# NEW YORK COURT OF APPEALS ROUNDUP

## UNUSUAL WORLD TRADE CENTER ARGUMENT, CHOICE-OF-LAW, TAINTED MARITAL PROPERTY

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This month, we discuss a decision in which the Court of Appeals' choice-of-law analysis led it to apply the laws of different jurisdictions to different tort claims arising out of a single accident. We also discuss a case in which the Court determined that money fraudulently obtained by an individual cannot be "followed by" its original owner into the hands of the individual's former spouse who acquired the money in a divorce proceeding in good faith, without knowledge of any fraud, and for consideration. In addition, we note an unusual reargument last week of *Matter of World Trade Center Bombing Litigation Steering Committee v. The Port Authority of New York and New Jersey*.

### WTC Reargument

The World Trade Center case was argued before a five-judge bench on June 1, 2011, after Chief Judge Jonathan Lippman and Associate Judge Robert S. Smith determined not to take part in the appeal. While the decision to have reargument cannot necessarily be attributed to an inability to secure a requisite four-judge majority of the Court from the five judges that heard the case on June 1, the full bench hearing on Aug. 24, 2011, follows the vouching-in by Acting Chief Judge Carmen Beauchamp Ciparick of the Second Department's Presiding Justice A. Gail Prudenti and Acting Third Department Presiding Justice Thomas E. Mercure. The authority for vouching-in Supreme Court Justices to sit for Judges of the Court who recuse themselves from hearing a particular case is found in Section 2(a) of Article VI of the New York State Constitution. It is rarely invoked.

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The case arose out of the terrorist bombing of the World Trade Center in 1993 by the use of a truck loaded with explosives driven into the publicly available parking garage under the Twin Towers. The explosion resulted in six deaths, with hundreds injured. A jury later attributed 68 percent of the fault for the bombing to the negligence of the Port Authority and 32 percent to the acts of the terrorists who drove the truck.

The principal issue on the appeal is whether the Port Authority is immune from liability because its activity in providing security was part of a governmental function rather than proprietary activity in operating a commercial garage open to the public.

The jury's apportionment of fault (68-32) may be seen as grossly unfair and in need of correction by the Court. The June 1 argument appeared to signal that the Court may be of the view that, because apportionment is not a legal issue, it is without jurisdiction to modify the result if the verdict is sustained. On the other hand, what can be viewed as unfairness in the apportionment determination by the jury could influence one's view of whether governmental immunity is appropriate.

**Choice-of-Law—Tort Liability**

To conduct a "*Neumeier*" choice-of-law analysis, a court must consider each plaintiff vis-à-vis each defendant. This is made clear by the Court's decision in *Edwards v. Erie Coach Lines Co.*, which involved six lawsuits arising out of a tragic collision near Genesco, N.Y. On Jan. 19, 2005, a charter bus carrying members of an Ontario women's hockey team plowed into the back of a tractor-trailer parked on the shoulder of a highway. Three of the bus passengers and the trailer driver were killed, and several bus passengers were injured.

After the collision, the injured passengers and representatives of those who died filed wrongful death and personal injury lawsuits against the bus driver, his employer, and the company that leased the bus, all of which were Canadian citizens (the "bus defendants"). They also asserted claims against the tractor-trailer driver, his employer, and the companies that hired the trailer, all of which were citizens of Pennsylvania (the "trailer defendants"). The choice-of-law issues presented by these split-domicile lawsuits were significant because Ontario caps non-economic damages where negligence causes catastrophic personal injury, whereas New York does not cap such damages in the case of a motor vehicle accident involving serious injury.

In the decision authored by Judge Victoria A. Graffeo, the Court provided an overview of the development of choice-of-law approaches taken by New York courts. It then reviewed the three-rule framework for resolving choice-of-law questions in the context of guest statutes. This framework set forth in *Neumeier v. Kuehner*, 31 N.Y.2d 121, 127 (N.Y. 1972), provides: (1) when the driver and passenger are domiciled in the same state

and the vehicle is registered there, the law of their shared jurisdiction controls; (2) when the driver and passenger reside in different states and the accident occurred in one of those states, the law of the place of the accident is applied; and (3) when the passenger, driver, and state in which the accident occurred are all distinct, the law of the state in which the accident occurs governs unless "it can be shown that displacing that normally applicable rule will advance the relevant substantive law purposes without impairing the smooth working of the multistate system or producing great uncertainty for litigants." Id. at 128.

In *Edwards*, the Court explained that, while both the Supreme Court and the Appellate Division, Fourth Department, purported to apply the *Neumeier* analysis, both had done so incorrectly. The Supreme Court determined that Ontario law applied to all claims after undertaking a single choice-of-law analysis for both the bus defendants and the trailer defendants. The parties reached a settlement on the apportionment of fault, 90 percent to the bus defendants and 10 percent to the trailer defendants. Meanwhile, plaintiffs had appealed the trial court's choice-of-law decision.

The Appellate Division affirmed. It conducted separate choice-of-law analyses with respect to the two groups of defendants, but ultimately reached the same conclusion as the trial court, i.e., that Ontario law should be applied to the claims against all defendants.

Affirming in part and reversing in part, the Court indicated that "the correct way to conduct a choice-of-law analysis is to consider each plaintiff vis-à-vis each defendant." Such an analysis is consistent with precedent[1] and called for by the very nature of the *Neumeier* framework. With respect to the bus defendants, the Court quickly agreed that, under the first *Neumeier* rule, the Ontario cap controlled any award of non-economic damages. As to the trailer defendants, the Court applied the third *Neumeier* rule, and found that New York law should govern because the conduct causing the injuries and the injuries themselves took place here. There was no cause to contemplate a jurisdiction other than New York because the trailer defendants did not ask the Supreme Court to consider the law of their domicile (Pennsylvania), and those defendants had no contacts whatsoever with Ontario.

Judge Ciparick issued a dissent, with which Judge Susan Phillips Read and Judge Theodore T. Jones concurred, arguing that *Neumeier* called for a single choice-of-law analysis when non-domiciliary defendants are jointly and severally liable to non-domiciliary plaintiffs in a tort action. The dissent contended that, because the claims all arose from a single incident, a separate *Neumeier* analysis for each defendant created unpredictability and lack of uniformity in litigation. Because plaintiffs and defendants are domiciled in different locations, the dissent argued, the law of the site of the tort should apply.

**Tainted Marital Property**

In *Commodity Futures Trading Commission v. Walsh*, the Court held that a person may retain assets obtained pursuant to a divorce decree if received in good faith—even when those assets were originally fraudulently acquired by the former spouse.

The Commodity Futures Trading Commission and Securities and Exchange Commission (the "agencies") commenced a federal court action in which they alleged violations of the anti-fraud provisions of the Commodity Exchange Act and the Securities Exchange Act against Stephen Walsh for misappropriating more than $550 million from funds he managed for various public and private institutional investors. The agencies also sued Walsh's ex-wife, Janet Schaberg, as a relief defendant. They sought disgorgement from Schaberg to recover any proceeds of Walsh's fraud that she held pursuant to the parties' separation agreement and divorce decree.

Two years before the agencies sued Walsh, Schaberg and Walsh had entered into a settlement agreement under which Schaberg conveyed to Walsh her ownership interest in the marital residence and waived any claim for maintenance in return for sole ownership of condominiums in New York City and Florida, $5 million cash, and a distributive award of $12.5 million. The U.S. District Court for the Southern District of New York froze the bulk of Schaberg's assets.

The U.S. Court of Appeals for the Second Circuit found that the determination of whether the injunctions freezing her assets were proper turned on open issues in New York law. It therefore certified two questions to the Court of Appeals: "(1) Does 'marital property' within the meaning of New York Domestic Relations Law §236 include the proceeds of fraud? (2) Does a spouse pay 'fair consideration' according to the terms of New York Debtor and Creditor Law §272 when she relinquishes in good faith a claim to the proceeds of fraud?"

The Court held that the proceeds of fraud can constitute marital property as defined in Domestic Relations Law §236. "It is therefore possible under the Domestic Relations Law to transfer assets derived from fraud to an innocent and unknowing spouse in a divorce proceeding." Judge Victoria A. Graffeo wrote for the majority. The Court based this conclusion upon the broad definition of marital property as "all property acquired by either or both spouses during the marriage and before the execution of a separation agreement or the commencement of a matrimonial action," and by noting that the term "acquired" does not require that property be segregated by its methods of acquisition, but merely means that a person gains possession.

The Court also explained that it has long been the law of New York that "money obtained by fraud or felony cannot be followed by the true owner into the hands of one

who has received it bona fide and for a valuable consideration in due course of business." Just as this principle promotes finality in business transactions, it allows people to conclusively wind up their affairs through a divorce proceeding and move on with their lives.

As to the second inquiry, the Court noted that transfers made pursuant to a valid separation agreement incorporated into a divorce decree are presumed to have been made for fair consideration, and thus reformulated the question to read: "Is a determination that a spouse paid fair consideration according to the terms of New York Debtor and Creditor Law §272 precluded, as a matter of law, where part or all of the marital estate consists of the proceeds of a fraud?"

The Court answered this question in the negative. While disgorgement is proper "where it is demonstrated that the transferee-spouse was aware of or participated in the fraud or otherwise failed to act in good faith," consistent with New York's "strong public policy of ensuring finality in divorce proceedings," an innocent spouse who received possession of tainted property in good faith and gave fair consideration for it should prevail over the claims of the original owner. It was clear that Schaberg gave consideration to Walsh for the assets she received in the divorce because she relinquished her interest in other marital assets and agreed not to seek maintenance.

Judge Eugene F. Pigott Jr. dissented, joined by Judge Robert S. Smith, arguing that "one cannot reasonably argue that a spouse—even an innocent one with no knowledge of her husband's fraud—could be said to have given 'fair equivalent value' by giving up future claims to the equitable distribution of proceeds in which she has no legitimate interest."

**Endnotes:**

1. See *Schultz v. Boy Scouts of America*, 65 N.Y.2d 189 (N.Y. 1985).