Think before seeking a LEAVE TO AMEND

by Richard C.O. Rezie

Recent case law points to an expanding view of *res judicata* that applies to all claims for which leave to amend is denied, creating a trap for the unwary. Before seeking leave to amend, it is important to carefully weigh this trend and consider your options.

A growing body of law holds that denial of leave to amend a complaint is *res judicata* as to the newly proposed claims, without regard to whether the claims arise out of the same transaction or occurrence as those already pending. Traditionally, *res judicata* as to claims not actually litigated in a prior proceeding was based on a finding that the claims arose out of the same "transaction or occurrence" as those presented and litigated in the original suit. However, a broader application of *res judicata* appears to be unfolding. Under this broad view, *res judicata* may preclude any claim for which leave to amend is denied, without analysis of whether it arose out of the same "transaction or occurrence" as the claims litigated in the action where leave to amend was denied. From this growing body of precedent, it is easy to see that leave to amend must be sought as soon as practicable and, if denied, the denial must be appealed. Otherwise, *res judicata* may be applied even if the new claim asserted is arguably unrelated to the original suit.

In fact, if the potential for denial of leave is great and the claim or counterclaim is permissive, the more prudent course may be to file a separate action and then seek consolidation, rather than seeking leave to amend. These issues must be care-

RICHARD C.O. REZIE IS AN ATTORNEY WITH GALLAGHER SHARP IN CLEVELAND.

fully analyzed before leave to amend is sought to avoid the unanticipated application of *res judicata*, if leave is denied. This presents a trap for those unfamiliar with the potentially disastrous effect of denial of leave to amend a complaint.

Ohio law: the effect of denial of leave to amend

By Supreme Court of Ohio precedent "[a]ll existing claims between opposing parties that arise out of the same transaction or occurrence must be litigated in a single lawsuit pursuant to Civ.R. 13(A), no matter which party initiates the action."[1] Under the traditional view, if an existing claim arising out of the "same transaction or occurrence" is not brought in the same action as other related claims, then it is barred by *res judicata*.[2] That traditional view is not the situation this article addresses.

The federal courts are split on whether denial of leave to amend alone is *res judicata*, or whether the issue to be analyzed is whether the proposed new claims arise out of the same transaction or occurrence.

In one of the few reported Ohio opinions on the scope of *res judicata* where leave to amend has been denied, the 10th Appellate District held in *Bush v. Dictaphone Corporation* that, "[A] properly denied motion to amend has a preclusive effect under principles of *res judicata*. A plaintiff will be bound by that preclusive effect unless the denial is reversed on appeal."[3] The appeals court did not analyze whether the claims presented in the proposed amendment arose out of the same "transaction or occurrence" as those presented in the original complaint. It based its decision solely on the denial of leave to amend. This issue was the subject of the dissent by Judge Lazarus:

> I believe, however, that by applying this rule here, the majority fails to focus on the basis of the rule itself and for claim preclusion in general—*i.e.*, that litigants must bring all claims arising out of the same transaction or occurrence in a single action if possible.[4]

Nonetheless, and even though the majority of the court was apprised of the issue by the dissent, the court set forth a bright line rule that denial of leave to amend is *res judicata* as to the claims in the proposed amended pleading (unless the denial is reversed on appeal). One might consider the *Bush* case an anomaly, if it were not for the depth of precedent on this issue in the federal courts.

Federal law: the effect of denial of leave to amend

The federal courts are split on whether denial of leave to amend alone is *res judicata*, or whether the issue to be analyzed is whether the proposed new claims arise out of the same transaction or occurrence.

In *EFCO Corp. v. U.W. Marx, Inc*, the 2nd Circuit stated the principle to be applied is as follows:

> Where a plaintiff's motion to amend its complaint in the first action is denied, and plaintiff fails to appeal the denial, *res judicata* applied to the claims sought to be added in the proposed amended complaint.[5]
>
> … In such situations, *regardless* of the state court's reasons for denying leave to amend, it may fairly be said that plaintiff has failed to avail himself of an opportunity to pursue a remedy in the state-court action, and thus application of *res judicata* is warranted.[6]

The court of appeals apparently based its *res judicata* determination mainly on the denial of leave to amend, rather than the more traditional "same transaction or occurrence" test. In fact, while it did address the traditional test, it found that the claims asserted in the proposed amendment "could certainly have [been] brought" in the original complaint, but not that they arose out of the same "transaction or occurrence" as the claims presented in the original complaint.

In the 5th Circuit, the U.S. District Court for the Middle District of Alabama reviewed the applicable precedent and found substantial weight to support its holding in *Hrabe v. Paul Revere Life Ins. Co.* that "the denial of Plaintiff's Motion For Leave to Amend Complaint was a final judgment on the merits as to all claims which Plaintiff proffered in her Amendment To Complaint."[7] The court in *Hrabe* also analyzed the traditional "transaction or occurrence" test, but did not make its decision on that basis:

> The court's finding that, in this case, the prior denial of Plaintiff's Motion For Leave To Amend Complaint is not merely procedural, as argued by Plaintiff, comports with the purpose of *res judicata*, which is to "encourage[] litigants to raise all claims arising out of one transaction in a single suit."[8]

One might conclude that the court found that a request for leave to amend is an implicit admission that those claims arise out of the same "transaction or occurrence." The court also found an exception to general *res judicata* preclusion where the court has split plaintiff's claims "by reason of no default on the part of the litigant," such as "a court's discretionary refusal to exercise jurisdiction over pendent state law claims."[9] Again, this exception has nothing to do with the traditional "transaction or occurrence" test.

The 8th Circuit Court of Appeals has been very strict in its application of *res judicata* where leave to amend is denied and then sustained on appeal. It was held that, "[I]t is well settled that denial of leave to amend constitutes *res judicata* on the merits of the claims which were the subject of the proposed amended pleading."[10] Further, the 8th Circuit Court of Appeals has "held that allegations in a complaint, leave to file which had been denied, are *res judicata* and that under *Poe v. John Deer Co.* the denial of leave to file the amended complaint … alleging fraud on the bankruptcy court, was *res judicata* on that issue."[11]

The 8th Circuit's analysis of its decision in *Poe* is most instructive:

> In *Poe*, Ms. Poe filed suit alleging discrimination in violation of 42 U.S.C. § 200e-5 ('Title VII') and 42 U.S.C. §1981. The district court granted summary judgment against Poe on the Title VII claim but allowed the section 1981 claim to be tried. Prior to trial, Ms. Poe sought to amend her complaint to include claims of *prima facie* tort, invasion of privacy and other tort theories of recovery. The court denied amendment, and the jury ruled against Ms. Poe on her section 1981 claim. Ms. Poe then filed another suit, against the same defendant, seeking the same relief and raising the same theories that she included in her amended complaint. The district court granted summary judgment for the defendant on *res judicata* grounds, and this court affirmed.[12]

The court never addressed the traditional "transaction or occurrence" test.

The 8th Circuit is also willing to impose sanctions for refiling a claim after the denial of leave to amend. In *King v. Hoover Group, Inc.*, the court reversed the district court's order, which denied defendant's motion for sanctions against an attorney because "[Plaintiff's] counsel should have realized that *King II* was barred by *King I* because of the identity of the facts and issues."[13] In *Professional Management Assoc., Inc. v. Employee's Profit Sharing Plan*, after holding that "[t]he denial of a motion to amend a complaint in one action is a final judgment on the merits barring the same complaint in a later action" and that, "[T]his is so even when denial of leave to amend is based on reasons other than the merits, such as timeliness" the court reversed the district court's order denying sanctions.[14] The 8th Circuit found that the district court had "abused its discretion" in failing to award sanctions.[15]

In *Northern Assurance Co. of America v. Square D Co.*, the 2nd Circuit recognized the expending scope of *res judicata* in the context of denial of leave to amend and sought to limit the expansive holdings of the other circuits.[16] The 2nd Circuit held that, "[I]n fact, the actual decision denying leave to amend is irrelevant to the claim preclusion analysis. … [I]nstead, the bar is based on the requirement that the plaintiff must bring all claims at once against the same defendant relating to the same transaction or event."[17] That holding is more in line with the historic bounds of *res judicata*. However, as previously discussed, courts in two other circuits and Ohio fail to use this limiting language.

In fact, under the traditional "transaction or occurrence" test, denial of leave to amend appears irrelevant. The general rule has always been, as stated by the Supreme Court of Ohio, that, "'[C]laim preclusion' is where a court of competent jurisdiction renders a final judgment on the merits of a case and, thereby, bars the same parties or their privities from relitigating issues that were raised *or could have been raised in the prior case*."[18] Therefore, regardless of whether the party actually raised a claim by way of amended complaint, if it could have been raised, then it would be barred. There would be no reason to look to whether leave to amend had been denied—it simply would not matter

as was pointed out by the 2nd Circuit in *Northern Assurance*, supra.[19] The fact that several courts (including at least one Ohio appellate court) have cited denial of leave to amend as their basis for a finding of *res judicata* (or claim preclusion) indicates it as an independent basis for this finding. Otherwise, discussion would be irrelevant. That appears to be both a new development in the law and an expansion of *res judicata* of which litigators must be increasingly wary.

Recent case law points to an expanding view of *res judicata* that applies to all claims for which leave to amend is denied, and without regard to whether they arise out of the same "transaction or occurrence." Before seeking leave to amend, it is important to carefully weigh this trend and consider the option of filing a separate action. This is especially so where the new claims to be asserted arguably arise out of a different "transaction or occurrence" and where counsel believes the risk of denial of leave to amend is substantial. Although neither filing a separate action, nor seeking leave to amend is free of risk; risk that is fully informed can be managed and minimized in light of this broader application of *res judicata* by some courts. ■

Endnotes

[1](Emphasis added.) *Rettig Enterprises, Inc. v. Koehler* (1994), 68 Ohio St.3d 274, paragraph one of the syllabus.
[2]*Id.*
[3]*Bush v. Dictaphone Corp.* (Mar. 30, 1999), Franklin App. No. 98AP-585, 1999 Ohio App. LEXIS 1423, at *13; *Ins. Outlet Agency, Inc. v. Am. Med. Sec., Inc.*, Licking App. No. 01 CA 118, 2002-Ohio-4268, at ¶16.
[4]Bush at * 14.
[5](C.A.2, 1997) 124 F.3d 394, 400.
[6](Emphasis added.) Compare *Northern Assurance Co. of America v. Square D Co.* (C.A. 2, 2000), 201 F.3d 84, 87-88 (holding under the traditional view "the typical situation where claim preclusion would apply after a denial of leave to amend [is where] … the plaintiff is seeking to add additional claims against the same Defendant and leave to amend is denied without reaching the merits of the claim. … [T]he bar is based on the requirement that the Plaintiff bring all claims at once against the same defendant relating to the same transaction or event."); *Johnson v. SCA Disposal Sev. of New England, Inc.* (C.A. 1, 1991), 931 F.2d 970, 976, fn. 19, quoting 18 C. Wright, A. Miller & E. Cooper, Federal Practice and Procedure §4412, at 104-05 (1981) (holding that "[d]enial of leave to amend to assert *all parts* of a claim partially asserted at the outset of the first action … should preclude a second action. …" [Emphasis added.]).
[7]*Hrabe v. Paul Revere Life Ins. Co.* (M.D. Ala. 1999), 76 F.Supp.2d 1297, 1304.
[8]*Hrabe*, 76 F.Supp.2d at 1304.
[9]*Id.*
[10]*King v. Hoover Group, Inc.* (C.A. 8, 1992), 958 F.2d 219, 222-223.
[11](C.A. 8 1982), 695 F.2d 1103; *Landscape Properties, Inc. v. Whisenhunt* (C.A. 8, 1997), 127 F.3d 678, 682.
[12]*Id.* at 683.
[13](C.A. 8, 1992), 958 F.2d 219, 222-223.
[14](C.A. 8, 2003), 345 F.3d 1030, 1032.
[15]*Id.*
[16](C.A. 2, 2000), 201 F.3d 84, 88.
[17] *Id.* at 88.
[18](Emphasis added.) *Voinovich v. Ferguson* (1992), 63 Ohio St.3d 198.
[19]*Northern Assurance Co. of America v. Square D Co.* (C.A. 2, 2000), 201 F.3d 84, 87-88.