

11 U.S.C. § 502(b)(9)
Relation back
Fed. R. Civ. P. 15(c)(1)(B)

Peak Web LLC, Case No. 16-32311

11/08/2017 PCM

Unpublished


Debtor objected to an amended claim filed by creditor Machine Zone, Inc., which was filed after the claims bar date. This memorandum opinion addresses whether the amended claim should be disallowed as untimely under 11 U.S.C. § 502(b)(9).

The question was whether the amendment related back to the timely filed claim. The amended claim was based on an amended complaint filed in state court. The court considered the allegations of the original complaint, which provided the basis for the original claim, and compared them to the allegations of the amended complaint for each cause of action to see whether the amended claims were new or were simply alleging the original claims with greater particularity.

The court concluded that some of the claims set out in the amended state court complaint related back but others did not and were barred so that Machine Zone could not pursue affirmative relief against debtor on those claims.

Below is an Opinion of the Court.

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PETER C. MCKITTRICK
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:)
PEAK WEB LLC,) Bankruptcy Case No.
) 16-32311-pcm11
)
Debtor.) MEMORANDUM OPINION RE OBJECTION
) TO CLAIM #48
)

Debtor Peak Web LLC objects to the amended claim of Machine Zone, Inc., filed after the claims bar date, seeking disallowance of the amended claim as untimely. For the reasons set out below, the objection will be sustained in part and overruled in part.

PROCEDURAL BACKGROUND

Before debtor filed chapter 11 bankruptcy in 2016, the parties had filed complaints against each other in California state court for claims arising out of a contractual relationship under which debtor was to provide web hosting services to support Machine Zone's online gaming business. Before the claims bar date, Machine Zone filed a proof of claim for "at least" \$23,000,000 plus an unspecified amount of punitive damages. The claim was based on the complaint Machine Zone had filed

1 prepetition against debtor in state court.

2 Debtor objected to the original claim on its merits. This court
3 abated action on that objection and granted relief from stay for the
4 parties to litigate the merits of the claims in state court.

5 After the October 13, 2016, claims bar date, Machine Zone filed an
6 amended claim for "at least" \$247,176,000, made up of \$47,176,000 in
7 compensatory and consequential damages and no less than \$200,000,000 in
8 punitive damages. The amended claim was based on a First Amended
9 Complaint filed in the state court litigation. Debtor objects to the
10 amended claim on its merits, but also argues that the amended claim
11 should be disallowed because it is untimely and does not relate back to
12 the original proof of claim. This court ruled that it will not abate the
13 objection to the amended proof of claim to the extent the issue is
14 whether the amended claim is timely.

15 Because Machine Zone had filed a Third Amended Complaint in state
16 court, it filed a Second Amended Claim in this case. The Second Amended
17 Claim did not change the amount of the claim from that set out in the
18 First Amended Claim. Debtor filed an Amended Objection to the Second
19 Amended Claim (Doc. #882), which reasserts and adopts the objection to
20 the First Amended Claim. Because the objection has been fully briefed
21 and the issues raised in the amended objection are the same as those
22 raised in the objection to the First Amended Claim, this court will
23 proceed with resolving the timeliness of the Second Amended Claim on the
24 same schedule as applied to the objection to the First Amended Claim.

1 LEGAL STANDARD

2 A claim that is not timely will be disallowed. 11 U.S.C.
3 § 502(b)(9). The court has discretion whether to allow an amendment to a
4 timely filed claim. In re Grivas, 123 B.R. 876 (Bankr. S.D. Cal. 1991).
5 The question in determining whether to allow an amendment to a timely
6 proof of claim is whether the amendment relates back to the timely filed
7 claim, or whether it is instead "a new claim styled as an amendment."
8 Id. at 878.

9 The rule "in the Ninth Circuit [is] that an amendment to a timely
10 proof of claim 'relates back' to a timely filed claim when the original
11 claim provided 'fair notice of the conduct, transaction, or occurrence
12 that forms the basis of the claim asserted in the amendment.'" In re
13 Jackson, 541 B.R. 887, 891 (9th Cir. BAP 2015) (citation omitted). The
14 courts analogize to Fed. R. Civ. P. 15(c), the federal civil procedure
15 rule governing relation back of amendments to pleadings. See In re
16 Solari, 63 B.R. 115, 117 (9th Cir. BAP 1986); In re Westgate-California
17 Corp., 621 F.2d 983 (9th Cir. 1980). That rule provides that an amended
18 pleading relates back to the date of the original pleading when "the
19 amendment asserts a claim or defense that arose out of the conduct,
20 transaction, or occurrence set out - or attempted to be set out - in the
21 original pleading[.]" Fed. R. Civ. P. 15(c)(1)(B).

22 "In determining whether an amended cause of action is to relate
23 back, the emphasis is not on the legal theory of the action, but
24 whether the specified conduct of the defendant, upon which the
25 plaintiff is relying to enforce his amended claim, is identifiable
26 with the original claim." Where an amended pleading seeks only to
add new claims to an original pleading, "the . . . court should . . .
analyze the two pleadings to determine whether they share a common
core of operative facts sufficient to impart fair notice of the
transaction, occurrence, or conduct called into question."

1 Federal Deposit Ins. Corp. v. Jackson, 133 F.3d 694, 702 (9th Cir. 1998)
2 (internal citations and quotations omitted).

3 Amendments are freely allowed for curing defects in the
4 original claim, providing greater detail to a previously-filed
5 claim, or pleading a new theory on previously-filed facts. However,
6 post bar-date amendments must be scrutinized to avoid approval of a
7 new claim styled as an amendment.

8 Grivas, 123 B.R. at 878 (citation omitted).

9 Thus, "amendments that do no more than restate the original claim
10 with greater particularity or amplify the details of the transaction
11 alleged in the" original claim will relate back. 6A Wright, Miller and
12 Kane, Federal Practice and Procedure § 1497 (2010). But where the change
13 is so great that defendant was not given adequate notice of the conduct,
14 transaction, or occurrence that forms the basis of the new claim, the
15 amendment will not relate back. Id. In deciding whether the claim gave
16 adequate notice, the court looks at whether the amended claim will likely
17 be proved by the same kind of evidence as would support proof of the
18 original claim. In re Dominguez, 51 F.3d 1502, 1510 (9th Cir. 1995). In
19 other words, could the evidence supporting the second set of allegations
20 have been introduced to prove the original claim? See In re Dean, 11
21 B.R. 542, 545 (9th Cir. BAP 1981), aff'd, 687 F.2d 307 (9th Cir. 1982).
22 It does not matter if the theory of recovery is different; "[i]t is the
23 operative facts that control the question of relation back, not the
24 theory of liability applied to those facts." In re Pacific Gas & Elec.
25 Co., 311 B.R. 84, 88 (Bankr. N.D. Cal. 2004). Amendments that allege
26 facts that "differ in both time and type from those the original pleading
set forth" do not relate back. Mayle v. Felix, 545 U.S. 644, 650 (2005).
Where the claims relate to fraud, the question is "whether the fraud

1 alleged in the [amended claim] is the same as the fraud alleged in the
2 [original claim]." In re Markus, 313 F.3d 1146, 1150 (9th Cir. 2002).

3 DISCUSSION

4 1. Original claim

5 The original state court complaint, on which the original proof of
6 claim was based, set out claims relating to a 2015 Master Service
7 Agreement, Service Level Agreement and associated Service Orders
8 (collectively "MSA") for breach of contract, declaration of the right to
9 terminate the 2015 MSA, breach of the covenant of good faith and fair
10 dealing, promissory estoppel, rescission of the 2015 MSA based on
11 fraudulent inducement, and negligent misrepresentation. Because debtor's
12 timeliness objection relates solely to the fraud-based claims, I will
13 limit my discussion to the claims for fraudulent inducement and negligent
14 misrepresentation.

15 A. Fraudulent Inducement

16 Machine Zone alleged that, during discussions beginning in January
17 2015, debtor represented that, with limited exceptions, it operated
18 industry standard best practices for Tier IV data centers (which requires
19 full redundancy of systems and equipment and necessary infrastructure)
20 and that it was capable of providing 100% network connectivity. It
21 alleged that, in February 2015, debtor made fraudulent representations to
22 induce Machine Zone to enter into the 2015 MSA, including that (1) it was
23 capable of providing the level of service required by Machine Zone; (2)
24 it operated at industry standard best practices for Tier IV data centers;
25 (3) its hosted environment would never go down; (4) it could provide full
26 monitoring and remote access; (5) it had high quality personnel; (5) in

1 response to an audit performed by Machine Zone before these contract
2 negotiations began, it had made improvements and was operating at a Tier
3 IV data center level; and (6) debtor was able to provide the required
4 services "from a hardware, infrastructure, personnel, processes and
5 operational perspective." Complaint at ¶ 54. It also alleged that
6 debtor concealed that its data centers failed to conform to industry
7 standard practices "in many, many regards[.]" Id. at ¶ 55.

8 In reliance on those representations, which Machine Zone alleged
9 were false and that debtor knew were false, Machine Zone entered into the
10 2015 MSA and paid debtor \$23,000,000. It sought rescission of the
11 agreement, seeking return of the \$23,000,000 paid to debtor plus
12 consequential damages.

13 B. Negligent Misrepresentation

14 In this claim, Machine Zone alleged that debtor represented that it
15 had unique knowledge and expertise regarding its ability to provide
16 uninterrupted web hosting services to Machine Zone for its games. In the
17 2015 MSA, debtor represented that debtor could and would provide
18 continuous service at Tier IV performance levels. Debtor knew or should
19 have known that Machine Zone would rely on debtor's representations about
20 its ability to provide those services and intended Machine Zone to rely
21 on them. It knew that the information was not true. Machine Zone
22 reasonably relied on debtor's assurances and suffered financial loss as a
23 result of debtor's failure to provide the promised level of service.

24 2. Amended Claim

25 The TAC on which the Second Amended Claim is based vastly expands
26 the allegations of misconduct. It alleges for the first time that the

1 parties had, before they entered into the 2015 MSA, entered into a 2014
2 MSA. It again alleged claims for breach of the 2015 MSA, declaratory
3 relief of the right to terminate that MSA, and breach of the covenant of
4 good faith and fair dealing with regard to the 2015 MSA. The claims that
5 are the subject of the timeliness objection are the claims based on
6 fraud: (1) fraudulent inducement and rescission relating to the 2015 MSA;
7 (2) fraudulent concealment as to the 2014 MSA; (3) fraudulent concealment
8 as to the 2015 MSA; (4) negligent misrepresentation; (5) false
9 advertising; and (6) unfair competition.

10 A. Fraudulent inducement - 2015 MSA

11 In this claim, Machine Zone alleges that debtor made intentional
12 misrepresentations in 2014 following a September 2014 outage that it was
13 doing everything it could to prevent such an outage from happening again,
14 and that it would hire additional experienced personnel to remedy the
15 service issues and furnish the level of service Machine Zone required.
16 It represented in May 2015 that its test and live game environments were
17 separate. Machine Zone alleges that those representations were false.

18 It also alleges that, in early 2015, during negotiation of the 2015
19 MSA, debtor intentionally concealed and failed to disclose material
20 facts. These included partial disclosures relating to the September 2014
21 service outage, which debtor represented was an aberration, debtor's
22 representation that it was doing everything it could to correct the
23 issues that led to the 2014 outage, and financial information provided to
24 Machine Zone in February 2015. Machine Zone alleges that debtor
25 concealed that it had suffered numerous service outages for other
26 customers in 2013 and 2014, it did not have the safety equipment in place

1 that it represented it did, it was depriving itself of the financial
2 resources needed to fix its problems by paying millions of dollars in
3 distributions to debtor's owners, and it removed information about its
4 financial weakness from the 2015 financial information provided to
5 Machine Zone.

6 It also alleges that debtor actively concealed information that it
7 had a duty to disclose, including a February 2014 service outage to other
8 customers and the financial information removed from the 2015 financial
9 spreadsheet provided to Machine Zone.

10 Machine Zone alleges that debtor knew that all of these partial
11 disclosures and concealments were false and were material to Machine
12 Zone. Machine Zone continued to rely on representations debtor made
13 before the 2014 MSA, and debtor made the misrepresentations and continued
14 to conceal material information in order to induce Machine Zone into
15 entering into the 2015 MSA. The "false and misleading statements to
16 Machine Zone gave Machine Zone the false impression that Peak was a
17 stable, sophisticated, and experienced data hosting business that had the
18 technology, manpower, and financial wherewithal to prevent Machine Zone
19 from suffering downtime." TAC at ¶ 133.

20 Machine Zone alleged harm from debtor's failure to provide the
21 agreed-upon services, seeking restoration of the \$26,651,000 paid to
22 debtor under the 2015 MSA plus consequential damages.

23 B. Fraudulent Concealment - 2014 MSA

24 In this claim, Machine Zone alleges that, before and during the 2014
25 MSA, debtor concealed the service outages it had experienced with other
26 customers and that it did not have the ability to meet its contractual

1 obligations. It also concealed that it had distributed millions of
2 dollars to its owners during the term of the 2014 MSA.

3 C. Fraudulent Concealment - 2015 MSA

4 Machine Zone alleges that debtor fraudulently concealed material
5 facts from it in order to induce Machine Zone into entering into the 2015
6 MSA. Instances of concealment include debtor's failure to disclose,
7 during negotiation of the 2015 MSA, that it had suffered service outages
8 with other customers in the past, its failure to disclose that outages
9 experienced by Machine Zone during the 2015 MSA were a result of lack of
10 adequate qualified staff, and that debtor did not have the financial
11 resources to provide the required level of service, caused at least in
12 part by debtor's distribution to its owners of millions of dollars up to
13 and during the term of the 2015 MSA. It alleges that it was harmed by
14 entering into the 2015 MSA.

15 D. Negligent Misrepresentation

16 Machine Zone alleges that, before and during the course of the 2014
17 MSA, and before and during the course of the 2015 MSA, debtor represented
18 that it was capable of providing uninterrupted web hosting services, but
19 it did not have the financial resources, qualified personnel, and system
20 capability to do that. Debtor did not have reasonable grounds for
21 believing that the information it provided to Machine Zone regarding its
22 ability to perform was correct.

23 E. False Advertising

24 In this claim, Machine Zone alleges that various advertising
25 materials contained false information that was likely to mislead the
26 public. The allegations claim that information contained in a marketing

1 deck sent to Machine Zone in December 2013 contained false information
2 about debtor's ability to provide web hosting that would never go down,
3 and that it had successfully provided services to dozens of other
4 businesses. It made representations in an October 2013 email regarding
5 its abilities to provide 100% uptime.

6 During negotiations of the 2014 and 2015 MSAs, debtor knew or should
7 have known that the claims of redundant architecture, customers that
8 trusted debtor, and its ability to provide continuous uptime were false
9 or likely to mislead. It then alleges that the advertisements did in
10 fact mislead, and that Machine Zone relied on those advertisements in
11 deciding to enter into the 2014 and 2015 MSAs.

12 F. Unfair Competition

13 In this claim, Machine Zone again alleges that debtor represented
14 that it had the capability to provide 100% service uptime and that it had
15 other customers that trusted debtor, which led Machine Zone to enter into
16 the 2015 MSA. Debtor intentionally concealed from Machine Zone its past
17 service failures with other customers, that it did not have the
18 technology to support 100% uptime, that it did not have the human
19 resources to support Machine Zone, and that it was in a precarious
20 financial position. This concealment, Machine Zone alleges, constitutes
21 an unfair business practice that caused Machine Zone harm.

22 3. Analysis

23 Machine Zone argues that I need not decide whether any of its claims
24 set out in the TAC should be disallowed as time-barred, because the
25 claims could be used as recoupment or setoff even if disallowed, and the
26 facts alleged may relate to its defense to debtor's claims against

1 Machine Zone. I need not and will not decide whether disallowed claims
2 can properly be used as recoupment or setoff or whether evidence
3 supporting the allegations in the TAC would be relevant to Machine Zone's
4 defense to debtor's claims. The question I am deciding in this claim
5 objection is whether the fraud-based claims alleged in the TAC can be
6 pursued as affirmative claims for relief against debtor. Use of claims
7 as setoffs, recoupment, or defenses is beyond the scope of this claim
8 objection.

9 In deciding whether the amended claim, as set out in the TAC,
10 relates back to the original claim and is therefore timely, I need to
11 compare the original claim to the amended claim, and determine whether
12 the amended claim arises out of the same conduct, transaction, or
13 occurrence as the original claim.

14 The facts set out in the original complaint related solely to
15 debtor's conduct during the negotiation of and after entry into the 2015
16 MSA. Those misrepresentations were alleged to have occurred in 2015,
17 except for representations made in response to a 2014 audit that debtor
18 was making improvements and was operating at a Tier IV data center level.
19 Thus, the conduct, transaction, or occurrence that was the subject of the
20 timely claim was debtor's conduct in late 2014 and 2015 leading to entry
21 of the 2015 MSA and thereafter, relating to its capability "from a
22 hardware, infrastructure, personnel, processes and operational
23 perspective" to provide the high level of service Machine Zone required.
24 Complaint at ¶ 54.

25 Debtor argues that the original complaint, which supported the
26 original proof of claim, was based "solely on Peak's alleged

1 misrepresentations--all made during the negotiations of the 2015 Master
2 Services Agreements ("2015 MSA")--about its technical capabilities to
3 provide MZ uninterrupted data hosting service for its Game of War
4 product." Peak's Response re Objection to Claim at 7. Because the TAC,
5 on which the Second Amended Proof of Claim is based, "disclaims" any
6 reliance on debtor's ability to provide 100% uptime, TAC at ¶ 7, it
7 argues that Machine Zone's expanded allegations of fraud cannot arise out
8 of the same conduct, transaction, or occurrence as the original claim.

9 Machine Zone, on the other hand, argues that the "transaction"
10 alleged in the original complaint was the 2015 MSA, therefore anything
11 debtor is alleged to have done or not done during the parties' entire
12 relationship that Machine Zone can allege ultimately led to the 2015 MSA
13 is part of that same transaction and relates back.

14 I conclude that neither party is correct. Contrary to debtor's
15 argument, the original complaint alleged fraud based on more than simply
16 debtor's inability to supply 100% uptime. Machine Zone alleged, for
17 example, that debtor represented it could provide the required level of
18 service "from a hardware, infrastructure, personnel, processes and
19 operational perspective." Complaint at ¶ 54. Those representations go
20 beyond representing that debtor could provide 100% uptime.

21 Machine Zone's argument applies too broad a level of generality.
22 The mere fact that a timely claim is based on a particular transaction
23 does not open the door to allegations of facts that, while arguably
24 related to the transaction, are not related in type and time to the
25 original conduct complained of. The Supreme Court rejected such a broad
26 approach to relation back in Mayle v. Felix, 545 U.S. 644 (2005). In

1 that case, the court considered relation back in the context of a
2 petition for a writ of habeas corpus. A petition for habeas corpus
3 challenging a criminal conviction must plead specific grounds for relief
4 and the facts supporting each ground. 545 U.S. at 648. The Court
5 applied the Fed. R. Civ. P. 15 standard for relation back to an amended
6 petition and concluded that the Ninth Circuit's expansive reading of
7 "conduct, transaction, or occurrence" to allow relation back so long as
8 the amended petition stemmed from the same trial, conviction, or sentence
9 as set out in the timely claim was too broad. Instead, the Court said,
10 "relation back depends on the existence of a common 'core of operative
11 facts' uniting the original and newly asserted claims." 545 U.S. at 659.
12 This approach, the Court said, is "consistent with the general
13 application" of the Rule 15 relation back provision in civil cases. Id.
14 at 664.

15 The relation back rule strikes a balance between two "competing
16 concerns": the idea that amendments to pleadings should be liberally
17 applied to allow the decision of claims on their merits and the purpose
18 of statutes of limitations to protect defendants from stale claims.
19 ASARCO, LLC v. Union Pacific R. Co., 765 F.3d 999, 1005 (9th Cir. 2014).
20 "[N]otice is an essential element in the relation back determination."
21 Id. at 1006. Relation back is allowed if the facts alleged arise from
22 the "common core of operative facts" set out in the original pleading,
23 such that the defendant is on notice that its conduct with regard to
24 those facts is at issue.

25 I will discuss each fraud claim alleged in the TAC in turn, focusing
26 on the operative facts pled in the original complaint and whether the

1 amended claims are based on a common core of operative facts such that
2 debtor had fair notice that its conduct with regard to those facts could
3 be called into question.

4 A. Fraudulent Inducement - 2015 MSA

5 As pled in the TAC, this claim alleges both intentional
6 misrepresentations and intentional omissions of key facts, including
7 partial disclosures and active concealment of certain facts.

8 i. Intentional Misrepresentations

9 Although this claim alleges many facts that pre-date the 2015 MSA
10 contract negotiation, the actual misrepresentations alleged, on which
11 Machine Zone relies for affirmative relief against debtor, are alleged to
12 have occurred in 2015, with the exception of the representations in
13 response to the 2014 audit about debtor's work to make improvements to
14 improve service. The alleged representations arise from the same core of
15 operative facts alleged in the original complaint, which was
16 representations during the negotiations leading up to the 2015 MSA
17 relating to debtor's ability to provide 100% uptime from the perspective
18 of hardware, infrastructure, personnel, processes and operations.

19 The allegation of debtor's representations about its improvement of
20 operations in response to the 2014 audit relates to the original
21 allegation about debtor's response to the earlier audit.

22 Debtor was on notice from the original complaint that its conduct in
23 relation to the negotiation of the 2015 MSA was at issue. The expanded
24 allegations in the TAC relate both in type and time to the original
25 complaint. Therefore I conclude that those instances of alleged
26 misrepresentations relate back to the original complaint and are not

1 barred.

2 ii. Intentional Omission of Key Facts

3 Whether the allegations of omission of facts and active concealment
4 relate back is a closer question.

5 The partial disclosures debtor is alleged to have made to Machine
6 Zone after a September 2014 outage of the cause for the outage and
7 debtor's response to it relate in both time and type to the allegation in
8 the original complaint about debtor's representations in response to the
9 September 2014 audit. Therefore, the claim is not barred to the extent
10 it is based on those allegations.

11 The alleged partial disclosure in February 2015 regarding debtor's
12 financial information also relates to the 2015 contract negotiations and
13 debtor's alleged conduct in inducing Machine Zone to enter into the 2015
14 MSA, and is not barred.

15 Machine Zone alleges two instances of active concealment when debtor
16 had a duty to disclose. First, it alleges that debtor concealed a
17 February 2014 outage debtor caused to other customers. Second, it
18 alleges concealment of first and second quarter 2014 financial
19 information in a 2015 financial disclosure.

20 I conclude that allegations of active concealment during the time
21 set out in the original complaint - late 2014 into early 2015 - are
22 related to the fraud alleged in the original complaint. Debtor was put
23 on notice by the original complaint that its conduct during that time
24 frame, in connection with working toward the 2015 MSA, was alleged to
25 support a claim for fraud. Therefore, an affirmative claim for relief
26 based on these allegations of concealment relates back and is not time-

1 barred.¹

2 B. Fraudulent Concealment - 2014 MSA

3 The TAC sets out as Count II a claim for fraudulent concealment
4 relating to the 2014 MSA. The original complaint did not contain any
5 allegations relating to or even mention the 2014 MSA. Machine Zone did
6 not address this claim in its briefing.

7 At the hearing on this motion, the court asked counsel for Machine
8 Zone whether it was pursuing this claim. Counsel asserted that it is not
9 seeking rescission of the 2014 MSA, but is pursuing Count II only as part
10 of a pattern of fraud related to the 2015 MSA.

11 All of the facts alleged in this count relate to conduct alleged to
12 have occurred before or during the course of the 2014 MSA. Because those
13 facts do not relate in time to the 2015 MSA, and in fact relate to a
14 contract that was not even mentioned in the original complaint, they do
15 not relate back to the original complaint and are time-barred. Machine
16 Zone cannot pursue any affirmative relief for damages arising out of the
17 conduct alleged in this count.² To the extent Machine Zone alleges that

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19 ¹ The original complaint and the TAC differ in the amount Machine
20 Zone seeks to recover from restoration of the payments made under the
21 2015 MSA. The original complaint sought recovery of \$23,000,000, while
22 the TAC seeks recovery of \$26,651,000. To the extent the TAC is simply
23 refining the amount sought by Machine Zone for rescission of the 2015
24 MSA, the increase in Machine Zone's claim relates back to the original
25 proof of claim.

26 ² The state court noted that this claim, as alleged in the Second
Amended Complaint (and now repeated in the TAC) does not contain any
allegations of damages relating to the 2014 MSA. However, despite the
label of the claim as "Fraudulent Concealment - 2014 MSA," the claim
alleged "that Machine Zone entered into the 2015 MSA, in addition to the

(continued...)

1 this conduct ultimately led to its entry into the 2015 MSA, the facts
2 alleged in this count go well beyond the time and type of fraud alleged
3 in the original complaint and do not relate back.³

4 C. Fraudulent Concealment - 2015 MSA

5 In this claim, Machine Zone alleges that debtor concealed material
6 facts during its negotiation of the 2015 MSA, including that its other
7 customers had experienced service outages in the past. It also alleges
8 that, during the course of the 2015 MSA, debtor concealed the cause of
9 outages Machine Zone experienced in 2015.

10 To the extent the TAC alleges that debtor concealed facts during the
11 negotiation and implementation of the 2015 MSA that it had a duty to
12 disclose, the allegations relate in time and type to the original
13 allegations of fraud with regard to the 2015 MSA. Therefore, this claim
14 relates back to the original claim and is not barred.

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17 ²(...continued)

18 2014 MSA, due to the fraudulent omissions alleged in that claim." Order
19 After Hearing at p.16:13-14 (Exh. G). It therefore denied the demurrer
because "a demurrer does not lie to a portion of a cause of action." Id.
at p.16:17-18.

20 ³ The TAC seeks compensatory and consequential damages of
21 \$47,176,000. The TAC does not specify how Machine Zone arrived at that
22 amount. However, this figure comes close to the sum of the \$26,651,000
23 sought for payments alleged to have been made under the 2015 MSA, and the
24 \$20,528,000 Machine Zone alleges that it paid to Peak Web under the 2014
25 MSA. TAC at ¶ 119, 136. To the extent the amended claim seeks damages
26 for the payments made to Machine Zone under the 2014 MSA, those damages
are time-barred. In addition, the original complaint and proof of claim
sought punitive damages in an unspecified amount. The TAC's amendment to
specify the amount of punitive damages relates back and is not barred, to
the extent the punitive damages relate to claims that survive this claim
objection.

1 D. Negligent Misrepresentation

2 As with the earlier claims, to the extent this claim alleges that
3 debtor misrepresented its capability to provide uninterrupted data
4 hosting services during its negotiation and performance of the 2015 MSA,
5 the facts arise out of the same conduct, transaction, or occurrence as
6 the fraud alleged in the original complaint. Alleged misrepresentations
7 that occurred before the 2014 audit referred to in the original
8 complaint, however, are outside the conduct complained of in the original
9 complaint, and do not relate back.

10 E. False Advertising and Unfair Competition

11 These two claims raise new theories for relief that were not alleged
12 in the original complaint. The fact that the amended claim sets out a
13 different theory of recovery is not determinative: “[i]t is the operative
14 facts that control the question of relation back, not the theory of
15 liability applied to those facts.” In re Pacific Gas & Elec. Co., 311
16 B.R. 84, 88 (Bankr. N.D. Cal. 2004).

17 Thus, as with the other claims, the question is whether the facts
18 alleged in support of these new theories for relief arise from the same
19 conduct, transaction, or occurrence as the original claim.

20 The advertising that forms the basis for the false advertising claim
21 is a December 2013 marketing deck and an October 2013 email. Although
22 the TAC alleges that Machine Zone relied on those false advertisements in
23 entering into the 2015 MSA, I conclude that marketing materials provided
24 to Machine Zone in 2013 fall well outside the allegations of
25 misrepresentation alleged in the original complaint. The original claim,
26 based on debtor’s conduct in late 2014 and early 2015, did not provide

1 reasonable notice to debtor that its advertising to Machine Zone back in
2 2013 was put at issue. This claim does not relate back and will be
3 disallowed.

4 The unfair competition claim is based more directly on alleged
5 representations and concealments leading to entry into the 2015 MSA. To
6 the extent the allegations relate to representations made in 2015 and
7 active concealment of material information in 2015, this claim relates
8 back to the original complaint.

9 CONCLUSION

10 The claims for fraudulent concealment with regard to the 2014 MSA
11 and the false advertising claim are time-barred. Affirmative claims for
12 relief based on allegations of misrepresentations and concealments that
13 pre-date the late 2014 time period alleged in the original complaint are
14 also time-barred. Debtor's objection to the Second Amended Claim is thus
15 sustained with regard to those claims and specifications of fraud. It is
16 otherwise overruled.

17 This ruling does not address the merits of the Second Amended Claim,
18 which will be determined in California state court. Further, this ruling
19 limits the affirmative relief Machine Zone may seek from debtor. But it
20 is not intended to limit evidence submitted in support of the surviving
21 claims, to the extent the state court determines that the evidence is
22 relevant. Nor do I express any opinion as to whether claims that are
23 disallowed as time-barred may be used for recoupment or setoff, or
24 whether Machine Zone can defend based on facts alleged in the barred
25 claims.

26 Counsel for debtor should submit an order consistent with this

1 Memorandum Opinion.

2 ###

3 cc: Douglas R. Pahl
4 Timothy J. Conway

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