "Lawsuit Reform." The public will think it's something better, not realizing they'll be losing their right to go to court. We've got the power to push it. Let the lawyers mock it as "deform." They can't compete with us. We got more money than they do. We own most of the media. We are the powerful.

The lawyers will fight back and say: One of the main purposes of the law is to see that the powerful do not always get their way. And I say; who says so? We'll demonize the lawyers. Don't call them trial lawyers. That sounds like Abe Lincoln. Call them personal injury lawyers. Add "predatory ambulance chasing" for good measure. Call them greedy. Tell lawyer jokes. There's always a few bad lawyers. When one gets caught or brings a stupid case, publicize it over and over. Poison the jury pool before the case even begins.

People never think they're the ones who are going to be hurt – it's always the other guy. And when they do get hurt and look for a lawyer, it'll be too late. By then, we'll have tort reform.

And once we get the public on our side, we'll go for –

Legislative Reform: Caps

Pass laws that put caps on awards and limit a jury's right to set damages. $25,000 is enough for pain and suffering. In an extreme case, maybe $250,000. I read about a 25-year-old woman, a violinist, who was hit by a drunk truck

driver and blinded as a result. For non-economic loss, that's pain and suffering, the jury awarded $3.5 MILLION. Ridiculous. What's she going to do with that money? Buy a Stradivarius? $25,000 would have been plenty.

I know some corporate executives and insurance company executives make $10 million and $20 million a year. These so-called trial lawyers will argue that even $250,000 is very small in comparison. No problem. We'll just point out the obvious distinction. The executives earned the money. That's capitalism. People who sue are looking to hit the jackpot. They didn't earn the money. Sure, we know appellate courts reduce a lot of those big verdicts, but no need to mention that. These humanitarian dreamers live in a world where everybody is supposed to love their neighbor – a fantasy world. Suing for pain and suffering – a crackpot humanitarian scheme.

If people suing had to pay the other side's lawyers' fees and expenses when they lose, they'd never sue in the first place.

Putting caps on awards and limiting lawsuits probably won't reduce insurance premiums, but they sound like they might. That's good enough. So push that line. Caps reduce the cost of insurance – even though they won't.

Never forget that insurance companies have to make a profit. That's why they're in business. They have to be protected from unscrupulous widows and orphans who bring these bogus lawsuits.

Something else we need is –

Arbitration

Another legislative goal is to get laws that permit mandatory arbitration. Arbitration is great. No jury. None of that conscience-of-the-community stuff like with a jury. And arbitrators who find in our favor will get repeat assignments.

We can't get arbitration in all cases, but we can get it in a lot of cases if we're smart. If people want to do business with us, make them agree to arbitration in advance. And we name the arbitrator. Bury it in small print in contracts. The courts uphold these clauses. It's one less case they have to deal with.

You operate a cruise line. Put it in the contract of carriage. You lease cars. Put it in the lease. You sell securities. Put a mandatory arbitration clause in the contract of sale. Baseball, football and all sports enterprises have contracts. The players, anxious to be in the big leagues, will sign anything, including a contract compelling arbitration.

The beauty of these clauses is the little guy signs them automatically, even before there's a dispute. Someday, the people and the courts will wake up and enforce only those arbitration agreements entered into after the dispute takes place. That way people would know what they're agreeing to. But it will take years before the courts and the people figure that out.

No-Fault

A fallback position we might consider is a no-fault compensation system. Everybody gets a little something but not much. Maybe their medical bills. But nobody can sue – for anything. We'll push no-fault auto insurance. Insurance carriers will make a fortune. A no-fault scheme is particularly good for the drug companies who can test their new products without worrying about lawsuits. If a few people have bad reactions – so what, there'll be no lawsuits. There'll be no punitive damages – in fact, let me bring a smile to your face, there'll be no damages of any kind.

And here's another great way to shut down these petty, avaricious lawsuits –

Loser Pays

If people suing had to pay the other side's lawyers' fees and expenses when they lose, they'd never sue in the first place. We get a law passed that if plaintiffs lose, or don't get at least what was offered to them, they have to pay our lawyers' bills. And our lawyers, being the best Wall Street can offer and billing by the hour, are damn expensive – and nobody knows that better than me. I pay their bills. "Loser pays" will stop these lawsuits once and for all. For those who complain we're shutting the courthouse door to the ordinary citizen, which of course we are, tell them it will eliminate only the frivolous lawsuits. In reality, it'll eliminate almost all lawsuits and save a bundle of money.

And let's not forget, we also need –

Judicial Reform

Let's face it. Too many judges are bleeding hearts. They were brought up on all that stuff about the dignity of the individual and the right to a jury and the Seventh Amendment. They forget: the best government is the least government.

We need hanging judges. Judges who will permit caps on damages. Judges who will make it hard to sue. Judges who will interpret the time to sue strictly. Judges who know corporations are what make America great. And for those judges who play ball, there'll be "seminars" at expensive resorts, all expenses paid – by us.

We need governors who'll appoint judges who represented corporations in private practice. We need a president who'll appoint federal judges who will strike down those damn class actions where thousands sue at one time. Make these troublemakers sue one at a time. They don't have a chance that way. We need a president who will appoint judges who will let corporations spend all they want on political contributions. It may take decades, but we can get it. We have the three things we

need to succeed: Money, more money and yes, even more money.

Remember, in the 1930s we had a Supreme Court that all by itself almost killed the New Deal – even though it was popular. We can get that kind of Supreme Court again – and this time we'll kill these champions of the underdogs once and for all who won't have their great protector, that traitor to his class, the sainted FDR, to save them.

And don't be afraid of –

Elections

To get the legislators we need, we got to get them elected. With unlimited political contributions from corporations, we can do it. Corporate cash speaks. And people will listen. The rich man's joke is always funny.

And when too many voters are the types that vote against us, like the young, the idealistic, the poor, those who don't speak English too well, the minorities, you know the types, we push for laws demanding better voter ID. That'll cut down their numbers. Those kinds of people will never get it right. Down South, they knew how to play that game for years with poll taxes.

Believe me, nowadays in this world of emerging technology, we probably can fool all the people all the time.

Another thing we need is –

Think Tank Reform

All the intellectuals seem to be on the other side. We can change that. We got the billionaires. We got the Chambers of Commerce. We can create our own Think Tanks – our own phony grassroot campaigns. Citizens for Reform. But it'll really be us. It may take years, but what we set up today can yield great results in the years to come. Corporate cash can provide the seed money. Then will bloom the oak trees of a world without consumer lawsuits. It's a dream that can come true.

Charity: With Other People's Money

It's easy for juries to give money when it's not their money. What about justice? What's mine is mine, not yours. Charity begins at home and should stay there. Let's remember our –

History

Society is getting soft. In years past, the Robber Barons knew what they were doing. One of them in 1890 was on his private train. It hit a young woman. The Baron offered to pay for her medical care at first but changed his mind when she died after a botched amputation. He grumbled that he could not possibly protect himself from swindle if he showed sympathy. The millionaire Baron would not even pay $622. That's the toughness of spirit we need to get tort reform. Sympathy and compassion for the little guy are the evils to be rooted out. Business is the engine that drives America. We cannot allow emotional appeals for the underdog to distract us from our mission, which is to reaffirm once and for all what Calvin Coolidge put so brilliantly: The business of America is business.

History also teaches us how to win. Back in 1894 there was a bad depression. We had to cut the wages of railroaders by 25% to 40%. We hired women and children who worked cheaper than the men. We couldn't reduce rent on their company housing or prices at the company store. Why? I repeat, there was a depression. Profits were threatened. But the railroaders were unreasonable and went out on strike. They thought they had us beat. They stopped the trains. The nation was paralyzed. They had an inspirational leader: Eugene V. Debs, and the greatest lawyer of the day: Clarence Darrow.

They had sob stories about the workers and their families who couldn't afford to buy at the company store where they had to buy and children not having enough to eat.

But we beat them. How? We owned the newspapers and we had the government. When they stopped the mail, our newspapers called them un-American. The government prosecutors went after them for conspiracy. They conspired to get a living wage and safer work conditions. That's right. But it's still a conspiracy. We got an injunction and put Debs in jail. We won. Strike over. Railroads running. All back to normal. Today, nobody ever even heard of Debs. We beat them with the power of government. That's how you deal with these pathetic pleas for "More." All they want is more of our money. But they should get "Less" not "More." Why? It's our money. We take the world as it is, not as is should be.

Our Secret Scheme

To make this happen, we need a scheme. It won't happen by itself. We can't do it alone. We need accomplices – those who will conspire with us to achieve our goals. Some of them won't agree with us on everything. Sometimes they won't even know they're being used but they can still be useful. That awful fellow Lenin had a name for people like that: Useful Idiots. Here are some useful idiots to whom we can appeal.

Tories

Tell the conservative-minded that lawsuits are a form of welfare. Tell them that people who sue don't want to work for a living. Tell them: "You work for your money and so should everyone else." Tell them victims are lazy and just want easy money. (However, if it's a catastrophic injury like the plaintiff lost a leg or saw her children killed or is paraplegic, play down the fact that some damn negligent fool destroyed her life.)

Tell the Tories: lawsuits drive up the cost of everything – products, medical care, going to a ballgame. (Ignore studies which show that many victims of malpractice don't even sue.) Tories hate anything that costs them

money and facts they don't agree with. They create their own reality. They make their own facts. Facts are easy. You don't like them, change them. You don't know that? What's the matter with you? Weren't you in school the day they taught public relations?

God's Soldiers

God's soldiers are often very good people who go for the theological approach. But there are great arguments for us in religion: The accident was part of God's plan. God'll take care of him. God is the only judge. We should not judge. God will provide. Suffering can be a blessing.

Believe it or not, this approach works sometimes. America is getting more evangelical – like a theocracy. We can use that.

But be careful here. You can overdo it. Some of the pious like to ask, "What would Jesus do?" While it's a lovely question, be careful. Jesus is, of course, a great and inspirational leader, but when it comes to business, let me be blunt, He wasn't always reliable. Remember the big deal He made about throwing the money lenders out of the Temple? What were they doing wrong? They were just small business people doing a job nobody else wanted. They made business possible in old Jerusalem. Without credit, there is no business. Christ is great, of course, but let me be clear, sometimes He went too far. Remember how He was always encouraging us to love each other and share the loaves and fishes? Let me not mince words: this starts to smell a little like Socialism.

In addition to our accomplices, we'll also have –

Our Hirelings

We'll hire the lobbyists, the politicians, the lawyers (our kind), the academics (our kind) who'll write treatises our way.

These types are ambitious. And remember: small talent and great ambition often go together. A natural collaboration. The ambitious are usually anxious to sell their souls. Old joke: Devil says to the ambitious young office seeker: I'll give you high office. Congress. Senate. Cabinet. Yes, maybe someday, even the presidency. And all you have to do is give me your soul. Young office seeker replies: what's the catch?

And we have the money to corrupt them. For those politicians who play ball, contributions will come pouring in and re-election will not be far behind. We'll make some of them governors, and yes, maybe even a president or two. It can be done. If they will come and preach with us in the Church of Tort Reform, we'll fill the collection baskets. It's smart. We give money to them. We've got plenty. They achieve high office. They vote our way. We keep our money. Everybody wins. Voltaire was right: This is the best of all possible worlds. Together we can do it.

And never forget, my friends, ours is a modest proposal. Some have suggested we should kill all the lawyers or eliminate all juries or outlaw every consumer's right to sue. But we've been more than reasonable and rejected those extremes. Yes, we're a little devious in the way we package our proposal but, as Nixon used to say, we're devious in the best sense of the word. As in all other things, we the captains of industry remain models of being fair and balanced.

Soon we'll have a meeting to put our plan in effect. It'll be secret. Somewhere in Appalachia. But we won't be discovered like that Mafia gang was.

In the Killmen Tobacco Co., we follow the motto of one of those great old Robber Barons: "Whatever is not nailed down is mine and if I can pry it loose, it's not nailed down." That's the spirit of Tort Reform.

For the Common Good

We're not doing this for ourselves. We're doing it for the American people. The American people don't know what's good for them. We do. We need a nation led by those with a clear vision of business unencumbered by regulations, lawsuits and governmental interference. We'll downsize government. We'll lower taxes and starve the beast. We'll crush labor and all that talk about worker safety. We'll disembowel this dreadful civil justice system. A brave new world. Free of lawsuits. Free of lawyers (except ours, of course). A world where government and business are one. Call it National Socialism if you will. Remember, corporations are people. Standard Oil and Joe Average Guy are really one and the same. Well maybe not, but anyway, push that line. The gullible may buy it. When we're finished, we'll have a government by the corporations, for the corporations and of the corporations.

We'll have an aristocracy of moneyed corporations, the very thing Jefferson feared. But nobody reads Jefferson anymore. He was always a little off the wall. Can you believe he actually said we have more to fear from the banks than from standing armies? What a character. No, I prefer Boss Tweed who said the way to get power is to take it.

We'll have a plutocracy where Big Coal, Big Oil, Big Tobacco, Big Drugs, Big Insurance are no longer abused. Our enemies can call it corporate welfare, but we'll call it what it is: common sense. A beautiful world of laissez-faire capitalism and, don't forget, full of profit. Profit. Profit, unregulated, untaxed, unlitigated. No consumer lawsuits. Just pure profit. That's what makes the world go round. Profit.

And that's what tort reform is all about. ■

1. Reluctantly, it must be admitted that Cruel Krulman has a point here and was quite prescient. Enemy soldiers have sued the makers of the herbicide Agent Orange, used to clear out the foliage where the Vietcong hid. Of course, they got nothing and, if anything, it shows how the tort system successfully resisted a frivolous claim.

BY ROBERT L. OSTERTAG

Not for Profit

Good Counsel: Meeting the Legal Needs of Nonprofits, Lesley Rosenthal (John Wiley & Sons, 2012)

Nonprofits are a major force in our nation's economy, its health, education and religious missions, its poverty-related needs, its environment and its social and community welfare, among many others. There are a million or more nonprofits. They account for almost $1.5 trillion annually in revenues and expenditures. Nationally, nonprofits employ more than 10 million people, approximately 7% of the nation's workforce, more than those employed in finance, insurance and real estate combined. In addition, nonprofits are served by non-employed volunteers, themselves numbering in the millions; the estimated value of those more than eight billion hours of effort approaches $175 billion, and it's growing.

Until recent times, only a small percentage of nonprofits have enjoyed regular access to legal counsel, whether in-house or out. That misfortune speaks to the economic realities of nonprofits' existence and their unique niche in our overall society. Now, however, given the complexities of our business world – with its multiple legal requirements involving governmental and consumer regulation, labor and employment, the myriad of rules governing financial operations, the public's need for transparency and more – the retention of legal counsel in one form or another has become virtually a necessity for nonprofits.

Lesley Rosenthal is General Counsel for a New York nonprofit – Lincoln Center for the Performing Arts. Lincoln Center is one of the world's jewels of culture, arguably unsurpassed anywhere for its eminence and vast contributions to the arts. A Harvard Law graduate, Ms. Rosenthal enjoyed a long and successful legal career at one of the city's most prestigious law firms, and in 2005, she was selected to serve in her current role. Ms. Rosenthal has taken hold of Lincoln Center's legal life and in the process has assembled what she refers to as a "Counsels' Council" comprising prestigious law firm members and their firms, general counsel for major companies and even a few law professors, all of whom, on a pro bono basis, have assisted her in meeting the Center's broad legal challenges. She estimates the value of their contributions to extend into the many millions of dollars. With the encouragement of Lincoln Center's President Reynold Levy, Stephen Younger, past president of the New York State Bar Association, and Jason Lilien, Chief of the Charities Bureau of the New York State Attorney General's Office, Ms. Rosenthal has authored a book titled *Good Counsel: Meeting the Legal Needs of Nonprofits*, in which she shares what she has learned in the process with those interested in laboring in the legal profession on behalf of nonprofits.

In so doing, she has provided a descriptive account of some of her own and Lincoln Center's legal experiences. She also has provided an impressive array of guidelines and "how to" suggestions and materials intended to train incoming counsel and those on both sides of the attorney-client relationship, including paid and volunteer lawyers and the nonprofit leader clients of otherwise unrepresented nonprofits. Although nonprofit leaders may be sophisticated in their executive and administrative efforts, they may not necessarily recognize the range of legal requirements appropriate to their undertaking. This book uniquely constitutes "a single volume for attorneys counseling public charities as well as nonprofit professionals, board members, volunteers and students of the sector who need a concise, accessible overview of the legal needs of nonprofits."

The 320-page book includes numbered footnotes, bibliography, extensive authorities and index, and a preface and a lengthy introduction which, in this case, are very much worth reading.

The text, which is clear, concise and pragmatic in its writing and presentation, is divided into three major parts: first, an overview of legal needs specific to nonprofits; then, a tour of their general business law needs; and finally, a segment on taking charge of their legal functions. Each part is divided into chapters, and each chapter is divided into segments that include checklists, practice pointers, focus questions and work plans. For openers, chapter 1 discusses the overall legal needs of nonprofits, their missions and unique terminology, the laws governing nonprofits, fiduciary duties, taxes and exemptions, among others.

Succeeding chapters include, among others, discussions on the legal and business basics of nonprofits; the benefits of incorporating; how to get organized; the requirements of and how to obtain tax exemption; how to acquire and maintain state recognition; trustee independence; corporate governance; an in-depth consideration of intellectual property laws, copyrights, trademarks and patents; the very important legal aspects of fund-raising, including restrictive gifts, endowments and other kinds of gifts and the laws that

CONTINUED ON PAGE 51

ROBERT L. OSTERTAG is a veteran practitioner with more than 50 years of experience. He is a Past President of the New York State Bar Association.

ATTORNEY PROFESSIONALISM FORUM

To the Forum:

My client is currently engaged in a litigation where her net worth is an issue.

At her deposition, my client testified that she had no income other than her salary. I had been planning on negotiating with my adversary to see if we could settle the case before an upcoming trial and I had called my client for some final settlement authority.

On the call, my client told me that she now "remembers" something she "forgot" to mention at her deposition. Previously, she had testified that she had no income other than what was reported on the W-2 that she received from her employer. Now she remembers she had received $50,000 from her recently deceased uncle a few weeks before her deposition when his estate was distributed based on his will. She does not want me to tell the opposing side or the court about the $50,000. Still, she's worried that the court might find out about the $50,000 since her uncle's will is a matter of public record. So, she gives me settlement authority.

Meanwhile, the private investigator I had previously hired just reported to me that the opposing party's statement in his affidavit that he is unable to work because he is injured is false. In fact, the opposing party has been working off the books as a messenger at the law firm of his attorney, Fraud U. Lent. By my calculation, if the opposing party reported the additional income, it would be relevant to damages.

Can I settle the case without admitting that my client had received the $50,000 from her uncle? If the case does not settle, and I am unable to convince my client to correct her testimony, am I obligated to withdraw from her representation? Am I permitted to disclose the $50,000 to the court?

In addition, the other side has made a settlement offer. May I tell my adversary that I am aware that his client's affidavit is false to try to get a better offer?

May I tell Mr. Lent that I will not file a disciplinary grievance against him based on his role in drafting the false affidavit if his client will just make a better offer?

May I tell opposing counsel that my client will pursue criminal perjury charges against the opposing party?

Sincerely,

A. Lot Goingon

Dear A. Lot Goingon:

There are a myriad of ethical issues which you have raised in this scenario. At the outset, N.Y. Rules of Professional Conduct Rule 4.1 requires that "[i]n the course of representing a client, a lawyer shall not knowingly make a false statement of fact or law to a third person." Furthermore, when dealing with an opposing party and the opposing party's counsel, Rule 3.4 requires that attorneys act with fairness and candor. Rule 3.4(a)(1) states that "a lawyer shall not . . . suppress any evidence that the lawyer or the client has a legal obligation to reveal or produce." Moreover, Rule 3.4(a)(4) requires that "a lawyer shall not . . . knowingly use perjured testimony or false evidence." Additionally, Rule 3.4(a)(5) states that "a lawyer shall not . . . participate in the creation or preservation of evidence when the lawyer knows or it is obvious that the evidence is false." Lastly, Rule 3.4(a)(6) requires that "a lawyer shall not knowingly engage in other illegal conduct or conduct contrary to these Rules."

Simply put, if your client was not truthful during her deposition about her assets, which appears to be a material fact that would be integral in determining the amount to be awarded in this particular action, there may be circumstances that would require disclosure to opposing counsel. The key words utilized in the aforementioned subsections of Rule 3.4(a) are "know" or "knowingly." "Know" does not mean believe. Here, depending on the precise on-the-record question and answer during the deposition, your client's purported recollection after her deposition that she had $50,000 in funds may be a significant deviation from her prior sworn testimony that she possessed no other income. This is further complicated by the fact that your client does not want you to inform either the opposing party or the court of the true disposition of her assets. The reality is that you do not have knowledge of your client's financial affairs. Your client's request that you not make any disclosure as to her actual financial status requires an examination of your responsibilities under subsections (1), (4), (5) or (6) of Rule 3.4(a). Lawyers may rely on a client's recitation of the facts. Even if a lawyer has some doubts about the client's veracity, so long as a lawyer's investigation of the facts does not conclusively demonstrate that the client's version of the facts is false or fraudulent, a lawyer can accept the client's word. Thus, if you maintained the position in settlement discussions

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

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

which arose from you client's sworn testimony that she had no assets even though she may have $50,000 in funds, you would not be in violation of these provisions of Rule 3.4(a) since you do not have knowledge of her actual financial status. However, if you had actual knowledge that your client "had" $50,000 while maintaining the position that your client had no assets as she had previously testified, then you could be in violation of subsection (1), (4), (5) or (6) of Rule 3.4(a).

Turning to your follow-up question on this point, assuming that you had actual knowledge that your client "had" the $50,000 and you are unable to convince your client to correct her testimony, then you could be obligated to withdraw as her counsel. Rule 1.16(b)(1) states that ". . . . a lawyer shall withdraw from the representation of a client when . . . the lawyer knows or reasonably should know that the representation will result in a violation of these Rules or of law." You could also be obligated to withdraw pursuant to Rule 1.16(b)(4) which states that " . . . . a lawyer shall withdraw from the representation of a client when . . . the lawyer knows or reasonably should know that the client . . . asserting a position in the matter, or is otherwise having steps taken, merely for the purpose of harassing or maliciously injuring any person." As you have previously indicated, your client does not want you to tell the opposing side or the court about the $50,000, and this appears to be done "merely for the purpose of harassing or maliciously injuring" the opposing party. This could be an example of conduct which would permit a lawyer to withdraw under Rule 1.16(b)(4).

Whether it is appropriate for you to disclose to the court the fact that your client informed you that she did have $50,000 is a trickier issue. Such information may be disclosed under Rule 1.16(b)(3). "Confidential information" under Rule 1.16(a) "consists of information gained during or relating to the representation of a client, whatever its source, that is (a) protected by the attorney-client privilege, (b) likely to be embarrassing or detrimental to the client if disclosed, or (c) information that the client has requested be kept confidential." As mentioned in your inquiry, although it is possible that the information concerning your client's receipt of the $50,000 may be a matter of public record, your client did request that this information be kept from both the opposing side and the court. Therefore, this information could be deemed as "confidential." Rule 1.6(b)(3) allows for the disclosure of "confidential information to the extent that the lawyer reasonably believes necessary . . . to withdraw a written or oral opinion or representation previously given by the lawyer and reasonably believed by the lawyer still to be relied upon by a third person, where the lawyer has discovered that the opinion or representation was based on materially inaccurate information or is being used to further a crime or fraud." From the facts you have described, it does appear that your client's failure to disclose her actual assets (after she had given sworn testimony at her deposition that she had no assets other than the prior support that she was receiving) was a fraudulent attempt by her to force a more favorable settlement from the other side and may be disclosed to the court.

It is also important to take note of the requirements of Rule 3.3(a)(1) which states that "[a] lawyer shall not knowingly . . . make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer." In addition, Rule 3.3(a)(3) requires that "[a] lawyer shall not knowingly . . . offer or use evidence that the lawyer knows to be false. If a lawyer, the lawyer's client, or a witness called by the lawyer has offered material evidence and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal . . . " As mentioned above in our discussion concerning Rule 3.4, a lawyer would be deemed to have been in violation of subsections (1) and (3) of Rule 3.3(a) if he or she had knowledge that the information received from the client is false. It is also important to note that Comment [8] to Rule 3.3 states that "[t]he prohibition against offering or using false evidence applies only if the lawyer *knows that the evidence is false*" (emphasis added) and that "[a] lawyer's reasonable belief that evidence is false does not preclude its presentation to the trier of fact." Lastly, Rule 3.3(b) states that "[a] lawyer who represents a client before a tribunal and who knows that a person intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal."

Notwithstanding your client's statement that she "remembered" having $50,000 after previously testifying that she had no assets, it may be argued that you did not have knowledge but instead had a reasonable belief as to your client's financial affairs and you could argue the position that she had no assets while maintaining compliance with subsections (1) and (3) of Rule 3.3(a). Any doubts that a lawyer may have about a client's factual representations must be resolved in favor of the client. Put in somewhat different language, lawyers are not judges of their client's positions.

With regard to your knowledge that your adversary may have falsified his client's affidavit, you must be extremely careful in how you handle this matter. There is nothing that prevents you under the Rules of Professional Conduct from sharing your knowledge with your adversary that his client's affidavit was false. However, you should be aware of Comment [5] to Rule 3.4 which states that the use of threats in negotiation may constitute the crime of extortion. You also may not threaten to file a disciplinary grievance against Mr. Lent based on his purported role in drafting the alleged false affidavit of his client. Rule 8.3(a) states that "[a] lawyer

who knows that another lawyer has committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer shall report such knowledge to a tribunal or other authority empowered to investigate or act upon such violation." Only if there is a good faith basis or suspicion as to Mr. Lent's conduct would it then be appropriate to file a grievance complaint against him. The best thing you can do is to conduct some discovery on this particular issue in order to prove your investigator's purported findings that the affidavit that was submitted was indeed false.

Lastly, you may not tell opposing counsel that your client will pursue criminal perjury charges if a better settlement offer is not made. As Rule 3.4(e) states, "a lawyer shall not . . . present, participate in presenting, or threaten to present criminal charges solely to obtain an advantage in a civil matter."

Sincerely,
The Forum by,
Vincent J. Syracuse, Esq., and
Matthew R. Maron, Esq.,
Tannenbaum Helpern Syracuse & Hirschtritt LLP

QUESTION FOR THE NEXT ATTORNEY PROFESSIONALISM FORUM:

I was retained by a company that was sued in a trademark infringement case. The plaintiff company's Vice President for Marketing and Sales was recently deposed, and I chatted amicably with him during several breaks. Parenthetically, the Vice President is also an attorney (non-practicing) and he is the plaintiff's primary decision maker.

The plaintiff-company's lawyers have been very accusatory and difficult to deal with. I do not believe that it will be possible to settle the case with them, or that they have communicated my settlement offer to their client.

Can I speak with the Vice President directly after the deposition phase and advise him of the settlement offer? Would it make a difference if the Vice President was also the plaintiff-company's general counsel? What if the Vice President calls me after the deposition phase (without informing his company's attorney) to discuss settlement? Should I take the call? What if my client seeks my advice about directly approaching the plaintiff-company to settle the matter (and bypass the attorneys)?

In addition, I have been regularly using email to communicate with my adversary during the course of settlement negotiations. Recently, I received an email from my adversary with a "cc" to the Vice-President. The email misstated my settlement offer and I saw this as a golden opportunity to communicate with the Vice-President. I pressed "reply all" and sent an email that responded to my adversary's email and stated my settlement position. Opposing counsel went ballistic and accused me of communicating with his client in violation of the Rules of Professional Conduct. Since I was responding to a communication that had "cc'd" the plaintiff, I believe that opposing counsel invited the use of "reply all" and implicitly gave his prior consent.

Who is right?
Sincerely,
What A. Mess

BOOK REVIEW
CONTINUED FROM PAGE 48

matter to fund-raisers; the registration requirements for charitable solicitation; compliance with grant terms; planned gifting; corporate contributions; lawyers as fund-raisers; IRS reporting; prudent investor standards; investment policies; risk management; financial distress and insolvency; the dynamics of human resource considerations, including employment relationships; the role of volunteer and intern personnel; labor law constraints and liability as they affect nonprofits; facilities and real estate management and the laws affecting those operational activities; political activities and lobbying, including their restrictions, prohibitions and limitations; record keeping; financial disclosure; the importance of taking charge of the various legal functions appropriate to nonprofits; and mobilizing other appropriate and necessary legal forces.

My favorite segments have to do with fund-raising and lobbying, both of which are so much in the news and public consciousness these days.

The book identifies a wide variety of operational traps and solutions, and it includes a reference to a companion website containing glossaries of nonprofit-related terms and links to a variety of additional materials and information appropriate to the subject.

While it is common in book reviews to include a paragraph or so of negative comment just to keep it honest, I've looked hard here for some basis of negative comment and I just can't find one. This single-volume treatise, a first of its kind, is a rather remarkable, up-to-date and virtually all-inclusive practice treatment that should be read by anyone seeking to enter the nonprofit area of law practice, and it should appear for ready reference on the shelves of every attorney responsible for counseling nonprofits. It is an achievement by one whose demanding responsibilities might be expected to leave little time for such a project. Lesley Rosenthal's willingness to display her prodigious writing skills and to offer her valuable personal time to share what has been for her an intense professional experience at one of the world's most significant arts providers is indeed worthy of conspicuous note. ■

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Sarasota, FL

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Rui Zhou
Lulu Zhu
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Emad A. Zowawi
Stacey Elizabeth Zyriek
Jonathon Albert Zytnick

to plead either a statutory or common-law prerequisite for recovery under a cause of action.

A court might not dismiss a complaint that's repetitious or inartfully pleaded. But dismissal is appropriate if the complaint is drafted so poorly that the court cannot tell whether the plaintiff has stated a cause of action.

Submitting Evidence

As the movant, you may submit with the motion any form of evidence, such as affidavits or other proof.[17] If your intention is to attack only the face of the complaint or counterclaim, you needn't submit any evidence.[18] When the moving party submits evidence with the motion, "the standard morphs from whether the plaintiff [or counterclaimant] *stated* a cause of action to whether it *has* one."[19]

> On a CPLR 3211(a)(7) motion to dismiss, the court favors the nonmoving party.

As the plaintiff (or counterclaimant), you may submit evidence of your own regardless whether the moving party attacks the facial sufficiency of your complaint (or counterclaim) or challenges its merits. If the moving party attacks the facial sufficiency of the complaint (or counterclaim), submit an affidavit to remedy any defect in your pleading.[20] If the moving party attacks the merits of one or more causes of actions, provide evidence that demonstrates that you have a cause of action "as opposed to mere allegations in the complaint."[21]

As the plaintiff (or counterclaimant), you might want to stand on your complaint (or counterclaim) and decline to submit affidavits in your opposition papers. You're not required to submit an affidavit. But you might want to submit evidence to "buttress a poorly pleaded complaint or cause of action . . . or to rebut an assertion by the defendant that the plaintiff [or counterclaimant] cannot demonstrate a material fact."[22]

On notice to all the parties, the court may convert a motion to dismiss to a motion for summary judgment.[23] If the court chooses not to convert the motion to a summary-judgment motion, the court may consider the affidavits for limited reasons: "to remedy defects in the complaint . . . or to show that . . . no serious dispute [exists] that a material fact is not a fact at all."[24] The *Legal Writer* will discuss in upcoming issues what happens when a court converts a motion to dismiss to a summary-judgment motion.

Opposing a Motion Under CPLR 3211(a)(7)

Oppose your adversary's motion in writing. As explained above, determine whether you should submit any proof in the form of affidavits or documentary evidence.

In tort actions against licensed architects, engineers, land surveyors, or landscape architects, plaintiffs must comply with CPLR 214-d and CPLR 3211(h). Under CPLR 214-d, plaintiffs must give "written notice of such claim to each . . . architect, engineer, land surveyor or landscape architect or . . . firm at least ninety days before the commencement of any action or proceeding." In the notice of claim, you must "identify the performance, conduct or omissions complained of, on information and belief, and shall include a request for general and special damages."[25] Under CPLR 3211(h), the plaintiff, in opposition to a 3211(a)(7) motion to dismiss, must demonstrate that "a substantial basis in fact and in law exists to believe that the performance, conduct or omission complained of . . . was negligent." The plaintiff must also show "that such performance, conduct or omission was a proximate cause of [the] damage complained of . . . or is supported by a substantial argument for an extension, modification or reversal of existing law."[26] The court will determine whether "relevant proof [supports the plaintiff's claim] as a reasonable mind may accept as adequate to support a conclusion of ultimate fact."[27]

Options Instead of Moving Under CPLR 3211(a)(7)

You may assert the defense of failure to state a cause of action in your answer instead of in a motion to dismiss under CPLR 3211(a)(7).[28]

No time limitations exist for moving to dismiss under CPLR 3211(a)(7).[29] *Exception:* You may not move to dismiss under CPLR 3211(a)(7) if you've moved to dismiss earlier under any subparagraph of CPLR 3211(a). If your time to move for summary judgment has run out, you may move to dismiss under CPLR 3211(a)(7).

If you, as the defendant, are uncertain what the court will do with the evidence you want to include with your 3211(a)(7) motion or you're uncertain whether the court will convert the motion to a summary-judgment motion, you might consider serving an answer and then moving for summary judgment under CPLR 3212.[30] This might be the best strategy if you want "to attack the sufficiency of the plaintiff's cause of action."[31]

Moving for summary judgment is sometimes a better strategy than moving to dismiss under CPLR 3211(a)(7). Even if you win the motion to dismiss, the court might allow the plaintiff (or counterclaimant) to replead the complaint (or counterclaim) or to serve and file a new compliant (or counterclaim).

Also, a summary-judgment motion will allow you to introduce proof — any form of admissible evidence — to contradict the plaintiff's allegations in the complaint. The burden will then shift to the plaintiff to offer proof in admissible form to prove each element of the plaintiff's cause(s) of actions in the complaint. The court's judgment has res judicata, or claim preclusion, effect.

If you're the moving party and the court denies your CPLR 3211(a)(7) motion, you may still move for summary judgment. The *Legal Writer*

will discuss motions for summary judgment after it concludes its discussion of CPLR 3211(a) and (b) motions to dismiss.

Options Before and After Court's Decision on CPLR 3211(a)(7) Motion

Even before the court renders its decision on the 3211(a)(7) dismissal motion, you may move, in opposition to the motion, under CPLR 3211(d) to forestall a decision on the merits. Under 3211(d), if "facts essential to justify opposition may exist but cannot then be stated, the court may deny the motion, allowing the moving party to assert the objection in his responsive pleading, if any." The court may also "order a continuance to permit further affidavits to be obtained or disclosure to be had and may make such other order as may be just."[32]

You may also replead if the court grants the CPLR 3211(a)(7) motion.

Right to Replead

Before January 1, 2006, if your adversary had moved to dismiss under CPLR 3211(a)(7), you could have sought leave to replead[33] — permission to bring the case anew. Your request should have been in writing, in your opposition papers to the motion to dismiss. You would have had to have submitted evidence in admissible form to the court that you had ample support for your cause of action or defense. Without that, a court would not have granted your motion for leave to replead.

On January 1, 2006, the legislature amended CPLR 3211(e). It removed language about leave to replead, the last sentence in CPLR 3211(e).[34] The purpose of amending 3211(e) was to allow a party to replead without having to seek leave to replead in writing.[35]

It's still unclear how long you have to move for leave to replead. One court allowed a plaintiff to replead half a year after the court dismissed some of the plaintiff's claims.[36] Neither the amendment nor any statement in its bill jacket, the court noted, prescribes any time limit on a motion for leave to replead.[37] Applying CPLR 3025, the standard for motions for leave to amend pleadings, the court noted that motions for leave to replead should be "freely granted absent prejudice or surprise to the opposing party."[38] The court asked the legislature to clarify the unresolved issues on a party's right to replead.[39]

If you're a cautious practitioner, you could seek the court's leave to replead in writing even though CPLR 3211(e) no longer requires you to do that. Granting leave to replead is discretionary.[40] A court might view your request for leave to replead in your opposition papers to the 3211(a)(7) motion as "a sign of diligence, which may help swing the discretion pendulum in the plaintiff's flavor."[41]

Or, you may move under CPLR 3025 for leave to amend your pleadings. But under 3025(b), you might have to overcome the prejudice hurdle: whether it would be "just" for the court to allow you to amend the pleadings.

In light of the amendment to CPLR 3211(e), your right to replead is almost "automatic."[42] Reading CPLR 3211(e), you could serve and file an amended complaint after the court has granted the moving party's motion to dismiss. This scenario might work if you, as the plaintiff or counterclaimant, had not amended your pleadings earlier, before the moving party served and filed a 3211(a)(7) motion to dismiss.

The safest practice when faced with a CPLR 3211(a)(7) dismissal motion is to "is to come forward, in the responding papers, with as much solid proof as [you] can muster to show a viable claim. Failing to [come forward with proof] may only add unnecessary time and expense to the litigation."[43]

If the court grants the 3211(a)(7) motion and denies your request for leave to replead, you may appeal from that order, including the portion of the order that denied leave.[44]

Dismissal Under CPLR 3211(a)(7)

If a court dismisses a case with prejudice, that determination is on the merits. That determination has preclusive effect.

Dismissal is appropriate if the complaint is drafted so poorly that the court cannot tell whether the plaintiff has stated a cause of action.

If a court dismisses a case without prejudice, that determination isn't on the merits. You'd have the right to replead.

A dismissal of a cause of action before the close of the plaintiff's evidence — before the plaintiff rests its case (or before the counterclaimant presents its entire case on the counterclaim) — isn't a final determination on the merits.[45] A dismissal under CPLR 3211(a)(7) therefore doesn't bar you under the doctrine of res judicata from repleading the matter. You may serve and file a new complaint based on the same set of facts to remedy the deficiencies in the earlier complaint, unless the statute of limitations has expired.

As the defendant, you may argue that the new case is barred under the doctrine of res judicata if the plaintiff sought leave to replead in opposing your earlier motion to dismiss and if the court denied that request. You may, thus, argue that the dismissal was on the merits.

In the next issue of the *Journal*, the *Legal Writer* will continue with the remaining provisions of CPLR 3211(a). ■

1. David D. Siegel, New York Practice § 265, at 462 (5th ed. 2011); *accord* John R. Higgitt, *CPLR*

CONTINUED ON PAGE 58

3211(a)(1) and (a)(7) Dismissal Motions-Pitfalls and Pointers, 83 N.Y. St. B. J. 32, 33 (Nov./Dec. 2011).

2. Higgitt, *supra* note 1, at 33.

3. Siegel, *supra* note 1, at § 265, at 462.

4. Higgitt, *supra* note 1, at 33.

5. Siegel, *supra* note 1, at § 265, at 463.

6. 1 Michael Barr, Myriam J. Altman, Burton N. Lipshie & Sharon S. Gerstman, New York Civil Practice Before Trial § 36:291, at 36-26 (2006; Dec. 2009 Supp.) (citing *Pacifico v. Playwrights Horizons Theatre Sch.*, 163 Misc. 2d 1084, 1086–87, 623 N.Y.S.2d 474, 475–76 (Sup. Ct., N.Y. Co. 1994) (finding incredible plaintiff's claims of brainwashing and surveillance)).

7. Higgitt, *supra* note 1, at 33.

8. *Id.* at 33.

9. Siegel, *supra* note 1, at § 265, at 463 (citing *Foley v. D'Agostino*, 21 A.D.2d 60, 65, 248 N.Y.S.2d 121, 127 (1st Dep't 1964)).

10. *Id.* at § 265, at 463 (citing *Westhill Exports, Ltd. v. Pope*, 12 N.Y.2d 491, 496, 191 N.E.2d 447, 449, 240 N.Y.S.2d 961, 964 (1963)).

11. Barr et al., *supra* note 6, § 36:290, at 36-26.

12. Siegel, *supra* note 1, at § 265, at 462.

13. Barr et al., *supra* note 6, § 36:294, at 36-27.

14. *Id.* at § 36:292, at 36-27 (citing *M.J. & K. Co., Inc. v. Matthew Bender and Co., Inc.*, 220 A.D.2d 488, 490, 631 N.Y.S.2d 938, 940 (2d Dep't 1995) ("The plaintiffs' mere contentions that third parties cancelled contracts with them because of the alleged defamatory remarks made by Bender's representatives, offered with no factual basis to support the allegations, was insufficient to state a cause of action for tortious interference with contractual relations.")).

15. Barr et al., *supra* note 6, § 36:300, at 36-27.

16. *Id.* at § 36:300, at 36-28 (citing *General Motors Acceptance Corp. v. Desbiens*, 213 A.D.2d 886, 888, 623 N.Y.S.2d 939, 942 (3d Dep't 1995) (holding no civil cause of action for criminal offense of harassment); *Ullmann v. Norma Kamali, Inc.*, 207 A.D.2d 691, 693, 616 N.Y.S.2d 583, 584 (1st Dep't 1994) (holding no cause of action for wrongfully discharging an at-will employee); *Jose F., v. Pat M.*, 154 Misc. 2d 883, 885, 586 N.Y.S.2d 734, 736 (Sup. Ct., Suffolk Co. 1992) (holding no cause of action for fraud or intentional infliction of emotional distress for partner's failure to use birth control).

17. CPLR 3211(c); *see generally* John R. Higgitt, Outside Counsel, *10 Tips to Improve Your Motion Practice*, N.Y.L.J., Apr. 12, 2012, p. 4, col. 1, *available at* http://www.law.com/jsp/article.jsp?id=1202548705192 (last visited June 11, 2012).

18. Siegel, *supra* note 1, at § 265, at 463.

19. Higgitt, *supra* note 1, at 33 (emphasis in original).

20. *Id.* at 34.

21. *Id.*

22. Barr et al., *supra* note 6, § 36:293, at 36-27.

23. CPLR 3211(c).

24. Barr et al., *supra* note 6, § 36:293, at 36-27 (citing *Rovello v. Orofino Realty Co., Inc.*, 40 N.Y.2d 633, 635, 357 N.E.2d 970, 972, 389 N.Y.S.2d 314, 316 (1976); *Guggenheimer v. Ginzburg*, 43 N.Y.2d 268, 275, 372 N.E.2d 17, 20–21, 401 N.Y.S.2d 182, 185–86 (1977). Professor Siegel explains the controversy about the *Rovello* rule, the Court of Appeals decision that "held that as long as the complaint states a claim on its face, the plaintiff need not — in response to the defendant's paragraph 7 objection — come forward with affidavits or other proof unless the court does in fact elect to treat the motion as one for summary judgment." Siegel, *supra* note 1, at § 265, at 463. Siegel explains that the *Rovello* rule "has resulted in holdings that the court cannot even consider the defendant's affidavits on a CPLR 3211(a)(7) motion unless and until it has elected to exercise its treat-as-summary-judgment power. This might in turn lead defendants to assume that they should not even bother submitting affidavits. Defendants should make no such assumption unless, of course, it is their intention to test only the face of the complaint." Siegel, *supra* note 1, at § 265, at 463.

25. CPLR 214-d.

26. CPLR 3211(h).

27. *Id.*

28. Siegel, *supra* note 1, at § 265, at 463. In 1987, the Second Department held that the objection cannot be used as a defense in the answer. *See Bentivegna v. Meenan Oil Co.*, 126 A.D.2d 506, 508, 510 N.Y.S.2d 626, 627 (2d Dep't 1987). That rule no longer exists. In 2008, the Second Department held that failure to state a cause of action can be pleaded as an affirmative defense in the answer. *Butler v. Catinella*, 58 A.D.3d 145, 150, 868 N.Y.S.2d 101, 105 (2d Dept 2008).

29. CPLR 3211(e).

30. Siegel, *supra* note 1, at § 265, at 463. Move for summary judgment "no later than one hundred twenty days after the filing of the note of issue, except with leave of court on good cause shown." CPLR 3212(a).

31. Barr et al., *supra* note 6, § 36:295, at 36-27.

32. CPLR 3211(d).

33. The language in the former statute, CPLR 3211(e), read: "Where a motion is made on the ground set forth in paragraph seven of subdivision (a), or on the ground that a defense is not stated, if the opposing party desires leave to plead again in the event the motion is granted, he shall so state in his opposing papers and may set forth evidence that could properly be considered on a motion for summary judgment in support of a new pleading; leave to plead again shall not be granted unless the court is satisfied that the opposing party has good ground to support his cause of action or defense; the court may require the party seeking leave to plead again to submit evidence to justify the granting of such leave."

34. The amendment came after the Court of Appeals cancelled out the last line of 3211(e). *See Rovello v. Orofino Realty Co., Inc.*, 40 N.Y.2d 633, 635, 357 N.E.2d 970, 972, 389 N.Y.S.2d 314, 316 (1976) (holding that a plaintiff, in response to a motion to dismiss under CPLR 3211(a)(7), need not submit affidavits).

35. Barr et al., *supra* note 6, § 36:320, at 36-29.

36. *Janssen v. Inc. Vill. of Rockville Ctr.*, 59 A.D.3d 15, 28, 869 N.Y.S.2d 572, 582 (2d Dep't 2008).

37. *Id.*

38. *Id.* at 27, 869 N.Y.S.2d at 581.

39. *Id.* (noting that the Legislature needs to address three issues: whether it intended eliminate motions for leave to replead, what standard to apply on a motion for leave to replead, and what time limitations exist for motions for leave to replead).

40. Higgitt, *supra* note 1, at 35.

41. *Id.*

42. Barr et al., *supra* note 6, § 36:320, at 36-29.

43. Siegel, *supra* note 1, at § 275, at 474.

44. Higgitt, *supra* note 1, at 35.

45. CPLR 5013.

Gerald Lebovits, a New York City Civil Court judge, teaches part-time at Columbia, Fordham, and NYU law schools. He thanks court attorney Alexandra Standish for researching this column. Judge Lebovits's email address is GLebovits@aol.com.

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LANGUAGE TIPS

BY GERTRUDE BLOCK

Question: Please comment on the word *tase*, which the *New Oxford American Dictionary* chose as runner-up to *lovacare* in 2007 in its annual contest for the "Word of the Year." That verb, which looks as if it is formed from the noun "taser," is still widely used, but shouldn't it be spelled *taser*?

Answer: No. The choice of verb *tase* is a backformation of *taser* (a small gun-like device that fires electric darts to temporarily immobilize an individual). Backformations, the creation of new words by the removal of what is considered to be a suffix, is a typically English process, modeled on verbs like *act* from *actor* and *edit* from *editor*. These verbs are usually derived from nouns. But *taser* never was a noun. It was formed as an acronym, from the first letters of the title "Thomas A. Swift Electric Rifle." Some readers may remember Tom Swift as the boy-hero of early-20th-century action novels that were immensely popular with teenage boys of that period.

In 2007, the *New Oxford American Dictionary* chose *locavore* as the winner. *Locavore* is a compound – the first syllable probably created from "local" – that refers to people who prefer to buy food in season from local farmers or to grow it themselves. The final syllable of *locavore* is probably modeled on the final syllable of *carnivore*, which means "flesh-eater." The compound *carnivore* is borrowed from the Latin *carni* ("flesh") and the Latin verb *vorare* ("to swallow up"). The other runner-up to *locavore* that year was *cougar*, a noun describing an "older" woman interested romantically in younger men.

Like many words chosen as "Word of the Year," the compound *locavore* is an odd and probably short-lived coinage. But some word-of-the-year winners take root in our language and become established as standard English. One such word is *subprime*, which leaped into prominence with the downturn of an economy exacerbated by borrowers defaulting on home loans they were unable to re-pay. The longevity of *subprime* is at least partly a result of the slow recovery of the economy. *Subprime* has already spawned new meanings. For example, at this university, law students have added the adjective form: "I subprimed my final exam!"

Another coinage whose life has exceeded expectation is the 2005 "Word of the Year," *truthiness*, which *Webster's New Millennium* defines as "[t]he state of wishing things to be true; . . . conformity to beliefs one feels or wishes were true." *Truthiness* is the reverse of *truthfulness*, "the quality of being true." Like "virtual reality," *truthiness* is the implication of, not the reality of, the word "truth." It is used as a pejorative to imply the truth of something that the user knows is not true.

Television comedian Stephen Colbert coined *truthiness* to indicate "facts" that one claims to know intuitively, instinctively or from the gut, despite facts, evidence, logic, and intellectual examination. Television watchers, bombarded by the assertions of presidential candidates, can understand why the coinage was created. Since *truthiness* is a handy word, expandable beyond politics, it may survive the current political campaign.

Sometimes a "Word of the Year" disappears for a while, then re-emerges with new synonyms. The noun *ripoff* is a good example. Its progenitor, the word *rip*, had been around for a long time, both as a verb and a noun, since about 1770. The verb meant "tear or cut apart violently," and the now-archaic noun meant "a dissolute person" or "some valueless article."

But *ripoff* emerged with its new meaning 200 years later, during the early 1970s. On this university campus it became noticeable in 1971. Early that year I asked the students in my freshman English class what they thought it meant, and almost none of them knew. But *ripoff* rapidly became popular, both as a verb and as a noun, and a year later, almost every student in my freshman English class could define it. As a verb, students defined *ripoff* to mean to "rob or steal from," and it soon added the meanings "to cheat" and "to swindle." As either a noun or a verb, *ripoff* meant "swindle."

Adults, especially those who considered themselves young-at-heart, gradually adopted *ripoff*. But the term disappeared almost as quickly as it had emerged. During the 1980s it was seldom in evidence, although in 1985, *The American Heritage Dictionary*, Second College Edition, still listed it.

But today *ripoff* seems to be achieving new life while retaining its original meanings. A recent headline read, "Elderly Are Ripoff Victims." Even without a second syllable, *rip* has survived with its original senses of figurative violence, tearing, or slashing. You can "rip" a thing ("The critic ripped the silly movie"), or a person (conservative journalists have "ripped Mitt Romney for being too moderate"). The idiom *let 'er rip* has also taken on new life. Because the term has retained its earliest meaning, *rip* can no longer be a candidate for "Word of the Year," but it may have a longer life. ■

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Fay, Jody
Fedorchak, James Mark
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Ruderman, Jerold R.
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Singer, Rhonda K.
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Strauss, Hon. Forrest
Wallach, Sherry Levin
Weis, Robert A.

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Gross, John H.
Harper, Robert Matthew
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Levy, Peter H.
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McEntee, John P.
Pachman, Matthew E.
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Shulman, Arthur E.
Tollin, Howard M.
Tully, Rosemarie
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Zuckerman, Richard K.

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Lee, Chanwoo
Risi, Joseph J.
Taylor, Zenith T.
Terranova, Arthur N.
Wimpfheimer, Steven

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Marinaccio, Michael A.
Millon, Steven E.
* Pfeifer, Maxwell S.

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Cohen, Orin J.
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Hall, Thomas J.
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Mulhall, Robert A.

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† *Delegate to American Bar Association House of Delegates* * *Past President*

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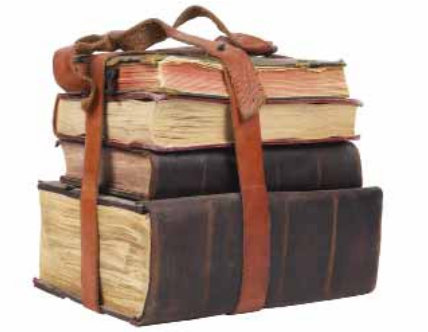

Drafting New York Civil-Litigation Documents: Part XVII — Motions to Dismiss Continued

In the last issue, Part XVI of this series, the *Legal Writer* discussed motions to dismiss, specifically three grounds for a CPLR 3211(a) dismissal motion: other action(s) pending (CPLR 3211(a)(4)); affirmative defense(s) (CPLR 3211(a)(5)); and improper counterclaim(s) (CPLR 3211(a)(6)).

The *Legal Writer* discussed CPLR 3211(a)(1), 3211(a)(2), and 3211(a)(3) in Part XV of this series.

We continue with more CPLR 3211(a) grounds, with an emphasis on CPLR 3211(a)(7) motions to dismiss for failing to state a cause of action.

Failure to State a Cause of Action Under CPLR 3211(a)(7): Overview

One of the most frequently used dismissal grounds in a civil action or proceeding in New York is that a plaintiff or counterclaimant has failed to state a cause of action under CPLR 3211(a)(7). Dismissal under CPLR 3211(a)(7) is "the equivalent of the old common law demurrer (presumably long since abandoned in New York), which conceded the truth of everything pleaded but contended that, even so, the pleading stated nothing actionable under the law."[1] The demurrer's purpose was to test a pleading's facial sufficiency.[2]

Practitioners use CPLR 3211(a)(7) in one of two ways: if the pleading is defective on its face or if a party pleads perfectly a claim but "attack[s] the merits of the cause of action."[3]

As the moving party, you may "attack the entire complaint [or counterclaim — or the petition in a summary proceeding] or target one or more of the specific causes of action."[4]

If you're attacking the pleading — the complaint or counterclaim — on its face, the court will deem the pleading's allegations to be true.[5] The court, however, won't accept as true "plainly incredible"[6] allegations. When challenging the complaint's or counterclaim's facial sufficiency, "the court's inquiry is limited to whether . . . the allegations stated any claim cognizable at law."

If you're attacking one or more causes of actions but not the entire complaint, the court's inquiry "is whether the challenged claims were stated in the complaint."[7] Under CPLR 3211(a)(7), "the word 'stated' means pleaded."[8]

On a CPLR 3211(a)(7) motion to dismiss, the court favors the nonmoving party. The court will deem the pleading to "allege whatever may be implied from its statements by fair and reasonable intendment."[9] The court will give the pleader — the plaintiff or the counterclaimant — "every favorable inference that might be drawn" from the pleading.[10] The court will decide "whether the plaintiff [or counterclaimant] can succeed on any reasonable view of the facts as stated and inferred."[11]

To succeed on a CPLR 3211(a)(7) motion to dismiss, the moving party "must convince the court that nothing the plaintiff [or counterclaimant] can reasonably be expected to prove would help; that the plaintiff [or counterclaimant] just doesn't have a claim."[12]

If documentary proof attached to the complaint contradicts the complaint's allegations, a court need not accept the documentary proof as true.[13]

> If you're attacking the pleading on its face, the court will deem the pleading's allegations to be true.

Reasons to Move Under CPLR 3211(a)(7)

Move to dismiss under CPLR 3211(a)(7) if the allegations in the complaint (or counterclaim) are conclusory and have no factual support.[14]

Move to dismiss for failure to state a cause of action when the plaintiff (or counterclaimant — or the petitioner in a summary proceeding) asserts a "novel theory of recovery in an effort to expand the law."[15] The court will then determine whether the theory of recovery exists in New York. If the court determines that the cause of action doesn't exist in New York, dismissal is warranted.[16]

If the plaintiff or counterclaimant failed to plead a necessary element of a cause of action, move to dismiss under CPLR 3211(a)(7).

Also, move under CPLR 3211(a)(7) if the plaintiff or counterclaimant failed

CONTINUED ON PAGE 56

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