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Res Judicata and Voluntary Dismissal with Prejudice: A Cautionary Tale of Accidental Preclusion

Voluntary dismissal of claims can be a smart strategic move in the right case at the right time for a number of reasons. Perhaps a better venue is available, or the client decided it's not the right time to bring the claims. However, it is important to carefully draft a stipulation of discontinuance with a mind toward avoiding the potential for a preclusive effect. The Appellate Division, Second Department recently considered a motion to dismiss claims that had been asserted and later discontinued with prejudice in a prior federal matter filed in the Southern District of New York. The “with prejudice” proved to be the plaintiffs’ undoing as the appellate court found the complaint barred by res judicata based on the predecessor’s action.

The Case: *Busher v. Barry*

In *Busher*, the plaintiffs, shareholders of the defendant real estate holding company whose sole asset was a golf course in Mamaroneck, brought a civil action in Westchester County Supreme against the holding company, its majority shareholder and members of the company’s board of directors, seeking judicial dissolution and alleging that the individual defendants breached their fiduciary duty to the company and its shareholders. Previously, the plaintiffs had filed an action in the Southern District of New York asserting claims premised largely on the same conduct. In that federal case, the court specifically dismissed the action in part on statute of limitations grounds, to the extent conduct took place prior to June 16, 2008, but dismissed the plaintiffs’ dissolution claim “without prejudice to Plaintiffs’ asserting the claim in a state court action.” Significantly, however, the plaintiffs then voluntarily dismissed their remaining derivative claims, including their breach of fiduciary duty claim, “with prejudice.” Subsequently, the plaintiffs filed this state court action for judicial dissolution and the defendants moved to dismiss on statute of limitations and res judicata grounds. The Westchester Supreme Court granted the defendants’ motion, and the appellate division affirmed.

The Second Department explained that while dismissal of a federal action without prejudice generally has no preclusive effect on a subsequent state action, a voluntary dismissal with prejudice “has the same preclusive effect as a judgment on the merits.” At the same time, such language in a stipulation must be narrowly interpreted given the severity of claim preclusion. In the instant case, the court determined that since the cause of action for dissolution was dismissed without prejudice, it was not precluded or time-barred to the extent the conduct took place after June 16, 2008. Unfortunately for the plaintiffs, the only relevant post-2008 conduct was the defendant directors’ alleged breach of fiduciary duty. Because that claim had been voluntarily dismissed with prejudice in the federal action, it was precluded on res judicata grounds. And because the only basis for the judicial dissolution claim was now barred by claim preclusion, the trial court properly dismissed that cause of action as

well.

Takeaway

While there are certainly instances where voluntarily dismissing claims in a lawsuit may benefit the client, litigators must always be cognizant of any potential preclusive effect down the line. Litigators must be wary and prepare any stipulations thoughtfully with an eye to any subsequent lawsuits that may arise.