IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

INHALATION PLASTICS, INC.

Plaintiff,

v.

Case No. 2:07-CV-116
JUDGE SMITH
MAGISTRATE JUDGE KING

MEDEX CARDIO-PULMONARY, INC.,

Defendant.

ORDER and
REPORT AND RECOMMENDATION

This matter is before the Court for consideration of Defendant's *Motion for Leave to File a Third Party Complaint*, Doc. No. 97, and the Plaintiff's *Motion to Strike Defendant's Counterclaim*, Doc. No. 99.

I.

Plaintiff Inhalation Plastics, Inc. ["Plaintiff"] commenced this action against Defendant Medex Cardio-Pulmonary, Inc. ["Defendant"] on February 15, 2007, alleging the breach of written and oral contracts. The claims arise in connection with Defendant's purchase of Plaintiff and of Plaintiff's business.[1] *First Amended Complaint*, Doc. No. 34, at ¶¶ 3-4. After the purchase, Defendant merged with Smiths Medical Holdco Limited ["Smiths Holdco"], a competitor of Plaintiff, and ceased manufacturing and distributing Plaintiff's former product

[1]Plaintiff is a manufacturer and distributor of medical products. Plaintiff is incorporated in the State of Illinois and has its principal place of business in that state. *Am. Complaint* at ¶¶ 1-2. Defendant is an Ohio corporation with its principal place of business in the State of California. *Id.* at ¶¶ 3-4.

lines. *Id.* at ¶ 10. Defendant assigned and transferred Plaintiff's rights under certain written contracts to Smiths Holdco. *Id.* at ¶¶ 10-11.

Count I of Plaintiff's *First Amended Complaint* alleges breach of an oral contract. Specifically, Plaintiff claims that Defendant's president, Dominick Arena, verbally offered to Plaintiff's president, Walter Levine, to pay Plaintiff "an amount of not less than $7,000,000, in exchange for [Plaintiff's] agreement to refrain from interfering with Medex-Smiths arrangement, and in exchange for Mr. Levine agreeing not to resign." *Id.* at ¶ 22. According to Plaintiff, "Mr. Arena stated in October of 2005 that he would work with [Smiths Holdco] to get between $7,000,000 and $10,000,000 to buy out [Plaintiff], and stated that if [Smiths Holdco] would not come up with the money, [Defendant] would pay the money." *Id.* Plaintiff alleges that it accepted this offer and refrained from filing suit for alleged breach of the parties' written contracts. *Id.* at ¶ 26. Arena resigned from employment but the alleged oral promise to Plaintiff was not fulfilled. *Id.* at ¶¶ 28-30.

Count II of Plaintiff's *First Amended Complaint* is pled in the alternative to Count I. It alleges breach of written agreements between Plaintiff and Defendant. *Id.* at ¶¶ 36-45. In particular, Plaintiff alleges that Defendant has acted in breach of the non-assignment clause of the Asset Purchase Agreement and in breach of the Machinery and Equipment Production Lease. *Id.* at ¶ 11. According to Plaintiff, Defendant's assignment and transfer "of all its rights, duties, obligations and interests in and under its agreements with [Plaintiff], and in and to all of the assets that it purchased and all of the machinery and equipment that it leased from [Plaintiff] . . . was likely to negatively impact the consideration that [Plaintiff] ultimately would receive under the agreements with [Defendant]." *Id.*

Defendant initially moved to dismisss Count II of the *First Amended Complaint;* that motion was denied. *Order*, Doc. No. 61. Defendant appealed that decision and the Court stayed proceedings on Count II pending resolution of that appeal by the United States Court of Appeals for the Sixth Circuit. *Opinion and Order*, Doc. No. 66. Discovery as to Count I was to proceed. *Id.* On June 29, 2010, the Sixth Circuit held that, although the Court has jurisdiction over the issue of liability on the Count II claims, any damage award would be subject to arbitration. *Inhalation Plastics, Inc. v. Medex-Cardio Pulmonary, Inc.*, No. 08-4550, 2010 WL 2640401 (6th Cir. June 29, 2010).

On July 8, 2010, the Court ordered that Defendant respond to Count II by August 9, 2010. Defendant thereafter filed its *Answer* and asserted three counterclaims. Doc. No. 96. On the same day, Defendant filed a *Motion for Leave to File a Third Party Complaint*, Doc. No. 97, seeking to add Walter Levine, former President of Plaintiff, and David Levine, former Vice-President of Plaintiff ["the Levines"], as third party defendants. According to Defendant, after acquiring Plaintiff's business, Defendant "discovered that many of the representations and warranties of [Plaintiff] – which were personally guarantied by both Walter Levine and David Levine pursuant to the Levine Guaranty – were false, and that facts material to the Agreements had been concealed by [Plaintiff]." *Proposed Third Party Complaint*, Exhibit A at ¶ 29, attached to Doc. No. 97. Defendant proposes to raise a breach of contract claim against the Levines. *Id.* at ¶¶ 50-57.

Plaintiff opposes Defendant's request for leave to file a *Third Party Complaint* and also moves to strike the counterclaims contained in the *Answer* filed on August 9, 2010. The Court now addresses the merits of the parties' motions.

II.

A. Plaintiff's *Motion to Strike*

Plaintiff moves to strike Defendant's counterclaims on the basis that the claims are compulsory and should have been asserted in the original *Answer* filed on April 16, 2008. Doc. No. 36.[2]

Fed. R. Civ. P. 13(a) requires that a counterclaim be raised in a responsive pleading if it "arises out of the transaction or occurrence that is the subject matter of the opposing party's claim" and "does not require adding another party over whom the court cannot acquire jurisdiction." Plaintiff argues that Defendant's counterclaims arise from the contractual relationship between the parties, which is also the subject of Plaintiff's claims, and that the counterclaims do not require parties over whom the Court cannot acquire jurisdiction.

Defendant's first counterclaim asserts a claim for breach of the Asset Purchase Agreement and the Production Lease:

> Despite its obligations pursuant to the express terms of the [Asset Purchase Agreement], [Plaintiff] breached the [agreement] by, among other things, failing to provide [Defendant] with inventory that could not be used or sold within the ordinary course of business, and providing [Defendant] with machinery and equipment which could not properly manufacture the products the equipment was supposed to produce.
>
> As a direct and proximate cause of [Plaintiff]'s aforementioned breaches, [Defendant] has suffered significant damages, as due to the breaches [Defendant] was required, among other things, to bring the assets acquired pursuant to the [agreement] to proper operating condition and repair.
>
> [Plaintiff] breached its obligations under the Production Lease by, among other things, failing to provide all of the assets leased to [Defendant]

[2]The Court notes that, in addition to filing its *Answer*, Defendant also filed its *Motion to Dismiss or Stay* on April 16, 2008. Doc. No. 35. The issues raised in that motion were the subject of the decision by the United States Court of Appeals for the Sixth Circuit.

> pursuant to the Production Lease in proper operating condition and repair.
>
> As a direct and proximate result of [Plaintiff's] aforementioned breaches of the Production Lease, [Defendant] has suffered significant damages, as due to the breaches, [Defendant] was required, among other things, to bring the assets acquired pursuant to the [Asset Purchase Agreement] to proper operating condition and repair so as to operate [Plaintiff's] business.

Answer and Counterclaims, Doc. No. 96, at ¶¶ 55-56 and 60-61.

Defendant's second counterclaim asserts a claim of fraudulent inducement: Plaintiff, "through its agents, Walter Levine and David Levine, knowingly, or with utter disregard for their truthfulness, made misrepresentations to [Defendant] and intentionally omitted facts material to [Defendant's] acquisition of [Plaintiff's] business." *Id.*, at ¶ 63. In particular, Defendant alleges that Plaintiff made material misrepresentations and omissions as to the "good operating condition and repair of the assets" purchased and leased by Defendant as well as the status of the inventory. *Id.*, at ¶¶ 64-66. Defendant claims that each representation or omission was material to the transaction, that Plaintiff knew that the representations or omissions were false and that Plaintiff intended that Defendant rely on those representations or omissions in acquiring Plaintiff's business. *Id.*, at ¶¶ 67-69.

Defendant's third counterclaim asserts a claim of fraud. Defendant claims that Plaintiff made misrepresentations and intentionally omitted material facts in connection with the purchase of Plaintiff's business. As a result, Defendant claims, it has incurred costs to "repair[ ] the assets acquired under the [Asset Purchase Agreement] and the assets it leased pursuant to the Production Lease . . . ." *Id.* at ¶ 81.

This Court agrees with Plaintiff that Defendant's counterclaims are compulsory

counterclaims within the purview of Fed. R. Civ. P. 13(a). Plaintiff argues that Defendant should have asserted its counterclaims when it filed its original answer to the *First Amended Complaint* on April 16, 2008; Defendant's failure to do so, Plaintiff argues, now renders the counterclaims untimely. This Court disagrees.

The counterclaims relate to Count II of the *First Amended Complaint*. Defendant has only recently been required to answer Count II of the *First Amended Complaint.* Prior to that time, Defendant's motion to dismiss Count II, and the appeal from the denial of that motion, served to suspend any obligation to answer Count II. Fed. R. Civ. P. 12(a)(4). "Rule 13(a) . . . only requires a compulsory counterclaim if the party who desires to assert a claim has served a pleading. . . . Where the rules do not require a pleading because of pending motions, the compulsory counterclaim requirement of Rule 13(a) is inapplicable." *Bluegrass Hosiery, Inc. v. Speizman Industries, Inc.*, 214 F.3d 770, 772 (6th Cir. 2000), citing *Martino v. McDonald's System, Inc.*, 598 F.2d 1079, 1082 (7th Cir. 1979). For these reasons, to the extent that Plaintiff seeks dismissal of the Defendant's counterclaims on the basis of timeliness, the motion is without merit.

Plaintiff also argues that Defendant's counterclaims for fraudulent misrepresentation and fraud are barred by the four year statute of limitations. R.C. § 2305.09. As an initial matter, Defendant argues that Plaintiff's motion to strike these counterclaims is inappropriate. According to Defendant, Plaintiff's motion is essentially a motion to dismiss the claims pursuant to Rule 12(b)(6). Plaintiff disagrees. According to Plaintiff, Defendant should have sought leave to file the counterclaims and that, had Defendant done so, leave would have been denied on the basis of futility of the proposed claims.

For the reasons stated *supra,* the Court concludes that Defendant was not required to seek leave of court in order to file its counterclaims. Thus, Plaintiff's argument based on futility of the claims is misplaced. Furthermore, the Court agrees with Defendant that Plaintiff's motion is directed to the substance of the two counterclaims. Rule 12(f) provides that "[t]he Court may order stricken from any pleading any insufficient defense or any redundant, immaterial, impertinent or scandalous matter." Fed. R. Civ. P. 12(f). In the Court's view, use of Rule 12(f) is inappropriate to determine whether Defendant's fraud counterclaims are timely, for purposes of the statute of limitations. Motions to strike are appropriate in circumstances where spurious issues can be eliminated and litigation streamlined before trial. *See e.g., Kelley v. Thomas Solvent Co.*, 714 F.Supp. 1439, 1442 (W.D. Mich. 1989). In contrast, in this instance, Plaintiff's motion is directed to the ultimate viability of two of Defendant's counterclaims. The Court declines to address the issue of timeliness of these counterclaims in the context of a Rule 12(f) motion.[3]

Finally, Plaintiff argues that the counterclaims should be stricken on account of Defendant's delay in presenting the counterclaims and resulting prejudice to Plaintiff. Plaintiff specifically argues that the counterclaims will require new initial disclosures and written discovery requests and responses. Further, Plaintiff fears that the counterclaims will require Plaintiff to locate sources of proof that are no longer available. According to Plaintiff, some of the machinery and equipment that is the subject of Defendant's misrepresentation claim has been lost, moved or otherwise disposed of by Defendant. In addition, former employees of Plaintiff who later worked for Defendant are no longer employed because the facility is no longer in

[3]The Court makes no determination, at this juncture, as to whether these two counterclaims are barred by the four year statute of limitations. The Court also declines to treat the Rule 12(f) motion as a motion under Rule 12(b)(6), as Defendant suggests. Plaintiff indicates in its *Reply Memorandum* that it does not intend to move to dismiss the counterclaims under Rule 12(b)(6) at this juncture. *See* Doc. No. 105, at 1.

operation. Thus, Plaintiff maintains that it will suffer substantial prejudice if it required to defend against the counterclaims.

The Court recognizes the potential for prejudice to Plaintiff with respect to discovery in connection with Defendant's counterclaims. As stated above, however, Defendant's counterclaims arise out of the same transaction as Plaintiff's written contract claim, which has only now reached a stage at which discovery can begin and the merits can ultimately be addressed. This delay, however, was a necessary consequence of Defendant's challenge to the Court's jurisdiction. The Court is nevertheless mindful of potential prejudice to Plaintiff that may arise due to the passage of time; however, such issues are more appropriately addressed as discovery on the claims progresses.

B. Defendant's *Motion for Leave to File a Third Party Complaint*

Defendant seeks leave to file a *Third Party Complaint* against Walter Levine, former President of Plaintiff, and David Levine, former Vice-President of Plaintiff ["the Levines"]. Defendant claims that, after acquiring Plaintiff's business, Defendant "discovered that many of the representations and warranties of [Plaintiff] – which were personally guarantied by both Walter Levine and David Levine pursuant to the Levine Guaranty – were false, and that facts material to the Agreements had been concealed by [Plaintiff]." *Proposed Third Party Complaint*, Exhibit A at ¶ 29, attached to Doc. No. 97. Defendant proposes to raise a breach of contract claim against the Levines. *Id.*, at ¶¶ 50-57.

Plaintiff opposes the motion and argues that the pleading is, in reality, a counterclaim, not a third party claim as Defendant suggests. According to Plaintiff, the allegations against the Levines do not seek "to pass off to either of them some or all of the liability [Defendant] may

have to [Plaintiff], but rather to recover for losses it claims to have sustained . . . based upon alleged representations and warranties [Plaintiff] made . . . regarding [Plaintiff's] machinery, equipment, inventory, customer base, and regulatory status." *Memorandum contra*, Doc. No. 100, at 2. Plaintiff opposes the assertion of any claims against the Levines for the same reasons articulated in its *Motion to Strike*, addressed *supra*.

Fed. R. Civ. P. 14(a)(1) provides that "[a] defending party may, as third-party plaintiff, serve a summons and complaint on a nonparty who is or may be liable to it for all or part of the claim against it." "[S]uch third-party practice, or impleader, is permitted only where the defendant can show that if it is found liable to the plaintiff, then the third party will be liable to the defendant." *Independent Liberty Life Ins. Co. v. Fiduciary and General Corp.*, 91 F.R.D. 535, 537 (D.C. Mich. 1981). In other words, in order to be add a third-party defendant, "it must be established that such third-party defendant will be secondarily or derivatively liable for any loss suffered by the principal defendant in the primary dispute. . . . [A]n entirely separate and independent claim cannot be maintained against a third party under Rule 14, even when it arises out of the same general set of facts as the main claim." *Id.*, citing *United States v. Joe Grasso & Son, Inc.*, 380 F.2d 749 (5th Cir. 1967).

After reviewing the proffered *Third Party Complaint* in this case, the Court agrees with Plaintiff that Defendant's proposed claim against the Levines is not of a secondary or derivative nature. Rather, Defendant's claim for breach of the Levine guaranty is independent of any liability Defendant may incur as a result of Plaintiff's claims. Defendant's proposed claim is, in reality, a counterclaim which should have been presented in Defendant's *Answer* filed on August 9, 2010. Doc. No. 96.

The addition of this counterclaim and the addition of the Levines to this action is governed by Rule 13(h) as well as Rules 19 and 20. Pursuant to Fed. R. Civ. P. 13(h), persons other than those made parties to the original action may be made parties to a counterclaim in accordance with Rules 19 and 20. Because Defendant did not present its proposed claim against the Levines as a counterclaim, the Court will consider whether leave to amend the *Answer* filed on August 9, 2010, is appropriate under Rule 15(a).

Fed. R. Civ. P. 15(a)(2) provides that leave to file an amended pleading should be freely given "when justice so requires." In *Foman v. Davis*, 371 U.S. 178 (1962), the United States Supreme Court held that the rule is to be interpreted liberally and, in the absence of undue delay, bad faith, or dilatory motive on the part of the movant, leave should be granted. In *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 401 U.S. 321 (1971), the Court noted that delay, coupled with demonstrable prejudice, either to the opposing party or to the court, can justify denial of leave.

In determining whether an amendment would cause prejudice, the Court is to consider whether the proposed claim will "require the opponent to expend significant additional resources to conduct discovery and prepare for trial" and whether the proposed claim will "significantly delay the resolution of the dispute [or] prevent the plaintiff from bringing a timely action in another jurisdiction." *Phelps v. McClellan*, 30 F.3d 658, 663 (6th Cir. 1994).

Plaintiff opposes the addition of any claim against the Levines on the basis of undue delay and prejudice. As the Court indicated *supra*, Defendant's counterclaims, including the proposed claim against the Levines, relate to Plaintiff's claim for breach of a written contract which has been ripe for consideration only since the recent resolution of Defendant's appeal. Despite the length of time that this case has been pending, the Court cannot conclude that Defendant has

acted with undue delay or dilatory motive in proposing to add a claim against the Levines. Furthermore, since discovery has just begun with respect to the claims for breach of a written contract, the Court cannot find, on this record, that Plaintiff will suffer demonstrable prejudice should Defendant be permitted to assert a claim against the Levines at this juncture. Defendant will therefore be granted leave to amend its answer in order to assert claims against the Levines.

III.

Defendant's *Motion for Leave to file a Third Party Complaint*, Doc. No. 97, which the Court construes as a motion for leave to amend the *Answer*, is **GRANTED**. Defendant must file its *Amended Answer*, joining the Levines under Rule 13(h), within **seven (7) days** of the date of this *Order*.

It is **RECOMMENDED** that Plaintiff's *Motion to Strike Defendant's Counterclaim*, **Doc. No. 99**, be **DENIED**.

If any party seeks review by the District Judge of this *Report and Recommendation*, that party may, within fourteen (14) days, file and serve on all parties objections to the *Report and Recommendation*, specifically designating this *Report and Recommendation*, and the part thereof in question, as well as the basis for objection thereto. 28 U.S.C. §636(b)(1); F.R. Civ. P. 72(b). Response to objections must be filed within fourteen (14) days after being served with a copy thereof. F.R. Civ. P. 72(b).

The parties are specifically advised that failure to object to the *Report and Recommendation* will result in a waiver of the right to *de novo* review by the District Judge and of the right to appeal the decision of the District Court adopting the *Report and Recommendation.*

See Thomas v. Arn, 474 U.S. 140 (1985); *Smith v. Detroit Federation of Teachers, Local 231 etc.*, 829 F.2d 1370 (6th Cir. 1987); *United States v. Walters*, 638 F.2d 947 (6th Cir. 1981).

October 28, 2010
DATE

S/ Norah McCann King
NORAH McCANN KING
UNITED STATES MAGISTRATE JUDGE