

**H**

Court of Appeals of New York.

**COMMODITY FUTURES TRADING COMMISSION**, Respondent,

v.

Stephen **WALSH** et al., Defendants,  
and

Janet **Walsh**, Appellant.

Securities and Exchange **Commission**, Respondent,  
v.

WG **Trading** Investors, L.P., et al., Defendants,  
and

Janet **Walsh**, Appellant, et al., Relief Defendant.

June 23, 2011.

**Background: Commodity Futures Trading Commission** and Securities and Exchange **Commission** filed securities enforcement action against persons who controlled various investment vehicles alleging violations of anti-fraud provisions of **Commodity Exchange Act** and Securities Exchange Act. The United States District Court for the Southern District of New York, [George B. Daniels, J.](#), granted preliminary injunctions to freeze bulk of assets of one defendant's former spouse, and she appealed. The United States Court of Appeals for the Second Circuit, [618 F.3d 218](#), certified questions.

**Holdings:** The Court of Appeals, [Grafteo, J.](#), held that:

(1) monies obtained by fraud cannot be followed by the original owner into the hands of an innocent former spouse who now holds them, or assets derived from them, as a result of a divorce proceeding where that spouse in good faith and without knowledge of the fraud gave fair consideration for the transferred property, and


(2) victims of fraud are entitled to pursue disgorgement from spouse who receives transfer of fraudulently-obtained assets in a divorce settlement, where it is demonstrated that the transferee-spouse was aware of or participated in the fraud or other-

wise failed to act in good faith.

Questions answered.

[Pigott J.](#), dissented in part in an opinion in which [Smith J.](#), concurred.

West Headnotes

**[1] Divorce 134**  **725**

134 Divorce

134V Spousal Support, Allowances, and Disposition of Property


134V(D) Allocation of Property and Liabilities; Equitable Distribution

134V(D)3 Proportion or Share Given on Division

134k725 k. In general. **Most Cited**

**Cases**

Implicit in the statutory framework of the Equitable Distribution Law is the concept that, upon dissolution of the marriage, there should be a winding up of the parties' economic affairs and a severance of their economic ties by an equitable distribution of the marital assets. [McKinney's DRL § 236](#).

**[2] Divorce 134**  **876.2(2)**

134 Divorce

134V Spousal Support, Allowances, and Disposition of Property

134V(D) Allocation of Property and Liabilities; Equitable Distribution

134V(D)9 Proceedings for Division or Assignment

134k876 Evidence

134k876.2 Presumptions and Burden of Proof

134k876.2(2) k. Nature or character of property or ownership in general. **Most Cited Cases**

There is a presumption under the Equitable

Distribution Law that all property, unless clearly separate, is deemed marital property. [McKinney's DRL § 236](#).

### [3] Divorce 134 689

#### 134 Divorce

134V Spousal Support, Allowances, and Disposition of Property

134V(D) Allocation of Property and Liabilities; Equitable Distribution

134V(D)2 Property Subject to Distribution or Division

134k688 Particular Interests as Separate or Marital Property

134k689 k. In general. [Most Cited Cases](#)

#### Cases

The proceeds of fraud can constitute marital property as defined in the Equitable Distribution Law. [McKinney's DRL § 236](#).

### [4] Divorce 134 781

#### 134 Divorce

134V Spousal Support, Allowances, and Disposition of Property

134V(D) Allocation of Property and Liabilities; Equitable Distribution

134V(D)5 Valuation, Division or Distribution of Particular Property or Interests

134k781 k. Nature of property or interest in general. [Most Cited Cases](#)

It is possible under the Domestic Relations Law to transfer assets derived from fraud to an innocent and unknowing spouse in a divorce proceeding. [McKinney's DRL § 236](#).

### [5] Implied and Constructive Contracts 205H 23

#### 205H Implied and Constructive Contracts

205HI Nature and Grounds of Obligation

205HI(B) Money Received

205Hk23 k. Reception under claim of right. [Most Cited Cases](#)

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.

### [6] Sales 343 234(6)

#### 343 Sales

343V Operation and Effect

343V(D) Bona Fide Purchasers

343k234 Nature and Grounds of Protection in General

343k234(6) k. Property lost or stolen.

#### Most Cited Cases

An owner may seek recovery of identifiable stolen property, such as a piece of artwork, from an innocent good faith purchaser for value.

### [7] Divorce 134 1350

#### 134 Divorce

134VI Operation and Effect of Divorce, and Rights of Divorced Persons

134k1350 k. In general. [Most Cited Cases](#)

Ex-spouses have a reasonable expectation that, once their marriage has been dissolved and their property divided, they will be free to move on with their lives.

### [8] Divorce 134 1359

#### 134 Divorce

134VI Operation and Effect of Divorce, and Rights of Divorced Persons

134k1356 Rights and Liabilities in General

134k1359 k. Rights and liabilities as to property in general. [Most Cited Cases](#)

### Fraudulent Conveyances 186 95(11)

#### 186 Fraudulent Conveyances

186I Transfers and Transactions Invalid

186I(G) Consideration

186k95 Transactions Between Husband and Wife

186k95(11) k. Postnuptial settlements.

#### Most Cited Cases

Monies obtained by fraud cannot be followed

by the original owner into the hands of an innocent former spouse who now holds them, or assets derived from them, as a result of a divorce proceeding where that spouse in good faith and without knowledge of the fraud gave fair consideration for the transferred property. [McKinney's DRL § 236](#).

### [9] Fraudulent Conveyances 186 ⚡77

#### 186 Fraudulent Conveyances

##### 186I Transfers and Transactions Invalid

##### 186I(G) Consideration

186k77 k. Sufficiency in general. [Most Cited Cases](#)

An evaluation of whether fair consideration is given for property that a creditor claims was transferred in a fraudulent conveyance must be determined upon the facts and circumstances of each particular case. [McKinney's Debtor and Creditor Law § 272](#).

### [10] Divorce 134 ⚡961

#### 134 Divorce

134V Spousal Support, Allowances, and Disposition of Property

134V(E) Settlement Agreements and Stipulations

134k961 k. Rights of creditors or third parties. [Most Cited Cases](#)

### Fraudulent Conveyances 186 ⚡76(1)

#### 186 Fraudulent Conveyances

##### 186I Transfers and Transactions Invalid

##### 186I(G) Consideration

##### 186k76 Nature and Adequacy

186k76(1) k. In general. [Most Cited Cases](#)

### Fraudulent Conveyances 186 ⚡95(11)

#### 186 Fraudulent Conveyances

##### 186I Transfers and Transactions Invalid

##### 186I(G) Consideration

186k95 Transactions Between Husband and Wife

186k95(11) k. Postnuptial settlements.

#### Most Cited Cases

In assessing whether a spouse pays fair consideration within the meaning of Debtor and Creditor Law in connection with a property distribution made pursuant to a separation agreement incorporated into a judgment of divorce, the first step is to determine whether the spouse relinquished rights to other untainted assets in the marital estate; second, a court needs to look beyond the tangible marital property at issue because New York recognizes other forms of legitimate consideration, including non-monetary consideration. [McKinney's Debtor and Creditor Law § 272](#).

### [11] Divorce 134 ⚡961

#### 134 Divorce

134V Spousal Support, Allowances, and Disposition of Property

134V(E) Settlement Agreements and Stipulations

134k961 k. Rights of creditors or third parties. [Most Cited Cases](#)

### Fraudulent Conveyances 186 ⚡95(1)

#### 186 Fraudulent Conveyances

##### 186I Transfers and Transactions Invalid

##### 186I(G) Consideration

186k95 Transactions Between Husband and Wife

186k95(1) k. Want or insufficiency of consideration. [Most Cited Cases](#)

Determination that a spouse paid “fair consideration” according to the terms of New York Debtor and Creditor Law is not precluded in action to set aside separation agreement as a fraudulent conveyance, as a matter of law, where part or all of the marital estate consists of the proceeds of fraud. [McKinney's Debtor and Creditor Law § 272](#).

### [12] Fraudulent Conveyances 186 ⚡95(11)

#### 186 Fraudulent Conveyances

##### 186I Transfers and Transactions Invalid

**186I(G) Consideration**

**186k95** Transactions Between Husband and Wife

**186k95(11) k.** Postnuptial settlements.

**Most Cited Cases**

Even where a spouse does not relinquish a “fair equivalent” for the aggregate of assets received pursuant to a separation agreement, it is possible that fair consideration may be exchanged for at least some of the assets, in determining whether to set aside transfer of assets to the spouse as a fraudulent conveyance. [McKinney's Debtor and Creditor Law § 272](#).

**[13] Fraudulent Conveyances 186 ↪182(1)****186** Fraudulent Conveyances

**186II** Rights and Liabilities of Parties and Purchasers

**186II(A)** Original Parties

**186k180** Rights and Liabilities of Grantees as to Creditors

**186k182** Personal Liabilities

**186k182(1) k.** In general. **Most**

**Cited Cases**

Victims of fraud are entitled to pursue disgorgement from spouse who receives transfer of fraudulently-obtained assets in a divorce settlement, where it is demonstrated that the transferee-spouse was aware of or participated in the fraud or otherwise failed to act in good faith, such as where the parties entered into a collusive divorce arrangement designed to conceal stolen money from its rightful owner. [McKinney's Debtor and Creditor Law § 272](#).

**[14] Divorce 134 ↪961****134** Divorce

**134V** Spousal Support, Allowances, and Disposition of Property

**134V(E)** Settlement Agreements and Stipulations

**134k961 k.** Rights of creditors or third parties. **Most Cited Cases**

**Fraudulent Conveyances 186 ↪95(11)****186** Fraudulent Conveyances

**186I** Transfers and Transactions Invalid

**186I(G)** Consideration

**186k95** Transactions Between Husband and Wife

**186k95(11) k.** Postnuptial settlements.

**Most Cited Cases**

Even where the spouse who obtains fraudulently-obtained assets executed a divorce settlement agreement in good faith and without knowledge of the source of the ill-gotten gains, defrauded parties may still recover if the spouse did not give fair consideration for the property. [McKinney's Debtor and Creditor Law § 272](#).

**[15] Divorce 134 ↪1359****134** Divorce

**134VI** Operation and Effect of Divorce, and Rights of Divorced Persons

**134k1356** Rights and Liabilities in General

**134k1359 k.** Rights and liabilities as to property in general. **Most Cited Cases**

**Fraudulent Conveyances 186 ↪95(11)****186** Fraudulent Conveyances

**186I** Transfers and Transactions Invalid

**186I(G)** Consideration

**186k95** Transactions Between Husband and Wife

**186k95(11) k.** Postnuptial settlements.

**Most Cited Cases**

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 or owners consistent with State's strong public policy of ensuring finality in divorce proceedings. [McKinney's Debtor and Creditor Law § 272](#).

\*\*\***823** Law Offices of Steven L. Kessler, New York City ([Steven L. Kessler](#) and [Eric M. Wagner](#) of counsel), for appellant.

Nancy R. Doyle, Assistant General Counsel, **Commodity Futures Trading Commission**, of the District of Columbia bar, admitted pro hac vice, Dan M. Berkovitz, Washington, D.C., and Gloria P. Clement, for **Commodity Futures Trading Commission**, respondent.

Allan A. Capute, of the District of Columbia bar, admitted pro hac vice, [Mark Cahn](#), Washington, D.C., [Anne K. Small](#) and Jacob H. Stillman, for Securities and Exchange **Commission**, respondent.

[Elliott Scheinberg](#), Staten Island, Nancy Kellman, White Plains, [Allan Mayefsky](#), New York City, [Michael Stutman](#) and [Aaron Weitz](#), amici curiae.

#### \*167 \*\*371 OPINION OF THE COURT

[GRAFFEO](#), J.

Stephen **Walsh** is a defendant in related actions brought by plaintiffs **Commodity Futures Trading Commission** and Securities and Exchange **Commission** (the Agencies) alleging violations of the anti-fraud provisions of the **Commodity Exchange Act** and the Securities Exchange Act. The Agencies claim that between 1996 and 2009, **Walsh** and his codefendant, Paul Greenwood, misappropriated more than \$550 million from funds they managed for various public and private institutional investors.<sup>FN1</sup>

<sup>FN1</sup>. Greenwood pleaded guilty to securities fraud charges in 2010. **Walsh's** criminal prosecution remains pending.

The Agencies also pursued disgorgement efforts against Janet Schaberg, the former spouse of **Walsh**, seeking to recover any proceeds she held of the fraud perpetrated by **Walsh**. Although there is no indication that she was aware of or participated in any wrongdoing related to her ex-husband's fraudulent scheme, the Agencies allege that a sizable amount of property derived from **Walsh's** illegal securities activities went into Schaberg's possession under the parties' separation agreement and divorce decree.

The United States Court of Appeals for the Second Circuit asks us two questions to assist it in discerning whether Schaberg has a legitimate claim to those funds, which would prevent the Agencies from obtaining disgorgement from her. These questions involve the interplay of the Domestic Relations Law and \*168 the Debtor \*\*372 \*\*\*824 and Creditor Law and implicate significant public policy considerations.

#### Background

Walsh and Schaberg were married in 1982 and have two children. Over the course of their 25-year marriage, Walsh was a substantial shareholder in or a management partner of a number of successful business enterprises, such as Champion Sportswear and Tanger Malls/Prime Outlets. As a couple, they acquired a number of homes, including condominiums in Florida and New York City, and a house in Port Washington, New York. Schaberg did not have outside employment during the marriage, but she volunteered at a number of charitable organizations.

In 2004, Schaberg and Walsh separated and divorce proceedings were initiated in early 2005. They entered into a "Stipulation of Settlement and Agreement" in November 2006 pursuant to [Domestic Relations Law § 236\(B\)\(3\)](#). Under the terms of the agreement, Schaberg conveyed her ownership interest in the Port Washington marital residence (with an alleged value of about \$7.5 million) to Walsh and she received sole ownership of the condominiums in New York City and Florida (with an alleged value of approximately \$6.7 million). The agreement also provided that Schaberg would retain nearly \$5 million held in several checking accounts and Walsh waived all claims to such monies. Walsh further agreed to pay Schaberg a distributive award of \$12.5 million, payable in biannual installment payments through 2020.<sup>FN2</sup> As part of the settlement, Schaberg further waived any claim for maintenance based on the parties' lengthy marriage and, except as otherwise provided in the agreement, relinquished her right "to a distributive award or an award of equitable distribution with respect to any

property acquired by [Walsh] either before or during the marriage.” In April 2007, the settlement agreement was incorporated, but not merged, into the parties’ final judgment of divorce. Schaberg moved to Florida in 2007 and remarried a year later.

**FN2.** Schaberg had received \$3 million in installment payments when Walsh ceased making the payments in 2009 as a result of a restraining order imposed on his assets.

Nearly two years after entry of the judgment of divorce, the Agencies filed separate complaints in the United States District Court for the Southern District of New York alleging large-scale **\*169** fraud by Walsh, Greenwood and various investment entities they controlled. Both complaints sought monetary penalties from the named defendants and disgorgement of ill-gotten gains from the defendants and relief defendants alike. Schaberg was named as a relief defendant, along with other parties believed to be in possession of proceeds from the fraudulent securities scheme.

The District Court granted the Agencies’ requests for preliminary injunctions freezing six of Schaberg’s brokerage and bank accounts containing approximately \$7.6 million. The court also prohibited Schaberg from transferring any real property, jewelry or artwork without court approval, thereby effectively freezing the bulk of her assets. Schaberg appealed, arguing that the District Court erred in issuing the injunctions because the property targeted by the injunctions was not subject to disgorgement.

The Second Circuit recognized that federal district courts have the power to order disgorgement from a relief defendant upon a finding that the party “(1) is in possession of ill-gotten funds and (2) lacks a legitimate claim to those funds” ( [618 F.3d 218, 225 \[2d Cir.2010\]](#) ). In this case, the Second Circuit has determined that the question as to whether the injunctions were properly issued turns on whether the **\*\*373 \*\*\*825** District Court correctly found, as a matter of law, that Schaberg

lacked a legitimate claim to the funds. **FN3** ACKNOWLEDGING SCHABerg’s assertion that she has a valid claim to the funds because “she acquired her assets pursuant to the separation agreement she executed with Walsh in their divorce proceedings, and that by executing this agreement she became a good faith purchaser for value of the assets” (*id.* at [226](#)), the court held that resolution of Schaberg’s contention implicated open issues of New York law. The Second Circuit therefore certified the following two questions to us:

**FN3.** The Second Circuit reserved judgment as to whether, under the first prong of the test, “some of her assets were purchased with funds that are not alleged to be the proceeds of fraud, and thereby would not be subject to disgorgement” ([618 F.3d at 226 n. 4](#)).

“(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 [\\*170New York Debtor and Creditor Law § 272](#) when she relinquishes in good faith a claim to the proceeds of fraud?” (*Id.* at [231–232](#).)

The Second Circuit also invited this Court to “reformulate these questions as it sees fit, or expand them to address any other issues of New York law pertinent to these appeals” (*id.* at [232](#)).

#### Marital Property

Schaberg asserts that she validly acquired certain assets pursuant to the settlement agreement, and that by entering into this agreement she became a good faith purchaser for value of the distributed property. The Agencies respond that monies derived from the securities fraud were not part of the marital estate in the first instance and, consequently, cannot be retained or transferred through equitable distribution of marital assets under [Domestic Relations Law § 236](#). The parties’ legal ar-

guments raise difficult policy questions, requiring us to weigh the competing interests of the original owners of funds stolen in a fraudulent scheme against the innocent former spouse of the defrauder.

We begin with the language and purpose of [Domestic Relations Law § 236](#), which codifies New York's Equitable Distribution Law. Under the terms of the statute, [section 236](#) “contemplates only two classes of property: marital property and separate property” ( *O'Brien v. O'Brien*, 66 N.Y.2d 576, 583, 498 N.Y.S.2d 743, 489 N.E.2d 712 [1985] ). Marital property is defined 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, regardless of the form in which title is held” ([Domestic Relations Law § 236\[B\]\[1\]\[c\]](#) ), and this broad definition “includes a wide range of tangible and intangible interests” (*Fields v. Fields*, 15 N.Y.3d 158, 162, 905 N.Y.S.2d 783, 931 N.E.2d 1039 [2010], *rearg. denied* 15 N.Y.3d 819, 908 N.Y.S.2d 152, 934 N.E.2d 885 [2010] [internal quotation marks and citation omitted] ). Separate property, in contrast, is narrowly limited to four discrete categories, none of which are applicable to this case.<sup>FN4</sup>

**FN4.** Specifically, separate property means:

“(1) property acquired before marriage or property acquired by bequest, devise, or descent, or gift from a party other than the spouse;

“(2) compensation for personal injuries;

“(3) property acquired in exchange for or the increase in value of separate property, except to the extent that such appreciation is due in part to the contributions or efforts of the other spouse;

“(4) property described as separate property by written agreement of the parties pursuant to subdivision three of this

part” ([Domestic Relations Law § 236\[B\]\[1\]\[d\]](#) ).

**\*\*\*826 \*\*374 Domestic Relations Law § 236** requires that a trial court equitably distribute marital property between the parties upon the dissolution of the marriage, while separate property remains **\*171** with the original spousal owner (*see* [Domestic Relations Law § 236\[B\]\[5\]](#) ). In making its distributive determination, the court is to consider a variety of statutory factors, including the duration of the marriage, the age and health of the parties, the income of each party, the extent of any maintenance award, the probable future financial circumstances of each party, and the nontitled spouse's direct or indirect contributions to the marriage, including “services as a spouse, parent, wage earner and homemaker” ([Domestic Relations Law § 236\[B\]\[5\]\[d\]](#) ). New York's Equitable Distribution Law also permits the parties—as happened here—to contract out of the elaborate statutory scheme and instead agree to a division or distribution of property, provided financial disclosure and the statutory requirements for a valid separation agreement are satisfied (*see* [Domestic Relations Law § 236\[B\]\[3\]](#) ).

[1] The Legislature adopted the Equitable Distribution Law in 1980 to replace the existing system of distribution, which had depended, in large measure, on the traditional common-law title theory of property. In recognition that marriage represents “an economic partnership to which both parties contribute as spouse, parent, wage earner or homemaker,” the Equitable Distribution Law was designed on “an entirely new theory which considered all the circumstances of the case and of the respective parties to the marriage” (*O'Brien*, 66 N.Y.2d at 585, 498 N.Y.S.2d 743, 489 N.E.2d 712). The comprehensive regime

“reflects an awareness that the economic success of the partnership depends not only upon the respective financial contributions of the partners, but also on a wide range of nonremunerated services to the joint enterprise, such as homemaking,

raising children and providing the emotional and moral support necessary to sustain the other spouse in coping with the vicissitudes of life outside the home” (*Price v. Price*, 69 N.Y.2d 8, 14, 511 N.Y.S.2d 219, 503 N.E.2d 684 [1986] [internal quotation marks and citations omitted] ).

Consistent with this purpose, and implicit in the statutory framework as a whole, is the concept that “upon dissolution of \*172 the marriage there should be a winding up of the parties' economic affairs and a severance of their economic ties by an equitable distribution of the marital assets” ( *O'Brien*, 66 N.Y.2d at 585, 498 N.Y.S.2d 743, 489 N.E.2d 712).

[2][3][4] Against this legislative backdrop, we must decide whether the dictates of *Domestic Relations Law § 236* and the purposes of equitable distribution permit the transfer of marital assets to a recipient spouse who is unaware that some or all of those assets were illegally acquired by the other spouse. The statute expansively defines marital property to encompass “all property acquired” by either spouse during the course of the marriage and there is a presumption that “all property, unless clearly separate, is deemed marital property” ( *Fields*, 15 N.Y.3d at 163, 905 N.Y.S.2d 783, 931 N.E.2d 1039 [internal quotation marks and citation omitted] ). Furthermore, the term “acquired” does not require that property be segregated by its methods of acquisition; it merely means that a person gains possession (*see* Black's Law Dictionary 26 \*\*375 \*\*\*827 [9th ed. 2009] ). Given that we have repeatedly held that the scope of marital property is to be “construed broadly” (*see e.g. Mesholam v. Mesholam*, 11 N.Y.3d 24, 28, 862 N.Y.S.2d 453, 892 N.E.2d 846 [2008] [internal quotation marks and citation omitted] ), we conclude that the proceeds of fraud can constitute marital property as defined in *Domestic Relations Law § 236* and answer the first certified question in the affirmative. It is therefore possible under the *Domestic Relations Law* to transfer assets derived from fraud to an innocent and unknowing spouse in a divorce proceed-

ing.

Nevertheless, the Agencies argue that, putting aside the language of *Domestic Relations Law § 236* and focusing on public policy considerations favoring the return of stolen property to its rightful owner, we should carve out an exception to the broad definition of marital property for the proceeds of fraud. They suggest that where, as here, it is alleged that the property transferred in a divorce proceeding was itself derived from stolen funds, a court should not reach the issue of fair consideration (the topic of the Second Circuit's second certified question) because it is simply irrelevant whether fair consideration was given. In their view, the original owner—a victim of embezzlement and not a mere creditor—should have an absolute right to seek disgorgement of the previously distributed property from the transferee-spouse. Although these contentions have appeal, we are unable to agree.

[5][6] It has long been the law of this State that “money obtained by fraud or felony cannot be followed by the true owner into the \*173 hands of one who has received it *bona fide* and for a valuable consideration in due course of business” (*Stephens v. Board of Educ. of Brooklyn*, 79 N.Y. 183, 186 [1879] ). This principle is premised on the recognition that, in contrast to chattels, “money has no earmark” and “cannot be identified” (*Hatch v. Fourth Natl. Bank of City of N.Y.*, 147 N.Y. 184, 192, 41 N.E. 403 [1895] ).<sup>FN5</sup> At its core, our rule favoring innocent transferees of stolen funds over defrauded owners is rooted in New York's “concern for finality in business transactions” (*Banque Worms v. BankAmerica Intl.*, 77 N.Y.2d 362, 372, 570 N.E.2d 189 [1991] ). We have explained that

FN5. By comparison, an owner may seek recovery of identifiable stolen property, such as a piece of artwork, from an innocent good faith purchaser for value (*see Solomon R. Guggenheim Found. v. Lubell*, 77 N.Y.2d 311, 317, 567 N.Y.S.2d 623, 569 N.E.2d 426 [1991] ).



“to permit in every case of the payment of a debt an inquiry as to the source from which the debtor derived the money, and a recovery if shown to have been dishonestly acquired, would disorganize all business operations and entail an amount of risk and uncertainty which no enterprise could bear” (*id.* [internal quotation marks and citation omitted] ).

[7] Similar concerns are relevant in the matrimonial realm. Ex-spouses have a reasonable expectation that, once their marriage has been dissolved and their property divided, they will be free to move on with their lives. To hold that the proceeds of fraud acquired by one spouse unbeknownst to the other cannot be subject to equitable distribution or conveyed through a settlement agreement as marital property would undermine one of the fundamental policies underlying the equitable distribution process, namely finality. The exception proposed by the Agencies would effectively undo court orders and settlement agreements for an indeterminate time after the “winding up of the parties' economic affairs” **376** **828** (*O'Brien*, 66 N.Y.2d at 585, 498 N.Y.S.2d 743, 489 N.E.2d 712), and “subvert the policy of upholding settled domestic relations ... in divorce cases” (*Rainbow v. Swisher*, 72 N.Y.2d 106, 111, 531 N.Y.S.2d 775, 527 N.E.2d 258 [1988]; see also *Boronow v. Boronow*, 71 N.Y.2d 284, 290–291, 525 N.Y.S.2d 179, 519 N.E.2d 1375 [1988] ).

[8] Moreover, as a practical matter, where the innocent spouse and matrimonial court are unaware of the tainted nature of particular assets, distribution of marital assets under [Domestic Relations Law § 236](#) (or pursuant to an opt-out settlement agreement) would become unworkable, particularly where the illegal activity of one spouse is not revealed for a number of **174** years subsequent to the divorce, as occurred in this case.<sup>FN6</sup> Analogizing to the rule articulated in *Stephens* and *Hatch* in the business setting, we conclude that monies obtained by fraud cannot be followed by the original owner into the hands of an innocent former spouse

who now holds them (or assets derived from them) as a result of a divorce proceeding where that spouse in good faith and without knowledge of the fraud gave fair consideration for the transferred property. That being said, whether Schaberg acted in good faith and paid fair consideration for the tainted property that came into her possession pursuant to the settlement agreement is another matter and is at the heart of the Second Circuit's second question, to which we now turn.

**FN6.** Of course, an entirely different situation is presented if it is known that both spouses participated in or were aware of the fraud or illegal conduct. In such cases, courts have held that it would be contrary to public policy to encourage “illegal activity by making an equitable distribution of the fruits of a criminal enterprise” ( *LaPaglia v. LaPaglia*, 134 Misc.2d 1030, 1032, 514 N.Y.S.2d 317 [Sup. Ct., Kings County 1987] ).

#### Fair Consideration

Schaberg contends that the District Court erred in holding, as a matter of law, that she lacked a legitimate claim to the frozen funds. She argues that she provided fair consideration in exchange for the allegedly fraudulent proceeds and thereby became a good faith purchaser for value through her execution of an arm's length separation agreement. She also claims that there is no evidence that she had knowledge of her ex-husband's illegal conduct, particularly since he had a history of being a successful entrepreneur and securities trader, nor did she engage in collusion in the divorce proceeding to deprive the defrauded parties recovery of their investments. The Agencies counter that, as a matter of law, Schaberg could not have given fair consideration because, in exchange for acquiring assets that were later determined to be derived from fraud, she only gave up a claim to a larger portion of the marital estate, which also consisted of Walsh's proceeds of fraud and, as such, her consideration was illusory. Again, both parties raise compelling argu-

ments.

[9] [Debtor and Creditor Law § 278](#) provides that a creditor whose claim has matured may have a fraudulent conveyance set aside “against any person” other than a good faith purchaser for value, defined as “a purchaser for fair consideration without \*175 knowledge of the fraud” ([Debtor and Creditor Law § 278](#)[1]). Fair consideration is given for property “[w]hen in exchange for such property, ... as a fair equivalent therefor, and in good faith, property is conveyed or an antecedent debt is satisfied” ([Debtor and Creditor Law § 272](#)[a]). It is well settled that an evaluation of whether fair consideration is given for property under [Debtor and Creditor Law § 272](#) must “be determined \*\*377 \*\*\*829 upon the facts and circumstances of each particular case” (*Halsey v. Winant*, 258 N.Y. 512, 523, 180 N.E. 253 [1932]).<sup>FN7</sup>

FN7. Here, as the Second Circuit noted, “it is essentially undisputed that Schaberg had no notice that the money she received in her divorce was derived from fraud” (618 F.3d at 229 n. 8), and “there is no reason to question Schaberg’s good faith” (*id.* at 230) in her execution of the settlement agreement. Hence, the only relevant element of [Debtor and Creditor Law § 272](#) is whether she gave “fair consideration” for the allegedly tainted assets she received through the parties’ property settlement.

[10] In assessing whether a spouse pays fair consideration within the meaning of [Debtor and Creditor Law § 272](#) in connection with a property distribution made pursuant to a separation agreement incorporated into a judgment of divorce, a court must examine a number of factors. Since consideration cannot be predicated on a spouse’s relinquishment of a claim to a greater share of the proceeds of fraud, the first step is to determine whether the spouse relinquished rights to other untainted assets in the marital estate. Clearly, this would constitute fair consideration.

Second, a court needs to look beyond the tangible marital property at issue because New York recognizes other forms of legitimate consideration, including nonmonetary consideration. For example, New York courts have found fair consideration where a spouse releases a claim for maintenance ( *see Federal Deposit Ins. Co. v. Malin*, 802 F.2d 12, 20 [2d Cir.1986]; *In re Fair*, 142 B.R. 628, 631 [Bankr.E.D.N.Y.1992]; *Darling v. Darling*, 22 Misc.3d 343, 358, 869 N.Y.S.2d 307 [Sup. Ct., Kings County 2008] ) or where consideration is predicated on “legally cognizable aspects of [the transferor’s] child support obligation” (*see First Fed. Sav. & Loan Assn. of Rochester v. Kasmer*, 140 A.D.2d 826, 828, 528 N.Y.S.2d 216 [3d Dept.1988] ). Similarly, the waiver of inheritance rights and the relinquishment of other “rights and remedies otherwise conferred by law” are also relevant to the determination of fair consideration ( *Marine Midland Bank–N.Y. v. Batson*, 70 Misc.2d 8, 10, 332 N.Y.S.2d 714 [Sup. Ct., Nassau County 1972] ). It is also possible that child custody or visitation concessions could be viewed as a \*176 valuable form of consideration. Indeed, based on the myriad types of consideration that arise in the unique context of marital dissolution, courts have repeatedly stated that “transfers made pursuant to a valid separation agreement incorporated into a divorce decree are presumed to have been made for fair consideration” (*Durand v. Ackerman*, 2010 WL 3834587, \*7, 2010 U.S. Dist. LEXIS 101755, \*21 [E.D.N.Y.2010]; *see also In re Cersosimo*, 2009 WL 3182989, \*4, 2009 Bankr LEXIS 2009, \*13–14 [E.D.N.Y.2009]; *Darling*, 22 Misc.3d at 358–359, 869 N.Y.S.2d 307).

[11] In certifying the second question to us, the Second Circuit implicitly presumed that the only consideration Schaberg could have given in exchange for the tainted property she received was her release of a claim to other proceeds of the fraud—if that is the case, her claim would be illusory. Despite Schaberg’s claim to the contrary, we must accept for purposes of answering this question the Second Circuit’s assumption that the marital es-

tate here “consisted almost entirely of the proceeds of fraud” (618 F.3d at 230). Yet, as we’ve discussed, there are other valid forms of consideration that are relevant to the determination of fair consideration, even where the bulk of a marital estate consists of ill-gotten gains. We therefore reformulate the second question to read as follows: “Is a determination that a spouse paid ‘fair consideration’ according to the terms of **\*\*378\*\*830** *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 fraud?” As reformulated, and under our analysis, we answer this question in the negative.

[12] Of course, the ultimate determination as to whether Schaberg gave fair consideration pursuant to *Debtor and Creditor Law § 272* under the facts and circumstances of this case is a matter for the federal courts to resolve. But we note, on this limited record, that Schaberg contends that she surrendered more than her right to claim through equitable distribution a greater portion of fraudulently obtained funds constituting the marital estate. She alleges that she waived a claim for maintenance under *Domestic Relations Law § 236(B)(6)*, the calculation of which is based on a variety of considerations, including the length of the marriage; she released her right to inherit from Walsh’s estate; and she dispensed with her interest in the multimillion-dollar marital residence located in Port Washington, **\*177** which she claims was not acquired with moneys derived from Walsh’s fraudulent activities.<sup>FN8</sup> Furthermore, even where a spouse does not relinquish a “fair equivalent” for the aggregate of assets, it is possible that fair consideration may be exchanged for at least some of the assets (cf. *Corporation of Lloyd’s v. Funk*, 246 A.D.2d 570, 572, 668 N.Y.S.2d 211 [2d Dept.1998], lv. dismissed 91 N.Y.2d 1002, 676 N.Y.S.2d 129, 698 N.E.2d 958 [1998]).

FN8. In particular, Schaberg asserts that the Port Washington property was purchased in 1999 with funds derived from

the sale of their previous marital residence, which in turn had been bought with legitimate funds in the early 1980s, long before **Walsh’s** allegedly fraudulent conduct took place. Notably, **Walsh** was apparently permitted to sell the Port Washington home and use a portion of the untainted proceeds from that sale to pay legal fees incurred in connection with his criminal prosecution ( see *Commodity Futures Trading Commn. v. Walsh*, 2010 WL 882875, \*3, 2010 U.S. Dist LEXIS 21992, \*9 [SD N.Y.2010] ).

[13][14][15] In sum, we are not unsympathetic to the interests of parties who were fraudulently deprived of their investments and who, understandably, seek the return of a portion of their stolen monies. Most definitely, the victims of fraud are entitled to pursue disgorgement where it is demonstrated that the transferee-spouse was aware of or participated in the fraud or otherwise failed to act in good faith. One example of bad faith would be where the parties entered into a collusive divorce arrangement designed to conceal stolen money from its rightful owner. And even where the recipient executed a settlement agreement in good faith and without knowledge of the source of the ill-gotten gains, the defrauded parties may still recover if the spouse did not give fair consideration for the property under *Debtor and Creditor Law § 272*. But we believe that 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 or owners consistent with this State’s strong public policy of ensuring finality in divorce proceedings.<sup>FN9</sup>

FN9. The Agencies suggest that disgorgement should be allowed because, upon turning the funds over to them, Schaberg could move to vacate the settlement agreement in state court on fraud grounds and seek a redistribution of any untainted assets Walsh may have received. But such an exercise would likely be fruitless, particu-

larly where it appears that, years after the property division, Walsh liquidated the only purportedly “clean” asset he owned—the Port Washington house.

Accordingly, the first certified question and, as reformulated, the second certified question should be answered in accordance with this opinion.

\*\*\*831 \*\*379 PIGOTT, J. (dissenting in part).

\*178 I agree with the majority's analysis and conclusion relative to the first certified question. I also agree with much of what the majority says in its discussion of the second question, but find its reformulation of that question unnecessary. The Second Circuit posed a narrowly tailored question that is relatively simple to answer, namely, “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?” (*Commodity Futures Trading Commn. v. Walsh*, 618 F.3d 218, 231–232 [2d Cir.2010].) I would answer that question in the negative.

[Debtor and Creditor Law § 278](#) states that a creditor with a matured claim may have a conveyance set aside against anyone “except a purchaser for fair consideration without knowledge of the fraud at the time of the purchase” ([Debtor and Creditor Law § 278](#)[1][a]). “Fair consideration is given for property, or obligation, ... [w]hen in exchange for such property, or obligation, as a fair equivalent therefor, and in good faith, property is conveyed or an antecedent debt is satisfied” ([Debtor and Creditor Law § 272](#) [a]).

The second certified question posed by the Second Circuit assumes that almost all of the proceeds in the marital estate consisted of the proceeds of fraud, the position taken by the **Commodity Futures Trading Commission** and the Securities and Exchange **Commission** (see 618 F.3d at 230 [noting that “in her separation from Walsh, Schaberg relinquished future claims to an equitable distribution of marital property that—it is al-

leged—consisted almost entirely of the proceeds of fraud”]). The Second Circuit also notes that “there is no reason to question Schaberg's good faith in relinquishing her claim to what she believed was a legitimate interest in a substantial fortune” (*id.* at 230). Taking these facts into account, the question is, assuming that the marital estate consists almost entirely of the proceeds of fraud, does an “innocent spouse” like Schaberg, by virtue of relinquishing future claims to those proceeds, pay fair consideration? The answer is, of course, “no,” as the majority essentially acknowledges: “consideration cannot be predicated on a spouse's relinquishment of a claim to a greater share of the proceeds of fraud” (majority op. at 175, 927 N.Y.S.2d at 829, 951 N.E.2d at 377).

Schaberg's forbearance from “ ‘seek[ing] through court proceedings or otherwise a distributive award or an award of equitable distribution with respect to’ any other property acquired by [Walsh] over the course of their marriage” \*179(*Walsh*, 618 F.3d at 229) does not constitute “fair consideration” where, as the Second Circuit has asked us to assume here, the Walsh proceeds were obtained as the result of fraud. 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. In such a case, the innocent spouse “has not given value for the misappropriated property, but rather has gained an interest in the property simply by virtue of being married to the person who misappropriated” it (see generally *In re Marriage of Allen*, 724 P.2d 651, 659 [Colo.1986] [citing cases]). Accordingly, I would answer the second certified question in the negative.

Chief Judge LIPPMAN and Judges CIPARICK, READ and JONES concur with Judge GRAFFEO; Judge PIGOTT dissents in part in a separate opinion in which Judge SMITH concurs.

\*\*\*832 \*\*380 Following certification of ques-

17 N.Y.3d 162, 951 N.E.2d 369, 927 N.Y.S.2d 821, 2011 N.Y. Slip Op. 05366  
(Cite as: 17 N.Y.3d 162, 951 N.E.2d 369, 927 N.Y.S.2d 821)

tions by the United States Court of Appeals for the Second Circuit and acceptance of the questions by this Court pursuant to section 500.27 of the Rules of the Court of Appeals ([22 NYCRR 500.27](#)), and after hearing argument by counsel for the parties and consideration of the briefs and the record submitted, certified questions answered in accordance with the opinion herein.

N.Y.,2011.

Commodity Futures Trading Com'n v. Walsh

17 N.Y.3d 162, 951 N.E.2d 369, 927 N.Y.S.2d 821,  
2011 N.Y. Slip Op. 05366

END OF DOCUMENT