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## MUNICIPAL LAW

BY JEFFREY D. FRIEDLANDER

### *Affirmative Litigation Efforts Help Bring in City Revenue*

For a City Law Department that is kept extraordinarily busy defending the city in lawsuits in which public policy is in issue and millions of dollars at stake, special effort is required to devote limited resources to identify, develop and bring affirmative cases. This problem was addressed in 1982, when then corporation counsel Frederick A. O. Schwarz Jr., established the Affirmative Litigation Division. In previous articles, I have discussed some of the major policy-based litigation undertaken by “Affirmative Lit,” including ongoing litigation concerning trafficking in illegal guns and sales of bootleg cigarettes.

Given the state of the economy and the need to secure for the city’s residents all monies due and owing, it is appropriate to focus on the activities of the division that secure city revenue. Over the years, the division’s work in this area has ranged from litigation over municipal bond refinancing to claims arising out of the city’s infrastructure, to contract disputes. This article discusses some of the division’s efforts, including the recovery of the costs of asbestos remediation, obtaining insurance coverage to which the city is entitled, litigation with the state—when this becomes necessary—over funding allocations, and recompense for damages resulting from cases of corruption. This article will also discuss efforts to pursue claims on behalf of public hospitals and the collection of administrative penalties. These efforts, combined with those of other divisions in the Law Department to recover rents, fees and tax revenues, contribute substantially to the public fisc.

#### **Asbestos Cost Recovery**

The city’s infrastructure includes more than a thousand school buildings and hundreds of other buildings and facilities. The majority of these structures were built in the first seven decades of the last century. As was common practice at the time, most were built with one or more asbestos-containing materials that typically served as insulation. As decades of litigation would uncover beginning in the 1970s, asbestos products continued to be marketed long after the major manufacturers knew of the dangers of asbestos fibers, including their carcinogenicity.

The city, like other building owners, was damaged by the installation of asbestos products in its buildings, and had claims against the asbestos manufacturers based on products liability and other claims. The city was among the first building owners to take action against the manufacturers to recover monies for the city to pay part of the large amounts



the city has spent—and continues to spend—to abate asbestos hazards in its schools and other buildings. In 1984, it commenced litigation against asbestos companies in New York Supreme Court. At the same time, it became involved in the bankruptcy proceedings that arose as first Johns-Manville Corporation and then other miners and manufacturers of asbestos filed for bankruptcy protection. Significantly, in Manville and the subsequent bankruptcies, the Law Department pressed the position that building owners, especially cities and other public

entities, were entitled to recover damages out of the bankruptcy estates.

The law department went on to file thousands of claims in the bankruptcies, and the city received a larger recovery than any other claimant in the country. Between settlements in the litigation and recoveries in the bankruptcies, the Law Department has brought in more than \$132 million thus far for the city.

#### **Insurance Coverage**

In general, the city is self-insured. Every dollar paid by the city to satisfy judgments against it or settle tort claims is a dollar less that the city can use for schools, police and all the other services the city provides. The exception to this general rule is coverage the city acquires as an additional insured from city contractors or permittees, who must purchase insurance including additional insured protection for the city. This is coverage that the city is entitled to, and, in the case of city contractors, that it pays for through the price of the contract. When all goes well, the insurer acknowledges its duties to the city as an additional insured, the insurer takes on the defense of the action against the city and usually indemnifies the city against its losses.

But too often, the insurer refuses to extend coverage to the city, and, where other efforts to obtain coverage are unsuccessful, the city must rely on courts to enforce the insurer’s policy obligations.<sup>1</sup> Working closely with the Law Department’s Tort Division and the Comptroller’s office, Affirmative Litigation identifies those cases where an insurer has failed to fulfill its policy obligations. Where the insurer continues to refuse to step up to the plate, Affirmative Litigation sues, seeking a declaratory judgment that decides the insurers’ duties. More than 200 such actions have been brought within the last nine years. The decisions are overwhelmingly in the city’s favor, and have added to the case law defining the broad duties of insurers toward their additional insureds.<sup>2</sup>

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The upshot of these activities is that insurers defend and indemnify the city. The savings to the city are very substantial: thanks to the efforts of the Law Department, insurers have paid out more than \$200 million in settlements and judgments that would otherwise have been paid from the city's coffers.

### **Litigation Against the State**

There are occasions when the city determines that a state agency has failed to provide it with all of the funds it is due under various programs. The city, of course tries to resolve these disputes without recourse to the courts, but frequently is left with no other avenue. Affirmative Litigation has brought numerous actions and proceedings against the state, restoring to the city funds it is owed.

Litigating against the state presents special challenges. This is illustrated in the city's litigation seeking damages for the state's multi-year failure to correct a computer programming error that caused Medicaid payments to be made to ineligible persons. For years, the State Department of Health had been improperly processing data received from the federal Social Security Administration, with the result that the state was providing Medicaid benefits to persons who were not eligible.

In New York, localities, including the city, pay a substantial share of Medicaid costs. The city first brought an Article 78 proceeding challenging the state's action and seeking recovery of the funds that the city had paid to the state on behalf of ineligible persons. But the state argued, and the courts agreed, that the claim could be brought only in the Court of Claims.<sup>3</sup>

The city then brought the claim in the Court of Claims, with the state again arguing that the claim should be dismissed. The court disagreed, finding that the city's claims based on a private right of action under Social Services Law §368-a, negligence, and for money had and received all had the appearance of merit.<sup>4</sup> The city's summary judgment motion, seeking recovery of more than \$16 million, is now pending.

In *City v. Johnson*,<sup>5</sup> Affirmative Litigation attorneys filed an Article 78 proceeding challenging changes in the state's formula for allocating foster care block grant monies in fiscal year 2003-04. Justice Karen Smith of the New York Supreme Court held the formula to have been arbitrary and capricious and ruled for the city.<sup>6</sup> Specifically, Justice Smith found that the model that the state used to predict the city's "true need" for foster care rested on a series of unsupportable and erroneous assumptions.

Justice Smith also held that the allocation underfunded the city because the state arbitrarily refused to consider in its calculations the city's foster care claims submitted after an arbitrary deadline. Justice Smith ordered the state to recalculate the allocation and, as a result, the city is recovering \$19,137,368 in funds for that fiscal year.

The city had brought a second lawsuit challenging the state's 2004-05 allocation on similar grounds, *City v. Johnson II*,<sup>7</sup> but in light of the city's victory in the first case, the state has agreed to pay an additional \$8,363,538 for fiscal year 2004-05 without further adjudication. The state also abandoned the model challenged by the city as faulty.

Similarly, in *City v. Novello*,<sup>8</sup> the city's Article 78 challenged the state's attempt to obtain from the city funds for home care services. State legislation imposed penalties on localities for failure to achieve targeted savings. The city argued that the State Department of Health's actions were not within the timeframe mandated by the Legislature and that the state had arbitrarily calculated the amount that it sought to take from the city. The First Department recently ruled for the city that the state was untimely and therefore lacked authority to take back \$28 million.<sup>9</sup>

### **Corruption Cases**

In addition to criminal sanctions that may await those who engage in corrupt activities, the law affords the city a variety of mechanisms to recover civil damages for its injuries. These include the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 USC §1964(c), the federal, state and city False Claims acts, and an arsenal of common law claims. Affirmative Litigation's actions deter municipal corruption as they bring in revenue to the city.

Affirmative Lit's role using civil litigation in municipal corruption cases to complement investigations by the city's Department of Investigations (DOI) and criminal prosecutions by the U.S. attorneys and district attorneys is illustrated in a very recent decision from U.S. District Court Judge Naomi Rice Buchwald. The city filed a civil RICO action after the U. S. Attorney for the Southern District of New York indicted the principal defendant, the former director of Management Information Systems in the Office of the Chief Medical Examiner. The defendant had embezzled millions of dollars in city funds in a fraudulent contracting and billing scheme. The defendant pled guilty in the criminal case, and the U.S. Attorney obtained a significant prison sentence and restitution for the city, of which \$836,022 has been received to date.

Moving for summary judgment in the civil case, Affirmative Litigation attorneys invoked collateral estoppel, arguing that the plea established all of the elements required for civil RICO, and a sentencing hearing established that damages were at least \$2.9 million. Judge Buchwald agreed.<sup>10</sup> Trebling the damages under RICO and subtracting the restitution paid to date yielded a judgment of more than \$8 million.

In the same case, the city named as defendants an overseas company and its principal that the city alleged were involved in laundering some of the monies embezzled from the city. The criminal indictment named the principal but the prosecutors subsequently dropped the charges against him. The city settled with these defendants for \$6.12 million before

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moving for summary judgment. The civil litigation successfully cast a wider net than the criminal prosecution and restored millions of dollars to the city's coffers. This is one of a series of cases in which Affirmative Lit works with DOI and prosecutors to obtain restitution orders, and, where appropriate, brings civil litigation to obtain broader relief.<sup>11</sup>

**Advocacy for Hospital System**

With the sole exception of the federal Veterans Administration, the New York City Health and Hospitals Corporation (HHC) is the nation's largest public hospital system. This \$6 billion a year hospital network is funded primarily by payments from private and public health insurance programs. Failure of insurers to make those payments or failure to pay the correct amount deprives HHC of funds it uses to provide services to New Yorkers.

For the past several years, Affirmative Litigation attorneys have worked with HHC and its Office of Legal Affairs to ensure that the system receives all the payments it is due. This advocacy has included direct negotiations with the insurers, filing complaints with the State Department of Insurance and, when necessary, litigation, recovering millions of dollars that would otherwise have gone uncollected.

**Uncollected Penalties**

The city enforces numerous codes to ensure public safety primarily through notices of violation that are adjudicated in various administrative tribunals. The principal tribunal is the city's Environmental Control Board.

One notable effort, begun more than five years ago on behalf of the city's Department of Transportation (DOT), resulted in tightening up enforcement of applicable rules to ensure that contractors who dig up city streets and sidewalks perform code-complaint street repairs. Multiple improvements were pursued simultaneously. DOT's regulations regarding insurance and bond requirements were revised. The practice of pursuing claims against sureties whose principals failed to restore roadways was invigorated. Regulations were re-written to authorize the withholding of permits to contractors who had failed to make proper street repairs. Department of Building regulations were revised to block licensed plumbers from forming new corporations when their prior corporations failed to pay penalties imposed against them.

In addition, the Law Department targeted the major scofflaws: those contractors who ignored multiple violations and accumulated hundreds of thousands of dollars in unpaid penalties. Supplemental proceedings, including subpoenas directed to the principals of the offending companies, were initiated. Where the principals had worked through multiple corporations, the information was amassed to pierce the corporate veil and reverse fraudulent transfers.<sup>12</sup>

The Law Department is now focusing on businesses that have accumulated unpaid penalties because of violations of the Building Code.

In addition to the claims described above, there are thousands of additional claims that the city pursues. Routine claims, smaller claims, and larger claims where tracking down the debtor and its assets are problematical are referred to an outside collection law firm, which is supervised by the Affirmative Litigation Division. These claims include overpayments to former city employees, overpayments of public benefits, defaulted loans, routine unpaid penalties and damage to city property. By this means, the city recovers about \$2.5 million each year.

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1. See, e.g., *City of New York v. Commerce and Industry Insurance Co. of Canada and St. Paul Fire and Marine Insurance Co.*, Index No. 402003/08, Supreme Court, New York Co. (decision of Justice Marylin G. Diamond, entered June 30, 2009)
2. See, e.g., *City of New York v. Zurich-American Ins. Group*, 27 A.D.3d 609 (2d Dept. 2006); *City of New York v. Evanston Ins. Co.*, 39 A.D.3d 153 (2d Dep't 2007); *City of New York v. Philadelphia Indem. Ins. Co.*, 54 A.D.3d 709, 710 (2d Dep't 2008).
3. *City of New York v. Wing*, 12 A.D.3d 180 (1st Dept. 2004), *lv. den.*, *City of New York v. Wing*, 4 N.Y.3d 705 (2005).
4. *City of New York v. State of New York*, Court of Claims, M-70556, Decision and Order, July 5, 2006.
5. Index No. 400110/04, Supreme Ct. N.Y. Co.
6. 2005 N.Y. Misc. LEXIS 3221; 233 N.Y.L.J. 7 (Jan. 11, 2005).
7. Index No. 400587/05, Sup. Ct. N.Y. Co.
8. Index No. 400705/05, Sup. Ct. N.Y. Co.
9. *City of New York v. Novello*, 800 N.Y.S.2d (1st Dep't 2009).
10. Memorandum and Decision dated July 7, 2009, in *City v. Venkataram*, 06 Civ. 6578 (NRB) (S.D.N.Y.).
11. Thus, for example, in *City of New York v. Pollock*, 2006 U.S. Dist. LEXIS 8391 (S.D.N.Y.), Judge Paul A. Crotty agreed with the city's invocation of collateral estoppel from pleas in a parallel criminal proceeding to find liable in a civil RICO action defendants who had defrauded the city of emergency rent payments.
12. In one proceeding, New York Supreme Court Justice Sheila Abdus Salaam agreed with the city, pierced the corporate veil, and held that all the principals were jointly liable. *City v. Grasso*, Index No. 404460/06 (Sup. Ct. N.Y. Co.) Decision and Order, dated March 27, 2007.