State of New York
Court of Appeals

OPINION

This opinion is uncorrected and subject to revision before publication in the New York Reports.

No. 16
Paramount Pictures Corporation,
Appellant,
v.
Allianz Risk Transfer AG, et al.,
Respondents,
et al.,
Defendant.

Richard B. Kendall, for appellant.
James A. Janowitz, for respondents.

GARCIA, J.:

Nearly ten years ago, following an unsuccessful investment venture, the parties began litigating their dispute in federal court. The district court entered judgment in favor of Paramount Pictures Corporation (Paramount) – the defendant in that action – and that

judgment was affirmed on appeal. Paramount – now the plaintiff – subsequently initiated this state court action. In this appeal, defendants assert that Paramount's claim is barred by res judicata because it should have been asserted as a counterclaim in the earlier federal action. We agree.

I.

In 2004, Melrose Investors LLC (Melrose) was formed as a special purpose vehicle to facilitate investment in certain films produced and distributed by plaintiff Paramount Pictures Corporation (Paramount). Defendants Allianz Risk Transfer AG, Marathon Structured Finance Fund, L.P., Newstar Financial Inc., and Munich Re Capital Markets New York, Inc. (the investors) invested in Melrose's debt and equity.

Prior to investing, the parties exchanged and executed a number of documents, including a Private Placement Memorandum (PPM) and a Subscription Agreement. The Subscription Agreement contained a number of representations and warranties, including, among others, a waiver provision and a covenant not to sue. Section 4 (s) of the Subscription Agreement provided that Paramount had not "made any express or implied representation, warranty, guarantee or agreement, written or oral" to the investors regarding a number of specified matters – for instance, the manner of distribution of any films. The next subsection, section 4 (t), provided that each investor "waives and releases all claims against Paramount" or any of its affiliates "arising out of, or in connection with, the offering of the Securities," and further "waives and releases Paramount" and its affiliates from "liability arising out of the matters described in paragraph (s) above, and

agrees that in no event shall it assert any claim or bring any action contradicting the acknowledgements and agreements in this paragraph or in Paragraph (s) above."

In December 2008, the investors brought suit in the District Court for the Southern District of New York, asserting claims for securities fraud (a federal question), common law fraud (a state-law cause of action), and unjust enrichment (a state-law cause of action).[1] The investors alleged that they had relied on "Paramount's knowing misrepresentations and omissions of information material to [the investors'] decision to invest in securities." In particular, the investors claimed that Paramount had induced them to invest through "disclosures in the PPM stating that Paramount regularly employed specific risk mitigation techniques when producing and distributing films," but that, "contrary to the specific and repeated representations in the PPM," Paramount "materially altered its production and distribution plans" with regard to the Melrose investment so as to "dramatically reduce the use of a key risk mitigation technique described in the PPM." In its answer, Paramount asserted, among other things, (i) that the investors' claims were barred because, contrary to the allegations, they had "relied on documents and information apart from the PPM in making their investment decisions," and (ii) that one of those documents, the Subscription Agreement, contained an "express waiver" barring those claims. Paramount did not assert

[1] The district court exercised federal question and supplemental jurisdiction over the subject matter of the action pursuant to 28 USC §§ 1331 and 1367 (see Allianz Risk Transfer v Paramount Pictures Corp., 2010 WL 1253957, *6, 2010 US Dist LEXIS 32218, *15 [SD NY, March 31, 2010, 08 Civ. 10420 (TPG)]). The court noted that it "also" had original jurisdiction pursuant to 28 USC § 1332 because the action "is between citizens of different states and/or foreign states and the amount in controversy exceeds $ 75,000 exclusive of interest and costs" (id.).

any counterclaims or otherwise allege that the investors had breached the covenant not to sue.

Following a bench trial, Paramount moved for entry of judgment in its favor. The district court granted Paramount's motion, finding "no basis for disregarding the [S]ubscription [A]greement" and "no legal reason why th[e] claim waiver would not apply as a matter of law." Because the waiver was "valid and enforceable," the court determined that "plaintiff investors waived their claims." The court further noted: "In paragraph 4(t) [of the Subscription Agreement] there is a waiver. And there is an agreement by the plaintiffs in no event to bring any claim. As I said, I do find that is binding." The investors appealed and the Second Circuit affirmed, holding that the investors "failed to establish the factual premise of their claims, and the district court correctly dismissed the complaint" (Marathon Structured Finance Fund, LP v Paramount Pictures Corp., 622 Fed Appx 85, 87 [2d Cir 2015]).

While the investors' appeal was pending in the Second Circuit, Paramount commenced this action in Supreme Court, alleging that the investors had breached the covenant not to sue in the Subscription Agreement by filing the federal action.[2] Paramount seeks compensatory damages of not less than $8 million – the attorneys' fees it allegedly incurred in the federal action, plus interest. The investors moved to dismiss the complaint, arguing, among other things, that Paramount's state court action was barred by res judicata

[2] Paramount has since settled with defendant Marathon Structured Finance Fund, L.P.

because Paramount was required, and failed, to raise its claim as a compulsory counterclaim in the federal suit. Paramount opposed the motion.

Supreme Court denied the investors' motion to dismiss. The court "decline[d] to apply FRCP 13 (a)'s compulsory counterclaim rule to support [the investors'] res judicata defense," reasoning that New York "has a permissive counterclaim rule that was enacted by the legislature," and it would "not be proper" to ignore that rule.

The Appellate Division unanimously reversed, granting the investors' motion and dismissing Paramount's complaint (Paramount Pictures Corp. v Allianz Risk Transfer AG, 141 AD3d 464 [1st Dept 2016]). While noting that "New York's permissive counterclaim rule would save [Paramount's claim] from the traditional bar of res judicata," the court determined that "the inquiry does not end there where the prior action was adjudicated in a compulsory counterclaim jurisdiction" (id. at 467). The court then determined that Paramount's claim was compulsory under Rule 13 (a) of the Federal Rules of Civil Procedure because "[i]t existed at the time [Paramount] served its answer to the complaint in the federal action and 'arises out of the transaction or occurrence that is the subject matter' of defendants' federal claim(s)" (id. [citations omitted]). Though it found no "binding precedent . . . hold[ing] that state courts must apply FRCP 13 (a)," the Appellate Division determined that "the later assertion in a state court action of a contention that constituted a compulsory counterclaim in a prior federal action between the same parties is barred under the doctrine of res judicata" (id. at 468).

We granted Paramount's motion for leave to appeal (28 NY3d 909 [2016]).

II.

The viability of Paramount's instant claim hinges on the preclusive effect of the parties' prior federal judgment. As the United States Supreme Court has instructed, "[t]he preclusive effect of a federal-court judgment" on a subsequent state court action is "determined by federal common law" (Taylor v Sturgell, 553 US 880, 891 [2008]; see also Semtek International Inc. v Lockheed Martin Corp., 531 US 497, 507 [2001], quoting Deposit Bank of Frankfurt v Board of Councilmen of the City of Frankfort, 191 US 499, 515 [1874]). "For judgments in federal question cases," the "uniform federal rules of res judicata" apply (Taylor, 552 US at 891 [citation, quotation marks, and brackets omitted]) whereas, "[f]or judgments in diversity cases, federal law incorporates the rules of preclusion applied by the State in which the rendering court sits" (id. at 891 n 4, citing Semtek, 531 US at 508). The United States Supreme Court "has the last word on the claim-preclusive effect of *all* federal judgments" (Semtek, 521 US at 507 [emphasis in original]).

The Supreme Court has not squarely addressed the applicable federally prescribed rule of decision – the uniform federal rules or state preclusion law – in a case where, as here, the judgment in the parties' federal action encompassed both federal- and state-law claims.[3] Where federal and state preclusion law dictate the same result, the applicable law

[3] Given the Supreme Court's express directive – that "[t]he preclusive effect of a federal-court judgment is determined by federal common law" (Taylor, 553 US at 891 [emphasis added]) – the applicable law is not an "open question" (concurring op at 1). To the extent any issue remains "open," it is only the federally prescribed rule of decision in a "mixed" jurisdiction case; in determining the preclusive effect of a federal judgment, our starting point is not, under any circumstances, "New York State's res judicata rules" (concurring op at 3). Nor can we ignore binding Supreme Court precedent simply because the parties purportedly "agree" that we should – even if applying the wrong law would somehow produce the right result (concurring op at 2-3).

is irrelevant; whether analyzed under federal law or under state law (or, as the dissent puts it, analyzed "separately"), the outcome is the same. But where federal law would bar the claim and state law would not, we anticipate (and the dissent apparently agrees) that federal preclusion doctrine will supply the applicable rule of decision, barring the claim. Under either scenario, the outcome prescribed by federal law will control. And so, under either scenario, a state law analysis is unnecessary.[4]

In the absence of a federal question claim, the res judicata rules of New York – the "State in which the rendering court" sat – would ordinarily govern the preclusive effect of state-law claims (Semtek, 531 US at 508). But "even when States are allowed to give federal judgments no more than the effect accorded to state judgments" – i.e., in diversity cases – "that disposition is by direction of [the United States Supreme Court], which has the last word on the claim-preclusive effect of *all* federal judgments" (Semtek, 531 US at 507 [emphasis in original]). As such, the Supreme Court has provided that state preclusion law may apply to federal diversity judgments only to the extent state law is not "incompatible with federal interests" (id. at 509).[5]

[4] Accordingly, we do not decide – even "implicitly" (dissenting op at 9) – whether, under New York state res judicata principles, the claim "is barred" (concurring op at 2) or "should proceed" (dissenting op at 9).

[5] The Supreme Court has not yet determined whether its Semtek concession – "allow[ing]" state res judicata principles to determine the preclusive effect of pure diversity judgments – applies in the context of counterclaims. And there is reason to believe it may not: Even where state preclusion law would allow an unasserted counterclaim to proceed, the defendant in a state court action that was preceded by a federal diversity action will often be able to remove the case to federal court, and Rule 13 (a) would then operate to "bar[] litigants from separately filing what should have been a compulsory counterclaim" (dissenting op at 4).

Those federal interests are heightened where, as here, the federal judgment encapsulates matters of federal substantive law. In addition to the general interests underlying res judicata – judicial economy, finality, consistency, among other things – the "need for a uniform federal rule" is enhanced where federal, rather than state, substantive law is at issue (id. at 508). Given those objectives, the Supreme Court has been unequivocal: Though "no federal textual provision addresses the claim-preclusive effect of a federal-court judgment in a federal-question case," the Court has "long held that States cannot give those judgments merely whatever effect they would give their own judgments, but must accord them the effect that this Court prescribes" (id.; see also Taylor, 552 US at 891). Accordingly, where federal preclusion principles would operate to preclude a claim – and state law principles would yield a conflicting outcome – the "federal courts' interest in the integrity of their own processes" justifies the displacement of New York law as the federally prescribed rule of decision (Semtek, 531 US at 509; see also Charles Alan Wright et al., Effect of State Law on Federal Res Judicata Rules, 18B Fed Prac & Proc Juris § 4472 [2d ed 2011]). Indeed, federal courts generally apply "federal preclusion law" where, as here, "the prior case involved both federal and state substantive law" (Lucas v JBS Plainwell, Inc., 2012 WL 12854880, *5 [WD Mich, March 8, 2012, 1:11-cv-302]; see also Chudacoff v University Medical Center, 525 Fed Appx 530, 531 [9th Cir 2013] [applying federal preclusion law to a judgment rendered by a federal court exercising federal question and supplemental jurisdiction]; In re Residential Capital, LLC, 507 BR 477, 490 [SD NY 2014] [same]; In re Zaharescu, 2013 WL 3762285, *2 [CD Cal, July 22, 2013, CV 12-9767-CAS] [same]). For these reasons, federal preclusion law governs our analysis.

III.

In federal court, Rule 13 of the Federal Rules of Civil Procedure governs the pleading requirements for counterclaims, requiring a defendant to plead certain related claims. Specifically, Rule 13 (a) provides, in relevant part, that a counterclaim is compulsory if it "arises out of the transaction or occurrence that is the subject matter of the opposing party's claim" (Fed Rules Civ Pro rule 13 [a]). Although the text of Rule 13 (a) does not explain the consequences for failure to plead a compulsory counterclaim, "virtually all courts agree that a party who fails to plead a compulsory counterclaim cannot raise that claim in a subsequent action" in federal court (Michael D. Conway, Narrowing the Scope of Rule 13 [a], 60 U Chi L Rev 141, 141 [1993]; Charles Alan Wright et al., Compulsory Counterclaims – Effect of Failing to Plead a Compulsory Counterclaim, 6 Fed Prac & Proc Juris § 1417 [3d ed 2010]). The rule itself and its accompanying Advisory Committee Notes are "silent on whether Rule 13 (a) was intended to be a rule of administration for the federal courts or was expected to have wider application" – namely, in state court actions (Wright, 6 Fed Prac & Proc Juris § 1417).

The investors do not contend that Rule 13 (a), by itself, operates to bar unasserted counterclaims raised subsequently in state court. And for good reason. At minimum, "it would be peculiar to find a rule governing the effect that must be accorded federal judgments by other courts ensconced in rules governing the internal procedures of the rendering court" (Semtek, 521 US at 503). And at worst, that interpretation would "violate

the jurisdictional limitation of the Rules Enabling Act" (id.; Wright, 6 Fed Prac & Proc Juris § 1417 [noting, with regard to Rule 13, that "the rulemakers decided that it was beyond the scope of the federal rules to regulate the effect of a judgment"]) – that the Federal Rules of Civil Procedure may not "abridge, enlarge or modify any substantive right" (28 USC § 2072 [b]). Instead, the investors contend that principles of res judicata act independently to bar Paramount's claim.

A.

The preclusive effect of a judgment is determined by two related but distinct concepts – issue preclusion and claim preclusion – which collectively comprise the doctrine of "res judicata" (see Taylor, 553 US at 892). Issue preclusion, also known as collateral estoppel, bars the relitigation of "an issue of fact or law actually litigated and resolved in a valid court determination essential to the prior judgment" (New Hampshire v Maine, 532 US 742, 748-749 [2001]; see also Restatement [Second] of Judgments § 27 [1982]). As a result, the determination of an essential issue is binding in a subsequent action, even if it recurs in the context of a different claim (Taylor, 553 US at 892).

While issue preclusion applies only to issues actually litigated, claim preclusion (sometimes used interchangeably with "res judicata") more broadly bars the parties or their privies from relitigating issues that were or could have been raised in that action (Cromwell v County of Sac, 94 US 351, 352 [1976]). The doctrine "encompasses the law of merger and bar" – it precludes the relitigation of all claims falling within the scope of the judgment, regardless of whether or not those claims were in fact litigated (Migra v Warren City School Dist. Bd. Of Educ., 465 US 75, 77 n 1 [1984]; Monahan v New York City Dept of

Corrections, 214 F3d 275, 285 [2d Cir 2000]; Wright, 6 Fed Prac & Proc Juris § 1417). As such, claim preclusion serves to bar not only "every matter which was offered and received to sustain or defeat the claim or demand," but also "any other admissible matter which might have been offered for that purpose" (Nevada v United States, 463 US 110, 129-130 [1983], citing Cromwell, 94 US at 352). In other words, claim preclusion may "foreclos[e] litigation of a matter that never has been litigated, because of a determination that it should have been advanced in an earlier suit" (Migra, 465 US at 77 n 1).

Collectively, these doctrines serve to "relieve parties of the cost and vexation of multiple lawsuits, conserve judicial resources, and, by preventing inconsistent decisions, encourage reliance on adjudication" (Allen v McCurry, 449 US 90, 94 [1980]). By promoting consolidation, res judicata shields litigants from undue harassment and protects against the substantial time and expense associated with needless and repetitive litigation (Taylor, 553 US at 892; see also Allan D. Vestal, Res Judicata/Preclusion by Judgment: The Law Applied in Federal Courts, 66 Mich L Rev 1723, 1723 [1967]). The reduction of duplicative proceedings similarly furthers the goals of convenience, efficiency and judicial economy – the same trial court presides over unified discovery, all relevant motions, and a single trial (Allen, 449 US at 94; Conway, 60 U Chi L Rev at 156). Res judicata also preserves the integrity of the courts by fostering finality and minimizing the risk of conflicting judgments, which serve only to undermine public confidence in the judicial process (see Nevada, 463 US at 128-129; Vestal, 66 Mich L Rev at 1723; Conway, 60 U Chi L Rev at 162).

B.

Invoking the doctrine of claim preclusion, the investors contend that Paramount's covenant not to sue claim should have been litigated in the prior federal action, and therefore Paramount's state court action is barred.[6] To establish claim preclusion, a party must show: (1) a final judgment on the merits, (2) identity or privity of parties, and (3) identity of claims in the two actions (see Blonder-Tongue Lab., Inc. v Univ. of Ill. Found., 402 US 313, 323-324 [1971]; Allen, 449 US at 94; Chase Manhattan Bank, N.A. v Celotex Corp., 56 F3d 343, 345-346 [2d Cir 1995]). The sole issue in this case is whether the claim to be litigated is "the same" as the claims previously litigated by the parties.

The Supreme Court has not articulated a precise test for determining whether there is an identity of claims for purposes of claim preclusion, and lower courts do not apply a uniform standard (see John F. Wagner, Jr., Proper Test to Determine Identity of Claims for Purposes of Claim Preclusion by Res Judicata Under Federal Law, 82 ALR Fed 829, § 2 [a]; Nevada, 463 US at 130 n 12, 131; I.A.M. National Pension Fund, Benefit Plan A v Industrial Gear Manufacturing Co., 723 F2d 944, 947-948 [D DC 1983]). Prior to the adoption of the Federal Rules of Civil Procedure, courts embraced "[t]he old theory of narrowing the issue down . . . to one single limited matter," thereby "forcing the parties to bring separate actions" (American Bar Association, Federal Rules of Civil Procedure and Proceedings of the Institute on Federal Rules, 247 [1938]; Williamson v Columbia Gas &

[6] While collateral estoppel is not at issue in this appeal, Paramount contends that, assuming its claim is not precluded, the investors will be collaterally estopped from challenging the district court's factual and legal findings with respect to the Subscription Agreement.

Elec. Corp., 186 F2d 464, 469 [3d Cir 1950]). Claims were litigated in a fragmented manner, favoring narrow and discrete issues over more comprehensive proceedings (American Bar Assn, Proceedings at 247; Restatement [Second] of Judgments § 24, Comment *a*). Procedural constraints, including inflexible pleading and joinder rules, reflected the common law attitude opposing (and in some cases, preventing) the consolidation of claims (Restatement [Second] of Judgments § 24, Comment *a*; id. § 22, Comment *a*; Funny Guy, LLC v Lecego, LLC, 293 Va 135, 144 [Va 2017]; Williamson, 186 F2d at 469). Underlying this policy was, in part, the notion that "[a] defendant should not be required to assert his claim in the forum or the proceeding chosen by the plaintiff but should be allowed to bring suit at a time and place of his own selection" (Restatement [Second] of Judgments § 22, Comment *a*); though antithetical to the policies underlying res judicata, a defendant's autonomy was thought to outweigh countervailing interests in convenience, efficiency, and judicial economy.

The common law doctrine of claim preclusion mirrored these limitations. For purposes of res judicata, case law focused on the precise "cause of action" asserted in the two suits (see United States v Memphis Cotton Oil Co., 288 US 62, 67-68 [1933]; see also In re General adjudication of All Rights to Use Water in the Gila River System and Source, 212 Ariz 64, 70 [Ariz 2006]) and, guided by the aim of pleading – "to frame one single legal issue" – that phrase came to have "a very narrow meaning" (Williamson, 186 F2d at 469). Indeed, "in the days when civil procedure still bore the imprint of the forms of action and the division between law and equity, the courts were prone to associate claim with a single theory of recovery, so that, with respect to one transaction, a plaintiff might have as

many claims as there were theories of the substantive law upon which he could seek relief against the defendant" (Restatement [Second] of Judgments § 24, Comment *a*). One version of the test, for instance, examined the "primary right" of the plaintiff that had allegedly been infringed, and scrutinized whether the two actions involved an alleged infringement of that same legal right by the same wrongful act or omission (see Wagner, 82 ALR Fed 829, § 2 [a]; Restatement [Second] of Judgments § 24, Comment *a*; Baltimore S.S. Co. v Phillips, 274 US 316, 321 [1927]). Another test focused on whether the same evidence that was considered in the first judgment would sustain the second (see Nevada, 463 US at 130 n 12; see also Wagner, 82 ALR Fed 829, § 2 [a]; Restatement of Judgments § 61 [1942]). These narrow conceptions of a "claim" limited the effects of res judicata, enabling piecemeal litigation with minimal risk of preclusion (see Williamson, 186 F2d at 469; Restatement [Second] of Judgments § 24, Comment *a*).

But "[d]efinitions of what constitutes the 'same cause of action'" for purposes of claim preclusion "have not remained static over time" (Nevada, 463 US at 130 [citations omitted]). Increasingly, modern practice has placed a premium on the policies underlying res judicata – notions of efficiency, finality, and judicial economy, among other things. The earlier common law rule favoring claim isolation and party autonomy has been gradually supplanted by a new "general philosophy" – one of "limiting the number of law suits possible over one controversy" (American Bar Assn, Proceedings at 247). In response to these evolving procedural ideas, courts have broadened preclusion principles to "apply in contexts not formerly recognized at common law" (Allen, 449 US at 94), and "[t]he scope of claims barred has expanded" (Conway, 60 U Chi L Rev at 145). In turn, modern

conceptions of res judicata embrace a broadened notion of the scope of a "claim" (see Williamson, 186 F2d at 469 ["(T)he meaning of 'cause of action' for res judicata purposes is much broader today than it was earlier."]; see also Vestal, 66 Mich L Rev at 1723-1724 [noting that the "increase in the use of the principle of res judicata/preclusion in federal courts" is embodied in, among other things, "(t)he expansion of the scope of the definition of 'claim' in connection with . . . claim preclusion"]; Restatement [Second] of Judgments § 24, Comment *a* ["The present trend is to see claim in factual terms and to make it coterminous with the transaction regardless of the number of substantive theories or variant forms of relief flowing from those theories, that may be available to the plaintiff; regardless of the number of primary rights that may have been invaded; and regardless of the variations in the evidence needed to support the theories or rights."]).

This progression is also reflected in the concomitant evolution of modern procedural rules – namely, pleading and joinder reforms – that similarly operate to urge consolidation of related claims into a single action (American Bar Assn, Proceedings at 247; Restatement [Second] of Judgments § 24, Comment *a*; Conway, 60 U Chi L Rev at 141; Williamson, 186 F2d at 469-470; Funny Guy, 293 Va at 146). Rule 13, for instance, was designed "to flush out all possible counterclaims early in the litigation; in other words 'to prevent multiplicity of actions and to achieve a just resolution in a single lawsuit of all disputes arising out common matters'" (Cyclops Corp. v Fischbach & Moore, Inc., 71 FRD 616, 619 [WD Pa 1976], citing 3 Moore's Federal Practice, ¶ 13.12 [1] [1974]). Though it may be "a species different" than res judicata, Rule 13 "also has a claim preclusive effect" in federal court, providing an "independent basis" to "bar[] claims that *should have* been

presented in a prior action" (Polymer Industrial Products Co. v Bridgestone/Firestone, Inc., 211 FRD 312, 318 [ND Ohio 2002], affd 347 F3d 935 [Fed Cir 2003 en banc]; Conway, 60 U Chi L Rev at 141, 157-158; Wright et al., 6 Fed Prac & Proc Juris § 1417). In other words, Rule 13 (a) operates as a procedural shortcut – an expedient employed by federal courts to achieve the preclusive ends of res judicata (Polymer 211 FRD at 318; Conway, 60 U Chi L Rev at 141; see also Trustees of New York City District Council of Carpenters Pension Fund v MI Installers & Furniture Services, Inc., 2013 WL 1385791, *8 [SD NY, March 28, 2013, No. 12 Civ. 2362 (VM)] [noting that the court's res judicata analysis hinged on "the same reason" as its compulsory counterclaim assessment]). Or, viewed another way, as modern procedural devices broadened the scope of claims that *may* (and in some cases, *must*) be litigated, the scope of claims covered by res judicata – those claims that *should* have been litigated – has symmetrically widened (see Restatement [Second] of Judgments § 24, Comment *a*; see also Funny Guy, 293 Va at 146 [citation and quotation marks omitted]).

C.

This modern notion of res judicata has called for a broadened standard for determining whether two claims – or, as in this case, a claim and counterclaim – are the "same" for purposes of claim preclusion. Though courts tasked with applying the "uniform federal rules of res judicata" employ a variety of formulations for purposes of defining a "claim," the clear trend has been towards the adoption of a transactional analysis (see

Wagner, 82 ALR Fed 829, § 2 [a]; see also Nevada, 463 US at 130 n 12; Conway, 60 U Chi L Rev at 145 n 23; Restatement [Second] of Judgments § 24, Comment *a*).[7]

As articulated by the Second Circuit, "[w]hether or not the first judgment will have preclusive effect depends in part on whether the same transaction or series of transactions is at issue, whether the same evidence is needed to support both claims, and whether the

[7] As the dissent notes, federal courts generally need not address the issue of res judicata in the context of counterclaims, as Rule 13 (a) will ordinarily operate in federal court to bar an unasserted compulsory counterclaim (dissenting op at 11-12). That said, those courts that have reached the issue have made clear that res judicata provides an "*independent* basis" to bar a counterclaim that should have been asserted in a prior action (Polymer, 211 FRD at 318 [dismissing the plaintiff's claim pursuant to Rule 13 (a) and "find(ing) an *independent* basis for dismissal under the doctrine of *res judicata*"] [emphasis in original], affd 347 F3d 935 [Fed Cir 2003 en banc]; see also Ross ex rel. Ross v Board of Educ. of Tp. High School Dist. 211, 486 F3d 279, 283 [7th Cir 2007] [the plaintiff's claim was barred pursuant to "(t)he federal law of claim preclusion," not Rule 13 (a), because it should have been asserted as a counterclaim in the parties' earlier litigation]; Pike v Freeman, 266 F3d 78, 90-91 [2d Cir 2001] [precluding a previously-unasserted counterclaim under "the doctrine of res judicata"]; Trustees of New York City District Council, 2013 WL 1385791, at *4-*8 [separately analyzing the plaintiff's unasserted counterclaim under Rule 13 (a) and "(t)he doctrine of res judicata," and concluding that, "for the same reasons th(e) action is not a compulsory counterclaim, it is not barred by res judicata"]; Casico v Nettles, 2011 WL 3847337, *6-*8 [SD NY, Aug. 30, 2011. No. 8:09-CV-1128 (GTS/DRH)] [dismissing the plaintiff's claims because they were "compulsory counterclaims" in the parties' prior federal action and "on the alternative ground of res judicata"]; Star Mark Management, Inc. v Koon Chun Hing Kee Soy & Sauce Factory, Ltd., 2009 WL 2922851, *7-*9 [ED NY, Sept. 8, 2009, No. 07-CV-3208 (KAM) (SMG)] [holding that the plaintiff's claims were barred "(u)nder the doctrine of *res judicata* or claim preclusion" because they should have been raised as a counterclaim in the prior action]). In Pike v Freeman, for instance, then-Judge Sotomayor assessed whether the defendant's claim was barred under "the doctrine of res judicata" – not Rule 13 (a) – where the defendant failed to raise it as a counterclaim in the parties' prior arbitral proceeding (266 F3d at 90-91). Although the court ultimately determined that the claim was not barred because it was "not based on the same transaction" as the plaintiff's claims, the court made clear that res judicata applies to a counterclaim that should have been previously raised even where, as in Pike, Rule 13 (a) did not apply in the prior proceeding (id. at 90-92).

facts essential to the second were present in the first" (Monahan, 214 F3d at 285; see also Ross, 486 F3d at 283). "To ascertain whether two actions spring from the same 'transaction' or 'claim,'" courts look to "whether the underlying facts are 'related in time, space, origin, or motivation, whether they form a convenient trial unit, and whether their treatment as a unit conforms to the parties' expectations or business understanding or usage'" (Pike, 266 F3d at 91). Put differently, "the question is whether the claim was sufficiently related to the claims in the first proceeding that it *should have been* asserted in that proceeding" (id. [emphasis in original]).

The approach embodied in the Second Restatement similarly provides that "[a] defendant who may interpose a claim as a counterclaim in an action but fails to do so" is precluded from relitigating that claims if "(a) [t]he counterclaim is required to be interposed by a compulsory counterclaim statute or rule of court, or (b) [t]he relationship between the counterclaim and the plaintiff's claim is such that successful prosecution of the second action would nullify the initial judgment or would impair rights established in the initial action" (Restatement [Second] of Judgments § 22). By incorporating compulsory counterclaims statutes and rules – adopted in all federal jurisdictions, and in the vast majority of states – the Restatement employs the transactional approach embodied in those statutes and rules to broaden the scope of a "cause of action" to which res judicata applies (see Wright, 6 Fed Prac & Proc Juris § 1417; see also Restatement [Second] of Judgments § 22).

In a "modern procedural system" – which "permits the presentation in [one] action of all material relevant to the transaction" – "[t]he transaction is the basis of the litigative

unit or entity which may not be split," irrespective of the variant legal theories available (Restatement [Second] of Judgments § 24, Comment *a* [emphasis added]). Under this approach, the law of claim preclusion reflects the expectation that "parties who are given the capacity to present their 'entire controversies' shall in fact do so" (id.; Williamson, 186 F2d at 469).

IV.

Under any transactional analysis, Paramount's covenant not to sue claim is sufficiently related to the investors' claims in the federal case so as to preclude its assertion in a subsequent action (Pike, 266 F3d at 91). In their federal suit, the investors predominantly alleged that, through material misrepresentations and omissions, Paramount induced them to invest in the Melrose investment. These fraud-type allegations necessarily implicate the negotiations surrounding the Melrose investment – namely, the representations, warranties, and disclosures made by Paramount in connection with the transaction. The investors' claims therefore required the district court to consider the scope and validity of the various documents exchanged and agreements executed in connection with the Melrose investment, including the PPM (cited frequently in the investors' federal complaint) and, as relevant here, the Subscription Agreement.

Indeed, in its ruling, the district court reached issues that would likely prove dispositive to Paramount's instant claim: the court noted that the waiver provision of the Subscription Agreement also contained "an agreement by the plaintiffs in no event to bring any claim" – i.e., a covenant not to sue – and held that those provisions were "binding" on the investors. This overlap of essential facts is exemplified most poignantly by

Paramount's offensive assertion of collateral estoppel in the instant case with respect to the district court's factual and legal findings concerning the Subscription Agreement.

At bottom, Paramount's covenant not to sue claim is based on the "same transaction" as the federal action (the Melrose investment); it involves much of the "same evidence" (the Subscription Agreement and surrounding negotiations); and its essential facts (the scope and validity of the Subscription Agreement's provisions) were present in the first action (see Monahan, 214 F3d at 285). Unlike in cases involving malicious prosecution or other similar claims, Paramount did not "depend upon the judgment" in the federal action in order to allege a breach of the covenant not to sue (Mali v Federal Ins. Co., 720 F3d 387, 395 [2d Cir 2013]; Mount Everest Ski Shops, Inc. v Nordica USA, Inc., 736 F Supp 523, 525 [D Vt 1989]). Nor did its claim depend on events subsequent to the filing of the investors' complaint (see Harris v Steinem, 571 F2d 119, 123 [2d Cir 1978]; see also Star Mark Management, 2009 WL 2922851, at *7-*9; Chrysler Corp. v Fedders Corp., 540 F Supp 706, 713 n 2 [SD NY 1982]). Rather, the covenant not to sue claim accrued immediately when the investors filed suit in the federal action and could be resolved upon consideration of nearly identical factual and legal issues.[8] Accordingly,

[8] The dissent notes an apparent absence of authority assessing whether a contractual covenant not to sue must be filed as a compulsory counterclaim (dissenting op at 17 n 9). This shortage is unsurprising: In the vast majority of cases, the counterclaiming parties apparently assume that these claims are compulsory and opt to plead them (see Taupita Investment, Ltd. v Benny Ping Wing Leung, 2017 WL 3600422, *7 [SD NY, Aug. 17, 2017, 14 Civ. 9739 (PAE)] [breach of covenant not to sue brought as a counterclaim]; Reach Music Pub., Inc. v Warner/Chappell Music, Inc., 2014 WL 5861984, *1 [SD NY, Nov. 10, 2014, No. 09 Civ. 5590 (KBF)] [same]; Kamfar v New York Restaurant Group, Inc., 347 F Supp 2d 38, 42 [SD NY 2004] [same]; Wallingford Shopping, LLC v Lowe's Home Centers, Inc., 2011 WL 96373, *6 [SD NY, Feb. 5, 2001, No. 98 Civ. 8463

because it should have been asserted in the parties' federal action, Paramount's claim is barred by res judicata.

V.

Pursuant to federal principles of claim preclusion – the applicable rules of decision in this case (Semtek, 531 US at 507) – Paramount's covenant not to sue claim is transactionally related to the investors' claims in the federal case, amounting to the same "claim" for purposes of res judicata. As such, Paramount's claim should have been asserted in the parties' prior federal action. Because it was not, it is now barred.

The order, insofar as appealed from, should be affirmed, with costs.

(AGS)] [same]; Society for Advancement of Educ., Inc. v Gannett Co., Inc., 1999 WL 33023, *1 [SD NY, Jan. 21, 1999, No. 98 Civ. 2135 (LMM)] [same]; Cefali v Buffalo Brass Co., Inc., 748 F Supp 1011, 1013 [WD NY 1990] [same]; Bellefonte Re Ins. Co. v Argonaut Ins. Co., 586 F Supp 1286, 1287 [SD NY 1984] [same]; Artvale, Inc. v Rugby Fabrics Corp., 232 F Supp 814, 819 [SD NY 1964] [same]; see also Wright, 6 Fed Prac & Proc Juris § 1417).

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No. 16

RIVERA, J. (concurring):

I agree with the plurality that plaintiff Paramount Pictures Corporation (Paramount), is barred by res judicata from pursuing a claim for attorneys' fees based on defendants' alleged breach of a covenant not to sue, because Paramount failed to assert this as a counterclaim in defendants' prior federal lawsuit against Paramount. However, I reach that conclusion without the need to determine, as the plurality does here, whether a federal court would agree that state law provides the proper analytic framework. We have no reason to opine on an open question of federal law – namely, what rule of res judicata applies to claims asserted in state court where there has been a prior federal judgment predicated on "mixed" subject matter jurisdiction and not solely on the existence of a federal question.[1]

[1] In a "mixed" subject matter jurisdiction case, jurisdiction is not predicated exclusively on either a federal question under 28 USC § 1331 or diversity under 28 USC § 1332. Such "mixed" cases include, for example, those in which a party asserts both federal and state law claims, and the federal court thus exercises federal question along with diversity or supplemental jurisdiction. Of course, there is no preclusive effect where, pursuant to 28 USC § 1367 (c), a federal district court declines to exercise supplemental jurisdiction

Paramount's claim is barred regardless of whether federal or New York State res judicata rules apply, because it arises out of the same transaction as the defendants' federal claim which was litigated to its conclusion in the prior federal action. Since the result is the same, the plurality's discussion is essentially an advisory opinion, and one that may prove mistaken (see New York Public Interest Research Group, Inc. v Carey, 42 NY2d 527, 530 [1977] [reminding us that "the courts should not perform useless or futile acts and thus should not resolve disputed legal questions unless this would have an immediate practical effect on the conduct of the parties"]). We should leave to the United States Supreme Court the problem of determining the state res judicata effect of a federal judgment predicated on "mixed" subject matter jurisdiction, or wait until the question is squarely presented to our Court.[2]

Indeed, the posture of this case and the manner in which the parties have litigated the issues render it particularly ill-suited for a complex analysis of the preclusive effect of a "mixed" subject matter federal judgment. The parties agree that this case should be decided under New York State's res judicata rules, and neither they, Supreme Court, nor

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over a state law claim, because in that case the party asserting the state claim did not have a full and fair opportunity to litigate the issue and the federal judgment does not resolve it. That is not the case before us now, however, since Paramount never asserted its claim in defendants' federal lawsuit.

[2] Contrary to the plurality's contention, the Supreme Court has not conclusively determined which res judicata law applies in these "mixed" subject matter jurisdiction cases (plurality op at 5 n 2). Indeed, the plurality recognizes that there is no direct case on point and goes to great lengths to counter the dissent's arguments that the Supreme Court would instruct state courts to look at the nature of the underlying claim rather than at the federal judgment (plurality op at 6-8; dissenting op at 6). The question is still undecided, and we need not resolve it here.

the Appellate Division discussed whether New York State or federal res judicata law applied. Much of the legal analysis the plurality opinion offers was never briefed by the parties or relied upon as the basis for the decisions of the lower courts. Here, to reach beyond the arguments squarely before us is inappropriate and unnecessary (cf. Greenlaw v United States, 552 US 237, 243 [2008] [observing that American courts, "in the first instance and on appeal . . . follow the principle of party presentation[– t]hat is, we rely on the parties to frame the issues for decision"]; People v Hawkins, 11 NY3d 484, 493 [2008] [noting that our Court's purpose is "best accomplished when [we] determine[] legal issues of statewide significance that have first been considered by both the trial and the intermediate appellate court"]).

The facts relevant to the res judicata analysis are not in dispute. Several investment entities (investors) sued Paramount in federal district court for the Southern District of New York for securities fraud, arising from Paramount's alleged misrepresentations and omissions. In that lawsuit, Paramount argued that the investors waived their right to sue for fraud under a waiver clause contained in section 4 (t) of the parties' Subscription Agreement. Section 4 (t) also contains what the parties refer to as a "covenant not to sue," by which each investor "agree[d] that in no event shall it assert any claim or bring any action contradicting the acknowledgments and agreements in this paragraph." After a bench trial, the district court dismissed the complaint, determining, in relevant part, that the investors waived their claims and failed to establish the alleged fraud, and further noting that the investors made a binding agreement "in no event to bring any claim." The Second

Circuit affirmed, concluding that the investors failed to establish the underlying facts of their claims and thus that the district court properly dismissed the complaint (Marathon Structured Finance Fund, LP v Paramount Pictures Corp., 622 Fed Appx 85, 87 [2d Cir 2015]).

While the federal appeal was pending, Paramount filed the instant action in state court against the same investors who were the plaintiffs in the prior federal action, seeking attorneys' fees for the investors' alleged breach of the covenant not to sue. Paramount concedes it could have asserted this cause of action as a counterclaim in the federal lawsuit, but did not do so. The Appellate Division held that Paramount's suit qualified as a compulsory counterclaim under Federal Rule of Civil Procedure 13 (a) and was thus barred in state court by res judicata (Paramount Pictures Corp. v Allianz Risk Transfer AG, 141 AD3d 464, 467-468 [1st Dept 2016]).

The plurality's discussion of which rule of res judicata to apply and the history of federal claim preclusion law is unnecessary (plurality op at 5-8 [Part II], 11-16 [Part III.B]), but I agree with the plurality's conclusion that Paramount's claim here is transactionally related to the prior federal claim and, as such, should have been asserted in that case as a compulsory counterclaim (plurality op at 18-20). Although the plurality reaches its judgment after what is ostensibly a "federal res judicata" analysis, it mirrors the analysis under our state law and leads to the same conclusion: Paramount's claim is clearly part of the same transaction, and so barred. Paramount effectively conceded that there is a transactional relationship between its claims by alleging in the trial court that the investors

were collaterally estopped from denying that section 4 (t)'s covenant not to sue applied in the state action because the district court found that section 4 (t)'s waiver provision applied.[3]

"It is blackletter law that a valid final judgment bars future actions between the same parties on the 'same cause of action'" (Matter of Reilly v Reid, 45 NY2d 24, 27 [1978]). "This State has adopted the transactional analysis approach in deciding res judicata issues [so that] once a claim is brought to a final conclusion, all other claims arising out of the same transaction or series of transactions are barred, even if based upon different theories or if seeking a different remedy" (O'Brien v City of Syracuse, 54 NY2d 353, 357 [1981]). Thus, res judicata "applies not only to claims actually litigated but also to claims that could have been raised in the prior litigation" (Matter of Hunter, 4 NY3d 260, 269 [2005]). As explained, and notwithstanding Paramount's exhortations to the contrary, Paramount's state claim is transactionally related to the investors' federal claim and should have been raised in the federal lawsuit. Since Paramount did not assert the claim when it had the chance, it may not avoid the consequences of its choice simply by crossing the street and filing in state court.

Paramount maintains that this ordinary analysis should not apply because New York is a permissive counterclaim jurisdiction, which reflects a legislative preference to maximize party forum selection. Paramount's argument misses the mark and distracts from

[3] In addition, the waiver and covenant not to sue clauses are both part of the same contract provision and indeed the same sentence in section 4 (t) of the parties' Subscription Agreement.

the central question in this case, namely what preclusive effect to give the prior federal court judgment. We answer that question by looking to the rules that define the scope and consequences of the litigants' claims and the final judgment entered. Where the prior litigation took place in a different jurisdiction, our law requires that we begin by looking to the law of the issuing forum to determine the judgment's scope in its home jurisdiction. Here, the final judgment in the prior action was entered by a federal court, under a system which has adopted a compulsory counterclaim pleading requirement (see Federal Rules of Civil Procedure 13 [a]). We give res judicata effect to the prior federal judgment as it stands under that pleading regime, with its attendant consequences for future litigation.[4] Here, because the federal court would bar Paramount from filing a second action to pursue its breach of contract claim, that same claim is barred under res judicata in our New York courts. As Judge Fuld explained over fifty years ago:

> "[W]hen the Federal suit was commenced, it is indisputably clear that the plaintiff[] now before us should have interposed as [a] counterclaim[] in the earlier litigation the very causes of action now sued upon. Having failed to do so, it necessarily follows that the judgment entered (by the [federal] Court) is *res judicata* as to the merits of the counterclaims which should have been pleaded. . . . 'To the extent to which a judgment of a federal court operates as *res ajudicata* in that court, it operates as *res adjudicata* in the courts of this state.' And . . . it likewise operates as *res judicata* in New York."

[4] By extension, if the prior action had been filed in a permissive counterclaim jurisdiction, then the party in a subsequent action might not be barred from pursuing the claim, absent some other grounds to preclude.

(Cummings v Dresher, 18 NY2d 105, 109 [1966] [Fuld, J., concurring], quoting Horne v Woolever, 170 Ohio St 178, 183 [1959]).

Nor does it affect the analysis that "[o]ur permissive counterclaim rule may save from the bar of res judicata those claims for separate or different relief that could have been but were not interposed in the parties' prior action" (Henry Modell & Co. v Minister, Elders & Deacons of Ref. Pro. Dutch Church of City of N.Y., 68 NY2d 456, 464 n 3 [1986]). That observation was made in the context of analyzing a prior New York state court judgment's preclusive effect on a subsequent New York state court action. Here, however, New York's pleading rules have no place, as the prior action was not brought in New York state court. Instead, Paramount was faced with defending itself in federal court, where it was subject to the Federal Rules of Civil Procedure, including Rule 13 (a), when it decided not to assert its transactionally-related counterclaim. It cannot now seek to escape the consequences of the tactical decision it made in federal court.

To the extent Paramount suggests that it appropriately relied on New York's permissive pleading requirement, it is mistaken. To refrain from asserting a claim carries risks even under New York's law. Even if the investors had initially brought suit in New York state court instead of federal court, it is not clear that Paramount's state claim would be permitted, as under our jurisprudence New York will not always allow a previously unasserted claim to proceed in a future state action. As the Court has explained, our permissive counterclaim rule "does not . . . permit a party to remain silent in the first action and then bring a second one on the basis of a preexisting claim for relief that would impair

the rights or interests established in the first action" (Henry Modell, 68 NY2d at 464 n 3). Paramount unpersuasively claims this state court action could not possibly impair rights or interests established in the prior federal case, since Paramount won in that lawsuit. Nothing in our case law limits the reach of a holding to the victorious party. If the federal decision established the rights and interests of the investors too, New York courts would be required to respect that decision as well.[5]

Moreover, Paramount's approach would encourage simultaneous litigation in two jurisdictions and promote forum shopping, contrary to the well-recognized policies underlying res judicata. "Res judicata is designed to provide finality in the resolution of disputes to assure that parties may not be vexed by further litigation" (Matter of Reilly, 45 NY2d at 28 [italics removed]). "[A] party who has been given a full and fair opportunity to litigate a claim should not be allowed to do so again" (Matter of Hunter, 4 NY3d at 269). Moreover, as the Court has oft explained, "[c]onsiderations of judicial economy as well as fairness to the parties mandate, at some point, an end to litigation" (Matter of Reilly, 45 NY2d at 28; see also e.g. Insurance Co. of State of Pennsylvania v HSBC Bank USA, 10 NY3d 32, 38 [2008]; Xiao Yang Chen v Fischer, 6 NY3d 94, 100 [2005]; Matter of Hunter,

[5] For example, the investors argued below that entertaining this suit for attorneys' fees separate from the underlying action would require a New York court to look over the shoulder of the federal court and make a number of judgments that were explicitly or implicitly settled by the action, including whether the initial suit was itself in "good faith." Of course, we have no occasion to further consider the question, given the inapplicability of New York's counterclaim rule.

4 NY3d at 269-270). Applying our state res judicata rules as I have described furthers these policies by promoting judicial economy and closure.

This case illustrates the point. Although Paramount could have filed its claim in the prior action, it filed its state action while the federal appeal was pending, after the parties had litigated in federal court for seven years, in the hopes of vindicating a claim that might have been impossible to establish under controlling Second Circuit precedent (see Artvale Inc. v Rugby Fabrics Corp., 363 F2d 1002, 1008 [2d Cir 1966] [holding that a party may not recover attorneys' fees on an action for breach of a covenant not to sue where the allegedly breaching plaintiff "claims in good faith" that the covenant "had been obtained by unfair means"]). To permit Paramount's use of the state courts in this way undermines the goals of finality and efficiency, in support of a litigant who had every opportunity to bring the claim in federal court but chose not to. Res judicata is one of the cornerstones on which the stability of our legal system rests and New York will not lend its courts or laws to undermine the settled decisions of other legitimate tribunals.[6]

For the foregoing reasons, under state res judicata principles, Paramount's claim is barred, requiring dismissal of the complaint.

[6] We recognize that "[t]hese strong policy bases, however, if applied too rigidly, could work considerable injustice. In properly seeking to deny a litigant two 'days in court', courts must be careful not to deprive [a litigant] of one" (Matter of Reilly, 4 NY3d at 28). Thus, res judicata does not bar separate litigation of a second claim where more than one claim arises out of a "course of dealing between the same parties" (id. at 28-29). Contrary to the argument advanced in the dissent, that is not the case here (dissenting op at 15 & n 6).

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No. 16

WILSON, J. (dissenting):

I begin with a proposition as to which I believe the plurality and I agree: New York is a "permissive counterclaim" jurisdiction, so that, had Allianz's initial lawsuit been filed in New York State court, without a federal securities law claim, Paramount would not have been required to file as a counterclaim thereto its claim that Allianz breached the contract's covenant not to sue. New York's legislature has adopted a different rule from Rule 13 (a) of the Federal Rules of Civil Procedure, driven by its judgment about the efficiency of the two different approaches (see CPLR 3019). In that regard, there is no right answer: the Federal Rules rest on a rebuttable presumption that trying all claims – including claims the defendant may have against the plaintiff – in a single action is the most efficient way to

proceed, even if that complicates, slows, and enlarges that lawsuit, because there will be no second lawsuit. New York, like several other states (including Maryland, Pennsylvania, and Connecticut), has made a different calculation, permitting defendants to choose not to litigate counterclaims as part of the initial action, so that the initial action may proceed more simply and expeditiously. The second action may be obviated because of settlement or substantially reduced or eliminated by operation of issue preclusion arising from the first action. Indeed, the procedural difference between New York's permissive counterclaim rule and the Federal Rules is not stark. Despite the requirement of Rule 13 (a), federal district courts often end up in the same place that a New York court would because of Federal Rules of Civil Procedure Rule 42 (b), which expressly permits federal district courts to bifurcate any counterclaims from the plaintiffs' claims.[1] Thus, the real difference in procedure is who (the court on motion of a party, rather than the defendant) makes the decision to try separately a counterclaim arising from the same transaction or occurrence.

[1] Hundreds of reported cases bifurcate Rule 13 (a) compulsory counterclaims from the plaintiffs' claims; sometimes, courts even bifurcate defenses, as Rule 42 (b) allows (see e.g. Seiko Epson Corp. v Glory S. Software Mfg., 2010 US Dist. LEXIS 4917, at *14 [D Or 2010] [granting motion to bifurcate trial of "Walker Process" counterclaim arising from same transaction or occurrence]; Donnelly Corp. v Reitter & Schefenacker USA Ltd. P'ship, 2002 US Dist. LEXIS 15205, at *26 [WD Mich 2002] [bifurcating both patent misuse defense and antitrust counterclaim arising from same transaction or occurrence]; Shire LLC v Mickle, 2011 US Dist LEXIS 76811, at *4-5 [WD Va 2011] [bifurcating counterclaims alleging sham litigation, slander, and breach of a contractual non-disparagement from breach-of-contract claim]; Otsuka Pharm. Co. v Apotex Corp., 143 F Supp 3d 188, 197 n 10 [D NJ 2015] [bifurcating patent misuse and antitrust claims because "(b)ifurcation, in turn, aims to ensure efficiency and avoid needless expense, particularly where resolution of the primary claims may, as here, obviate the need to proceed to discovery on the remaining claims"].)

From that starting point, I believe the plurality has made two wrong turns, either of which, if righted, would independently produce a different result here.

First, Semtek Int'l Inc. v Lockheed Martin Corp. (531 US 497, 508 [2001]) holds that a federal court sitting in diversity must apply the res judicata rules of the forum state. Taylor v Sturgell (553 US 880, 891 [2008]) holds that a federal court vested with federal question jurisdiction must apply federal common-law res judicata rules. Neither case decides what a federal court should do when both federal and state-law claims are present. The plurality concludes that, so long as a federal court's judgment is entered in an action that raised a federal claim, the preclusive effect of all claims disposed of in that lawsuit must be determined by federal res judicata law. The Supreme Court has not directly decided that question, but I believe the Supreme Court would decide the question differently, holding that the claim-preclusive effect of each claim in the federal action should be determined by the res judicata principles of the jurisdiction whence each claim sprung.[2] The legal source of each claim, not the source of the federal court's jurisdiction, should determine the applicable claim-preclusion law. Here, under my approach, the claim-preclusive effect of the dismissal of Allianz's federal securities law claim would be

[2] That is not to say that the forum state's substantive law would always apply. I understand Semtek to include the choice-of-law rules of the forum state – not the res judicata law of the forum state even if the courts of that state would, in a particular case, choose the law of a foreign state. Semtek's underpinning requires a federal court sitting in diversity to do exactly what the forum state would do, even if that is to choose the law of a different state (see 531 US at 508 ["This is, it seems to us, a classic case for adopting, as the federally prescribed rule of decision, the law that would be applied by state courts in the State in which the federal diversity court sits"] [emphasis added]).

determined by federal res judicata principles, but the claim-preclusive effect of the dismissal of Allianz's New York State law claims would be determined by New York's res judicata principles. Paramount's claim would not be barred by New York's law of res judicata, because it would not nullify the original judgment or impair the rights of the parties established in the prior action.

Second, my above disagreement with the plurality's conclusion does not matter in this case, because Paramount's counterclaim for breach of the covenant not to sue is not barred by federal or New York claim-preclusion doctrine. The plurality misinterprets federal claim-preclusion law and reaches the wrong result in its application. Neither the Supreme Court nor the Federal Courts of Appeals have decided whether a covenant not to sue can be separately litigated in state court as a matter of federal res judicata. In federal courts, it is Rule 13 (a) – not federal claim preclusion doctrine – that bars litigants from separately filing what should have been a compulsory counterclaim. Rule 13 (a) is a procedural rule expressing the policy choice of the federal courts as to how best to operate efficiently, and cannot impose that choice on state legislatures that have made a different judgment. Federal res judicata principles would not bar subsequent litigation in state court unless that litigation would nullify the original judgment or impair the rights of the parties established in the first action, neither of which is true here.

I.

A.

As the plurality explains, the preclusive effect of a judgment of a federal court is determined by federal common law, which, in turn, is ultimately pronounced by the United States Supreme Court (see Semtek, 531 US at 503). In Semtek, the Supreme Court directed that federal courts sitting in diversity (that is, when no federal question is present) must apply the preclusion law of the state in which the federal courts sits (id. at 508). Where a lawsuit is based on the violation of the federal constitution or a federal statute, "federal courts participate in developing 'uniform federal rule[s]' of res judicata, which [the United States Supreme Court] has ultimate authority to determine and declare" (Taylor, 553 US at 891). Semtek involved state-law claims only; Taylor involved a federal claim only. Neither case explicitly states how the claim-preclusive effect should be determined when, as here, a case involves both federal and state-law claims.

The plurality's answer to that question is that "where federal preclusion principles would operate to preclude a claim – and state law principles would yield a conflicting outcome – the 'federal courts' interest in the integrity of their own processes' justifies the displacement of New York law," citing Semtek (plurality op at 8).[3] In Semtek, the

[3] The plurality's cases do not support its theory. Each of those cases concerns supplemental jurisdiction, not diversity jurisdiction. Supplemental jurisdiction requires that the state-law claims be "so related to claims in the action within such original jurisdiction that they form part of the same case or controversy under Article III of the United States Constitution" (28 USCA § 1367). A claim based on diversity jurisdiction,

Supreme Court illustrated the type of incompatibility that might require resort to federal res judicata principles – dismissal of a lawsuit with prejudice for "willful violation of discovery orders," because allowing the plaintiff to re-file in state court would implicate "federal courts' interest in the integrity of their own processes" (see Semtek at 509). Nothing remotely like that comes into play simply because a state, as here, has made a choice that differs from the choice made in Rule 13 (a). There is no question that Rule 13 (a) would bar the separate filing in federal court of a claim that should have been filed as a compulsory counterclaim, but there is no incompatibility – or even federal interest implicated – by a state's choice to allow that claim to be filed in state court.

The plurality's answer is not the answer I predict the Supreme Court will eventually give. Instead, Semtek's rationale requires us to analyze the claim-preclusive effects of the federal claim and the state law claims separately. In the present case, the claim-preclusive effect of the judgment dismissing the federal 10b-5 claim should be determined by the "uniform federal rules of res judicata" (id.). The claim-preclusive effect of the judgment as to the state law fraud and unjust enrichment claims, however, should be determined by New York's rules of res judicata.

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in contrast, need not have any relationship to the federal claim, and its claim-preclusive effect may therefore have a very different sweep than that of the federal claim. Indeed, state-law claims appended to federal claims by way of supplemental jurisdiction are precisely the set of claims in which Rule 13 (a) and federal res judicata law are congruent. In re Residential Capital, LLC (507 BR 477, 490 [SD NY 2014]) makes that very distinction ("When federal jurisdiction in a prior case is based on federal question jurisdiction, with the court exercising supplemental – not diversity – jurisdiction over the plaintiff's remaining claims, federal preclusion doctrine applies.").

In Semtek, the Court held that the claim-preclusive rule of the forum state should be applied in diversity cases:

> "Since state, rather than federal law is at issue, there is no need for a uniform federal rule. And indeed, nationwide uniformity in the substance of the matter is better served by having the same claim-preclusive rule (the state rule) apply whether the dismissal has been ordered by a state or federal court. This is, it seems to us, a classic case for adopting, as the federally prescribed rule of decision, the law that would be applied by state courts in the State in which the federal diversity court sits"

(531 US at 508.) With that rationale in mind, it becomes important to recall that the claim-preclusive effect of any judgment is determined by the claims in which the merits were actually adjudicated. Indeed, Semtek held that despite Federal Rule of Civil Procedure Rule 41 (b)'s specification that an involuntary dismissal operates as an "adjudication on the merits," claim-preclusive effect is not given to all claims nominally disposed of "on the merits," but only to those "in which the merits of [a party's] claim are in fact adjudicated [for or] against the [party] after trial of the substantive issues" (id. at 502). Thus, if a complaint contains two causes of action, and a court dismisses one without prejudice (or in some other manner in which the merits are not decided) and adjudicates the other to conclusion, only the second claim will have preclusive effect, not the first. If the first is a claim based on federal law, and the second a claim based on state law, Semtek's rationale would require the claim-preclusive effect of the state law claim to be determined by state-law res judicata principles, not federal. Taking the example one step further, if both the federal and state-law claims are adjudicated on the merits, the

claim-preclusive effect of the federal claim would be determined by federal common law, as per Taylor, but the claim-preclusive effect of the state-law claim would be determined by state res judicata principles, as per Semtek.

As was true in Semtek, "any other rule would produce the sort of 'forum shopping . . . and . . . inequitable administration of the laws' that Erie seeks to avoid . . . since filing in, or removing to, federal court would be encouraged by the divergent effects that the litigants would anticipate from likely grounds of dismissal" (id. at 508-509). Under the plurality's rule, some parties would be similarly incentivized to forum shop by including a federal claim – related or not, colorable or not – along with state law claims. Put differently, the claim-preclusive effect of a federal court's judgment should not turn on the court's subject-matter jurisdictional basis, but on the source of each claim's underlying substantive law.

In a case heard in federal court, where both a federal claim and a state-law claim are present, the claim-preclusive effect of the federal claim will be determined by federal claim-preclusion doctrine, as Taylor requires, and the claim-preclusive effect of the state-law claim will be determined by state claim-preclusion doctrine, as Semtek provides. Again, the plurality and I agree that, if the claim-preclusive effect of either one would bar a subsequent claim, it does not matter what the effect of the other would be – the subsequent claim is barred. That is, each claim adjudicated on the merits by the federal court will have its own claim-preclusive effect, independent of the others. Take, as an example, a plaintiff who sues for a declaration of patent invalidity (federal claim) and for

unfair competition by the patent holder, based on deceptive marketing of the patented product (state-law claim). Each claim, if decided on the merits, will have a different claim-preclusive effect, based on the nature of the claim itself. The patent claim, if decided in the plaintiff's favor, would preclude the patent holder from bringing a later infringement action against the plaintiff (under federal res judicata rules). The unfair competition claim, if decided on the merits, would not bar a subsequent claim by the patent holder for patent infringement. My analytical difference with the plurality (if a federal claim is present, the plurality would apply federal common-law claim preclusion doctrine to determine the effect of all claims in the case, whereas I would apply federal claim-preclusion doctrine to the federal claims and state claim-preclusion doctrine to the state claims) is not the source of our disagreement as to the result here; that disagreement arises from our divergent views on whether the federal court's judgment rejecting Allianz's federal securities fraud claims operates to preclude Paramount from bringing its claim for breach of the covenant not to sue, discussed below.

B.

If, as I believe, the Supreme Court would direct us to apply New York res judicata principles to determine whether Paramount's claim is barred by the prior judgment on the state law claims, then it would not be barred. (I do not want to read too much into the plurality's opinion but, by deciding this case on the basis of a difficult and unsettled proposition of federal law, the plurality implicitly agrees that the result would be different under New York law.) Under New York rules of claim preclusion, Paramount's

covenant-not-to-sue claim should proceed. When asking whether a litigated claim precludes the defendant in the action from bringing a claim against the original plaintiff, New York's "decisive test" is "whether the substance of the rights or interests established in the first action will be destroyed or impaired by the prosecution of the second" (Schuykill Fuel Corp. v B. & C. Nieberg Realty Corp., 250 NY 304, 308 [1929]); see also Henry Modell & Co. v Minister, Elders & Deacons of Reformed Protestant Dutch Church of City of New York, 68 NY2d 456, 461 [1986]; Eubanks v Liberty Mortg. Banking Ltd., 976 F Supp 171, 173 [EDNY 1997] ["Only a defendant who is silent in the first action and then tries to bring a second action that would undermine 'the rights or interests established in the first action' is barred under New York's res judicata rule"]). With respect to plaintiff claim splitting, New York has adopted the broader, transactional approach of the Restatement (Second) of Judgment (see Reilly v Reid, 45 NY2d 24, 30 [1978]). However, those two scenarios must be kept distinct, as New York's claim preclusion rule "has a narrower effect on a defendant who then brings her claim in a separate action than it does on the plaintiff who brings successive claims that arise from the same transaction" (Eubanks at 173).

II.

The plurality asserts that under federal res judicata principles, a defendant in a prior federal question action cannot later assert, in state court, a counterclaim that arises from the same transaction or occurrence as the original federal claim. How can that be? As the plurality correctly notes, it cannot be by means of FRCP 13 (a) "by itself" (plurality op at

7).[4] The federal rule cannot prescribe the preclusive effect of a federal judgment on a second, state court action without violating the Rules Enabling Act (see Semtek at 503 ["(I)t would be peculiar to find a rule governing the effect that must be accorded federal judgments by other courts ensconced in rules governing the internal procedures of the rendering court itself. Indeed, such a rule would arguably violate the jurisdictional limitation of the Rules Enabling Act"]; 28 USC § 2072 [b]). There is similarly no question that FRCP 13 (a) does not merely codify federal rules of res judicata. If it did, the rule would be superfluous (see Painter v Harvey, 863 F2d 329, 333 [4th Cir 1988]), and nothing in the legislative history suggests that the drafters meant Rule 13 (a) as a codification of federal res judicata.

Instead, the plurality suggests a novel theory: although at the time Rule 13 (a) was enacted, it barred (as a procedural rule applicable only to federal courts) actions that would not have been barred by the doctrine of claim preclusion, federal common law of claim preclusion has "systematically widened" over the years to the point that it is now coterminous with Rule 13 (a). The plurality's conclusion is completely unwarranted.

As a general matter, the federal cases on which the plurality relies for the proposition that federal common law has expanded to be coterminous with Rule 13 (a) do not support

[4] However, the plurality contradicts itself later when claiming that Rule 13 "also has a claim preclusive effect . . . Rule 13(a) operates as a procedural shortcut – an expedient employed by federal courts to achieve the preclusive ends of res judicata" (plurality op at 15).

any such proposition.[5] Neither the Supreme Court nor any federal Court of Appeals has held that Rule 13 (a) has been rendered superfluous by the evolution of federal common law of res judicata, nor could the courts reach that issue except in the context present here, because in cases brought in federal court, Rule 13 (a) would govern the result, rendering any incidental discussion of federal common law pure dicta.[6]

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[5] For example, Polymer Industrial Products Co. v Bridgestone/Firestone, Inc. (211 FRD 312, 318, affd 347 F3d 935 [Fed Cir en banc]) is a case in which the Federal Circuit reaffirmed its rule that a lawsuit alleging patent infringement is a compulsory counterclaim under Rule 13 (a) to an initial declaratory action for noninfringment. There is no question that claim preclusion would bar the filing of a counterclaim that was merely a mirror image of the initial claim – not because the two claims arose from the same transaction or occurrence, but because the separate litigation of one after the other was decided would constitute an attempt to relitigate the first judgment. Monahan v New York City Dep't of Corrections (214 F3d 275, 279-280 [2d Cir 2000]) held that corrections officers were barred by the doctrine of res judicata from bringing the exact same claim previously brought and lost by "by the president of the Correction Officers' Benevolent Association, [] the exclusive bargaining agent for New York City correction officers." Again, traditional principles of claim preclusion would prevent separate parties in privity from retrying the same claim against the same defendant. Ross v Bd. of Educ. (486 F3d 279 [7th Cir 2007]), is a case in which res judicata barred a student who had previously sued the school district for violation of the IDEA from bringing a second suit against the district for violations of the ADA, the Rehabilitation Act, and the Civil Rights Act, arising out of the same conduct that underlay the initial lawsuit. Here too, traditional principles of res judicata (claim splitting) – not some "expanded" form of res judicata – barred her claim. Importantly, none of the cases relied on by the plurality involve a counterclaim that is not merely a mirror image of the initial claim.

[6] In fact, "the doctrine applied by most courts seems to be the converse. That is, absent the compulsory counterclaim rule, a pleader is never barred by res judicata from suing independently on a claim that he refrained from pleading as a counterclaim in a prior action" (6 Fed Prac & Proc Civ § 1410 [3d ed]). At most, there are no "uniform" rules of res judicata, because some federal Courts of Appeals appear to adhere to the narrower conception of res judicata (see e.g. Martino v McDonald's Sys., Inc., 598 F2d 1079, 1083 [7th Cir 1979] ["(L)ong-standing principles of res judicata establish a narrowly defined class of 'common law compulsory counterclaims . . . For cases like this one, to which Rule 13 (a) is inapplicable, Martino's argument correctly states the general rule. When facts form the basis of both a defense and a counterclaim, the defendant's failure to allege

Second, and much more fundamentally, the doctrine of claim preclusion, which derives from the doctrines of merger and bar, protects the finality of a judgment; courts could not exist unless their judgments meant something, and to mean something, the same essential claim cannot repeatedly be retried by the losing party, in hope of winning someday. Therefore, a plaintiff cannot bring the same or related claims over and over, and the defendant cannot try to attack the original judgment by bringing his or her own claims later. A counterclaim rule, on the other hand, reflects a judgment about whether it would be more efficient to litigate a different claim by a different party in the original lawsuit or a separate lawsuit. A litigant in federal court who chooses not to file a compulsory counterclaim is barred from filing that claim later in federal court, because the federal courts have made a procedural choice that efficiency and fairness would best be served by hearing all claims at once if they arise from the same transaction or occurrence, unless the district court bifurcates the claim for efficiency's sake.[7] The efficiency determination by federal courts is not implicated when a suit is later brought in state court, because a federal court is in no way burdened by the filing of the state court action. With its permissive counterclaim rule, New York has made a different efficiency choice about procedure, and its courts will bear whatever burden there is in hearing a second case.

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these facts as a defense or a counterclaim 'does not preclude him from relying on those facts in an action subsequently brought by him against the plaintiff.'")

[7] See 18 Fed Prac & Proc Juris § 4414 [3d ed] ["(S)ubsequent litigation so close to the first action as to present questions of defendant preclusion ordinarily 'arises out of the transaction or occurrence that (was) the subject matter of' the first action, and is foreclosed by direct operation of Rule 13(a)"] [emphasis added]).

Of course, a federal court judgment would preclude a defendant from bringing a state court action that would nullify that federal judgment or impair the rights established in the first action; that is the purpose of claim preclusion. Additionally, because of the procedural choice made in Rule 13 (a), a defendant would be barred from bringing his or her counterclaim – even if it would not be barred by claim preclusion – in a separate federal court action, because the Federal Rules have made an efficiency judgment about how cases will proceed, and the procedural rules of the federal courts apply to the second action if attempted in federal court.[8] It would be quite strange, though, for the federal court to "extend" the preclusive effect of its judgment to a subsequent claim, arising from the same transaction or occurrence, brought by a defendant seeking to litigate a state law claim and have his or her own day in state court, where the state has made the choice to allow a defendant that option. Unless a judgment on the separately-filed claim would nullify or undermine the federal judgment, federal courts have neither a res judicata interest nor an efficiency interest in that outcome.

[8]A compulsory counterclaim rule is not the only option. A court could adopt a counterclaim rule requiring that, when A sues B, both A and B must join every claim they have at the time against each other, even if the claims have no common factual nexus. Likewise, a court rule could say nothing about counterclaims, and allow claims (not otherwise barred by res judicata) to be brought in separate actions or not. A court could even have a procedural rule barring the bringing of counterclaims (other than those that would be barred by res judicata). Yet, in none of those cases is the counterclaim rule necessary to preserve the meaning of the court's judgment. Res judicata is what protects the judgment and the rights of the parties established in that judgment, regardless of the counterclaim rule.

The plurality relies on the history of what constitutes a "claim" for purposes of federal claim preclusion to support its conclusion that federal res judicata now encompasses the compulsory counterclaim law. However, the plurality fails to recognize the different effects of claim preclusion on plaintiffs and defendants. The "expansion" the plurality refers to – what constitutes a claim for purposes of claim preclusion – relates to restrictions on plaintiffs' "claim splitting." When a final judgment is rendered in favor of the plaintiff, the plaintiff cannot later bring an action on the original claim or any claims that arose out of the same transaction or occurrence, because his or her claims "merged" into the original judgment. Such a rule protects "the interests of the defendant and of the courts in bringing litigation to a close" (Restatement [Second] of Judgments § 24 cmt b [1982]). Contrary to the plurality's contention, procedural changes (e.g., rules about joinder of parties) allowed for such an expansion to take place, but the expansion was not a necessary result of such changes.

Claim preclusion restricts the defendant, too, but in different ways. Absent a compulsory counterclaim rule, there are two situations where a defendant in the first action may be barred from bringing a second action on a claim that could have been raised in the first action: where successful prosecution of the counterclaim in a subsequent action would (1) nullify the original judgment or (2) impair the rights of the parties established in the first action (see Valley View Angus Ranch, Inc. v Duke Energy Field Servs., Inc., 497 F3d 1096, 1101 [10th Cir 2007]; Martino v McDonald's Sys., Inc., 598 F2d 1079, 1084-85 [7th Cir 1979]; 18 Fed Prac & Proc Juris § 4414 [3d ed]; Restatement [Second] of Judgments §

22 cmt f [1982]). "For such an occasion to arise, it is not sufficient that the counterclaim grow out of the same transaction or occurrence as the plaintiff's claim" (Restatement [Second] of Judgments § 22 cmt f). It does not matter that the facts relevant to a counterclaim are also relevant to a defense asserted: "[A]fter litigation of the defense judgment is given for the defendant, the defendant is not precluded by the rule of merger from maintaining a subsequent action against the plaintiff based upon these facts. In the subsequent action, the rules of issue preclusion will apply to issues litigated and determined in the first action" (Restatement [Second] of Judgments § 22 cmt d). Nor does it matter that the counterclaim itself could also have been raised as a defense: "The failure to interpose a defense to the plaintiff's claim precludes the defendant from thereafter asserting the defense as a basis for attacking the judgment. But the defendant's claim against the plaintiff is not normally merged in the judgment given in that action, and issue preclusion does not apply to issues not actually litigated. The defendant, in short, is entitled to his day in court on his own claim" (id. cmt b; see also Valley View Angus Ranch at 1101 n 6).

III.

Under both federal and state claim preclusion law, Paramount's claim is not barred. Neither precludes a defendant from bringing a claim arising from the same transaction or occurrence as the plaintiff's claim, unless doing so would nullify the judgment or impair the rights established in the first action. In federal court, Rule 13 (a) would prevent the defendant from filing separately. This case is not in federal court, our rules – not federal rules – apply, and whether wisely or unwisely, New York has made a different procedural

choice. Thus, the only question is whether litigation of Paramount's covenant-not-to-sue claim would nullify the federal court judgment or impair the rights of the parties from the first action.

Although Paramount's claim for breach of the covenant not to sue arises from the contract, it does not in any way attack the judgment or impair Allianz's rights from the first action. How could it when Paramount was victorious in the first action? Issue preclusion would prevent Allianz from relitigating issues it lost, but neither federal nor New York rules of claim preclusion restrict Paramount from bringing its claim for breach of the covenant not to sue in a separate state court action.[9] I therefore dissent.

[9] It is hardly clear that Paramount's claim for breach would constitute a compulsory counterclaim under Rule 13 (a). In affirming the district court, the United States Court of Appeals for the Second Circuit noted that Allianz "do[es] not assert that Paramount committed any misconduct or wrongdoing apart from the misrepresentations or omissions Paramount purportedly made in the offering documents" (Marathon Structured Finance Fund, LP v Paramount Pictures Corp., 622 Fed Appx 85 [2d Cir 2015]). The district court held that the offering statements were truthful, which finding the Second Circuit affirmed. Alllianz's claims arose from the alleged falsity of the offering statements; Paramount's claim for breach arises from a specific contract provision, not the offering statements. The parties cite no law, apparently because there is none, in which a court has held that Rule 13 (a) requires a claim of breach of a contractual covenant not to sue be filed as a compulsory counterclaim to a fraud claim. The plurality contends that the absence of law on this point is because parties always state breaches of the covenant not to sue as counterclaims, not separate lawsuits, and cites some examples. Here are some examples of litigants who took the opposite approach: see e.g. Grendene USA, Inc. v Brady, 2015 WL 1499229, at *3 [SD Cal 2015] [holding breach of covenant not to sue claim was not compulsory under FRCP 13 (a) because "(the prior action) involves facts dealing with alleged infringement. . . This action involves facts dealing with the Bradys decision to file a lawsuit based on that alleged infringement. . . These are separate facts as the decision to bring a legal cause of action is separate from the elements of that cause of action"]; Gramercy Advisors, LLC v Ripley, 2014 WL 4188099, at *8 [SD NY 2014]; Oracle Corp. v ORG Structure Innovations LLC, 2012 WL 12951187, at *5 [ND Cal 2012]; Abbott v Okoye, 2010 WL 3220184, at *3 [ED Cal 2010], affd 460 F Appx 678

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Order, insofar as appealed from, affirmed, with costs. Opinion by Judge Garcia. Judges Stein and Fahey concur. Judge Rivera concurs in result in an opinion, in which Chief Judge DiFiore concurs. Judge Wilson dissents in an opinion. Judge Feinman took no part.

Decided February 20, 2018

[9th Cir 2011]. Permissive counterclaim jurisdictions give defendants the choice; defendants make different choices based on their strategic judgments.