

## NEW YORK COURT OF APPEALS ROUNDUP:

### STANDARD FOR PLEADING FRAUD, DISCOVERY SANCTIONS, AND IMPOSING POST-RELEASE SUPERVISION

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June 12, 2008

In a recent decision of the Court of Appeals that we discuss this month, the Court interpreted the CPLR's pleading requirement for fraud claims, particularly with respect to claims against individual officers of a corporation that is alleged to have engaged in a fraudulent scheme.

Another case that we discuss tells a cautionary tale for lawyers: the Court upheld the striking of a defendant's answer as a sanction for discovery abuse, even though that resulted in a substantial default judgment in a case of doubtful validity.

Finally, resolving an issue as to which the appellate division departments had been divided, the Court held that post-release supervision is part of a sentence and thus must be pronounced by the judge before the defendant at the time of sentencing.

#### **Pleading Fraud**

The requirement of CPLR 3016(b) that the circumstances constituting the wrong in a cause of action sounding in fraud "shall be stated in detail" could not be more simply stated. The sole issue before the Court in [\*Pludeman v. Northern Leasing Systems Inc. \(NLS\)\*](#), was whether, with respect to certain individually named senior officers of the corporate defendant, the complaint met this pleading requirement. The case attracted the attention of the Chamber of Commerce of the United States of America, which submitted an amicus brief.

The Court, in an opinion by Judge Theodore T. Jones for a 5-2 majority, concluded that the Rule 3016(b) pleading standard had been met. The dissent in the Court of Appeals by Judge Robert S. Smith, joined by Judge Susan Phillips Read, like the dissent filed in the Appellate Division (3-2), shows that the level of specificity required lies in the perception of the court based upon the pleaded facts and the reasonable inferences that may be drawn from them.

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The facts in the case were not complicated. Plaintiffs, suing individually and not as a class, were a group of owners of small businesses in various states who entered into written lease agreements and personal guarantees with NLS for point of sale equipment. Plaintiffs alleged that they had been deceptively caused to sign the leases that were presented to them by selling agents for NLS as one-page documents, when in fact the leases consisted of four pages and contained onerous terms that had been concealed from the plaintiffs.

While agreeing with the dissent that something more than "notice pleading" is required, the majority of the Court concluded that the facts alleged were sufficient to inform the defendants with respect to the incidents of which plaintiffs complained.

The facts that appear to have persuaded the Court to sustain the claims were that the fraudulent conduct alleged was not an isolated incident but rather a nationwide scheme that took place over some years, which permitted the "reasonable inference" that the individuals, who held key positions at NLS, "knew of and/or were involved in the fraud." The Court also referred to the "language, structure and format" of the leases, and the allegation that the NLS agents who obtained the leases did not provide the lessees with a copy of the agreement at the time it was signed, as additional facts permitting the inference of fraud. Allegations specific to each individual defendant were not required.

The dissent by Judge Smith pointed out that, while the Court in the past has given little attention to fraud pleading requirements, federal courts applying [Rule 9\(b\)](#) of the Federal Rules of Civil Procedure have, although not uniformly, required the pleading of particularized facts to support the inference that defendants acted either recklessly or with fraudulent intent. Indeed, Judge Smith stated his support for New York's adoption of the U.S. Court of Appeals for the Second Circuit's requirement that the facts pleaded permit a "strong inference of fraud" for a fraud complaint to be sustained, a standard that has been adopted by statute for certain federal securities actions.

We suggest that this is an important decision in New York. Based upon *Pludeman*, if one can plead facts that, when taken together with the circumstances as alleged, give rise to a reasonable inference of fraud, a fraud pleading will be sustained even in the absence of direct allegations against each defendant.

### **Discovery Default**

Because its answer was stricken due to its failure to provide discovery, defendant Safway Steel Products was ordered to pay a \$700,000 judgment in a personal injury action that may well have been fraudulently brought. The Court upheld this result, underscoring that parties should comply with discovery obligations and orders, and supporting a trial court's discretion to impose harsh sanctions when parties do not.

The plaintiff in [Wilson v. Galicia Contracting & Restoration Corp.](#) suffered permanent injury to his

retina from a foreign object. His complaint alleged that, when he was walking under a scaffold that had been assembled by Safway and looked up, a piece of metal fell into his eye.

Over a period of months, Safway failed to comply with plaintiff's formal and informal discovery requests or with the terms of a preliminary conference order. The court entered a conditional order directing the company to provide discovery, or its answer would be stricken. Safway still failed to comply. A default judgment therefore was entered, and the court held an inquest to determine damages. During the pendency of the inquest, plaintiff produced the foreign object to another defendant, whose expert gave an opinion that it was a lead pellet that had been fired into plaintiff's eye by an air gun. Plaintiff then discontinued his action against the defendants other than Safway with prejudice.

The issue presented was whether the trial court had been correct in regarding plaintiff's alleged fraud as separate from the matter of Safway's sanctions. The Court of Appeals, in a memorandum opinion, agreed that plaintiff's suspected fraud did not provide a basis for vacating the default judgment or damages award against Safway.

Safway did not offer any valid reason for its failure to produce discovery as required. Instead, it attempted to raise in the Court of Appeals an argument based upon the requirement of CPLR §3215(f) that an application for default judgment be supported by a verified complaint or proof of the facts constituting the claim. Because this argument had not been made previously, however, the Court would not consider it. Safway failed to pursue an argument it had raised below under CPLR 5015(a)(3), which provides that a party may be relieved from terms of a judgment on the grounds of "fraud, misrepresentation, or other misconduct" of the adverse party. The Court refused to consider this argument as unpreserved.

Dissenting Judge Eugene F. Pigott Jr. asserted that the Court should have considered Rule 5015(a)(3) despite Safway's abandonment of its argument thereunder "because courts have a fundamental duty to ensure that judgments are not procured by fraud." The majority, however, concluded that the integrity of the judicial process requires that parties be compelled to abide by statutes and orders, and further stated that the "objectives of honesty and integrity" are not served when a court itself goes outside of applicable law to raise unpreserved arguments.

### **Post-Release Supervision**

Penal Law §§70.00(6) and 70.45(1) mandate that sentences for violent felons (other than persistent felons) include post-release supervision (PRS). Violation of a condition of the PRS may result in revocation of the release and incarceration.

In two decisions resolving six appeals, the unanimous Court stated firmly that because PRS "represents a significant punishment component that restricts an individual's liberty," it is part of a defendant's sentence and therefore must be imposed by a judge and pronounced before the defendant. Judge Carmen Beauchamp Ciparick's opinions for the Court in both cases explained that, when this procedure is not adhered to, the sentence must be vacated. This result did not

provide the appellants with much relief, however, because their cases were remanded for resentencing in accordance with the law mandating PRS.

The defendants in some of the appeals had entered guilty pleas, and asserted that they had not been informed at the time that their sentences would include PRS. None of these defendants sought to vacate his plea, however. The defendants in other appeals were convicted after trial. In none of the cases was the PRS component stated by the sentencing judge in open court. In some cases it was recorded by the clerk on either a court worksheet or the commitment sheet (in some instances those documents also were initialed by the judge), but in one case PRS was added to the commitment sheet by the Department of Correctional Services (DOC).

In [\*Earley v. Murray\*, 451 F.3d 71, 74-76 & n.1 \(2d Cir. 2006\)](#), the Second Circuit held that due process requires that the sentence imposed by a judge is controlling and cannot be increased by administrative amendment. The Court of Appeals did not find it necessary to reach the constitutional arguments of the appellants in either [\*People v. Sparber\*](#) or [\*Matter of Garner v. New York State Dept. of Correctional Services\*](#), however, because it found the result to be dictated by statute.

CPL §§380.20 and 380.40 require that a sentence must be "pronounce[d]" in every case in which a conviction is entered, and that the defendant must be "personally present" at the time. The manner in which sentencing was handled in each of the cases on appeal did not comport with these requirements. Sentencing is a "uniquely judicial responsibility" and thus cannot be performed by a clerk or the DOC, the Court held. Moreover, it is important for a sentence to be pronounced in open court for the benefit of both the defendant and the public, and a judicial endorsement of a clerk's notation does not fulfill that purpose.

The defendants sought to have PRS stricken from their sentences, arguing that because the one-year period for the People to appeal an illegal sentence had elapsed, the People could not seek resentencing. But the Court ruled that the defendants could not escape mandatory PRS, nor was there any procedural bar to having the correct sentences properly imposed in resentencing.