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Res Judicata Does Not Insulate Fraudsters Who Prey on Out-Of-State Defendants

The doctrine of *res judicata*, or claim preclusion, can be a powerful defense when attempting a second bite at the proverbial apple; it precludes a litigant from rehashing a claim with the same parties that was decided on the merits in a prior proceeding. Ordinarily, *res judicata* even applies when a party fails to appear in a case and the claims are resolved by default judgment. A recent case in the Southern District of New York, however, illustrates the limits of *res judicata* as applied to default judgments arising out of a massive fraud scheme.

The Case: *Aghaeepour v. Northern Leasing Systems, Inc.*

In *Aghaeepour v. Northern Leasing Systems, Inc.*, the plaintiff-consumers alleged that the defendants had operated a complex and insidious scheme in which they forged lease agreements with the plaintiffs and then instituted frivolous breach of contract lawsuits in New York City Civil Court against them based on those agreements. In many cases, the actions resulted in default judgments against the plaintiffs, who lived outside of New York and could not afford expensive, long-distance litigation. The plaintiffs asserted claims against the defendants under the Federal Racketeer Influenced Corrupt Organizations (RICO) Act and the federal and New York Fair Debt Collection Practices Acts (FDCPA), among others. While the litigation was pending, the New York Attorney General concluded a years-long investigation confirming many of the plaintiffs' allegations and seeking to vacate the default judgments entered against the plaintiffs.

The defendants moved to dismiss the New York FDCPA claim based on *res judicata*, specifically the default judgments they obtained against the plaintiffs in civil court. While recognizing the important judicial economy purpose served by *res judicata*, which seeks to avoid duplicative litigation, Judge Nelson Stephen Román found the facts of this case could not support its application by the defrauding defendants.

Judge Román's Rationale

The three primary reasons for Judge Román's decision to hear the cases: 1) while default judgments are usually considered final and on the merits for *res judicata* purposes, the Attorney General's investigation and efforts to vacate the default judgments raised serious questions about the validity of those judgments and their application as *res judicata* to the instant case; 2), in both the Second Circuit and Second Department, *res judicata* does not apply when a party is not seeking to overturn the underlying judgment but rather is bringing distinct claims. Here, the plaintiffs were not seeking an adjudication on the merits in civil court regarding the defendants' fraudulent scheme, so they remained free to assert their claims in the federal case; 3) the court pointed to the long-standing exception to *res judicata* where the second litigation alleged a scheme that was "astronomically greater" than the claims litigated in the first action.

Takeaway

While a party always should assume that a default judgment is final and subject to *res judicata*, the application of claim preclusion principles is not unfettered. Particularly in cases involving RICO and/or significant fraud claims, the defaulting plaintiff may get his day in court and an opportunity to prove that his adversary is a fraudster.