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Evolving Case Law on What Economic Injuries Are Sufficient to Satisfy New York's Long-Arm Jurisdiction Statute

Civil Procedure

Jurisdiction

New York's long arm statute allows state courts to exercise personal jurisdiction over an out of state defendant that commits a tortious act outside the state that caused injury in it. But attorneys from Weil, Gotshal & Manges LLP suggest that defendants facing claims of economic harm have a much more difficult time showing that sufficient damages alleged occurred within the state of New York. However, recent case law involving intellectual property rights are more likely to be found to be subject to the statute than those facing other business related claims.

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Introduction

New York Civil Practice Law and Rules 302(a) allows a New York court to exercise personal jurisdiction over a non-domiciliary who ''(3) commits a tortious act without the state causing injury to person or property within the state, except as to a cause of action for defamation of character arising from the act, if he . . . (ii) expects or should reasonably expect the act to have consequences in the state and derives substantial revenue from interstate or international commerce.''

Thus, a New York court has jurisdiction over an out-of-state defendant (assuming federal due process requirements are satisfied) if a plaintiff can adequately allege that: (1) the defendant committed a tortious act outside the state; (2) the cause of action arises from that act; (3) the tortious activity caused injury within the state; (4) the defendant expected or should reasonably have expected the act to have consequences in the state; and (5) the defendant derives substantial revenue from interstate or international commerce. *LaMarca v. Pak-Mor Mfg. Co.*; *see generally* David D. Siegel, N.Y. Practice § 88 (5th ed.).

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Federal due process requirements, of course, allow a state to exercise personal jurisdiction over an out-of-state defendant only if that defendant has sufficient ''minimum contacts'' with the forum such that the exercise of jurisdiction ''does not offend 'traditional notions of fair play and substantial justice.' '' *Int'l Shoe Co. v. Washington.*

As the U.S. Supreme Court recently held, ''[i]n order for a court to exercise specific jurisdiction over a claim, there must be an 'affiliation between the forum and the underlying controversy, principally, [an] activity or an occurrence that takes place in the forum State.' '' *Bristol-Myers Squibb Co. v. Super. Ct. of Cal., S.F. Cty.* (quoting *Goodyear Dunlop Tires Operations, S.A. v. Brown.)* The *Bristol-Myers Squibb* court noted that the nonresident plaintiffs there ''were not prescribed Plavix [the drug at issue] in California, did not purchase Plavix in California, did not ingest Plavix in California, and were not injured by Plavix in California'' and, as a result, held that California did not have an adequate link with the nonresidents' claims to assert personal jurisdiction over the out-of-state defendant.

This due process case law highlights the importance of the in-state injury requirement in CPLR 302(a)(3). In this context, determining whether physical harm was

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suffered—say from a traffic or industrial accident—within New York is comparatively simple; locating the situs of a financial injury, on the other hand, can be a more complex endeavor. The case law interpreting CPLR 302(a)(3)(ii) makes clear that a primary economic injury must be in-state and that an *in*direct economic injury suffered by a New York-based plaintiff (*e.g.*, a loss of revenue or profits by a New York company as a result of sales lost in another state) is insufficient.

In the leading case, *Fantis Foods, Inc. v. Standard Importing Co.*, a New York-based wholesaler filed a third-party claim against a Greek co-operative dairy association. It was alleged that the association diverted, from the plaintiff to a competing wholesaler, from a warehouse in Greece or on the high seas, feta cheese that had been ordered and accepted for delivery by the New York plaintiff. While the plaintiff was based in New York, the cheese had been contracted for delivery to Chicago. The diversion caused the New York plaintiff lost sales and profits.

The New York Court of Appeals, New York's highest court, held that New York did *not* have long-arm jurisdiction over the non-domiciliary defendant since the alleged tort occurred out of state—where the cheese allegedly was diverted—and the primary injury was felt by the plaintiff in Chicago where the cheese was to be shipped (and presumably sold). Because the only injury from (or foreseeable consequence of) the tort in New York was the fact that the plaintiff was located in New York and in that sense suffered an indirect loss of revenue or profits here, the court held there was no jurisdiction because the injury was too remote to satisfy the requirement that an injury occur within the state.

Cases Finding Insufficient Economic Injury in New York *Fantis Foods,* notwithstanding that it was decided over 35 years ago and thus in a very different world of commerce, remains good law and continues to be cited by state and federal courts for the proposition that an economic injury must be suffered in-state that is more than just an indirect financial loss in order to satisfy CPLR 302(a)(3)(ii).

Interestingly, *Fantis Foods* followed (and cited) the Second Circuit's earlier ruling in *American Eutectic Welding Alloys Sales Co. v. Dytron Alloys Corp.* There, the plaintiffs were two New York corporations that alleged that one of the defendants, a competitor of plaintiffs, damaged their business by inducing plaintiffs' sales representatives to come to work for that defendant and ''use confidential information to woo away plaintiffs' customers'' *in states outside of New York*, thereby causing injury to plaintiffs in New York. The District Court held that it lacked personal jurisdiction under New York's long arm statute because there was no ''substantial contact'' with New York.

On appeal, the Second Circuit noted the absence (at that time) of ''express guidance'' from that court or the New York Court of Appeals ''whether such damage is, under section 302(a)3, 'injury ... within the state.' '' The Second Circuit then observed that ''[r]esolution of that issue is complicated by the fact that the alleged tort here is not the type [CPLR 302(a)(3)] was primarily designed to cover, since the tortious activity and its resulting damage are of a commercial rather than a physical nature. Nevertheless we must locate the situs of injury . . .''

The Second Circuit continued, ''[o]f course, there is no question that plaintiffs suffered some harm in New York in the sense that any sale lost anywhere in the United States affects their profits. But that sort of derivative commercial injury in the state is only the result of plaintiffs' domicile here.'' It added:

> Conceptually it is difficult for this Court to hold that a [plaintiff who suffers a] personal or property injury in another state by virtue of a tortious act committed in that state can be said to have suffered some injury within the State of New York simply because he is domiciled here. In other words, Section 302(a)(3) of the CPLR looks to the imparting of the original injury within the State of New York and not resultant damage, in order that jurisdiction might be effectuated. To hold otherwise would open a veritable Pandora's Box of litigation subjecting every conceivable prospective defendant involved in an accident with a New York domiciliary to defend actions brought against them in the State of New York. This is hardly the minimal contact with the State prerequisite to the exercise of its power over a prospective defendant.

The Court concluded that, ''we believe that the New York courts would refuse to sustain jurisdiction . . . on these facts . . .'' The Second Circuit thus correctly predicted *Fantis Foods*.

New York courts have continued to apply the rule that long-arm jurisdiction under CPLR 302(a)(3)(ii) is not available to a plaintiff just because it suffers some indirect financial loss in New York. In *Flamel Tech. v. Soula*, for example, a French corporation authorized to do business in New York brought an action in New York against its former president, a French citizen, seeking a declaratory judgment that the defendant must turn over certain intellectual property that he allegedly misappropriated when he left the company. The plaintiff further alleged that the defendant made false statements in France that he was co-owner of plaintiff's technology, which statements allegedly caused injury to the corporation's investors in New York. The defendant moved to dismiss for lack of personal jurisdiction.

The court held that ''[p]laintiff's attempt to establish jurisdiction pursuant to CPLR 302(a)(3)(ii) lacks merit, as the New York courts generally hold that the situs of the injury for a tort is where the events giving rise to the injury occurred, and is not based upon the fact that a party who happens to incur an indirect financial loss is domiciled in New York.'' As a result, the allegations of the complaint were held not to satisfy CPLR 302(a)(2)'s requirement that an injury be suffered in New York.

More recently, in *BGC Partners Inc. v. Avison Young (Canada) Inc.*, a real estate brokerage company and its newly-acquired subsidiary sued a competing broker and multiple affiliates of that broker alleging conspiracy to unlawfully loot the assets of the subsidiary, tortious interference, theft of trade secrets, and aiding and abetting breach of fiduciary duty. Plaintiffs alleged that defendants stole commissions, offices, contracts, sales and financial services, trade secrets, and personnel from real estate offices across the country.

The trial court, citing *Fantis Foods*, declined to exercise jurisdiction over various non-New York defendants. It found a failure to allege facts from which it could be inferred that (i) such defendants reasonably expected their acts to have consequences in New York and (ii) plaintiffs suffered a direct injury in New York—given the out-of-state nature of the alleged wrongful

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acts and given that the only injury alleged to have been sustained in New York from the torts of those defendants was the alleged diversion of commissions, which it found constituted only indirect or derivative economic injury to the plaintiffs in New York. (''It has, however, long been held that the residence or domicile of the injured party within a State is not a sufficient predicate for jurisdiction, which must be based upon a more direct injury within the State and a closer expectation of consequences within the State than the indirect financial loss resulting from the fact that the injured person resides or is domiciled there''). The court, however, ordered jurisdictional discovery as to certain other non-New York defendants to determine if the New York defendant was acting at the direction of such foreign entities.

And just last year, in *Verragio Ltd. v. Malakan Diamond Co.*, a New York jewelry designer and retailer brought suit against a jewelry manufacturer and wholesaler based in California alleging copyright infringement and seeking actual damages, the recovery of profits, and an injunction. The plaintiff alleged that infringing jewelry was sold by the defendant in Wisconsin, Ohio, and Idaho.

The District Court dismissed the case for lack of personal jurisdiction, holding that ''the mere fact that the injured party resides or is domiciled in New York is not a sufficient predicate for jurisdiction under CPLR 302(a)(3),'' and the situs of the injury was where the plaintiff lost business (California, Wisconsin, Idaho, or Ohio), not New York.

While some courts have cited *Fantis Foods* for the proposition that economic harm alone is never sufficient for a plaintiff to adequately allege an injury within New York, *see, e.g.*, *Penguin Grp. v. Am. Buddha* (''*Penguin I*'') (''the suffering of economic damages in New York is insufficient, alone, to establish a 'direct' injury in New York'') (discussed below), that is arguably too broad a statement since *Fantis Foods* held only that the injury in New York must be more than just an *in*direct financial loss, although this is not entirely clear under the subsequent case law.

Jurisdiction Found Where Direct Business Injury Is in New York New York courts have found that economic harm resulting from an out-of-state tort sufficiently constituted a direct injury within the state to satisfy CPLR 302(a)(3)(ii) mostly in cases involving intellectual property-related torts (though certainly alleging an injury to intellectual property rights held in New York is not itself sufficient) and when there is some other New York connection.

For instance, in *Sybron Corp. v. Wetzel*, curiously decided by the New York Court of Appeals just slightly over a year *before* it decided *Fantis Foods*, a New York manufacturer brought suit against a former New York-based employee and a New Jersey competitor seeking to enjoin the employment of the individual in New Jersey and of any disclosure by him of trade secrets.

Although the trial court denied the corporate defendant's motion to dismiss, the Appellate Division reversed, holding that New York did not have personal jurisdiction.

On further appeal, the New York Court of Appeals found jurisdiction over the nonresident corporation under CPLR 302(a)(3)(ii) because the proof demonstrated that there was a ''conscious plan to engage in unfair competition and misappropriation of trade secrets'' and that the competitor could reasonably foresee that substantial effects of those torts would be felt in New York. Although actual injury had not yet occurred (which the dissent argued meant the long-arm statute was not satisfied), the Court of Appeals majority considered factors such as that a loss of significant business within New York was likely, the former employee allegedly possessed trade secrets learned in New York, and the alleged primary rationale for his hiring by the competitor was his experience working for the plaintiff in New York.

Sybron thus held that a tort committed outside the state that was likely to cause the loss of significant business and other injury within the state was sufficient to establish long-arm jurisdiction. The New York Court of Appeals thereby clarified that New York courts can find the existence of a direct business-type injury in New York sufficient to satisfy CPLR 302(a)(3)(ii) so long as the New York connection is substantial and more than just the plaintiff's in-state domicile. Indeed, the court in *Sybron* noted that:

Plaintiff's case does not rest on so narrow a foundation nor does its case depend on whether unfair competition injures it in every State in which it does business. It is, however, critical that it is New York where plaintiff manufactures . . . and the alleged trade secrets were acquired, and the economic injury plaintiff seeks to avert stems from the threatened loss of important New York customers.

Special Rule for Online Copyright Infringement? What constitutes a sufficient injury in New York is a moving target, however, because the Internet adds a further complication to determining the situs of a tort-based injury, one that has resulted in a special rule for cases alleging digital piracy. *See Verragio*.

This special approach began with *Penguin I*. There, the plaintiff was a New York-based trade book publisher that brought a copyright infringement action alleging that defendant American Buddha, an Oregon nonprofit, electronically copied and published complete versions of four copyrighted works on online libraries operated, apparently, out of Arizona or Oregon.

The District Court had observed two competing lines of authority as to the situs of injury (for long-arm jurisdiction purposes) in intellectual property infringement cases, (a) those finding the situs of injury where the infringing conduct occurred and (b) those finding it where the plaintiff and the intellectual property were located; the District Court found the former line of cases more persuasive and dismissed the complaint for want of jurisdiction.

On appeal, the Second Circuit described the requisite analysis as ''determin[ing] 'whether there [was] an injury in New York sufficient to warrant § 302(a)(3) jurisdiction' '' by applying a '' 'situs-of-injury test,' '' which required a court '' 'to locate the original event which caused the injury.' ''

The Second Circuit noted that, under the case law, the ''original event occurs where the first effect of the tort that ultimately produced the final economic injury is located.'' It pointed out that the alleged New York connection in the case before it was much less than in *Sybron*, which involved the alleged loss of a New York-specific customer base and the alleged acquisition of trade secrets in New York.The Second Circuit, how-

ever, commented that *Sybron* suggested that the New York Court of Appeals might determine that the injury alleged by Penguin was ''more than derivative economic harm within the State.''

Given the lack of precedent from the New York Court of Appeals (or the Second Circuit itself) on which of the competing lines of lower court cases identified by the trial court were correct, the Second Circuit certified the question to New York's highest court.

The New York Court of Appeals answered the certified question (as that Court modified it to focus on online infringement) in *Penguin Grp. v. Am. Buddha* (''*Penguin II*''). It held that while the suffering of only derivative economic damages in New York from a tort committed elsewhere is insufficient under CPLR 302(a)(3)(ii), jurisdiction was present in the case before it because the plaintiff alleged that it suffered more than just financial harm.

The appeals court relied on plaintiff's allegations that the defendant published multiple books which had been copyrighted by plaintiff online in their entirety, without permission, thereby (i) destroying plaintiff's economic incentive to publish or write and (ii) harming plaintiff's in-state property interests. The court observed that the Internet ''by its nature is intangible and ubiquitous'' and that ''the intended consequence of'' the infringement was ''the instantaneous availability of those copyrighted works . . . for anyone, in New York or elsewhere, with an Internet connection to read and download . . . free of charge.''

In finding jurisdiction, the *Penguin II* court observed that, unlike a typical tort where the locus of the injury is a particular location, plaintiff's ''alleged injury in this case involves online infringement that is dispersed throughout the country and perhaps the world. In cases of this nature, identifying the situs of injury is not as simple as turning to the place where plaintiff lost business . . . because there is no singular location that fits that description.'' (citing *American Eutectic* as an example of a case where the loss of business was at a specific location outside New York).

The court deemed it ''illogical to extend that concept [of equating the situs of a plaintiff's injury with the place where its business is lost or threatened, to] online copyright infringement cases where the place of uploading is inconsequential and it is difficult, if not impossible, to correlate lost sales to a particular geographic area.''

The Court of Appeals also found it to be a ''critical factor'' helping tip ''the balance in favor of identifying New York as the situs of injury'' that copyright owners have a ''unique bundle of rights,'' including the right of reproduction, the right to prepare derivative works, the right to distribute, and the right to perform the work publicly, which are violated by online infringement.

The Court held that, ''[b]ased on the multifaceted nature of these rights, a New York copyright holder whose copyright is infringed suffers something more than the indirect financial loss we deemed inadequate in *Fantis Foods*.'' (American Buddha subsequently filed a third motion to dismiss for lack of personal jurisdiction asserting a failure to satisfy the substantial revenue from interstate or foreign commerce prong of the statute. The trial court granted this motion and the case was dismissed. *Penguin Grp. v. Am. Buddha*.)

Second Circuit Construes *Penguin II* Narrowly Importantly, the Second Circuit has construed *Penguin II* as limited to the digital context. In *Troma Entertainment Inc. v. Centennial Picture Inc.*, the Second Circuit, citing (among other cases) *Fantis Foods*, *Penguin I*, and *Penguin II*, found that the New York long-arm statute was *not* satisfied where a New York based movie producer asserted claims against non-residents for copyright infringement, common law fraud, and tortious interference with prospective economic advantage.

The plaintiff alleged that the non-resident defendants usurped two potential licensing agreements in Germany relating to movies over which plaintiff owned the distribution rights.

After the District Court dismissed the case for lack of jurisdiction, the plaintiff appealed and argued to the Second Circuit that personal jurisdiction existed under CPLR 302(a)(3)(ii) because the alleged infringement caused harm to the bundle of rights identified in *Penguin II* held by the plaintiff in New York as the copyright holder. The plaintiff contended that, as a result, ''its allegations amount to more than the assertion of mere economic injury within the state.''

The Second Circuit, however, rejected this contention and held that, in light of the allegations of the complaint, ''Troma's assertion of such an injury . . . is far too speculative to support a finding that Troma suffered injury in New York within the meaning of section 302(a)(3)(ii).''

The Second Circuit distinguished *Troma* from *Penguin II*, where the alleged infringement was not localized because the defendant allegedly made the copyrighted materials available on the internet. It held that, in the case before it, in contrast, the defendant's alleged activities could be circumscribed to a particular locality, Germany, and was ''therefore more like 'traditional commercial tort cases' in which 'the place where [the plaintiff's] business is lost or threatened' exerts a significant gravitational influence on the jurisdictional analysis.'' (citing *Penguin II*).

The reach of *Troma*, however, is far from clear.

In *Lewis v. Madej*, Southern District of New York Judge Cote arguably applied *Penguin II* more broadly than had the Second Circuit in *Troma*.

In *Lewis*, the plaintiffs, an individual resident in New York and a New York LLC, sued two non-domiciliary individuals, one based in London and one in an unknown location, as well as a business which was incorporated, and claimed to have offices, in Wyoming and allegedly had customers in Colorado, though its principal place of business was unknown. Plaintiffs alleged that they had registered the name of a to-be-launched investment firm with the appropriate regulatory agency and had begun the licensing process and so informed prospective clients. Plaintiffs' subsequent efforts to register the business name with the Patent and Trademark Office, however, were unsuccessful because defendants already had secured a trademark for a similar name, allegedly for the purpose of frustrating plaintiffs' business. Plaintiffs sued for a declaration that defendants' trademark in the business name was invalid and for damages under various causes of action.

The only defendant who could be served, the entity defendant, moved to dismiss on the grounds of, among other things, lack of personal jurisdiction under CPLR 302(a)(3)(ii). In reviewing the several statutory factors, the District Court found, among other things, that the

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defendant expected or should have expected its tortious conduct ''to have consequences in New York'' given the allegation that ''it specifically targeted the plaintiffs who are domiciled in New York.''

The Court cited *Penguin I* for the proposition that ''[d]istrict courts in this Circuit have consistently found that the tort of trademark infringement causes injury in the state where the allegedly infringed intellectual property is held.'' It then turned to the New York Court of Appeals' decision in *Penguin II*, which it characterized as holding that a New York copyright owner sustained an in-state injury as a result of online infringement because of a copyright owner's right to prevent others from using the property, though it noted the narrow construction given that decision by the Second Circuit in *Troma*. Nevertheless, it held that ''the victim of the intentionally tortious conduct [here at issue] resides in New York and experienced the intended injury here.'' The Court later added:

This is, unlike *Troma*, not a ''traditional commercial tort case'. . . It is premised on intentional and fraudulent trademark infringement specifically directed at the plaintiffs who reside in New York. The harms in New York are thus not 'remote or consequential.' ''

This perhaps less-than-fully-satisfying effort to distinguish *Troma* shows how the courts still are struggling with these issues, but we note the facts of *Lewis* did not suggest a primary relevant situs outside of New York as did the facts of *Troma*.

Conclusion As specific jurisdiction and federal due process requirements continue to be litigated at the highest authority, New York common law appears to still be evolving as to what constitutes sufficiently direct business injury to satisfy New York's long-arm statute, especially as the world of commerce becomes increasingly more internet-based.

Fantis Foods held that indirect economic damages (*i.e.*, a loss of profits or revenues) suffered by an entity located in New York where the immediate harm (*e.g.*, loss of sales or a customer) occurred outside of New York is insufficient to meet the in-state injury requirement of CPLR 302(a)(3)(ii).

Consistent with *Sybron*, *Penguin II*, and *Lewis*, however, in limited circumstances, business injury may be sufficient so long as the immediate injury is in New York or if the actual injury cannot be limited to particular geographic region due to the Internet and there is some significant New York connection. So, for example, if a plaintiff domiciled in New York is tortuously deprived of a significant sale to a New York customer, or is defrauded into making a significant payment from a New York bank account, as a result of a fraud that is committed by a non-NY domiciled defendant outside of New York, that may be sufficient to constitute a direct injury in New York under the state's long-arm statute. The latter example, however, is contrary to those New York cases which seem to construe *Fantis Foods* and its progeny as holding that economic injury alone is never enough.

This seems to be an issue on which the New York Court of Appeals will need to provide yet further guidance, especially given the Supreme Court's close attention to a state court's ability to assert personal jurisdiction over a foreign defendant in consideration of federal due process requirements.