Appellate Division Review

Privileged Communications with Law Firm General Counsel

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by E. Leo Milonas and Andrew C. Smith

E. Leo Milonas
Litigation
+1.212.858.1615
eleo.milonas@pillsburylaw.com

Andrew C. Smith
Litigation
+1.212.858.1743
andrew.smith@pillsburylaw.com

E. Leo Milonas is a partner in Pillsbury's Litigation practice and a former associate justice of the Appellate Division, First Department. **Andrew C. Smith** also is a Litigation partner. Senior associates Jay D. Dealy and Joshua I. Schlenger and associate Dina E. Yavich assisted in preparing this column.

As "Hamilton" rapped its way to 11 Tony Awards, we were reminded that Alexander Hamilton remarked in The Federalist Papers that a separate judiciary "will always be the least dangerous" branch of government, having "neither force nor will, but merely judgment." As recent opinions of the Appellate Division demonstrate, mere judgment can be quite forceful as well. Below are some of the highlights from the second quarter of 2016.

First Department

Attorney-Client Privilege. In a closely watched case (certainly among law firms) of first impression in New York, the First Department held in *Stock v. Schnader Harrison Segal & Lewis*[1] that communications between attorneys and their law firm's in-house general counsel regarding their ethical obligations in representing a firm client are privileged.

Defendant law firm represented plaintiff in negotiating his employment separation. When plaintiff later tried to exercise his stock options and was informed they had expired because the separation had shortened the exercise window, plaintiff sued first his former employer and then defendant for malpractice.

Plaintiff sought discovery of communications between the partner who handled the separation negotiations and the firm's in-house general counsel concerning the partner's ethical obligations after having been called as a witness by the employer. The Supreme Court found that the legal advice had been for plaintiff's benefit (the "fiduciary exception" to the attorney-client privilege) and ordered the communications be produced.

In a unanimous decision written by Justice David Friedman, the First Department reversed. The court held that the attorney-client privilege applies to communications with a law firm's in-house general counsel just as it applies to communications with outside counsel. Because the general counsel's "real client" was the partner seeking advice regarding her own ethical obligations, and not the plaintiff, the fiduciary exception did not apply. The court refused to adopt a "current client exception" to the attorney-client privilege recognized by some courts. This exception holds that a law firm cannot withhold internal communications relating to an ongoing client representation, on the rationale that the law firm has an imputed conflict when it concurrently represents its client's interests and its own. Such an exception would have "the effect of penalizing the law firm from seeking advice from one of its own lawyers," while pushing lawyers to consult outside counsel, which would "increase the cost of obtaining ethical advice" and "likely substantially delay the process of obtaining such advice."

Shareholder Derivative Actions. Satisfying the "demand" requirement for a derivative shareholder suit requires more than just making a pre-suit demand, the First Department held in Culligan Soft Water Co. v. Clayton Dubilier & Rice.[2]

Following a leveraged buyout, minority shareholders in *Culligan* brought a derivative action alleging that the company was saddled with debt while value was extracted through a $375 million dividend. Under New York's Business Corporation Law (BCL), shareholders must demand the company's board of directors bring an action before doing so themselves. Accordingly, BCL §626(c) requires that a derivative complaint "set forth with particularity" the efforts "to secure the initiation of such action by the board or the reasons for not making such effort." In dismissing the complaint, the Supreme Court read BCL §626(c) as requiring a complaint to allege not only a pre-suit demand, but also that the board wrongfully rejected the demand.

In an unsigned opinion, the First Department rejected the Supreme Court's reading but nevertheless affirmed the dismissal. Pleading wrongful rejection was not required by the BCL, the court concluded, but the complaint was deficient because the plaintiffs did not give "the board a reasonable opportunity to investigate and respond to the demands" before filing suit and therefore "did not satisfy the demand requirement" under BCL §626(c).

Second Department

Partnerships. If a minority partner wrongfully dissolves a partnership, but the remaining partners elect to continue the business as a going concern, should the value of the dissolving partner's interest be discounted to reflect the partner's lack of control in the operations of the partnership? Addressing this issue of first impression in the Second Department, the court in *Congel v. Malfitano*[3] concluded that a minority discount should be applied.

The defendant general partner, who held a 3 percent interest in a limited partnership that owned the Poughkeepsie Galleria Shopping Center, unilaterally elected to dissolve the partnership on grounds of deadlock. When the remaining partners sued for breach of contract, the general partner asserted a counterclaim under Partnership Law §69, which entitled him to "the value of his interest of the partnership, less any damages caused to his copartners by the dissolution," so long as the remaining partners elected to continue the partnership business as a going concern.[4]

The Supreme Court rejected plaintiffs' contention that a "minority discount" should be applied, relying on Court of Appeals case law that rejected the application of a minority discount in calculating the "fair value" of a dissenting minority shareholder's stock in a close corporation in appraisal proceedings under BCL §§623 and 1118.[5]

In a unanimous opinion authored by Justice Thomas A. Dickerson, the Second Department disagreed. Citing First Department and the Supreme Judicial Court of Massachusetts precedent,[6] the court distinguished calculating "fair value" in appraisal proceedings from calculating the "value" of the shares of a partner who has wrongfully dissolved a partnership. The concerns that applying a minority discount in appraisal proceedings would unfairly encourage oppressive majority conduct and enrich majority shareholders who cash out dissenting shareholders did not apply here. "[T]he defendant has no right to compel a liquidation sale of the partnership's shopping mall and receive a proportionate share of the liquidation value of that asset," the court concluded, directing the Supreme Court to recalculate the value of the dissolving partner's interest by applying the 66 percent minority discount used by plaintiffs' expert witness.

Disability Benefits for Firefighters. How permanent are permanent disability benefits for firefighters? General Municipal Law §207-a(2) guarantees the payment of benefits to a firefighter who is permanently disabled in the line of duty, including the continued payment of the firefighter's regular salary until the mandatory retirement age. In Matter of *Masullo v. City of Mount Vernon*,[7] a case of first impression in the Second Department, the court held that a municipality that began paying such benefits at a time when it did not have a benefits application process could not require the firefighter to undergo the application process as a condition to continued receipt of benefits.

In April 2004, the petitioner firefighter for the City of Mount Vernon was injured in the line of duty, became permanently disabled, and retired. At the time, Mount Vernon had no application procedure for Section 207-a(2) benefits, and it simply began paying petitioner benefits. The city adopted an application process thereafter, but continued paying benefits to petitioner until 2008, when it required him to submit an application. When petitioner did so, the city found that his condition did not warrant Section 207-a(2) benefits, and promptly stopped paying them. After an unsuccessful Article 78 review, petitioner appealed to the Second Department.

Writing for a unanimous panel, Justice Hector D. LaSalle concluded that "the City was without authority to require the petitioner to submit to the application and eligibility processes adopted by the City subsequent to the petitioner's retirement, and after the City had already paid the petitioner his Section 207-a(2) benefits for over four years." The court found that the city's actions amounted to "an improper reconsideration of an award of benefits based on improved medical evidence," which is not authorized by the statute.

Third Department

Parole Hearings. When a juvenile offender faces a life sentence without possibility of parole, the sentencing court is constitutionally required to consider the offender's youth and its attendant circumstances in relationship to the crime. In *Hawkins v. New York State Department of Corrections and Community Supervision*,[8] the Third Department held that a juvenile offender who receives a life sentence with the possibility of parole is entitled to the same consideration at parole hearings.

When Dempsey Hawkins appeared for his tenth parole hearing, he had served 36 years of a sentence of 22 years to life for strangling to death his girlfriend when he was 16 years old. The Board of Parole denied his request for release without consideration of his youth at the time of the crime, on the grounds that release "would so deprecate the seriousness of [his] offense as to undermine the respect for the law."

In a majority opinion written by Justice William E. McCarthy, the Third Department affirmed the Supreme Court's order directing a de novo parole hearing. The U.S. Supreme Court has held that a sentence of life without possibility of parole for a juvenile offender violates the Eighth Amendment if the crime reflects transient immaturity.[9] The Third Department reasoned that "[a] parole board is no more entitled to subject an offender to the penalty of life in prison in contravention of this rule than is a Legislature or a sentencing court." As a consequence, in order for a juvenile offender to have a "meaningful opportunity to obtain release," the parole board must consider the significance of the petitioner's youth and its circumstances at the time the crime was committed.

Neglect of People With Disabilities. When a state agency charged with protecting people with disabilities finds that a report of neglect by a care facility's staff is unsubstantiated, can the agency nevertheless make a finding of neglect as against the facility itself? No, the Third Department concluded in *Anonymous v. David Molik*.[10]

Petitioner operated an intermediate care facility for individuals with cognitive and physical disabilities. One evening, two staff members left the facility's common room unattended, during which time one of the residents engaged in inappropriate sexual contact with another resident. Respondent Justice Center for the Protection of People with Special Needs, which is tasked under the New York People with Special Needs Act of 2012 with investigating claims of abuse and neglect, concluded that the staff members did not violate any policies by leaving the common room. However, it made a finding of neglect against the facility itself for failing to provide clear protocols for supervision of the common room and for failing to increase supervision of the resident who had a history of similar inappropriate contact. Petitioner brought a CPLR Article 78 proceeding challenging the finding of neglect, which the Supreme Court transferred to the Appellate Division.

In a unanimous opinion authored by Justice Karen K. Peters, the Third Department held that the Justice Center exceeded its statutory authority. Under New York Social Services Law §493, the Justice Center is only authorized to substantiate a report of neglect against a facility if the individual subject of the report cannot be identified. The court explained, "[w]hile the Legislature may not have contemplated a scenario where, as here, the Justice Center would find the subject of a report fully absolved from responsibility while determining that the facility engaged in conduct amounting to neglect, 'the plain language of a statute may not be overridden to avoid an undesirable result in a particular situation.'"

Fourth Department

Arbitration. Woe to the arbitrator who disregards his or her mandate and fails to consider evidence, the Fourth Department teaches in *Matter of O'Flynn v. Monroe County Deputy Sheriffs' Association*.[11]

Following his one-car rollover accident, a Monroe County deputy sergeant was charged with five violations, including aggravated DWI and endangering the welfare of a child. A disciplinary hearing panel upheld the charges and terminated the officer's employment. At the subsequent arbitration held under the parties' collective bargaining agreement (CBA), the arbitrator determined that the blood alcohol test results were inadmissible, dismissed two of the charges, and concluded that demotion was a more appropriate sanction.

After the arbitrator issued the award, the petitioners made an application to the Supreme Court to vacate the award pursuant to CPLR 7511.

In an unsigned opinion, the Fourth Department affirmed the Supreme Court's order vacating the award and ordering a rehearing before a different arbitrator. The CBA required the arbitrator to review the record of the disciplinary hearing and determine if the finding was based on clear and convincing evidence. The arbitrator, however, "clearly exceeded" his authority when he decided to exclude the blood alcohol test results from his review.

Endnotes

1 2016 N.Y. Slip Op. 05247 (1st Dept. June 30, 2016).

2 2016 N.Y. Slip Op. 04129 (1st Dept. May 31, 2016).

3 2016 N.Y. Slip Op. 03845 (2d Dept. May 18, 2016).

4 N.Y. Partnership Law §69(2)(c)(II).

5 See *Matter of Friedman v. Beway Realty Corp.*, 87 N.Y.2d 161, 167 (1995).

6 Vick v. Albert, 47 A.D.3d 482 (1st Dept. 2008); *Anastos v. Sable*, 443 Mass. 146, 819 N.E.2d 587 (2004).

7 2016 N.Y. Slip Op. 04225 (2d Dept. June 1, 2016).

8 2016 N.Y. Slip Op. 03236 (3d Dept. Apr. 28, 2016).

9 *Miller v. Alabama*, 132 S.Ct. 2455 (2012).

10 2016 N.Y. Slip Op. 04288 (3d Dept. June 2, 2016).

11 2016 N.Y. Slip Op. 05261 (4th Dept. July 1, 2016).

Pillsbury Winthrop Shaw Pittman LLP | 1540 Broadway | New York, NY 10036 | +1.877.323.4171