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Appellate Division Review

Departments Addressed Matters of First Impression in the Fourth Quarter

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As viewers of the 2017 College Football National Championship well know, the fourth quarter is often when the real excitement happens. Based on the Justices' recent opinions, the same could be said of the Appellate Division. Below are some of the 2016 fourth quarter highlights from the four Departments.

First Department

Inspection of Books and Records. In a decision of apparent first impression, the First Department held in *Matter of Pokoik v. 575 Realties*[1] that shareholders' common law right to inspect books and records extends to the books and records of the corporation's whollyowned subsidiaries.

The petitioners, shareholders of 575 Realties (575), sought to inspect the books and records of 575 and its wholly-owned subsidiary in order to "investigate possible fiduciary mismanagement and wasteful dissipation of corporate assets through the payment of excessive salaries and compensation." Supreme Court denied the petition as to the subsidiary on the grounds that the petitioners were not direct shareholders.

In a unanimous, unsigned opinion, the First Department reversed. Although there was no evidence that corporate formalities were not followed, the respondents did not refute petitioners' allegations that 575 and its subsidiary shared offices and management and were both dominated by certain family members. Moreover, 575 had no employees or payroll of its own, paid no salaries or workers' compensation insurance, and issued no Forms W-2. On these facts, at least, the court concluded the petitioners had established their common law right to inspect the subsidiary's books and records. A contrary rule "would allow respondents to shield their alleged misdeeds from scrutiny," because the subsidiary's books and records would "never be discoverable by anyone other than 575's board of directors."

In Pari Delicto. The Bernard L. Madoff investment scandal continues to generate interesting case law. In the recent decision in *New Greenwich Litigation Trustee v. Citco Fund Services (Europe) B.V.*,[2] the First Department held that claims asserted by the bankruptcy trustee of certain Madoff feeder funds were barred by the in pari delicto doctrine, which "mandates that the courts will

not intercede to resolve a dispute between two wrongdoers."

Limited partners of the funds originally brought derivative actions against the funds' manager, former administrators and external accountants and auditors for failing to conduct adequate due diligence of Madoff Securities. Following the funds' own bankruptcy proceeding, the funds' bankruptcy trustee filed amended complaints against the administrators, accountants and auditors. Unlike the original, derivative complaints against the manager, the amended complaints alleged that the funds were not responsible for, and had no knowledge of, Madoff's Ponzi scheme. Notwithstanding this new allegation, Supreme Court strictly applied the in pari delicto doctrine and dismissed the trustee's claims.

In a unanimous opinion by Justice Peter Tom, the First Department affirmed. The court explained that, notwithstanding the trustee's own "innocence," the trustee "stands in the funds' shoes, and is subject to a defense based on the in pari delicto doctrine to the same extent as the funds" themselves. The court held the trustee to the derivative complaints' allegations of "the funds' imputed wrongdoing," which "are at least equal to those asserted against the [administrator, accountant and auditor] defendants in the amended complaints." The court also refused to apply the "adverse interest" exception (applicable where an agent has "*totally abandoned* his principal's interests and [is] acting *entirely* for his own or another's purposes") because the conduct of the manager "enabled the funds to continue to survive and to attract investors."

Second Department

Access to Courts. CPLR §§8501(a) and 8503 require nonresident plaintiffs to post security for the costs for which they would be liable if their lawsuits are unsuccessful. In *Clement v. Durban*,[3] the Second Department was presented with the "constitutional issue of first impression in the appellate courts" of whether these provisions violate the Privileges and Immunities Clause of the U.S. Constitution.

Clement arose from a motor vehicle accident in Brooklyn. During the pendency of the action, the plaintiff moved to Georgia, leading the defendants to move for an order directing plaintiff to post $500 security for costs. Plaintiff countered that the security requirement deprived outof-state plaintiffs of reasonable access to New York courts in violation of the Privileges and Immunities Clause. Supreme Court ruled for defendants.

In a unanimous opinion by Justice Thomas A. Dickerson, the Second Department affirmed. The court noted that "the Privileges and Immunities Clause is satisfied so long as a resident is given access to the courts of the State upon terms which in themselves are reasonable and adequate for the enforcing of any rights he [or she] may have." The Second Department held that the "modest" amount of security was indeed reasonable because "nonresident plaintiffs are unlikely to have assets in New York that may be used to enforce a costs judgment." Furthermore, the court concluded that CPLR §§8501(a) and 8503 do not impose higher costs on nonresident plaintiffs because security is not a cost: Once the lawsuit is brought to conclusion, "a nonresident plaintiff is in the same position as a resident plaintiff."

Personal Jurisdiction. If a New York joint venture wants to enforce in New York a promissory note executed by an out-of-state investor, it would be well-advised to require its investors to consent to personal jurisdiction, the Second Department teaches in *America/International 1994 Venture v. Mau*.[4]

The defendant, an Illinois resident, invested in the plaintiff, a New York joint venture to engage in oil and gas drilling, by executing a promissory note and subscription agreement. The subscription agreement appointed a New York-based company to act as the agent of the investors in the operation of the venture. Plaintiff sued when the defendant failed to pay the promissory note, and the defendant moved to dismiss for lack of personal jurisdiction on the grounds that he had not transacted business in New York. Supreme Court granted the motion.

In a unanimous opinion by Justice Leonard B. Austin, the Second Department affirmed. Because the defendant executed and delivered the agreements in Illinois, he did not personally transact business in New York under CPLR §302(a)(1). The court rejected plaintiff's agency theory of personal jurisdiction for two reasons. There was no allegation that defendant exercised control over the agent, and indeed the subscription agreement expressly curtailed the investors' right to control or terminate the agent. In addition, the court noted that the agent's actions in New York, and appointment under the subscription agreement, were

unrelated to the cause of action to collect on the promissory note.

Third Department

Real Property. And the Legislature said, Let us tax light. It did not mean fiber optic cables, however, the Third Department concluded in *Level 3 Communications v. Clinton County*.[5] After the First Department ruled that petitioner's fiber optic installations were not taxable real property under RPTL §102(12)(i) (covering telecommunications),[6] petitioner sought a refund of taxes it had paid respondent between 2010 and 2012. Petitioner commenced an Article 78 proceeding, and the Supreme Court dismissed the petition on the grounds, inter alia, that the fiber optic installations were taxable under RPTL §102(12)(f).

In a unanimous opinion authored by Presiding Justice Karen K. Peters, the Third Department disagreed. RPTL §102(12)(f)'s provision that real property includes "equipment for the distribution of heat, light, power, gases and liquids" does not apply to fiber optic cables. The court concluded that, while fiber optic cables "transmit" light, they do not "distribute" light within the meaning of the statute. The ruling did not help the petitioner's refund application, however, as the court agreed with the holding below that the taxes had been paid voluntarily and without protest at the time.

Fourth Department

Family Court. The Fourth Department was called on to decide an issue of first impression at the appellate level of whether the Family Court retains subject matter jurisdiction to conduct a permanency hearing pursuant to FCT §1086 et seq., after a neglect petition has been dismissed. In the *Matter of Jamie J.*,[7] a divided court concluded that it did.

Upon a petition alleging that the respondent-mother's one-week-old child was neglected, the Family Court directed the temporary removal of the child. Following a fact-finding hearing, however, the court dismissed the petition for lack of evidence. The court proceeded with a permanency hearing, during which the mother consented to the child's continued placement with the father, subject to the right to challenge the court's subject matter jurisdiction.

Writing for the panel majority, Justice Henry J. Scudder acknowledged "the silence of the Legislature with respect to the scenario presented in this case." The majority concluded that if the Legislature had intended for placement to end upon dismissal of the petition, it would have said so. Rather, the Family Court retains jurisdiction until such time as the child is discharged from placement, a determination which the Family Court must make in light of the best interests of the child, including the risk of abuse or neglect if the child is returned to the parent.

Endnotes

1 2016 N.Y. Slip Op. 06648 (1st Dept. Oct. 11, 2016).

2 2016 N.Y. Slip Op. 06796 (1st Dept. Oct. 18, 2016).

3 2016 N.Y. Slip Op. 08500 (2d Dept. Dec. 21, 2016).

4 2016 N.Y. Slip Op. 07915 (2d Dept. Nov. 23, 2016).

5 2016 N.Y. Slip Op. 06930 (3d Dept. Oct. 20, 2016).

6 *Matter of RCN N.Y. Communications v. Tax Comm'n of the City of N.Y.*, 95 A.D.3d 45 (2012).

7 2016 N.Y. Slip Op. 07424 (4th Dept. Nov. 10, 2016).

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