In The

Supreme Court of Virginia

RECORD NO. 091244

AME FINANCIAL CORPORATION,

Appellant,

v.

PAUL G. KIRITSIS, EMILIE A. KIRITSIS, and GREENPOINT MORTGAGE FUNDING, INC.,

Appellees.

BRIEF OF APPELLANT

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STATEMENT OF THE CASE

This appeal arises from a suit filed in the Chesterfield County Circuit Court by Paul and Emilie Kiritsis, in connection with a mortgage loan to finance the purchase of their home. They sued four defendants, including AME Financial Corporation, a Georgia company, on several theories, including fraud.

AME filed an answer within 21 days after service of process. But because the answer was signed by AME's vice president instead of by a Virginia attorney, the trial court struck it and ruled that AME was in default. Upon learning of this ruling one week later, AME hired a lawyer and moved for relief under Rule 3:19(b). The trial court denied this motion and three motions to reconsider.

The court conducted a trial on damages 18 months after the default ruling, and entered judgment in favor of the homeowners. In later proceedings, the court entered judgment in favor of a codefendant, GreenPoint Mortgage

Funding, Inc., on its cross-claim against AME. That ruling was based on the original default ruling. The court entered final judgment on March 20, 2009. This Court awarded AME an appeal on November 17, 2009.

ASSIGNMENTS OF ERROR

1. The trial court abused its discretion by denying AME Financial's motions for relief under Rule 3:19(b), and in entering judgment based on default, because AME Financial demonstrated good cause for such relief.

2. The trial court erroneously granted judgment against AME Financial on GreenPoint's cross-claim, based in part on its finding of default.

3. The trial court refused to consider AME Financial's demurrer before awarding judgment.

QUESTIONS PRESENTED

1. Does a trial court abuse its discretion when it refuses relief from default because the defendant did not follow legal advice given to it by the *plaintiff's* lawyer? (Assignments 1 and 2)

2. Do the new provisions of Rule 3:19(b) permit a trial court to refuse relief from a short, technical default, where the plaintiff suffers no prejudice by the delay? (Assignments 1 and 2)

3. May a trial court enter a default judgment without determining whether the complaint states a claim for which relief can be granted? (Assignment 3)

STATEMENT OF FACTS

1. AME's dealings with the homeowners.

Since the trial court found AME to be in default, it accepted the facts as pleaded in the complaint. AME sought leave to plead many denials of those facts, and to demur to the complaint, but the trial court denied that request.

Accordingly, the following facts (in this part 1) pleaded by the homeowners, most of which are sharply disputed, formed the basis for the trial court's adjudication of AME's liability to the homeowners.

Paul and Emilie Kiritsis contracted to buy a house in Chesterfield County, and applied to Fidelity Financial Mortgage Corporation for financing. The loan was to be at an adjustable rate, adjusting annually after the first ten years, with a ceiling of 8-5/8%.

Fidelity, having paired with AME, delivered loan documents, comporting with the above terms, to the

homeowners' lawyer at closing. The homeowners signed the documents and closed on the purchase and the loan.

Weeks later, AME contacted the homeowners and asked that they execute a replacement note on different terms. The differences were that the rate would adjust after six months, not ten years; and the interest ceiling was 12%. The homeowners refused to sign the new note.

Thereafter, a vice president of AME executed the replacement note as attorney-in-fact for the homeowners. The homeowners had not given anyone power of attorney to execute the replacement note on their behalf.

AME assigned the note to GreenPoint Mortgage Funding, Inc. GreenPoint increased the interest rate after the first six months. When the homeowners challenged the legitimacy of the note, AME continued to insist that the replacement note was in effect. AME fabricated another document (which document is not identified in the complaint) to bolster its claim; it has never produced the original of that document.

2. Facts relating to AME's answer.

The homeowners served process on AME on May 24, 2006. A week later the company's vice president, Wayne Bonertz, called the homeowners' lawyer, Bradley P. Marrs, to discuss the matter. AME then filed a timely answer, in which it denied most of the homeowners' allegations.

But the answer was signed only by Bonertz, not by a Virginia attorney. Marrs moved to strike the pleading, and set a hearing for July 21, 2006 on that motion and on a request that AME be declared to be in default.

Upon receiving these motions, Bonertz contacted a Virginia lawyer who agreed to investigate the matter. In doing so, the lawyer spoke with Marrs on July 19, but Marrs did not disclose in this conversation the impending hearing, or allude to it in any way.[1]

On July 21, no one appeared in court on behalf of AME. The court struck the answer and placed the company in

[1] A. 1532-33.

default. Seven days later, while reviewing the court's file, AME's attorney learned of this order and immediately filed a motion for appropriate relief.

The trial court considered AME's motion on October 24, 2006. Marrs made an unsworn representation to the court that he had advised AME vice president Bonertz in June that Virginia law required that the company hire an attorney to file pleadings in the case.[2] Based on Marrs's representation, the court denied AME's motion (and a subsequent motion to rehear), and continued to regard the company as being in default.

That judge then recused himself from the case, and a new judge was assigned. AME asked the new judge to reconsider the default ruling, but she denied the motion and sanctioned AME's lawyer for having filed it. The new judge eventually entered judgment in favor of the homeowners and against all defendants. The case remained pending for adjudication of GreenPoint's cross-claim against AME.

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[2] A. 1533.

3. AME's dealings with the mortgage assignee.

Before assigning the loan to GreenPoint, AME had agreed to indemnify GreenPoint from claims arising from the note. Since GreenPoint was one of the named defendants in the homeowners' suit, it filed a cross-claim, asking the trial court to compel AME to repurchase the note and to pay its legal fees and other damages. This claim fully depended upon the resolution of the homeowners' original claim – if the execution of the replacement note was proper pursuant to a valid power of attorney, then the cross-claim would be moot.[3]

The trial court ordered AME to repurchase the note for $1.075 million, and awarded GreenPoint $186,362.17 in costs and legal fees.

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[3] See, e.g., A. 34, ¶¶ 62, 66; A. 1226, 1232, 1240-41 (AME's default was binding on GreenPoint, leading to GreenPoint's claim).

ARGUMENT

Standard of Review

For the dominant issue of this appeal, this Court reviews the refusal to grant relief from default, and to permit the filing of a late answer, for abuse of discretion.[4] Assignment 3 presents a legal issue, which the court reviews de novo.[5]

Discussion

1. AME should have been granted relief from its technical default. (Assignments 1 and 2)

The trial court awarded the homeowners and GreenPoint various forms of relief against AME. But the foundation for each of those awards was a ruling by which the trial court refused to relieve AME of its technical default.

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[4] *Williams v. Service Inc.*, 199 Va. 326, 329, 99 S.E.2d 648, 651 (1957).

[5] *Alcoy v. Valley Nursing Homes, Inc.*, 272 Va. 37, 41, 630 S.E.2d 301, 303 (2006).

If this Court reverses that ruling, then AME will be able to defend all of the parties' claims on the merits, instead of being saddled with the fraud allegations in the complaint.

At the outset, there is no question that AME's original answer was insufficient. Due to the Georgia company's unfamiliarity with Virginia law, it filed an answer in its own right, without the signature of a member of the Virginia State Bar.[6] AME accordingly does not assign error to the trial court's decision to strike the answer. But AME retained a Virginia attorney and moved for relief promptly after the pleading defect was asserted, long before any substantive developments in the case.

This action was filed after this Court's revision of the Rules of Court to create a single form of action under Part 3 (effective Jan. 1, 2006). Accordingly, the case is governed by the provisions of the revised rules.

Germane to this appeal, the 2006 amendments included a liberalization of procedures for obtaining relief

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[6] UPC 1-3 (corporations may not appear pro se).

from a brief technical default such as this one. Two leading commentators on Virginia practice have noted this effect:

> Traditionally in Virginia, merely letting the 21 day answer period slip by has been the source of disaster. Beginning in 2006, Rule 3:19 ameliorates to some extent the most common situation—where there is a short delay in the defendant's proffering of a responsive pleading—technically missing the deadline.[7]

This case thus implicates the first-impression question of what "good cause" a defendant must show in order to justify relief under the new, more forgiving standard of Rule 3:19(b). This Court has yet to issue a published ruling interpreting the new rule, but Sinclair's analysis is informative. In §11.4(F) of the treatise, he observes that:

- The sooner the defendant appears and seeks to defend on the merits, "the lower the standard should be" in evaluating the basis of his request. Thus, a delay of six months, as in *Cooper v. Davis*,[8] would be evaluated more

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[7] K. Sinclair and L. Middleditch, *Virginia Civil Procedure*, §11.4(D) (4th ed. 2007) (hereinafter "Sinclair").
[8] 199 Va. 472, 100 S.E.2d 691 (1957).

stringently than would the delay of a few weeks here, especially when considered with AME's timely attempt to defend.

- The rule reflects the Court's preference for having cases decided on the merits instead of on procedural grounds. Thus, the commentators forecast, "any consideration which casts the defendant's conduct in a light other than a bald-faced effort to delay or obstruct the plaintiff, will likely be accepted as 'good cause' under Rule 3:19."

- This section of the treatise concludes by observing that a short delay in the filing of an answer rarely affects the plaintiff:

> However, in the overwhelming majority of instances, the passage of a few days (or even a few weeks) between the prescribed due-date for filing an answer and the date on which a defendant actually proffers a late answer will not cause any detriment to the plaintiff other than the short delay itself, putting off commencement of discovery and trial preparations.

AME never did anything to indicate an intention to abandon a defense to this suit. It filed a timely answer, only to see that answer struck by the court. It promptly retained Virginia counsel, who filed an appropriate motion under Rule 3:19(b) the same day that he learned of the default order. The homeowners never claimed that the delay affected them in any way; they merely received the benefit of the technical defect in the original answer.

All of these considerations point to the appropriateness of the requested relief. But the trial court, apparently evaluating the case using a more stringent standard than the one in Rule 3:19(b), refused to grant it, and abused its discretion in doing so.

* * *

In explaining his decision in a subsequent order, the original trial judge, before he recused himself, credited Marrs's recollection of his telephone conversation with AME's vice president. Specifically, the court found that this

conversation "put AME on notice that [it] needed Virginia counsel."[9]

It is important to consider the context of this conversation. According to the trial court's finding, AME's vice president received legal advice from the attorney for the parties who were suing the company. This advice went beyond that permitted in R.P.C. 4.3(b).[10]

Instead of simply advising AME to retain counsel, the homeowner's lawyer advised the vice president what kind of attorney to retain (i.e., admitted in Virginia), and that the company could not file pleadings without such counsel. He advised Bonertz why it would be advantageous for the company to settle the suit immediately, instead of incurring the expense of hiring an attorney.[11]

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[9] A. 171-72.

[10] "A lawyer shall not give advice to a person who is not represented by counsel, other than the advice to secure counsel . . . ."

[11] For the attorney's version of the extended scope of the conversation, see A. 101 and 122-24 (including attorney's view of AME's settlement calculus).

The trial court necessarily held that AME was required to accept this advice from the attorney for its adversary. The court specifically based its ruling upon the fact that AME had not done what its *opponent's lawyer* had advised it to do. But no party is required to accept legal advice from an opposing attorney. Instead of applying the liberal standard of Rule 3:19(b), the trial court held the company strictly liable, in a million-dollar case, for failing to heed Marrs's legal advice.

Measured by the more forgiving standard of the new rule, as described by Sinclair, AME stated a proper case for relief. Because it disdained the liberalizing effect of the new rule, the trial court abused its discretion in denying that relief, leading inexorably to the imposition of judgment in favor of the homeowners and GreenPoint. (The basis for any duty of AME to repurchase the note from GreenPoint was the default-based fraud finding.)

Consistent with this Court' preference for resolution of cases on the merits, as embodied in Rule 3:19(b), AME

should be permitted to put forth a meaningful defense to the claims against it.

2. The trial court erroneously failed to rule on whether the complaint stated a claim for which relief can be granted. (Assignment 3)

Independent of the validity of its default ruling, the trial court still had an obligation to consider AME's contention that the complaint failed to state a claim for which relief could be granted. A trial court may not enter a default judgment based on a facially-invalid complaint.[12]

The homeowners filed a five-count complaint. AME filed a detailed demurrer to Counts II through V, alleging that those counts failed to state valid claims. (Count I is no longer at issue, since the homeowners did not prevail on that claim and did not assign any cross-error.)

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[12] *Landcraft Co. v. Kincaid*, 220 Va. 865, 870, 263 S.E.2d 419, 422 (1980) (failure of motion for judgment to state a cause of action "is held to disable the court from entering a valid default judgment") (decided under former Rule 3:17).

The trial court flatly refused to consider whether the complaint stated a proper claim. The order denying relief from default states, "The Court declined to consider AME's *Demurrer* as it was not removed from default."[13] AME raised the issue of this failure to state a claim when it renewed its request for relief from default.[14] Instead of considering this motion, the trial court sanctioned AME's lawyer for having filed it. (The sanction order is the subject of a separate appeal, which the Court granted on September 1, 2009. Record No. 091245.)

Given this Court's directive in *Landcraft Co.*, the trial court was obligated to consider and rule upon the demurrer, instead of sweeping it aside by a ruling of default. If the Court does not reverse on Assignments 1 and 2, it should remand the case for a full evaluation of the demurrer.[15]

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[13] A. 172 (italics in original).
[14] A. 186, ¶4; A. 189-90, ¶¶20-23.
[15] *Orndorff v. Commonwealth*, 271 Va. 486, 505-06, 628 S.E.2d 344, 355 (2006) (remanding case where trial court erroneously did not rule on material issue).

CONCLUSION

In order to address the harsh consequences attendant to technical defaults, this Court crafted the provisions of Rule 3:19(b) to permit relief from short defaults and to enable more cases to be decided on the merits. The trial court erroneously evaluated AME's request under the pre-2006 standards (now embodied in Rule 3:19(d)(1), providing for relief within 21 days after default *judgment*) and refused to grant relief. The court abused its discretion in doing so, and also erred in failing to consider whether the complaint stated a claim for which relief can be granted.

The Court should remand this case with direction to grant AME relief from default and leave to file its answer and demurrer, with further proceedings under the Rules of Court. In the alternative, the Court should remand the case for consideration of AME's demurrer.

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CERTIFICATE

I hereby certify that, pursuant to Rule 5:26(d), fifteen paper copies and eight electronic copies, on compact disc, of the foregoing Brief of Appellant and Appendix have been hand-filed with the Clerk of the Supreme Court of Virginia and three paper copies of the same have been mailed, postage prepaid, this 11th day of December, 2009, to the following:

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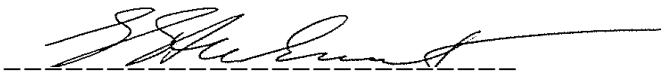

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