New York Court of Appeals Decisions Updates

Issue 2

- No Private Right of Action under GBL §395-a
  In Schlessinger v. Valspar Corporation, 21 NY3d 166 (2013), the Second Circuit Court of Appeals asked the New York Court of Appeals "to resolve two questions regarding General Business Law § 395-a, which (with certain exceptions) forbids the termination before expiration of any 'maintenance agreement covering parts and/or service'."

- Enforceability of Restraining Notice
  In Verizon New England, Inc. v. Transcom Enhanced Services, Inc., 21 NY3d 66 (2013), the Court of Appeals considered whether "an at-will, prepayment service agreement, which lack[ed] any obligation to continue services or a commitment to engage in future dealings, constitute[d] a property interest or debt subject to a CPLR 5222(b) restraining notice". The Court of Appeals held such a restraining notice was unenforceable.

- Judgment Creditor's Rights in Turnover Proceeding
  In Commonwealth of the Northern Mariana Islands v. Canadian Imperial Bank of Commerce, 21 NY3d 55 (2013), the Court of Appeals addressed questions certified from the Second Circuit "as to whether a judgment creditor can obtain a CPLR article 52 turnover order against a bank to garnish assets held by the bank's foreign subsidiary."

- Retroactive Application of Amendment to Statute Not Allowed
  In James Square Associates LP v. Dennis Mullen, Commissioner New York State Department of Economic Development, 21 NY3d 233 (2013), the question presented to the Court of Appeals was "whether the retroactive application of the 2009 Amendments to the Empire Zones Program complie[d] with the Due Process Clause of the Fifth Amendment." The Court of Appeals concluded that the retroactive application of the 2009 Amendments violated plaintiffs' due process rights.

- Formalities of Acknowledgment in Prenup Enforced
  In Galetta v. Galetta, 21 NY3d 186 (2013), a matrimonial action, plaintiff Michelle Galetta sought a determination that a prenuptial agreement that she and defendant Gary Galetta signed was invalid due to a defective acknowledgment. The Court of Appeals determined that the parties' prenuptial agreement was indeed invalid.

- Constitutionality of Amendment to Wicks Law
  At the outset of its decision in Empire State Chapter of Associated Builders and Contractors, Inc. v. Smith, 21 NY3d 309 (2013), the Court of Appeals held that "where the Legislature has enacted a law of state-wide impact on a matter of substantial State concern but has not treated all areas of the State alike, the Home Rule section of the State Constitution does not require an examination of the reasonableness of the distinctions the Legislature has made".

- New York Cabs and the Constitutionality of the HAIL Act
  In Greater New York Taxi Association v. State of New York, 21 NY3d 289 (2013), the issue on appeal was the constitutionality of the so-called "HAIL Act," which regulates "medallion taxi cabs (or "yellow cabs") and livery vehicles, vital parts of New York City's transportation system."

- Starbucks at Center of Application of Tip-Pooling Statute
  In Baremboim v. Starbucks Corporation, 2013 NY Slip Op 04754 (June 26, 2013), the Court of Appeals answered questions posed by the United States Court of Appeals for the Second Circuit on the legality of Starbucks Corporation's tip-splitting policy under Labor Law § 196-d.

- Defect in Default Judgment – Not Jurisdictional
  In order to obtain a judgment by default, CPLR § 3215(f) requires an applicant to file "proof of the facts constituting the claim." In Manhattan Telecommunications Corporation v. H&A Locksmith, Inc. 21 NY3d 200 (2013), the Court of Appeals was faced with the question of whether non-compliance with the "proof of facts requirement" is a jurisdictional defect that nullifies a default judgment. The Court of Appeals held that the defect was not jurisdictional.

- Priority of Liens Resolved
  Altschuler Shaham Provident Funds, Ltd. v. GML Tower, LLC, 2013 NY Slip OP 04273 (June 11, 2013) was a mortgage foreclosure action that arose from a failed redevelopment of the Hotel Syracuse, complex in downtown Syracuse New York. The Court of Appeals addressed a dispute about conflicting claims of priority between "a building loan mortgage made pursuant to an unfiled building loan contract [and] subsequently-filed mechanic's liens."

- Consequences of Insurers Breach of Duty to Defend Malpractice
  In K2 Investment Group, LLC v. American Guarantee & Liability Insurance Company, 2013 NY Slip Op. 04270 (June 11, 2013), the Court of Appeals held that "when a liability insurer has breached its duty to defend its insured, the insurer may not later rely on policy exclusions to escape its duty to indemnify the insured for a judgment against him."

- Examination of "Against Public Policy" Disclaimers of Coverage
  J.P. Morgan Securities Inc. v. Vigilant Insurance Company, 21 NY3d 324 (2013), involved an "insurance dispute arising from the insured's monetary settlement of a Securities and Exchange Commission (SEC) proceeding and related private litigation predicated on the insured's violations of Federal securities laws." The Supreme Court denied the carrier's motion to dismiss. The Appellate Division reversed and dismissed the complaint. And the Court of Appeals granted leave to appeal, reversed and reinstated the complaint of the insured.

Issue 2

No Private Right of Action under GBL §395 -a

Is there a private right of action for an alleged violation of Section 395-a of the General Business Law? Answer: No.

In *Schlessinger v. Valspar Corporation*, 21 NY3d 166 (2013), the Second Circuit Court of Appeals asked the New York Court of Appeals "to resolve two questions regarding General Business Law § 395-a, which (with certain exceptions) forbids the termination before expiration of any 'maintenance agreement covering parts and/or service'." The New York Court of Appeals held that "General Business Law § 395-a does not make contract clauses that contradict its terms null and void; and that violation of section 395-a alone does not give rise to a cause of action under General Business Law § 349." *Id.*

Schlessinger and her co-plaintiff purchased furniture from Fortunoff's Department Store together with the "Guardsman Elite 5 year Furniture Protection Plan." *Id.*

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Abstract

In Schlessinger v. Valspar Corporation, 21 NY3d 166 (2013), the Second Circuit Court of Appeals asked the New York Court of Appeals "to resolve two questions regarding General Business Law § 395-a, which (with certain exceptions) forbids the termination before expiration of any 'maintenance agreement covering parts and/or service'."

Fortunoff's filed for bankruptcy; a claim was made under the plan for unspecified damages to the furniture; and, based upon a store closure provision in the plan, a full refund of the $100 plan payment was tendered.

Plaintiffs sued, in the U.S. District Court for the Eastern District of New York, for, among other things, breach of contract under General Business Law § 395-a and for damages under General Business Law § 349. The District Court Judge dismissed the complaint; Schlessinger appealed; and the Second Circuit certified the questions presented to the Court of Appeals.

The Court of Appeals held that "[u]nlike certain other provisions in the General Business Law, there is no express or implied private right of action to enforce section 395-a". Instead, the legislature chose to assign enforcement exclusively to government officials. *Id.* at 171.

As to Section 349-a, while the Court of Appeals noted that section 349(h) expressly created a private right of action thereunder, "Section 349 does not grant a private remedy for every improper or illegal business practice, but only for conduct that tends to deceive consumers [.]" *Id.* at 172. The Court of Appeals found that the conduct as to which complaint was made did not constitute a "deceptive act or practice" encompassed by Section 349.

Issue 2

Enforceability of Restraining Notice

Can a judgment creditor restrain and collect payments due under an at-will service agreement? Answer: No.

In *Verizon New England, Inc. v. Transcom Enhanced Services, Inc.*, 21 NY3d 66 (2013), the Court of Appeals considered whether "an at-will, prepayment service agreement, which lack[ed] any obligation to continue services or a commitment to engage in future dealings, constitute[d] a property interest or debt subject to a CPLR 5222(b) restraining notice". *Id.* at 68. The Court of Appeals held such a restraining notice was unenforceable.

Verizon obtained a judgment in 2009 from the United States District Court in the District of Massachusetts against Global NAPs, Inc. ("GNAPs"). In an effort to enforce the judgment against GNAPs, Verizon served a restraining notice on Transcom, with whom GNAPs did business.

Verizon commenced a special proceeding against Transcom for a turnover of property and debts that Transcom owed to GNAPs. The Supreme Court dismissed the petition, and a divided Appellate Division affirmed.

The Court of Appeals held that the Transcom agreement with GNAPs was not an attachable or assignable property because "when Transcom received the restraining notice it had an oral agreement that *if* Transcom paid GNAPs, GNAPs would provide one week's worth of services. This agreement was terminable at will, at any time, without prior notice, meaning that Transcom had no obligation after receiving one week's of services to engage GNAPs for another week's worth of services." *Id.* at 71. The Court of Appeals concluded that, "because Transcom prepaid for services to be provided by GNAPs on a week-to-week basis, without any commitment or promise for additional services, or any assurance of a continued purchase of services, Transcom neither owed any debt to, nor possessed any property of, GNAPs that could be subject to a restraint notice." *Id.* at 71-72.

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In Verizon New England, Inc. v. Transcom Enhanced Services, Inc., 21 NY3d 66 (2013), the Court of Appeals considered whether "an at-will, prepayment service agreement, which lack[ed] any obligation to continue services or a commitment to engage in future dealings, constitute[d] a property interest or debt subject to a CPLR 5222(b) restraining notice". The Court of Appeals held such a restraining notice was unenforceable.

Issue 2

Judgment Creditor's Rights in Turnover Proceeding

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Abstract

In Commonwealth of the Northern Mariana Islands v. Canadian Imperial Bank of Commerce, 21 NY3d 55 (2013), the Court of Appeals addressed questions certified from the Second Circuit "as to whether a judgment creditor can obtain a CPLR article 52 turnover order against a bank to garnish assets held by the bank's foreign subsidiary."

Can a creditor collect on a judgment against a bank by reaching assets held by a subsidiary of the bank? Answer: No.

In *Commonwealth of the Northern Mariana Islands v. Canadian Imperial Bank of Commerce*, 21 NY3d 55 (2013), the Court of Appeals addressed questions certified from the Second Circuit "as to whether a judgment creditor can obtain a CPLR article 52 turnover order against a bank to garnish assets held by the bank's foreign subsidiary." *Id.* at 57. The Court of Appeals held that "for a Court to issue a post-judgment turnover order pursuant to CPLR 5225(b) against a banking entity, that entity itself must have actual, not merely constructive, possession or custody of the assets sought [and] it is not enough that the banking entity's subsidiary might have possession or custody of a judgment debtor's assets". *Id.* at 57-58.

In 1994 the Commonwealth obtained tax judgments in the amount of more than $18 million against William and Patricia Millard. In 2011, the Commonwealth registered the tax judgments in the Southern District of New York and commenced proceedings seeking a turnover order against garnishees holding assets of the Millards. The Commonwealth sought a turnover against Canadian Imperial Bank of Commerce, "a Canadian bank headquartered in Toronto, with a branch in New York, as a garnishee under the theory that the Millards maintained accounts in [subsidiaries of the bank]", including a ninety-two percent owned Cayman Island direct subsidiary of the bank. *Id.* at 58.

CPLR § 5225(b) authorizes a special proceeding for a turnover order to enforce a judgment against an asset of a judgment debtor in the "possession or custody" of a third party. "The Commonwealth contend[ed] that the phrase 'possession or custody' inherently encompasse [d] the concept of control, and, therefore, section 5225(b) [was] applicable to garnishees with constructive possession of a judgment debtor's assets. *Id.* at 60. The Court of Appeals noted that: "the plain language of section 5225(b) refers only to 'possession or custody,' excluding any reference to 'control' [and] [t]he absence of this word is meaningful and intentional [in that] the failure of the Legislature to include a term in a statute is a significant indication that its exclusion was intended[.]". *Id.*

In this regard, the Court of Appeals noted that, unlike CPLR Section 5225(b), CPLR § 3119 provides that a subpoena may be issued to a person "in the possession, custody or control" of discoverable documents. *Id.* at 62. In conclusion, the Court of Appeals held that "because 'possession, custody or control' has been construed to encompass constructive possession, then, by contrast, legislative use of the phrase 'possession or custody' contemplates actual possession." *Id.* at 63.

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Issue 2

Retroactive Application of Amendment to Statute Not Allowed

Did the retroactive effect of an amendment to a statute constitute a violation of constitutional rights? Answer: No.

In *James Square Associates LP v. Dennis Mullen, Commissioner New York State Department of Economic Development*, 21 NY3d 233 (2013), the question presented to the Court of Appeals was "whether the retroactive application of the 2009 Amendments to the Empire Zones Program complie[d] with the Due Process Clause of the Fifth Amendment." *Id.* at 240. The Court of Appeals concluded that the retroactive application of the 2009 Amendments violated plaintiffs' due process rights.

Plaintiffs were businesses which were certified, prior to 2008, to participate in a program "to stimulate private investment, private business development, and job creation in certain geographic areas characterized by persistent poverty, high unemployment, shrinking tax bases, and dependence on public assistance[,] through a variety of state tax incentives designed to attract new businesses to the state and to enable existing businesses to expand and create more jobs." *Id.* The Legislature enacted amendments to the plan in 2009 that "were to be applied retroactively to January 1, 2008". *Id.* at 243.

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In James Square Associates LP v. Dennis Mullen, Commissioner New York State Department of Economic Development, 21 NY3d 233 (2013), the question presented to the Court of Appeals was "whether the retroactive application of the 2009 Amendments to the Empire Zones Program complie[d] with the Due Process Clause of the Fifth Amendment." The Court of Appeals concluded that the retroactive application of the 2009 Amendments violated plaintiffs' due process rights.

Pursuant to the 2009 Amendments, plaintiffs were retroactively decertified from the program. While administrative appeals were pending, plaintiffs filed an action "seeking a declaration that the decertification constituted an improper retroactive application of the 2009 Amendments". *Id.* at 243. Supreme Court granted plaintiffs' motion for summary judgment and "declared that the legislature's [retroactive decertification] as applied was an unconstitutional taking of [property]." *Id.* The Appellate Division affirmed, concluding that "the time period at issue, the lack of warning to plaintiffs, and the lack of legitimate public purpose of the retroactive application of the 2009 Amendments rendered it unconstitutional, null and void." The State appealed "on the issue of whether the 2009 Amendments can be applied retroactively." *Id.* at 245.

The Court of Appeals affirmed noting at the outset that "[f]or centuries our law has harbored a singular distrust of retroactive statutes[.]" *Id.* at 246. The Court of Appeals nevertheless held that: "the retroactive tax liability imposed in the present case cannot be characterized as so flagrant as to constitute the confiscation of property under the Takings Clause [because] [p]laintiffs had no guarantee that they would ever recoup their business investments through the receipt of tax credits, and the New York Constitution provides that tax exemptions are freely repealable[.]" *Id.* at 247.

The Court of Appeals next turned to the question of "whether plaintiffs' due process rights were infringed". The Court concluded that "the plaintiffs had no warning and no opportunity at any time in 2008 to alter their behavior in anticipation of the impact of the 2009 Amendments[;] "the legislature's overt omission of retroactivity language in the 2009 Amendments[;] and "[the State's failure] to set forth a valid public purpose were the retroactive application of the 2009 Amendments." The Court of Appeals held that there [was] no cognizable valid public purpose for the retroactive effect of the 2009 Amendments[.]" *Id.* at 248-50.

Issue 2

Formalities of Acknowledgment in Prenup Enforced

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Abstract

In Galetta v. Galetta, 21 NY3d 186 (2013), a matrimonial action, plaintiff Michelle Galetta sought a determination that a prenuptial agreement that she and defendant Gary Galetta signed was invalid due to a defective acknowledgment. The Court of Appeals determined that the parties' prenuptial agreement was indeed invalid.

Was a pre-nuptial agreement enforceable where the agreement was not properly acknowledged? Answer: No.

In *Galetta v. Galetta*, 21 NY3d 186 (2013), a matrimonial action, plaintiff Michelle Galetta sought a determination that a prenuptial agreement that she and defendant Gary Galetta signed was invalid due to a defective acknowledgment. Supreme Court denied plaintiff's motion for summary judgment; a divided Appellate Division affirmed on other grounds; and the Court of Appeals reversed, granted plaintiff's motion for summary judgment and determined that the parties' prenuptial agreement was invalid.

Domestic Relations Law § 236(B)(3) provides that to be valid and enforceable, a prenuptial agreement must be "in writing, subscribed by the parties, and acknowledged or proven in the manner required to entitle a deed to be recorded." *Id.* at 191.

Looking to the Real Property Law for guidance, the Court of Appeals noted that Section 291 thereof governs the recording of deeds and requires that "'[a] conveyance of real property… on being duly acknowledged by the person executing the same, or proved as required by this chapter,…may be recorded in the office of the Clerk of the County where such real property is situated.' *Id.* Real Property Law § 292 "requires that the party signing the document orally acknowledge to the notary public or other officer that he or she in fact signed the document. Real Property Law § 303 precludes an acknowledgment from being taken by a notary or other officer 'unless he [or she] knows or has satisfactory evidence that the person making it is the person described in and who executed such instrument." And Real Property Law § 306 compels the notary or other officer to execute 'a certificate…stating all the matters required to be done, known or proved' and to endorse or attach that certificate to the document." *Id.* at 192.

When the prenuptial agreement was signed in 1997, the form of acknowledgment of the wife's signature recited that "before me came (name of signer) to me known and known to me to be the person described in and who executed the foregoing instrument and duly acknowledged to me that s/he executed the same." *Id.* at 193.

In marked contrast, the certificate of acknowledgment of the husband's signature "inexplicably omitted" the phrase "to me known and known to me"[.]. *Id.*

Plaintiff wife claimed that the prenuptial agreement was unenforceable because the husband's acknowledgment was defective. Defendant husband claimed that the acknowledgement "substantially complied" with the requirements of the Real Property Law.

The Court noted that "[s]ince one acknowledgment included all the requisite language and the other did not, it seems likely that the omission resulted from a typographical error[,]". *Id.* at 196 The Court also characterized the "to me known and known to me" phrase as "a core component of a valid acknowledgment[.]". *Id.* at 194.

The Court of Appeals noted that "a party can rely on custom and practice evidence to fill in evidentiary gaps 'where the proof demonstrates a deliberate and repetitive practice by a person in complete control of the circumstances'[.]". *Id.* at 197. In this case, the proof of "custom and practice" to "resolve the question of whether a cure is possible" was deemed insufficient because "[i]n his affidavit, the notary public did not state that he actually recalled having acknowledged the husband's signature, nor did he indicate that he knew the husband prior to acknowledging his signature." *Id.*

While asserting that he recognized his own signature on the certificate, "the notary had no independent recollection [of the event] but maintained that it was his custom and practice 'to ask and confirm that the person signing the document was the same person named in the document,' and he was 'confident' he had done so when witnessing the husband's signature". *Id.*

The Court of Appeals concluded that "the averments presented by the notary public in this case [were] too conclusory [to demonstrate a deliberate and repetitive practice]". Instead, "the affidavit by the notary public in this case merely paraphrased the requirement of the statute – he stated it was his practice to 'ask and confirm' the identity of the signer – without detailing any specific procedure that he routinely followed to fulfill that requirement". *Id.* at 197-98.

The Court of Appeals concluded that "[a]s such, even assuming a defect in a certificate of acknowledgment could be cured under Domestic Relations Law § 236(B)(3), defendants' submission was insufficient to raise a triable question of fact as to the propriety of the original acknowledgment procedure." *Id.* at 198.

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Issue 2

Constitutionality of Amendment to Wicks Law

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Abstract

At the outset of its decision in Empire State Chapter of Associated Builders and Contractors, Inc. v. Smith, 21 NY3d 309 (2013), the Court of Appeals held that "where the Legislature has enacted a law of state-wide impact on a matter of substantial State concern but has not treated all areas of the State alike, the Home Rule section of the State Constitution does not require an examination of the reasonableness of the distinctions the Legislature has made".

May the legislature amend a law having state-wide impact to treat counties within the state in a different manner? Answer: Yes.

At the outset of its decision in *Empire State Chapter of Associated Builders and Contractors, Inc. v. Smith*, 21 NY3d 309 (2013), the Court of Appeals held that "where the Legislature has enacted a law of state-wide impact on a matter of substantial State concern but has not treated all areas of the State alike, the Home Rule section of the State Constitution does not require an examination of the reasonableness of the distinctions the Legislature has made". *Id.* at 313.

The Wicks Law relates to the requirements to be followed by public entities seeking bids on construction contracts. From its inception until 2008, "the Wicks Law applied everywhere in the State to contracts whose costs exceed $50,000." *Id.* at 314.

In 2008, the Legislature amended the Wicks Law with respect to the $50,000 threshold.

"The new, higher thresholds, unlike the old one, are not uniform throughout the State. They are $3 million in the five counties located in New York City; $1.5 million in Nassau, Suffolk and Westchester Counties; and $500,000 in the other 54 counties." *Id.* Plaintiffs' challenged the 2008 amendment as violating the State Constitution (the so-called Home Rule section) "by unjustifiably favoring the eight counties with higher thresholds – i.e., by loosening Wicks Law restrictions to a greater extent for them than for other counties." *Id.* Supreme Court dismissed the complaint; and a divided Appellate Division affirmed.

The State Constitution provides, in substance, that "every local government shall have power to adopt and amend local laws not inconsistent with the provisions of this Constitution or any general law relating to its property, affairs or government". *Id.* at 316.

The Home Rule section of the State Constitution provides that the legislature "[s]hall have the power to act in relation to the property, affairs or government of any local government only by general law, or by special law only [in the following circumstances]": either based upon a Home Rule message from the Legislature or a certificate of necessity from the Governor." *Id.* Neither of the prerequisites were obtained in this case. To the contrary, the 2008 amendments to the Wicks Law was based upon an argument that such an amendment was permitted without a "Home Rule message" or certificate of necessity from the Governor where the subject "is a matter of substantial State concern". *Id.* at 317.

The Court of Appeals held that “the manner of bidding on public construction contracts is a matter of substantial State concern [and the amendments] though they do not treat all counties alike unquestionably affect the State as a whole.” *Id.*

The Court of Appeals noted that: “to subject legislation like the 2008 amendments to the Wicks Law to Home Rule analysis would lead us into a wilderness of anomalies. If state-wide legislation like this is subject to Home Rule restrictions, how are the restrictions to be implemented? From where must a home rule message come?” *Id.* at 319.

Accordingly, the Court of Appeals concluded that “the Home Rule provisions of the Constitution were never intended to apply to legislation like this. They were intended to prevent unjustifiable State interference in matters of purely local concern. No one contends such interference has occurred here.” *Id.* [Parenthetically, the Court of Appeals also held that several of plaintiffs’ claims relating to the apprenticeship provisions of the 2008 legislation arguably unconstitutionally discriminated against out-of-state contractors.]

Issue 2

New York Cabs and the Constitutionality of the HAIL Act

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Abstract

In Greater New York Taxi Association v. State of New York, 21 NY3d 289 (2013), the issue on appeal was the constitutionality of the so-called "HAIL Act," which regulates "medallion taxi cabs (or "yellow cabs") and livery vehicles, vital parts of New York City's transportation system."

May the legislature amend the law relating to taxi/livery service in New York City without the approval of the City Council? Answer: Yes.

In *Greater New York Taxi Association v. State of New York*, 21 NY3d 289 (2013), the issue on appeal was the constitutionality of the so-called "HAIL Act," which regulates "medallion taxi cabs (or "yellow cabs") and livery vehicles, vital parts of New York City's transportation system." *Id.* at 296.

According to the Court of Appeals: "the Act's stated aim is to address certain mobility deficiencies in the City of New York, namely: the lack of accessible vehicles for residents and non-residents with disabilities; the dearth of available yellow cabs in the four boroughs outside of Manhattan ('outer boroughs') where residents and non-residents must instead rely on livery vehicles; and the sparse availability of yellow cab service outside Manhattan's central business district and the two Queens airports, locations where close to 95% of yellow cabs pick up their customers[.]" *Id.*

Yellow cabs operate under a license or medallion affixed to the outside of the taxi cab as proof that the taxi has been licensed to operate by the Taxi and Limousine Commission.

The New York State Legislature delegated to the New York City Council "the discretionary authority to register, license and limit the number of yellow cabs, and to establish ordinances and regulations [on] parking and passenger pick-ups and discharges[.]" *Id.* at 297.

As the Court of Appeals noted: "in contrast to yellow cabs, livery vehicles are prohibited from picking up street hails and may accept passengers only on the basis of telephone contact or other pre-arrangement[.]". *Id.* The Court of Appeals also noted that: "this [rule] has not prevented some livery vehicles from illegally accepting street hails." *Id.* The problem is that the price of the fare of livery vehicles is not regulated as with yellow cabs, and "a substantial number of livery vehicles are ill-equipped to provide service to persons with disabilities." *Id.*

The legislature adopted the HAIL license program "that calls for the [Taxi and Limousine Commission] to issue 18,000 "'**H**ail **A**ccessible **I**nter-borough **L**icenses'" allowing 'for-hire vehicles', i.e., livery vehicles to accept street hails in the outer boroughs and those areas in Manhattan outside its central business district[.]" *Id.* at 297-98 Yellow cabs retained the exclusive right to pick up street-hailing passengers in Manhattan's central business district and at the two Queens airports.

Plaintiffs, medallion owners, their representatives and others challenged the HAIL act "on the ground that the regulation of yellow cabs and livery enterprises has always been a matter of local concern"; and that the HAIL Act violated the so-called "Municipal Home Rule Clause" of the New York State Constitution. *Id.* at 300.

The Supreme Court granted the plaintiffs' motion for summary judgment and nullified the HAIL Act. The parties stipulated to a direct appeal to the Court of Appeals on constitutional grounds.

Plaintiffs challenged the HAIL Act "on the ground that the State lack[ed] a substantial interest in the regulation of the yellow cab and livery enterprises in the City, claiming that such regulation has historically been within the province of the City itself[.]" *Id.* at 301. The Court of Appeals noted that the Municipal Home Rule clause and the New York State legislation delegating authority to the New York City Council "does not mean that [the State] has surrendered its authority to regulate in that area, particularly where the proposed regulation promotes a substantial State in interest[.]" *Id.* at 302.

In this regard, the Court of Appeals determined that:

> "the HAIL Act addresses a matter of substantial concern. This not a purely local issue. Millions of people from within and without the State visit the City annually. Some of these visitors are disabled, and will undoubtedly benefit from the increase of accessible vehicles in the Manhattan central business district and in the outer boroughs. The Act is for the benefit of all New Yorkers, and not merely those residing within the City. Efficient transportation services in the State's largest City and international center of commerce is important to the entire State. The Act plainly furthers all of these significant goals.

The Court of Appeals then concluded that "not only does the Act, including its challenged provisions, address substantial State concerns, but it also 'bear[s] a reasonable relationship' to those concerns." *Id.* at 306. Accordingly, the Court of Appeals held that "Supreme Court erred in concluding that the Act violates the municipal Home Rule Clause[.]" *Id.*

Issue 2

Defect in Default Judgment – Not Jurisdictional

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Abstract

In order to obtain a judgment by default, CPLR § 3215(f) requires an applicant to file "proof of the facts constituting the claim." In Manhattan Telecommunications Corporation v. H&A Locksmith, Inc. 21 NY3d 200 (2013), the Court of Appeals was faced with the question of whether non-compliance with the "proof of facts requirement" is a jurisdictional defect that nullifies a default judgment. The Court of Appeals held that the defect was not jurisdictional.

May a trial court enter a default judgment where the plaintiff (creditor) has failed to submit facts constituting the claim? Answer: Yes.

In order to obtain a judgment by default, CPLR § 3215(f) requires an applicant to file "proof of the facts constituting the claim." In *Manhattan Telecommunications Corporation v. H&A Locksmith, Inc.* 21 NY3d 200 (2013), the Court of Appeals was faced with the question of whether non-compliance with the "proof of facts requirement" is a jurisdictional defect that nullifies a default judgment. The Court of Appeals held that the defect was not jurisdictional. *Id.* at 202.

Manhattan Telecommunications sued several defendants to whom the company claimed it had provided telephone services pursuant to written agreements for which the company had not been paid. Copies of the agreements were not attached to the verified complaint. All defendants defaulted and default judgments were entered.

Ariq Vanunu moved to vacate the default judgment against him "asserting that his default was excusable and that he had meritorious defenses to the action". *Id.* Supreme Court denied the motion finding inexcusable delay in moving to vacate the default. The Appellate Division reversed. And then the Court of Appeals reversed the Appellate Division.

The Court of Appeals stated that "the Appellate Division was correct in holding that [the] plaintiff's complaint, though verified, failed to supply 'proof of the facts constituting the claim' against Vanunu, as CPLR § 3215(f) requires." *Id.* at 203. However, the Court continued "[while] the default judgment was defective...not every defect in a default judgment requires or permits a Court to set it aside". *Id.* The Court of Appeals continued: "the defect in the default judgment before us is not jurisdictional in [that Supreme Court lacked jurisdiction to enter the default]. A failure to submit the proof required by CPLR § 3215(f) should lead a Court to deny an application for a default judgment, but a Court that does not comply with this rule has merely committed an error – it has not usurped a power it does not have. The error can be corrected by the means provided by law – i.e., by an application for the relief from the judgment pursuant to CPLR § 5015. *Id.* 203-4.

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Issue 2

Starbucks at Center of Application of Tip-Pooling Statute

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Abstract

In Baremboim v. Starbucks Corporation, 2013 NY Slip Op 04754 (June 26, 2013), the Court of Appeals answered questions posed by the United States Court of Appeals for the Second Circuit on the legality of Starbucks Corporation's tip -splitting policy under Labor Law § 196-d.

May an employer's tip-splitting policy include workers with limited supervisory duties? Answer: Yes.

In *Baremboim v. Starbucks Corporation*, 2013 NY Slip Op 04754 (June 26, 2013), the Court of Appeals answered questions posed by the United States Court of Appeals for the Second Circuit on the legality of Starbucks Corporation's tip-splitting policy under Labor Law § 196-d.

That Labor Law provision, in substance, prohibits an employer, its agent or officers from demanding or sharing in gratuities received by employees.

Plaintiffs "brought a putative class action in the United States District Court for the Southern District of New York alleging that Starbucks' policy of including shift supervisors in the tip pools was unlawful under Labor Law § 196-d[.]" *Id.* at 2. The District Court dismissed the suit. At the same time, the District Court, in a parallel action, "concluded that there was a triable issue of fact as to whether assistant store managers are tip-pool eligible." *Id.* at 3.

Upon appeal, the Second Circuit certified a series of "unresolved questions of New York law" to the Court of Appeals. *Id.* In 2011, the New York State Department of Labor issued a "Hospitality Industry Wage Order" that clarified that "an employee's ability to participate in a tip pool [under § 196-d] 'shall be based upon duties and not titles' and codified that the Department's] long-standing construction of § 196-d as limiting tip-pool eligibility to workers who 'performed, or assist in performing personal service to patrons at a level that is a principle and regular part of their duties and is not merely occasional or incidental'." *Id.* at 6.

The Court of Appeals concluded that "employer-mandated tip splitting should be limited to employees who, like waiters and busboys, are ordinarily engaged in personal customer service, a rule that comports with the 'expectation[s] of the reasonable customer'[.]". *Id.* at 7. The Court also noted that "the [Department] has consistently and, in our view, reasonably maintained that employees who regularly provide direct service to patrons remain tip-pool eligible even if they exercise a limited degree of supervisory responsibility." *Id.* Accordingly, the Court of Appeals concluded that "an employee whose personal service to patrons is a principal or regular part of his or her duties may participate in an employer-mandated tip allocation arrangement under Labor Law § 196-d, even if that employee possesses limited supervisory responsibilities. But an employee granted meaningful authority or control over subordinates can no longer be considered similar to waiters and busboys within the meaning of section 196-d and, consequently, is not eligible to participate in a tip pool." *Id.* at 8.

Issue 2

Priority of Liens Resolved

Does a subsequently-filed mechanic's lien take priority over an improperly-filed building loan mortgage? Answer: Yes.

Altschuler Shaham Provident Funds, Ltd. v. GML Tower, LLC, 2013 NY Slip OP 04273 (June 11, 2013) was a "mortgage foreclosure action [that arose] from a failed redevelopment of the Hotel Syracuse, complex in downtown Syracuse New York." *Id.* at 1. The Court of Appeals addressed a dispute about conflicting claims of priority between "a building loan mortgage made pursuant to an unfiled building loan contract [and] subsequently-filed mechanic's liens[.]" *Id.* at 4.

The Court of Appeals summarized that:

> "Section 22 of the Lien Law requires that a building loan contract, with or without the sale of land and before or simultaneously with the recording of a building loan mortgage made pursuant to it, must be filed in the clerk's office of the county where the land subject to the contract is located along with a borrower's affidavit stating the consideration paid or to be paid for the loan, any expenses incurred or to be incurred in connection with the loan, and the net sum available for the construction project." *Id.* at 6.

The Court of Appeals admonished that "[s]ection 22 also mandates the filing of any subsequent modifications of a building loan contract [be made] within 10 days after their execution." *Id.*

And the Court of Appeals finally concluded that "[f]ailure to comply with these filing requirements changes the ordinary priority of liens, with a properly filed mechanic's lien taking priority over the interests of the parties to the contract [and that] a construction lender must file the building loan contract in order to achieve lien priority, or, put the opposite way, the statute imposes a so-called 'subordination penalty' on a lender who does not [comply]." *Id.* at 6-7.

Authors

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Abstract

Altschuler Shaham Provident Funds, Ltd. v. GML Tower, LLC, 2013 NY Slip OP 04273 (June 11, 2013) was a mortgage foreclosure action that arose from a failed redevelopment of the Hotel Syracuse, complex in downtown Syracuse New York. The Court of Appeals addressed a dispute about conflicting claims of priority between "a building loan mortgage made pursuant to an unfiled building loan contract [and] subsequently-filed mechanic's liens."

Issue 2

Consequences of Insurers Breach of Duty to Defend Malpractice

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Abstract

In K2 Investment Group, LLC v. American Guarantee & Liability Insurance Company, 2013 NY Slip Op. 04270 (June 11, 2013), the Court of Appeals held that "when a liability insurer has breached its duty to defend its insured, the insurer may not later rely on policy exclusions to escape its duty to indemnify the insured for a judgment against him."

May a liability insurance carrier that breached its duty to defend thereafter refuse to pay a judgment based upon a policy exclusion? Answer: No.

In *K2 Investment Group, LLC v. American Guarantee & Liability Insurance Company*, 2013 NY Slip Op. 04270 (June 11, 2013), the Court of Appeals held that "when a liability insurer has breached its duty to defend its insured, the insurer may not later rely on policy exclusions to escape its duty to indemnify the insured for a judgment against him [.]" *Id.* at 1-2.

Plaintiffs made two mortgage-secured loans totaling $2.83 million to Goldan, LLC. After Goldan defaulted, plaintiffs learned that the mortgages had not been recorded. Goldan was subsequently forced into bankruptcy.

According to the Court of Appeals: "Plaintiffs brought a lawsuit against Goldan and two of its principals, Mark Goldman and Jeffrey Daniels, asserting a number of claims. One claim was asserted by each plaintiff against Daniels, a lawyer, for legal malpractice. Plaintiffs alleged that Daniels acted as their attorney with respect to their loans to Goldan, and that his failure to record the mortgages was 'a departure from good and accepted legal practice'." *Id.* at 2.

After receiving notice of the malpractice claim from Daniels, American Guarantee, his malpractice carrier, refused to provide "either defense or indemnity coverage". *Id.* One of the stated reasons for denial of coverage was that "the allegations [of the claims] against Daniels '[were] not based on the rendering or [failing] to render legal services for others[.]" *Id.*

After this disclaimer was sent, a settlement demand on Daniels was made for $450,000 – significantly less than the $2 million limit of American Guarantee's policy. Daniels sent the demand to American Guarantee, which rejected it stating the same reasoning as before. *Id.*

Plaintiffs adverse to Daniels subsequently obtained a default judgment on the malpractice claims against Daniels in excess of the $2 million limit. Daniels thereafter "assigned to plaintiffs all of his rights against American Guarantee and plaintiffs, as Daniels's assignees, brought the present action against American Guarantee for breach of contract and bad faith for failure to settle the underlying lawsuit." *Id.*

Upon cross motions for summary judgment, the Supreme Court granted Daniels' breach of contract claims, holding that "American Guarantee breached its duty to defend Daniels, and was therefore bound, up to the $2 million limit of its policy to pay the resulting judgment against him." *Id.* at 3. The Supreme Court dismissed the bad faith claims, and a divided Appellate Division affirmed.

The Court of Appeals affirmed summary judgment "in plaintiffs' favor on the breach of contract claims[.]". *Id*. The Court of Appeals held that, "by breaching its duty to defend Daniels, American Guarantee lost its right to rely on [certain policy] exclusions in litigation over its indemnity obligation." *Id*.

The Court of Appeals noted that "it is well settled that an insurance company's duty to defend is broader than its duty to indemnify" [and that] when an insurer has breached its duty to defend and is called upon to indemnify its insured for a judgment entered against it, the insurer may not assert in its defense grounds that would have defeated the underlying claims against the insured[.]" *Id*.

In conclusion the Court of Appeals admonished that "an insurance company that has disclaimed its duty to defend 'may litigate only the validity of its disclaimer'. If the disclaimer is found bad, the insurance company must indemnify its insured for the resulting judgment, even if policy exclusions would otherwise have negated the duty to indemnify." *Id*. Explaining the rationale for the decision, the Court of Appeals stated that "this rule will give insurers an incentive to defend the cases they are bound by law to defend, and thus give insureds the full benefit of their bargain. It would be unfair to insureds, and would promote unnecessary and wasteful litigation, if an insurer, having wrongfully abandoned its insured's defense, could then require the insured to litigate the effect of policy exclusions on the duty to indemnify". *Id*.

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Issue 2

Examination of "Against Public Policy" Disclaimers of Coverage

Authors

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Abstract

J.P. Morgan Securities Inc. v. Vigilant Insurance Company, 21 NY3d 324 (2013), involved an "insurance dispute arising from the insured's monetary settlement of a Securities and Exchange Commission (SEC) proceeding and related private litigation predicated on the insured's violations of Federal securities laws." The Supreme Court denied the carrier's motion to dismiss. The Appellate Division reversed and dismissed the complaint. And the Court of Appeals granted leave to appeal, reversed and reinstated the complaint of the insured.

May an insured pursue claims against a carrier arising from an SEC suit for disgorgement of funds? Answer: Yes.

J.P. Morgan Securities Inc. v. Vigilant Insurance Company, 21 NY3d 324 (2013), involved an "insurance dispute arising from the insured's monetary settlement of a Securities and Exchange Commission (SEC) proceeding and related private litigation predicated on the insured's violations of Federal securities laws." *Id.* at 330. The Supreme Court denied the carrier's motion to dismiss. The Appellate Division reversed and dismissed the complaint. And the Court of Appeals granted leave to appeal, reversed and reinstated the complaint of the insured.

In addition to the SEC action, Bear Stearns, a subsidiary of JP Morgan, was named as a defendant in a number of private class action lawsuits brought by various mutual funds based on similar "late trading" and other "market timing allegations." *Id.* at 331. Bear Stearns settled with the SEC for $250 million and the private actions for $14 million. Bear Stearns also alleged that the cost of defending the SEC proceeding and the private actions amounted to $40 million.

Subsequently, Bear Stearns sought indemnification from its primary carrier and excess carriers for three claims:

- $160 million SEC disgorgement payment (less a $10 million self-insured detention);
- $40 million in defense costs; and
- $14 million private settlement.

Bear Stearns did not seek coverage for the $90 million SEC penalty. *Id.* at 332.

The insurers denied coverage on all claims and Bear Stearns sued for breach of contract and a declaratory judgment. "The [i]nsurers moved to dismiss the complaint…arguing, among other things, that Bear Stearns could not be indemnified for any portion of the SEC disgorgement payment as a matter of public policy." *Id.* at 333

The Court of Appeals:

> "recognized two situations in which a countervailing public policy will override the freedom to contract, thereby precluding enforcement of an insurance agreement. First, an insurer may not indemnify an insured for a punitive

> damages award, and a policy provision purporting to provide such coverage is unenforceable... The rationale underlying the public policy exception emphasizes that allowing coverage 'would defeat the purpose of punitive damages, which is to punish and to deter others from acting similarly'...Second, as a matter of public policy, an insured may not seek coverage when it engages in conduct 'with the intent to cause injury'..." [citations omitted]. *Id.* at 334-35.

As to the public policy exception principles, Bear Stearns:

> "urge[d] that they do not prohibit coverage here since the bulk of the disgorgement payment – approximately $140 million – represented the improper profits acquired by third-party hedge fund customers, not revenue that Bear Stearns itself pocketed. Put differently, Bear Stearns allege[d] that much of the payment, although labeled disgorgement by the SEC, did not actually represent the disgorgement of its own profits [and submitted] that the rule precluding coverage for disgorgement should apply only where the insured requests coverage for the disgorgement for its own illicit gains." *Id.* at 336.

While noting that "we certainly do not condone the late trading and market timing activities described in the SEC order," the Court of Appeals concluded that the defendant insurers "ha [d] not met their heavy burden of establishing, as a matter of law on their CPLR 3211 dismissal motions, that Bear Stearns is barred from pursuing insurance coverage under its policies." *Id.* at 338.