

Classifying Personal Injury Settlements in the Second Department

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In article in last month's issue of this newsletter discussed the facts of the recent case of *Howe v. Howe*, ___ A.D.3d ___, ___ N.Y.S.2d ___, 2009 WL 3136332 (2d Dept. 2009), and its outcome in the Appellate Division, Second Judicial Department. The case addressed several important issues concerning the classification of personal injury awards and disability benefits in a divorce action. It also dealt with the quantum of evidence required to show that an asset should be treated as economic, rather than disability, compensation.

There are some important lessons matrimonial attorneys practicing in the Second Department should take from this case. Let's explore some of them.

Court Says Economic Components of Personal Injury Settlements Are Separate

One of the issues addressed by the Appellate Division in *Howe* was whether a portion of a settlement received by the husband following an injury, which represented compensation for economic loss that occurred during the marriage, should be considered marital property subject to equitable distribution. Although the Court of Appeals had never addressed the issue, many thought that the question had been settled. As the Second Department noted in *Howe*, "The

conventional wisdom that the economic component of a personal injury award is separate property is derived from the holding of the Appellate Division, Third Department, in *Fleitz v. Fleitz*, 200 AD2d 874, 606 NYS2d 825 and the decisions of the Appellate Division, First Department and the Appellate Division, Fourth Department, that have followed it (*see Gann v. Gann*, 233 AD2d 188, 649 NYS2d 154; *Solomon v. Solomon*, 206 AD2d 971, 615 NYS2d 949).” That being said, the Second Department had yet to weigh in, which it did in *Howe*.

The husband in the divorce case had become a New York City firefighter soon after the parties’ marriage and had remained employed with the Fire Department until approximately 16 months prior to the commencement of the divorce action. During the period immediately following the terrorist attacks on 9/11, the husband became disabled as a result of his service and retired with a disability pension. He also received an award from the September 11th Victims Compensation fund. A portion of the award, in the amount of \$127,571, was specifically designated as compensation for economic loss.

At the trial of the parties’ divorce action, the wife asserted that the portion of the award from the Victims Compensation Fund designated as compensation for economic loss (as opposed to compensation for non-economic injuries such as pain and suffering) should be considered marital property subject to equitable distribution. The Supreme Court rejected the wife’s argument, holding that the economic component of the award constituted “compensation for personal injuries” within the meaning of Domestic Relations Law ‘ 236(B)(1)(d)(2) and, therefore, the entire award was the separate property of the husband.

The Second Department found initially that a portion of the award was indeed intended to compensate the husband for earnings lost by him during the parties’ marriage. Therefore, if in fact the economic portion of the award could properly be considered marital property, the wife would have a valid claim to some portion of it. It was here that the Second Department deviated from its brethren.

In *Fleitz v. Fleitz*, 200 AD2d 874 (3d Dept. 1994), the Third Department held that there was no ambiguity in the text of Domestic Relations Law (DRL) § 236(B)(1)(d) that required interpretation. That court found that the definition of “separate property” contained therein made no distinction between the economic and non-economic elements of personal injury compensation. The Second Department was less convinced than the *Fleitz* court, however, that the phrase “compensation for personal injuries” as used in DRL § 236(B)(1)(d) was unambiguous concerning the question of what constitutes separate vs. marital property. “The phrase ‘compensation for personal injuries,’” the Second Department said, “is not without ambiguity. It can be read equally clearly as encompassing the entire award in a personal injury action or as limiting the marital share of that award to the portion constituting compensation for the actual injuries, *i.e.*, the pain and suffering component. While a definition of the term separate property as ‘any recovery in a personal injury action’ would be clear, that is not the phrase the Legislature used.”

The court stated that viewing the phrase “compensation for personal injuries” as including the economic component of a personal injury award would be inconsistent with the logic of the Equitable Distribution Law. However, notwithstanding its statements indicating a contrary result, the Second Department, relying primarily on legislative history, including the commentaries of Professor Henry H. Foster (who, according to the court, was actively involved in drafting New York’s Equitable Distribution Law), concluded that the phrase “compensation for personal injuries” as utilized in DRL § 236(B)(1)(d)(2) was meant to include the economic as well as the non-economic aspects of a personal injury award. According to the court, the commentaries of Dr. Foster indicated that the exception from marital property for personal injury compensation, without segregating out the element of compensation for economic loss, was included in order to obtain additional and important backing for the new law. Therefore, based on this legislative history, the court held that such an award ‘including any economic component’ is the separate property of the recipient spouse.

What It Means to the Non-Injured Spouse

It is apparent that the holding in *Howe* may, in certain circumstances, have devastating consequences economically for the spouse of an individual who is disabled, incurs substantial medical bills and is unable to work as a result of an injury. It is not difficult to imagine a situation in which the primary breadwinner in a marriage is injured and unable to continue employment as a result of disability. In this hypothetical situation, the parties may be compelled to deplete marital assets and incur massive debts while awaiting for years the resolution of the disabled spouse's personal injury claims. Furthermore, in order to meet ongoing expenses, the non-injured spouse may be required to expend any earnings from his or her own employment, rather than accumulating savings. After years of struggling financially, the day comes when the disabled spouse receives his or her personal injury settlement, which includes compensation for economic loss experienced over a period of many years during the marriage. Although the parties have entirely depleted their marital assets and suffered years of economic hardship, in a divorce action between the parties, the recovery by the disabled spouse will be considered entirely his or her separate property under the holding in *Howe*.

The aforesaid result would clearly be inequitable. Although the court may attempt through the exercise of discretion to rectify any inequity that may be created by classifying the economic components of a personal injury award as the separate property of the recipient spouse, these remedies may prove ineffectual. For example, where appropriate, the court may try to remedy the inequity through an award of maintenance. However, if the spouse seeks to remarry following the divorce, this would not remedy the situation. The court may also consider a disproportionate distribution to the non-injured spouse of any remaining marital assets. However, if there are no remaining marital assets to distribute as a result of the expenditure of these assets during the period of disability, this remedy may not be available to the court.

As recognized by Justice Robert A. Spolzino in writing for the court in *Howe*, the blanket classification of the economic components of a personal injury award as the separate property of the injured spouse is clearly inconsistent with the logic behind the Equitable Distribution Law,

the purpose of which is “to treat marriage in one respect as an economic partnership.” *Hartog v. Hartog*, 85 NY2d 36 (1995). For example, currently in the State of New York, the enhanced earning capacity attributable to licenses and advanced degrees earned during the marriage is valued based on projected post-commencement earnings and treated as marital property subject to equitable distribution. Surely if the equitable distribution law can continue to have such a broad application in defining marital assets, the legislature should consider an amendment to DRL ‘ 236(B)(1)(d) to provide that the portion of a personal injury recovery representing compensation for economic loss suffered during the marriage, including lost wages and medical expenses, is to be considered marital property subject to equitable distribution.

Disability Pensions

In *Howe*, the Second Department went on to consider the issues of whether the failure to present expert testimony to establish the separate portion of a public disability pension precludes the court from making a determination that a portion of the pension is separate property. The court then addressed the methodology to be employed in determining what portion of a public disability pension constitutes separate property of the titled spouse.

After trial, Supreme Court in *Howe* had found that the husband had failed to meet his burden of establishing through expert testimony that a portion of his disability pension was separate property. Therefore, Supreme Court determined that the entire pension constituted marital property subject to equitable distribution and awarded the wife a share of the pension pursuant to the *Majauskas* formula (*see Majauskas v. Majauskas*, 61 NY2d 481 (1984)).

The husband appealed the trial court’s determination with respect to the distribution of his disability pension, contending that the lack of expert testimony was not fatal to his separate property claim because, according to him, the determination as to which portion of the pension constituted separate property could be made by the pension administrator.

In addressing the issue, the Appellate Division noted that, to the extent the disability pension represents deferred compensation, it is subject to equitable distribution. Conversely, to the extent

that a disability pension constitutes compensation for personal injuries, that portion of the pension is separate property that is not subject to equitable distribution. Notwithstanding the husband's failure to present expert testimony, and his apparent failure to establish the separate property component of the disability pension, the Appellate Division held that, under the circumstances, his failure to meet this burden was not fatal to his claim. The Second Department cited its decision in *Carney v. Carney*, 236 AD2d 574 (2d Dept. 1997), in which it had affirmed as being within the discretion of the trial court an order reopening the trial to permit the firefighter/husband to introduce evidence necessary to establish the separate portion of his disability pension. It noted that in *Carney* the decision was based on "the court's implicit conclusion that the deficiency of proof on this issue at the trial deprived the defendant of substantial justice." It also cited the decision in *McNelis v. McNelis*, 6 AD3d 673 (2d Dept. 2004), in which it was determined that the husband's testimony was sufficient, without more, to reverse a determination that the defendant's husband's pension was entirely marital property.

In *Howe*, the court concluded that, under the facts of the case, the separate portion of the husband's pension could be determined, despite the limited evidence with respect to the issue in the record. The court, citing *Palazzolo v. Palazzolo*, 242 AD2d 688 (2d Dept. 1997), set forth a specific methodology by which the disability and non-disability portions of a public employee's pension are defined. The court noted that although the record was insufficient for it to make the requisite calculation, that information would be available to the pension administrator and an appropriate Domestic Relations Order could be drafted to implement the distribution pursuant to the methodology set forth by the court. Therefore, despite an utter failure of proof on the issue, the court remitted the matter for the entry of an appropriate domestic relations order consistent with the decision.

Conclusion

The decision in *Howe* with respect to the distribution of the husband's disability pension is noteworthy in several respects. First, the decision makes it clear that despite a party's failure at trial to meet his or her burden of demonstrating that an asset ' and in particular a disability

pension ‘ constitutes separate property, the court may in any event credit the separate property claim. The decision is also noteworthy in that it adopts a methodology by which the separate and marital portions of the public disability pension may be distinguished without resorting to expert testimony. However, although the methodology appears on its face to resolve the issue of the classification of marital property, it does not address issues which certainly arise in the drafting of an appropriate domestic relations order, such as the allocation of pre-retirement benefits and the selection of either a single life annuity or joint and survivor options. Furthermore, as noted by the court in *Howe*, in many situations, such as those involving private disability pensions, the methodology set forth therein may be unworkable. In those situations, a party seeking to establish a separate property component of such a pension would be well advised to establish a complete trial record, including expert testimony concerning the issue, if necessary.

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