

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

ZELENKOFKSKE AXELROD CONSULTING, : CIVIL ACTION
L.L.C. :
 :
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 v. :
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 PAUL STEVENSON and :
 STEPHEN MESSINGER : NO. 99-3508

M E M O R A N D U M

WALDMAN, J.

August 5, 1999

Presently before the court is defendants' Motion to Dismiss or to Transfer this action involving an alleged breach by defendants of covenants not to compete with plaintiff.

Defendants operated a healthcare consulting company in Fairfax, Virginia. In October 1998 they agreed to sell the assets of their company to plaintiff for \$117,729 and entered into virtually identical employment agreements with it. These agreements contained provisions restricting defendants' right to compete with plaintiff. Pursuant to the agreements, defendants moved from their Fairfax, Virginia office to plaintiff's Washington, D.C. office.

Shortly thereafter, a disagreement developed between the parties regarding the terms of defendants' employment. By letter dated June 26, 1999, plaintiff proposed to defendants a new agreement (the "separation agreement") for the termination of defendants' employment with plaintiff to supersede the employment

agreements. The separation agreement contained a similar covenant not to compete. Defendants made some changes to the proposal and sent a marked-up copy to plaintiff by telefax on June 28, 1999. Plaintiff asserts that it immediately accepted the counter-proposal and "explicitly and implicitly" conveyed that acceptance "by scheduling a conference call to be held on June 29, 1999 with [defendants]" to discuss implementation of the agreement. By letter dated June 29, 1999 and telefaxed on June 30, 1999, defendants retracted their letter of June 28th.

On June 30, 1999, defendants filed a complaint against plaintiff in the Eastern District of Virginia asserting claims for breach of contract, wrongful discharge, fraudulent inducement and a declaration that the covenants not to compete in the employment agreements are unenforceable. On July 9, 1999, plaintiff filed the complaint in the instant action in the Montgomery County Court of Common Pleas seeking a declaration that the separation agreement is valid and asserting alternative claims for breach of the covenants not to compete in the separation agreement and in the employment agreements respectively, conversion of plaintiff's business files and injunctive relief to prevent such client contacts as are inconsistent with the covenants not to compete.

Defendants timely removed that action to this court. They now contend that plaintiff's complaint should be dismissed

because the claims asserted therein are compulsory counterclaims in the first-filed action in the Eastern District of Virginia or alternatively, that this case should be transferred to that district.

Federal Rule of Civil Procedure 13(a) provides:

A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim and does not require for its adjudication the presence of third parties of whom the court cannot acquire jurisdiction.

The Rule is designed "to achieve resolution in a single lawsuit of all disputes arising out of common matters." Southern Const. Co. v. Pickard, 371 U.S. 57, 60 (1962). It requires a party to assert all compulsory counterclaims it has against an opposing party and bars the initiation of a second suit based upon such a counterclaim. See Seattle Totems Hockey Club, Inc. v. National Hockey League, 652 F.2d 852, 854 (9th Cir. 1981); Rohm and Haas Co. v. Brotech Corp., 770 F. Supp. 928, 935 (D. Del. 1991) (ordering dismissal of action based on claims that should have been brought as counterclaims in prior filed action); Timberland Co. v. Sanchez, 129 F.R.D. 382, 383 (D.D.C. 1990); Republic Telcom Corp. v. Telemetrics Communications, Inc., 634 F. Supp. 767, 768 (D. Minn. 1986) (staying action involving claim that should be compulsory counterclaim in first-filed suit).

"[A] counterclaim is compulsory if it bears a logical relationship to an opposing party's claim" such that separate trials on each party's claim "would involve a substantial duplication of effort." Savarese v. Agriss, 883 F.2d 1194, 1208 (3d Cir. 1989) (citation omitted). Claims are logically related if they involve "(1) many of the same factual issues; (2) the same factual and legal issues; or (3) offshoots of the same basic controversy between parties." XEROX Corp. v. SCM Corp., 576 F.2d 1057, 1059 (3d Cir. 1978).

Plaintiff's claim for breach of the covenants not to compete in whichever agreement is found to be operative involves the same legal and factual issues as defendants' claim in the Virginia action for a declaration that the covenants are unenforceable and these claims are clearly "offshoots of the same basic controversy between the parties." Plaintiff's claims for a declaration that the separation agreement is valid and for breach of that agreement are also "offshoots of the same controversy" as they involve the scope of defendants' contractual rights to compete with plaintiff. Plaintiff's claim for conversion is likewise an offshoot of the same controversy as it involves property which defendants allege in the Virginia suit they were fraudulently induced to part with and which plaintiff asserts was misappropriated for use by defendants in competing with plaintiff.

At the core of plaintiff's claims in the instant action is what, if any, valid restrictions exist on defendants' rights to compete with plaintiff. The factual and legal issues involved in such a determination are squarely implicated in the Virginia action. The separate resolution of each action would clearly require a substantial duplication of effort.

Plaintiff has not argued that its claims do not qualify as compulsory counterclaims. Rather, it contends that this is immaterial "because the 'first-filed' rule is inapplicable to this matter." Assuming that Rule 13(a) does not bar the assertion of a compulsory counterclaim by way of a second separate action where the "first-filed" rule is inapplicable, plaintiff has not justified a departure from that rule in this case.¹

Under the first-filed rule, in cases of federal concurrent jurisdiction involving the same parties and issues, the court of first-filing must proceed to decide the matter. See EEOC v. University of Pennsylvania, 850 F.2d 969, 971 (3d Cir. 1988), aff'd 493 U.S. 182 (1990). Departures from the rule

¹ Although the scope of the first-filed rule is potentially broader than Rule 13(a), when Rule 13(a) is violated the first-filed rule will generally be implicated. Where a counterclaim which satisfies the test for a "logical relationship" to an opposing party's pending claim is separately asserted, there will almost invariably be two actions involving the same parties and issues within the ambit of the first-filed rule.

are "rare" and the second action should proceed only in "exceptional circumstances." Id. at 979. Exceptions have been made where the plaintiff in the first-filed action acted in bad faith or was motivated by forum shopping, where the second-filed suit had developed further at the time the motion was made and where "the first-filing party instituted suit in one forum in anticipation of the opposing party's imminent suit in another, less favorable, forum." Id. at 976. Even where the first-filed action is one for a declaratory judgment, however, the first-filed rule applies. See Crosley Co. v. Westinghouse Electric & Mfg. Co., 130 F.2d 474, 476 (3d Cir. 1942); Fischer & Porter Co. v. Moorco Intern., Inc., 869 F. Supp. 323, 325 (E.D. Pa. 1994).

Plaintiff does not contend that the second-filed case has developed further than the first and it has not.²

Plaintiff contends the first-filed rule should not be applied because defendants engaged in forum shopping and "lulled" plaintiff by engaging in settlement negotiations while actually preparing for litigation. Plaintiff points to the apparent overnight delay in telefaxing the June 29th letter retracting

² No substantive action was taken in the state court prior to removal. The case was assigned after removal to a colleague who took no action because he became gravely ill. The case was then reassigned to this judge, a briefing schedule was set on the instant motion and an interim agreement by defendants to honor the terms of the disputed covenants was achieved. Thus, this case is at the point of a threshold determination of whether it should be dismissed or transferred.

proposed amendments to the separation agreement as evidence of defendants' bad faith attempt to lull.

That defendants telefaxed on June 30th a letter dated June 29th simply is not evidence of bad faith or an attempt to lull plaintiff. That defendants engaged in settlement negotiations until filing suit on June 30th does not demonstrate bad faith. The settlement of disputes is encouraged, but parties frequently engage in settlement discussions while preparing to litigate. A party does not relinquish its right ultimately to decide to sue in its forum of choice by engaging in settlement discussions. A party by virtue of engaging in settlement discussions is not obligated to provide notice to his adversary that he has decided to sue to allow the adversary to commence suit first.³ This is not a case where one party lulled another into sacrificing some substantive advantage.

Plaintiff has not shown that defendants engaged in forum shopping or maneuvering to secure a forum with more favorable substantive or procedural law. A plaintiff has necessarily filed suit in its chosen forum, most frequently because that forum is more convenient. "If filing in a district that is more convenient to the plaintiff than to the defendant is enough to open the plaintiff up to a charge of forum shopping,

³ Indeed, defendants in their brief accuse plaintiff of now attempting to forum shop.

then the exception would swallow the [first-filed] rule." Roadmaster Corp. v. Nordic Track, Inc., 1993 WL 625537, *3 (N.D. Ill. Sept. 20, 1993). Forum shopping "is seeking out a forum solely on the basis of having the suit heard in a forum where the law or judiciary is more favorable to one's cause than in another." Id. There has been no showing to substantiate forum shopping in this case.

Moreover, to justify a disregard of the first-filed rule, forum shopping must be the sole reason for choosing one forum over another and thus will rarely be found where the first action was filed in a logical place. See Moore Corporation Ltd. v. Wallace Computer Services, Inc., 898 F. Supp. 1089, 1099-1100 (D. Del. 1995); Fischer & Porter, 869 F. Supp. at 325. The Eastern District of Virginia is a very logical and proper forum for the first-filed action. Defendants negotiated and executed the employment agreements in that district. They live and work in that district. It is from that district that they are offering consulting services in a manner alleged to breach their contractual obligations to plaintiff.

This is also not a situation where the first-filing party has selected a forum which involves extraordinary inconvenience or expense to another. The Eastern District of Virginia is not a distant forum. Moreover, it appears that the two individual defendants are the ones who may suffer most from

having to litigate away from their home base. Defendant Messinger's averment that plaintiff's managing director warned defendants that plaintiff has "deep pockets" and could "break" defendants with litigation costs has not been controverted.

Plaintiff has asserted claims which are compulsory counterclaims in defendants' prior action. Plaintiff has filed an action involving the same parties and issues present in the prior Virginia action, and has not demonstrated any "exceptional circumstance" warranting a deviation from the first-filed rule. In these circumstances, the court may stay proceedings in the second action, dismiss without prejudice to plaintiff to replead its claims in the prior action or, when justified under 28 U.S.C. § 1404(a), transfer the second action to the court of first-filing for consolidation or other appropriate disposition. See University of Pennsylvania v. EEOC, 493 U.S. 182, 187 n.1 (1990), Pumpelly v. Cook, 106 F.R.D. 238, 239 (D.D.C. 1985); Wright, Miller & Kane, Federal Practice and Procedure: Civil 2d § 1418, at 143-44.

In any event, "[t]he fairest and most efficient course [is] to permit the parties to litigate all aspects of the dispute in the forum in which the controversy was first raised." Pumpelly, 106 F.R.D. at 240. If consistent with § 1404(a), a transfer would place all aspects of the parties' dispute in the court of first-filing for such consolidation,

reconfiguration or other management as the court deems most appropriate.

When considering whether to transfer pursuant to § 1404(a), courts weigh the various private and public interests favoring proceeding in each forum. The private interests include plaintiff's choice of forum, the defendant's preference, whether the claim arose elsewhere, the convenience of the parties as indicated by their relative physical and financial condition, the convenience of the witnesses who may be unavailable for trial in one of the fora and the location of pertinent books and records to the extent they could not be produced in the alternative forum. Jumara v. State Farm Ins. Co., 55 F.3d 873, 879 (3d Cir. 1995). The public interests include the enforceability of a judgment, practical considerations that could make the trial easier, more expeditious or less inexpensive, the relative administrative difficulty in the two fora resulting from court congestion, the local interest in deciding local controversies at home, the public policies of the fora, and the familiarity of the trial judge with the applicable law. Id. at 879-80.

The plaintiff's choice of forum is generally accorded substantial weight, however, the defendant's preference logically should receive greater weight than otherwise where he is the plaintiff in a related action covered by the first-filed rule in his forum of choice. Also, the existence of a prior related

action in the transferee district is a strong factor weighing in favor of transfer in the interest of judicial economy. See Manufacturers Hanover Trust Co. v. Palmer Corp., 798 F. Supp. 161, 165 (S.D.N.Y. 1992) (collecting cases). See also Fat Possum Records, Ltd. v. Capricorn Records, Inc., 909 F. Supp. 442, 447 (N.D. Miss. 1995) (noting lack of substantive difference between dismissal, stay or transfer of second-filed action and transferring case to district of first-filed action pursuant to § 1404(a)); Pumpelly, 106 F.R.D. at 240 (dismissing second action without prejudice to plead complaint as compulsory counterclaims in first action where § 1404(a) transfer was precluded by lack of original venue in district of first-filing); Schmidt v. Leader Dogs for the Blind, Inc., 544 F. Supp. 42, 47 (E.D. Pa. 1982) (§ 1404(a) authorizes transfer of case even if only to enable its consolidation with related case pending in transferee court).

Most of the third-party witnesses identified would be somewhat more inconvenienced by appearing in Virginia but not enough to significantly alter the balance. Both fora have some relationship to and interest in the resolution of the parties' dispute. The public policy of neither forum would be undermined by the litigation of this controversy in either forum.⁴

⁴ Plaintiff has not suggested that this court's docket is appreciably less congested than that of the alternative forum and has not contradicted defendants' representation that the Eastern District of Virginia is acclaimed for paring its docket at the speed of a "rocket." Insofar as the parties' contractual obligations are governed by Pennsylvania law, the Virginia court will have to apply that law to resolve the claims already pending before it. Federal courts routinely apply the law of various states in resolving diversity claims and the court in Virginia is undoubtedly capable of applying Pennsylvania law insofar as this may be necessary.

It would be more inconvenient and financially burdensome for defendants to litigate in Philadelphia than for plaintiff to litigate in Virginia. Defendants live and are working from their homes in northern Virginia. Plaintiff has an office in Washington, a short distance from the courthouse in Alexandria, and by its own account has "deep pockets."

Clearly the parties' dispute can be resolved far more easily, more expeditiously, less expensively and with far more efficient use of judicial resources if all aspects of the dispute are consolidated before the same court. Consistent with the first-filed rule, this can only be achieved in the Eastern District of Virginia and this weighs heavily in favor of transfer. See Tingley Systems v. Bay State HMO Management, 833 F. Supp. 882, 888 (M.D. Fla. 1993) (transferring second-filed breach of contract and misappropriation of trade secrets action pursuant to § 1404(a) to court of first-filed declaratory judgment action "in the interest of justice to permit suits involving the same parties and issues to proceed before one court").

Accordingly, defendants' motion will be granted in that this action will be transferred to the Eastern District of Virginia at Alexandria consistent with 28 U.S.C. § 1404(a). An appropriate order will be entered.

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O R D E R

AND NOW, this day of August, 1999, upon
consideration of defendants' Motion to Dismiss or Transfer to the
Eastern District of Virginia (Doc. #2) and plaintiff's response
thereto, consistent with the accompanying memorandum, **IT IS**
HEREBY ORDERED that said Motion is **GRANTED** in that the above
action is **TRANSFERRED** to the United States District Court for the
Eastern District of Virginia at Alexandria.

BY THE COURT:

JAY C. WALDMAN, J.