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LITIGATION REVIEW



Default Judgment Motions

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Your client makes a loan and, in return, receives a mortgage note, which reflects the real property upon which the mortgage securing the note will be recorded. Shortly after the loan is made, the borrower fails to repay the amount due. Although the mortgage that was intended to secure the note was never prepared or recorded, you bring an action to enforce the note, with the filing of a verified complaint containing various alternative causes of action, to collect the amount due.

The defendant-borrower fails to appear in the action within the time to respond. You move for a default judgment, relying upon the verified complaint. Default judgment easily granted, correct? Not so simple, as shown in graphic detail by a new, well-reasoned decision by the Nassau Supreme Court Justice Leonard Austin of the Commercial Part. Your client makes a loan and, in return, receives a mortgage note, which reflects the real property upon which the mortgage securing the note will be recorded. Shortly after the loan is made, the borrower fails to repay the amount due. Although the mortgage that was intended to secure the note was never prepared or recorded, you bring an action to enforce the note, with the filing of a verified complaint containing various alternative causes of action, to collect the amount due.

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In *Bales v. Pfeifer* (NYLJ, April 26), the plaintiff alleged that he lent \$300,000 to defendant and, in return, defendant signed a mortgage note reciting certain real property upon which a mortgage was to be filed to secure payment of the amount due. For some unknown reason the plaintiff alleged in his verified complaint that the sum of \$340,000 was to be repaid on the \$300,000 loan within just 45 days of the date the note was signed.

In the verified complaint, the first three causes of action attempted to allege claims for fraud, seeking the principal and alleged interest due under the note, respectively, while the fourth cause of action sought recovery of the principal and interest under the note itself. Although four separate defendants were named in the action, only one defendant had been served with process, so the motion for a default judgment was directed against this sole defendant.

CPLR 3215(f) provides in relevant part:

On any application for judgment by default, the applicant shall file proof of service of the summons and the complaint, or a summons and notice served pursuant to subdivision (b) of rule 305 or subdivision (a) of rule 316, and proof by affidavit made by the party of the facts constituting the claim, the default and the amount due. Where a verified complaint has been served it may be used as the affidavit of the facts constituting the claim and the amount due; in such case, an affidavit as to the default shall be made by the party or his attorney.

In moving for a default judgment pursuant to CPLR 3215(f), plaintiff offered proof that the sole defendant that was served failed to appear within the time required. Plaintiff also offered the verified complaint as proof of the facts upon which the action was based.

Justice Austin not only denied the motion for a default judgment, but dismissed the entire action against all defendants sua sponte. His decision provides instructive guidance on both proper procedure for obtaining a default judgment as well as the importance of properly pleading all the essential elements of an alleged cause of action in a verified complaint.

As Justice Austin noted, in addition to proving that the summons and complaint were served, and that the defendant failed to respond thereto within the time required, a plaintiff seeking a default judgment must submit proof of the facts underlying the action, by affidavit, or through a verified complaint.

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While it is true that by defaulting a defendant is deemed to admit all of the factual allegations of the complaint, this alone is not sufficient for a finding of liability in favor of the plaintiff on the causes of action alleged. In addition to this implied admission, courts must require plaintiffs to "present some proof of liability so that the reviewing court can determine that the 'prima facie validity' of the uncontested cause of action has been established . . . because the granting of a default judgment does not become a 'mandatory ministerial duty' upon a defendant's default." *Gagen v. Kipany Productions Ltd.*, 289 A.D.2d 844, 735 N.Y.S.2d 225, 227-28 (3d Dept. 2001).

In short, as noted by Justice Austin: "The party seeking a default judgment must establish the existence of a prima facie cause of action against the defaulting party."

Beginning of Troubles

Although the plaintiff in *Bales* did, in fact, submit a verified complaint setting forth the factual basis of the various causes of action to recover on the note, that was actually the start of the plaintiff's problems.

Justice Austin reviewed the proof submitted, and carefully analyzed the allegations of the verified complaint to determine whether a prima facie case had been established, even though the defendant did fail to appear and would be deemed to have admitted all of the allegations of the complaint.

In doing so, Justice Austin observed that while the note contained a specific interest rate, the amount plaintiff claimed to be due for both the principal and interest rendered the effective interest rate criminally usurious. Relying upon General Obligations Law §5-501(6), Penal Law §190.40 and corresponding case law, Justice Austin then noted that "[l]oans which are criminally usurious are void ab initio preventing the lender from recovering either the principal or the interest." From there, matters only got worse for the plaintiff.

Because the interest sought was criminally usurious, Justice Austin refused to enforce the fourth cause of action seeking payment under the note. Then, turning to the first three causes of action, which attempted to allege claims of fraud in different permutations, Justice Austin made several significant observations.

First, to the extent those causes of action sought to recover under the note, the court found they were an improper attempt to circumvent the criminal usury laws.

Next, Justice Austin noted that the fraud claims failed to allege causes of action on their face because, among other things, they were not pleaded in sufficient detail, the plaintiff committed several careless errors of its own in failing to detect the alleged fraud, and the plaintiff failed to satisfy his legal duty to ascertain truthful information available by public record or through the exercise of due diligence, which would have uncovered the alleged misrepresentations.

Indeed, Justice Austin noted that the plaintiff himself admitted that "he failed to exercise due diligence in this transaction." Thus, Justice Austin concluded that the complaint failed to allege any cause of action for fraud.

In the end, not only did the plaintiff fail to obtain a default judgment, but, because of the fatal defects in the pleading and proof, Justice Austin proceeded to dismiss the entire case against all defendants sua sponte.

Several lessons can be gleaned from this well-reasoned and thorough decision.

First, careful thought should be given to the precise elements of each and every cause of action attempted to be alleged in a complaint, even in those situations where the facts and law seem to be straightforward. In this case, seeking to enforce a simple note transaction without addressing the applicability and impact of the usury laws was

fatal. The complaint in fact contradicted itself by seeking to enforce a note, yet claiming interest that was unenforceable.

Second, adding gratuitous allegations of "fraud" in an apparent attempt to "spice up" a straightforward commercial transaction can backfire if the facts are not pleaded with sufficient detail and do not satisfy all the required elements of fraud. Here, plaintiff alleged that he was defrauded by defendant, yet admitted that he did not even carefully read the note at issue.

Third, adequate proof must be considered and submitted with a motion for a default because a party cannot simply rely upon defendant's "admission" of the facts as a result of the failure to appear. If the verified complaint is relied upon as proof of the facts, both the factual allegations as well as the elements of the causes of action attempted to be alleged must be submitted.

Finally, this decision also gives food for thought to a defendant who is seeking to challenge a judgment already entered upon a default. That is, where the motion court has not properly scrutinized the level of proof submitted by plaintiff on the motion for default, there is a fertile ground for vacating the default, even apart from the standard requirements of establishing a meritorious defense and excusable default. For example, in addition to the various grounds set forth in CPLR 5015(a) for vacating a default, "a court may vacate its own judgment for sufficient reason and in the interests of substantial justice," *Woodson v. Mendon Leasing Corp.*, 100 N.Y.2d 62, 760 N.Y.S.2d 727 (2003), which would include reassessing the level of proof submitted by plaintiff.

Similarly, an appellate court has authority to reverse a decision granting a default judgment based upon the plaintiff's failure to offer adequate proof of a prima facie cause of action. See, e.g., *Joosten v. Gale*, 129 A.D.2d 531, 514 N.Y.S.2d 729 (1st Dep't 1987).