

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

PETER EDWARDS : CIVIL ACTION
 :
v. :
 :
 :
STORAGE TECHNOLOGY CORP. : NO. 97-5427

MEMORANDUM

Giles, C.J.

February ___, 1999

Plaintiff, Peter Edwards (“Edwards”), brings this diversity action against Storage Technology Corp. (“StorageTek”), his former employer, seeking damages for breach of an employment contract. Based upon documents produced during discovery, StorageTek now seeks leave to amend its answer to add affirmative defenses and counterclaims based on fraud and negligent misrepresentation. For the reasons that follow, the motion is granted and StorageTek may file an amended answer with the requested counterclaims.

Background

Edwards brought this suit in the Court of Common Pleas of Delaware County on August 1, 1997, alleging that he and StorageTek had agreed to a five-year employment contract that would have paid him in excess of \$75,000 per year with potential bonuses and other earnings that would have paid him more than \$166,000 his first year. The position also required that Edwards relocate from Boston to the Philadelphia area. Edwards claims his employment was terminated without cause about three months after it had begun. On August 25, 1997, StorageTek removed the case to this court, pursuant to 28 U.S.C. §§ 1441(a) and 1446(b), basing jurisdiction on diversity of citizenship, 28

U.S.C. § 1332. On September 16, 1997, StorageTek filed an answer. On June 11, 1998, Edwards, with leave of this court, filed an amended complaint, which StorageTek answered on June 19, 1998.

In December 1998, the parties came before this court for resolution of a discovery dispute. StorageTek sought production of certain documents from third party Digital Equipment Corp. (“Digital”), one of Edwards’s former employers, relating to his performance at Digital and his reasons for leaving that job. Edwards opposed production of the documents, which were subject to a confidentiality provision in the settlement agreement. Following in camera review, this court on December 23, 1998 ordered production of certain documents relating to Edwards’s departure from Digital.

StorageTek believes, based on those documents, that Edwards provided false information about his employment history during employment discussions with StorageTek in March 1995. Specifically, Edwards stated that he had left Digital because he was recruited by another company and that his performance at Digital never was criticized and that he left Digital voluntarily as an employee in good standing.

StorageTek claims that such statements were false and that they form the basis for state law claims of fraud and negligent misrepresentation, which StorageTek now seeks to assert as affirmative defenses and counterclaims.

Discussion

StorageTek seeks leave to amend pursuant to Fed. R. Civ. P. 13(f) and 15(a). The former rule states that when a pleader has omitted a counterclaim through oversight, inadvertence, or excusable neglect, or “when justice requires,” he may by leave of court set up the counterclaim in an amended pleading. Fed. R. Civ. P. 13(f). The latter rule permits a party generally to amend pleadings by leave of court and commands that “leave shall be freely given when justice so requires.” Fed. R. Civ. P. 15(a). The two rules together “have been construed to require essentially the same standards for granting leave to add omitted counterclaims.” Bryant v. Clark, No. 91-4352, 1991 WL 212092, *1 (E.D. Pa. 1991) (citing cases); see also id. at *2 (quoting Perfect Plastics Indus., Inc. v. Cars & Concepts, Inc., 758 F. Supp. 1080, 1081-82 (W.D. Pa. 1991) (noting that the language of Rule 13(f) is “especially flexible and allows the court to exercise its discretion and permit amendment whenever it seems desirable to do so”). The decision to grant or deny leave is within the sound discretion of the district court, however the command that leave is to be given freely when justice requires is a mandate that must be heeded. Foman v. Davis, 371 U.S. 178, 182 (1962); see Heyl & Patterson, Int’l., Inc. v. F.D. Rich Housing of the Virgin Islands, Inc., 663 F.2d 419, 425 (3d Cir. 1981) (quoting 3 Moore’s Federal Practice, ¶ 15.08(2) at 15-59 (2d ed. 1980) (“courts have shown a strong liberality” in allowing amendments), cert. denied, 455 U.S. 1018 (1982)).

In determining whether to permit a defendant to amend its answer to add a

counterclaim, the court must consider the presence or absence of a number of factors, including: 1) whether the counterclaim is compulsory; 2) whether the defendant has acted in good faith; 3) whether the defendant has unduly delayed filing the counterclaim; 4) whether the plaintiff would suffer undue prejudice if the amendment is allowed; and 5) whether the counterclaim is meritorious or whether amendment would be futile. See Fort Washington Resources, Inc. v. Tannen, 153 F.R.D. 565, 566 (E.D. Pa. 1994); Bryant, 1991 WL 212092 at *2; Perfect Plastics, 758 F. Supp. at 1082; see also Heyl & Patterson, 663 F.2d at 425 (quoting Foman, 371 U.S. at 182).

In the context of amending pleadings generally, the Third Circuit has held that “prejudice to the non-moving party is the touchstone for the denial of the amendment.” Bechtel v. Robinson, 886 F.2d 644, 652 (3d Cir. 1989) (quoting Cornell & Co. v. Occupational Safety and Health Rev. Comm’n, 573 F.2d 820, 823 (3d Cir. 1978)). The non-moving party bears a heavy burden in challenging a proposed amended pleading. Heyl & Patterson, 663 F.2d at 426. He must do more than merely claim prejudice; it must show that it was unfairly disadvantaged or deprived of the opportunity to present facts or evidence which it would have offered had the amendments been filed timely. Bechtel, 886 F.2d at 652 (citing Heyl & Patterson Int’l., 663 F.2d at 426). Absent such prejudice, the district court must ground its denial in one of the other factors, Bechtel, 886 F.2d at 652-53 (citing Heyl & Patterson, 663 F.2d at 425), however the court should be hesitant to deny amendment, even at a later stage of the litigation, when no such prejudice has been

demonstrated. Perfect Plastics, 758 F. Supp. at 1082.

The court considers these factors in turn.

Undue Prejudice to the Plaintiff

Edwards claims that he will suffer prejudice if the amendment is permitted, primarily because permitting the counterclaim will require additional, increased, and prolonged discovery. The parties will need to depose personnel from Digital, which Edwards fears will add “enormous expense to a simple case.” Additional document discovery and review also will be necessary, related to Edwards’s performance for two previous employers. This court has imposed a March 15 deadline for the completion of discovery.

However, the essential question under Rules 15(a) and 13(f) is whether asserting the counterclaim now will burden or disadvantage the plaintiff in a way that it would not have had the counterclaim been brought previously. See Heyl & Patterson, 663 F.2d at 426 (holding that party opposing amendment “must show that it was unfairly disadvantaged or deprived of the opportunity to present facts or evidence which it would have offered” had the amendments been timely). Edwards cannot show that type of actual prejudice in this case. The additional discovery related to Edwards’s employment at Digital would have been necessary had StorageTek brought the counterclaim at the time of its initial answer in September 1997 or in its answer to the amended complaint in June 1998. The timing does not create prejudice that would not have existed previously.

While it is true that StorageTek requested leave just six weeks prior to the court-ordered close of discovery, that alone is not sufficient prejudice to deny amendment.

Moreover, the taking of this same discovery about Edwards's employment history with Digital would be necessary in any event, because many of the questions raised by the proposed counterclaims would be raised by StorageTek's defenses to the breach of contract claim. See Perfect Plastics Indus., 758 F. Supp. at 1082 ("In all likelihood, the questions raised by the counterclaims would, in any event, be litigated in the action as defenses."). StorageTek initially inquired into Edwards's employment history in order to establish a defense that it would not have entered into the contract had it known about Edwards's employment history with Digital, and might enable it to limit liability or damages. See McKennon v. Nashville Banner Publ'g Co., 513 U.S. 352, 360 (1995) (addressing the use of after-acquired evidence in an employment discrimination case to shape the proper remedy and damages). A plaintiff asserting breach of contract can anticipate that one possible defense would be fraud-in-the-inducement of that contract and that such a defense may be asserted as a counterclaim. Therefore the need for such discovery, Perfect Plastics, 758 F. Supp. at 1082, and the assertion of a counterclaim, Bryant, 1991 WL 212092, at *2, both should be foreseeable to a plaintiff bringing this action. Given that, there is no indication that Edwards will be unduly prejudiced by this court granting StorageTek leave to file the amended answer.

Compulsory Counterclaim

A counterclaim is compulsory, and therefore is waived if not asserted, “if it arises out of the transaction or occurrence that is the subject matter of the opposing party’s claim.” Fed. R. Civ. P. 13(a). The operative question in this circuit is whether the counterclaim bears a logical relationship to an opposing party’s claim, which in turn includes claims that involve: “(1) many of the same factual issues; (2) the same factual and legal issues; or (3) offshoots of the same basic controversy between the parties.” Xerox Corp. v. SCM Corp., 576 F.2d 1057, 1059 (3d Cir. 1978). Under the third, and perhaps the first, prong of this standard, the proposed counterclaims are compulsory and would be barred to StorageTek if leave to raise them in the instant case is denied. See id. at 1059; Perfect Plastics, 758 F. Supp. at 1082.

Edwards asserts that the claim and proposed counterclaim arise from different transactions or occurrences, that the breach of contract claims are based on StorageTek’s failure to pay him earned wages, while the counterclaims are based on the question of whether or not he worked earning the wages. This argument adopts too narrow a construction of “offshoots of the same basic controversy.” The parties allegedly agreed to a five-year employment contract and Edwards seeks, among other damages, five years of his base salary of \$75,000. (Am. Compl. ¶ 34). StorageTek wants to argue that, through his misrepresentations and omissions, Edwards committed fraud in order to induce them to enter into the contract. (Countercl. ¶¶ 18-20). The basic controversy is the employment

relationship between Edwards and StorageTek and that contract that resulted from that relationship. The claim of a breach of that contract and the defense and counterclaim of fraud in entering that contract arise from the same basic controversy, that employment relationship. The counterclaims are compulsory and the argument for permitting StorageTek to amend therefore is “especially compelling.” Perfect Plastics, 758 F. Supp. at 1082 (quoting Spartan Grain & Mill Co. v. Ayers, 517 F.2d 214, 220 (5th Cir. 1975)).

Undue Delay

This court finds no evidence of undue delay by StorageTek in seeking to bring its counterclaims. StorageTek bases these counterclaims on the documents produced by Digital under court order in December and StorageTek moved this court for leave to amend within six weeks of obtaining those documents. StorageTek also sought the consent of opposing counsel prior to seeking leave from this court. Edwards’s separation from Digital was governed by a confidentiality provision, which prevented StorageTek from obtaining these documents and information in any other manner any earlier than December. Moreover, Edwards strenuously objected to production of the Digital documents and the information contained therein. Edwards thus cannot argue that StorageTek should have sought the documents at an earlier point in time; he presumably would have opposed release of the documents regardless of when StorageTek sought production.

Meritorious Counterclaim

This court may deny leave to amend where the counterclaim is not meritorious and amendment therefore would be futile. Heyl & Patterson, 663 F.2d at 425. This requires the court to review the merits of the proposed pleading, applying the standards of Fed. R. Civ. P. 12(b)(6) and construing the allegations of the counterclaim in the light most favorable to the defendant/counterclaimant. Fort Washington Resources, 153 F.R.D. at 566. Edwards argues that the counterclaims are defective in two respects. The court rejects both arguments and holds that the counterclaims are meritorious for Rule 13(f) purposes.

First, Edwards argues that the counterclaims are barred by the two-year Pennsylvania Statute of Limitations on actions for fraud and negligent misrepresentation. 42 Pa. Cons. Stat. § 5524(7) (“Any other action or proceeding to recover damages for injury to person or property which is founded on negligent, intentional or otherwise tortious conduct . . . including deceit or fraud.”). On its face, the counterclaim refers to events occurring in February 1995, meaning the statute of limitations lapsed in February 1997; Edwards argues that the counterclaims are time-barred.

Pennsylvania recognizes an exception to the statute of limitations that ““delays the running of the statute until the plaintiff knew, or through the exercise of reasonable diligence should have known, of the injury and its cause.”” Beauty Time, Inc. v. VU Skin Systems, Inc., 118 F.3d 140, 144 (3d Cir. 1997) (quoting Urland v. Merrell-Dow

Pharmaceuticals, 822 F.2d 1268, 1271 (3d Cir. 1987)). As already discussed, supra, StorageTek did not learn the factual basis for its fraud claims until the Digital documents were produced in December 1998. Because those documents and the information therein were governed by a confidentiality agreement, no amount of due diligence would have revealed the relevant details about Edwards's employment at Digital any earlier. The terms of the settlement agreement between Edwards and Digital prohibited Digital from providing any such information. There was no way that StorageTek could have learned any of the information contained in the Digital documents in 1995 or any time prior to production in December. Therefore, the discovery rule applies, the two-year statute of limitations did not begin to run until December 1998, and these claims are timely.¹

Second, Edwards argues that the proposed counterclaim does not meet the heightened pleading requirements for fraud established by the rules of civil procedure. The rules require that in all claims for fraud or mistake, "the circumstances constituting fraud or mistake shall be stated with particularity." Fed. R. Civ. P. 9(b). The rules require

¹ In addition, the counterclaim is not as untimely as Edwards claims. Although Rule 13(f) is silent as to whether an amended pleading relates back to the date of the original pleading for statute of limitations purposes, Rule 15(c)(2) states that an amended pleading relates back if "the claim or defense asserted in the amended pleading arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading." Courts and commentators have construed the two rules together so that once the standard of Rule 13(f) is satisfied, the general provisions of Rule 15 control, including the provision for relation back, the addition of counterclaims. See Perfect Plastics, 758 F. Supp. at 1083; 6 Wright & Miller, Federal Practice and Procedure, § 1430 at 228 (2d ed. 1990). Because the amended answer and counterclaim relates back to the date of the original answer, filed in September 1997, StorageTek only is a few months beyond the running of the limitations period, not the full two years that Edwards claims.

a pleader to allege “(1) a specific false representation of material fact; (2) knowledge by the person who made it of its falsity; (3) ignorance of its falsity by the person to whom it was made; (4) the intention that it should be acted upon; and (5) that the [pleader] acted upon it to his damage.” Shapiro v. UJB Fin. Corp., 964 F.2d 272, 284 (3d Cir.), cert. denied, 506 U.S. 934 (1992). However, the Third Circuit has made clear regarding Rule 9(b) that “focusing exclusively on its particularity language is too narrow an approach and fails to take account of the general simplicity and flexibility contemplated by the rules.” Seville Indus. Mach. Corp. v. Southmost Mach. Corp., 742 F.2d 786, 791 (3d Cir. 1984) (internal quotation marks omitted), cert. denied, 469 U.S. 1211 (1985); Killian v. McCulloch, 850 F. Supp. 1239, 1253-54 (E.D. Pa. 1994). There simply must be some precision and some measure of substantiation in the pleading to satisfy the rule. Killian, 850 F. Supp. at 1254.

While not a model of specificity, the proposed counterclaim is sufficient under the standards of Rule 9(b). StorageTek alleges three occasions in which Edwards falsely stated that his performance at Digital had not been criticized and that he voluntarily terminated his employment--to a recruiter acting on StorageTek’s behalf, to someone at StorageTek, and on his employment application--statements that StorageTek claims were false. (Countercl. ¶¶ 7-8, 13-15). StorageTek avers that Edwards knew his statements were false (Countercl. ¶¶ 9, 15), that he intended for StorageTek to rely on them (Countercl. ¶¶ 10, 16), and that StorageTek did rely on them to its detriment. (Countercl.

¶¶ 12, 17). This is sufficiently precise for purposes of Fed. R. Civ. P. 9(b).

Conclusion

For the foregoing reasons, the motion to amend the answer and add the requested counterclaims is granted.

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ORDER

AND NOW, this ___ day of February 1999, upon consideration of Defendant's Motion for Leave to Amend its Answer and Affirmative Defenses to Plaintiff's Amended Complaint and to Assert Counterclaims, it hereby is ORDERED that the motion is GRANTED. The clerk of court is directed to docket the Amended Answer, Affirmative Defenses, and Counterclaims as filed.

BY THE COURT:

JAMES T. GILES C.J.

copies by FAX on
to

An appropriate order follows.