Appellate Division Review

Stream of Decisions Includes Advances in E-Discovery and Insurance

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While closing out a dry month bereft of the storied April showers, we observe that last year, in contrast, was New York City's wettest year on record. Rainfall in New York for 2011 reached a remarkable 72.81 inches, more than twice the total precipitation than consistently clammy Seattle.

During the first quarter of 2012, despite drought elsewhere, the Appellate Division's four departments provided the profession with a steady shower of decisions. Below, we discuss some key advancements from New York's jurisprudential rainmakers.

First Department

E-Discovery

The strict federal standards governing a party's obligation to preserve electronic documents prior to litigation apply in state court, a unanimous panel of the First Department ruled. In *VOOM HD Holdings v. EchoStar Satellite*,[1] the court warned counsel and clients that "[o]nce a party reasonably anticipates litigation, it must, at a minimum, institute an appropriate litigation hold to prevent the routine destruction of electronic data."

The dispute arose after EchoStar, a satellite broadcaster, agreed to carry VOOM's channels. EchoStar asserted that VOOM was in breach of the contract and, in June 2007, sent VOOM a demand letter. "[E]xtremely concerned" that the matter would end up in litigation, VOOM implemented a litigation hold in July 2007, including the automatic preservation of e-mails. EchoStar formally terminated the contract in January 2008, and VOOM sued it the next day. However, EchoStar did not implement a litigation hold until after VOOM filed suit, and did not suspend its computer system's automatic deletion of e-mails until four months after litigation had commenced.

Citing *Zubulake v. UBS Warburg*,[2] a widely followed federal case on electronic evidence preservation, the First Department upheld spoliation sanctions against EchoStar. In an opinion for a unanimous panel, Justice Sallie Manzanet-Daniels ruled that EchoStar was required to act affirmatively to preserve its documents from at least June 2007, when it first sent a demand letter.

The duty to preserve evidence is triggered "when a party is on notice of a credible probability that it will become involved in litigation," the First Department held. The court viewed that rule as reflecting "the reality of how business relationships

disintegrate." Even while parties appear to be negotiating a resolution, Justice Manzanet-Daniels observed, they may be "preparing frantically for litigation behind the scenes." Deferring the preservation duty until litigation is commenced "would encourage parties who actually anticipate litigation, but do not yet have notice of a 'specific claim' to destroy their documents with impunity."

In a subsequent case decided in February, the First Department refined the e-discovery rule by applying the *Zubulake* framework to discovery cost allocations. Writing on behalf of a unanimous panel in *U.S. Bank Nat'l Ass'n v. GreenPoint Mortg. Funding*,[3] Justice Rolando Acosta stated that "*Zubulake* presents the most practical framework for allocating all costs in discovery, including document production and searching for, retrieving, and producing" electronically stored information. The First Department noted that, although the producing party bears the initial costs of e-discovery, those costs may be shifted between the parties in the court's discretion, using various factors set forth in *Zubulake* as a guide.

Insurance Law

Liability insurers who deny coverage based on untimely notice were themselves held to a strict timeliness standard by the First Department in *George Campbell Painting v. National Union Fire Ins.*[4] In a unanimous decision authored by Justice David Friedman, the First Department held that written notice of a disclaimer of liability coverage cannot be deferred while other possible grounds for denial are investigated.

The underlying dispute involved a workplace injury during renovation of the Henry Hudson Bridge. The injured subcontractor sued George Campbell Painting, the general contractor, to recover for his injuries. Campbell did not notify its excess insurer, National Union Fire Insurance Co. (NUFIC), until a year after it first became aware of the potential need for excess coverage. Although NUFIC's policy required timely notice, NUFIC did not reject Campbell's year-old claim immediately. Instead, it engaged in extended communications with Campbell that included requests for additional information before finally rejecting the claim due to late notice.

Campbell sued for a declaration that NUFIC's late-notice disclaimer was itself untimely under Insurance Law §3420(d)(2), which requires a liability insurer to give the insured written notice of disclaimer of a personal injury claim "as soon as is reasonably possible." Overturning its prior precedent,[5] the First Department held that the statute "precludes an insurer from delaying issuance of a disclaimer on a ground that the insurer knows to be valid—here, late notice of the claim—while investigating other possible grounds for disclaiming." Because NUFIC "had no right to delay disclaiming on the late-notice ground," Justice Friedman wrote, NUFIC's disclaimer "was ineffective as a matter of law."

Reinsurance Law

Affirming a $420 million judgment against reinsurers, the First Department clarified the application of the "follow-the-fortunes" doctrine in *United States Fidelity & Guaranty v. American Re-Insurance*.[6] The appellate court required the reinsurers to cover an insurer's settlement of asbestos claims that was "at least arguably within the scope of the insurance coverage that was reinsured."

The decision stemmed from a 2002 settlement, in which United States Fidelity & Guaranty Company (USF&G) and other insurers paid $987.3 million to satisfy all asbestos-related claims against Western MacArthur Company. USF&G's reinsurers denied its claim against them, and contended that USF&G acted in bad faith.

In a 4-1 decision authored by Justice Acosta, the First Department concluded that the follow-the-fortunes doctrine required the reinsurers to accept USF&G's reinsurance presentation. Under that doctrine, the court explained, "the reinsurer agrees to follow the insurer's financial obligations (fortunes), wherever they lead either company." Thus, the reinsurers were prohibited from "second guess[ing] USF&G's decisions" concerning allocation of the loss and other points to which the reinsurers had taken exception.

Second Department

Judicial Diversion

To be eligible for judicial diversion, in which defendants may be removed from the criminal process and placed in treatment for drug or alcohol abuse, the defendant need not prove that he is a "low-level offender" or that substance abuse was the "exclusive or primary cause" of his criminal behavior. Instead, the Second Department ruled in *People v. DeYoung*[7] that judicial diversion

may apply to crimes as serious as class B felonies, and the defendant need only show that substance abuse was "a contributing factor" to the offense.

The defendant Charles DeYoung was charged with a class C felony for smuggling large quantities of marijuana in exchange for a payment of $5,000. A court-ordered alcohol and substance abuse evaluation revealed a long and continuing history of chemical dependence. The evaluator ultimately found, however, that DeYoung used the money from his crime "to pay rent, bills and insurance" in addition to purchasing marijuana and alcohol. On that ground, the Orange County Court denied judicial diversion.

The Second Department reversed,in a unanimous decision written by Justice Plummer E. Lott. To support judicial diversion under the Drug Law Reform Act of 2009, the court held, substance abuse must be "a contributing factor" in the defendant's criminal behavior, not necessarily "the exclusive or primary cause." Because the record revealed that all the factors supporting judicial diversion were present, the Appellate Division held that defendant's application for judicial diversion should have been granted.

Third Department

Service of Process

The Hague Convention authorizes service of process on foreign parties by mail, the Third Department held in *New York State Thruway Authority v. Fenech*,[8] reversing its prior position and aligning itself with the Second and Fourth departments. Article 10(a) of the Hague Convention preserves a litigant's "freedom to send judicial documents, by postal channels, directly to persons abroad," absent objection by the destination state. Some courts have held that the word "send" refers to something other than service of process. That has been the Third Department's position since 1985.[9]

Writing for the unanimous panel, Justice Thomas E. Mercure "revisited" that rule, changed it, and explained why a new direction was warranted. While Article 10(a) refers to "the freedom to send judicial documents," he wrote, the Hague Convention itself is limited to service of process. Thus, if Article 10(a) were interpreted as applying only to documents sent, but not served, the provision would become "meaningless." Additionally, the Third Department observed, the Hague Convention's negotiating history reveals that its drafters intended Article 10(a) to encompass service of process.

Municipal Reorganization

Making it easier to fight City Hall by changing local government, the Third Department has held that a ballot measure to reorganize city government does not require a "fiscal note," i.e., a plan to fund any proposed expenditures.

The petitioners in *Saratoga Citizen v. Franck*[10] had proposed a local law to change the government of the City of Saratoga from its current strong mayoral structure to a city manager form. The City Clerk determined that the proposal did not comply with the Municipal Home Rule Law because it did not include the required fiscal note.

Writing for a unanimous court, Justice Edward O. Spain disagreed. The Home Rule statute usually requires that a petition for a proposed local law include a fiscal note. That requirement, however, excludes proposed laws seeking "to reorganize the functions of city government...[by] rel[ying] partly or solely on normal budgetary procedures to provide the funding for the city's expenses under such reorganization," so long as the proposal does not "require specific salaries or the expenditure of specific sums of money not theretofore required."[11]

In this case, even though the proposed measure specified the salaries of certain officials, those proposed salaries would have reduced Saratoga's payroll by $88,500. Therefore, the Third Department concluded, the proposed expenditures were "already required by the current charter" and the reorganization could rely on "normal budgetary procedures" to fund the city's expenses. Citing the statute's legislative history, Justice Spain made clear that the fiscal note requirement should not "stand in the way of a general charter revision or...require new sources of revenues when the normal budgetary procedure is adequate."

Fourth Department

Search and Seizure

May a county court issue an order to collect a DNA sample without notice to the defendant, with the result that police officers approach the defendant on the street, handcuff him, transport him to the police station,

and taser him until he opens his mouth for a buccal swab? In *People v. Smith*,[12] a 4-1 decision authored by Justice Erin M. Peradotto, the Fourth Department answered that question with a firm "no."

DNA samples are "corporeal evidence," and thus a buccal swab (obtained from the inside of the cheek) is still a search and seizure, the Fourth Department explained. In this case, the defendant's DNA was thought to match that of suspects in three armed robberies. The Niagara County Court issued an order to show cause to obtain a buccal swab, and the defendant submitted. But, the first DNA sample was sent to the wrong lab and was "compromised." The County Court therefore issued a second order—this time, without notice to the defendant. Police in Niagara Falls then proceeded to execute the order forcibly.

The Fourth Department suppressed the DNA evidence. Because there were no exigent circumstances, the court ruled that an order to obtain a DNA sample had to be made "upon notice to the suspect." Further, tasering the defendant into submission to obtain the swab was "objectively unreasonable" under the circumstances. The defendant "did not threaten, fight with or physically resist the officers," the Appellate Division observed. Rather, he simply refused to open his mouth.

Endnotes

1 2012 N.Y. Slip Op. 00658 (1st Dept. Jan. 31, 2012).

2 220 F.R.D. 212, 218 (S.D.N.Y. 2003).

3 2012 N.Y. Slip Op. 01515 (1st Dept. Feb. 28, 2012).

4 2012 N.Y. Slip Op. 00254 (1st Dept. Jan. 17, 2012).

5 *DiGuglielmo v. Travelers Prop. Cas.*, 6 A.D.3d 344 (1st Dept. 2004).

6 2012 N.Y. Slip Op. 00421 (1st Dept. Jan. 24, 2012).

7 2012 N.Y. Slip Op. 02112 (2d Dept. March 20, 2012).

8 2012 N.Y. Slip Op. 01167 (3d Dept. Feb. 16, 2012).

9 See *Reynolds v. Woosup Koh*, 109 A.D.2d 97 (3d Dept. 1985).

10 2012 N.Y. Slip Op. 02556 (3d Dept. April 5, 2012).

11 Municipal Home Rule Law §37(11).

12 2012 N.Y. Slip Op. 01896 (4th Dept. March 16, 2012).

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