

What Attorneys Need to Know About the New Jersey Supreme Court's Entire Controversy Doctrine Ruling

While the breadth of the ECD is sometimes overstated by nervous lawyers, it still can have drastic consequences, so keep the Supreme Court's holding in 'Bank Leumi' in mind but be guided by your particular situation.

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The New Jersey Supreme Court in Bank Leumi USA v. Kloss, Docket No. 083372, 2020 WL 4091413 (N.J. Sup. Ct. July 21, 2020), recently provided clear guidance to defendants who seek to file a pre-answer motion to dismiss, but have claims of their own and do not want to run afoul of New Jersey's Entire Controversy Doctrine ("ECD") and lose the right to later assert those claims. The Court held that the ECD does not bar a party who files a successful pre-answer motion to dismiss from later asserting claims that arise from the same transactional facts. The clarity provided by the Court's decision should better enable practitioners to recommend the most efficient and effective means by which their clients may assert any claims they may have against a plaintiff who sues them first.

The Sometimes Frightening and Nerve-racking ECD

The ECD (N.J. Ct. R. 4:30A) requires litigants to assert all affirmative claims relating to the controversy between them and to join all parties with a material interest in the controversy. Otherwise, forever hold their peace. The ECD understandably scares many lawyers. After all, its consequences are very harsh and there has been a great deal of litigation (and sometimes confusion) over how it applies to various types of claims, from environmental actions to legal malpractice claims. Some may therefore tend to assume it will apply and follow the safest course of action to make sure they do not run afoul of it later down the road – even if there are good arguments as to why it would not seem to apply. Again, this tendency is understandable. But it is important keep current and to understand when the ECD clearly will *not* apply that so we can be aware of all of our clients' options and recommend the most efficient and effective course of action to take.

The Issue: How and When to Assert Your Client's Claims When Facing Baseless Claims from the Adversary

Your client is served with a summons and complaint. The claims are bogus on their face and, in fact, your client is the "real plaintiff" with legitimate claims. You want to immediately move to dismiss the claims against your client, but do not want to somehow run afoul of the ECD with respect to your client's own claims and risk not being able to assert them later on if the court grants your motion to dismiss. Perhaps there is also another state in which you can, and want, to litigate your client's claims rather than in the instant action. Or, your client can and wants to litigate its claims in federal court, but wants the motion to dismiss heard in state court. You worry, though, about what might happen under the ECD if you do not assert the claims in the pending action.

If you are fine with litigating your claims in state court, why not file a standalone counterclaim in the pending action without answering the complaint while your dismissal motion is pending? Because the Rules do not allow it. A counterclaim is not among the exclusive list of pleadings allowed under N.J. Ct. R. 4:5:1. Instead, under N.J. Ct. R. 4:7-1, a counterclaim must be part of a “pleading” (namely, an answer to a complaint). The District of New Jersey, applying Federal Rules of Civil Procedure 7 and 13 (the federal analogues to New Jersey Court Rules 4:5-1 and 4:7-1), has stricken standalone counterclaims on precisely this basis. See, e.g., *Castro v. Sanofi Pasteur*, Civ. Act. No. 11-7178, 2017 WL 4776626, at *1 & ECF No. 100 (D.N.J. Oct. 23, 2017) (“[T]he Court finds the Federal Rules forbid parties from raising a counterclaim as a separate pleading outside of a recognized pleadings.”).

Other options may be to commence a separate action asserting your client’s claims while your motion to dismiss is pending, or to file an answer in that action with a counterclaim and plead failure to state a claim as an affirmative defense. But do you *need* to elect either course to avoid the ECD? According to the Supreme Court, no.

The New Jersey Supreme Court’s Holding in *Bank Leumi*

On certification of a question of law from the Third Circuit, the New Jersey Supreme Court in *Bank Leumi* held that the ECD does not bar a party who files a successful pre-answer motion to dismiss a claim from later asserting its own claims that arise from the same transactional facts. The Court recognized that the New Jersey Court Rules provide two options for a defendant seeking to dismiss a claim: It can file a pre-answer motion to dismiss or it can file an answer to the complaint and raise failure to state a claim in its answer as an affirmative defense. A defendant choosing the latter approach must raise in its counterclaim all claims encompassed by the ECD – that is, all claims arising out of the same transaction or series of transactions. This is so because a “pleading” such as an answer triggers the preclusive effects of the ECD, whereas a motion to dismiss does not as it is not a “pleading.”

The Court recognized that applying the ECD to bar claims by a party that filed a pre-answer motion to dismiss would be problematic in several respects. First, it would effectively nullify that first option of filing a pre-answer motion to dismiss for litigants “who anticipate they may at some point have an affirmative claim of their own or simply prefer a cautious approach.” Second, it would be inequitable. A party filing a motion to dismiss does not have an opportunity to affirmatively assert its own claims within that motion and therefore would not have a “fair and reasonable opportunity” to fully litigate its claims if court grants the motion. Third, it could incentivize plaintiffs “to bring baseless actions in a time and manner most convenient to them in an attempt to prevent defendants from developing more legitimate claims as they see fit.” Otherwise stated, a plaintiff could assert a meritless claim to impose a time squeeze on a defendant and force it to assert its claims in that action or in a parallel action the defendant would need to commence before the court decides the motion to dismiss – when there may be years left on a statute

of limitations and when the defendant may need and desire significantly more time to investigate and develop its claims.

And, while the Court did not need to address this issue, as a strategical matter, your client may simply want to avoid filing an answer if at all possible if dismissal is a realistic possibility. Why be faced with conducting a full investigation and potentially having to admit allegations that may not state a proper cause of action but may nonetheless be damaging down the line (e.g., to the client's reputation or in another lawsuit)?

Under the Supreme Court's ruling, a defendant can seek pre-answer dismissal of the plaintiff's claims and file its own claims when it is ready to do so, and, assuming there is jurisdiction elsewhere, in the court of its choice.

Hadn't This Issue Been Decided Already?

At first blush, it may appear as though this issue had been long-settled. To some extent it had, but apparently not entirely, and not by our highest Court. Again, the New Jersey Supreme Court's decision was in response to a certified question posed by the Third Circuit, which was hearing an appeal from the District of New Jersey's dismissal of the bank's claims on ECD grounds. The bank filed its complaint in the District Court after successfully moving pre-answer to dismiss claims asserted in state court by parties collectively referred to in both matters as "Kloss." Kloss moved to dismiss the bank's claims in the later-filed federal action based on the ECD. The District Court granted the motion, holding that the bank should not have filed a pre-answer motion to dismiss in the state court action if it desired to assert its own claims. Instead, it should have filed an answer to the complaint in the state court action, asserted failure to state a claim as an affirmative defense and asserted a counterclaim in the state court action.

The District Court acknowledged, but distinguished, Allstate New Jersey Insurance Co. v. Cherry Hill Pain & Rehab Institute, 389 N.J. Super. 130 (App. Div. 2006), where the Appellate Division had held the ECD did not bar claims asserted by a party that was a defendant to a prior action in which it had successfully moved pre-answer to dismiss the claims against it. The District Court noted the Appellate Division's recognition of public policy reasons in Allstate presented by the specific types of claims (insurance fraud) that the insurer wished to assert in the later-filed action, and also the fact that they were "separate and distinct" from those asserted in the first-filed action. The Supreme Court in Bank Leumi articulated more of a bright-line rule that does not rely on public policy or whether the claims at issue arose from the same transaction.

Practical Considerations/Pointers

As a side note, practitioners are reminded that the ECD applies to judgments issued by New Jersey state courts because the preclusive effect of a judgment is generally determined by the preclusion law of the issuing court. Thus, a federal court may apply the ECD to bar claims that could have been litigated in New Jersey state court in an action on which the New Jersey court entered judgment. (While the Third Circuit has recently

held the ECD would not apply to a judgment entered by a federal court in New Jersey, there may be room for debate down the line based on earlier U.S. Supreme Court precedent).

Here are a few scenarios that be present themselves for which the decision in Bank Leumi may provide helpful guidance:

Removing to federal court: Your client has been sued and wants to immediately move to dismiss. For public relations reasons or perhaps other business reasons, the client needs these claims dismissed as quickly as possible and can deal with asserting its claims against the plaintiff later on. Your client also does not want to engage in any discovery on the plaintiff's claims. If there is federal jurisdiction, you can remove the case to federal court, but keep in mind that a motion to dismiss typically takes significantly longer to decide in federal court rather than in state court. Also, the mere filing of a motion to dismiss in federal court does not stay discovery, and so you may be engaged in months of discovery on plaintiff's claims while your pre-answer motion to dismiss is pending. New Jersey Superior Court generally holds motion days twice a month with motions fileable 16 days before a return date. Motions to dismiss are often decided right on the return date (although there are exceptions). The Court's holding in Bank Leumi would allow your client to seek dismissal in state court and later assert its own claims in federal court if it prevails. Note, though, that depending on the types of claims and the basis of your dismissal motion, you may feel you have a higher likelihood of success in federal court than in state court.

Filing in another state: It may be that more than one states' courts have jurisdiction over your claims against the plaintiff and you prefer to litigate in another state. The Court's holding in Bank Leumi would allow your client to seek dismissal in New Jersey state court and later assert its own claims in another state's court with jurisdiction.

Immediately filing your client's claims: If your client wishes to assert its own claims immediately while awaiting the decision on its motion to dismiss the claims against it, your client may file a parallel action in state court. If the court grants the motion to dismiss in the first-filed action, you can then continue to litigate the action you filed (and perhaps you will have already started discovery in that action). If the court denies the motion, you will have two actions pending, but you can then generally consolidate them if they arose from the same transactions and series of events.

With all of the above in mind, the ECD can still present different scenarios and have nuances. While its breadth is sometimes overstated by nervous lawyers, it still can have drastic consequences, so keep the Supreme Court's holding in-mind, but be guided by your particular situation.

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