

RENDERED: April 2, 1999; 2:00 p.m.
NOT TO BE PUBLISHED

Commonwealth Of Kentucky

Court Of Appeals

NO. 1997-CA-001415-MR

THOMAS C. WINTERS, D/B/A TOM'S
GARAGE & AUTO BODY

APPELLANT

v. APPEAL FROM JEFFERSON CIRCUIT COURT
HONORABLE JOHN WOODS POTTER, JUDGE
ACTION NO. 94-CI-01726

COLONIAL PACIFIC LEASING AND
TONY TANDY, D/B/A AMARILLO COLLISION EQUIPMENT

APPELLEES

AND

NO. 1997-CA-001520-MR

COLONIAL PACIFIC LEASING

CROSS-APPELLANT

v. CROSS-APPEAL FROM JEFFERSON CIRCUIT COURT
HONORABLE JOHN WOODS POTTER, JUDGE
ACTION NO. 94-CI-01726

THOMAS C. WINTERS AND THOMAS C.
WINTERS, D/B/A TOM'S GARAGE AND AUTO BODY

CROSS-APPELLEE

OPINION
REVERSING AND REMANDING

** ** * * * * *

BEFORE: BUCKINGHAM, GARDNER AND KNOFF, JUDGES.

GARDNER, JUDGE: Appellant, Thomas Winters (Winters) appeals from a judgment of the Jefferson Circuit Court awarding damages to Colonial Pacific Leasing (Colonial) pursuant to a lease agreement

entered into between Winters and Colonial's predecessor. Winters argues on appeal that Colonial's claim was barred because of res judicata. Colonial has filed a cross-appeal, asserting that the trial court's damages were inadequate. After reviewing the record below and the applicable law, this Court must reverse and remand for proceedings consistent with this opinion.

Winters is the sole proprietor of Tom's Garage and Auto Body in Louisville, Kentucky. On July 12, 1990, Winters leased an auto frame straightening machine produced by Precision Liner, Inc. (Precision) from Capital Leasing, Inc. (Capital) for sixty months at \$456.81 per month.¹ On July 16, 1990, Capital sold and assigned all of its rights to the lease payments to Colonial. Winters apparently initially accepted the machine but shortly after receiving it, discovered numerous alleged problems with the machine. He also asserts that he was not provided with training regarding use of the machine which had been promised to him. Winters made only one payment on the machine and refused to make any other payments because of the machine's defective condition.

On December 10, 1990, Winters sued both Precision and Colonial. He claimed that Precision misrepresented the price of the machine, the training to be supplied, and the terms of the lease agreement. He contended that Colonial knew that he had been fraudulently induced into signing the lease. In January

¹Winters had seen an advertisement in a trade magazine for the machine and contacted Precision. Winters talked with Tony Tandy of Precision about the machine and attempted to purchase it outright but was unable to procure financing from local banks. Winters then decided to lease the equipment and did so through Capital.

1991, Colonial contacted Winters' attorney and discussed settlement to avoid litigation costs. Colonial never filed a pleading based on an apparent agreement with Winters' counsel wherein his counsel granted authority for Colonial to refrain from filing an answer until it heard further from him. In April 1991, Colonial informed Winters that in recognition that there was a settlement possibility, Colonial would not pursue any claims against Winters at that time. Precision filed an answer, and discovery between Precision and Winters proceeded. In January 1992, Winters' counsel withdrew from the case.² In April 1993, Precision moved the court to dismiss Winters' action for failure to prosecute. The court granted the motion and dismissed Winters' action with prejudice. Colonial was apparently never notified of the motion to dismiss or the court's order granting the motion.³

On April 4, 1994, Colonial filed suit against Winters to recover the remaining fifty-nine payments due under the lease. Winters filed an answer and then moved to dismiss Colonial's action, because Colonial's claim was a compulsory counterclaim which should have been raised in the 1990 action, thus estopping Colonial from raising it. Colonial responded, contending that Winters' motion should be denied since Colonial had never filed a

²Colonial asserts that it was never notified that Winters' counsel had withdrawn from the case.

³Colonial states it did not learn of the dismissal until after the motion had been granted when it tried to resume negotiations with Winters' counsel. It states that when negotiations with Winters' counsel later broke down, it had no choice but to file suit to recover Winters' unpaid lease payments and to recoup its losses.

responsive pleading in the earlier case and had never been informed of the dismissal. In November 1994, the circuit court entered a memorandum dismissing Colonial's action on grounds that the first action had been dismissed with prejudice. Colonial filed a motion to amend, alter or vacate the dismissal on grounds that it had no notice of Precision's Kentucky Rule of Civil Procedure (CR) 77.02 motion or of the dismissal. The court conducted a hearing and then granted the motion and set aside its dismissal, noting that the factual circumstances were not what the court perceived in granting the dismissal. Winters subsequently moved to file a third party complaint against Precision's successor in interest, Tony Tandy d/b/a Amarillo Collision Equipment (Tandy). Tandy moved to dismiss the complaint because the dismissal of the earlier suit was res judicata. The court granted Tandy's motion.

Colonial and Winters filed motions for summary judgment regarding issues of liability. Colonial argued that the lease agreement contained conspicuous disclaimers of Colonial's responsibility for the condition, merchantability, and fitness of the machine. It also maintained that the lease clearly set out that Winters was obligated to make payments under the lease regardless of the machine's condition. It argued as well that Winters' sole remedy was against Precision. Winters on the other hand contended that the warranty language in the lease was inconspicuous, that Colonial was not a holder in due course as assignee and could not raise the defense of warranty exclusion, that he had given notice to Capital within seven days of delivery

of the machine that it was unworkable and to stop payment to the manufacturer and that he was a victim of fraudulent conduct by Precision and Capital in leasing an absolutely unworkable machine. In December 1995, the circuit court entered partial summary judgment for Colonial on liability. The court concluded that the warranty exclusions were conspicuous and that Colonial as assignee could assert Capital's rights under the lease. The court also held that Winters had to assert a setoff, counterclaim or fraud claim against Precision and was therefore estopped because of the earlier dismissal.

On September 9, 1996, the circuit court granted judgment against Winters for \$17,899 with interest at eight percent from July 23, 1990 to the date of the order less \$3,200 (the amount recovered from the sale of the straightening machine) with the difference to bear interest at twelve percent from the date of the order until paid. It allowed Colonial to recover its court costs. It set the issue of the amount of attorney fees collectable by Colonial for a later jury trial. The parties in an order in February 1997 agreed that a judgment would be entered against Winters in the stipulated amount of \$8,000. In May 1997, the circuit court issued a final order in which it briefly outlined the pertinent procedural and substantive rulings which were to become final and appealable. The court then issued a judgment for Colonial for \$14,699 plus interest and \$8,000 for attorney fees. Winters appealed from the court's judgment, and Colonial has cross-appealed.

Winters argues that the circuit court erred by setting aside its dismissal of this case and by refusing to allow him to file a third party complaint. He argues specifically that the claim Colonial now makes would have been a compulsory counterclaim in the earlier action he brought that was dismissed. He has asked this Court to reverse the judgment of the circuit court's final order and remand this action to the trial court with instructions to dismiss. After reviewing the record, we believe the trial court erred by reinstating the action.

CR 41.02(1) states, "[f]or failure of the plaintiff to prosecute or to comply with these Rules or any order of the court, a defendant may move for dismissal of an action or of any claim against him."

Unless the court in its order for dismissal otherwise specifies, a dismissal under this Rule, and any dismissal not provided for in Rule 41, other than a dismissal for lack of jurisdiction, for improper venue, for want of prosecution under Rule 77.02(2), or for failure to join a party under Rule 19, operates as an adjudication upon the merits.

CR 41.02(3). A dismissal with prejudice acts as a bar to again asserting the cause of action so dismissed. Polk v. Wimsatt, Ky. App., 689 S.W.2d 363, 364 (1985). It has the effect of a judgment on the merits constituting the case res judicata. Id. Under the doctrine of res judicata, a judgment on the merits in a prior suit involving the same parties or their privies bars a subsequent suit based upon the same cause of action. Napier v. Jones, By and Through Reynolds, Ky. App., 925 S.W.2d 193, 195 (1996) (citations omitted). Under a subsidiary rule of res judicata, res judicata applies not only to issues disposed of in

the first action, but to every point which properly belonged to the subject of the first action and which in the exercise of reasonable diligence might have been brought forward at that time. Egbert v. Curtis, Ky. App., 695 S.W.2d 123, 124 (1985).

CR 13.01 addresses compulsory counterclaims and provides in pertinent part:

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.

A claim should be brought as a counterclaim where it arises out of a transaction or occurrence that was the subject of the opposing party's claim. Shanklin v. Townsend, Ky., 467 S.W.2d 779, 781 (1971). If an action is a compulsory counterclaim it must be included in the first suit and falls under the rule of res judicata. Egbert v. Curtis, 695 S.W.2d at 124. See also Cianciolo v. Lauer, Ky. App., 819 S.W.2d 726 (1991).⁴ CR 13.06 provides that when a pleader fails to set up a counterclaim through oversight, inadvertence, or excusable neglect, or when justice requires, he or she may by leave of court set up the counterclaim by amendment. When a party decides to forego taking action in a lawsuit in the expectation that another party will protect its interests, it does so at its own peril. New York

⁴Mellon Bank, N.A. v. Ternisky, 999 F.2d 791 (4th Cir. 1993) seems to espouse law that is contrary to Kentucky's holdings.

Petroleum Corp. v. Ashland Oil, Inc., 757 F.2d 288, 292 (Em. App. 1985). Such action does not constitute excusable neglect. Id.

In the instant case, Winters in his earlier action sued Precision and Colonial based upon the allegedly defective machine and alleged fraud practiced by both defendants. Colonial entered settlement negotiations with Winters and filed no pleadings. Well over one year elapsed and Winters' counsel subsequently withdrew from the case. Again, more than one year elapsed until upon Precision's motion, Winters' case was dismissed with prejudice for failure to prosecute. Colonial has asserted that it was not notified of the dismissal of the suit. At some point Colonial did learn of the dismissal and then apparently entered into renewed negotiations with counsel for Winters. When negotiations broke down, Colonial filed its own claim against Winters more than one year after the dismissal of the original action.

It is clear that Colonial's claim was a compulsory counterclaim which arose out of the same transaction as Winters' claim. Colonial was asking for the lease payments that were to be made by Winters as a result of leasing the equipment in dispute. Even if Colonial had been negotiating with Winters, it should have filed a pleading and counterclaim and also kept abreast of the developments in the case. Once it learned of the dismissal, it should have sought relief and attempted to file a belated pleading and claim in the original action or had the dismissal set aside because it had not been notified and had been negotiating with Winters. Instead, it apparently continued

negotiating, filed no pleadings and later filed its own separate action. Res judicata applies in this case because Colonial had a compulsory counterclaim which should have been brought in the first action. Further, any new claim Winters tried to bring against Tandy would be barred pursuant to res judicata based upon the dismissal granted to Tandy's immediate successor in interest.⁵ Therefore, we must reverse the circuit court's judgment and remand for the circuit court to enter an order dismissing Colonial's action.

For the foregoing reasons, the judgment of the Jefferson Circuit Court is reversed and remanded for proceedings consistent with this opinion.

KNOPF, JUDGE, CONCURS.

BUCKINGHAM, JUDGE, DISSENTS BY SEPARATE OPINION.

BUCKINGHAM, JUDGE, DISSENTING. As it is my conclusion that the trial court correctly granted Colonial's motion to alter, amend, or vacate and allowed Colonial to pursue its claim against Winters, I must respectfully dissent.

The majority opinion herein states that Colonial "should have filed a pleading and counterclaim and also kept abreast of the developments in the case." I disagree, as Colonial was not required to file a responsive pleading (which would have set forth any compulsory counterclaim) pursuant to its written agreement with Winters' counsel. Further, Colonial would have "kept abreast of the developments in the case" had it been

⁵We find it unnecessary to address the other issues raised by Winters or the issue raised by Colonial in its cross-appeal.

given notice of Precision's motion to dismiss and the trial court's dismissal order.

The majority opinion also states that once Colonial learned of the dismissal of the original action, it should have sought relief at that time. While Colonial could have sought relief in this manner, it was not precluded from filing this action to assert its claim. As is argued in its brief, Colonial's failure to assert a compulsory counterclaim in the original action did not bar a later assertion of its claim in this action, since it never filed a responsive pleading in the first action and was not required to do so. See Mellon Bank, N.A. v. Ternisky, 999 F.2d 791 (4th Cir. 1993).

As stated in the majority opinion, res judicata applies not only to issues which were disposed of in the first action, but it also applies to issues which belonged to the subject of the first action and which, in the exercise of reasonable diligence, might have been brought forward at that time. Egbert v. Curtis, Ky. App., 695 S.W.2d 123, 124 (1985). As Colonial was not required to file a responsive pleading at the time the case was dismissed due to its agreement with Winter and was never given notice of the motion to dismiss or of the order of dismissal, it cannot be said that Colonial failed to exercise reasonable diligence by not asserting its compulsory counterclaim.

In short, I conclude that Colonial has been deprived of its rights to assert a claim against Winters through no fault of its own.

BRIEF FOR APPELLANT/CROSS-
APPELLEE:

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BRIEF FOR APPELLEE/CROSS-
APPELLANT:

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