

An accounting firm brought a federal diversity action against a former client for failing to pay for the firm's audit of the client's financial statements. After the client answered, the parties settled, and the court dismissed the action with prejudice. The client subsequently sued the firm for negligently performing the audit. The firm moved to dismiss the negligence action on the basis of res judicata (claim preclusion).

Is the court likely to grant the motion?

- A. No, because the firm's negligence was never raised or decided in the first action.
- B. No, because the first action was resolved by settlement.
- C. Yes, because the court dismissed the first action with prejudice.
- D. Yes, because the negligence claim was transactionally related to the claim in the first action and should have been asserted as a counterclaim.

Explanation:

Res judicata (claim preclusion) provides that a valid final judgment on the merits precludes the relitigation of identical claims between **identical parties**. Parties are identical if they occupy the same roles in the first and subsequent actions—eg, the same party must be the plaintiff in both actions. But when the same parties occupy **different roles** (as seen here), claim preclusion will still apply if a party violated the first court's **compulsory-counterclaim rule**.

Here, the accounting firm brought the first action in federal court. Under FRCP 13, a counterclaim is compulsory (ie, must be asserted) if it:

- arises from the **same transaction or occurrence** as the opposing party's claim *and*
- does **not require adding a party** over whom the court cannot acquire jurisdiction.

The client's negligence claim against the accounting firm was transactionally related to the firm's claim in the first action since both concern the same audit. Since the client's claim does not require adding any parties, it should have been asserted as a counterclaim in the first action. By violating the compulsory-counterclaim rule, the client is precluded from asserting that claim in the second action. Therefore, the court in the second action will likely grant the firm's motion to dismiss based on res judicata.

(Choice A) Although the firm's negligence was never raised or decided in the first action, claim preclusion bars a claim that *should* have been asserted in a prior action (as seen here).

(Choice B) A judgment entered due to a settlement is entitled to claim-preclusive effect. However, such a judgment does not trigger [issue preclusion](#), which requires actual litigation.

(Choice C) The fact that the first court dismissed the action with prejudice is insufficient by itself to trigger claim preclusion. That is because the claims in the first and second actions must also be transactionally related to trigger the compulsory-counterclaim rule.

Educational objective:

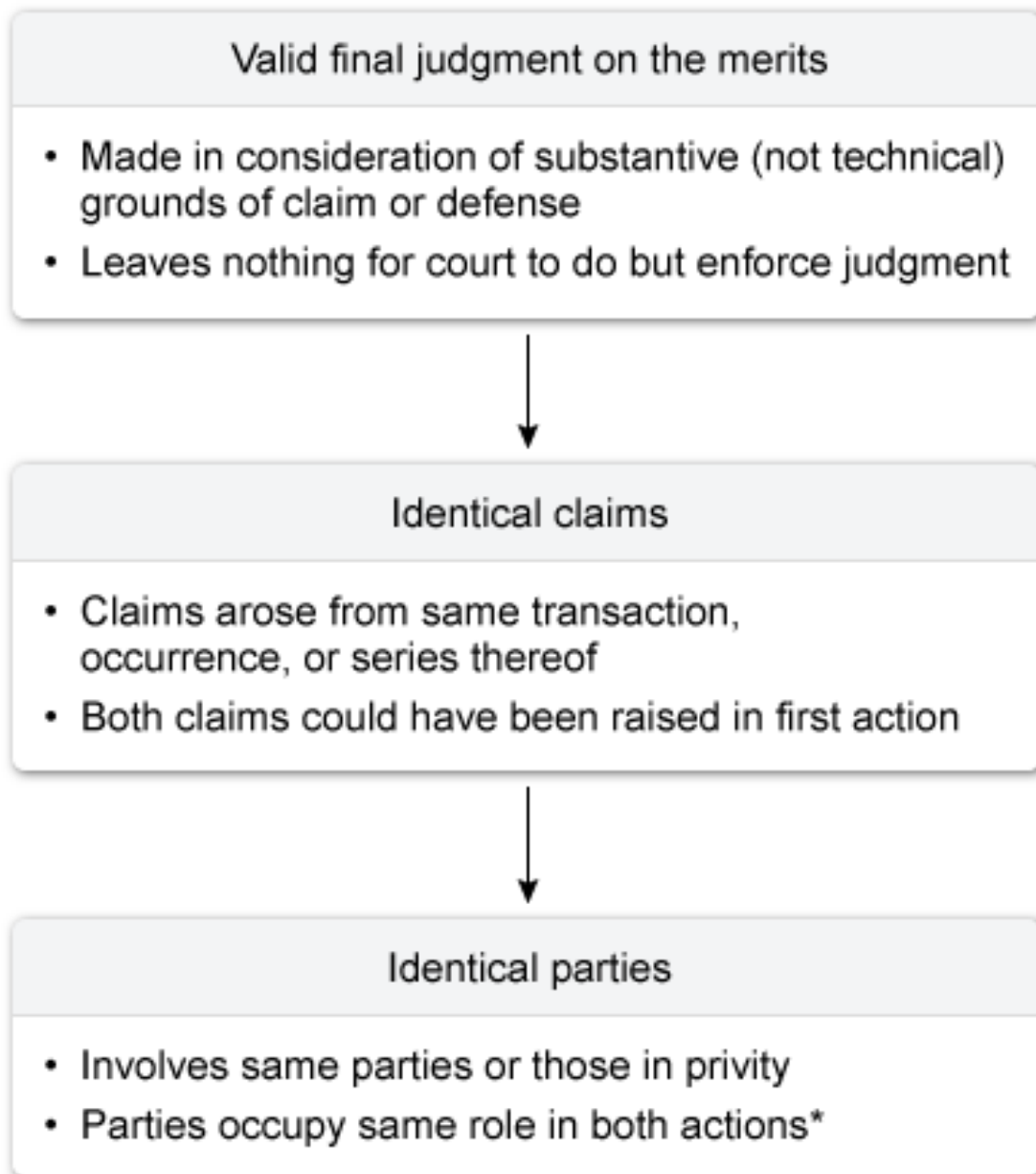
Claim preclusion applies if the parties occupy the same roles in the first and subsequent actions—ie, the parties are identical. If the parties are not identical, claim preclusion will still apply if a party violated the first court's compulsory-counterclaim rule.

FRCP = Federal Rule of Civil Procedure.

References

- Restatement (Second) of Judgments § 22 (Am. Law Inst. 1982) (explaining compulsory-counterclaim exception to identical-parties requirement).
- Fed. R. Civ. P. 13(a) (compulsory counterclaim).

Claim-preclusion requirements



*Parties need not occupy the same role if a party violates the first court's compulsory counterclaim rule.