UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re

MERCY HOSPITAL OF WATERTOWN, INC., d/b/a GENESIS HEALTHCARE OF NEW YORK,

Debtor.

Case No. 99-16945

FINSERV HEALTHCARE SYSTEMS, INC.,

Plaintiff,

v.

Adv. Pro. No. 01-90141

MERCY HOSPITAL OF WATERTOWN, INC., d/b/a GENESIS HEALTHCARE OF NEW YORK, and HCA GENESIS, INC.,

Defendants.

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF MERCY HOSPITAL OF WATERTOWN, INC. and HCA GENESIS, INC., as Assignees,

Counterclaimant and Third-Party Plaintiffs,

v.

TRIZETTO GROUP, INC.,

Third-Party Defendant.

APPEARANCES:

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Hon. Robert E. Littlefield, Jr., U.S. Bankruptcy Judge

MEMORANDUM-DECISION AND ORDER

The matter before the court is the Plaintiff's motion for dismissal of the Defendants' counterclaim and the third-party complaint filed by the Defendants and the Official Committee of Unsecured Creditors ("Creditors' Committee"). Jurisdiction over this matter pursuant to 28 U.S.C. §§ 157(a), 157(b)(1), 157(b)(2) and 1334(b) is considered below.

Facts

On December 28, 1999, the Plaintiff and the Debtor, both incorporated in New York and with principal places of business in New York, entered into a service agreement. Part One,

Attachment A, Attachment B, and Attachment C[1] of the service agreement specified the receivables reduction services for medical billing and the accounts receivable management services the Plaintiff agreed to provide to the Debtor. The periodic reports the Plaintiff agreed to generate were set forth on page 3, paragraph N of the service agreement and in Attachment B. Paragraph N did not list any report called a "cash flow model" or a "receivables projection." Part Three of the service agreement sets forth the service fees and costs the Debtor agreed to pay for those services.

In the part of the service agreement labeled "Agreement," the Debtor acknowledged that it had not been induced to enter into the agreement by any representation or warranty that was not set forth in the agreement and that the agreement embodied the entire understanding of the parties. The service agreement's warranties included performance of all services according to the provisions set forth in Part One of the service agreement. In another provision of the service agreement labeled "Entire Agreement," the parties agreed all prior agreements, promises or representations not contained in the service agreement were of no force and effect.

The service agreement also contained a provision called "Limitation of Liability." It provided for a one-year statute of limitations for any action arising out of the services under the agreement, except for an action based on gross negligence or fraud. The parties also agreed to a three-year statute of limitations for actions for non-payment of services and that Finserv would only be liable for special, indirect or consequential damages in the event of a "court conviction" of fraud or gross negligence. On May 24, 2001, the Plaintiff commenced an adversary proceeding against the Defendants, asking the court to establish as an administrative expense all

[1]None of the Attachments are included in the record currently before the court.

postpetition amounts due pursuant to the service agreement. According to the complaint, the Plaintiff rendered services to the Debtor from March 1, 2000 to March 31, 2001. The Plaintiff also asks the court to direct the Defendants to pay immediately the amounts allegedly due ($212,307.14, plus attorneys' fees and costs), and to take any actions necessary to assert surcharges against estate property pursuant to section 506(c).

On August 23, 2001, Defendant HCA Genesis, Inc. ("HCA"), receiver of the Debtor and, later, purchaser of certain assets of the Debtor, filed an answer. Largely a general denial, it also contained two affirmative defenses: (1) the complaint fails to state a claim upon which equitable relief can be granted, and (2) the complaint seeks an improper preference among administrative claimants. This answer did not contain a counterclaim or a third-party complaint. The Debtor, the other defendant in this action, filed an answer on December 5, 2001; it mimics the one filed by Defendant HCA.

On January 15, 2002, the court conducted a pretrial conference with the parties. During the conference, the parties informed the court of settlement discussions they were conducting. Based on these pending settlement talks, the court adjourned the conference.

On June 25, 2002, the Debtor's Chapter 11 case was dismissed. The court issued an order to show cause in the adversary proceeding as to why it should not be dismissed due to the dismissal of the underlying case. Prior to the return date and in response to the court's show cause, the parties filed a joint motion to retain jurisdiction. Citing *Porges v. Gruntal*, 44 F.3d 159 (2d Cir. 1995), they asserted that the court had the authority to retain jurisdiction over the adversary proceeding, despite dismissal of the underlying case, because judicial economy, convenience to the parties, fairness and comity existed. They argued the court was intimately familiar with the Debtor and its bankruptcy case, a scheduling order had been issued in May

2002, diversity jurisdiction did not exist so the matter would have to be decided by a New York Supreme Court and could not be considered by the district court, and a new proceeding in state court would add years and increased expenses resulting in substantial prejudice to the parties. Their motion papers contained many references to a "counterclaim" and a "third-party complaint," but neither of those had been filed prior to the court issuing the order to show cause.

On July 18, 2002, the Defendants filed another answer.[2] The second answer contained the same general denials and the same affirmative defenses as the original answer. It also contained the counterclaims and a third-party complaint, which are both the subject of the Plaintiff's motion to dismiss.[3]

Of the five causes of action set forth in the counterclaim and third-party complaint, two are against the Plaintiff only and three are against the Plaintiff and Trizetto Group, Inc. ("Trizetto"), the entity the Defendants allege acquired Finserv in December 1999. In the first cause of action, the Defendants and the Creditors' Committee allege the Plaintiff fraudulently induced the Debtor to enter into the service agreement by making false representations in December 1999. In the second cause of action, the cause of action labeled "breach of contract," the Defendants and the Creditors' Committee allege gross negligence and reckless conduct by the Plaintiff and breaches of the service agreement. There are no references to specific dates within the allegations.

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[2]The document labeled "Answer, Counterclaim, and Third-Party Complaint" is captioned with the Creditors' Committee as a counterclaimant and third-party plaintiff. However, counsel for the Creditors' Committee did not sign this pleading and has not filed a notice of appearance in this proceeding, possibly due to the dismissal of the underlying case.

[3]According to the court docket, the second answer was filed on July 18, 2002, but the filing dates for the counterclaim and the third-party complaint are both July 19, 2002. Since all three are part of the same document, the court is unable to explain the different filing dates.

The Defendants and the Creditors' Committee allege fraud by the Plaintiff and Trizetto in their third cause of action. They allege the Plaintiff, acting under direction and control of Trizetto, provided the Debtor with materially false and misleading projections in June 2000 and December 2000 which the Debtor, Defendant HCA, the Creditors' Committee, the Internal Revenue Service, and the court relied upon. The Defendants base their fourth cause of action on breach of fiduciary duty and constructive fraud. They allege the Plaintiff and Trizetto had superior knowledge and professional expertise, and both caused the Debtor, Defendant HCA, and the Creditors' Committee to depend upon them for the collection of the Debtor's receivables. They also allege the duty of reasonable care arose from the relationships of the parties, the bankruptcy case, and the public interest in seeing the service agreement performed with reasonable care.

Although the Defendants allege the December 1999, June 2000, and December 2000 dates, they allege very few additional dates in their counterclaim and third-party complaint. Paragraph 64(b), part of the third, fourth and fifth causes of action, contains the latest in time date; it alleges the Plaintiff and Trizetto were aware that projections for November 2001 were overstated by 80%. Paragraph 64, however, contains representations surrounding the December 2000 Receivables Projection; thus, it appears the November 2001 date is merely a typographical error. Other than paragraph 14's allegation that Mercy Hospital operated a nursing facility "[p]rior to July 2001," and paragraph 64(a)'s allegation that the Plaintiff had no basis in fact for projecting the collection of $3,000,000 by February 28, 2001, the Defendants do not allege any other 2001 dates.

Paragraphs 2, 29, 30, 31, 36, 44- 45, 47, 49, 50-69, 73 and 75-77 of the counterclaim and third-party complaint contain many allegations. In those paragraphs, the Defendants and the

Creditors' Committee allege that: (1) Finserv and Trizetto knew the receivables constituted a material proportion of the Debtor's total revenues and that its viability depended upon its efficient collection; (2) Finserv said it understood the Debtor's receivables situation and stated it had the experience, resources and capability to manage, bill and collect them; (3) Finserv assumed sole control over billing and collection of the receivables, rendering the Debtor entirely dependent upon it; (4) Finserv and Trizetto knew the Defendants, the Creditors' Committee and the court would rely upon its analysis and projections of income attainable from the receivables; (5) Finserv and Trizetto made oral and written representations regarding the receivables that were materially false and misleading; (6) the Defendants and the Creditors' Committee justifiably reposed their trust and confidence in Finserv and Trizetto and relied upon their advice, judgment and projections; and (7) there is a "public interest" in having the service agreement performed with reasonable care for both the Debtor's continuing viability and proper proceedings in the court.

In the wherefore clauses, the Defendants seek dismissal of the complaint. Defendant HCA also seeks actual damages of not less than $4,000,000, exemplary or punitive damages of $1,000,000, costs, expenses, and attorneys' fees. Although its counsel did not sign the pleading, the Creditors' Committee seeks actual damages of $250,000.

On July 8, 2002, ten days before the second answer was filed, the parties had filed a stipulation which set the date by which the Plaintiff had to file an answer to the counterclaim and Trizetto had to file an answer to the third-party complaint. Instead of an answer, the Plaintiff and Trizetto filed the instant motion to dismiss the counterclaim and third-party complaint on September 9, 2002.

The Defendants[4] filed opposition to the dismissal motion. In an affidavit filed with the opposition papers, counsel for the Counterclaimant and Third-Party Plaintiffs alleges he disclosed the nature of the counterclaims to Finserv's and to Trizetto's counsel in August 2001. He also alleges each of their attorneys agreed the counterclaims did not need to be served while they pursued settlement negotiations. According to him, at a conference conducted by the court, their counsel agreed an amended answer and counterclaims could be filed and served according to a schedule agreed to by the parties and ordered by the court. The court does not recall that hearing and has not found that agreement in the record.

At the July 19, 2002 hearing on the court's show cause, the court heard the arguments of the parties. Since they were filed on or about that same date, the court had not reviewed the second answer, counterclaim, and third-party complaint prior to the hearing. On August 16, 2002, the court signed an order prepared by the parties, retaining jurisdiction over the adversary proceeding. The court does not recall reviewing the second answer, counterclaim, and third-party complaint prior to signing that order.

The Plaintiff's motion to dismiss was initially scheduled for a hearing on October 24, 2002. It was adjourned at the request of the parties on several occasions. On January 8, 2003, the parties informed the court that they did not require oral argument.

Arguments

The Plaintiff and Trizetto argue the court should dismiss the counterclaim and third-party complaint for failure to state a claim as required by Fed. R. Civ. P. 12(b)(6) and Fed. R. Bankr. P. 7012(b). Additionally, the Plaintiff and Trizetto argue the fraud claims should be dismissed

[4]Counsel for the Creditors' Committee did not sign the opposition to the dismissal motion.

for failure to plead fraud with particularity pursuant to Fed. R. Civ. P. 9(b) and Fed. R. Bankr. P. 7009.

Another one of the Plaintiff's and Trizetto's main contentions is the Defendants and the Creditors' Committee have merely recast breach of contract causes of action as gross negligence and fraud causes of action in order to escape the service agreement's one-year statute of limitations provision. Citing *Clark-Fitzpatrick, Inc. v. Long Island R.R. Co.*, 70 N.Y.2d 382 (1987), they contend no tort claim lies in a contract case unless a violation of a legal duty independent of the contract itself has occurred. They assert neither the counterclaim nor the third-party complaint contains an allegation regarding an independent legal duty. To them, the Defendants and the Creditors' Committee simply allege violations of the contractual duties of managing, collecting, analyzing, and reporting on the collection of the receivables as required under the service agreement, not duties that were independent of that agreement.

The Plaintiff and Trizetto further contend the third-party complaint should be dismissed because what the Defendants and the Creditors' Committee have alleged does not meet the third-party practice requirements of Fed. R. Civ. P. 14(a). The Plaintiff and Trizetto point out the third-party complaint does not contain a single allegation that Trizetto is liable to the Defendants and to the Creditors' Committee for all or part of the Plaintiff's claim against them. They also contend the third-party complaint does not allege sufficient facts to pierce the corporate veil.

Finally, the Plaintiff and Trizetto argue the Creditors' Committee has no standing to sue. They assert the caption describes the Creditors' Committee as an assignee of the Debtor's claims, but the counterclaim and the third-party complaint do not contain any allegations regarding its status. They note the sale order only provided the Creditors' Committee with an economic interest in a portion of the net proceeds of any successful prosecution brought by HCA

against Finserv; it did not assign any causes of action to the Creditors' Committee. They also note the counterclaim and the third-party complaint do not contain any allegations of a cognizable injury Trizetto caused the Creditors' Committee.

In response, the Defendants and the Creditors' Committee contend the statute of limitations set forth in the service agreement does not bar their causes of action. According to them, the allegations contained in their second (breach of contract), fourth (breach of fiduciary duty/constructive fraud) and fifth (gross negligence) causes of action are based upon gross negligence or fraud within the specific meaning of the agreement's limitations provision and are not time-barred.

The Defendants and the Creditors' Committee also contend that Finserv and Trizetto have either waived the statute of limitations defense, or should be estopped from asserting it. To support this argument, the Defendants and Creditors' Committee refer to their counsel's affidavit. They do not, however, cite a transcript of the hearing where counsel for the Plaintiff and Trizetto allegedly agreed to the filing of an amended answer and a counterclaim, and they do not state when this alleged agreement was entered into, filed, or ordered by the court.

The Defendants and Creditors' Committee argue they allege facts sufficient to support the existence of a fiduciary duty in their third cause of action, and those allegations are incorporated in their fourth cause of action. To support their contention, they refer to the allegations contained in paragraphs 2, 29, 30, 31, 36, 44- 45, 47, 49, 50-69, 73 and 75-77 of their second answer. They assert *Bridgestone/Firestone v. Recovery Credit Services, Inc.*, 98 F.2d 13 (2d Cir. 1996), supports their legal argument that Finserv and Trizetto breached their fiduciary duty to them. They argue they have pled all of the elements described in that case, including allegations that Finserv and Trizetto occupied a position of trust or confidence that imposed

obligations beyond the service agreement and exercised sole knowledge and control over the receivables. They also argue Finserv had discretion to exercise its obligations under the service agreement, unlike the defendant in *Bridgestone/Firestone*.

The Defendants and Creditors' Committee further contend *Brown v. Lockwood*, 76 A.D.2d 721 (2d Dept. 1980), supports their constructive fraud cause of action. They assert they have pled sufficient facts and circumstances to make out a case of constructive fraud based upon their allegations regarding Finserv's and Trizetto's superior knowledge and the false representations Finserv and Trizetto made which they reasonably relied upon.

As for their causes of action for gross negligence and fraud, the Defendants and Creditors' Committee refer to several paragraphs in their second answer, arguing the allegations in those paragraphs support those claims. They argue, once again, that the relationships among the parties, the circumstances of the bankruptcy proceedings, and public interest all gave rise to a fiduciary duty and the duty of reasonable care. They also cite the *Bridgestone/Firestone* decision as additional support.

Regarding the third-party designation and standing to sue, the Defendants and Creditors' Committee state they are willing to accede to the demand to remove the Committee as a counterclaimant if the Committee can retain its present economic interest in the net proceeds of any successful litigation as provided in the sale order. They argue their claims against Trizetto, however, are not controlled by Fed. R. Civ. P. 14, but by Rule 20, the federal rule of civil procedure that provides for permissive joinder of parties. They assert the joinder was within the scope of Rule 15(a) and the court's scheduling order; they also assert Trizetto "voluntarily appeared and moved without contesting jurisdiction." They are willing to change the third-party defendant designation if the court requires it.

Finally, the Defendants and Creditors' Committee argue that Trizetto mistakenly assumes the only allegations against it assert vicarious liability for Finserv's actions. They contend they are suing Trizetto for its own torts as set forth in their third, fourth and fifth causes of action. They point to paragraphs 19-21, 42 and 64 of their second answer, the paragraphs where they have alleged Trizetto acted through its own officers and employees and dominated and controlled Finserv's actions and decisions. At least one of its officers was closely involved in the June 2000 and the December 2000 alleged fraudulent misrepresentations. In addition to arguing those paragraphs contain the language they say they contain, the Defendants and Creditors' Committee go on to allege additional facts that are not contained in their second answer.

The Plaintiff and Trizetto respond that any claimed promise not to rely on the statute of limitations must be in writing under N.Y. Gen. Oblig. L. § 17-103, and no such writing exists here. According to them, the court must dismiss all causes of action not based on gross negligence or fraud as a matter of law since the service agreement provided for a one-year statute of limitations for all causes of action based on the contract. They contend the causes of action that are covered by that provision are the second (breach of contract), third (breach of fiduciary duty), and fifth (to the extent it is based on ordinary negligence).

The Plaintiff and Trizetto reiterate that the Defendants and the Creditors' Committee misplace their reliance on what they call the "alarm company cases"[5] because no such

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[5] The "alarm company cases" cited by the Defendants and the Creditors' Committee are *Fireman's Fund Ins. Co. v. ADT Sec. Sys., Inc.*, 847 F. Supp. 291 (E.D.N.Y. 1994*); Hanover Ins. Co. v. D&W Central Station Alarm Co., Inc.,* 164 A.D. 2d 112, 560 N.Y.S. 2d 293 (1st Dept. 1990); and *Rand & Paseka Mfg. Co., Inc. v. Holmes Protection, Inc*., 130 A.D. 2d 429, 515 N.Y.S. 2d 468 (1st Dept. 1987).

independent tort duty arises in an ordinary commercial context, especially when the alleged harm is solely economic injury. They argue the Defendants and the Creditors' Committee have not alleged any injuries like the personal injuries or the property damage that occurred in the alarm company cases. Once again, the Plaintiff and Trizetto contend the Defendants' and Creditors' Committee's claims are nothing more than breach of contract claims improperly dressed up as fraud and gross negligence claims in an attempt to avoid the statute of limitations bar.

Finally, regarding the Defendants' and the Creditors' Committee's claim that Trizetto is liable for its own torts, the Plaintiff and Trizetto argue that claim cannot go forward because it was not pled with the particularity required by Fed. R. Civ. P. 9(b).[6]

Discussion

The Plaintiff's motion to dismiss the counterclaim and the third-party complaint involves seven issues the court must determine: (1) its jurisdiction; (2) the Creditors' Committee's standing to sue; (3) Fed. R. Civ. P. 14 and third-party complaints in a bankruptcy proceeding; (4) counterclaims in a bankruptcy proceeding; (5) statute of limitations; (6) Fed. R. Civ. P. 12(b)(6) and the failure to state a claim in a bankruptcy proceeding; and (7) Fed. R. Civ. P. 9(b) and the failure to plead fraud with particularity in a bankruptcy proceeding. Those issues are addressed below.

I. Jurisdiction

In the adversary proceeding the Plaintiff commenced, it essentially seeks court approval

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[6]Counsel for the Defendants also filed a letter brief on November 13, 2002, and counsel for the Plaintiff and Third-Party Defendant requested that it be stricken. The court will not consider the contents of the letter brief due to the late date it was filed and the Defendants' failure to seek court permission to file a sur reply.

and payment of an administrative expense. The vehicle post petition creditors usually use to obtain such relief is a motion to approve allowance and payment of an administrative expense. *See* 11 U.S.C. § 503; Fed. R. Bankr. P. 9014. A motion to approve allowance and payment of an administrative expense is a core proceeding under 28 U.S.C. § 157(b)(2)(B), and the court has jurisdiction under 28 U.S.C. §§ 157(a), 157(b)(1) and 1334(b).

In their counterclaim, the Defendants and Creditors' Committee seek monetary damages from the Plaintiff for torts and fraud it allegedly committed against them. In their third-party complaint, they seek the same relief from an entity that was neither a creditor nor a party in the bankruptcy case. Post petition claims that a debtor may have against others, especially entities that are not parties in interest in the bankruptcy case, are not routinely adjudicated by the bankruptcy court. The court where jurisdiction would otherwise lie if the debtor had not filed a bankruptcy petition, be it a state or federal court, would usually decide those disputes.

The court finds the timing of the filing of the second answer very troubling. The Defendants and the Creditors' Committee filed the second answer, counterclaim and third-party complaint either the day before or on the return date of the court's order to show cause for dismissal of the adversary proceeding.[7] As found above, the court did not have time to read the document or consider its contents prior to the show cause/dismissal hearing. Despite the order it signed retaining jurisdiction, the court now believes that if the counterclaim and third-party complaint had been filed well in advance of the show cause/dismissal hearing, it would have followed the general rule that "related proceedings ordinarily should be dismissed following termination of the underlying bankruptcy case." *Porges v. Gruntal*, 44 F.3d at 162. Had it done

[7] *See* n. 3.

so, it certainly would have taken action to ensure the entire dispute was placed before the proper state or federal court.

II. Creditors' Committee's Standing

The court notes the absence of the Creditors' Committee signature on the second answer and on the papers filed in opposition to the Plaintiff's motion to dismiss the counterclaim and third-party complaint. The Committee is in the caption of the second answer and the papers filed in opposition to the Plaintiff's motion to dismiss the counterclaim and third-party complaint but, as found above, its attorney has not signed either document and has not filed a notice of appearance. Thus, the Committee has not yet appeared in this adversary proceeding.

Moreover, the alleged injuries happened to the Debtor. In a bankruptcy context, an injury to the debtor will often have the trickle down effect of monetarily damaging the debtor's prepetition creditors. An economic injury, however, does not automatically convey standing upon them to assert a claim against the alleged wrongdoer. Furthermore, in their memorandum of law opposing the motion to dismiss, the Defendants have essentially conceded the Committee only has an economic interest in a portion of the net proceeds of any successful action brought by HCA.

All of this leads the court to conclude the Committee does not have standing to pursue the counterclaim or the third-party complaint. The caption will be amended to reflect its dismissal from this proceeding, and the remainder of this decision will refer only to the Defendants as the counterclaimants and the third-party plaintiffs.

III. Fed. R. Civ. P. 14[8]

[8]Fed. R. Bankr. P. 7014 provides that Fed. R. Civ. P. 14 applies in adversary proceedings.

Fed. R. Civ. P. 14(a) provides that a defendant, as a third-party plaintiff, may bring in a third party by serving a summons and complaint upon a person not a party to the action who is or may be liable to the third-party plaintiff for all or part of the plaintiff's claim against the third-party plaintiff. It also provides that the third-party plaintiff does not need to obtain leave of court if the third-party plaintiff files the third-party complaint not later than 10 days after filing the original answer. If the third-party complaint is not filed within that time frame, the rule requires the third-party plaintiff to obtain leave on motion with notice to all parties.

The second answer does not contain a single allegation that Trizetto is or may be liable to the Defendants, the third-party plaintiffs here, for all or part of the Plaintiff's claim against the Defendants. Furthermore, as found above, the Defendants served the second answer, which contained the third-party complaint, almost one year after they had filed the original answer.

The Defendants argue they have raised their claims against Trizetto under Fed. R. Civ. P. 20, and their claims fall within the scope of the scheduling order and Fed. R. Civ. P. 15(a).[9] Rule 15 provides for amended and supplemental pleadings, and Rule 20 allows for permissive joinder of parties. Rule 20(a) provides, *inter alia*, all persons may join in one action as plaintiffs if they assert any right to relief jointly, severally, or in the alternative in respect of or arising out of the same transaction or occurrence. That same rule also provides for permissive joinder of persons as defendants if there is asserted against them jointly, severally, or in the alternative, any right to relief in respect of or arising out of the same transaction or occurrence.

Here, Trizetto does not seek to join as a plaintiff. Moreover, neither the Plaintiff nor the

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[9]Fed. R. Civ. P. 20 is made applicable in adversary proceedings via Fed. R. Bankr. P. 7020, and Fed. R. Bankr. P. 7015 provides that Fed. R. Civ. P. 15 applies in adversary proceedings.

Defendants seek to join Trizetto as a defendant in the adversary proceeding itself. While the Defendants want to sue Trizetto in this court for damages allegedly owed by it, the permissive joinder rule is not available to them to achieve that end. As for the scheduling order, it provides for amended pleadings like Rule 15 does; it also sets the time limit for filing amended pleadings. The scheduling order does not, however, contain any language overriding the requirements of the federal rules, especially where adding parties and entirely new causes of action are concerned. To the extent the Defendants thought it did, they were mistaken.

The court concludes the third-party complaint should be dismissed. Not only have the Defendants failed to follow the federal rule's time requirements, they are not using third-party practice for a proper purpose. Similar to the court's ruling regarding the Creditors' Committee, the third-party complaint is dismissed and the caption will be amended to reflect its dismissal from this proceeding.[10]

IV. Counterclaim[11]

Fed. R. Bankr. P. 7013 provides that Fed. R. Civ. P. 13 applies in adversary proceedings with some exceptions. In a bankruptcy adversary proceeding, a debtor in possession who fails to plead a counterclaim through oversight, inadvertence, or excusable neglect, or when justice so requires, may amend the pleading by leave of court. Fed. R. Bankr. P. 7013.

The record does not contain any evidence that the Defendants, one of whom is the Debtor

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[10]By dismissing the third-party complaint, the court has effectively dismissed, once again, the Creditors' Committee as a third-party plaintiff. Therefore, the "ORDERED" part of this decision will simply direct that the third-party complaint is dismissed and the caption amended to reflect its dismissal.

[11]The counterclaims issue, to the extent the statute of limitations comes int play, is also discussed below in part V of the decision.

and was the debtor in possession when the complaint was filed, failed to plead their counterclaims due to the Debtor's "oversight, inadvertence, or excusable neglect." The fact that the Defendants took almost one year to assert their counterclaims bolsters a conclusion that their omission was not due to "oversight, inadvertence, or excusable neglect." The late filing of the counterclaims and the fact that the original answer is essentially a general denial that does not contain allegations regarding the conduct, transaction, or occurrence which might have at least put the Plaintiff on notice of the Defendants' objection to paying what is still allegedly owed for services the Plaintiff rendered under the service agreement, strongly suggests leave to amend should not be granted to the Defendants. Even if the Defendants had alleged the conduct or transaction in their original answer, that would not have put the Plaintiff on notice of any affirmative claim they intended to pursue against it.

As found above, the Defendants' counsel has alleged that Plaintiff's counsel agreed to extend the time for filing an amended answer and counterclaim. If such a conversation had occurred, Plaintiff's counsel would have essentially agreed to extend the statute of limitations. The court has already found there is no record of that agreement between counsel. Based upon the lack of any record and the statute of limitations problems the Defendants face (which are discussed in part V below), the court discounts their allegation that the Plaintiff essentially agreed not to raise the statute of limitations by agreeing to additional time for the Defendants to file their counterclaim.

The court is inclined to dismiss the counterclaim based solely on its late filing. However, due to the Defendants' apparent confusion regarding the language in the scheduling order setting the filing date of any amended pleadings, the fact that all of the parties asked the court to retain jurisdiction despite the underlying bankruptcy case's dismissal, and because the court will hear

the trial on the complaint's causes of action, the court will consider the merits of any part of the counterclaim that survives the remaining arguments of the Plaintiff's motion to dismiss.

V. Statute of Limitations

As found above, the service agreement provides for a one-year statute of limitations for breach of contract causes of action arising out of services rendered under the agreement, except for actions based on gross negligence or fraud. Under New York law, parties may agree to shorten the statute of limitations for particular claims. *See* N.Y. Civ. Prac. L. & R. 201.

The Defendants describe the second cause of action in their counterclaim as a breach of contract. That is the only cause of action they identify that way. Despite the label they give it, in the paragraphs following the caption of the second cause of action, the Defendants allege gross negligence and reckless conduct by the Plaintiff as well as breaches of the service agreement.

The court agrees with the Plaintiff that the second cause of action merely restates the contractual obligations set forth in the service agreement. In that cause of action, the Defendants have not alleged a single duty the Plaintiff assumed other than the duties it agreed to perform under the service agreement; thus, the Defendants have not sufficiently stated a claim based on gross negligence. *See Clark-Fitzgerald, Inc.*, 70 N.Y.2d at 390.

If the Defendants are only able to prove mere negligence or a breach of contract at trial, the second cause of action will be dismissed unless the Defendants prove the negligence or breach of contract occurred within one year prior to July 19, 2002,[12] the date the counterclaim was filed, because of the one-year statute of limitations provision in the service agreement. The

[12]*See* n. 3.

court has already commented on the Defendants' failure to timely assert their counterclaim and their failure to give the Plaintiff notice of anything other than a general denial of the Plaintiff's allegations in the original answer. Furthermore, as found above, no 2001 dates are mentioned in the second cause of action of the counterclaim. For these reasons, the court is not persuaded that the statute of limitations should be tolled.

As for the fifth cause of action, the one the Defendants describe as negligence and gross negligence, the court will not dismiss it at this time due to the sufficient allegations of gross negligence contained in paragraphs 12 through 81. The allegations in those paragraphs include all of the allegations in the third cause of action. In the third cause of action, the Defendants allege the Plaintiff provided materially false and misleading receivables projections, reports not covered by the service agreement's provisions. Once again, however, if the Defendants only prove mere negligence at trial, they must prove the Plaintiff committed that tort within one year prior to July 19, 2002 due to the one-year statute of limitations provision.

VI. Fed. R. Civ. P. 12(b)(6)[13]

Under Fed. R. Civ. P. 12(b)(6), a plaintiff may make a motion to dismiss a counterclaim for failure to state a claim upon which relief can be granted. As found above, the counterclaim contains five causes of action: (1) fraud in the inducement; (2) breach of contract; (3) fraud; (4) breach of fiduciary duty/constructive fraud; and (5) negligence and gross negligence. The first and third causes of action are discussed in part VII below because they involve actions based solely on fraud. The court has already decided the counterclaim's second and fifth causes of action contain sufficient allegations of gross negligence to allow them to survive a motion to

[13]Fed. R. Civ. P. 12(b)(6) is made applicable in adversary proceedings via Fed. R. Bankr. P. 7012(b).

dismiss at this time. That leaves the fourth cause of action.

As the court has already found, in their fourth cause of action, the Defendants assert the Plaintiff had a fiduciary duty to them; they allege the Plaintiff had superior knowledge which they depended on for the management, collection and analysis of their accounts receivable. They also allege the relationships of the parties, the bankruptcy proceedings, and "public interest" give rise to a duty of reasonable care. At a glance, it seems they have sufficiently pled a cause of action based on a breach of fiduciary duty. The alleged breach, however, happened in a contractual setting, a context where parties generally deal at arms-length with no relation of confidence or trust sufficient to find the existence of a fiduciary relationship. *Mid-Island Hosp., Inc. v. Empire Blue Cross and Blue Shield*, 276 F.3d 123 (2d Cir. 2002).

In the *Mid-Island Hosp. Inc.* case, the Second Circuit states, "[a] debtor-creditor relationship is not by itself a fiduciary duty although the addition of 'a relationship of confidence, trust, or superior knowledge or control' may indicate such a relationship exists." *Id*. at 130 (citation omitted). The Second Circuit went on to state a fiduciary relationship only arises in a commercial transaction when "extraordinary circumstances" also exist. *Id.*

While the Defendants have used the very words of the Second Circuit when they allege in their counterclaim that the Plaintiff has "superior knowledge," merely mimicking the language contained in a controlling decision does not meet the procedural requirement of adequately pleading a breach of fiduciary duty cause of action. As for "extraordinary circumstances," the only ones that arguably existed here were that the Debtor was in bankruptcy and operated a hospital. The Defendants, however, have not cited any case law, statute, or regulation which imposes a fiduciary duty upon the provider of collection services to a hospital or post petition collection services to a debtor. To the court, the Defendants merely seek to impose a fiduciary

duty on the Plaintiff that they say is separate and distinct from those provided for in the service agreement in order to attempt to escape the one-year statute of limitations they face; thus, the court declines to consider the fourth cause of action and dismisses it.

VII. Fed. R. Civ. P. 9(b)

Fed. R. Civ. P. 9 applies in adversary proceedings via Fed. R. Bankr. P. 7009. Under Fed. R. Civ. P. 9(b), a party asserting a cause of action based on fraud must state the circumstances constituting fraud with particularity.

In their first cause of action the Defendants have pled fraud in the inducement. The court has found the service agreement contains a provision where the parties agreed the only representations the parties relied on in entering into the agreement were set forth in the service agreement, and a provision which stated all prior representations were of no force and effect. Although the Defendants' counterclaim contains causes of action based on alleged duties arising outside of the contract, they have never alleged or contended the service agreement is not the complete embodiment of their contractual relationship. Therefore, because the parole evidence rule would preclude the Defendants from introducing any evidence other than the service agreement and the agreement contained all of the representations, the Defendants cannot meet their burden of proving fraud in the inducement, and the court dismisses it.

As for the Defendants' third cause of action, in order to maintain a claim of fraud in a commercial transaction setting, the Defendants have to demonstrate: (1) a legal duty separate from the contractual duties; or (2) a fraudulent misrepresentation collateral or extraneous to the contract. *See Bridgestone/Firestone*, 98 F.3d at 19-20 and cases cited therein. The court has already determined the Defendants cannot show the Plaintiff owed them an independent legal duty, and they cannot prove what representations the Plaintiff made other than those in the

service agreement. The Defendants do not allege the Plaintiff made fraudulent misrepresentations in the service agreement.

Furthermore, the allegations they base their fraud claim on do not provide the Plaintiff with the specific "who, what, where, when" information required by Fed. R. Civ. P. 9(b) in a pleading seeking damages for fraud. For all of these reasons, the court dismisses the third cause of action.

Accordingly, it is

ORDERED, that the third-party complaint is dismissed, and the caption of the adversary proceeding shall be amended to reflect its dismissal; and it is further

ORDERED, that the first, third and fourth causes of action of the Defendants' counterclaim are dismissed; and it is further

ORDERED, that the Defendants may proceed on the second and fifth causes of action of their counterclaim to the extent set forth in this decision; and it is further

ORDERED, that all counsel shall attend a pretrial conference in this adversary proceeding on September 19, 2003 at 11:00 a.m. and be prepared to discuss the facts the parties can stipulate to, the facts that must be determined by the court after trial, the potential evidentiary issues at trial, the extent the causes of action in the complaint and the counterclaim can be submitted as a matter of law, and the length of the October 2003 trial.

It is so ORDERED.

Dated:

Hon. Robert E. Littlefield, Jr.
U.S. Bankruptcy Judge