IN THE UNITED STATES DISTRICT COURT

FOR THE WESTERN DISTRICT OF WISCONSIN

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GREAT LAKES HIGHER EDUCATION GUARANTY CORPORATION, a Wisconsin non-profit corporation,

Plaintiff,

v.

EDFUND, INC., a California non-profit public benefit corporation,

Defendant.

OPINION AND ORDER

99-C-0786-C

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Like the summer zucchini crop, this case is growing out of control. It began as a straightforward contract claim for money damages brought by plaintiff Great Lakes Higher Education Guaranty Corporation against defendant EdFund, Inc. after the failure of the parties' agreement for development of software for processing student financial aids. Both parties provide student loan guarantee services. Plaintiff is located in Wisconsin and provides services for that state and others; defendant is located in California and provides services for that state. Both parties utilize automated data processing systems to process loan applications, track loan status, administer claims and process collections.

Plaintiff filed this case on December 13, 1999. By stipulation and court order, the parties agreed that defendant did not have to file and serve its answer until March 6, 2000. On that day, defendant filed an answer and sixteen counterclaims. In the caption of the pleading, it named "Does 1 through 100" as "counterdefendants." On April 10, 2000, plaintiff filed a motion for stay pending arbitration of the dispute or, alternatively, a motion to dismiss ten of the sixteen counterclaims. In addition, it filed a "conditional answer" to all of the counterclaims that would become operative as to the ten counterclaims it had moved to dismiss only if its motion for stay was denied.

On June 9, 2000, while plaintiff's motion to dismiss was under advisement, defendant filed amended counterclaims under an amended caption in which it added Great Lakes Higher Education Servicing Corporation and Great Lakes Loan Services, Inc. to the 100 Does it had named as counterdefendants previously. Defendant did not move for leave of court to amend or file a stipulation of the parties agreeing to the proposed amendment.

Although defendant continued to assert sixteen counterclaims, they were not all the same counterclaims asserted in its first pleading. For example, defendant added a claim of copyright joint authorship under its agreements with plaintiff (new count two), deleted its claim of intentional interference with prospective economic advantage (old count twelve), added a claim of deceit and fraudulent concealment (new count thirteen), a claim of constructive fraud

(new count fourteen) and made a number of other changes. With these changes, portions of plaintiff's motion to dismiss needed revision. Before initiating a new round of briefing on the amended counterclaims, I held a status conference with counsel and advised defendant that I would not consider its new counterclaims until it had filed a motion for leave to amend its counterclaim and also that the purported "counterdefendants" could not be counterdefendants when they had never filed a claim that defendant could counter. I anticipated that defendant would file the same amended answer and counterclaim and a third party complaint, together with a motion for leave to file the amended pleadings. On July 5, 2000, defendant did file an amended answer, counterclaim and third party complaint, together with a brief in support, but in its new amended answer, defendant dropped any claims against the 100 Does, Great Lakes Higher Education Servicing Corporation and Great Lakes Loan Services, Inc., named Great Lakes Higher Education Corp. as a third-party defendant, dropped many of its counterclaims and filed four completely new ones for a total of ten counterclaims. Plaintiff filed a brief in opposition to the motion to amend on July 17, 2000. Before that date, defendant filed a motion of dismissal of counts five, six, seven, twelve, fourteen, fifteen and sixteen of the counterclaims it had asserted in its original answer, filed on March 6.

The case is before the court now on defendant's motions to file the amended answer, counterclaims and third party complaint and to dismiss claims from its original answer.

Plaintiff objects to both motions, expressing some of the same frustration I have experienced in trying to deal with the constantly shifting nature of defendant's counterclaims and "counterdefendants." Plaintiff states that it will withdraw its objections to the amendment if the counterclaims are limited to those asserted in the original pleading and not abandoned subsequently and if Great Lakes Higher Education Corp. is not added as a third party defendant. The counterclaims in the proposed answer to which plaintiff does not object are defendant's claims of declaratory relief as to copyright joint authorship (count one); copyright joint authorship under the parties' agreements program (count two); copyright infringement (count three); false designation of origin under the Lanham Act (count four); breach of contract (count five); and unjust enrichment (count ten).

In the event that some or all of defendant's proposed counterclaims are allowed to go forward, plaintiff asks for an award of attorney fees and costs for the time it spent responding to the counterclaims in the original answer that defendant has now withdrawn. If defendant is allowed to pursue its claim of breach of fiduciary duty, plaintiff asks that defendant be required to turn over certain materials it has withheld from discovery as subject to attorney-client privilege. Additionally, plaintiff wants the court to order defendant to provide a bill of particulars relating to its claim of copyright infringement.

Defendant will not agree to plaintiff's proposal, making it necessary to review the

proposed amendment to determine whether it is in the interests of justice to allow it. See Fed. R. Civ. P. 15(a). Plaintiff contends that defendant's sixth, seventh, eighth and ninth proposed counterclaims would not survive a motion to dismiss; therefore, it would be futile to approve an amendment to assert these claims. See, e.g., Estate of Porter v. State of Illinois, 36 F.3d 684, 690 (7th Cir. 1994) (amendment is futile gesture when it would not survive motion for summary judgment).

Defendant's sixth counterclaim is labeled breach of covenant of good faith; its seventh counterclaim is labeled "Misrepresentation Inducing EdFund to Enter into Partnership with Great Lakes"; its eighth counterclaim is inducing breach of a fiduciary duty and its ninth counterclaim is headed "Breach of Fiduciary Duty Deriving from Partnership." Before assessing the viability of these claims, it is necessary to determine whether the counterclaims would be governed by Wisconsin or California law. That question arises because the parties agreed in the project agreement they signed that the governing law would be that of the party being sued. See Art. 4(I) ("any dispute . . . shall be governed and determined by the law of the defendant party's situs"). That determination rests on the nature of the counterclaims, that is, whether they are permissive or compulsory counterclaims. Although plaintiff brought the suit, defendant is not necessarily the party being sued when it comes to the counterclaims it is asserting. As to any compulsory counterclaims, defendant has no say in the choice of forum or

the applicable law; it is now or never for those claims. See, e.g., Burlington Northern Railway v. Strong, 907 F.2d 707, 710 (7th Cir. 1990) (if counterclaim is compulsory and party does not bring it in original suit, that claim is barred thereafter). Assuming that Art.4(I) was made part of the parties' agreement as a brake on either party's resorting to litigation too readily, the provision should be applied so as to treat defendant as a plaintiff only as to those counterclaims that could be reserved for another suit. Therefore, California law will apply to the compulsory counterclaims; Wisconsin law will apply to the permissive counterclaims.

The next question is determining which claims are compulsory. Fed. R. Civ. P. 13(a) governs compulsory counterclaims. It defines such a counterclaim as one "that arises out of the transaction or occurrence that is the subject matter of the opposing party's claim." The rule has been interpreted as encouraging the "simultaneous and final resolution of all claims which arise from a common factual background," Warshawsky & Co. v. Arcata National Corp., 552 F.2d 1257, 1261 (7th Cir. 1977), and having as its purpose "to prevent multiplicity of actions and to achieve resolution in a single lawsuit of all disputes arising out of common matters," 6 Charles Alan Wright et al., Federal Practice and Procedure § 1409 (2d ed. 1990).

Of the four disputed counterclaims, the sixth and seventh are clearly compulsory: the sixth goes to the contractual duties of both parties and, if proven, might serve as a defense to plaintiff's claim of breach of contract; the seventh might establish that the contract was void

from the beginning. A fair reading of the ninth counterclaim suggests that it too might be classified as compulsory.

The fact that these three counterclaims appear to be compulsory does not mean that defendant can pursue them in this case. The sixth counterclaim (breach of the duty of good faith and fair dealing) can go forward. In essence, it is not much more than an affirmative defense and, whatever the state of Wisconsin law on this subject, California law appears to recognize an independent cause of action for breach of the covenant of good faith. The seventh and ninth counterclaims are a different matter. Plaintiff objects to these claims as untimely, because they were never raised earlier in these proceedings, and as futile. They are both. Initially, the allegations of the seventh counterclaim (misrepresentation inducing defendant to enter into partnership agreement) fall short because the who, what, where, when and how of the alleged misrepresentation are not stated, as required under Fed. R. Civ. P. 9(b) ("In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity."). No one reading the proposed amended answer can tell what representations plaintiff is alleged to have made. There are no statements quoted, no spokesperson identified, and no detail given about any time or place where misstatements are alleged to have been made. I will not allow defendant to amend to add this counterclaim.

As to the ninth counterclaim, there is the problem that nothing in the pleadings shows

that plaintiff tried to make defendant its partner or that it succeeded. Defendant's conclusory and unsupported allegations to that effect will not suffice, particularly in the face of the parties' memorandum of understanding and project agreement that are part of the pleadings, in which the parties specified in extensive detail that their relation was *not* to be construed as that of a partnership. See, e.g., Memorandum of Understanding, Art. IX ("This Agreement shall not constitute, create, give effect to, or otherwise imply a joint venture, partnership, pooling arrangement or business organization of any kind. The Parties are independent Parties and neither shall act as an agent for or partner of the other for any purpose . . . ."); Project Agreement, Art. H ("Nothing in this Agreement is intended or to be construed to make Great Lakes and EdFund partners or joint venturers, or to make the employees, agents or representatives of Great Lakes into employees, agents or representatives of EdFund, or the employees, agents or representatives of EdFund into employees, agents or representatives of Great Lakes.") I will deny defendant's proposed amendment as it relates to the supposed "partnership" relation between the parties.

The eighth counterclaim is a conundrum, at least at this point. It relates to the alleged inducement of defendant's chief executive officer to jump ship and join plaintiff. It is arguable that this is a permissive counterclaim because the issues of fact and law raised by the inducement claim are not the same as those raised by plaintiff's breach of contract claim. If it

is permissive, Wisconsin law would govern, with the result that Wisconsin's economic loss doctrine might bar defendant from bringing this claim as anything but a breach of the parties' contractual agreement that they would not solicit, recruit, hire or otherwise employ the employees of the other during the term of the agreement or for one year afterward. In this event, it is harder to argue that the claim is one that is separate and distinct from plaintiff's breach of contract claim.

Under the economic loss doctrine, when there is a breach of a contract to which commercial entities are party and there is no personal injury or damage to other property resulting from the breach, the parties are limited to the remedies for which they contracted. They may not seek remedies under tort theories. See, e.g., Daanen & Janssen, Inc. v. Cedarapids, Inc., 216 Wis. 2d 395, 400, 573 N.W.2d 842, 844-45 (1998) (applying doctrine to commercial entity's purchase of product that did not meet its expectations). See also Miller v. U.S. Steel Corp., 902 F.2d 573, 574 (7th Cir. 1990) (holding that "tort law is a superfluous and inapt tool for resolving purely commercial disputes" as opposed to purely economic ones). The rationale for the doctrine is that it maintains the fundamental distinction between tort and contract law; it protects the freedom of commercial parties to allocate economic loss by contract; and it encourages the commercial purchaser to assume or insure against the risk as the party best situated to assess that risk. See Daanen & Janssen, Inc., 216 Wis. at 403, 573

N.W.2d at 846.

The question is sufficiently complex that I cannot say with certainty at this time whether this counterclaim should be treated as compulsory or permissive or, if the latter, whether the economic loss doctrine would bar the claim. Therefore, I will allow defendant to go forward with this counterclaim. However, I agree with plaintiff that defendant cannot pursue this claim unless it is willing to disclose to plaintiff the materials that it contends were given to plaintiff in violation of defendant's chief executive officer's fiduciary duty. Only if defendant forswears any reliance on these materials and makes it clear that it will not make any reference to the allegedly misappropriated confidential materials will it be relieved of its duty to make immediate disclosure.

This leaves only one amendment issue: whether defendant should be permitted to add plaintiff's parent as a third party defendant. Plaintiff argues that the proposed amendment is untimely and that allowing it would slow the progress of the litigation considerably because the parent corporation would have to be given an opportunity to move to dismiss the counterclaims; it would need time beyond the previously set deadline to name expert witnesses; and it might want to assert a third party counterclaim against defendant and perhaps against CSAC, another California entity associated with defendant, which would add further delay to the proceedings.

This case has been pending for eight months. The trial date is less than six months away. Defendant has offered no reason for its late effort to add plaintiff's parent, except to say that it only recently became aware of the fact that the parent owns one of the software programs in dispute; its only excuse for the late discovery of this fact is that it did not engage in the necessary discovery earlier. I see no reason to add further delay to this already drawn out litigation by allowing defendant to add another defendant on an issue that is tangential to the claim of breach of contract.

I am not persuaded that plaintiff is entitled to an award of attorney fees and costs for the time and expenses incurred in moving to dismiss claims that defendant has now withdrawn. Plaintiff is no worse off than it would have been if it had persuaded the court to grant its motion to dismiss. Its motion to dismiss was successful in persuading defendant to withdraw many of its claims; it was not a waste of time.

Defendant's motion to withdraw certain counterclaims it had alleged in its original answer will be denied as moot. The operative pleading is the amended answer and counterclaims filed on July 5, 2000, as amended by this order. It supersedes the original answer.

Plaintiff's request for a bill of particulars from defendant, identifying the bases for defendant's claim of copyright infringement will be denied. Plaintiff should be able to obtain

the same information through contention interrogatories. If plaintiff encounters resistance, it should file a prompt motion to compel.

ORDER

IT IS ORDERED that defendant EdFund, Inc.'s motion to file an amended answer is GRANTED; its motion to file amended counterclaims is GRANTED with respect to proposed counterclaims 1-6, 8 and 10; it is DENIED with respect to proposed counterclaims 7 and 9; its motion to file a third party complaint against Great Lakes Higher Education Corp. is DENIED; and its motion to withdraw certain counterclaims asserted in its original answer is DENIED as moot. FURTHER, IT IS ORDERED that no later than August 7, 2000, defendant is to withdraw in writing its claim of confidentiality as to the materials turned over to plaintiff by employees of defendant and heretofore identified as subject to the attorney-client privilege or is to state in writing that it will not pursue any claim as to which the allegedly confidential materials would be relevant. Plaintiff's request for a bill of particulars is DENIED.

Entered this 31st day of July, 2000.

BY THE COURT:

BARBARA B. CRABB
District Judge