10-257-cv

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

MARTIN GROSZ, LILIAN GROSZ,

Plaintiffs-Appellants,

—against—

THE MUSEUM OF MODERN ART, Herrmann-Neisse with Cognac, Painting by Grosz, Self-Portrait with Model, Painting by Grosz, Republican Automatons, Painting by Grosz,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR PLAINTIFFS-APPELLANTS

DAVID ROWLAND, ESQ.
PATRICIA HERTLING, ESQ.
ROWLAND & PETROFF
2 Park Avenue
New York, New York 10016
(212) 685-5509

RAYMOND J. DOWD, ESQ.
THOMAS V. MARINO, ESQ.
LUKE A. MCGRATH, ESQ.
DUNNINGTON BARTHOLOW
& MILLER LLP
1359 Broadway, Suite 600
New York, New York 10018
(212) 682-8811

Attorneys for Plaintiffs-Appellants

TABLE OF CONTENTS

PAGE(S)

TABLE OF AUTHORITIES

CASE **PAGE(S)**

I. Federal Cases

II. State Cases

III. State Statues

IV. Federal Rules

V. Secondary Sources

Plaintiffs-Appellants Martin and Lilian Grosz, the heirs of George Grosz ("Grosz" or the "Grosz Heirs"), submit this reply brief in further support of their appeal from a dismissal of the First Amended Complaint ("the Complaint") and entry of judgment and in response to the brief in opposition submitted by Respondent Museum of Modern Art ("MoMA") dated September 30, 2010 ("MoMA Brief" or "MoMA at ___").

I.

PRELIMINARY STATEMENT

In this diversity case involving application of New York law, the United States District Court of the Southern District of New York by the Hon. Colleen McMahon erred by turning New York's "demand and refusal" accrual rule for true owners to recover stolen art on its head. Specifically, the decisions appealed from create a new "implied refusal" exception to the "demand and refusal" rule, and shifts the burden – in the context of a motion to dismiss – against the plaintiff, rather than requiring the defendant to plead and prove the affirmative defense of limitations pursuant to New York law and the Federal Rules of Civil Procedure. The Grosz Heirs seek replevin or in the alternative the impressment of a constructive trust on three paintings created by George Grosz that were stolen from him and from Alfred Flechtheim, Grosz's Jewish art dealer (the "Paintings"). The

Paintings were stolen when Grosz, a resident of Berlin, fled political persecution in Nazi Germany in 1933.

This appeal turns on whether the District Court erred in failing to convert a Rule 12(b)(6) motion to a Rule 56 summary judgment motion (pursuant to Rule 12(d) of the Federal Rules of Civil Procedure) before considering, over the Grosz Heirs' timely objections, settlement communications extrinsic to the Complaint submitted by MoMA in support of a pre-answer motion to dismiss. In the Complaint the Grosz Heirs alleged that MoMA refused the Grosz Heirs' demand for the Paintings on April 12, 2006. Rather than accepting the April 12, 2006 refusal date as true and drawing inferences favorable to the Grosz Heirs from the Complaint's allegations and the documentary evidence attached thereto, the District Court, over the objections of the Grosz Heirs, initiated a fact-finding exercise and implied an earlier "refusal" date from inadmissible settlement materials extrinsic to the Complaint.

On this appeal, MoMA asserts that the District Court correctly applied New York's "demand and refusal" rule in rejecting the Grosz Heirs claims as time barred. MoMA's argument, however, misconstrues New York law. To protect the true owners of stolen art, New York adopted the "demand and refusal" statute of limitations accrual rule in the landmark *Lubell* case. 77 N.Y.2d 311 (1991). New York's Court of Appeals chose the rule that would be the most protective of true

owners of stolen art. The District Court's decisions seriously undermine the "demand and refusal" rule by holding that: (i) "refusals" may be implied from the mere retention of property; and, (ii) a "refusal" may be inferred from settlement negotiations. The District Court's holding contradicts the New York law cited in Appellants' brief requiring a refusal to be unequivocal and under New York's master/servant rule, "authorized" by the legal possessor. Notwithstanding the absence of an unequivocal, "authorized" refusal satisfying New York law, the District Court inferred a "refusal" in the mere passage of time, and in inadmissible settlement communications extrinsic to the Complaint in which MoMA's Executive Director expressly disclaimed any authority to refuse the Grosz Heirs' claims.

The central legal issue presented here is whether, without converting to a Rule 56 motion pursuant to Rule 12(d) and providing notice and an opportunity to submit additional evidence, the District Court may resolve disputed issues of fact and dismiss a Complaint pursuant to Rule 12(b)(6) on statute of limitations grounds in reliance on materials extrinsic to the Complaint when:

- Consideration of any extrinsic evidence requires conversion to a Rule 56 motion;
- The extrinsic evidence in question constituted settlement negotiations inadmissible pursuant to Rule 408 of the Federal Rule of Evidence and, in any event, should not have been considered on a motion to dismiss under Rule 12(b)(6) even if admissible;

- The extrinsic evidence could not be deemed "integral" to the Complaint;
- The District Court drew at least two principle negative inferences (the "Negative Inferences") from this extrinsic, inadmissible material: (i) the MoMA "refused" the Grosz demand before April 12, 2006; and (ii) that such unpleaded "refusal" was "authorized;"
- The Negative Inferences are disputed by the Grosz Heirs and contradicted by the evidence produced in discovery;
- The Negative Inferences contradict the well-pleaded allegations of the Complaint, which: (i) are supported by evidence attached to the Complaint; and (ii) present a plausible circumstance in which no MoMA representative had actual or apparent authority to issue any "refusal" prior to a vote of MoMA's Board of Trustees on April 11, 2006;
- The Negative Inferences were not drawn in the light most favorable to the Grosz Heirs because the evidence demonstrates that MoMA's spokesperson, Glenn Lowry, was authorized to negotiate, but not refuse, the Grosz Heirs' demand for the Paintings;
- A letter written in 2008 from MoMA to the Grosz Heirs represented (and admitted) that MoMA's refusal of the Grosz Heirs' claims to the Paintings occurred on April 12, 2006 demonstrating grounds for equitable estoppel and tolling.

The Grosz Heirs submit that the District Court committed reversible error by: (a) resolving disputed issues of fact to dismiss the Grosz Heirs' claims on statute of limitations grounds on a Rule 12(b)(6) motion to dismiss; (b) drawing the Negative Inferences and other unfavorable inferences as well as making numerous premature credibility determinations against the Grosz Heirs; and (c) depriving the Grosz Heirs the opportunity to prove grounds for equitable estoppel, tolling and otherwise present evidence negating the contentions of undue delay raised by MoMA in support of its motion to dismiss.

On June 22, 2010, with MoMA's consent, *amici curiae* Jewish community leaders and organizations, Holocaust educators, artists and art historians, and legal scholars and practitioners dedicated to the promotion of alternative dispute resolution submitted a brief to this Court urging reversal of the District Court's decision. *Amici* urged, *inter alia*, proper development of a factual record; compliance with federal policy in favor of expeditious restitution of property; that use of settlement communication to invalidate claims is a violation of the letter and spirit of Rule 408 of the Federal Rules of Evidence; and that facts relevant to spoliation of Jews such as Alfred Flechtheim during the Holocaust are susceptible of judicial notice and should not be subject the guesswork involved on a Rule 12(b)(6) motion to dismiss. Furthermore, *Amici* concluded that Lowry lacked authority to refuse the Grosz Heirs demand prior to April 12, 2006, that no express refusal occurred prior to April 12, 2006, and that "Lowry's 'temporizing language' calls out for application of the equitable doctrines of tolling and estoppel. (Brief Amicus Curiae at 13-15).

Accordingly, this Court should reverse and remand for further proceedings as demonstrated herein.

II.

COUNTERSTATEMENT OF RELEVANT FACTS

A. The Complaint Contains Well-Pleaded Factual Allegations Demonstrating That The Paintings Were Stolen.

The Complaint alleges that in January, 1933, Grosz fled Nazi persecution in fear of his life on the eve of Hitler's seizure of power, leaving his entire artistic *oeuvre*, including the Paintings, in the hands of Alfred Flechtheim, his art dealer. (Vol. I, A-21). The Complaint further alleges that:

- The Nazis forced Flechtheim to liquidate the inventory of his galleries and stole the proceeds. (Vol. I, A-32).
- The Nazis issued a formal decree confiscating the Paintings. (Vol. I, A-22).
- Following the liquidation, a woman named Charlotte Weidler falsely claimed that she "inherited" *Poet* from Flechtheim (Vol. I, A-25); and
- A Dutch art dealer named van Lier stole *Self-Portrait with Model* and *Republican Automatons.* (Vol. I, A-27).

These well-pleaded allegations, if taken as true, demonstrate that the Paintings were stolen.

B. The Grosz Heirs Demanded MoMA Return The Paintings By Claiming Ownership, But Consented To MoMA's Retention Of Those Paintings While MoMA Conducted An Investigation.

On November 24, 2003, Ralph Jentsch, on behalf of the Grosz Heirs, wrote to MoMA asserting an ownership claim to the Paintings. (Vol. I, A-44, A-183-184). Following the claim, MoMA offered to share ownership of the Paintings and

engaged with the Grosz Heirs in years of investigation, settlement discussions and research. (Vol. I, A-186-193, A-323-324). During this time, the Grosz Heirs consented to MoMA's possession of the Paintings. (Vol. I, A-186) (letter dated April 12, 2006 referring to "more than two years of shared research and discussions"); (Vol. I, A-442) (letter dated January 5, 2006 referring to grant of extensions of time to resolve claim); (Vol. I, A-193) (letter dated January 20, 2006 consenting to cooperate in Katzenbach investigation).

On January 18, 2006, Lowry wrote to Jentsch emphasizing that he had no authority to refuse the Grosz Heirs' claims and informing the Grosz Heirs that MoMA's Board of Trustees had not reached a decision on whether or not to return the Paintings because MoMA's research and investigation was ongoing. (Vol. I, A323-324). On January 20, 2006, Jentsch responded, pledging his continued cooperation with MoMA's investigation. (Vol. I, A-193). On April 12, 2006, Lowry wrote to the Grosz Heirs informing them that MoMA's Board of Trustees had decided to accept the recommendations of investigator Nicholas Katzenbach and therefore MoMA refused to return *Poet* and *Self-Portrait with Model*. (Vol. I, A-186). On June 26, 2008, MoMA's counsel Henry Lanman wrote to David Rowland, counsel for the Grosz Heirs, describing MoMA's multi-year, joint, provenance investigation and concluding "[a]t the conclusion of his investigation, Mr. Katzenbach recommended to the Museum's Board of Trustees that it reject

your clients' claims, a decision that was communicated to your clients on April 12, 2006." (Vol. II, A-540).

On April 10, 2009, within three years of MoMA's April 12, 2006 refusal – the only refusal date that MoMA's counsel Henry Lanman confirmed as MoMA's date of refusal (Vol. II, A-540) – the Grosz Heirs initiated this action.

III.

RELEVANT PROCEDURAL HISTORY

On June 4, 2009, MoMA filed a pre-answer motion to dismiss pursuant to Rule 12(b) of the Federal Rules of Civil Procedure. [Docket Nos. 13-18]. MoMA argued that the allegations of the Complaint were not plausible. A declaration submitted with MoMA's motion attached letters that were not attached to, referenced or relied upon in the Grosz Heirs' Complaint. [Docket No. 15]; (Vol. I, A-187-193). MoMA also submitted foreign legal expert opinions on German and Dutch law. [Docket Nos. 16-17]. In their papers, MoMA accused Grosz and the Grosz Heirs of undue delay in asserting their claims.

On June 25, 2009, the Grosz Heirs opposed the motion to dismiss, arguing *inter alia* that: (i) on a motion to dismiss the district court must limit itself to a consideration of facts alleged on the face of the Complaint; (ii) on a motion to dismiss the district court must limit its inquiry only to documents attached as exhibits or incorporated by reference in the Complaint and not engage in fact-

finding in regard to disputed accrual issues; and (iii) factual allegations in MoMA's memorandum of law and attachments to affidavits are to be disregarded. [Docket No. 23 at 3, 9]. For the limited purpose of negating MoMA's contentions of undue delay, a permitted use under Rule 408 of the Federal Rules of Evidence, the Grosz Heirs submitted additional settlement communications to demonstrate that MoMA's submissions were selective and misleading.

In opposing the motion to dismiss, the Grosz Heirs emphasized that any submissions of extrinsic materials relating to MoMA's potential affirmative defenses should be disregarded in determining a Rule 12(b)(6) motion. [Docket No. 23 at 3]. In addition to these objections to *any* consideration of extrinsic evidence, the Grosz Heirs' submitted evidence rebutting MoMA's claims that the allegations of the Complaint were not plausible. The Grosz Heirs submitted an expert report by Dr. Jonathan Petropoulos, the world's leading expert in Nazi art looting. Dr. Petropoulos analyzed the allegations of the Complaint, the underlying documentation and relevant scholarship and concluded that the allegation that Flechtheim's gallery was looted by a Nazi and that each of the Paintings was lost or stolen was consistent with the evidence and contemporary Holocaust historical scholarship. (Vol I., A-325-404). In addition, while preserving objections to MoMA's submission of extraneous materials on a motion to dismiss, the Grosz

Heirs submitted an expert report from German legal expert Dr. Gordian Hasselblatt countering MoMA's arguments on German law. (Vol. I, A-405-424).

By July 1, 2009, the parties had fully briefed MoMA's motion to dismiss. On December 1, 2010, the Grosz Heirs requested permission to either: (i) provide the Court with additional evidence; or (ii) amend the pleadings should the Court convert MoMA's pending motion to dismiss into a Rule 56 summary judgment motion (Vol. II, A-429). On December 2, 2009, the District Court denied the Grosz Heirs' request. (SPA-1). On December 30, 2009, the Grosz Heirs filed objections to Magistrate Judge Theodore Katz's refusal to permit discovery into Alfred Flechtheim documents at the MoMA (the "Objections").

On January 6, 2010, the District Court ordered MoMA to suspend work responding to the Objections (SPA-2) and granted MoMA's motion to dismiss pursuant to Rule 12(b). (SPA 3-31). In its Order granting MoMA's motion, the District Court determined that MoMA's failure to return the paintings for more than a year and a half constituted a refusal "as a matter of law." (SPA 33-51). The District Court further determined that a letter sent by MoMA's Director, Glenn Lowry, dated July 20, 2005 communicated a refusal "utterly inconsistent with plaintiffs' claim of right." (SPA 33-51). The Grosz Heirs moved for reconsideration on January 20, 2010. On March 3, 2010, the District Court denied the motion to reconsider. (SPA 33-51).

IV.

SUMMARY OF ARGUMENT

The Court should reverse and remand for further proceedings for four reasons. *First*, the district court erred by considering inadmissible materials extrinsic to the Complaint and engaging in fact-finding to support drawing negative inferences as to limitations rather that taking the facts alleged in the Complaint as true and drawing all favorable inferences therefrom. *Second*, the District Court erred by finding an implied refusal and incorrectly determining the date upon which the Grosz Heirs' claims accrued under New York's "demand and refusal" statute of limitations accrual rule governing stolen artwork claims. *Third*, the remaining arguments raised by the MoMA are without merit because: (i) arguments the Grosz Heirs press on this appeal have not been waived; (ii) New York Law did not bar any claim to *Poet* before the Grosz Heirs demanded its return; (iii) German law is not relevant and does not bar the Grosz Heirs claims; and (iv) on remand the Grosz Heirs are entitled to the discovery denied them by the erroneous Magistrate Judge's ruling. *Fourth*, in any event, the Court should have allowed the Grosz Heirs an opportunity to amend the Complaint.

V.

ARGUMENTS AND AUTHORITIES

This Circuit reviews *de novo* a district court's dismissal of a complaint pursuant to Rule 12(b)(6), construing the complaint liberally, accepting all factual allegations in the complaint as true, and drawing all reasonable inferences in the plaintiff's favor. *Holmes v. Poskanzer,* 342 Fed.Appx. 651, 652, 2009 WL 2171326, 1 (2d Cir. 2009) *citing Chambers v. Time Warner, Inc.*, 282 F.3d 147, 152 (2d Cir. 2002).

A. The District Court Erred By Considering Inadmissible Materials Extrinsic To The Complaint And Engaging In Fact-Finding To Support Drawing Negative Inferences As To Limitations Rather Than Taking The Facts Alleged In The Complaint As True And Drawing All Favorable Inferences Therefrom.

On appeal, MoMA erroneously asserts that the District Court properly considered material extrinsic to the Complaint to resolve the disputed accrual date of the Grosz Heirs' claims for the purpose of MoMA's determining affirmative defense of limitations raised in MoMA's Rule 12(b)(6) motion to dismiss. To the contrary, the District Court committed reversible error by addressing any affirmative defense in a pre-answer Rule 12(b)(6) motion because: (i) the Complaint clearly alleges a correct date of accrual and the purported question of limitations asserted by MoMA is not clear from the face of the Complaint; (ii) the District Court erred by relying upon materials extrinsic to the Complaint on a

motion to dismiss pursuant to Rule 12(b)(6); and (iii) the District Court made factual determinations and credited evidence improperly under Rule 12(b)(6).

1. The District Court erred by entertaining MoMA's asserted affirmative defense of limitations because the Complaint clearly alleges a correct date of accrual and the purported question of limitations is not clear from the face of the Complaint.

The District Court erred in entertaining MoMA's limitations defense pursuant to Rule 12(b)(6) erroneously relying on *McKenna v. Wright* for the proposition that a defendant may raise an affirmative defense in a pre-answer Rule 12(b)(6) motion if the defense appears on the face of the complaint. (SPA-6); 386 F.3d 432, 436 (2d Cir. 2004). This Circuit permits consideration of the affirmative defense of statutes of limitations pursuant to Rule 12(b)(6) motion to dismiss for failure to state a claim where the dates in the complaint show that the action is barred by the statute of limitations. *See Ghartey v. St. John's Queens Hosp.*, 869 F.2d 160, 162 (2d Cir. 1989). To prevail on a Rule 12(b)(6) limitations defense, the defendant must prove that plaintiff can prove no set of facts warranting relief. *See McKenna v. Wright*, 386 F.3d at 436.

Even if MoMA's affirmative defense of limitations did appear on the face of the complaint (which it did not), the District Court erred by failing to correctly apply *McKenna*. *McKenna* dealt with the affirmative defense of qualified immunity, not statutes of limitation, and, in any event required a

"more stringent standard" under which a defendant raising an affirmative defense on a Rule 12(b)(6) motion must overcome all reasonable inferences drawn from facts in favor of the plaintiff that would *defeat* the affirmative defense. *See McKenna*, 386 F.3d at 436. The District Court did not draw all inferences in favor of the Grosz Heirs. If it did so, it would have inferred that: (i) as described in MoMA's letter attached as Exhibit 27 of the Complaint, MoMA and the Grosz Heirs engaged in consensual settlement negotiations and a consensual investigation from November 24, 2003 through April 12, 2006; (ii) settlement discussions included the Grosz Heirs consent to MoMA retaining possession of the artworks pending a final determination by MoMA's Board of Trustees; and (iii) MoMA's Executive Director, Lowry, had no authority to refuse the Grosz Heirs demand and could not communicate such a refusal without advance authorization by a formal vote of MoMA's Board of Trustees. These inferences are supported by MoMA's admission against interest in 2008 that it refused the Grosz demand on April 12, 2006. (Vol. II, A-540). and by the MoMA Board of Trustee's written refusal communicated to the Grosz Heirs on April 12, 2006 (the date of refusal alleged in the Complaint) attached to the Complaint as Exhibit 27. (Vol. I, A-186). Indeed, any other inference renders meaningless the Board of Trustees decision taken April 11, 2006 and its

April 12, 2006 communication of that decision. Because the District Court did not draw these inferences and properly apply *McKenna*, the District Court erred and should be reversed.

2. The District Court erred by relying upon evidence extrinsic to the Complaint on a motion pursuant to Rule 12(b)(6).

The District Court erroneously based its inference of a pre-April 2006 "refusal" on letters between Lowry and the Grosz Heirs that are not included or referenced in the Complaint. MoMA at 19; (SPA-21-22). The District Courts' reliance on these documents is clear error because these extrinsic materials cannot be used to demonstrate that Plaintiff failed to state a claim upon which relief can be granted pursuant to Rule 12(b)(6). *See Global Network Communications, Inc. v. City of New York*, 458 F.3d 150, 154 -156 (2d Cir. 2006). Conversion to a Rule 56 Motion with notice and an opportunity for all parties to present all material made pertinent to such a motion by Rule 56 is mandatory if matters outside the pleading are presented to and not excluded by the court. *See id.* (referring to Rule 12(b), now Rule 12(d)); Rule 12(d); *see also Friedl v. City of New York*, 210 F.3d 79, 83-84 (2d Cir.2000). As this Court has made abundantly clear in, "[t]he purpose of Rule 12(b)(6) is to test, in a streamlined fashion, the formal sufficiency of the plaintiff's statement of a claim for relief without resolving a contest regarding its substantive merits." *Id.*

Here, the District Court improperly avoided the mandatory conversion required by Rule 12(d), but sought to justify its use and reliance upon these documents by asserting that the Court may consider documents that the plaintiff either possessed or knew about and relied upon in bringing the lawsuit. SPA-21 (citing cases)). The Grosz Heirs did not "rely upon" the extrinsic materials the District Court considered. This Court has noted in *Chambers v. Time Warner, Inc.* that "this standard [allowing consideration of documents outside a complaint] has been misinterpreted on occasion." See Chambers v. Time Warner, Inc. 282 F.3d 147, 153 (2d Cir. 2002). In *Chambers*, this Court stated "we reiterate here that a plaintiff's reliance on the terms and effect of a document in drafting the complaint is a necessary prerequisite to the court's consideration of the document on a dismissal motion; mere notice or possession is not enough. *Id.* Accordingly, the District Court's consideration of the extrinsic materials constitutes clear error.

In addition, the cases relied upon by the Court, *Feld v. Feld* , 279 A.D.2d 393, 720 N.Y.S.2d 35, 2001 N.Y. Slip Op. 00595 (2001) and *Borumond v. Assar*, 2005 WL 741786 (W.D.N.Y.) demonstrate that the issues resolved by the District Court should not have been resolved on a motion to dismiss pursuant to Rule 12(b)(6). *Feld*, involved a motion for

summary judgment, not a motion to dismiss. Similarly, *Borumond* involved a determination after a bench trial. Accordingly, the District Court committed error in resolving disputed facts on materials extrinsic to the Complaint without following Rule 12(d) and converting MoMA's motion to a Rule 56 motion.

Finally, notwithstanding the District Court's consideration of materials outside of the Complaint, the District Court failed to give the parties notice that it would rely upon these documents and, thus, transform the MoMA's motion to a motion for summary judgment under Rule 56. (SPA-1 (stating the Court "will NOT augment the record on the motion." (emphasis in original)). To the contrary, on December 1, 2009, Plaintiffs requested the opportunity pursuant to Rule 12(d) to submit additional evidence if the Court were to treat the motion as a Rule 56 motion, but the District Court denied Plaintiffs' request. (SPA-1). Indeed, the District Court styled its opinion and order, dated January 6, 2010, as a decision on MoMA's motion to dismiss. (SPA-3). Accordingly, the scope of the District Court's determination was limited to the face of the Complaint and the District Court erred by engaging in a fact-finding exercise and not excluding, but instead, weighing evidence extrinsic to the Complaint and making credibility determinations.

3. The District Court made factual determinations and credited evidence improperly under Rule 12(b)(6).

The District Court determined that even if MoMA's failure to return the paintings for more than a year and a half did not constitute a refusal "as a matter of law," the letter Lowry sent to the Grosz Heirs on July 20, 2005 communicated a refusal "utterly inconsistent with plaintiffs' claim of right." (SPA 21). The District Court's ruling was based on the following erroneous factual determinations and negative inferences: (i) MoMA's possession of the Paintings was an overt act of refusal and not a retention agreed to by the Grosz Heirs pending MoMA's Board of Trustees' final determination; (ii) Lowry's letter, dated July 20, 2005, was not an attempt to settle the matter pending MoMA's final determination; and (iii) that Lowry possessed the actual or apparent authority to communicate a refusal prior to April 12, 2006.

Each of the above fact determinations was disputed before the District Court. If the District Court had taken as true the relevant facts alleged in the Complaint and drawn all inferences in the light most beneficial to the Grosz Heirs, the District Court would have concluded that a bailment arose, consistent with the Grosz Heirs' ownership. MoMA failed below to dispute that these materials were compromise communications.

On the contrary, the District Court was constrained to take as true the allegations in the Complaint that MoMA first refused the Grosz Heirs demand on April 12, 2006 (Vol. I A-30; 44; 186 (refusal letter)). Accordingly, the District Court erred by failing to accept all allegations in the Complaint as true and draw all inferences in favor of the Grosz Heirs.

B. The District Court Erred By Finding An Implied Refusal And Incorrectly Determining The Date Upon Which The Grosz Heirs' Claims Accrued Under New York's "Demand and Refusal" Statute Of Limitations Accrual Rule Governing Stolen Artwork Claims.

MoMA argues on appeal that the District Court correctly determined that the Heirs claims accrued on July 20, 2005 and that those claims are barred by New York's three-year limitations period for conversion and replevin. MoMA at 25-27. This assertion is without merit because the District Court erred in applying New York's demand and refusal rule here.

Under New York law, stolen property remains stolen until returned to the true owner and a cause of action for replevin does not accrue until there has been unequivocal, authorized "refusal." (Brief at 28); *Lubell*, 77 N.Y.2d at 317-318; *Susi v. Belle Acton Stables, Inc.*, 360 F.2d 704, 713 (2d Cir. 1966). The determination of whether a refusal occurred is a fact-specific inquiry inappropriate at the early stage of a proceeding. *See*, *e.g.*, *In re Saft*, 24 Misc. 3d 1214(A), 897 N.Y.S.2d 672 (N.Y. Surr. 2009). The burden is on the party asserting the limitations defense on a motion to

dismiss to demonstrate that a "refusal" satisfying New York law occurred. *See Bano v. Union Carbide Corp.*, 361 F.3d 696, 710 (2d Cir. N.Y. 2004) (statute of limitations is an affirmative defense, see N.Y.C.P.L.R. § 3018(b), on which the defendant has the burden of proof).[1]

Here, the Grosz Heirs consented to MoMA's possession during MoMA's investigation. (Vol.II, A-469-470). After a number of years in which the parties researched the facts and negotiated possible resolutions, MoMA sent the Heirs a formal refusal dated April 12, 2006. (Vol. I, A-44) (Complaint alleging MoMA's refusal); A-186 (refusal dated April 12, 2006 attached to Complaint)). Later, in 2008, MoMA's counsel confirmed that April 12, 2006 was the date of MoMA's refusal. (Vol.II, A-540). Before that time, Lowry admitted that neither he nor MoMA could communicate (by words or actions) the decision of MoMA's Board refusing the Heirs request because only the Board had authority to communicate such a refusal. (Vol. I, A-323). Accordingly, the Court erred in implying a refusal based upon MoMA's delay for four reasons.

---

[1] Outside the context of an affirmative defense being raised on a Rule 12(b)(6) motion Motion to Dismiss, this Court recently stated in *Bakalar v. Vavra*, — F.3d —, 2010 WL 3435375 (2d Cir. Sept 2, 2010), a case MoMA relies upon, that once the true owner has made an arguable claim of title, the burden of proof under New York law shifts to the possessor to prove that the artwork was not stolen. This burden-shifting is not implicated here on appeal.

First, the Heirs consented to MoMA's possession up to the date the MoMA Board would communicate a formal refusal. (Vol. I, A-44, 186, Vol.II, A-469). As discussed above, under New York law, a cause of action for replevin does not accrue until there has been a concrete demand and an unequivocal refusal. *See Solomon*, 77 N.Y.2d at 317-318. Because the Grosz Heirs consented to MoMA's possession in bailment, no limitations period was triggered during MoMA's investigation. Under New York law, until a refusal occurs, there is no conversion. It was MoMA's burden to prove otherwise, but such a fact intensive inquiry is inappropriate on a motion to dismiss. *See, e.g., In re Saft*, 24 Misc. 3d 1214(A), 897 N.Y.S.2d 672 (N.Y. Sur. 2009).

Second, MoMA and Lowry had no authority to communicate a refusal to the Heirs and did not communicate such a refusal. An agent without authority cannot communicate a refusal under New York "demand and refusal" doctrine. *Goodwin v. Wertheimer*, 99 N.Y. 149, 1 N.E. 404 (1885). Here, MoMA bore the burden of proving both that: (i) MoMA communicated an unequivocal, authorized refusal to the Grosz Heirs before April 12, 2006; and (ii) the Grosz Heirs could not prove otherwise that they were entitled to relief. The District Court did not hold MoMA to that burden. In fact, Lowry admitted that he had no authority to refuse the Grosz

Heirs demand. (Vol. I, A-323). Without such authority, there could be no refusal. Accordingly, nothing Lowry or MoMA did before the Board's decision on April 12, 2006 could have triggered the running of limitations in this matter and the Grosz Heirs were entitled to all favorable inferences on this point.

Third, any delay that the District Court perceived based upon this undeveloped record could not imply refusal because New York allows a reasonable time within which a possessor may investigate a demand for the return of property. (Brief at 33); *see* 61 A.L.R. 621 (collecting cases from all jurisdictions); *Ball v. Liney*, 48 N.Y. 6, 12 -13 (1871); *Restatement (Second) Torts* § 240 (1965). MoMA undertook its investigation with the knowledge and consent of the Heirs. (*See* Vol. I, A-186). During the period of investigation, MoMA brought in an expert who took approximately three months to conduct his investigation. Due to the complexity of the matters involved, this time was reasonable and the District Court should have drawn all inferences on this point in the Grosz Heirs' favor. Indeed, MoMA does not and cannot argue that the time was unreasonable. In short, neither the Court nor MoMA dispute that had the Board of Trustees determined to return the Paintings, MoMA would have done so. Accordingly, the District Court erred in finding an implied refusal based upon the passage of time

within which MoMA conducted its investigation and its Board of Trustees decided whether or not to refuse the Grosz request.

Fourth, MoMA should not benefit from a limitations defense here when MoMA's promise to investigate and MoMA's 2008 communications regarding the agreed-upon refusal date prompted the Heirs to rely to their detriment on MoMA's good faith and forbear bringing suit before 2009. Under New York law, the doctrines of equitable tolling or equitable estoppel may defeat a statute of limitations defense when the plaintiff was induced by fraud, misrepresentations or deception to refrain from filing a timely action. *Bisson v. Martin Luther King Jr. Health Clinic*, 07-5416-CV, 2008 WL 4951045 (2d Cir. Nov. 20, 2008); *Abbas v. Dixon*, 480 F.3d 636, 642 (2d Cir. 2007). Even where the face of the complaint discloses a failure to file within the time allowed, the plaintiff may come forward with allegations explaining the delay. *Hoover v. Langston Equip. Associates, Inc.*, 958 F.2d 742, 744 (6th Cir. 1992).

The District Court correctly found Lowry's communications to be "temporizing" yet failed, as it was required to do, to draw inferences favorable to the Grosz Heirs relating to such temporizing. Lanman's letter to Rowland in 2008 made representations that MOMA's refused the Grosz Heirs demand on April 12, 2006 after years of consensual investigation. (Vol. II, A-540). MoMA never modified or withdrew this representation at any time prior to

April 10, 2009, the date that this suit was filed. MoMA cannot now belatedly change positions and disavow Lanman's representation, particularly where the Grosz Heirs so clearly relied on it to their detriment. (Brief at 40-41)

C. The Remaining Arguments MoMA Raises Are Without Merit Because: (i) arguments the Grosz Heirs press on this appeal have not been waived; (ii) New York Law did not Bar any claim to *Poet* before the Grosz Heirs demanded its return; (iii) German law is not relevant and does not| bar the Grosz Heirs claims; and (iv) on remand the Grosz Heirs are entitled to the discovery denied them by the erroneous Magistrate Judge's ruling.

The remainder of MoMA's numerous, tertiary arguments raised on appeal are meritless and were fully address in the Brief. Certain arguments relating to the District Court's: (i) use of evidence extrinsic to the complaint; and (ii) determination of the time at which the Grosz claims accrued are amply addressed elsewhere herein. Accordingly, only the following outstanding arguments need be addressed in summary fashion below.

1. The arguments the Grosz Heirs press on this appeal have not been waived.

MoMA asserts that the Grosz Heirs' arguments have been waived. MoMA at 30. This argument is without merit. The Grosz Heirs objected to MoMA's use of evidence extrinsic to the Complaint, and only provided additional rebuttal evidence while reserving their objections. [Docket 23 at n.1, 3, 9, 12-13, 17]; (*see also* Brief at 36). Furthermore, as set forth in the Brief and uncontested by MoMA, the Grosz Heirs specifically requested that they be allowed notice and

opportunity to present additional evidence should the District Court convert the MoMA's motion into a Rule 56 Motion. (Brief at 39; Vol. II, A-429). Accordingly, the Grosz Heirs have preserved the arguments made on appeal.

2. New York Law did not bar any claim to *Poet* before the Grosz Heirs demanded its return.

MoMA asserts that New York law bars the Grosz Heirs' claim to *Poet* based upon MoMA's purported bad faith and the Grosz Heirs unreasonable delay. MoMA at 40-42. These arguments are without merit. In the first instance, MoMA argues "[t]he works were not stolen from Grosz or by anyone else." MoMA at 2. MoMA cannot argue that the allegations of theft are implausible and that it was a good faith purchaser, but, at the same time, argue that it purchased *Poet* in bad faith. In addition, MoMA's argument ignores that New York law permits the Grosz Heirs to plead in the alternative (*i.e.* that MoMA was a good faith purchaser and, alternatively, that MoMA lacked good faith in order to pursue both legal and equitable relief). *Regan v. Metropolitan Life Ins. Co.*, 80 Fed. Appx. 718 (2d Cir. 2003). Here, the Grosz Heirs plead in the alternative for an impressment of a constructive trust, which has a six-year limitations period and would only accrue upon MoMA's Board of Trustees ratifying an illegal act of its officers – which, if MoMA's new argument that it purchased *Poet* in bad faith is to be credited, accrued on April 11, 2006 and is therefore, timely. In any event, the District Court correctly drew the favorable inference that for the purposes of the current motion

to dismiss, MoMA was a good faith purchaser. (SPA-12-13). Similarly, MoMA's argument of "unreasonable delay" is merely a rehashed *laches* argument that the District Court likewise ruled was not properly before it on MoMA's motion to dismiss. (SPA-16-18). In addition, MoMA's *laches* argument is an affirmative defense not properly decided on a Rule 12(b)(6) motion. *See Bakalar v. Vavra*, 2006 WL 2311113, 3 -4 (S.D.N.Y. August 10, 2006) *citing Brennan v. Nassau County*, 352 F.3d 60, 64 (2d Cir. 2003)(laches cannot be determined unless the factual record is fully developed.). Accordingly, MoMA's argument that New York law bars the Grosz claims to *Poet* is without merit.

3. German law is not relevant and does not bar the Grosz Heirs claims.

MoMA further asserts that German law bars the Grosz Heirs' claims. MoMA at 44-52. This argument is without merit because the District Court previously applied New York law and this determination is the law of the case. (SPA-15). Any other determination would be contrary to this Court's recent determination in *Bakalar v. Vavra*, a case MoMA relies upon in its opposition. *See Bakalar v. Vavra*, — F.3d —, 2010 WL 3435375 (2d Cir. Sept 2, 2010). Accordingly, MoMA's change in choice of law argument should be rejected.

4. On remand the Grosz Heirs are entitled to the discovery denied them by the erroneous Magistrate Judge's ruling.

MoMA also asserts that the Magistrate Judge's ruling denying discovery in this matter is merely harmless error. MoMA at 55-57. This argument is without merit. The Grosz Heirs are entitled to discovery of materials related to other Fleichtheim acquisitions because this discovery is reasonably calculated to lead to the discovery of admissible evidence. *See* Rule 26(b)(1) of the Federal Rules of Civil Procedure. As *Amici* make clear on this appeal, a full and fair opportunity to make the appropriate record before the trial court is of grave importance in this matter. (Brief Amicus Curiae at 26-28). Accordingly, the Grosz Heirs request that this Court instruct the District Court on remand to compel further production pursuant to the Grosz Heirs' previously promulgated discovery demands.

D. In Any Event, The District Court Should Have Allowed The Grosz Heirs An Opportunity To Amend The Complaint.

In addition to the arguments above, the Court should vacate the District Court's order granting MoMA's motion to dismiss and remand with instructions to allow the Grosz Heirs to amend their Complaint. On December 1, 2009, the Grosz Heirs sought leave to amend the Complaint based on evidence discovered on November 20, 2009 (Docket No. 63, Ex. A). To support their application, the Grosz Heirs proffered specific evidence demonstrating Lowry's lack of authority to refuse the Grosz Heirs' claims

prior to April 12, 2006. (Docket No. 65 at 10-11); (Vol.II, A-482). These proffered factual allegations entitled the Grosz Heirs to relief under New York's "demand and refusal" rule because – regardless of Jentsch's deposition testimony – if Lowry had no authority to refuse the Grosz demand, MoMA's refusal could not have been communicated on or before April 12, 2006 (contrary to the District Court's erroneous finding otherwise). The District Court denied the Grosz Heirs' motion to amend as futile based upon reference to deposition testimony of Grosz's agent, Jentsch. (SPA - 49-50). This was error and an abuse of discretion because the District Court created a subjective test instead of correctly applying New York's demand and refusal rule.

Amendments should be freely given when justice so requires. *See* Rule 15(2); *see In re Sims*, 534 F.3d 117, 132 (2d Cir. 2008) (a district court has abused its discretion if it based its ruling on an erroneous view of the law, on a clearly erroneous assessment of the evidence, or rendered a decision that cannot be located within the range of permissible decisions). Where an amendment is proposed in opposition to a dismissal motion, the amendment will be denied as futile only if it appears beyond doubt that the plaintiff can plead no facts entitling him to relief. *Milanese v. Rust-Oleum Corp.*, 244 F.3d 104, 110 (2d Cir. 2001).

The District Court's refusal to permit the Grosz Heirs to amend the Complaint was based on a fundamental error of New York law. New York's Court of Appeals adopted the "demand and refusal" rule as the rule the most protective of true owners of stolen art. *Lubell*, 77 N.Y.2d at 320. Contrary to the District Court's implication, the demand and refusal rule is not a subjective test of when a plaintiff first perceives that a demand will be refused. *Compare id with* (SPA-19). Accordingly, Jentsch's subjective state of mind is not dispositive. Indeed, a determination based upon the subjective perceptions of an owner's agent in the midst of negotiations while a corporate entity has not made any decision whatsoever on a demand (and the owners had consented to the corporate entity's possession pending that final corporate decision) would undermine New York's "demand and refusal" rule altogether. This is especially true when, as here, this determination is made on an incomplete record on a motion to dismiss pursuant to Rule 12(b)(6).

The District Court further erred by holding "*Plaintiff affirmatively pleaded that the museum refused to toll the statute of limitations* (Compl. ¶ 23), so once the limitations period started to run it kept on running." (SPA – 51) (italics in original). The Complaint's allegation refers to MoMA's refusal to toll the statute of limitations in connection with David Rowland's

inquiries in 2008. (*See* A -540-541) It is clear that the District Court based its denial of leave to amend the Complaint on the erroneous assumption that MoMA's refusal to toll the statute of limitations occurred prior to April 12, 2006. This finding is irrelevant if this Court determines (as it should) that MoMA first refused the Grosz demand on April 12, 2006 as alleged in the Complaint.

VI.

CONCLUSION

In this action based on diversity jurisdiction, the District Court was required to put itself into the shoes of the New York courts in applying New York's "demand and refusal" rule, a rule unique to New York designed to be the most protective of the true owner's rights to stolen property. Rather than following New York precedents, the District Court wrote the "refusal" requirement out of the rule.

Nor did the District Court follow the Federal Rules of Civil Procedure. Rather following Rule 12(d)'s mandate, strictly enforced in this Circuit to convert to a summary judgment motion if consideration of extrinsic evidence was to occur, the District Court improperly considered extrinsic materials. Rather than accepting all well-pleaded allegations to be true, drawing favorable inferences and requiring MoMA to prove that the

Grosz Heirs could prove *no* set of facts entitling them to relief as Rule 12(b) requires, the District Court resolved a disputed fact issue involving the refusal date against the Grosz Heirs and repeatedly drew negative inferences, made premature credibility determinations, and voiced skepticism as to the Complaint's well-pleaded and historically-grounded allegations.

For the reasons set forth above and in Appellants' brief, the Judgment should be vacated, leave to amend the Complaint should be granted, and the case reassigned on remand with instructions to permit the discovery requested.

Dated: New York, New York
October 27, 2010

DUNNINGTON, BARTHOLOW & MILLER LLP

By: _____/s/_____

Raymond J. Dowd
Thomas V. Marino
Luke A. McGrath
1359 Broadway, Suite 600
New York, NY 10018
Tel: (212) 682-8811
Fax: (212) 661-7769
rdowd@dunnington.com

ROWLAND & PETROFF

David J. Rowland
Patricia Hertling
Two Park Avenue, 19th Floor
New York, NY 10016
Tel: (212) 685-5509
DavidJohnRowland@cs.com
patricia.hertling@rowlandlaw.com

CERTIFICATE OF COMPLIANCE

I hereby certify that:

1. Pursuant to Rule 32(a)(7)(B) of the Federal Rules of Appellate Procedure, the foregoing appellant's brief contains 6,977 words, excluding those portions of the brief exempted by Rule 32(a)(7)(B)(iii).

2. Pursuant to Rule 32(a)(5) and the type style requirements of Rule 32(a)(6), the foregoing appellant's brief has been prepared in a proportionally spaced typeface using Microsoft Word in 14 point font in Times New Roman type style.

Dated: October 27, 2010

_____/s/_____
Raymond J. Dowd
Attorney for Plaintiffs-Appellants

CERTIFICATE OF SERVICE & CM/ECF FILING

10-257-cv Grosz v. MoMA

I hereby certify that I caused the foregoing Reply Brief for Plaintiffs-Appellants to be served on counsel for Defendants-Appellees via Electronic Mail generated by the Court's electronic filing system (CM/ECF) with a Notice of Docket Activity pursuant to Local Appellate Rule 25.1:

Charles S. Sims
Margaret Antinori Dale
Jennifer Lindsay Jones
Proskauer Rose LLP
1585 Broadway
New York, New York 10036
(212) 969-3950

Attorneys for Defendants-Appellees

I certify that an electronic copy was uploaded to the Court's electronic filing system. Six (6) hard copies of the foregoing Reply Brief for Plaintiffs-Appellants were sent to the Clerk's Office By Hand Delivery to:

Clerk of Court
United States Court of Appeals, Second Circuit
United States Courthouse
500 Pearl Street, 3rd floor
New York, New York 10007
(212) 857-8576

on this 27th day of October 2010.

Notary Public:

/s/ Nadia R. Oswald Hamid

Sworn to me this

October 27, 2010
NADIA R. OSWALD HAMID
Notary Public, State of New York
No. 01OS6101366
Qualified in Kings County
Commission Expires November 10, 2011

/s/ Renee Anderson

Renee Anderson
Record Press, Inc.
229 West 36th Street, 8th Floor
New York, New York 10018
(212) 619-4949