Caution
As of: Feb 17, 2012

FREDERICK ADLER, et al., Plaintiffs, -against- ALCIDE CORPORATION, Defendant.

96 Civ. 1214 (DAB)

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

1998 U.S. Dist. LEXIS 15219

September 29, 1998, Decided
September 30, 1998, Filed

DISPOSITION: [*1] Defendant's Motion for leave to amend Answer to include affirmative defense, counterclaim and third party claim for breach of fiduciary duty GRANTED.

CASE SUMMARY:

PROCEDURAL POSTURE: Plaintiffs, royalty holders and investors, sued defendant corporation and claimed monies were owed to them under a royalty agreement for sales of certain veterinary germicidal products made by the corporation. The corporation moved for leave to amend its answer to add an affirmative defense, counterclaim, and third party claim, all based on an alleged breach of fiduciary duty by the royalty holders. The royalty holders opposed the motion.

OVERVIEW: The parties disputed whether the royalty agreement covered sales of certain versions of a product as well as sales of other products. The corporation moved for leave to plead that a certain royalty holder, and a proposed third party defendant, violated their fiduciary duties as directors and officers of the corporation when they voted to approve the royalty agreement that awarded substantial financial benefits to their own pockets. The royalty holders argued that the claim was time-barred, and the amendment should be denied as frivolous, prejudicial, and a cause of undue delay to this litigation. The corporation disputed that the claim was beyond the appropriate statute of limitations. The corporation also argued that even if the claim was so construed, the proposed amendment could still be brought under state law. The court agreed that state law allowed the corporation's claim to be brought. The royalty holders further alleged that the proposed amendments based on fiduciary breach were futile because there was no evidence that the agreement in question was unfair, but the royalty holders arguments rested on factual allegations that were beyond the pleadings.

OUTCOME: The corporation's motion for leave to amend its answer to include an affirmative defense, a counterclaim, and a third party claim for breach of fiduciary duty was granted. The court did not find that

undue prejudice or delay would result from allowing the corporation's proposed amended counterclaim.

LexisNexis(R) Headnotes

Civil Procedure > Pleading & Practice > Pleadings > Amended Pleadings > General Overview
Civil Procedure > Pleading & Practice > Pleadings > Counterclaims > General Overview
[HN1] See *Fed. R. Civ. P. 15(a)*.

Civil Procedure > Pleading & Practice > Pleadings > Amended Pleadings > General Overview
[HN2] The United States Supreme Court emphasizes that leave to amend should be denied only under limited circumstances: In the absence of any apparent or declared reason - such as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc. - the leave should, as the rules require, be freely given.

Civil Procedure > Pleading & Practice > Pleadings > Amended Pleadings > General Overview
Civil Procedure > Appeals > Standards of Review > Abuse of Discretion
[HN3] Although the grant or denial of leave to amend is within the discretion of that a district court, a decision without any justifying reason may be an abuse of that discretion and inconsistent with the spirit of the Federal Rules of Civil Procedure.

Civil Procedure > Pleading & Practice > Pleadings > Counterclaims > General Overview
Civil Procedure > Pleading & Practice > Pleadings > Cross-Claims > General Overview
[HN4] Under N.Y. Crim. Proc. Law § 203(d), a counterclaim that arises from the same transactions, occurrences, or series of transactions and occurrences, upon which the complaint depends may be maintained even if it was barred when the action was commenced. Codifying the doctrine of equitable recoupment, § 203(d) is based on the principle that it would be highly inequitable to permit a party to place a question before a court and then prevent the opposing party from disputing issues lying at the foundation of the claim. Recoupment does not allow one transaction to be offset against another, but only permits a transaction which is made the subject of suit by a plaintiff to be examined in all its aspects, and judgment to be rendered that does justice in view of the one transaction as a whole.

Contracts Law > Breach > General Overview
Contracts Law > Remedies > Ratification
Governments > Fiduciary Responsibilities
[HN5] Courts find that counterclaims alleging fiduciary breach arise from the same transaction upon which the claim depended for the purposes of N.Y. Crim. Proc. Law § 203(d).

Civil Procedure > Pleading & Practice > Pleadings > Counterclaims > General Overview
Civil Procedure > Pleading & Practice > Pleadings > Cross-Claims > General Overview
Contracts Law > Remedies > Reformation
[HN6] New York courts clearly hold that counterclaims for reformation do not enjoy the relief from the time-bar embodied in N.Y. Crim. Proc. Law § 203(d).

Contracts Law > Defenses > Ambiguity & Mistake > Mutual Mistake
Contracts Law > Defenses > Fraud & Misrepresentation > General Overview
Contracts Law > Formation > Ambiguity & Mistake > Mutual Mistake
[HN7] Recission is a remedy whereby a party seeks to disaffirm a contract and return to the status that existed before the transaction was executed. Reformation alters the contract terms on the basis of an intent that should have been but was not made explicit. Mutual mistake or mistake of one party and fraud of the other with respect to a material part of the contract permits reformation.

Civil Procedure > Pleading & Practice > Pleadings > Amended Pleadings > Leave of Court
[HN8] Regarding a motion for leave to amend an answer, that the amendments would not serve any purpose is a valid ground to deny a motion for leave to amend. However, if a movant has at least colorable grounds for relief, justice does require leave to amend. Accordingly, unless a proposed amendment is clearly frivolous or legally insufficient on its face, the substantive merits of a

claim or defense should not be considered on a motion to amend.

Civil Procedure > Pleading & Practice > Pleadings > Amended Pleadings > Leave of Court
[HN9] If amending a pleading will cause prejudice to a nonmoving party then leave to amend is only reluctantly granted, if at all. To determine what constitutes prejudice a court will consider whether the new claim would (1) require an opponent to expend significant additional resources to conduct discovery and prepare for trial; (ii) significantly delay the resolution of the dispute; or (iii) prevent a movant from bringing a timely action in another jurisdiction. Delay alone is usually not a sufficient reason for denying leave to amend. The amount of delay must be balanced against the result of prejudice.

Civil Procedure > Pleading & Practice > Pleadings > Amended Pleadings > General Overview
Civil Procedure > Discovery > Undue Burdens
[HN10] Parties, at times, are permitted to assert new claims long after they acquire the facts necessary to support such claims and, at times, are permitted to amend a complaint on the eve of trial. Although allowing an amendment may require additional discovery, that burden does not necessarily qualify as undue prejudice.

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For DEFENDANTS: Paul T. Meiklejohn, SEED AND BERRY, LLP, Seattle, Washington.

JUDGES: DEBORAH A. BATTS, United States District Judge.

OPINION BY: DEBORAH A. BATTS

OPINION

MEMORANDUM & ORDER

DEBORAH A. BATTS, United States District Judge.

Defendant has moved for leave to amend the Answer to add an affirmative defense, counterclaim, and third party claim, all based on an alleged breach of fiduciary duty by Plaintiffs. Plaintiffs oppose the motion to amend. For the reasons set forth below, the Court grants Defendant's motion.

I. BACKGROUND

This suit was instigated by a group of royalty holders and investors in Alcide Corporation who claim monies are owed to them under a 1983 royalty agreement for sales of certain [*2] veterinary germicidal products made by Defendant. (Compl. PP 18, 20). In brief, the parties dispute whether the royalty agreement covered sales of certain versions of the product "Alcide" -- a teat dip for cows originally made with the ingredient of lactic acid and then reformulated with mandelic acid -- as well as sales of products both made under expired patents and developed from them. (*Id.* P 30-76).

Plaintiffs filed suit on February 20, 1996. This matter was initially assigned to the Honorable Louis L. Stanton, who ordered the submission of pre-trial materials on February 3, 1997. The case was, however, reassigned to this Court on July 29, 1996. By letter dated January 13, 1997, the parties jointly requested an adjournment of the schedule set by Judge Stanton until the end of February, 1997, to allow the completion of depositions and document discovery. Three days later, Defendant requested a pre-motion conference to seek permission to file a motion for leave to amend the answer. After numerous letter submissions by both sides, the Court held a conference on May 16, 1997. This Court ordered that the parties choose either to proceed to mediation by June 16, 1997, or to serve [*3] the motion for leave to amend by July 16, 1997. The parties opted for mediation. After this course failed to produce an amicable settlement, the parties notified the Court by letter dated October 27, 1997 of their desire to proceed with a motion schedule. The Court granted that request, and a later extension of that briefing schedule, such that the motion was submitted to the Court on January 16, 1998.

Defendant moves for leave to plead that Plaintiffs Alliger, Librizzi and Priser, and proposed third party defendant Elliot Siff, [1] violated their fiduciary duties as directors and officers of Alcide Corporation when they voted as a majority of the board to approve the 1983

royalty agreement that awarded such substantial financial benefits to their own pockets. *See* Proposed Counterclaim PP 14-16, Def.'s Ex. 1. Plaintiffs argue that the claim is time-barred, and the amendment should be denied as frivolous, prejudicial and a cause of undue delay to this litigation.

> 1 Elliot Siff is the general partner of Plaintiff Old Hill Associates, and was President and a member of the board of Alcide Corporation when the royalty agreements were made. *See* Proposed Counterclaim, P 5 (Def.'s Ex. 1).

[*4] II. DISCUSSION

[HN1] The Federal Rules of Civil Procedure state that leave to amend "shall be freely given when justice so requires." *Fed. R. Civ. Pro. 15(a). See also Fed. R. Civ. Pro. 13(f)*; *Bank of New York v. Sasson, 786 F. Supp. 349, 352 (S.D.N.Y. 1992)*(rule allowing counterclaims by amendment follows the same standard). [HN2] The United States Supreme Court has emphasized that leave to amend should be denied only under limited circumstances:

> In the absence of any apparent or declared reason -- such as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc. -- the leave should, as the rules require, "be freely given."

Foman v. Davis, 371 U.S. 178, 182, 9 L. Ed. 2d 222, 83 S. Ct. 227 (1962). Accord In re American Express Co. Shareholder Litigation, 39 F.3d 395, 402 (2d Cir. 1994); *State Teachers Retirement Bd. v. Fluor Corp., 654 F.2d 843, 856 (2d Cir. 1981)*. [HN3] "Although the grant or denial of leave to amend is within the discretion of the district court, a decision [*5] 'without any justifying reason' may be an 'abuse of that discretion and inconsistent with the spirit of the Federal Rules.'" *Evans v. Syracuse City School District, 704 F.2d 44, 46 (2d Cir. 1983)* (quoting *Foman, 371 U.S. at 182*)).

Plaintiffs argue that the proposed amendments would be futile because any claims of fiduciary breach in ratifying the 1983 royalty contract would be time-barred. Defendant disputes that this claim is beyond the appropriate statute of limitations. Defendant also contends that even if the claim is so construed, the proposed amendment could still be brought under *Section 203(d) of the New York C.P.L.R.*.

The Court agrees that *Section 203(d)* allows Defendant's claim to be brought, even if Defendant's claim would otherwise be time-barred. [HN4] Under this provision, a counterclaim that arises from "the same transactions, occurrences or series of transactions and occurrences, upon which the complaint depends" may be maintained even if it was barred when the action was commenced. *N.Y.C.P.L.R. § 203(d)*. Codifying the doctrine of "equitable recoupment," *Section 203(d)* is based on the principle that "it would be highly inequitable to permit a party to place a question [*6] before a court and then prevent the opposing party from disputing issues lying at the foundation of the claim." *118 East 60th Owners, Inc. v. Bonner Properties, Inc., 677 F.2d 200, 203 (2d Cir. 1982)*. "Recoupment does not allow one transaction to be offset against another, but only permits a transaction which is made the subject of suit by a plaintiff to be examined in all its aspects, and judgment to be rendered that does justice in view of the one transaction as a whole." *Rochester Health Network, Inc. v. Rochester Hosp. Serv. Corp., 123 A.D.2d 509, 507 N.Y.S.2d 100, 101* (N.Y. App. Div. 4th Dep't 1986).

Here, Plaintiffs brought suit to determine the terms and scope of the 1983 royalty agreement. Defendant argues that the broad interpretation urged by Plaintiffs renders the royalty agreement one that would fail the fairness test applicable when directors of a corporation stand on both sides of a transaction. *See* Def.'s Mem. Law at 12-13. *E.g. Cinerama, Inc. v. Technicolor, Inc. 663 A.2d 1156, 1169 (Del. 1995)*. Thus, the allegations of fiduciary breach hinge upon the central question under litigation: the extent of the royalty rights awarded to the directors when they [*7] ratified the agreement. In comparable scenarios, [HN5] courts have found that counterclaims alleging fiduciary breach arose from the same transaction upon which the claim depended for the purposes of *Section 203(d)*. *See e.g. Levine v. Angus, 1993 U.S. Dist. LEXIS 8465*, No. 92 Civ. 2210, 1993 WL 227713, at *1, 2 (S.D.N.Y. June 22, 1993)(counterclaim for breach of fiduciary duty and unjust enrichment allowed in action for breach of royalty agreement); *Falk v. FFF Industries, Inc., 731 F. Supp. 134, 141-2 (S.D.N.Y. 1990)*(counterclaim that salary increase taken

by director violated his employment contract was allowed where director had brought suit to recover under the same contract). *See also American Home Assurance Co. v. Belvedere Ins. Co., 1996 U.S. Dist. LEXIS 5157,* *2-3, No. 88 Civ. 4415, 1996 WL 191969, at *1, (S.D.N.Y. April 19, 1996)(defense based on fraud in the inducement allowed under *Section 203(d)*).

Plaintiffs argue that the proposed amendments are asking in effect for reformation of the contract, thereby placing them beyond the purview of *Section 203(d)*. [HN6] New York courts have clearly held that counterclaims for reformation do not enjoy the relief from the time-bar embodied in *Section 203(d)*. *See SCM Corp. v. Fisher Park Lane* [*8] *Co., 40 N.Y.2d 788, 390 N.Y.S.2d 398, 401-2, 358 N.E.2d 1024 (N.Y. 1976)*(landlord's proposed counterclaim to increase tenant's liability for electricity expenses in lease terms was not allowed since that claim went to "the negotiation and articulation of the agreement made between the parties prior to its execution"); *182 Franklin Street Holding Corp. v. Franklin Pierrepont Assoc., 217 A.D.2d 508, 630 N.Y.S.2d 64, 66* (N.Y. App. Div. 1st Dep't, 1995)(counterclaim for reformation based on earlier contract not allowed in action to enforce terms of note and mortgage). The Court is not persuaded however, that this line of authority directs the result here. The heart of this dispute is the terms of the royalty contract: whether payments must be make under expired patents, whether certain products fall within two patents, and if not, whether the agreement's other terms nonetheless provide for royalty payments on those products. *See* Compl. PP 30-38. Where both parties are urging contradictory interpretations of the same agreement upon the Court, it is of little persuasive value to label one "a *de facto* claim for reformation," and the other, a claim to enforce the contract. [*9] *See* Pls.' Mem. Law at 12. Defendant presents the proposed counterclaim of fiduciary breach as a bar to Plaintiffs' recovery for breach of contract. *See* Def.'s Proposed Amended Answer, Def.'s Ex. 1, at 18-19. Defendant does not seek either to reform or rescind the contract, [2] nor to recover the royalty payments made pursuant to the 1983 agreement. Instead, Defendant claims that payments have never been made for products not covered under the patents, and that Plaintiffs' have been aware of that fact since 1986. *See Proposed Counterclaim, Def.'s Ex. 1 P 17*. Defendant also states that payments for products made under one patent stopped in April, 1995, when the patent expired. *See id. P 18*. On the basis of these allegations, and from the portions of the contract included within the Complaint, it is not apparent to the Court that the contract terms are as self-evident as Plaintiffs claims. Since the litigation centers upon the interpretation of contract terms, the proposed amendment related to the apportionment of benefits by fiduciaries to themselves under that contract as it is interpreted, is sufficiently related to Plaintiffs' claim for the purposes of *Section 203(d)*. [*10]

> 2 [HN7] Recision is a remedy whereby a party seeks to disaffirm the contract and return to the status that existed before the transaction was executed. *See Banque Arabe Et Internationale D'Investissement v. Maryland Nat'l Bank, 850 F. Supp. 1199, 1212 (S.D.N.Y. 1994)*. Reformation alters the contract terms on the basis of "an intent that should have been but was not made explicit." *Heath v. State, 278 A.D. 8, 103 N.Y.S.2d 397, 399* (N.Y. App. Div., 3rd Dep't, 1951). Mutual mistake or mistake of one party and fraud of the other with respect to a material part of the contract permits reformation. *Thompson v. Howell, 20 A.D.2d 963, 249 N.Y.S.2d 623, 624* (N.Y. App. Div. 4th Dep't, 1964).

Plaintiffs further allege that the proposed amendments based on fiduciary breach are futile because there is no evidence that the agreement in question was unfair. *See* Pls.' Mem. of Law at 17. [HN8] "That the amendments would not serve any purpose is a valid ground to deny a motion for leave to amend." *Kaster v. Modification Systems,* [*11] *Inc., 731 F.2d 1014, 1018 (2d Cir. 1984)*. However, if the movant has "at least colorable grounds for relief, justice does require leave to amend." *Id.* (internal citations omitted). Accordingly, "unless a proposed amendment is clearly frivolous or legally insufficient on its face, the substantive merits of a claim or defense should not be considered on a motion to amend." *Lerman v. Chuckleberry Publishing, Inc., 544 F. Supp. 966, 968 (S.D.N.Y. 1982)*, rev'd on other grounds, *745 F.2d 123 (2d Cir. 1984)*. [3]

> 3 This standard demands an inquiry akin to that required by *Rule 12(b)(6) of the Federal Rules of Civil Procedure. CBS, Inc. v. Ahern, 108 F.R.D. 14, 18 (S.D.N.Y. 1985)*. Plaintiffs' argument that Defendant's proposed counterclaim should be held to a summary judgment standard because discovery has been completed, is not supported by the caselaw. *See* Pls.' Mem. Law at 6-7.

Defendant's claim of fiduciary breach is not meritless on its face. The proposed amended Answer alleges that the majority [*12] of the Board of Alcide Corporation who approved the transaction also stood to gain from the royalty agreement, and that the required disclosure of this interest was not made. *See* Def.'s Proposed Amended Answer, Def.'s Ex. 1, PP 14-16. Thus, the essential elements for a breach of fiduciary duty are presented. *See generally Cinerama, 663 A.2d at 1169*. Plaintiffs' arguments to the contrary rest on factual allegations that are beyond the pleadings. *See* Pls.' Mem. Law at 17-18. It would therefore be inappropriate at this juncture for the Court to prevent the amendment.

Plaintiffs also oppose the Defendant's motion for leave to amend on the basis of undue delay, bad faith, and prejudice to the opposing party. Plaintiffs argue that Defendant "waited far too long to seek this amendment," that this unexplained delay indicates that Defendant "has simply reconsidered a prior decision not to raise a dubious defense," and that the need for further depositions and possible impleading of additional parties is sufficiently burdensome to warrant denial of leave to amend. *See* Pls.' Mem. Law at 18, 21, and 22-24.

[HN9] If amending a pleading will cause prejudice to the nonmoving party then [*13] leave to amend is only reluctantly granted, if at all. *Strauss v. Douglas Aircraft Co., 404 F.2d 1152, 1155 (2d Cir. 1968)*; *Peralta, 1989 U.S. Dist. LEXIS 6859,* at *2. To determine what constitutes prejudice the Court will consider whether the new claim would "(1) require the opponent to expend significant additional resources to conduct discovery and prepare for trial; (ii) significantly delay the resolution of the dispute; or (iii) prevent the [movant] from bringing a timely action in another jurisdiction." *Block v. First Blood Associates, 988 F.2d 344, 350 (2d Cir. 1993)* (citing *Tokio Marine and Fire Ins. Co. v. Employers Ins. of Wausau, 786 F.2d 101, 103 (2d Cir. 1986)*. Delay alone is usually not a sufficient reason for denying leave to amend. *United States v. Continental Ill. Nat'l Bank and Trust Co. of Chicago, 889 F.2d 1248, 1254 (2d Cir. 1989)*; *State Teachers, 654 F.2d at 856*. The amount of delay must be balanced against the result of prejudice. *Evans, 704 F.2d at 46-47*.

Plaintiffs contend that the timing of Defendant's request alone shows bad faith and/or dilatoriness. The Court disagrees. Neither the pace of this litigation as a whole, nor the [*14] fact that the request to amend was made at a point when discovery was near completion, is sufficiently egregious to indicate any such tactics were employed by the Defendant. *See e.g. Dweck v. Pacificorp Capital, Inc., 1997 U.S. Dist. LEXIS 1940*, No. 91 Civ. 2905, 1997 WL 80537, at *1, 4 (S.D.N.Y. Feb. 26, 1997)(allowing amendment after four years transpired and just before summary judgment motion, discussing other cases). While it is certainly preferable for claims to be asserted as early as possible in the discovery process, [HN10] "parties have been permitted to assert new claims long after they acquired the facts necessary to support such claims and have even been permitted to amend a complaint on the eve of trial." *Hannah v. Metro-North Commuter Railroad Co., 753 F. Supp. 1169, 1176 (S.D.N.Y. 1990)*(citations omitted). Although allowing the amendment may require additional discovery, that burden does not necessarily qualify as undue prejudice. *See Tomlinson v. St. Paul Reinsurance Mgmt. Corp., 1998 U.S. Dist. LEXIS 1728*, No. 96 Civ. 4760, 1998 WL 65996, at *1, 4 (S.D.N.Y. Feb. 17, 1998)(citing additional cases).

Plaintiffs predict that the proposed amendment will then obligate them to conduct depositions of two other board members, [*15] to redepose at least two individuals and the current management of Alcide Corporation, to retain an additional expert on the question of fairness, and to join two other directors who were interested in the 1983 royalty agreement. *See* Pls.' Mem. Law at 23-24. Defendant disputes that such extensive discovery would be necessary as a result of the proposed amendment. *See* Def.'s Mem. at 24. Using the *Block* factors, additional cost might befall the Plaintiffs if it had to redepose some of the witnesses. However, the cost of any such extra discovery will be taken on by the Defendant. Hence, no extra cost will befall the Plaintiffs. Second, the Plaintiff's case may be delayed but only if extra discovery is needed. If that is indeed the case, the delay will be at most sixty days, which is minimal in light of the fact that no trial date has been scheduled.

In light of the above considerations, the Court does not find that undue prejudice or delay will result from allowing Defendant's proposed amended counterclaim. Accordingly, Defendant's motion for leave to amend is hereby granted.

III. CONCLUSION

For the above reasons, the Court hereby GRANTS Defendant's Motion for leave to [*16] amend the Answer

to include an affirmative defense, counterclaim and third party claim for breach of fiduciary duty.

Defendant shall file the Amended Answer within 20 days of the date of this Order. Plaintiffs shall file any responsive pleading within 20 days of service of the Amended Answer. Any additional discovery shall be completed by January 25, 1999. Any party contemplating making a dispositive motion must notify opposing counsel by February 26, 1999, in accordance with the Court's Individual Rules and Procedures.

SO ORDERED.

Dated: New York, New York

September 29, 1998

Deborah A. Batts

U.S.D.J.