son-Patman Act; none of goods purchased physically crossed a state line between their shipment by supplier and receipt by producer. Clayton Act, § 2(a), as amended by Robinson-Patman Price Discrimination Act, 15 U.S.C.A. § 13(a).

9. Commerce ⇐62.13

Bulk paper supplier's interstate purchases from paper manufacturers to supply its just-in-time (JIT) requirements were made to meet anticipated needs of specific customers, so that stream of commerce was not broken by fact that ultimate sales to customers were made intrastate, and jurisdictional requirement was satisfied in action in which competitor challenged purchases on basis of price discrimination in violation of Robinson-Patman Act. Clayton Act, § 2(a), as amended by Robinson-Patman Price Discrimination Act, 15 U.S.C.A. § 13(a).

10. Trade Regulation ⇐914

"Price discrimination" in violation of Robinson-Patman Act means nothing more than a difference in price charged to different purchasers or customers of discriminating seller for products of like grade or quality. Clayton Act, § 2(a), as amended by Robinson-Patman Price Discrimination Act, 15 U.S.C.A. § 13(a).

See publication Words and Phrases for other judicial constructions and definitions.

11. Trade Regulation ⇐914

Different prices must have been charged at reasonably contemporaneous times in order to support claim of price discrimination in violation of Robinson-Patman Act. Clayton Act, § 2(a), as amended by Robinson-Patman Price Discrimination Act, 15 U.S.C.A. § 13(a).

12. Trade Regulation ⇐914

Bulk paper supplier's sale of paper to forms producer at prices which exceeded, by over $10 per hundredweight, prices charged to producer's competitors, reflected sale at facially disparate prices and established case of price discrimination in violation of Robinson-Patman Act. Clayton Act, § 2(a), as amended by Robinson-Patman Price Discrimination Act, 15 U.S.C.A. § 13(a).

13. Trade Regulation ⇐914

Sales made by corporate division of bulk paper supplier were attributable to supplier, for purposes of claim of price discrimination by seller in violation of Robinson-Patman Act; because sale was made by division, rather than subsidiary, there was no separate corporate "form" to respect. Clayton Act, § 2(a), as amended by Robinson-Patman Price Discrimination Act, 15 U.S.C.A. § 13(a).

14. Trade Regulation ⇐914

Firm's wholly owned subsidiary and firm itself amount to single "seller" for purposes of claim of price discrimination in violation of Robinson-Patman Act. Clayton Act, § 2(a), as amended by Robinson-Patman Price Discrimination Act, 15 U.S.C.A. § 13(a).

15. Trade Regulation ⇐914

Under "functional availability doctrine," no discriminatory pricing in violation of Robinson-Patman Act occurs where purchaser could but does not take advantage of lower price or discount which is functionally available to all customers on an equal basis. Clayton Act, § 2(a), as amended by Robinson-Patman Price Discrimination Act, 15 U.S.C.A. § 13(a).

See publication Words and Phrases for other judicial constructions and definitions.

16. Trade Regulation ⇐914

Bulk paper supplier's special direct, just-in-time, or truckload pricing programs were functionally available alternatives of which paper forms producer was aware but chose not to take advantage, so that functional availability doctrine barred producer's claim of discriminatory pricing in violation of Robinson-Patman Act; favorable prices were functionally available to producer as well as its competitors, and producer would have received benefit of favorable prices enjoyed by its competitors had it not been financially troubled, and had its management not made policy decision to buy paper only on "as-needed" basis. Clayton Act, § 2(a), as amended by Robinson-Patman Price Discrimination Act, 15 U.S.C.A. § 13(a).

17. Trade Regulation ⇐913

Unlike other federal antitrust statutes, which focus on harm to competition generally, discriminatory pricing prohibition under Robinson–Patman Act is directed toward protecting individual competitors as well, and accordingly sets forth "incipiency standard," under which reasonable possibility of competitive harm, as opposed to demonstrated, actual harm, is sufficient to prove competitive injury. Clayton Act, § 2(a), as amended by Robinson-Patman Price Discrimination Act, 15 U.S.C.A. § 13(a).

See publication Words and Phrases for other judicial constructions and definitions.

18. Trade Regulation ⇐929

As a practical matter, competitive injury which must be established to support claim of price discrimination under Robinson-Patman Act is usually shown in either of two ways: proof of lost sales or profits, or proof of a substantial price discrimination between competitors over time. Clayton Act, § 2(a), as amended by Robinson-Patman Price Discrimination Act, 15 U.S.C.A. § 13(a).

19. Federal Civil Procedure ⇐2484

Genuine issue of material fact as to whether paper forms producer had lost sales because of its inability to match prices of competitors, who had allegedly been sold paper by bulk supplier at lower price, precluded summary judgment on issue of whether producer had suffered competitive injury which would support claim of discriminatory pricing in violation of Robinson-Patman Act. Clayton Act, § 2(a), as amended by Robinson-Patman Price Discrimination Act, 15 U.S.C.A. § 13(a).

20. Trade Regulation ⇐929

Paper forms producer which alleged that bulk paper supplier had charged its competitors lower prices failed to show that supplier had engaged in substantial price discrimination over time, as would establish competitive injury sufficient to support claim of discriminatory pricing in violation of Robinson-Patman Act; nothing indicated which allegedly discriminatory prices involved transactions which satisfied "in commerce" jurisdictional requirement, and allegedly discriminatory pricing plan came into existence only one year before action was filed. Clayton Act, § 2(a), as amended by Robinson-Patman Price Discrimination Act, 15 U.S.C.A. § 13(a).

21. Monopolies ⇐28(1.4)

In order to have standing to bring antitrust suit for damages under Clayton Act, plaintiff must show fact of damage; amount of damage is not important for antitrust standing, as it is sufficient that some damage has occurred, but there must be some causal link between damage and violation of antitrust laws. Clayton Act, § 4, 15 U.S.C.A. § 15.

22. Monopolies ⇐28(1.4)

If direct evidence of injury is insufficient to show that defendant's antitrust violations, as opposed to other causes, contributed to some extent to plaintiff's injuries, plaintiff lacks antitrust standing and may not recover in damages.

23. Federal Civil Procedure ⇐2484

Genuine issue of material fact as to whether paper forms producer had suffered actual injury, in form of lost sales, due to allegedly discriminatory pricing by bulk paper supplier, precluded summary judgment on issue of whether producer had antitrust standing to seek damages under Clayton Act based on impermissible price discrimination in violation of Robinson-Patman Act. Clayton Act, §§ 2(a), 4, as amended by Robinson-Patman Price Discrimination Act, 15 U.S.C.A. §§ 13(a), 15.

24. Evidence ⇐400(3)

Sales ⇐22(4)

Under Pennsylvania version of Uniform Commercial Code (UCC), integration clause contained in bulk paper supplier's proposed terms for contract with paper forms producer was not timely objected to by producer and did not materially alter terms of contract, so that clause became part of agreement and operated to bar producer from proving terms of its alleged oral agreement in breach of contract action. 13 Pa.C.S.A. § 2207.

25. Sales ⇐15.1

Bulk paper supplier, and paper forms producer with which it contracted, both regularly dealt in bulk paper, and thus were "merchants" for purposes of Pennsylvania version of Uniform Commercial Code (UCC) with respect to dispute arising from contract. 13 Pa.C.S.A. § 2104.

See publication Words and Phrases for other judicial constructions and definitions.

26. Sales ⇐1(3)

Under Pennsylvania law, paper forms producer failed to establish specific terms of alleged oral agreement by bulk paper supplier to sell paper to producer at or below "market" price; producer could not even define meaning of "market" price, and representative of supplier did not make enforceable promise, but merely statement of what supplier's practice was, combined with vague assurances about the future.

27. Sales ⇐54

Course of dealing, which is admissible to explain or supplement even fully integrated writing under Pennsylvania version of Uniform Commercial Code (UCC), should not be permitted to be used as "bootstrap" to avoid stricter provisions of parol evidence rule for complete and exclusive writings. 13 Pa. C.S.A. § 2202.

28. Fraud ⇐3, 58(1)

Under Pennsylvania law, elements of fraudulent misrepresentation, which must be proved by clear and convincing evidence, are (1) a misrepresentation, (2) a fraudulent utterance thereof, (3) intention that recipient will thereby be induced to act, (4) justifiable reliance by recipient upon misrepresentation, and (5) damage to recipient as proximate result.

29. Fraud ⇐58(1), 64(1)

Pennsylvania law requires trial judge to decide as matter of law before he submits fraud case to jury whether plaintiff's evidence attempting to prove fraud is sufficiently clear, precise, and convincing to make out prima facie case.

30. Fraud ⇐12

Mere promise to perform future acts, which promise is not kept, does not amount to fraud under Pennsylvania law.

31. Fraud ⇐12

Promise which promisor had no intention of keeping at time he made it may be actionable as fraud under Pennsylvania law.

32. Fraud ⇐12, 20

Paper forms purchaser failed to establish that representative of bulk paper supplier had made any promise to sell paper at or below market rate, that even if promise was made, it was uttered with present intent not to perform it, or that it relied on alleged promise, as required to establish fraud claim against supplier under Pennsylvania law.

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Dale Hershey, Mary K. Austin, Eckert, Seamans, Cherin & Mellott, Pittsburgh, PA, for Defendant.

MEMORANDUM OPINION AND ORDER

D. BROOKS SMITH, District Judge.

Precision Printing Company, a now defunct business forms producer, has sued Unisource Worldwide for alleged acts of fraud, breaches of contract, and, most significantly, antitrust violations of the price-discrimination provisions of the Robinson–Patman Act, 15 U.S.C. § 13(a). Precision contends that Unisource, a major supplier of bulk paper, illegally gave Precision's competitors more favorable prices, increasing Precision's relative raw material costs and thereby making it uncompetitive in the forms marketplace. Precision also alleges that Unisource fraudulently misrepresented that it would give Precision its most favorable prices but failed to do so. Unisource denies all of these allegations and has counterclaimed for money Precision allegedly owes on various unpaid invoices. The parties have filed cross-motions for summary judgment and the case is now ripe for disposition. For the following reasons, I will deny plaintiff's motion and grant summary judgment to defendant.

I. FACTUAL BACKGROUND

Precision Printing Company was in the business of manufacturing and selling printed forms to businesses, banking institutions, health care facilities and other organizations.[1] It operated in the short-to-medium run segment of the market, generally producing 500 to 10,000 forms on any given order. Dkt. no. 25, at 105, 144. Precision's most significant raw material was blank paper, which averaged 55 to 75 percent of the cost of production, and 35 to 45 percent of the net sale price to the customer. *Id.* at 314, 331. Precision purchased paper from a variety of suppliers, but primarily from Unisource and its predecessor, Copco.[2] Dkt. no. 20, exh. 6, at 64–65, 68; dkt. no. 25, at 107.

Precision's two principal competitors were Business Forms, Inc. ("BFI") and Thornhill Printing, both of which were short or medium-run printers of comparable size. Dkt. no. 25, at 136–137, 144, 324, 328. All three manufacturers produced their product using essentially the same type of machinery, paper and techniques. *See id.* at 136, 143–44, 147–49, 152, 327.

Unisource is a Delaware corporation with its principal place of business in Columbus, Ohio. Its primary business is selling wholesale quantities of paper to commercial printing companies like Precision and its competitors, for which purpose it maintains a warehouse in Pittsburgh, Pennsylvania. Unisource sells on demand from this warehouse to fill the ad hoc needs of its customers; such transactions are referred to by the parties as warehouse sales. During the time period material to this litigation, Precision purchased all of its non-carbonless paper in this manner. Unisource also sells truckload quantities of paper, either directly from the manufacturer or from a Unisource warehouse outside Pennsylvania, in what are known as direct sales. These transactions typically involve lower prices than warehouse sales. Dkt. no. 20, Dunkle decl. ¶ 3–4, exh. 7, at 27–28. In addition, Unisource operated a "Just-in-Time" ("JIT") plan, under which purchasers could obtain better prices and stabilized paper availability by committing to purchase specified quantities of paper.

In 1994, Unisource added a division known as Rollsource. The function of Rollsource was to service specifically the needs of those members of the web offset printing industry, such as Precision and its competitors, who purchased paper primarily in roll form. Dkt no 25, at 145–46. Rollsource apparently operated in a manner similar to the JIT plan. Precision, however, unlike its competitors BFI and Thornhill, was not given an offer to become a Rollsource customer. *Id.* at 343. Unisource typically purchased paper from Rollsource to service non-Rollsource customers like Precision, then "internally burdened" the transaction with overhead costs before setting the final price. Dkt. no. 33, exh. E, at 113–14, 153. As a result, those customers who remained with Unisource generally paid higher prices for paper than Rollsource customers paid.

All of Unisource's sales were made pursuant to invoices with "boilerplate" terms and conditions on the reverse sides. Dkt. no 20, Dunkle decl., ¶ 2. Those terms included an integration clause and a contractual, one-year statute of limitations for any claims against the seller. The invoices made no representation regarding how the prices charged compared to the market in general or to any other customer in particular.

Precision Printing developed serious cash flow problems and began to fall behind in paying its paper suppliers sometime around 1992. As a result, some vendors placed Precision on COD status and would not sell product to it except for cash. Unisource, however, worked out payment terms that allowed Precision to continue buying paper while it paid down its past debt, although it

1. Although Precision still exists as a corporate entity, it ceased operations on December 31, 1996.

2. Much of the paper Precision purchased consisted of carbonless forms paper, dkt. no. 25, at 151, which came directly from Appleton Paper, was priced solely by Appleton, and only passed through Unisource, which acted merely as a sales agent on those transactions. Because Unisource played no part in the pricing of carbonless forms paper, I will not consider sales of that type of paper in my antitrust analysis.

refused to take Precision on as a Rollsource customer because of its credit history.[3] *See* dkt. no. 20, exh. 8 *passim;* dkt. no. 33, exh. C at 22; exh. E, at 154–55. According to Precision, Unisource also promised to supply its paper needs at a price at or below "market."

Precision alleges that, in early 1995, it became aware that Unisource, contrary to its promise, was charging Precision twenty percent more for paper than the prices charged its competitors, Thornhill and BFI. Dkt. no. 25, at 131. That discovery was the impetus for the filing of this suit.

II. STANDARD FOR EVALUATING SUMMARY JUDGMENT MOTIONS

The standard for granting summary judgment is, twelve years after the *Celotex* trilogy of cases, well-established. Summary judgment shall be "rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed.R.Civ.P. 56(c). "[T]he burden on the moving party may be discharged by showing ... that there is an absence of evidence to support the nonmoving party's case." *Celotex Corp. v. Catrett,* 477 U.S. 317, 325, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986) (internal quotation marks omitted). "[S]ince a complete failure of proof concerning an essential element," *id.,* 477 U.S. at 323–24, on which a party bears the burden of proof at trial establishes that the moving party is "entitled to a judgment as a matter of law," the nonmoving party must establish the existence of every element essential to [its] case. *Id.*

Once the moving party has satisfied its burden, the nonmoving party is required by Federal Rule of Civil Procedure 56(e) to establish that there remains a genuine issue of material fact. *Clark v. Clabaugh,* 20 F.3d 1290, 1294 (3d Cir.1994). The nonmovant "may not rest upon mere allegation or denials of [its] pleadings, but must set forth specific facts showing that there is a genuine issue for trial." *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 256, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). A fact is material if it "might affect the outcome of the suit under the governing law ..." *id.,* 477 U.S. at 248, and is "genuine" "if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Id.* at 248, 257.

In determining whether a nonmovant has established the existence of a genuine issue of material fact requiring a jury trial, the evidence of the nonmovant must "be believed and all justifiable inferences are to be drawn in [its] favor." *Id.* at 255. Whether an inference is justifiable, however, depends on the evidence adduced. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574, 595–96, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986). An inference based upon speculation or conjecture does not create a material factual dispute sufficient to defeat summary judgment. *Robertson v. Allied Signal, Inc.,* 914 F.2d 360, 382 n. 12 (3d Cir.1990). Likewise, "simply show[ing] that there is some metaphysical doubt as to the material facts" does not establish a genuine issue for trial. *Matsushita,* 475 U.S. at 586.

III. LIABILITY UNDER THE ROBINSON–PATMAN ACT

A. Introduction

[1] Precision contends that Unisource practiced price discrimination in violation of § 2(a) of the Robinson–Patman Act by granting Precision's principal competitors lower prices than it gave Precision.[4] This type of disparate pricing, in which a manufacturer or distributor favors certain of its customers at the expense of others, is known as secondary line discrimination, in contrast to primary

3. In May 1995, Precision stopped making its debt reduction payments and Unisource filed a collection suit in the Allegheny County Court of Common Pleas, which is docketed at GD 95–20037 and is still pending.

4. The Robinson–Patman Act is, in actuality, a 1936 legislative amendment of the 1914 provisions of the Clayton Act. *See* 49 Stat. 1526 (1936); 38 Stat. 730 (1914). Thus, the Clayton and Robinson–Patman acts will be referred to interchangeably, except where the difference is significant.

line discrimination, in which one seller charges discriminatory prices in order to gain an advantage over its own competitors. *See, e.g., Best Brands Beverage, Inc. v. Falstaff Brewing Corp.*, 842 F.2d 578, 584 n. 1 (2d Cir.1987); ABA Section of Antitrust Law, *Antitrust Law Developments (hereinafter "ABA Treatise")* 446 (4th ed.1997); William C. Holmes, *Antitrust Law Handbook* § 3.03, at 494 (1997).

[2] "Stated broadly, Section 2(a) of the Clayton Act provides that a seller cannot discriminate in price between purchasers of goods of like grade and quality where substantial competitive injury may result." Holmes, *supra*, § 3.02, at 483. Although the Act's purpose is simple to state, its interpretation and application are not; indeed, because of its imprecise drafting, numerous courts and commentators have noted that Robinson–Patman is one of the most difficult, if not inscrutable, antitrust laws in existence. As one commentator has written:

> [T]he Robinson–Patman Act of 1936[ ] is the most awkwardly drafted of all antitrust legislation. This statute was a roughly hewn, unfinished block of legislative phraseology when it left Congress, and has required much interpretive refinement by the [Federal Trade] Commission and the courts to reveal the contours of its meaning and application. Indeed, so confusing is some of this language that experience in applying its provisions is the only reliable guide for the wise practitioner.

Jerrold G. Van Cise *et al., Understanding the Antitrust Laws* 56 (9th ed.1986); *accord Automatic Canteen Co. v. Federal Trade Comm'n*, 346 U.S. 61, 65, 73 S.Ct. 1017, 1020, 97 L.Ed. 1454 (1953) (Frankfurter, J.) ("precision of expression is not an outstanding characteristic of the Robinson–Patman Act"); Robert H. Bork, *The Antitrust Paradox* 382 (2d ed.1993) (referring to the Act as "the misshapen progeny of intolerable draftsmanship coupled to wholly mistaken economic theory"); Holmes, *supra*, § 3.02, at 483 (the Robinson–Patman Act is "[t]he most complex and controversial of the antitrust laws"); ABA Treatise, *supra*, at 429 (the Act's "complex draftsmanship has led to extensive interpretation").[5]

Section 2(a) of the Robinson–Patman Act provides that:

> It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of commodities of like grade and quality, where either or any of the purchases involved in such discrimination are in commerce, where such commodities are sold for use, consumption, or resale within the United States or any Territory thereof or the District of Columbia or any insular possession or other place under the jurisdiction of the United States, and where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them: Provided, That nothing herein contained shall prevent differentials which make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered: Provided, however, That the Federal Trade Commission may, after due investigation and hearing to all interested parties, fix and establish quantity limits, and revise the same as it finds necessary, as to

5. The Act has been assailed on policy grounds as well, the most frequent criticism being that its prohibitions on price discrimination protect inefficient competitors at the expense of consumer welfare, placing the Act in tension with the remainder of antitrust law. *See, e.g.*, Bork, *supra*, at 382–94. Indeed, the government, which has responsibility for enforcing the Act's provisions, has largely ignored it in recent times. *See* Holmes, *supra*, at 484 (noting that the United States Department of Justice "has been openly critical of the Act for several years and has refrained from actively enforcing it"); ABA Treatise, *supra*, at 430 ("government enforcement generally has been limited to FTC cases, and FTC enforcement of the Act in the last fifteen years has been minimal"). For purposes of adjudicating this case, of course, such criticism carries no weight; this court's task—and its only task absent unconstitutionality—is faithfully to apply any statute that Congress has enacted.

particular commodities or classes of commodities, where it finds that available purchasers in greater quantities are so few as to render differentials on account thereof unjustly discriminatory or promotive of monopoly in any line of commerce; and the foregoing shall then not be construed to permit differentials based on differences in quantities greater than those so fixed and established: And provided further, That nothing herein contained shall prevent persons engaged in selling goods, wares, or merchandise in commerce from selecting their own customers in bona fide transactions and not in restraint of trade: And provided further, That nothing herein contained shall prevent price changes from time to time where in response to changing conditions affecting the market for or the marketability of the goods concerned, such as but not limited to actual or imminent deterioration of perishable goods, obsolescence of seasonal goods, distress sales under court process, or sales in good faith in discontinuance of business in the goods concerned.

15 U.S.C. § 13(a). I will now proceed to analyze the facts presented by this record against the recognized elements of a case arising under the above-quoted statutory provision.

B. The Commerce Requirement

[3, 4] Section 2(a) of the Act makes it "unlawful for any person *engaged in commerce, in the course of such commerce,* ... to discriminate in price ... where either or any of *the purchases involved in such discrimination are in commerce....*" 15 U.S.C. § 13(a) (emphases added). Thus, the plaintiff must establish three elements to meet the commerce requirement: (1) the defendant must be engaged in interstate commerce; (2) the price discrimination must occur in the course of that commerce; and (3) at least one of the transactions that the plaintiff proffers for comparison to prove discriminatory pricing must have actually moved in commerce; that is, crossed a state line. *Gulf Oil Corp. v. Copp Paving Co.*, 419 U.S. 186, 195, 200, 95 S.Ct. 392, 42 L.Ed.2d 378 (1974).[6] As a practical matter, if the third element is satisfied, the first two will be as well. *See Liquilux Gas Servs. v. Tropical Gas Co.*, 303 F.Supp. 414, 416–17 n. 2 (D.P.R. 1969); *In re International Tel. & Tel. Corp.*, 104 F.T.C. 280, 419 (1984); ABA Treatise, *supra*, at 430 & n. 9.

[5] In any event, Unisource does not dispute, nor could it, that it engages regularly in interstate commerce. The fact that it purchases and sells paper from out-of state manufacturers through warehouses in several states to customers dispersed among those states satisfies this requirement. Moreover, it is clear that Unisource's alleged price discrimination took place "in the course of such commerce." The discrimination Precision alleges occurred in the course of Unisource's regular business of selling paper, not in some isolated transaction unrelated to it, such as the sale of a used forklift from Unisource's warehouse.

That leaves the question, did the goods in at least one of the sales that Precision must compare to prove discriminatory pricing physically cross a state line? In the direct sense, the answer is "no." Precision, its principal competitors and the Unisource warehouse through which the shipments passed are all located within Pennsylvania. From this, Unisource argues that its sales fail the commerce test set forth in *Copp*. This is only partly correct.

In *Copp*, the plaintiff was a producer of asphaltic concrete used for surfacing highways and defendants were manufacturers of liquid petroleum asphalt, a key component of plaintiff's product. 419 U.S. at 188–89. Plaintiff alleged that defendants had sold asphalt at discriminatory prices, charging more for the product in places where plaintiff was not a competitor. *Id.* at 190–91. All of defendant's relevant sales were made inside the State of California, and, due to the extreme bulk and low value of asphaltic concrete,

6. This statutorily imposed "in commerce" nexus is a significantly higher burden than that present under the Commerce Clause in general, or the Sherman Act in particular. *Id.*, 419 U.S. at 194–95. The commerce requirement under the Robinson–Patman Act, therefore, is properly viewed as both a substantive and jurisdictional prerequisite for the imposition of liability.

plaintiff could sell its product only inside its home state. *Id.* at 188–89. Plaintiff accordingly argued that the fact that the asphaltic concrete was used to surface local segments of the interstate highway system caused the sales to be "in commerce."

The Supreme Court disagreed, holding that, under the stringent commerce test set forth in the Act, one or more of the compared transactions must cross a state line. *Id.* at 200. In so holding, the Court stressed the need for the "facially narrow" language of the Act to be applied in a manner that is "anchored to the economic realities of interstate markets, the intensely practical concerns that underlie the purposes of the antitrust laws." *Id.* at 198. Thus, the Court opined that the Act reaches "only persons or activities within the flow of interstate commerce—the practical, economic continuity in the generation of goods and services for interstate markets and their transport and distribution to the consumer." *Id.* at 195.

A similar result was reached in *Coastal Fuels of Puerto Rico, Inc. v. Caribbean Pet. Corp.*, 79 F.3d 182 (1st Cir.), *cert. denied*, —— U.S. ——, 117 S.Ct. 294, 136 L.Ed.2d 214 (1996). There, plaintiff operated a refined petroleum distribution business in Puerto Rico, which sold, *inter alia*, bunkering oil used to fuel ships. Defendant operated an oil refinery on the same island. *Id.* at 186. Plaintiff alleged that defendant practiced price discrimination by selling fuel to plaintiff's competitors at lower prices, eventually forcing plaintiff out of business. The court held that § 2(a) of the Robinson–Patman Act could not be applied because none of the sales had crossed a state line. *See id.* at 189, 190.

[6] This general rule is refined, however, by the "stream of commerce" doctrine. When a manufacturer ships its goods in interstate commerce to a wholesaler's warehouse for its general inventory, any otherwise intrastate sales the wholesaler then makes to its customers are not considered "in commerce." The stream of commerce is deemed to have been broken. As one court put it:

> The flow of commerce ends when goods reach their "intended" destination. In gauging the point of destination courts consider whether goods coming from out of state respond to a particular customer's order or anticipated needs. If so, the sales meet the "in commerce" requirement even though the goods may be stored in a warehouse before actual sale to the buyer. However, goods leave the stream of commerce when they are stored in a warehouse or storage facility for general inventory purposes, that is, with no particular customer's needs in mind.

Zoslaw v. MCA Dist. Corp., 693 F.2d 870, 878 (9th Cir.1982) (citations omitted).[7]

[7] Accordingly, it is generally held that such warehouse sales lose their intrastate character, notwithstanding an intrastate sale, if any of the following three conditions are met: (1) the goods are purchased by the supplier upon the order of a customer with the definite intention that the goods are to go at once to the customer; (2) the goods are purchased by the supplier to meet the needs of specified customers pursuant to some understanding with the customer, even though the goods are not to be delivered to the customer immediately; (3) the goods are purchased by the supplier based upon anticipated needs of specific customers. *See, e.g., L & L Oil Co. v. Murphy Oil Corp.*, 674 F.2d 1113, 1116 (5th Cir.1982); *Luzerne & Lackawanna Supply Co. v. Peerless Indus., Inc.*, 855 F.Supp. 81, 85 (M.D.Pa.1994); *Callahan v. A.E.V., Inc.*, No. 92–556, 1994–2 Trade Cases (CCH) ¶ 70,761, 1994 WL 682756, *7 (W.D.Pa. Sep. 26, 1994) (citing cases); *cf. Standard Oil Co. v. FTC*, 340 U.S. 231, 237–38, 71 S.Ct. 240, 243–44, 95 L.Ed. 239 (1951) (gasoline stored at bulk facility in anticipation of customers' anticipated winter demands remained in interstate commerce).

[8] Applying this standard, it is evident that none of Unisource's sales to Precision met the commerce requirement. Precision purchased from Unisource's Pittsburgh

7. The *Zoslaw* court acknowledged the Supreme Court's decision in *Copp* and held, along with two other circuits, that the stream of commerce doctrine retained its viability after that case. *Id.* at 878 n. 10 (citing cases).

warehouse on an ad hoc, spot-market basis as its needs dictated. None of the goods it purchased physically crossed a state line between their shipment by Unisource and their receipt by Precision. Except for the few truckload purchases Precision made, which it neither identifies in the record nor relies upon in its price comparisons, all of Unisource's sales to Precision retained their intrastate character.

[9] Unisource's sales to Precision's competitors stand on a somewhat different footing. Those customers commonly purchased by the truckload or through the JIT program, whether from Unisource or Rollsource. Truckload sales were shipped from outside Pennsylvania and thus directly satisfy the commerce requirement. And in order to participate in the JIT program, purchasers had to commit to certain tonnage requirements in advance. Accordingly, all of Unisource's purchases from the various paper manufacturers to supply its JIT requirements were made to meet "the anticipated needs of specific customers," *Murphy*, 674 F.2d at 1116. As to these sales, the stream of commerce was not broken and the commerce requirement was accordingly met. To recapitulate, all of the competitors' truckload and JIT sales remained in commerce.[8]

C. *Price Discrimination*

1. Legal Standard

[10, 11] For any claim asserted under § 2(a) of the Robinson–Patman Act to succeed, the plaintiff must adduce evidence of an actual instance of price discrimination. This requirement is straightforward: under the Act, "price discrimination means nothing more than a difference in price charged to different purchasers or customers of the discriminating seller for products of like grade or quality." *Stelwagon Mfg. Co. v. Tarmac Roofing Sys., Inc.*, 63 F.3d 1267, 1271 (3d Cir.1995) (citing cases); *accord Texaco, Inc. v. Hasbrouck*, 496 U.S. 543, 559, 110 S.Ct. 2535, 110 L.Ed.2d 492 (1990) ("price discrimination within the meaning of § 2(a) is merely a price difference"). The different prices, however, must have been charged at reasonably contemporaneous times. *See Zwicker v. J.I. Case Co.*, 596 F.2d 305, 309 (8th Cir. 1979); *Atalanta Trading Corp. v. FTC*, 258 F.2d 365, 371–72 (2d Cir.1958) (§ 2(d) case).

2. Facially Disparate Prices

There is no question that Unisource made sales to two or more different purchasers, or that the products sold were of like grade and quality. Precision, Thornhill and BFI all purchased standard grades of roll paper from Unisource. Nor can it be seriously contended that the sales were not reasonably contemporaneous; indeed, the record indicates that at least one pair of sales took place on the same day. Dkt. no. 25, at 243–44.

[12] The record also indicates that the same product was sold at facially different prices. On February 8, 1994, for example, Precision purchased 12 pound white forms bond and 15 pound white forms bond paper from Unisource (Copco), priced at $57.00 and $50.50 per hundredweight, respectively. That same day, BFI purchased the same two types of paper from Rollsource at $46.00 and $38.00, respectively. *Id.*

Precision also relies on certain invoices, *see* dkt. no. 25, at 220–23, which most likely document an April 1992 warehouse sale because less than a full truckload of paper was shipped, although it could have been a JIT less-than-truckload sale. If it was only a warehouse sale, then it retained its intrastate character and was not actionable. It is not clear from this record, at least as argued by the parties, whether this, or any, Unisource invoice constituted a discriminatory, "in commerce" sale to a Precision Printing competitor. If such a sale took place, then a facial instance of price discrimination exists there as well. In either event, however, Precision has adduced sufficient evidence of at least one price difference on an "in commerce" (Rollsource) transaction.[9]

8. Of course, if Precision's competitors made any "spot" purchases, that is, purchases not covered by a JIT or similar agreement, those sales would, like Precision's, have to be considered intrastate in character.

9. Although not relevant to the instant discussion, the precise number of discriminatory sales bears heavily on the issues of economic harm and damages.

3. Sales by Rollsource

[13] For its part, Unisource argues that any sales made by Rollsource must be excluded as a matter of law from the price discrimination analysis. It contends that Rollsource is a separate, independently managed subsidiary and therefore its sales to Precision's competitors cannot be compared to Unisource's sales to Precision (dkt. no. 21, at 17). According to Unisource, unless the parent (Unisource) actively controls the operations of the subsidiary (Rollsource), the subsidiary's separate form must be respected.

I cannot accept Unisource's argument. Rollsource is a *division*, not a *subsidiary*, of Unisource, as evidenced by Rollsource's price lists (dkt. no. 33, at UW01023), invoices (*id.* at UW00561) and Unisource's own admissions in its reply brief (dkt. no. 38, at 8). Thus, there is no separate corporate form to "respect."

Even if Rollsource were a subsidiary, it is questionable whether the Third Circuit would follow the principal case that Unisource relies upon, *Acme Refrigeration of Baton Rouge, Inc. v. Whirlpool Corp.*, 785 F.2d 1240, 1243 (5th Cir.1986). The *Acme* court held that, "[i]n the absence of evidence that [the parent] actively controlled [the subsidiary] or the terms of the latter's sales, we must conclude that they are not the same seller." The court, however, failed to discuss a key Supreme Court case decided two years earlier, *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 104 S.Ct. 2731, 81 L.Ed.2d 628 (1984). There, in deciding that a subsidiary could not legally be said to conspire with its parent within the meaning of § 1 of the Sherman Act, 15 U.S.C. § 1, the Court opined:

> A parent and its wholly owned subsidiary have a complete unity of interest.... With or without formal "agreement," the subsidiary acts for the benefit of the parent, its sole shareholder. [T]he parent may assert full control at any moment if the subsidiary fails to act in the parent's best interests.... Antitrust liability should not depend on whether a corporate subunit is organized as an unincorporated division or a wholly owned subsidiary.... The economic, legal, or other considerations that lead corporate management to choose one structure over the other are not relevant to whether the enterprise's conduct seriously threatens competition.

Id., 467 U.S. at 771–72.

[14] This language, although technically dictum in the Robinson–Patman context, was extended to that act in another § 2(a) case, *Caribe BMW, Inc. v. BMW*, 19 F.3d 745 (1st Cir.1994). There, the First Circuit faced the issue of whether "a firm's wholly owned subsidiary and the firm itself amount to a 'single seller' under the Robinson–Patman Act[.]" Then judge Breyer, in a thoroughly reasoned opinion, concluded that they were a single entity for purposes of price discrimination analysis, relying on *Copperweld* to distinguish earlier contrary authority, including *Acme*. *Id.* at 749. The *Caribe* court also opined that "there does not seem to be any special Robinson–Patman Act purpose that a case-specific 'control' inquiry would further. To the contrary, one would not want a seller to be able to defeat the statute's clear objectives by transforming unlawful, into lawful, price discrimination through the creation of a separately incorporated 'distributor' that sells to the disfavored customers, whether or not the parent retained "control" over the pricing decisions of the subsidiary." *Id.* at 750.[10] In the face of this post*Acme* caselaw, I believe that the Court of Appeals, as well as the Supreme Court, would find *Caribe* persuasive. I therefore decline to accept Unisource's argument that even the subsidiary form should be respected in this instance.

4. The Functional Availability Defense

a. Introduction

Unisource contends that Precision's Robinson–Patman claim is negated by the "functional availability defense." According to Unisource, Precision had the option to take advantage of the same pricing programs offered to its competitors by participating in direct, JIT or truckload programs, but de-

10. *But see* Stephen Calkins, Copperweld *in the Courts: The Road to* Caribe, 63 Antitrust L.J. 345 (1995) (criticizing *Caribe*'s extension of *Copperweld* to the Robinson–Patman Act).

clined to do so. Thus, Unisource argues, any higher prices that may have been paid by Precision were strictly its own fault and liability cannot attach to Unisource.

[15] The functional availability defense is a judicial graft on § 2(a) and is not explicitly embodied in the text of the statute. ABA Treatise, *supra*, at 464; Holmes, *supra*, § 3.04, at 522. Although often referred to as a defense, it really is not a defense at all and is more properly thought of as the functional availability doctrine. As one court described it:

> Where a purchaser does not take advantage of a lower price or discount which is functionally available on an equal basis, it has been held that either no price discrimination has occurred, or that the discrimination is not the proximate cause of the injury.

Shreve Equipment, Inc. v. Clay Equipment Corp., 650 F.2d 101, 105 (6th Cir.1981) (citing cases, including *Sweeney & Sons, Inc. v. Texaco, Inc.*, 637 F.2d 105 (3d Cir.1980)). In *Sweeney*, the Third Circuit held that "a uniform pricing formula applicable to all customers is not a price discrimination under the act[,]" as long as the favored "price was available, not only in theory but in fact, to all purchasers." 637 F.2d at 120. The *Sweeney* court thus held that the plaintiff failed to establish that the defendant's pricing discriminated in violation of the Robinson–Patman Act.

b. Plaintiff's knowledge of the existence of defendant's special pricing plans

[16] A discount is not "functionally available" if the plaintiff did not know about it. *See Caribe*, 19 F.3d at 752. Here, however, the evidence indicates otherwise. Charles Bacu of Precision and Randy Dunkle of Unisource had discussed arrangements under which Precision would commit to specific quantities of paper in exchange for more favorable pricing, although Precision did not know at that time specifically what its competitors were paying or that they had taken advantage of it. Bacu admitted that Dunkle talked to him about truckload sales and the JIT program. Dkt. no. 20, Exh. 6, at 74, 76. And while Unisource never specifically offered him that program or gave him a price list, Precision was enrolled in a similar program at Brown Paper which did result in a lower price. *Id.* at 76. Thus, Bacu assumed that it would result in a lower price from Unisource as well. Nevertheless, Bacu told Dunkle that Precision could not avail itself of such a program with Unisource because he was having trouble keeping his commitment under Brown's plan and Precision was unable to commit to a set tonnage of paper per month. *Id.* at 78. The only reasonable inference from this evidence is that Precision knew that these discounts were available, but chose for its own reasons not to take advantage of them.

The same result obtains for truckload sales. Although Precision did occasionally buy a truckload on occasion in the past, its general policy was to buy paper as needed, not to fill up the warehouse. *Id.* at 60. That simply was not the fault of Unisource, but was a management decision by Precision.

That leaves only the Rollsource sales, as to which the record does indicate the existence of "in commerce" price differences. There, however, Rollsource declined to take Precision as a customer because of its past due credit history, just as it refused to take any customer with substantial past due balances. *See* dkt. no 33, exh. F at 24. "Section 2(a) is not violated when the credit decisions are based upon legitimate business reasons." *Bouldis v. U.S. Suzuki Motor Corp.*, 711 F.2d 1319, 1325 (6th Cir.1983) (holding no Robinson–Patman violation when manufacturer refused to extend favorable credit provisions to financially struggling dealer). Here, it was simply not an act of price discrimination to disfavor a buyer with a greater propensity for slow payment and doubtful accounts.

c. Were the favorable prices functionally available to all customers?

The availability doctrine is also limited by the requirement that the favorable prices must be functionally available to all customers. For example, if a manufacturer offers a bargain price on VCRs if the retailer purchases in lots of 100,000 units, that discount is functionally available only to the largest,

national chain retailers, not the local, independently owned appliance store. Hence, the discount does not satisfy the requirements of the availability defense. *See Federal Trade Comm'n v. Morton Salt Co.*, 334 U.S. 37, 42–43, 68 S.Ct. 822, 92 L.Ed. 1196 (1948) (availability defense denied where no individual retail grocers ever purchased sufficient quantities of salt to obtain discount pricing). Here, however, by Precision's own admission in its brief "[d]uring the time period of 1990 through 1995, the three companies [Precision, Thornhill and BFI] were of comparable size. All three [were] short to medium run business forms printing companies." Dkt. no. 24, at 5. Thus, Precision was not denied more favorable pricing because of its comparatively smaller size vis-a-vis its competitors, but because of reasons peculiar to Precision Printing itself, specifically its bad credit and inability to commit to purchases in advance.

d. Did a generally available special pricing program exist?

Precision nevertheless argues that the functional availability doctrine cannot be applied on summary judgment because the evidence is controverted as to whether these special pricing programs even existed or their terms were met by those companies receiving the favorable prices. It relies for this contention on the testimony of its competitors' personnel, through which it purports to show that the competitors were not aware that they received any special prices, and on the testimony of one of its own employees through which it seeks to establish that BFI and Thornhill were ineligible for JIT pricing.

On Precision's first point, Mr. Drechsler of Thornhill Printing testified that he had no idea what the JIT discount was or meant. Dkt. no. 33, exh. D at 54–55. He also testified that he participated in no special pricing programs with Unisource. *Id.* at 38. Drechsler also testified that, although he provided lists of paper quantities that Thornhill was committing to purchase in the future, no one at Unisource asked him to do so. *See* dkt. no. 37, exh. 15, at 38. Nevertheless, while this witness may have suffered a lapse of memory or been ignorant of the pricing program's terms, the price lists on which he was examined during that phase of his testimony clearly referred to "JIT Warehouse Pricing." Dkt. no. 33, exh. J. UW9320–27. No contention is made that the documents were forged or fraudulent. Accordingly, Precision's reliance on Drechsler's ignorance of the program is unavailing.

Moreover, Thornhill normally purchased paper by the truckload, which Precision did not. *Id.* at 65–66. That in itself, would justify charging Thornhill a lower price, whether the truckloads were part of a JIT plan or not. If those truckloads came out of Unisource's general inventory, then they were not "in commerce," as already discussed. On the other hand, if they were not warehouse sales, they must have been part of a JIT or similar plan. So, either the lower price was not actionable, or it proves the existence of the very plan Precision denies.[11]

The best argument Precision has against applying the functional availability doctrine is that David Howell, a current Rollsource and former Unisource executive, did not name Thornhill and BFI as JIT customers, as evidenced in the following exchange:

> Q. So to your knowledge neither BFI nor Thornhill were participating in a JIT prior to Rollsource?
>
> A. In either of those account situations, I don't think there was ever a firm commitment made to be a preferred source or a single source. . . .

Dkt. no. 33, exh. F at 29. Arguably, one could infer from this testimony that Thornhill and BFI were receiving the benefits of JIT pricing without meeting the same terms offered to others, including Precision. That would negate the functional availability doctrine and amount to price discrimination.

Nevertheless, such an inference is negated by the undisputed facts that Precision knew that discount programs were available, and

11. Even if the truckload were shipped out of the general inventory of a Unisource warehouse in another state, the fact remains that Precision had the opportunity to buy by the truckload—and had done so in the past—but declined to avail itself of that purchasing option during the time period relevant to this litigation.

that its competitors were committing to purchase certain tonnages of paper in advance, *see* dkt. no. 37, exh. 16, at 78. That commitment is what defendant asserts as the *sine qua non* of the JIT program in its brief and that is precisely what BFI and Thornhill, but not Precision, were able to make and keep. Had Precision not been financially troubled, and had management not made a policy decision to buy paper only on an "as-needed" basis, Precision would have had the benefit of the favorable prices enjoyed by its competitors. There would then have been no disparate pricing, regardless of whether those competitors were "really" eligible for the lower prices, and thus, no violation of the Robinson–Patman Act.

e. Conclusion

Accordingly, I conclude that there is no genuine issue of material fact and that Unisource has satisfied the requirements to assert the functional availability doctrine. There was therefore no price discrimination, and no violation of the Act. For the sake of completeness, however, I will proceed to analyze the other elements of Precision's Robinson–Patman claim.

D. Competitive Injury

Section 2(a) of the Robinson–Patman Act makes disparate pricing illegal only "where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them[.]" 15 U.S.C. § 13(a). In addition, § 4 of the Clayton Act provides a private right of action for treble damages only to "any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws." 15 U.S.C. § 15. I will analyze these two standards *seriatim*.

1. Section 2(a) of the Robinson–Patman Act

[17] The statute provides two ways for a plaintiff to demonstrate competitive harm. First, it can attempt to prove that the price discrimination was of such a character that may substantially "lessen competition or tend to create a monopoly[.]" 15 U.S.C. § 13(a). Second, the plaintiff can adduce evidence showing that the defendant's disparate pricing regime may substantially "injure, destroy or prevent competition with any person who either grants or knowingly receives its benefits, or the customers of either of them[.]" [12] *Id.* Unlike other federal antitrust statutes, which focus on harm to competition generally, *Brown Shoe Co. v. United States*, 370 U.S. 294, 320, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962), the Robinson–Patman Act is directed toward protecting individual *competitors* as well, *J.F. Feeser, Inc. v. Serv–A–Portion, Inc.*, 909 F.2d 1524, 1531, 1535 (3d Cir.1990). Accordingly, the Act sets forth what is referred to as an "incipiency standard," meaning that a reasonable possibility of competitive harm, as opposed to demonstrated, actual harm, is sufficient to prove competitive injury. *See Falls City Industries, Inc. v. Vanco Beverage, Inc.*, 460 U.S. 428, 434–35, 103 S.Ct. 1282, 75 L.Ed.2d 174 (1983).

12. An interesting issue that arises under this language is whether, in a secondary line price discrimination case, the favored competitor must have actual knowledge of the discrimination. The statute, as set forth in the main text, proscribes price discrimination where its effect may be to "prevent competition with any person who either grants or *knowingly* receives the benefit of such discrimination, or with customers of either of them[.]" 15 U.S.C. § 13(a) (emphasis added). Preventing competition with the grantor (Unisource) is not an issue here, because this is not a primary line case, and there is no cited evidence in the record that Thornhill or BFI knew they were receiving better prices than Precision was being charged. In order to find competitive injury, then, I must rely upon the language referring to "with customers of either of them," specifically Precision's competition with Thornhill and BFI as the common customers of Unisource. Such a construction of the statutory text is plausible, but it tends to render "knowingly receives" as surplusage, in derogation of long-recognized canons of construction, under which courts should give meaning and effect to every word and phrase in a statute. Applying that canon, it would appear that the "customers of" language was included only to make "tertiary line" cases actionable and not to eliminate the knowledge requirement in secondary line cases. Because neither party raises this issue, and I have found no authority resolving it, I will proceed on the assumption that knowledge on the part of the favored purchaser is not required.

[18] After many decades of judicial interpretation of the two-part statutory test quoted above, it has become well-settled that competitive injury, as a practical matter, "is usually shown in either of two ways: proof of lost sales or profits, or ... proof of a substantial price discrimination between competitors over time." *Feeser*, 909 F.2d at 1535 (citations omitted). I will address these two alternate standards in turn.

a. Direct evidence of lost sales or profits

[19] In *Feeser*, the evidence of lost sales the court found most persuasive was the testimony of the plaintiff's customers to the effect that plaintiff "lost sales because of its inability to match its competitors' prices...." 909 F.2d at 1537. Here, as in that case, there is testimony, in the form of a customer's affidavit, that at least one customer shifted business away from Precision because it was no longer price-competitive. Dkt. no. 25, at 1–2. In response, Unisource points to other evidence that other customers abandoned Precision because it made direct sales in competition with them or because they thought Precision was financially unstable. Precision's evidence is sufficient, nevertheless, for it to raise a genuine issue of material fact on the issue of competitive harm.

b. Evidence of substantial price discrimination over time

This test, which has its roots in *Morton Salt*, presumes adverse competitive effects where "the price differential is (1) substantial enough to influence a disfavored customer's resale prices; or (2) occurs in a market with low profit margins and intensive competitive conditions." *Feeser*, 909 F.2d at 1538 (citing *Morton Salt*, 334 U.S. at 47, 68 S.Ct. at 828–29). "Generally, the longer the duration [of the price discrimination], the more likely injury will be found." In *Stelwagon Mfg. Co. v. Tarmac Roofing Systems, Inc.*, 63 F.3d 1267, 1272–73 (3d Cir.1995), the court held that evidence of price discrimination in the range of 5–25% over three to four years was sufficient to meet this standard.

[20] Here, Precision relies on the affidavit of its expert, Holly Sphar, CPA, who prepared an analysis of the prices charged to Precision and its competitors over the 37-month period from January 1992 through January 1995 and concluded that Precision paid eleven percent more for paper than did its rivals. This report is problematic, however, because it appears to include intrastate warehouse sales in its comparisons. As discussed *supra*, these transactions are not eligible for comparison because, even if they involve discriminatory prices, intrastate price discrimination is not forbidden by the Robinson–Patman Act. There is no indication in the Sphar report of which, if any, of the alleged discriminatory prices involved "in commerce" transactions, either as Rollsource sales, JIT sales or truckload shipments from Unisource. Rollsource, it must be noted, came into existence only in 1994. Accordingly, plaintiff has not adduced sufficient evidence of substantial price discrimination over time.

2. Section 4 of the Clayton Act

[21] As already stated, there are two parts to the injury requirement in a Robinson–Patman case in which money damages are sought. While the mere likelihood of injury to competition or a competitor will suffice if the plaintiff seeks only an injunction, its entitlement to damages arises under § 4 of the Clayton Act, 15 U.S.C. § 15. *Feeser*, 909 F.2d at 1539. That section provides a private right of action for treble damages to "any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws...." Thus, in order to have standing to bring suit for damages, the plaintiff must show "fact of damage." *E.g., Allen–Myland, Inc. v. IBM Corp.*, 33 F.3d 194, 201 (3d Cir.1994). "The amount of the damage is not important for antitrust standing; it is sufficient that some damage has occurred. There must, however, be some causal link between the damage and the violation of the antitrust laws." *Id.*

[22] Although "antitrust plaintiffs have not been held to an unduly rigorous standard of proving antitrust injury," *Stelwagon*, 63 F.3d at 1273, and need only show a reasonable inference to avoid summary judgment

under *Feeser*, 909 F.2d at 1539–40, if the "direct evidence of injury" is insufficient to show that the defendant's antitrust violations, as opposed to other causes, contributed to some extent to plaintiff's injuries, plaintiff may not recover in damages. *Stelwagon*, 63 F.3d at 1274–1276.

[23] In this case, Precision has produced evidence from which a factfinder could conclude that the plaintiff suffered actual injury, specifically the evidence of lost sales because Precision became uncompetitive in its pricing. Under *Feeser*, that is sufficient. 909 F.2d at 1540. While defendant has produced evidence that other factors caused Precision to fail, Precision has sufficiently presented a disputed issue of material fact on this point.

E. Summary

Although Precision has raised disputed issues of material fact as to many of the elements of its Robinson–Patman claim, that claim fails in its entirety under the functional availability doctrine. Precision had the opportunity to obtain the lower prices it complains its competitors received, but, for its own reasons, chose or found itself unable to do so. Unisource is entitled to summary judgment on this claim, which will be dismissed with prejudice.

IV. PRECISION'S STATE LAW CLAIMS

In addition to its Robinson–Patman antitrust claim, Precision has also alleged that Unisource made and breached oral promises that it would provide Precision with paper at or below the market price. In the alternative, Precision contends that Unisource never intended to fulfill its promise and is guilty of fraud.

A. Breach of Contract

Precision avers that Unisource made an oral agreement under which it promised to sell paper to Precision at or below "market" price, an agreement Unisource breached when it gave Precision's competitors better pricing. This claim is problematic, for two reasons.

First, all of Unisource's sales to Precision were made pursuant to standard, printed invoices. Dkt. no. 20, Dunkle decl. ¶ 2. These invoices contain *inter alia*, an integration clause:

> 14. **MISCELLANEOUS.** This contract constitutes the entire agreement between Buyer and Seller relating to the goods or services covered hereunder. No modifications shall be binding upon the Seller unless in a writing signed by Seller's duly authorized representative....

Dkt. no. 20, exh. 3. Precision attempts to avoid the effect of this clause, and the parol evidence rule it triggers,[13] by invoking section 2–207 of the Uniform Commercial Code, which provides:

> Additional terms in acceptance or confirmation
>
> (a) General rule.—A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.
>
> (b) Effect on contract.—The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:
>
> (1) the offer expressly limits acceptance to the terms of the offer;
>
> (2) they materially alter it; or
>
> (3) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.
>
> (c) Conduct establishing contract.—Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the

13. *See* 13 Pa.C.S.A. § 2202. Precision does not attempt to argue that the integration clause, if a part of the parties' contract *vel non*, was not "intended ... as a complete and exclusive statement of the terms of the agreement." *Id.* Thus, to the extent the parol evidence rule applies, as discussed *infra*, both consistent and contradictory oral evidence must be excluded. *See id.*

writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this title.

13 Pa.C.S.A. § 2207

Section 2–207 provides rules to deal with the "battle-of-the-forms" that often results when the buyer's purchase order and the seller's invoice contain conflicting terms. Those provisions have no application to this case, because there apparently were no dueling forms. Precision points neither to purchase orders nor to any other documents that purport to contravene any of the terms printed on Unisource's invoices.

[24–26] Even if there were such evidence, under § 2–207(b), Unisource's terms would be "construed as proposals for addition to the contract." *Id.* Because both parties are merchants, as defined in § 2–104,[14] Unisource's terms would be presumed to become part of the contract, unless they constituted material alterations or Precision lodged a timely objection to their inclusion. The record in this case is devoid of any evidence that Precision ever objected to the integration clause at any time during its course of dealing with Unisource, and Precision does not contend that the clause worked a material alteration of the bargain. Thus, the parol evidence rule is applicable and bars Precision from proving the terms of its alleged oral agreement. *See, e.g., Mellon Bank Corp. v. First Union Real Estate Equity & Mortgage Investments,* 750 F.Supp. 711, 714 (W.D.Pa. 1990) (Smith, J.) (citing cases), *aff'd,* 951 F.2d 1399, 1404–08 (3d Cir.1991); *Gianni v. R. Russel & Co.,* 281 Pa. 320, 126 A. 791 (1924).

Second, even if Precision were free from the restraints of the parol evidence rule and could attempt to prove an oral contract, Precision has failed to define the terms of that contract with any real specificity, as required by Pennsylvania law. *See, e.g., Seiss v. McClintic–Marshall Corp.,* 324 Pa. 201, 188 A. 109, 110 (1936). Indeed, Precision cannot even define the meaning of the term "market price;" its principal witness, Charles Bacu, testified that he didn't "know if there is a market price of paper. I never heard of a market price of paper, ever. . . ." Dkt. no. 20, exh. 6, at 92. Precision's best—and only—direct evidence of any kind of oral contract arises from the following snippet of testimony from Paul Blatnicky:

> Q. Did anybody from Unisource tell you that the prices at which Unisource *was selling* to Precision Printing were at or below the market price?
>
> A. I would say probably Randy Dunkle, yes.
>
> Q. To the best of your recollection, what were the words he used?
>
> A. "Paul, you *got* the best prices. Paul, we are going to keep you competitive. Paul we are not going to raise your prices this time even though we are raising everybody else's prices because we want you to be more competitive and give us more money.

Dkt. no. 33, exh. C at 68 (emphases added). This is insufficient.

[27] Dunkle's representation is not a promise that Unisource will, for a set period of time, sell Precision all of its paper needs at or below market price, but merely a statement of what Unisource's practice was at the time the statement was made, coupled with vague assurances about the future that do not lend themselves to effective judicial enforcement. Because Dunkle made no enforceable promise, Unisource cannot be held liable for allegedly breaching it.[15]

14. That section provides that a merchant is someone who "deals in goods of the kind[,] or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction. . . ." 13 Pa.C.S.A. § 2104. Comment 2 states that, under § 2–207, "almost every person in business would . . . be deemed to be a merchant. . . ." Here, both parties regularly deal in bulk paper, and must therefore be considered merchants within the meaning of this section.

15. Precision also attempts to use these statements to prove a course of dealing, as permitted by 13 Pa.C.S.A. § 2202(1). Under 13 Pa.C.S.A. § 1205, "[a] course of dealing is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding

Accordingly, Precision's breach of contract claim fails and will be dismissed with prejudice.

B. Fraud

Precision has also sued Unisource for fraud, alleging:

> 16. During the meetings between Plaintiff's representatives and Defendant's representatives, defendant promised that the price charged to Plaintiff for any purchases of wholesale paper products during the years 1993, 1994 and 1995 would be at or below the relevant market price for the particular wholesale paper products.

Dkt. no. 10, ¶ 16. Precision had earlier attempted to raise this issue as a counterclaim in the collection action pending against it in the Allegheny County Court of Common Pleas, but that court denied leave to amend its answer because Precision alleged only "a promise to do something in the future that [was] not kept," dkt. no. 20, exh. 5, an allegation insufficient, without more, to make out a claim of fraud.[16] I agree.

[28–31] The law of fraud is well-settled. As the late Judge (formerly Justice) Hutchinson put it:

> Under Pennsylvania law, fraudulent misrepresentation has five elements, each of which must be proved by clear and convincing evidence. The elements are:
>
> (1) a misrepresentation, (2) a fraudulent utterance thereof, (3) an intention that the recipient will thereby be induced to act, (4) justifiable reliance by the recipient upon the misrepresentation, and (5) damage to the recipient as a proximate result.
>
> Pennsylvania law requires the trial judge to decide as a matter of law before he submits a case to the jury whether plaintiffs' evidence attempting to prove fraud is sufficiently clear, precise and convincing to make out a prima facie case.

Mellon Bank Corp. v. First Union Real Estate Equity & Mortgage Investments, 951 F.2d 1399, 1409 (3d Cir.1991); *accord Krause v. Great Lakes Holdings, Inc.*, 387 Pa.Super. 56, 563 A.2d 1182, 1187 (1989). A mere promise to perform future acts, which promise is not kept, does not amount to fraud, *Mellon Bank*, 951 F.2d at 1409; *Krause*, 563 A.2d at 1187, although a promise which the promisor had no intention of keeping at the time he made it may be actionable as fraud. *Mellon Bank*, 951 F.2d at 1410 (citing cases); *Phoenix Technologies, Inc. v. TRW, Inc.*, 834 F.Supp. 148, 152 (E.D.Pa.1993).

[32] Precision's fraud claim founders, first, on the fact that there is insufficient evidence that any such promise was ever made, as discussed *supra*. Thus, the first element of fraud—a misrepresentation—is not satisfied.

Second, as Unisource argues, there is no evidence that its "promise"—if in fact one was even made—was uttered with the present intent not to perform it. Precision responds that, at the time the statements were made, Unisource knew that it was not performing according to its terms by giving Precision prices at or below market. Accordingly, Precision asserts that a factfinder could infer that the promise was false when made.

I cannot accept this argument, and the following hypothetical illustrates my point. If a merchant says to a customer, "From now on, I will give you prices at or below mar-

for interpreting their expressions and other conduct." Put another way, the manner in which the parties performed in a previous similar sales transaction provides a basis for interpreting what their contract requires of them under their present contract. Here, however, no evidence is cited or argued to indicate that Unisource ever gave Precision the favorable prices to which it claims it was entitled. Without such evidence of past performance, Precision can only establish a "course of promises," not a course of dealing. This argument, then, is nothing more than an attempt to use parol evidence to prove what Unisource allegedly promised. Course of dealing, which is admissible to explain or supplement even a fully integrated writing under UCC § 2-202, should not be permitted to be used as a "bootstrap" to avoid the stricter provisions of the parol evidence rule for complete and exclusive writings.

16. This state court holding would raise the question of preclusion if the judgment has become final. Because it is not clear from the record whether it has, I will proceed to decide the issue *de novo*.

ket," the fact that the merchant is not currently giving the customer the benefit of those prices has no bearing on its present intent to perform the promise. There could exist a whole host of reasons, totally unrelated to fraud, that would explain why the merchant would honestly promise to give superior pricing in the future, notwithstanding the inferior prices it was charging in the present. If the merchant had said, "you have always been given my most favorable prices, and you will continue to receive them in the future," then a claim of fraud becomes more persuasive. As Precision's argument stands, however, it cannot suffice. Precision's evidence simply does not permit the inference of a fraudulent state of mind.

Third, Precision has failed to sufficiently prove that it relied on Unisource's alleged misrepresentations, that is, that it made no special commitment to purchase paper from Unisource on account of its promise. I agree; the testimony of Precision officers and employees Bacu, Jurczak and Frueh indicates that Precision commonly price-shopped when purchasing paper. Dkt. no. 20, exh. 6, at 29–32, 70–72, exh. 8, at 57–58, exh. 10. Moreover, it is clear that Precision sometimes purchased paper from Unisource because other suppliers refused to extend credit to Precision. To the extent that occurred, those purchasing decisions were dictated by Precision's financial difficulties, not by its reliance on Unisource's promises. In the alternative, Precision would have taken the same actions even in the absence of the alleged misrepresentations.[17] Either way, the element of reliance is negated.

Finally, in its brief, Precision attempts to propound a theory at variance from the one alleged in its complaint and discussed *supra*:

> Precision's claim ... is that Dunkle made a false representation when he promised Precision that it would receive the best available price while at the same time Unisource was charging Precision's competitors substantially less ...
>
> Unisource's position [in this litigation] assumes that "market price" defines the industry price from all paper vendors. In this case, "market price" only defines what Unisource was charging its customers in the Pittsburgh area.

Dkt. no. 33, at 26–27. This theory also fails.

The term "market price" is defined as "the price that a commodity brings when sold in a given market; prevailing price." *Webster's New World Dictionary* 828 (3d coll. ed.1988). While market price could be interpreted to mean the price of paper generally in the Pittsburgh market, it cannot fairly be read to refer to the prices of a single seller in that market, at least in the absence of nearly perfect competitive conditions in which all suppliers charged the same price. Such market conditions were, as the record evidence of disparate prices and price-shopping behavior demonstrates, unknown in the Pittsburgh paper market. For Precision's theory to succeed, it would have to allege that Unisource promised it, not market price or better, but a price at or equal to the lowest price it charged any of Precision's competitors. Aside from the fact that this is not what Precision averred in paragraph 16 of its amended complaint, the record is devoid of sufficient evidence that any such representation was made, except for the testimony, quoted above, that, "Paul, you *got* the best prices." Even if that statement was made, it was not, as discussed supra, a promise to continue giving Precision the best prices.

I will therefore grant summary judgment to Unisource on this issue and dismiss the fraud claim with prejudice.

V. UNISOURCE'S COUNTERCLAIM AGAINST PRECISION

Unisource has counterclaimed against Precision for $189,072.64 in unpaid invoices, and for a service charge in the amount of $73,738.33. In his deposition, Paul Blatnicky of Precision acknowledged that it had an outstanding account payable to Unisource of $163,700. Dkt. no. 20, exh. 11, at 2, 6–10, 30. Thus, it is undisputed that Precision owes Unisource at least $ 163,700, and Unisource

17. These weaknesses in Precision's fraud theory are further exacerbated by the difficulty, discussed *supra* in the disposition of the breach of contract claim, of finding that Unisource ever made any specific promise.

seeks partial summary judgment in this amount. Precision's only response is that it is entitled to a set-off based upon the results of its contract and fraud claims. Because all of Precision's claims are being dismissed on the merits, this argument is unavailing and partial summary judgment will be granted to Unisource in the amount of $163,700. Any monies over and above that amount, of course, remain to be resolved in future proceedings in this case.

ORDER

AND NOW, this 30th day of January 1998, upon consideration of the parties' cross-motions for summary judgment (dkt.nos.20, 23) and the arguments relative thereto, it is hereby ORDERED and DIRECTED that:

1. Plaintiff's motion for summary judgment, dkt. no. 23, is DENIED.

2. Defendant's motion for summary judgment on plaintiff's claims and partial summary judgment on defendant's counterclaim, dkt. no. 20, is GRANTED.

3. Defendant's motion to compel deposition of Holly W. Sphar, dkt. no. 26 is DENIED AS MOOT.

4. Plaintiff's motion for protective order to quash subpoenas issued to third parties, dkt. no. 27, is DENIED AS MOOT.

5. Counsel shall appear in my Pittsburgh chambers on Friday, February 13, 1998, at 9:00 AM for a pretrial/status conference on the remaining issues presented by defendant's counterclaim.

KOPPERS COMPANY, INC., by its successor, BEAZER EAST, INC., Plaintiff,

v.

CERTAIN UNDERWRITERS AT LLOYD'S, LONDON, and Certain London Market Insurance Companies, Defendants.

Civil Action No. 85–2136.

United States District Court, W.D. Pennsylvania.

Feb. 23, 1998.

Insured brought action against primary and excess liability insurers to recover for breach of contract by failing to pay claims for property damage caused by pollution. Insured settled with several primary and excess insurers. The United States District Court for the Western District of Pennsylvania, Cohill, Senior District Judge, 847 F.Supp. 360, affirmed United States magistrate judge's opinion on privilege and work product issues. Appeal was taken. The Court of Appeals, 40 F.3d 1240, granted mandamus and vacated order. The District Court entered judgment for insured holding excess insurers liable for full amount of claim without reducing verdict to account for settlements with other insurers. Appeals were taken. The Court of Appeals, Stapleton, Circuit Judge, 98 F.3d 1440, reversed and remanded. Insured moved for partial summary judgment based on judicial estoppel and law of the case. The District Court, Maurice B. Cohill, Jr., J., held that: (1) insurers' admission in prior appeal that policies were triggered judicially estopped them from asserting inconsistent position that coverage was not triggered, and (2) jury's finding that insured had neither expected nor intended to damage property at any polluted sites was not law of the case.

Motion denied.

1. Estoppel ⇐68(2)

"Doctrine of judicial estoppel" is grounded in equity and precludes party from

sue here without improper or unconstitutional reference to the content of the expressive conduct it was regulating.

Finally, the Court must decide whether the incidental restrictions on the alleged First Amendment freedoms at stake here is no greater than is essential to the furtherance of Currituck County's governmental interest in enacting the ordinance. As discussed above, the governmental interest served by section 808 is the protection of the health, safety, morals, and general welfare of the citizenry of Currituck County. The Defendants have properly reserved HM districts for the legitimate establishment of adult entertainment businesses, and have therefore not completely barred the operation these businesses. The ordinance "expressly allows for reasonable alternatives to any asserted regulation of speech." *D.G. Restaurant*, 953 F.2d at 147. The ordinance is thus a valid time, place, and manner restriction. Plaintiffs' claims that the ordinance effectively "zones" them out of any commercially viable land is unavailing. As the Fourth Circuit noted in *D.G. Restaurant*, "[t]he decision to restrict adult businesses to a specific area does not oblige the [county] to provide commercially desirable land." *Id.*

CONCLUSION

The Court thus concludes that section 808 of the Currituck County ordinances serves an important and substantial governmental interest and does not by its terms regulate dancing or any communicative element alleged to have been conveyed by topless dancing, and that any incidental restriction on erotic dancing is permitted since the regulation by the ordinance is narrowly tailored. The regulation of adult entertainment by the Defendants is a content-neutral time, place, and manner restriction.

Plaintiffs' Motion for Summary Judgment is thus DENIED, and Defendants' Motion to Dismiss is hereby GRANTED.

SO ORDERED.

Sharon LAMB, Plaintiff,

v.

JOHN UMSTEAD HOSPITAL, Defendant.

No. 5:97CV–1019–BR3.

United States District Court, E.D. North Carolina, Western Division.

Sept. 1, 1998.

Employee, who had worked as a social worker for state-operated hospital, brought action against employer alleging violation of the Americans with Disabilities Act (ADA). On employer's motion to dismiss, the District Court, Britt, Senior District Judge, held that: (1) in enacting ADA, Congress effectively abrogated the states' immunity from suits by private citizens, and, therefore, employee was permitted to bring ADA claim against hospital, and (2) employee's complaint was sufficient to state prima facie case of discrimination under ADA, despite lack of specific allegations.

Motion denied.

1. Federal Courts ⇐265

In enacting Americans with Disabilities Act (ADA), Congress effectively abrogated the states' immunity from suits by private citizens, and, therefore, employee of state-operated hospital was permitted to bring ADA claim against hospital. U.S.C.A. Const. Amends. 11, 14; Americans with Disabilities Act of 1990, § 2 et seq., 42 U.S.C.A. § 12101 et seq.

2. Federal Courts ⇐265, 267

Under the Eleventh Amendment, a state is granted immunity from suits initiated by its own citizens in federal court if the state has not consented to such suits; however, Congress has the authority to abrogate a state's immunity pursuant the Fourteenth

Amendment. U.S.C.A. Const.Amends. 11, 14.

3. Federal Courts ⇐265

In determining whether, in attempting to abrogate the states' immunity from suit, Congress exceeded the scope of its powers under the Fourteenth Amendment, a court must first determine whether Congress has unequivocally expressed its intent to abrogate the immunity and, second, whether Congress has acted pursuant to a valid exercise of power in abrogating that immunity. U.S.C.A. Const.Amends. 11, 14.

4. Constitutional Law ⇐211(2)

Any law that draws a distinction among people is susceptible to an equal protection challenge. U.S.C.A. Const.Amend. 14.

5. Constitutional Law ⇐213.1(2), 215, 224(1)

While classifications subject to Fourteenth Amendment equal protection challenge based on race or national origin are subject to strict scrutiny, and classifications based on sex are subject to intermediate scrutiny, other classifications, like age and disability, are subject only to the rational basis test. U.S.C.A. Const.Amend. 14.

6. Constitutional Law ⇐213.1(2)

Under the rational basis test, a law subject to Fourteenth Amendment equal protection challenge will be upheld if it is rationally related to a legitimate government purpose. U.S.C.A. Const.Amend. 14.

7. Constitutional Law ⇐82(6.1)

Correct rule for determining the scope of Congress's power under enforcement clause of the Fourteenth Amendment is the *Boerne* proportionality test, according to which a statute must be proportional or congruent to the injury to be prevented or redressed. U.S.C.A. Const.Amend. 14.

8. Constitutional Law ⇐209, 213.1(1)

Levels of judicial scrutiny applied in equal protection cases are a judicial framework; they provide standards for determining the validity of state legislation or other official action that is challenged as denying equal protection, but do not define the limits of Congress's power to enforce the Fourteenth Amendment. U.S.C.A. Const.Amend. 14.

9. Constitutional Law ⇐70.3(6)

While the Supreme Court retains the power to decree the substance of the Fourteenth Amendment's restrictions on the states, and Congress may not enlarge those powers, Congress's conclusions regarding the need for given legislation are entitled to much deference. U.S.C.A. Const.Amend. 14.

10. Constitutional Law ⇐225.1

Enforcement clause of the Fourteenth Amendment allows Congress to enact legislation designed to eliminate irrational laws classifying the disabled and to prevent other arbitrary and invidious discrimination that deprives the disabled of the equal protection of the laws to which they are entitled if legislation is congruent and proportional to the injury to be prevented. U.S.C.A. Const. Amend. 14.

11. Constitutional Law ⇐209

Statute's lack of proportionality or congruence to the injury to be prevented or remedied indicates that Congress has, in effect, legislated the substance of the equal protection clause. U.S.C.A. Const.Amend. 14.

12. Civil Rights ⇐103

Congress's finding of a significant likelihood of unconstitutional action with respect to the disabled, as set forth in Americans with Disabilities Act (ADA), was entitled to judicial deference. Americans with Disabilities Act of 1990, § 2(a, b), 42 U.S.C.A. § 12101(a, b).

13. Civil Rights ⇐103

Americans with Disabilities Act (ADA) exhibits a congruence and proportionality between the injury to be prevented or remedied, namely, discrimination against the disabled, and the statutory provisions adopted as a means to that end; even though some provisions seek to address conduct that is not itself unconstitutional, ADA does not provide sweeping remedies that exceed the harms it is designed to redress. Americans with Dis-

abilities Act of 1990, § 2 et seq., 42 U.S.C.A. § 12101 et seq.

14. Constitutional Law ⇐82(6.1)

Fourteenth Amendment's enforcement clause does not constrain Congress in its choice of remedies, and Congress does not exceed the scope of its authority under the enforcement clause merely by enacting legislation that, among other things, imposes affirmative conduct upon the states. U.S.C.A. Const.Amend. 14.

15. Civil Rights ⇐103

Congress's imposition of affirmative conduct, such as reasonable accommodation, upon the states under the Americans with Disabilities Act (ADA) was not an attempt to establish the meaning of a constitutional provision, but rather was only one of the means chosen by Congress to effectuate the substantive equal protection right of freedom from discrimination to which the disabled were entitled. U.S.C.A. Const.Amend. 14; Americans with Disabilities Act of 1990, § 2 et seq., 42 U.S.C.A. § 12101 et seq.

16. Civil Rights ⇐103
Constitutional Law ⇐225.1

Americans with Disabilities Act's (ADA) accommodation provisions, even if viewed as provisions requiring special treatment of the disabled, were permissible under Fourteenth Amendment's enforcement clause; ADA most effectively accomplished its purpose of prohibiting arbitrary and irrational discrimination against qualified individuals with disabilities if it was interpreted as an attempt to achieve substantive, rather than mere formal, equality for the disabled. U.S.C.A. Const. Amend. 14; Americans with Disabilities Act of 1990, § 2 et seq., 42 U.S.C.A. § 12101 et seq.

17. Constitutional Law ⇐209

Legislation enacted to achieve a state of affairs where people are treated equally may justifiably include provisions requiring adjustments to the status quo, under Fourteenth Amendment's enforcement clause. U.S.C.A. Const.Amend. 14.

18. Civil Rights ⇐103
Constitutional Law ⇐225.1
Federal Courts ⇐265

Enactment of the Americans with Disabilities Act (ADA) fell within Congress's enforcement power under the Fourteenth Amendment and consequently was a valid and effective abrogation of the states' immunity to suit; Congress unequivocally expressed its intent to abrogate the states' immunity and there was a congruence and proportionality between injury to be remedied and means adopted to that end. U.S.C.A. Const.Amend. 11; Americans with Disabilities Act of 1990, § 2 et seq., 42 U.S.C.A. § 12101 et seq.

19. Civil Rights ⇐235(3)

Allegations in employee's complaint were sufficient to state prima facie case of discrimination under Americans with Disabilities Act (ADA), despite lack of specifics regarding the nature of her alleged disability, essential duties of her position, the impact of her alleged disability on her ability to perform the essential duties of her position with or without reasonable accommodation and a request for reasonable accommodations. Americans with Disabilities Act of 1990, § 102(a), 42 U.S.C.A. § 12112(a).

20. Civil Rights ⇐234

Court rule governing specificity in pleadings requires, at a minimum, that a plaintiff asserting a claim under the Americans with Disabilities Act (ADA) identify the nature of her alleged disability. Americans with Disabilities Act of 1990, § 102, 42 U.S.C.A. § 12112; Fed.Rules Civ.Proc.Rule 8(a)(2), 28 U.S.C.A.

John B. Meuser, Raleigh, NC, Deborah N. Meyer, Hollowell, Peacock & Meyer, Raleigh, NC, for Plaintiff.

Victoria L. Voight, Asst. Atty. Gen., Raleigh, NC, for Defendant.

ORDER

BRITT, Senior District Judge.

This matter is before the court on defendant's motion to dismiss. The motion has been fully briefed and is ripe for decision.

I. Background

Plaintiff, Sharon Lamb, was employed by the North Carolina Department of Human Resources which operates defendant, John Umstead Hospital, as a social worker until her discharge on 31 May 1996. On 1 June 1996, plaintiff filed a complaint with the Equal Employment Opportunity Commission (EEOC) alleging discrimination in violation of the Americans with Disabilities Act, 42 U.S.C. § 12101, et seq. (ADA). Plaintiff received a right to sue letter from the EEOC on 29 September 1997 and filed this action on 24 December 1997.

Defendant has moved to dismiss plaintiff's complaint pursuant to Rules 12(b)(1), (2) and (6) of the Federal Rules of Civil Procedure, asserting that the Eleventh Amendment to the United States Constitution bars plaintiff's ADA claim and that plaintiff has failed to state a claim under the ADA. Plaintiff responds that the Eleventh Amendment immunity upon which defendant relies has been legally abrogated by Congress and does not prohibit plaintiff's claim. Plaintiff also maintains that she has adequately plead her ADA claim.

II. Motion to Dismiss

Defendant John Umstead Hospital has filed a motion to dismiss plaintiff's complaint pursuant to Fed.R.Civ.P. 12(b)(6). For purposes of such a motion, the complaint is construed in the light most favorable to the plaintiff and its allegations are taken as true. As stated by the Supreme Court in *Conley v. Gibson*, 355 U.S. 41, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957):

> In appraising the sufficiency of the complaint we follow, of course, the accepted rule that a complaint should not be dismissed for failure to state a claim unless it appears beyond a doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.

Id. at 45–46, 78 S.Ct. 99. "[T]he issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claim." *Revene v. Charles County Comm'rs*, 882 F.2d 870, 872 (4th Cir.1989).

III. ADA's Abrogation of States' Immunity

[1] Plaintiff alleges that defendant has violated the ADA, which prohibits intentional discrimination against qualified individuals with disabilities "in regard to job application procedures, the hiring, advancement, or discharge of employees, employee compensation, job training, and other terms, conditions, and privileges of employment." 42 U.S.C. § 12112(a). The ADA also requires employers to make reasonable accommodations for the disabled. 42 U.S.C. § 12112(b)(5)(A) and (B). Along with employment, the statute applies to a range of activities including government services, public accommodations, and communications. The ADA covers public entities, including States, 42 U.S.C. § 12131(1)(A), and requires them to operate their programs and services in a manner readily accessible to disabled individuals. 42 U.S.C. § 12131(2); 42 U.S.C. § 12132.

Defendant, an agency of the State of North Carolina, argues that the Eleventh Amendment to the United States Constitution entitles it to immunity from an ADA suit by a private citizen.

[2] The Eleventh Amendment states:

> The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

U.S. Const. Amend. XI. Under the Supreme Court's broad interpretation of the Eleventh Amendment, a State is also granted immunity from suits initiated by its own citizens in federal court if the State has not consented to such suits. *Seminole Tribe of Florida v. Florida*, 517 U.S. 44, 54, 116 S.Ct. 1114, 134 L.Ed.2d 252 (1996) (citing *Hans v. Louisiana*, 134 U.S. 1, 10 S.Ct. 504, 33 L.Ed. 842 (1890)). However, Congress has the authority to abrogate a State's immunity pursuant to Section 5 of the Fourteenth Amendment. *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 238, 105 S.Ct. 3142, 87 L.Ed.2d 171 (1985); *Seminole Tribe*, 517 U.S. at 59, 116 S.Ct. 1114.

[3] The issue before the court is whether Congress, in enacting the ADA and attempting to abrogate the States' immunity from suit, exceeded the scope of its powers under Section 5 of the Fourteenth Amendment. The Supreme Court set forth a test for determining that issue in *Seminole Tribe,* 517 U.S. at 55, 116 S.Ct. 1114. First, a court must determine whether Congress has " 'unequivocally expresse[d] its intent to abrogate the immunity.' " *Id.* (quoting *Green v. Mansour,* 474 U.S. 64, 68, 106 S.Ct. 423, 88 L.Ed.2d 371 (1985)). Second, a court must determine "whether Congress has acted 'pursuant to a valid exercise of power' " in abrogating that immunity. *Id.*

> The ADA explicitly states that
>
> [a] State shall not be immune under the [E]leventh [A]mendment to the Constitution of the United States from an action in Federal or State court of competent jurisdiction for a violation of this chapter. In any action against a state for a violation of the requirements of this chapter, remedies (including remedies at both law and equity) are available for such a violation to the same extent as such remedies are available ... against any public or private entity other than a state.

42 U.S.C. § 12202. Because Congress has unequivocally expressed its intent to abrogate the States' immunity, the issue before the court is narrowed to an inquiry as to the validity of Congress's exercise of power.

Pursuant to *Seminole Tribe* and precedent cited therein, Section 5 of the Fourteenth Amendment to the Constitution, "the enforcement clause," allows Congress to abrogate States' immunity from suit guaranteed by the Eleventh Amendment. *Seminole Tribe,* 517 U.S. at 59, 116 S.Ct. 1114. Section 5 provides that "Congress shall have the power to enforce, by appropriate legislation, the provisions of [that] article." U.S. Const. Amend. XIV. Therefore, Congress can enact legislation pursuant to Section 5 that is designed to enforce the prohibitions expressly directed at the States in Section 1 of the Fourteenth Amendment, and Congress may validly abrogate the States' immunity from suit in those circumstances. *Seminole Tribe,* 517 U.S. at 59, 116 S.Ct. 1114. In *Katzenbach v. Morgan,* 384 U.S. 641, 651, 86 S.Ct. 1717, 16 L.Ed.2d 828 (1966), the Supreme Court wrote:

> Correctly viewed, § 5 is a positive grant of legislative power authorizing Congress to exercise its discretion in determining whether and what legislation is needed to secure the guarantees of the Fourteenth Amendment.

In *City of Boerne v. Flores,* 521 U.S. 507, 117 S.Ct. 2157, 138 L.Ed.2d 624 (1997), the Supreme Court explained:

> "Whatever legislation is appropriate, that is, adapted to carry out the objects the amendments have in view, whatever tends to enforce submission to the prohibitions they contain, and to secure to all persons the enjoyment of perfect equality of civil rights and the equal protection of the laws against State denial or invasion, if not prohibited, is brought within the domain of Congressional power."

Boerne, 521 U.S. at ——, 117 S.Ct. at 2163 (quoting *Ex Parte Virginia,* 100 U.S. 339, 345–346, 25 L.Ed. 676 (1879)).

The question logically follows whether the ADA is designed to enforce the provisions expressly directed at the States in Section 1 of the Fourteenth Amendment. That question must be resolved by applying the proportionality test set forth in *Boerne,* 521 U.S. at ——, 117 S.Ct. at 2164. Defendant argues that, aside from being disproportionate to the injury it seeks to redress, the ADA is not designed to enforce the equal protection clause for two reasons: 1) the ADA protects a class of individuals who do not enjoy heightened scrutiny under the equal protection clause of the Fourteenth Amendment; and 2) the ADA is not "remedial," but rather it creates positive rights of entitlement and provides special treatment and accommodations for the disabled as against other, non-disabled individuals and the States. (Def. Mem. at 5.)

First, the court will discuss the equal protection clause and the protection from discrimination that it confers upon the disabled in conjunction with defendant's "suspect class" argument. Second, the court will apply the proportionality test prescribed by

Boerne. Third, the court will address defendant's argument pertaining to the remedial nature of the ADA.

A. The Equal Protection Clause and the Disabled

[4–6] Section 1 of the Fourteenth Amendment provides: "No state shall ... deny to any person within its jurisdiction the equal protection of the laws." U.S. Const. Amend. XIV. Any law, therefore, that draws a distinction among people is susceptible to an equal protection challenge. See Erwin Chemerinsky, CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES at 527 (1997). While classifications based on race or national origin are subject to strict scrutiny, and classifications based on sex are subject to intermediate scrutiny, other classifications, like age and disability, are subject only to the rational basis test. *Id.* at 529. Under the rational basis test, a law will be upheld if it is rationally related to a legitimate government purpose. *Id.*

In *Cleburne,* the Supreme Court held that the "mentally retarded" do not constitute a suspect or quasi-suspect class entitled to heightened scrutiny for purposes of equal protection analysis. *Cleburne,* 473 U.S. at 442–446, 105 S.Ct. 3249. The Court stated, however, that its "refusal to recognize the retarded as a quasi-suspect class does not leave them entirely unprotected from invidious discrimination. To withstand equal protection review, legislation that distinguishes between the mentally retarded and others must be rationally related to a legitimate governmental purpose." *Id.* at 446, 105 S.Ct. 3249. Applying the rational basis test, the Court invalidated a zoning ordinance and a permitting scheme because they were based on an "irrational prejudice against the mentally retarded." *Cleburne,* 473 U.S. at 449–450, 105 S.Ct. 3249. Significantly, the Supreme Court's decision in *Cleburne* explicitly recognizes that some classifications of disabled people are irrational,[1] *id.,* and in doing so, recognizes that protection from discrimination on the basis of disability is a substantive right enforceable through the equal protection clause. *Id.* at 446, 105 S.Ct. 3249.

In *Brown v. North Carolina Division of Motor Vehicles,* 987 F.Supp. 451, 457 (E.D.N.C.1997), the court stated that, where Congress invokes its power under Section 5 of the Fourteenth Amendment, "[t]he question becomes whether Congress is legislating to protect a class cognizable under § 1 of the Fourteenth Amendment." *Cleburne* demonstrates that the Supreme Court has recognized the disabled as a cognizable class for equal protection purposes.

Defendant argues that, because the disabled are not a suspect class for purposes of equal protection analysis, the ADA's identification of the disabled as a "discrete and insular minority"[2]—a classification typically entitled to heightened scrutiny—evidences Congress's attempt to legislate the substance of the Fourteenth Amendment. As such, according to defendant, the ADA cannot be considered an enactment designed to "enforce" the equal protection clause. The argument suggests that, because States may, under the equal protection clause, enact laws classifying the disabled as long as they have a legitimate governmental purpose when doing so, Congress may not decree that the disabled are entitled to treatment as a sus-

1. Although *Cleburne* addressed the "mentally retarded," courts have concluded that the reasoning in that opinion extends equally to the physically disabled. See *Coolbaugh v. Louisiana,* 136 F.3d 430, 433–434, n. 1 (5th Cir.1998), petition for cert. filed, 66 U.S.L.W. 3783 (May 28, 1998) (No. 97–1941). The ADA prohibits discrimination against both groups.

2. In enacting the ADA, Congress found that "individuals with disabilities are a discrete and insular minority who have been faced with restrictions and limitations, subjected to a history of purposeful unequal treatment, and relegated to a position of political powerlessness in our society based on characteristics that are beyond the control of such individuals and resulting from stereotypic assumptions not truly indicative of the individual ability of such individuals to participate in, and contribute to, society." 42 U.S.C. § 12101(a)(7). Unlike the Religious Freedom Restoration Act (RFRA), the statute at issue in *Boerne,* the ADA does not attempt to dictate that courts apply intermediate or strict scrutiny to classifications of the disabled. In *Boerne,* the Supreme Court struck down Congress's explicit attempt to mandate heightened judicial scrutiny of legislation placing burdens upon the free exercise of religion. *Boerne,* 521 U.S. at ——, 117 S.Ct. at 2171.

pect class and thereby: 1) impose a higher standard of conduct upon the States by way of the Fourteenth Amendment; or 2) "force the courts to adopt a new regime vis-a-vis the classification of individuals with disabilities." *Brown*, 987 F.Supp. at 458.

The "suspect class" argument seems to be made in an effort to curtail Congress's Section 5 power, in a manner consistent with *Boerne* and *Seminole Tribe*, by offering a bright line rule delineating the scope of that power. As noted by the Fourth Circuit in *Abril v. Virginia*, 145 F.3d 182, 187 (4th Cir.1998), a case dealing with the Fair Labor Standards Act, "it cannot be that Congress's Section 5 enforcement power may 'appropriately' be exercised—even for prophylactic purposes—to eradicate every classification of persons imposed (or allowed to continue of externally imposed) by a state." The "suspect class" rule would allow Congress to legislate pursuant to Section 5 only with respect to those classes of individuals that the Supreme Court has determined are entitled to heightened scrutiny.

Although it has the advantage of offering a bright line, that rule is nevertheless inconsistent with *Boerne* and *Seminole Tribe*, both of which specifically affirm that Congress may exercise its Section 5 power to enforce the equal protection clause. *Boerne*, 521 U.S. at ——, 117 S.Ct. at 2164; *Seminole Tribe*, 517 U.S. at 59, 116 S.Ct. 1114. Contrary to the reasoning in *Brown*, the requirement that a class be "cognizable" under the equal protection clause does not imply that a class must be entitled to "heightened constitutional protections" in order to permit Congress to legislate on its behalf pursuant to Section 5. *Brown*, 987 F.Supp. at 458. The groups or classes of individuals that are subjected to intentional, arbitrary, or irrational discrimination in violation of the Fourteenth Amendment are not, as *Cleburne* demonstrates, limited to those classes entitled to heightened scrutiny. The "suspect class" rule offered by defendant would prevent Congress from legislating on behalf of such groups and would thereby circumscribe Congressional power in a manner inconsistent with the very text of Section 5.

[7] The correct rule for determining the scope of Congress's Section 5 power is the proportionality test set out in *Boerne*, according to which a statute must be proportional or congruent to the injury to be prevented or redressed. *Boerne*, 521 U.S. at ——, 117 S.Ct. at 2164. The Fourth Circuit applied a similar test in *Abril:* the limits of Congress's Section 5 power "are to be found by considering, in light of developed equal protection jurisprudence, whether the particular inequality targeted by the attempted abrogation is such as to justify congressional elimination as a means of enforcing Equal Protection Clause guarantees." *Abril*, 145 F.3d at 187–188.

[8] Accordingly, this court explicitly rejects the suggestion that "Congress's power must be limited to the protection of those classes found by the Court to deserve 'special protection' under the Constitution." *Clark v. California*, 123 F.3d 1267, 1270–71 (9th Cir. 1997), cert. denied, *Wilson v. Armstrong*, —— U.S. ——, 118 S.Ct. 2340, 141 L.Ed.2d 711 (1998). The levels of judicial scrutiny applied in equal protection cases are a judicial framework. They provide " 'standards for determining the validity of state legislation or other official action that is challenged as denying equal protection.' " *Id.* at 1271. The levels of scrutiny do not define the limits of Congress's power to enforce the Fourteenth Amendment.[3] "Such a conclusion 'would confine the legislative power in this context

3. The *Abril* court discussed the fact that public sector employees are not a recognized suspect or quasi-suspect class and suggested that protecting groups from arbitrary state action therefore delimits Congress's Section 5 power to eliminate or prohibit the inequality at issue. *Abril*, 145 F.3d at 188. The *Abril* majority did not, however, acknowledge or discuss the impact of the *Boerne* decision and its language regarding the sweep of Congressional power. See *Boerne*, 521 U.S. at ——, 117 S.Ct. at 2163; *Abril*, 145 F.3d at 192 (Butzner, J., dissenting). See also, infra, Section III.B.2. Moreover, the Supreme Court has not held that any law is, in fact, irrational or arbitrary with respect to public sector employees. Applying *Abril*'s proportionality test "in light of developed equal protection jurisprudence," i.e., *Cleburne*, discrimination against the disabled "justifie[s] Congress's elimination as a means of enforcing equal protection clause guarantees." *Abril*, 145 F.3d at 187–188.

to the insignificant role of abrogating only those state laws that the judicial branch was prepared to adjudge unconstitutional, or of merely informing the judgment of the judiciary by particularizing the "majestic generalities" of § 1 of the Amendment.' " *Goshtasby v. Bd. of Trustees of the Univ. of Illinois*, 141 F.3d 761, 770 (7th Cir.1998). Instead,

> Congress's role as a legislative body permits it to scrutinize every problem it addresses as carefully as it chooses. In the context of enforcing the Fourteenth Amendment, Congress is free to assess the constitutionality of state action that would be shielded from heightened judicial scrutiny by the application of the rational basis test....
>
> Properly understood, Congress's power to legislate under the Fourteenth Amendment thus has little connection to the levels of review articulated by the Supreme Court. Because the Equal Protection Clause invalidates all irrational discrimination, disabled individuals, like anyone else, have the right to be free from it.

Elizabeth Welter, *The ADA's Abrogation of Eleventh Amendment State Immunity as a Valid Exercise of Congress's Power to Enforce the Fourteenth Amendment*, 82 Minn. L.Rev. 1139, 1161–62 (April 1998).

[9, 10] While the Supreme Court retains the power to decree the substance of the Fourteenth Amendment's restrictions on the states, and Congress may not enlarge those powers, *Boerne*, 521 U.S. at —— and ——, 117 S.Ct. at 2172 and 2166, Congress's conclusions regarding the need for given legislation are entitled to much deference. *Id.* at 2172. In this context, the Supreme Court has explicitly found, not only that the disabled are a class entitled to Fourteenth Amendment protection, but also that certain laws classifying the disabled are irrational and in violation of the equal protection clause. *Cleburne*, 473 U.S. at 449–450, 105 S.Ct. 3249. Consequently, Section 5 of the Fourteenth Amendment allows Congress to enact legislation designed to eliminate such irrational laws and to prevent other arbitrary and invidious discrimination that deprives the disabled of the equal protection of the laws to which they are entitled if, as required by *Boerne*, that legislation is congruent and proportional to the injury to be prevented. *Boerne*, 521 U.S. at ——, 117 S.Ct. at 2164.

B. Proportionality Analysis under Boerne

[11] Under *Katzenbach*, a statute may be regarded as an enactment to enforce the Equal Protection Clause, if "it is 'plainly adapted to that end' " and if "it is not prohibited by but is consistent with 'the letter and spirit of the constitution.' " *Katzenbach*, 384 U.S. at 651, 86 S.Ct. 1717.

> While the line between measures that remedy or prevent unconstitutional actions and measures that make a substantive change in the governing law is not easy to discern, and Congress must have wide latitude in determining where it lies, the distinction exists and must be observed. *There must be a congruence and proportionality between the injury to be prevented or remedied and the means adopted to that end.* Lacking such a connection, legislation may become substantive in operation and effect.

Boerne, 521 U.S. at ——, 117 S.Ct. at 2164 (emphasis added). In other words, a statute's lack of proportionality or congruence to the injury to be prevented or remedied indicates that Congress has, in effect, legislated the substance of the equal protection clause. *Id.* at 2164. Defendant argues that the means of prohibiting discrimination included in the ADA lack the requisite proportionality and congruence to the injury to be prevented or remedied. (Def. Mem. at 7.)

The proportionality inquiry has been described as having two facets: an examination of both "the extent of the threatened constitutional violations, and the scope of the steps provided in the legislation to remedy or prevent such violations." *Coolbaugh v. Louisiana*, 136 F.3d 430, 435 (5th Cir.1998), petition for cert. filed, 66 U.S.L.W. 3783 (May 28, 1998) (No. 97–1941). The court will examine these facets in turn.

1. *The Extent of the Threatened Constitutional Violations*

[12] The purpose of the ADA is to eliminate and prohibit discrimination against individuals with disabilities. 42 U.S.C.

§ 12101(b). In enacting the ADA, Congress made extensive and explicit factual findings regarding the discrimination that the disabled have suffered, thereby documenting the extent of the threatened constitutional violations.[4] 42 U.S.C. § 12101(a) (1995); *Coolbaugh*, 136 F.3d at 435 (discussing Congressional fact-finding regarding discrimination against the disabled, which Congress intended to address in enacting the ADA). Among other findings, Congress noted the following:

> (1) some 43,000,000 Americans have one or more physical or mental disabilities, and this number is increasing as the population as a whole is growing older;
>
> (2) historically, society has tended to isolate and segregate individuals with disabilities, and, despite some improvements, such forms of discrimination against individuals with disabilities continue to be a serious and pervasive social problem;
>
> (3) discrimination against individuals with disabilities persists in such critical areas as employment, housing, public accommodations, education, transportation, communication, recreation, institutionalization, health services, voting, and access to public services;
>
> (4) unlike individuals who have experienced discrimination on the basis of race, color, sex, national origin, religion, or age, individuals who have experienced discrimination on the basis of disability have often had no legal recourse to redress such discrimination;
>
> (5) individuals with disabilities continually encounter various forms of discrimination, including outright intentional exclusion, the discriminatory effects of architectural, transportation, and communication barriers, overprotective rules and policies, failure to make modifications to existing facilities and practices, exclusionary qualification standards and criteria, segregation, and relegation to lesser services, programs, activities, benefits, jobs, or other opportunities;
>
> (6) census data, national polls, and other studies have documented that people with disabilities, as a group, occupy an inferior status in our society, and are severely disadvantaged socially, vocationally, economically, and educationally....

42 U.S.C. § 12101(a) (1995). Before enacting the ADA, Congress considered a wide range of evidence and made its findings based on that evidence. *Coolbaugh*, 136 F.3d at 436. Congress cited at least "seven substantive studies or reports to support its conclusion that discrimination against the disabled is a serious and pervasive problem." *Id.* at 436–37 (discussing relevant legislative history).

As noted by the Supreme Court in *Boerne*, "[i]t is for Congress in the first instance to 'determin[e] whether and what legislation is needed to secure the guarantees of the Fourteenth Amendment,' and its conclusions are entitled to much deference." *Boerne*, 521 U.S. at ——, 117 S.Ct. at 2172. The Court also emphasized the deference appropriate to Congress's anti-discrimination legislation in *Katzenbach v. Morgan*, 384 U.S. 641, 653, 86 S.Ct. 1717, 16 L.Ed.2d 828 (1966):

> It [is] for Congress ... to assess and weigh the various conflicting considerations—the risk or pervasiveness of the discrimination in governmental services, the effectiveness of ... [the] means of dealing with the evil, the adequacy or availability of alternative remedies, and the nature and significance of the state interests that would be affected.... It is not for us to review the congressional resolution of these factors. It is enough that we be able to perceive a basis upon which the Congress might resolve the conflict as it did.... Any contrary conclusion would require us to be blind to the realities familiar to the legislators.

Congress's finding of a significant likelihood of unconstitutional action with respect to the disabled, as set forth in 42 U.S.C. § 12101(a) and accompanying, substantial legislative history, is entitled to judicial deference. The

4. It should be noted that Congress made no specific findings regarding the seriousness or scope of discrimination against religious person in enacting RFRA, 42 U.S.C. §§ 2000bb to 2000bb–4, which was held unconstitutional in *Boerne* as an enactment exceeding Congress's § 5 enforcement powers. See *Coolbaugh*, 136 F.3d at 435 n. 2, and 438.

ADA thus satisfies the first facet of the proportionality analysis set forth in *Boerne*.

2. *The Scope of the Remedy*

[13] As required by *Boerne*, the ADA also exhibits a congruence and proportionality between the injury to be prevented or remedied, i.e., discrimination against the disabled, and the means adopted to that end, i.e., the statutory provisions.

The ADA does not provide sweeping remedies that exceed the harms it is designed to redress. First and foremost, the Act broadly prohibits discrimination against *qualified* individuals with disabilities. 42 U.S.C. §§ 12112(a) and 12132. It does not, for example, require employers to hire a quota of disabled individuals. While the Act also requires States to accommodate the disabled in various ways, only reasonable accommodations are mandated. 42 U.S.C. § 12112(5)(A) and (B). Reasonable accommodations include modifications or adjustments that: 1) are required to ensure that a qualified applicant with a disability can be considered for the position she desires; 2) enable employees with disabilities to perform essential job functions; and 3) enable employees with disabilities to enjoy the benefits and privileges of employment as are enjoyed by employees without disabilities. 29 C.F.R. § 1630.2(*o*); see also 29 C.F.R. § 1630.2(*o*)(2). An employer or State entity may avoid making such accommodations, however, by showing that the requested accommodation would impose upon it an undue burden or hardship.[5] Moreover, pursuant to 42 U.S.C. § 12113(a), an employer can defend against a charge of discrimination when an employer's refusal of employment to a disabled individual is "job-related and consistent with business necessity." These limiting provisions illustrate the proportionality of the ADA. By its own terms, the scope of the remedies offered by the ADA are appropriately tailored to the injury, i.e., discrimination against the disabled, that Congress sought to address in enacting that statute.

The ADA's unequivocal purpose is to deter, prevent and remedy unconstitutional discrimination, i.e. irrational classification and discrimination against the disabled. This legislation reflects "Congress's considered efforts to remedy and prevent what it perceived as serious, widespread discrimination against the disabled." *Coolbaugh*, 136 F.3d at 438. While some of the ADA's provisions may seek to address conduct that is not itself unconstitutional, that fact does not render the ADA's remedy disproportionate to the injury it seeks to address. Nor does it suggest that the enactment of the ADA, in its entirety, was beyond the sweep of Congress' powers under the Fourteenth Amendment. As the *Boerne* Court explained, "[l]egislation which deters or remedies constitutional violations can fall within the sweep of Congress's enforcement power even if in the process it prohibits conduct which is not itself unconstitutional and intrudes into 'legislative spheres of autonomy previously reserved to the States.' " *Id.* at 2163.[6]

5. Defendant argues that the requirements of the ADA will impose substantial implementation and litigation costs upon the States, and that those requirements render the statute's attempt to abrogate States' immunity ineffective. (Def. Mem. at 6.) The State, however, is entitled to assert in ADA litigation that the cost of accommodation is so significant that it makes a particular accommodation unreasonable. The term "undue hardship" is defined as an action requiring "significant difficulty and expense," when considered in light of factors such as the nature and cost of the accommodation needed, the financial resources available, and the nature and circumstances of the State entity. 42 U.S.C. § 12111(10); 29 C.F.R. § 1630.2(p). The ADA, therefore, has a built-in mechanism for dealing with defendant's concern. The cost of litigation, standing alone, simply cannot be relied upon as a valid reason to invalidate anti-discrimination legislation.

6. In *City of Rome*, for example, the Supreme Court held that the Voting Rights Act's "ban on electoral changes that are discriminatory in effect is an appropriate method of promoting the purposes of the Fifteenth Amendment, even if it is assumed that § 1 of the Amendment prohibits only intentional discrimination in voting." *City of Rome v. United States*, 446 U.S. 156, 177, 100 S.Ct. 1548, 64 L.Ed.2d 119 (1980).

Congress's power pursuant to the enforcement clauses of the Fifteenth and Fourteenth Amendments are analogous. "Section 2 of the Fifteenth Amendment grants Congress [the] power to enforce by 'appropriate legislation' the provisions of that amendment," and the Supreme Court has held "that the basic test to be applied in a case involving § 2 of the Fifteenth Amendment is the same as in all cases concerning the express powers of Congress with relation to the reserved powers of the States.' " *Katzenbach*, 384 U.S. at

C. The Remedial Nature of the ADA

Defendant makes the broader argument that, in enacting the ADA, Congress exceeded the scope of its power under Section 5 because the legislation is simply not remedial or preventive as required by *Boerne*. *Boerne*, 521 U.S. at ——, 117 S.Ct. at 2170. First, defendant argues that the ADA is not "remedial" because the accommodation provisions, in requiring affirmative conduct on the part of the States and entitling the disabled to certain benefits, constitute Congressional legislation of the substance of the equal protection clause. Second, defendant argues that the ADA is essentially entitlement legislation intended to provide the disabled with special benefits, not to redress invidious discrimination. The court will address these arguments in turn.

1. *Affirmative Conduct*

[14] Despite the fact that *Boerne* permits legislation that deters or remedies constitutional violations to also prohibit some conduct that is not unconstitutional, defendant argues that the accommodation provisions of the ADA do not merely prohibit constitutional conduct, they also require States to engage in affirmative conduct necessary to accommodate the disabled. (Def. Mem. At 8–9.) Section 5, however, does not constrain Congress in its choice of remedies, and Congress does not exceed the scope of its Section 5 authority merely by enacting legislation that, among other things, imposes affirmative conduct upon the States. As noted in *Boerne*, "[r]emedial legislation under § 5 'should be adapted to the mischief and wrong which the [Fourteenth] [A]mendment was intended to provide against.'" *Boerne*, 117 S.Ct. at 2170. The Supreme Court has not stated that Congressional imposition of affirmative conduct on the States is, by definition, non-remedial and, consequently beyond Congress's Section 5 powers. In fact, comparing the reach and scope of RFRA with other measures passed pursuant to Congress's enforcement power, the *Boerne* Court specifically referenced, and implicitly approved, *City of Rome*, 446 U.S. at 177, 100 S.Ct. 1548, in which the Court rejected a challenge to a Voting Rights Act provision that imposed preclearance requirements upon certain jurisdictions. Those provisions required jurisdictions to submit changes in electoral practices to the Department of Justice for preimplementation review.

[15] Congress's imposition of affirmative conduct, such as reasonable accommodation, upon the States does not constitute an attempt to "establish the meaning of [a] constitutional provision[]." *Boerne*, 521 U.S. at ——, 117 S.Ct. at 2168. Rather, the accommodation requirements constitute only one of the means chosen by Congress to effectuate a substantive equal protection right—freedom from discrimination—to which the disabled are entitled.

2. *Entitlement*

[16] Defendant also argues that the ADA is not "remedial" legislation, but rather entitlement legislation requiring States to provide special preferences for the disabled. Defendant relies on the decision in *Brown v. North Carolina Division of Motor Vehicles*, 987 F.Supp. 451, 458–459 (E.D.N.C.1997), to support that argument.[7] In *Brown*, the court wrote,

> [The ADA] is not "remedial" in the same sense as are most anti-discrimination statutes enacted under the Enforcement Clause. Title VII of the Civil Rights Act of 1964 is a prototypical example of a statute which seeks a state of affairs where individuals are treated equally, without regard to race, sex, or age. The ADA, on the other hand, seeks to single out the disabled for special, advantageous treatment.... This is beyond the purview of the Enforcement Clause as the concept of entitlements has little to do with promoting the "equal protection of the laws." ...

650–651, 86 S.Ct. 1717. That test was formulated in *McCulloch v. Maryland*, a case establishing the reach of Congressional power under the Necessary and Proper Clause. *Id.* See also *Abril*, 145 F.3d at 186.

7. See also *Pierce v. King*, 918 F.Supp. 932, 940 (E.D.N.C.1996).

> [T]he ADA does not remediate invidious, arbitrary or irrationally made classifications. At least as concerns the public accommodation provisions at issue here, the ADA would force States to single out disabled individuals for advantageous treatment.

Id.

First, as noted above, and contrary to the language in *Brown*, the ADA was specifically designed with the overall and explicit purpose of prohibiting, preventing, and remedying the irrational classification of and intentional discrimination against the disabled. 42 U.S.C. § 12101(b). Second, as permitted by *Boerne*, Congress has the power under the enforcement clause to prohibit otherwise constitutional conduct when enacting legislation to deter or remedy constitutional violations. *Boerne*, 521 U.S. at ——, 117 S.Ct. at 2163. Consequently, the accommodation provisions, even if viewed as provisions requiring special treatment of the disabled, are constitutionally permissible under *Boerne*.

This court respectfully disagrees, however, with the *Brown* opinion and with defendant's argument in reliance thereon, that the ADA, unlike other anti-discrimination statutes, is not "remedial" because it is not designed to achieve a state of affairs where individuals are treated equally. Treating individuals equally does not mean treating them identically. The Fourteenth Amendment mandates equal protection, not identical treatment.[8] The ADA most effectively accomplishes its purpose of prohibiting arbitrary and irrational discrimination against qualified individuals with disabilities if it is interpreted as an attempt to achieve substantive, rather than mere formal, equality for the disabled.

> Formal equality calls for identical treatment, and does not allow for existing differences, while substantive equality requires individualized treatment to yield equal opportunity. For example, imagine designing an oval course for a footrace. The designer using a principle of formal equality would draw a single starting line across the track. It would be formally equal to treat the runners identically. However, it would be substantively equal to realize that those running on the outside of the oval would have farther to run than those on the inside. Therefore, a principle of substantive equality would require the designer to create a series of starting lines so that each runner would run the same distance to the finish line. The single starting line is equal in the sense that it starts all the runners in an identical place, but it gives those on the inside track an advantage. The multiple starting lines are not identical, but they equalize the distance to be covered. Those individuals who have been excluded from the social contract for generations are like the runners on the outside of the track. They have much farther to go to get to the finish line. If we treat them identically to those who have been part of the social contract for years, we merely perpetuate existing differences. Therefore, our constitutional structure, which has given the inside track

8. As noted by Erwin Chemerinsky, "the Supreme Court has never attempted to define equal protection and commentators have ... contrast[ed] two conceptions of equal protection: one that focuses on equal treatment and the other that looks at equal results." Chemerinsky at 527, n. 8. Margaret Phillips has explored the theory underlying those concepts of equality as follows:

> Implicit in both the special treatment and the equal treatment approach is the need for a standard. Being treated the "same as" or "different from" means being treated the same as something or different from something.... When acknowledgment of the physical reality of [disability] is defined as "different" or "special," the implied standard that disability is being compared to is the physical reality of being [non-disabled]. When a [disabled person] is accorded "equal" treatment, she is accorded the same treatment as a [non-disabled individual]. This is appealing to our conception of equality, which is premised on the idea that everyone should be treated the same—no one is discriminated against, and no one is privileged. However, this notion defies reality by failing to account for the fact that [the non-disabled and the disabled] are not the same and have different needs.

Margaret Phillips, *Umbilical Cords: The New Drug Connection*, 40 Buff.L.Rev. 525, 561 (1992). As this adapted analysis illustrates, even the premise that individuals should be treated equally does not mandate that the disabled should be treated like the non-disabled. Such a conclusion presumes a nondiscriminatory norm, when in fact, the status quo is specifically tailored to the needs or abilities of the non-disabled.

to some citizens, must provide substantive equality to be legitimate.

Jane Rutherford, *Equality as the Primary Constitutional Value: The Case for Applying Employment Discrimination Laws to Religion*, 81 Cornell L.Rev. 1049, 1072–1073 (1996).

To apply Rutherford's concept of equality in the ADA context, consider the example of a State courthouse without an access ramp. Disabled and non-disabled individuals are similarly situated in that they both need to enter the building. Individuals in wheelchairs, however, simply cannot do so. The provision of a ramp, a reasonable accommodation pursuant to 29 C.F.R. § 1630.2(o)(2)(i), ensures equal access to that building. With the addition of a ramp, all people can enter—and all people are thereby treated equally with respect to that public building.

[17] One may only interpret the ADA as a statute requiring entitlements and special treatment if one assumes that the status quo is non-discriminatory. It is the opinion of this court that such an assumption is erroneous. The discrimination prohibited by the ADA is not only the invidious but also the irrational and the arbitrary. As illustrated by the compendious fact-finding of Congress, the disabled face the effects of arbitrary and irrational classification on a daily basis.[9] While some of the discrimination faced by the disabled may not be invidious or intentional, one cannot underestimate the discriminatory effect of being ignored, discounted, or merely assumed not to exist. A building without a ramp is just that—an assumption that an individual in a wheelchair does not exist. Whatever the reason for the lack of a ramp—whether dislike of the disabled, financial considerations, or mere thoughtlessness—the result is the same: lack of access. For the disabled, the status quo is clearly not non-discriminatory. Consequently, legislation enacted to achieve a state of affairs where people are treated equally may justifiably include provisions requiring adjustments to the status quo.

D. Summary

[18] For all of the reasons stated above, the enactment of the ADA falls within Congress's Section 5 enforcement power and consequently constitutes a valid and effective abrogation of the States' immunity to suit. See *Clark*, 123 F.3d at 1270; *Coolbaugh*, 136 F.3d at 438; *Kimel v. State Bd. of Regents*, 139 F.3d 1426, 1433 (11th Cir.1998) (holding ADA is valid exercise of the enforcement clause of the Fourteenth Amendment and concluding that States do not have Eleventh Amendment immunity from suit); *Seaborn v. Florida*, 143 F.3d 1405 (11th Cir.1998) (same); See also *Autio v. AFSCME, Local 3139*, 140 F.3d 802, 806 (8th Cir.1998) (holding ADA represents a proper exercise of Congress's Section 5 enforcement power under the Fourteenth Amendment), rehearing en banc granted and opinion vacated (June 7, 1998); *Muller v. Costello*, 997 F.Supp. 299 (N.D.N.Y.1998) (ADA valid abrogation of States' immunity); *Martin v. Kansas*, 978 F.Supp. 992 (D.Kan.1997); *Wallin v. Minnesota Dep't of Corrections*, 974 F.Supp. 1234 (D.Minn.1997) (relying on *Autio*), aff'd, 153 F.3d 681, 1998 WL 477227 (8th Cir.1998); *Williams v. Ohio Dep't of Mental Health*, 960 F.Supp. 1276 (S.D.Ohio 1997); and *Niece v. Fitzner*, 941 F.Supp. 1497 (E.D.Mich.1996). But see *Garrett v. Bd. Of Trustees of Univ. Of Alabama*, 989 F.Supp. 1409 (N.D.Ala. 1998); *Brown v. N.C. Division of Motor Vehicles*, 987 F.Supp. 451 (E.D.N.C.1997); and *Nihiser v. Ohio EPA*, 979 F.Supp. 1168 (S.D.Ohio 1997), each holding that the ADA is not an effective abrogation of States' immunity. Accordingly, defendant's motion to dismiss plaintiff's complaint on Eleventh Amendment grounds will be denied.

IV. Insufficiency of Plaintiff's Complaint

[19] Defendant argues that plaintiff's claim under the ADA should be dismissed

9. "Arbitrary can be distinguished from invidious because one can act arbitrarily without intending to harm. For example, a committee that fails to consider the interests of the disabled community when it approves plans or a new public building may be acting arbitrarily by failing to recognize these interests, without intending to frustrate the access of the disabled." Note, *Section 5 and the Protection of Nonsuspect Classes after City of Boerne v. Flores*, 111 Harv.L.Rev. 1542, 1546 (1998).

because plaintiff's complaint contains no factual allegations regarding: 1) the nature of plaintiff's alleged disability; 2) its severity and duration; 3) the position in which plaintiff was employed; 4) the essential duties of that position; 5) the impact of plaintiff's alleged disability on her ability to perform the essential duties of her position with or without reasonable accommodation; or 6) the timing and nature of her notice to defendant of her disability and request for reasonable accommodations therefor. (Def. Mot. at 12.)

The ADA provides in relevant part:

> No covered entity shall discriminate against a qualified individual with a disability because of the disability of such individual in regard to job application procedures, the hiring, advancement, or discharge of employees, employee compensation, job training, and other terms, conditions, and privileges of employment.

42 U.S.C. § 12112(a). Only a "qualified individual with a disability" may bring a civil action under the ADA. That term is further defined as "an individual with a disability who, with or without reasonable accommodation, can perform the essential functions of the employment position that such individual holds or desires." 42 U.S.C. § 12111(8). "Disability" is, in turn, defined as:

> (A) a physical or mental impairment that substantially limits one or more of the major life activities of such individual;
>
> (B) a record of such an impairment; or
>
> (C) being regarded as having such an impairment.

Id. at § 12102(2). See *King v. Wilmington Transit Co.*, 976 F.Supp. 356, 358 (E.D.N.C. 1997).

One of the questions before the court on defendant's motion to dismiss is whether a description or identification of the nature of an alleged disability is necessary to state a claim for relief under the ADA. Federal Rule of Civil Procedure 8(a)(2) requires that a claim for relief contain "a short and plain statement of the claim showing that the pleader is entitled to relief." Generally, Fed. R.Civ.P. 8(a)(2) requires more than a conclusory statement of entitlement to relief. Regarding claims brought under the ADA, some courts have held that Fed.R.Civ.P. 8(a)(2) "requires a statement of the nature of the plaintiff's claimed disability, the actions by defendant which amount to the impermissible discrimination, the occasions of the discrimination, and the injury that occurred." *Young v. Warner–Jenkinson Co., Inc.*, 170 F.R.D. 164, 166 (E.D.Mo.1996) (citing *Eisenach v. Miller–Dwan Medical Center*, 162 F.R.D. 346, 349 n. 3 (D.Minn.1995); *Breeden v. Enterprise Leasing Co.*, No. 4:95–CV–1821 CAS, 1995 WL 781700, at *2 (E.D.Mo. Dec.28, 1995)). See also *Super v. Price Waterhouse*, 1995 WL 498773, *2 (S.D.N.Y. Aug.22, 1995) (striking from complaint plaintiff's allegations under the ADA because complaint failed entirely to identify her disability and thereby failed to satisfy the requirements of Rule 8(a)(2)).

As noted by defendant, plaintiff's complaint fails to identify the nature of plaintiff's disability.[10] Moreover, plaintiff has alleged no specific facts from which the court could conclude that she has the requisite disability to qualify her for relief under the ADA. Plaintiff's conclusory allegation that she is a "qualified individual with a disability" does not satisfy the requirements of Rule 8(a)(2). (Compl.¶ 3.)

In addition, while plaintiff alleges that her employer "engaged in employment practices in violation [of] Sections 102(a), 102(d)(4)(A) and 107(a) of the ADA, 42 U.S.C. §§ 12112(a), 12112(d)(4)(A), and 12117(a)," (Compl.¶ 10), plaintiff does not identify in her complaint the particular actions by defendant which amount to the impermissible discrimination, nor does she specify the occasions of that discrimination. Finally, with respect to "the injury that occurred," plaintiff alleged that defendant "failed or refused to provide plaintiff with an accommodation for her disability," (Compl.¶ 10), but she failed to identify the way in which defendant failed to do so or the accommodations plaintiff requested.

10. Unlike the complaint at issue in *King*, plaintiff's complaint does allege that she is a "qualified individual with a disability." (Compl.¶ 3.) See *King*, 976 F.Supp. at 358. Consequently, the holding in *King* is not dispositive in this case.

[20] This court holds that Rule 8(a)(2) requires, at a minimum, that a plaintiff asserting a claim under the ADA identify the nature of her alleged disability. While such specificity is a requirement under Rule 8(a)(2), plaintiff's lack of specific allegations does not merit dismissal of her claim. As noted by plaintiff, her complaint has placed defendant on notice that her ADA claim rests upon her allegedly disabled status for a particular period of time. Plaintiff has made allegations which, if true, could establish a prima facie case under the ADA. Therefore, the court will allow plaintiff ten (10) days to file an amended complaint to provide the level of specificity required by Rule 8(a).

V. Conclusion

This court finds that Congress's enactment of the ADA was a valid exercise of its Section 5 power to enforce the equal protection provisions of the Fourteenth Amendment. As such, Congress effectively abrogated the States' immunity from suits by private citizens, and plaintiff is therefore permitted to bring a claim under the ADA against defendant, an agency of North Carolina. Defendant's motion to dismiss plaintiff's complaint based on the argument that it is immune from such suits is DENIED.

Defendant's motion to dismiss plaintiff's complaint for failure to state a claim for which relief can be granted is also DENIED. Plaintiff is DIRECTED to submit an amended complaint within ten (10) days from the date of this Order identifying the nature of her disability.

Jasmyne and Patrick BOBBITT, Jr., by their next friends Alisa and Patrick BOBBITT, Sr., and Alisa and Patrick Bobbitt, Sr., Jason Brown, by his next friend, Ledell Brown, Jareem Chavis, by his next friend, Eva Chavis, Keyonda and Timesha Mangum, by their next friend, Aretha Mangum, Lakeisha McLean, by her next friend, Alesia McLean, Diane McDougal, Jessica Utley, by her next friend, Dorise Utley, and Clay Hallman, Derrick Miller, and Christopher Williams, Plaintiffs,

v.

RAGE INC., Mid-Atlantic Pizza Huts, Inc., and Pizza Hut of Hickory No. 2, Inc., Defendants.

No. 5:98CV19.

United States District Court, W.D. North Carolina, Statesville Division.

July 27, 1998.

Two groups of primarily African-American patrons brought civil rights action against franchised pizza restaurant. Upon restaurant's motion to dismiss, the District Court, McKnight, United States Magistrate Judge, held that: (1) group of patrons who alleged no more than poor service with racially discriminatory animus failed to state claims under either § 1981 or public accommodation discrimination statute, and (2) group of patrons who alleged that they were required to prepay for their dinners stated claims under both § 1981 and public accommodation discrimination statute.

Motion granted in part and denied in part.

1. Federal Civil Procedure ⇐1772

Complaint should not be dismissed on ground that court doubts whether plaintiff will ultimately prevail in the action. Fed. Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

2. Civil Rights ⇐118

Aim of section 1981 is to remove the impediment of discrimination from a minority citizen's ability to participate fully and equally in the marketplace. 42 U.S.C.A. § 1981.

3. Civil Rights ⇐118

Right given by section 1981 extends not only to interactions between citizens and gov-

Although *Sampson* involved a probationary civilian government employee, several courts have held that the rule applies to members of the military as well. *Guerra v. Scruggs*, 942 F.2d 270, 274 (4th Cir.1991), *Chilcott v. Orr*, 747 F.2d 29, 33 (1st Cir.1984). We note that plaintiff is to receive a general discharge under honorable conditions, not a dishonorable discharge, which carries much more serious consequences. At least four courts of appeals have rejected claims that any stigma attached to a general discharge under honorable conditions is sufficiently extraordinary to merit the imposition of a preliminary injunction. *Guerra*, 942 F.2d at 274, *Hartikka v. United States*, 754 F.2d 1516 (9th Cir. 1985), *Chilcott*, 747 F.2d at 34, *McCurdy v. Zuckert*, 359 F.2d 491 (5th Cir.1966), *cert. denied*, 385 U.S. 903, 87 S.Ct. 212, 17 L.Ed.2d 133 (1966). We agree. Furthermore, the *Guerra* court explicitly held that the district court erred in granting an injunction prohibiting the discharge of a serviceman pending an appeal to the Army Board for Correction of Military Records, despite the district court's finding that the administrative appeal process might take years. 942 F.2d at 274.

We do not see how plaintiff's discharge under the circumstances of this case is more harmful than the injury to a civilian government employee when terminated for an alleged wrongdoing. Plaintiff's situation is not "extraordinary," nor does it "so far depart from the normal situation that irreparable injury might be found." *Sampson*, 415 U.S. at 92, n. 68, 94 S.Ct. at 953, n. 68. Based on the Supreme Court decision in *Sampson* as well as the precedents of *Guerra*, *Hartikka*, *Chilcott*, and *McCurdy*, this Court finds that plaintiff has failed to establish that irreparable harm will occur if he is discharged from the Navy pending a decision by the BCNR.[5] Accordingly, plaintiff's motion for a preliminary injunction will be denied.

ORDER

AND NOW, this 5th day of October, 1993, for the reasons set forth in the foregoing Memorandum, it is hereby ORDERED that the motion of plaintiff, Edward Wilburn, for a preliminary injunction is DENIED.

It is further ORDERED that this Court's temporary restraining Order entered on September 14, 1993 and extended on September 24, 1993 is VACATED.

5. Without evidence to the contrary, we will presume that the BCNR will act promptly and not unreasonably delay a decision on any appeal filed by plaintiff.

In re WESTINGHOUSE SECURITIES LITIGATION.

This Order Relates to the Purchaser Class Action.

Civ. A. Nos. 91–354, 91–624.

United States District Court, W.D. Pennsylvania.

July 27, 1993.

Shareholders brought action against corporation, corporate principals, accountant, investment banker, and securities underwriters, alleging violations of federal securities laws and common-law negligent misrepresentation. Defendants filed motions to dismiss. The District Court, D. Brooks Smith, J., held that: (1) shareholders failed to state securities fraud claim to extent that claim rested on alleged restructuring and reclassifying certain accounts by corporation and subsidiary; (2) shareholders' specific allegations of wrongfully understated loan loss reserves were sufficiently substantial, in relation to corporation's net income, to be deemed legally material for securities fraud purposes; (3) statements by corporation and subsidiary about adequacy of loan loss reserves were not misleading, under "bespeaks caution" doctrine; and (4) shareholders failed to state negligent misrepresentation claim under Pennsylvania law.

Complaint dismissed.

1. **Federal Civil Procedure ⇐1829**

When deciding motion to dismiss for failure to state claim, court must accept as true all facts alleged in complaint, and view them in light most favorable to plaintiff. Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

2. **Federal Civil Procedure ⇐1772**

To prevail on motion to dismiss for failure to state claim, movant must establish that no relief could be granted under any set of facts that plaintiff could prove. Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

3. **Federal Civil Procedure ⇐1832**

When allegations of complaint rest on construction placed on document, it is proper to refer to that document at pleadings stage to determine whether document can bear construction placed on it.

4. **Federal Civil Procedure ⇐636**

Under fraud pleading rule, plaintiffs may not simply point to bad result and allege fraud; rather, plaintiffs must plead with particularity the circumstances of alleged fraud in such way as to inject precision and some measure of substantiation into their allegations of fraud. Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

5. **Federal Civil Procedure ⇐636**

Stringent particularity requirement for pleading fraud applies to allegations of securities fraud. Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

6. **Federal Civil Procedure ⇐636**

Under fraud pleading rule, plaintiffs need not plead intent to defraud with stringent particularity to permit inference that defendants are accused of possessing the requisite scienter to state cause of action for fraud. Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

7. **Securities Regulation ⇐60.27(1), 60.45(1), 60.47, 60.48(1)**

To state securities fraud claim, private plaintiff must plead (1) false representation of (2) material (3) fact, (4) defendant's knowledge of its falsity and his intention that plaintiff rely on it, (5) plaintiff's reasonable reliance on defendant's false representation, and (6) plaintiff's resultant economic loss. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

8. **Securities Regulation ⇐60.40**

Individual defendants may be held liable for securities fraud under section of Securities Exchange Act of 1934 if plaintiff can establish individual defendants' "controlling person" relationship to defendant corporation. Securities Exchange Act of 1934, §§ 10(b), 20, as amended, 15 U.S.C.A. §§ 78j(b), 78t.

9. **Securities Regulation ⇐25.18, 25.21(2, 5)**

Plaintiffs need not allege reliance, scienter or damages under section of Securities Act of 1933 regarding false registration statement, though they must allege that shares they purchased are traceable to false or misleading registration statement. Securities Act of 1933, § 11, as amended, 15 U.S.C.A. § 77k.

10. **Securities Regulation ⇐25.62(2, 3)**

To state claim under section of Securities Act of 1933 regarding purchase of security following false prospectus or oral communication, plaintiffs need not allege scienter on part of defendant, nor must they allege their own reliance on misstatement or omission. Securities Act of 1933, § 12(2), as amended, 15 U.S.C.A. § 77*l*(2).

11. **Securities Regulation ⇐25.62(2)**

To state claim under section of Securities Act of 1933 regarding purchase of security following false prospectus or oral communication, plaintiffs must allege that they did not know of defendants' untruth or omission, and that defendants knew, or in exercise of reasonable care, could have known of misrepresentation or omission. Securities Act of 1933, § 12(2), as amended, 15 U.S.C.A. § 77*l*(2).

12. **Securities Regulation ⇐35.16**

Aider and abettor liability for securities fraud should properly focus on connection between alleged conduct of corporation and alleged conduct of secondary defendants, not

on relationship between plaintiff class and secondary defendants.

13. Securities Regulation ⇐35.16

Only if outside accountant, investment banker, and securities underwriters were alleged to have knowingly or recklessly participated in corporation's allegedly fraudulent actions in substantial way could they be properly held liable for corporation's securities fraud as aiders and abettors.

14. Federal Civil Procedure ⇐636

Shareholders' allegations with respect to manipulation by corporation and its subsidiary of nonearning and reduced earning receivables did not satisfy pleading standards under Securities Exchange Act of 1934 and civil rule; shareholders' claim that defendants lacked "basis" or "reasonable justification" for restructuring nonearning loans and reclassifying them as reduced earning loans amounted to no more than dispute over accuracy of their accounting practices, or challenge to corporation's opinion and belief as to when collectability on loans became doubtful, neither of which was actionable. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc. Rule 9(b), 28 U.S.C.A.

15. Federal Civil Procedure ⇐636

Shareholders' allegation that corporation and its subsidiary failed to disclose fact and effects of loan restructurings and reclassifications satisfied pleading standards under Securities Exchange Act of 1934 and civil rule; allegation stated when and where omissions were made, and how defendants failed to comply with Generally Accepted Accounting Principles (GAAP). Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

16. Federal Civil Procedure ⇐636

Securities fraud allegation based upon failure to disclose devalued asset base, or failure to timely foreclose in substance upon devalued property, is inadequate unless it explains wrongfulness of defendants' course of action. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

17. Securities Regulation ⇐60.20

Corporation's making of additional commercial real estate loans at below market rates to struggling debtor who rarely invested any capital in underlying properties is risky, may be wrongheaded, may even be gross mismanagement, but is not fraudulent. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

18. Securities Regulation ⇐60.20

Shareholders' allegation that corporation restructured nonperforming commercial real estate loans in such a way that, in economic substance, corporation, and not borrowers, was owner of underlying property in kind of "joint venture" arrangement in order to conceal losses failed to state securities fraud claim; allegation primarily concerned mismanagement. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

19. Securities Regulation ⇐60.20

Mere fact that corporation's loan reserves are discovered, ex post, to be inadequate does not provide basis for securities fraud claim. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

20. Securities Regulation ⇐60.27(5)

If corporations' agents' projections or opinions with respect to data such as loan loss reserves are reasoned and justified, with sound factual or historical basis, they are not actionable under fraud section of Securities Exchange Act of 1934, even if inaccurate. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

21. Securities Regulation ⇐60.27(4)

When corporation's agents' opinions with respect to data such as loan loss reserves are issued without genuine belief or reasonable basis, are made knowingly or recklessly, and are inaccurate, they constitute culpable conduct actionable under fraud section of Securities Exchange Act of 1934 and related rule. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

22. Securities Regulation ⇐60.45(1)

Issuer's alleged recklessness in issuing baseless opinions or projections is sufficient to establish scienter element of securities fraud claim. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

23. Federal Civil Procedure ⇐636

Shareholders alleged lack of reasonable basis for failure to take loan loss reserves with sufficient particularity to put corporation and its subsidiary on notice of nature of shareholders' securities fraud claim. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

24. Federal Civil Procedure ⇐636

To survive motion to dismiss, fraud pleading rule requires that plaintiff plead specific false representation of material fact. Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

25. Securities Regulation ⇐60.27(6)

Adequacy of corporation's loan loss reserves is type of information that would significantly influence reasonable investor, for purpose of determining whether allegation that corporation lacked reasonable basis for failure to take loss reserves stated securities fraud claim. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

26. Securities Regulation ⇐60.27(1)

In securities fraud action, legal materiality of fact does not turn solely upon type of information that fact represents. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc. Rule 9(b), 28 U.S.C.A.

27. Securities Regulation ⇐60.27(1)

If particular fact alleged in securities fraud action is relevant in terms of sort of information that investors care about, in other words, information concerning management and financial position of corporation, but trifling as matter of consequence, information is not legally material. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc. Rule 9(b), 28 U.S.C.A.

28. Securities Regulation ⇐60.27(1)

Corporation's failure to disclose that loan portfolio is likely to be impaired by some de minimis amount may be "relevant" in that it is type of information that investors care about, but of such "dubious significance" as to be "trivial" and hardly conducive to informed decision making by reasonable shareholders, and, thus, immaterial as matter of law in securities fraud action. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc. Rule 9(b), 28 U.S.C.A.

29. Securities Regulation ⇐60.46

Comparing alleged failure by corporation and its subsidiary to establish loss reserves for particular loans to current assets, rather than total assets, was more accurate indicator of materiality, for purpose of determining whether shareholders' allegations satisfied materiality element for securities fraud action. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

30. Securities Regulation ⇐60.46

In determining whether allegations are sufficient to satisfy materiality element of securities fraud action, when it appears "probable," as opposed to "reasonably possible" or "remote," that assets has been impaired by amount that can be reasonably estimated, corporation's previously established loss reserve, or "loss contingency," should be treated as actual loss; at that point, proper accounting response is to accrue loss reserve as charge against income as of date of financial statements. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc. Rule 9(b), 28 U.S.C.A.

31. Securities Regulation ⇐60.46

To determine materiality in securities fraud action of corporation's allegedly inadequate loan loss reserves when it appears that asset has been impaired by amount that can be reasonably estimated, focus must be amount of loan loss reserves alleged to have been wrongfully not posted as percentage of income during relevant period, rather than as percentage of current assets. Securities Ex-

change Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

32. Federal Civil Procedure ⇐1825

At motion to dismiss stage of securities fraud litigation, doubts about materiality should be resolved in favor of nonmovant. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

33. Securities Regulation ⇐60.46

Shareholders' specific allegations of wrongfully understated loan loss reserves were sufficiently substantial, in relation to corporation's net income, to be legally material, and, thus, allegations were sufficient to satisfy materiality element of securities fraud action; amounts identified by shareholders for reserves that allegedly were wrongfully not established represented 9.6% of reported income for one quarter, 26.9% of income for another quarter, and 15% of net income for fiscal year. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

34. Securities Regulation ⇐60.48(1)

Under "bespeaks caution" doctrine, statements by corporation and its subsidiary about adequacy of their loan loss reserves were not misleading, and did not render them liable to shareholders in securities fraud action; corporation and subsidiary, in their annual and quarterly reports filed with Securities and Exchange Commission (SEC), consistently hedged their statements of belief about adequacy of their reserves and prospects of future operations with qualifying remarks transparent enough to raise red flags for even the least sophisticated investor. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

35. Securities Regulation ⇐60.48(1)

Shareholders, who relied in securities fraud action on alleged fraud on the efficient securities market practiced by corporation, could not simultaneously claim that market participants, who at the margin make the market efficient by sophisticated analysis of available information, would have naively overlooked corporation's cautions about its statements regarding adequacy of loan loss reserves. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

36. Securities Regulation ⇐60.48(1)

Statement by corporation's chief executive officer (CEO) that corporation believed that its loan loss reserves were adequate, and unqualified statement by unidentified corporate spokesman contradicting securities analyst's opinion about necessity of another write-off, lacked "bespeaks caution" language, and, thus, shareholders' allegations that such statements contained misrepresentations stated claim for securities fraud. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

37. Securities Regulation ⇐60.27(6)

Shareholders' allegations that corporation and its subsidiary knowingly and recklessly misrepresented their net receivables and real estate owned in several Securities Exchange Commission (SEC) annual and quarterly reports, through carrying as receivables real estate investments that should have been considered foreclosed in substance and therefore accounted for as real estate owned, and through misrepresenting value of real estate owned by carrying such assets at outstanding amounts due under secured loans rather than at fair market value of underlying property, failed to state claim for securities fraud. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

38. Federal Civil Procedure ⇐636

Shareholders' allegations that, throughout proposed class period, corporation and its subsidiary misrepresented, through overstatement, the quality of their internal controls, failed to state claim for securities fraud; shareholders had not pled with particularity facts that would put defendants on notice of any claim of alleged fraud, and subsidiary's internal auditors clearly denied that internal controls were inadequate. Securities Exchange Act of 1934, § 10(b), as

amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

39. **Securities Regulation** ⇐60.27(6)

Fact that internal auditors recommended improvements in valuation methods and tighter standards for internal valuations did not support shareholders' claim in securities fraud action that corporation, in its annual report filed with Securities Exchange Commission (SEC), fraudulently or even inaccurately represented its internal controls as adequate to provide reasonable assurance that assets were safeguarded and that books and records reflected authorized transactions of corporation. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

40. **Securities Regulation** ⇐60.27(6)

Shareholders could not cite confidential communications, policy recommendations and internal memoranda identifying measures by which corporation could improve some area of operations, and then allege that corporation had previously committed actionable securities fraud by overstating quality of internal controls. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

41. **Securities Regulation** ⇐60.27(1)

Section of Securities Exchange Act of 1934 prohibiting use of manipulative or deceptive device or contrivance in connection with purchase or sale of security is designed to ensure full and accurate disclosure and may not be used to punish firms for identifying and implementing improvements to corporate policies. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

42. **Securities Regulation** ⇐60.30

Investment banker's statement in memorandum to corporation's chief executive officer (CEO) that most analysts were probably unaware of full extent of problem with corporation's nonperforming real estate did not constitute advice that CEO should mislead analysts, and, thus, did not provide basis for securities fraud liability. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

43. **Securities Regulation** ⇐60.30

Insofar as investment banker was alleged by shareholders to have failed to draw proper conclusions from known facts about adequacy of corporation's loan loss reserves, claims were purely negligence allegations, not claims that banker participated with intent to bring about corporations' chief executive officer's unqualified statement about adequacy of reserves, and, thus, allegation did not state securities fraud claim. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

44. **Securities Regulation** ⇐60.30

Shareholders' allegation that investment banker provided insufficient internal controls to detect true state of corporation's affairs only weeks about being retained was insufficient to state securities fraud claim. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

45. **Securities Regulation** ⇐60.30

No reasonable person could conclude from earnings outlook portion of investment banker's report, which stated belief that corporation's subsidiary's auditors would challenge adequacy of loan loss reserves and argued strongly for additional provisions in fourth quarter, that banker attempted to mislead securities analysts as to adequacy of reserves or that banker aided and abetted corporation's chief executive officer's alleged attempt to do so, and, thus, report did not support shareholders' securities fraud claim against banker. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

46. **Federal Civil Procedure** ⇐629

Even at pleading stage, allegation which is refuted by document from which it is derived cannot support cause of action.

47. **Securities Regulation** ⇐60.30

Shareholders' allegation that investment banker's partners and executive believed that corporation's chief executive officer's statements to securities analysts regarding adequacy of corporation's loan loss reserves

were false when made did not satisfy requirements of securities fraud cause of action against banker, since banker neither made nor counselled making those statements. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

48. **Securities Regulation** ⇐60.27(1)

Discussion materials did not support shareholders' allegation in securities fraud action that investment banker recommended that corporation's subsidiary's auditors release earnings results without disclosing any of banker's acquired knowledge concerning subsidiary's troubled real estate loans or allegedly planned charge against income; no recommendations were made in materials, and the only mention of charge against income was posed as alternative strategy option of choosing between one-time restructuring charge versus pay-as-you-go alternative. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

49. **Securities Regulation** ⇐60.30

Even if investment banker recommended charge against income to corporation's board, banker had no duty to disclose its recommendation to marketplace of investors, and, thus, lack of disclosure did not give rise to securities fraud claim against banker. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

50. **Securities Regulation** ⇐60.30

Shareholders' assertions in securities fraud action of investment banker's knowledge that economy was weak, that real estate credit market was weak, and that market for commercial properties was weak were in no way equivalent to asserting that banker was responsible for corporation's $975 million charge that was made when corporation allegedly knew that it was inadequate, and was planning undisclosed second charge. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

51. **Securities Regulation** ⇐60.30

Shareholders' allegations that corporation's independent accountant's unqualified opinions on corporation's financial statements in class period directly violated fraud section of Securities Exchange Act of 1934 and related rule, by certifying in financial documents that audits were conducted in accordance with Generally Accepted Accounting Standards (GAAS) and that statements were prepared in conformity with Generally Accepted Accounting Principles (GAAP) when accountant in fact violated GAAS, were sufficient to state claim. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

52. **Securities Regulation** ⇐60.30

To state direct securities fraud claim against corporation's independent accountant, shareholders would have to allege that accountant knowingly or with reckless indifference made false statement of material fact intending to induce shareholders' reliance thereon. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

53. **Securities Regulation** ⇐60.30

It is not actionable securities fraud against corporation's auditor that financial statement is incorrect or even that party audited is committing fraud that auditor does not detect, since expression of auditor's opinion does not make auditor an insurer of every investor who purchases in reliance on financial statement. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b).

54. **Securities Regulation** ⇐60.30

Shareholders' complaint was inadequate to state any cause of action against independent accountant for aiding and abetting securities fraud by corporation; shareholders' allegations that accountant "agreed" that subsidiary's loan loss reserves would be 2.5%, and "approved" inadequate level of reserves so that performance bonuses could be garnered, were inherently improbable as matter of fact and were insufficient as matter of law. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

55. **Securities Regulation** ⇐60.30

Fact that accountant received fees from corporation was insufficient to establish aiding and abetting liability against accountant in shareholders' securities fraud action; shareholders did not allege that accountant's compensation was well above market rate or that it was somehow bartered for favorable opinion. Securities Exchange Act of 1934,

§ 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

56. Securities Regulation ⇐60.30

Accountant's alleged indirect financial interest in corporation's subsidiary, arising out of accountant's acting as subsidiary's chief financial officer (CFO) at time of audits of corporations, was immaterial in determining accountant's aiding and abetting liability in shareholder's securities fraud action. Securities Exchange Act of 1934, § 10(b), as amended, 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

57. Securities Regulation ⇐25.19, 25.56

To state claim under provisions of Securities Act of 1933 regarding false registration statement or false prospectus, plaintiffs need only allege that they acquired security which was accompanied by registration statement, any part of which contained untrue statement of material fact or omitted to state material fact required to be stated therein or necessary to make statements therein not misleading, regardless of scienter. Securities Act of 1933, §§ 11, 12(2), as amended, 15 U.S.C.A. §§ 77k, 77*l*(2).

58. Federal Civil Procedure ⇐636

Allegations of violations of sections of Securities Act of 1933 that sound in fraud must be plead with the particularity required by fraud pleading rule. Securities Act of 1933, §§ 11, 12(2), as amended, 15 U.S.C.A. §§ 77k, 77*l*(2); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

59. Securities Regulation ⇐25.20(1), 25.-61(4)

Shareholders' allegations that individuals each possessed the power, or potential power, to control activities of corporation or its subsidiaries were sufficient to allege "controlling person" liability in action brought under Securities Act of 1933 to recover for alleged misrepresentations in registration statement and prospectus. Securities Act of 1933, §§ 11, 12(2), 15, as amended, 15 U.S.C.A. §§ 77k, 77*l*(2), 77*o*; Fed.Rules Civ. Proc.Rule 9(b), 28 U.S.C.A.

See publication Words and Phrases for other judicial constructions and definitions.

60. Federal Civil Procedure ⇐1809

Conclusory allegation that defendants sold or solicited purchase of securities will withstand motion to dismiss in action brought under section of Securities Act of 1933 regarding false prospectuses only if accompanied by allegations of fact that defendants did sell or solicit purchase of securities. Securities Act of 1933, § 12(2), as amended, 15 U.S.C.A. § 77*l*(2); Fed.Rules Civ.Proc. Rule 9(b), 28 U.S.C.A.

61. Securities Regulation ⇐25.61(3)

Shareholders' allegation that corporation and controlling persons aided and abetted one another in connection with preparation of false and misleading registration statement/prospectus and documents incorporated therein by reference and that were used in conjunction with sale of securities to shareholders failed to state claim under section of Securities Act of 1933 regarding false prospectuses; shareholders did not allege that corporation and controlling persons sold or solicited purchase of securities. Securities Act of 1933, § 12(2), as amended, 15 U.S.C.A. § 77*l*(2); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

62. Securities Regulation ⇐25.20(1), 25.-61(2)

Preparation of false and misleading registration statement/prospectus and documents incorporated therein by reference that are used in conjunction with sale of securities does not make one a "seller" of securities who can be held liable under section of Securities Act of 1933 for the misrepresentation. Securities Act of 1933, § 12(2), as amended, 15 U.S.C.A. § 77*l*(2).

See publication Words and Phrases for other judicial constructions and definitions.

63. Securities Regulation ⇐25.18, 25.56

When considering whether claim has been stated under sections of Securities Act of 1933 for false and misleading statements in registration statement or prospectus, courts are not limited to quotations and allegations contained on face of complaint, and can examine registration statement and prospectus themselves. Securities Act of 1933, §§ 11, 12(2), as amended, 15 U.S.C.A. §§ 77k, 77*l*(2); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

64. **Securities Regulation** ⇐25.62(3)

Under "bespeaks caution" doctrine, shareholders failed to state claim against corporation and controlling persons under Securities Act of 1933 for making false and misleading statements in registration statement or prospectus, given cautionary statements in prospectus and Securities Exchange Commission (SEC) filings regarding corporation's competitive status, adequacy of its restructuring plan, reclassification of assets, and loan loss reserves. Securities Act of 1933, §§ 11, 12(2), as amended, 15 U.S.C.A. §§ 77k, 77*l*(2); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

65. **Securities Regulation** ⇐25.62(3)

Shareholders failed to state claim under Securities Act of 1933 against underwriters for alleged untrue statements of material fact in prospectus and registration statement that accompanied public offering, given that allegedly actionable statements were also accompanied by statements bespeaking caution. Securities Act of 1933, § 11(a)(5), as amended, 15 U.S.C.A. § 77k(a)(5); Fed.Rules Civ. Proc.Rule 9(b), 28 U.S.C.A.

66. **Securities Regulation** ⇐25.61(6)

To state viable claim against underwriters pursuant to section of Securities Act of 1933 regarding false prospectuses, there must be allegation that particular underwriter sold or solicited sale of securities to plaintiffs. Securities Act of 1933, § 12(2), as amended, 15 U.S.C.A. § 77*l*(2).

67. **Securities Regulation** ⇐25.61(2)

Plaintiffs may not rely on what in other contexts might be called market share liability to show that defendants were "sellers," and, thus, to state viable cause of action under section of Securities Act of 1933 regarding false prospectuses. Securities Act of 1933, § 12(2), as amended, 15 U.S.C.A. § 77*l*(2).

68. **Securities Regulation** ⇐25.61(6)

To state valid claim against underwriters pursuant to section of Securities Act of 1933 regarding false prospectuses, shareholders could not rely on underwriters' alleged aiding and abetting of one another, to attribute action by one underwriter to all other underwriters. Securities Act of 1933, § 12(2), as amended, 15 U.S.C.A. § 77*l*(2).

69. **Federal Civil Procedure** ⇐187

Before question of class status can be addressed in action brought under section of Securities Act of 1933 regarding false prospectuses, there must be representative plaintiff who alleges sale or solicitation by each proposed defendant. Securities Act of 1933, § 12(2), as amended, 15 U.S.C.A. § 77*l*(2).

70. **Fraud** ⇐29

Contractual privity is not required to state claim for negligent misrepresentation under Pennsylvania common law.

71. **Fraud** ⇐13(3)

In Pennsylvania, negligent misrepresentation is tort, the elements of which are set forth in Restatement (Second) of Torts § 552.

72. **Fraud** ⇐13(3)

Imposing liability, pursuant to Pennsylvania common-law tort of negligent misrepresentation, upon corporation and controlling persons for allegedly negligent misrepresentations in Securities Exchange Commission (SEC) forms would improperly subject them to potential liability in indeterminate amount for indeterminate time to indeterminate claim.

73. **Fraud** ⇐13(3)

Liability pursuant to Pennsylvania common-law tort of negligent misrepresentation does not obtain where corporation does not and cannot know identity of recipients of its disclosures at time those disclosures are made.

74. **Fraud** ⇐13(3)

Fact that corporation was required by law to supply information to Securities Exchange Commission (SEC) did not mean that corporation and controlling persons could be subject to liability pursuant to Pennsylvania common-law tort of negligent misrepresentation for alleged misrepresentations in SEC reports, since corporation and controlling persons would be subject to prospect of liability to almost unlimited class of persons.

75. **Fraud** ⇐13(3)

Pennsylvania's Supreme Court would not make fraud on the market theory applicable to common-law claim of negligent mis-

representation with regard to public offering of securities.

76. Action ⇐27(1, 5)

Disclosure of information by corporation's investment banker, accountant, and underwriters was purely matter of contract between corporation and those entities, not a public duty, and, therefore, liability pursuant to Pennsylvania common-law tort of negligent misrepresentation for inaccurate disclosures could not be premised on public duty theory.

77. Federal Courts ⇐14, 313, 356

Subject matter jurisdiction was lacking with respect to shareholders' state law claim of negligent misrepresentation against underwriters of public offering of securities, where there were no federal claims against underwriters to which any tort claims could be pendent, and there was no allegation that jurisdictional threshold for diversity jurisdiction was met or was likely to be met.

Michael Malakoff, Malakoff Doyle & Finberg, Howard A. Specter, George C. Mahfood, Alfred G. Yates, Pittsburgh, PA, Arthur N. Abbey, Joshua N. Rubin, Jules Brody, Melissa R. Emert, Stull Stull & Brody, New York City, for plaintiffs.

Joseph A. Katarincic, Terrance J. O'Rourke, Pittsburgh, PA, Dennis J. Block, Weil Gotshal & Manges, New York City, for defendants Paul E. Lego and William A. Powe.

Mark C. Rifkin, Richard D. Greenfield & Partners, Haverford, PA, lead counsel for plaintiffs in the Derivative Action.

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OPINION AND ORDER

D. BROOKS SMITH, District Judge.

I. *INTRODUCTION*

Westinghouse Credit Corporation (WCC) is a subsidiary of Westinghouse Financial Services, Inc. (WFSI), itself a wholly-owned subsidiary of Westinghouse Electric Corporation (Westinghouse). WCC was formed in 1954 to finance consumer sales of Westinghouse products; however, it eventually expanded into new credit markets, including industrial and commercial finance and sophisticated corporate lending. In the early 1980s, WCC hit its stride when it tapped into the booming commercial and residential real estate markets.

Such success, however, was short-lived. WCC's fortunes collapsed along with the real estate market in the late–1980s, and the price of Westinghouse stock tumbled during the class period from a high of $39.375/share to a low of $15.875/share. Consolidated Amended Class Action Complaint (Docket No. 84) ¶¶ 185, 186. Now, like so many lending institutions battered by the late–1980s real estate bust, *see* Michael Quint, *Investors Challenging Banks on Bad Loans*, N.Y. Times, January 28, 1991, at D1, Westinghouse, along with its outside accountant and investment bankers, is defending against shareholders who allege that the company made false and misleading statements regarding the health of its financial services units, thereby artificially inflating the price of Westinghouse stock and damaging plaintiffs who purchased that stock at what they claim to have been an artificially high price.

The Purchaser Class Action plaintiffs filed their action on February 28, 1991. Over the course of the next year, the parties skirmished over several discovery motions, until March 18, 1992, when Magistrate Judge Lancaster ordered Westinghouse to make available to plaintiffs, on a continuous basis from April 1, 1992 to April 29, 1992, at WCC's offices, documents relating to 536 accounts designated as "Assets Held for Sale or Restructuring" for inspection and copying. On June 15, 1992, after having reviewed some 3.5 million pages of active investment file documents, plaintiffs filed a Consolidated Amended Class Action Complaint[1] (Complaint) and an Amended and Supplemental Complaint relating to the derivative action against Westinghouse, Civil Action No. 91–624 (Derivative Complaint) (Docket No. 85). This action is currently before the Court on defendants' motions to dismiss (Docket No. 90, 91, 101, 106).

II. *BACKGROUND*

As noted above, WCC sharply increased its lending activity in the 1980s, expanding into highly leveraged corporate transactions, high-yield securities, and especially, commercial real estate markets. WCC's primary source of funds for these investments was short-term commercial paper debt. When the real estate market softened during the late–1980s and into the early–1990s, many of WCC's real estate receivables began underperforming, and the underlying investment properties lost value. Therefore, on May 8, 1990, in order to protect WCC's standing with the commercial paper ratings agencies, Westinghouse entered into a support agreement with WCC, pursuant to which Westinghouse agreed to maintain for three years, by regular capital infusions if necessary, WCC's total debt-to-equity ratio at a maximum of 6.5 to 1. ¶ 97; Exhibit O to Defendant Westinghouse's Memorandum in Support of Motion to Dismiss Consolidated Amended Class Action Complaint (Westinghouse Memo) at 8.

By September 21, 1990, the Corporate Finance Section of Westinghouse's Treasury Department had prepared a report entitled "Strategic Considerations—WFSI, Discussion Points," Exhibit Y to Westinghouse Memo, which assessed the diminished value

1. Plaintiffs' Complaint is 185 pages long, and paragraph numbers 346 through 373 are used twice. Throughout this memorandum, an asterisk will be used to denote the second set of paragraphs. For example ¶ 346 is on page 127, while ¶ 346* is on page 137.

of WFSI assets and offered direction for WFSI's future plans. ¶ 111. The report, the contents of which were not released to the public, ¶ 112, discussed the various strategies available to WFSI as it faced increasing problems in its real estate portfolio. The alternatives under consideration were stated as follows:

> A—maintain size and likely growth, modest change in mix—acquire Enterprise and United, but stop there
>
> B—maintain size, improve growth outlook by aggressive change in mix—fund aggressive growth in thrifts and mortgage banking by liquidating WCC's current business
>
> C—contract size, maintain mix—accept write down, apply proceeds for sale of written down assets to debt repayment, pursue thrifts and mortgage banking on modest scale
>
> D—pay dividend, contract size and growth—aggressively liquidate assets, distribute cash to parent—abandon thrifts and mortgage banking

Exhibit Y at 15. The report speculated that alternatives B and D were unlikely, and raised the possibility of a fifth alternative, the "missing alternative—focus on selling leasehold residuals and other 'hidden' assets to produce gains for write offs, reduce cost structure (internally generated gains used to write off non-earning assets)." *Id.* at 17.

The report suggested that Westinghouse continue to "modify and complete the Strategic Plan" and "complete the Lazard study—evaluate exit vs. hold alternatives." *Id.* at 18. The report concluded, *inter alia*, that it was "unlikely" that WFSI would continue to operate as a long-term, core business, and that it would eventually exit the real estate markets. The report recommended that WFSI hold its portfolios for exit when the markets recovered, and stated that there was "no need for [a] self-inflicted writedown—unless assets can be liberated." Finally, the report recommended "engag[ing] Lazard to [evaluate the costs and benefits of a] near-term exit vs. hold for later exit," and "to assist in internal restructuring effort, and validate Corporate views—also, to assist in communications message." *Id.* at 20.

Westinghouse did retain Lazard Freres & Co. (Lazard), an investment banking firm, on September 28, 1990. ¶ 115. After interviewing key WCC personnel about WCC's real estate portfolios, Lazard allegedly began preparing Westinghouse's CEO and Chairman of the Board of Directors, Paul Lego, for a meeting with securities analysts scheduled for October 24, 1990. ¶ 125. At the October 24, 1990 meeting, Lego allegedly told the analysts: "We believe our reserves are adequate. We see no major problems there," and, "We do not believe we will have to take any kind of major hit in financial services. We believe our reserves are adequate." ¶ 131.

Lazard subsequently informed Westinghouse that:

> Markets do not currently expect any major write-off. They rely on a statement by Westinghouse's management, at the October 24, meeting, that there are no prospects of such write-offs. Several reports quote the statement as the source of their belief.... Because it would come as a relative surprise and in contradiction to previous announcements, a large write-off might put the credibility of Westinghouse's management at risk.

¶ 132.

On February 27, 1991, Westinghouse and WCC announced that they were taking a $975 million pre-tax charge against fourth-quarter 1990 earnings as part of a restructuring plan adopted by Westinghouse for its WFSI and WCC subsidiaries. ¶ 150. Westinghouse also made a cash contribution of $525 million to WFSI during the first quarter of 1991 and extended its 1991 support agreement with WCC to June 1994. Exhibit O to Westinghouse Memo at 8.

Also on February 27, 1991, Lego stated in a letter to shareholders: "We believe the loss provision and related actions decisively address the problems at WFSI." Lego concluded that, "By taking this special charge, we have strengthened the financial position of the corporation. The short-term problems we are experiencing in no way detract from the long-term opportunities we see in our

markets. We remain fully confident of our ability to create outstanding returns to our shareholders over the long term." ¶ 153; Exhibit K to Westinghouse Memo at 6, 8.

Concurrent with the February 27, 1991 press release, Westinghouse and WCC filed with the SEC Forms 8–K, pursuant to Sections 13 or 15(d) of the Securities Exchange Act, which require the periodic filing of reports necessary to keep reasonably current the information and documents contained in a registration statement. 15 U.S.C. §§ 78m, 78o (d) (1988). In its February 27, 1991 Form 8–K, WCC disclosed its identification of "$139 million in real estate properties owned, $653 million in marketable securities, $538 million in non-earning receivables and $1.3 billion in reduced earning receivables [2] restructured to earn less than their original contractual rate." Exhibit L to Westinghouse Memo at 2.

On or about March 11, 1991, Westinghouse and WCC filed annual reports, Form 10–K, for the 1990 fiscal year. Exhibits M and N to Westinghouse Memo. On or about April 18, 1991, and again on or about May 6, 1991, Westinghouse filed with the SEC a registration statement, Form S–3, and Prospectus in conjunction with a May 9, 1991 public offering of 19,000 shares of Westinghouse common stock at $26.50 per share. Exhibits O, P, and Q to Westinghouse Memo.

On October 7, 1991, Westinghouse filed a Form 8–K that announced that net income was down over the first three quarters of 1991 compared to the same period in 1990, and issued another press release announcing "a major change in strategy to accelerate a broader disposition of assets in its financial services subsidiary, resulting in the recording of a $1.68 billion valuation provision during the third quarter." ¶ 179; Exhibit V to Westinghouse Memo at 4. Addressing this second substantial charge against earnings within 9 months, Lego explained: "Because of the prolonged recession, the lack of credit in real estate markets and the nation's oversupply of commercial properties, which have diminished the current value of real estate assets, we have determined to take these decisive actions." ¶ 181; Exhibit V at 10. Lego also stated: "While disappointing, this performance is the result of the comprehensive plan we announced today that is intended to accelerate the recovery of our Financial Services unit and to put the corporation back on the track toward improved operating and financial performance." *Id.* at 5.

Finally, on or about November 14, 1991, Westinghouse and WCC filed with the SEC their quarterly reports, Form 10–Q, for the third quarter of 1991. Exhibits W and X to Westinghouse Memo. WCC cited "limited progress ... in liquidating or restructuring real estate and corporate financing assets," [3] Exhibit X at 9; Westinghouse disclosed that:

> Operating profit for the third quarter and first nine months was down significantly compared with the same periods of 1990. Third quarter operating profit included a $1.68 billion valuation provision established to facilitate the previously announced plans to downsize Financial Services. Excluding the $1.68 billion valuation provision, operating profit for the quarter and first nine months was sharply lower than the same periods of 1990. The decline in operating profit was due to significant increases in loan loss provisions from continuing business operations.

Exhibit W at 11. Westinghouse also announced that it would enter into a new support agreement with WCC, "stipulat[ing] the same financial support with respect to [WCC's 6.5 to 1] debt-to-equity ratio," and providing financial support necessary to guarantee WCC's commercial paper borrowings, and to maintain WCC's debt ratings. Exhibit X at 10.

2. WCC defines "reduced-earning receivables" as "real estate loans for which principal is expected to be repaid but which earned less than the original contractual rate during the last month in the period for which financial information is presented." Exhibit S to Westinghouse Memo at 14. "Usually, reduced-earning loans have been modified or restructured because of financial difficulties of the borrower." *Id.*

3. $595 million of WCC's marketable securities, mostly high-yield corporate debt securities, were sold during the first nine months of 1991. Exhibit X to Westinghouse Memo at 15, 25.

III. *DISCUSSION OF THE COMPLAINT*

A. *Westinghouse Allegations*

Plaintiffs' causes of action against Westinghouse include claims for violations of Sections 10(b) and 20 of the Securities Exchange Act of 1934, as amended (the Exchange Act), 15 U.S.C. §§ 78j(b), 78t (1988), and Rule 10b–5 promulgated thereunder, 17 C.F.R. § 240.10b–5 (1992) [4]; Sections 11, 12(2), and 15 of the Securities Act of 1933, as amended (the Securities Act), 15 U.S.C. §§ 77k(a), 77*l* (2), 77*o* (1988) [5]; and for negligent misrepresentation under principles of Pennsylvania common law.[6] Plaintiffs allege that as early as 1988, defendants were aware of the serious deterioration of WCC's real estate and highly-leveraged transactions portfolios, but as set forth in more detail in Part V, *infra*, failed to: (1) fully disclose the extent of the losses in the receivables, attempting to hide those losses; (2) make appropriate valuation provisions to the loan loss reserves established to cover the nonperforming or underperforming receivables; and (3) disclose the effect of the losses upon Westinghouse's and WCC's commercial paper ratings and on Westinghouse in light of Westinghouse's financial obligations to WCC under the support agreement. ¶ 46.

B. *The Secondary Defendant Allegations*

Plaintiffs also allege causes of action under Section 10(b), Section 11, Section 12(2), and common law negligent misrepresentation against Price Waterhouse, Westinghouse's independent accountant, Lazard, an investment banking firm retained in September 1990 to advise Westinghouse, and several securities underwriters (including Lazard) who underwrote Westinghouse's May 1991 public offering of common stock.

The first substantive mention of the secondary defendants appears at ¶ 48. Price Waterhouse and Lazard are alleged generally to have "aided" Westinghouse, WCC, and the individual defendants in concealing the deteriorating condition of WCC's real estate loans during the March 28, 1989 through October 22, 1991 period. The factual specifics concerning this aid are distributed among ¶¶ 53, 56 and 64: Price Waterhouse and Lazard are alleged to be responsible for WCC's publication of artificially reduced levels of nonearning real estate receivables in WCC's Forms SEC 10–Q and Forms 10–K. Price Waterhouse and Lazard also aided the Westinghouse defendants in some undescribed way in reclassifying nonearning real estate as reduced earning receivables. Price Waterhouse is additionally alleged to have failed to disclose WCC's portfolio of underperforming real estate receivables after auditing WCC's 1988 and 1989 financial statements, and to have authorized Westinghouse's announcement of its 1990 unaudited financial results on January 17, 1991.

Next, in ¶ 77 through ¶ 90, Price Waterhouse is alleged to have audited Westinghouse's and WCC's year-end statements in 1989, 1990 and 1991 and received fees from Westinghouse for doing so. Price Waterhouse is alleged to have assisted Westinghouse and WCC at unspecified times to conceal WCC's losses and risky loans in three ways: (1) by agreeing that WCC's reserve for loan losses would not exceed 2.5% of receivables; (2) by failing to disclose WCC's reclassification of nonearning receivables as reduced earnings receivables, WCC's growing volume of reduced earning receivables, and WCC's in-substance foreclosures; and (3) by misrepresenting that Price Waterhouse's audits were consistent with Generally Accepted Accounting Standards (GAAS) and that Westinghouse and WCC's financial statements were prepared in accordance with Generally Accepted Accounting Principles (GAAP). In 1990, Price Waterhouse is alleged to have informed WCC management of its reluctance to remain at a 2.5% level of reserves, and approved an increase to a 2.8% level of reserves. Plaintiff alleges that Price Waterhouse misrepresented this level of reserves as adequate, despite knowing at year-

4. Count One at ¶¶ 407–422.

5. Counts Two through Five at ¶¶ 423–466.

6. Count Six at ¶¶ 467–471.

end 1990, facts demonstrating that the level of reserves was deficient by $1 billion or more.

Plaintiffs' allegations then turn, in ¶ 103 et seq., to Lazard. Lazard is alleged to have been retained by Westinghouse as a financial adviser in August or September 1990; to have conducted a study of WFSI and WCC; and to have produced a document entitled Westinghouse Credit Corporation—Discussion Outline. Exhibit B to Underwriter Defendants' Compendium of Exhibits (Compendium).

Lazard partners Felix Rohatyn and Kenrick Wilson allegedly prepared Lego and Warren H. Hollinshead, Westinghouse's Treasurer and CFO, for an October 24, 1990 meeting with securities analysts. Lazard executive Steve Niemczyk is alleged to have written a script containing proposed answers to questions expected from the securities analysts, which script included two statements actually made by Lego at the October 24, 1990 analysts' meeting:

> We believe our reserves are adequate. We see no major problems there.... We do not believe we will have to take any kind of major hit in financial services. We believe our reserves are adequate.

Compendium, Exhibit A at 7.

Plaintiffs allege that these statements were false and that the Lazard personnel responsible knew or recklessly disregarded facts which demonstrated that the statements were false. ¶ 131.

Lazard allegedly continued to analyze WCC's status in December 1990 and January 1991, and learned of WCC's deteriorated asset values, high levels of nonearning receivables, and the inadequacy of WCC's reserves. Construing an ambiguity in the complaint most favorably to the plaintiffs,[7] plaintiffs also allege that at the time of the January 16, 1991 earnings report Westinghouse had already planned the charges it later took against 1990 income, ¶ 138, and that Lazard learned of this plan by January 9, 1991. ¶ 136. On January 9, 1991 Lazard allegedly recommended that Westinghouse release fourth-quarter and year-end 1990 earnings results on January 16, 1991 without disclosing any of these facts. Lazard also allegedly recommended a board meeting to discuss a restructuring of WFSI and WCC, a meeting which took place on January 30, 1991.

Plaintiffs allege that Westinghouse personnel met with personnel from Lazard and Shearson Lehman Brothers on February 7, 1991 to discuss the effect on the ratings of Westinghouse commercial paper of an "expected charge to earnings." ¶ 143. In response to Westinghouse's request, Lazard completed a document on February 11, 1991 entitled Model Restructuring and Financial Plan which proposed, *inter alia*, a $1.0–$1.2 billion charge to increase loan loss reserves. ¶ 145.

Westinghouse and Lazard allegedly determined to seek the rating agencies' reaction to the proposed charge, ¶ 147, and on February 20, 1991, Lego and other Westinghouse personnel met with Moody's and Standard and Poor's. The plan submitted by Westinghouse differed in several respects from the Model Plan prepared by Lazard. ¶ 148.

On February 27, 1991, Westinghouse announced its $975 million charge against 1990 earnings. Allegedly Lazard and Price Waterhouse knew this "did not provide for adequate reserves," and "chose to conceal the losses" with a "crash effort to sell off the losing real estate loans and properties." ¶ 155. Lazard allegedly also prepared a document for use at the February 27, 1991 board meeting entitled Westinghouse Electric—Board Meeting Q & A, and which read as follows:

> Q: Are the reserves adequate?
>
> A: Given the results of each of these review processes, the charge taken today is clearly reasonable but was at the low end of the range identified by management in conjunction with the strategic review performed by Lazard.

7. Plaintiffs allege in ¶ 136 that as of January 1991, Westinghouse was planning to take a single charge, presumably the February 1991 charge; in ¶ 138 plaintiffs allege that Westinghouse was planning "charges to 1990 income." (Emphasis added).

The charge taken is clearly based on economic conditions today. Given the unstable environment in which we are currently operating, further economic deterioration could lead to future charges and further capital calls on the parent.

Furthermore, the level of charge taken today is also highly contingent on the implementation of disposition strategies, which continue to be developed, and on market conditions. It is based on an understanding of how management will deal with underperforming assets: An orderly but aggressive liquidation plan.

In this regard, a timely and active monitoring of the ongoing restructuring/disposition plan is crucial. Not a monthly process, but weekly.

Q: When do we need to see "real" results?

A: By the end of the second quarter following the charge, meaningful results should be evident.

A timely reduction in commercial paper through application of cash proceeds raised via asset dispositions;

A progressive reduction in the level of underperforming assets; and

Stable to increasing core earnings and ROE.

Q: What happens in the event there is further deterioration?

A: More draconian steps would be required to preserve credit ratings at a cost to current earnings. But to the extent that WCC's asset disposition strategy, or its ability to term out additional debt, can reduce commercial paper in the near term, there will be less of a risk due to further economic deterioration an/or [sic] a drop in credit ratings. The key is clearly what can be done in the near-term prior to any further deterioration. ¶ 157.

In April and May of 1991, Westinghouse proceeded with another facet of its restructuring plan, a public offering of 19 million shares of common stock. Westinghouse filed a prospectus and registration statement with the SEC in connection with the offering which took place on May 9, 1991. The prospectus stated that the financial statements incorporated by reference in the prospectus were incorporated "in reliance on the report of Price Waterhouse." ¶ 168; Exhibit Q to Westinghouse Memo at 18. The public offering was apparently completed before the fall of 1991. On September 6, 1991, Moody's and Standard & Poor's downgraded Westinghouse's commercial paper. ¶ 178. In response, Westinghouse took an additional $1.68 billion charge to add to its reserve for loan losses. ¶ 179.

Plaintiffs allege that as early as October, 1990, Lazard and Price Waterhouse knew that the conditions which Westinghouse gave in October 1991 as reasons for its additional charge existed. ¶ 182. Plaintiffs allege that Lazard and Price Waterhouse also knew facts in February 1991 that should have caused them to conclude that the first charge was grossly inadequate. *Id.* Lazard and Price Waterhouse nonetheless allegedly aided Westinghouse in taking the $975 million charge by representing that it was adequate to cover losses inherent in WCC's portfolio, which resulted in the share prices of the May, 1991 offering not reflecting the true financial weakness of the company. ¶ 183, ¶ 185.

Plaintiffs also allege that in connection with public documents and SEC filings Price Waterhouse made knowing or reckless misrepresentations by falsely stating that Westinghouse and WCC's internal controls were adequate, ¶ 351, ¶ 371*, when in fact Price Waterhouse knew, ¶ 355, that they were not. Allegedly, WCC lacked standards for reporting, *inter alia*, in-substance foreclosures, ¶ 356, cash-flow projections, ¶ 357, internal valuations, ¶ 358–60, and lending policies. ¶¶ 369–73.

Plaintiffs contend that Price Waterhouse also falsely stated that the financial statements accompanying the Annual Reports accurately represented WCC's financial position, ¶ 192, ¶ 347*, and that Price Waterhouse's audits of those statements were conducted in accordance with GAAS. ¶ 192, ¶ 351*, ¶ 365*.

According to plaintiffs, Price Waterhouse on January 23, 1991 also was aware that WFSI had identified $2.6 billion in underperforming assets, but nonetheless stated that it

believed WFSI's loss reserves for 1990 were adequate. ¶ 360*, ¶ 361*.

Additionally, Price Waterhouse was retained by Westinghouse in August, 1990 to act as CFO for Brad Cable. WCC provided $10 million to effect a leveraged buyout of Brad Cable in September, 1990. Allegedly, Price Waterhouse's inventory of Brad Cable revealed shortfalls which were covered by WCC. ¶¶ 297–99. Acting as CFO of Brad Cable at the same time Price Waterhouse was auditing Westinghouse's financial statements allegedly rendered Price Waterhouse unable to conduct an independent audit of Westinghouse, ¶ 405, thereby resulting in Price Waterhouse accepting incorrect information from WCC. ¶¶ 374–403.

The allegations summarized above are the basis for the following causes of action against the secondary defendants:

Count One—In ¶ 409, Price Waterhouse and Lazard are alleged to have violated Section 10(b) of the Exchange Act and Rule 10b–5 promulgated thereunder by making "statements, described above [which] were false and misleading when made." The general reference to statements is understood to refer to the specific statements alleged in the body of the complaint, which are again summarized in ¶ 413.

Count Two—In ¶ 429 and ¶ 430, Price Waterhouse, Lazard and the underwriter defendants are alleged to have violated Section 11 of the Securities Act in connection with the May, 1991 public offering, by participating in the making of false statements in the registration statement, prospectus, and documents incorporated therein. The references to false statements made or true statements not made are understood to refer to the specifics alleged in the body of the complaint, and are summarized in ¶¶ 431–433, and in ¶ 434 as to Price Waterhouse only.

Count Three—Lazard and the underwriter defendants are alleged, in ¶ 442, to have sold Westinghouse common stock in the May 1991 offering through the use of a false or misleading registration statement and prospectus in violation of Section 12(2) of the Securities Act.

Count Four—Price Waterhouse is alleged to have violated Section 11 of the Securities Act in the same manner alleged in Count Two, towards the persons who purchased Westinghouse common stock directly through Westinghouse's dividend reinvestment plan. ¶ 452.

Finally, in Count Six, Price Waterhouse, Lazard and the underwriter defendants are alleged to have committed the tort of negligent misrepresentation by failing to disclose Westinghouse's lack of adequate reserves and by affirmatively representing that Westinghouse's loss reserves were adequate and that Westinghouse's book value accurately reflected its financial condition. ¶ 469.

IV. *PLEADING STANDARDS*

A. *Rule 12(b)(6)*

[1, 2] When deciding a motion to dismiss for failure to state a claim under Fed. R.Civ.P. 12(b)(6), the Court must accept as true all facts alleged in the complaint, and view them in the light most favorable to the plaintiff. *Markowitz v. Northeast Land Co.*, 906 F.2d 100, 103 (3d Cir.1990); *D.P. Enterprises, Inc. v. Bucks County Community College*, 725 F.2d 943, 944 (3d Cir.1984). In order to prevail on a Rule 12(b)(6) motion, the movant must establish that no relief could be granted under any set of facts that the plaintiff could prove. *Conley v. Gibson*, 355 U.S. 41, 45–46, 78 S.Ct. 99, 101–02, 2 L.Ed.2d 80 (1957); *Ransom v. Marrazzo*, 848 F.2d 398, 401 (3d Cir.1988).

[3] Where the allegations of the complaint rest on the construction placed on a document, it is proper to refer to that document at the pleadings stage to determine whether the document can bear the construction placed on it. *See Fudge v. Penthouse Int'l, Ltd.*, 840 F.2d 1012, 1015 (1st Cir.), *cert. denied*, 488 U.S. 821, 109 S.Ct. 65, 102 L.Ed.2d 42 (1988); *Teagardener v. Republic–Franklin Inc. Pension Plan*, 909 F.2d 947, 949 (6th Cir.1990), *cert. denied*, 498 U.S. 1027, 111 S.Ct. 678, 112 L.Ed.2d 670 (1991); *Cortec Industries, Inc. v. Sum Holding, L.P.*, 949 F.2d 42, 47 (2d Cir.1991), *cert. denied*, —— U.S. ——, 112 S.Ct. 1561, 118 L.Ed.2d 208 (1992).

B. *Rule 9(b)*

Fed.R.Civ.P. 9(b) provides: "In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally." Under Rule 9(b), a plaintiff must plead

> (1) a specific false representation of material fact; (2) knowledge by the person who made it of its falsity; (3) ignorance of its falsity by the person to whom it was made; (4) the intention that it should be acted upon; and (5) that the plaintiff acted upon it to his damage.

Shapiro v. UJB Financial Corp., 964 F.2d 272, 284 (3d Cir.), *cert. denied*, — U.S. —, 113 S.Ct. 365, 121 L.Ed.2d 278 (1992) (citing *Christidis v. First Pennsylvania Mortgage Trust*, 717 F.2d 96, 99 (3d Cir.1983)).

[4] Under Rule 9(b), plaintiffs may not simply point to a bad result and allege fraud. Rather, plaintiffs must plead with particularity the circumstances of the alleged fraud in such a way as to inject "precision and some measure of substantiation into their allegations of fraud." *Seville Industrial Machinery Corp. v. Southmost Machinery Corp.*, 742 F.2d 786, 791 (3d Cir.1984), *cert. denied*, 469 U.S. 1211, 105 S.Ct. 1179, 84 L.Ed.2d 327 (1985). By way of example, allegations of "who, what, when, where, and how: the first paragraph of any newspaper story," would satisfy the particularity requirement of Rule 9(b). *See Dileo v. Ernst & Young*, 901 F.2d 624, 627 (7th Cir.), *cert. denied*, 498 U.S. 941, 111 S.Ct. 347, 112 L.Ed.2d 312 (1990); *cf. Seville Industrial Machinery*, 742 F.2d at 791 (allegations of "date, place or time" fulfill the requirements of Rule 9(b)).

[5] This stringent particularity requirement, which applies to allegations of securities fraud, *Recchion v. Westinghouse Electric Corp.*, 606 F.Supp. 889, 894 (W.D.Pa.1985), serves three purposes: "(1) to place the defendants on notice and enable them to prepare meaningful responses; (2) to preclude the use of a groundless fraud claim as a pretext to discovering a wrong or as a 'strike suit'; and (3) to safeguard defendants from frivolous charges which might damage their reputations." *Fox v. Equimark Corp.*, 782 F.Supp. 295, 298 (W.D.Pa.1991) (citations omitted).

The United States Court of Appeals for the Third Circuit has cautioned against permitting "sophisticated defrauders to successfully conceal the details of their fraud." *Christidis*, 717 F.2d at 99–100. Therefore, courts sometimes relax the rule when "factual information is peculiarly within the defendant's knowledge or control," *Craftmatic Securities Litigation v. Kraftsow*, 890 F.2d 628, 645 (3d Cir.1989); but a plaintiff who makes such allegations must still provide a "statement of the facts upon which the allegations are based." *Id.*

[6] Finally, Rule 9(b) permits "knowledge and other condition of mind of a person [to be] averred generally." Therefore, plaintiffs need not plead intent to defraud with stringent particularity to permit the inference that the defendants are accused of possessing the requisite scienter to state a cause of action for fraud. *Cramer v. General Telephone & Electronics Corp.*, 582 F.2d 259, 272–73 (3d Cir.1978), *cert. denied*, 439 U.S. 1129, 99 S.Ct. 1048, 59 L.Ed.2d 90 (1979).

C. *Section 10(b)*

[7, 8] Section 10(b) of the Exchange Act provides: "It shall be unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . ., any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j(b) (1981). SEC Rule 10b–5, promulgated under authority of Section 10(b), makes it unlawful to "make any untrue statement of a material fact or to omit to state a material fact" such that prospective purchasers or sellers of securities are misled. 17 C.F.R. Section 240.10b–5 (1992). To state a claim under Section 10(b) and Rule 10b–5, a private plaintiff must plead (1) a false representation of (2) a material (3) fact; (4) the defendant's knowledge of its falsity and his intention that the plaintiff rely on it; (5) the plaintiff's reasonable reliance on defendant's false representation; and (6) the plaintiff's

resultant economic loss. *Lewis v. Chrysler Corp.*, 949 F.2d 644, 649 (3d Cir.1991). Individual defendants may be held liable under Section 10, pursuant to Section 20 of the Exchange Act, if the plaintiff can establish the individual defendants' "controlling person" relationship to the defendant corporation.

D. *Section 11*

[9] To bring a claim under Section 11 of the Securities Act, a plaintiff must allege that he "acquired" a security which was accompanied by a registration statement, "any part" of which "contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading." 15 U.S.C. § 77k(a) (1988). Plaintiffs need not allege reliance, scienter or damages, *see* Louis Loss, *Fundamentals of Securities Litigation* 896–97, 902 (2d ed. 1988), though they must allege that the shares they purchased are traceable to a false or misleading registration statement. *Shapiro*, 964 F.2d at 286.

E. *Section 12(2)*

[10, 11] Section 12(2) of the Securities Act provides that a person who "offers or sells" newly issued securities "by means of a prospectus or oral communication" that misrepresents or omits a material fact "is liable to the person purchasing such security from him" in an initial offering. 15 U.S.C. 77*l* (1988). As with Section 11, plaintiffs need not allege scienter on the part of the defendant, nor must they allege their own reliance on the misstatement or omission. However, in order to state a claim under Section 12(2), plaintiffs must allege that they did not know of the defendants' untruth or omission, and that the defendants knew, or in the exercise of reasonable care, could have known of the misrepresentation or omission. *See Ballay v. Legg Mason Wood Walker, Inc.*, 925 F.2d 682, 687–688 (3d Cir.), *cert. denied*, —— U.S. ——, 112 S.Ct. 79, 116 L.Ed.2d 52 (1991).

F. *Aiding and Abetting*

[12, 13] Plaintiffs allege that Price Waterhouse and the underwriter defendants are liable both for their independent violations of the securities laws and as aiders and abettors of Westinghouse's violations. Complaint ¶ 422. The two theories asserted must be considered separately and distinctly, because aider and abettor liability should properly focus on the connection between the alleged conduct of Westinghouse and the alleged conduct of the secondary defendants, not on the relationship between the plaintiff class and the secondary defendants. Only if Price Waterhouse, Lazard, and the other underwriters are alleged to have knowingly or recklessly participated in Westinghouse's allegedly fraudulent actions in a substantial way can they be properly held as aiders and abettors. *Monsen v. Consolidated Dressed Beef Co.*, 579 F.2d 793, 799–800 (3d Cir.), *cert. denied*, 439 U.S. 930, 99 S.Ct. 318, 58 L.Ed.2d 323 (1978); *Landy v. FDIC*, 486 F.2d 139, 162–63 (3d Cir.1973), *cert. denied*, 416 U.S. 960, 94 S.Ct. 1979, 40 L.Ed.2d 312 (1974). The direct liability claims against the accountant and underwriters, by contrast, require examination of the communication or nondisclosure of information by the accountant and underwriters to the plaintiffs. Here, whatever is alleged to have been done or not done by Westinghouse must not be conflated with the allegations against the secondary defendants.

V. *COUNT ONE*

A. *Westinghouse's Alleged Financial Misrepresentations*

1. *"Westinghouse and WCC Wrongfully Deflated Their Reported Nonearning Assets and Concealed Reduced Earning Receivables"*

Plaintiffs allege that Westinghouse and WCC manipulated their aggregate nonearning receivables [8] accounts in order to report artificially low levels of nonearning receivables in WCC's SEC quarterly and annual reports. ¶¶ 49–56. The effect of this alleged

8. "Nonearning receivables" or "non-earning assets" are defined as "[l]oans on which accrual of interest has been suspended because collectibility is doubtful." American Institute of Certified Public Accountants, *Audits of Finance Companies* 103 (1988).

manipulation would be to overstate the quality of the receivables portfolio, thereby deceiving the investing public into believing that those portfolios were more valuable (i.e., had a higher expected future cash flow) than they actually did. ¶¶ 194–198.

Specifically, plaintiffs allege that Westinghouse and WCC systematically deleted certain assets from the nonearning receivables category during the last month of each quarter. Nonearning loans were allegedly restructured, ¶ 204, and transferred to the unreported "less-than-carry," or, more conventionally, "reduced-earning" receivables category. ¶ 205. Plaintiffs allege that this concealment scheme enabled Westinghouse and WCC to create the appearance that they "were justified in recognizing income on those receivables when such recognition was wholly unwarranted." ¶ 205.

Plaintiffs similarly allege that WCC routinely "restructured and modified" the loans of defaulting borrowers "to earn less than their original contract interest rates" in order "to avoid the disclosure and required recognition of substantial losses on these loans." ¶¶ 57–60. In this manner, plaintiffs aver, WCC increased its internally recorded reduced earning receivables account by approximately $1 billion. ¶ 62. The effect of these loan restructurings was to mislead "the marketplace into the belief that WCC's problem loans were limited to the reported but artificially deflated nonearning receivables, which amounted to only 5–7% of WCC's net real estate receivables portfolio," when in reality, by plaintiffs' calculations, WCC's "problem real estate loans" constituted "as much as 60% of its real estate loan portfolio." ¶ 63.

Defendants argue that restructuring loans for defaulting borrowers is "a perfectly reasonable business practice," not inconsistent with GAAP, and that plaintiffs' concealment theory is "entirely conclusory, with no allegations regarding specific loans or deviations, much less material deviations, from generally accepted accounting principles." Westinghouse Memo at 21. Defendants also contend that those specific accounts that plaintiffs have identified and alleged to be part of the concealment scheme, ¶¶ 207–245, constitute such a small portion of the 536 accounts for which plaintiffs have had discovery (an even smaller portion of all Westinghouse assets) as to be immaterial. Westinghouse Memo at 32; *see also* Appendix 1.

[14] Plaintiffs' allegations with respect to defendants' manipulation of non-earning and reduced earning receivables do not satisfy the pleading standards under Section 10(b) of the Securities Act and Rule 9(b). Plaintiffs repeatedly claim that defendants' lacked a "basis" or "reasonable justification" for restructuring nonearning loans and reclassifying them as reduced earning loans. ¶¶ 207–245. But these allegations amount to no more than a dispute over the accuracy of defendants' accounting practices, or a challenge to Westinghouse's opinion and belief as to when collectibility on the loans became doubtful, neither of which constitutes an actionable claim. *See Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 479, 97 S.Ct. 1292, 1304, 51 L.Ed.2d 480 (1977) (internal corporate mismanagement not actionable under § 10(b)); *In re Scott Paper Securities Litigation*, 138 F.R.D. 56 (E.D.Pa.1991) (allegation that a projection was issued without a reasonable basis and therefore actionable "must contain facts that if proved would substantiate the charge of lack of a reasonable basis") (citing *Craftmatic*, 890 F.2d at 645).

Plaintiffs obviously attempt to allege more than simple internal corporate mismanagement, and paint a picture of asset manipulation in the service of nondisclosure. Plaintiffs claim that Westinghouse and WCC attempted to conceal nonearning receivables by restructuring and improperly reclassifying them as reduced earning receivables, and that defendants knew or should have known this was inconsistent with reasonable accounting practices. This is an allegation that, if properly made, would significantly influence the reasonable investor, *Shapiro*, 964 F.2d at 281. However, without an explanation of *how* defendants' actions violated Generally Accepted Accounting Principles, plaintiffs' allegation is conclusory rather than factual, and therefore insufficient under the particularity requirements of Rule 9(b). *See Shapiro*, 964 F.2d at 284–85; *Christidis*, 717 F.2d at 100. To the extent plaintiffs' claim

rests on defendants' alleged restructuring and reclassifying certain accounts, without more, defendants' motion to dismiss plaintiffs' claim under Section 10(b) and Rule 10b–5 is meritorious.

[15] Whether or not defendants' restructurings and reclassifications were justified or made with sufficient basis, defendants still had a duty to disclose the fact and effects of the restructurings and reclassifications. Plaintiffs' allegation that defendants failed to so disclose, *see e.g.*, ¶¶ 198, 211, 213, 216, 219, 223, 229, 238, 240, 242, directly concern the "philosophy of full disclosure," *Santa Fe*, 430 U.S. at 477, 97 S.Ct. at 1303, embodied in the federal securities laws, and withstands defendants' motion to dismiss. Specifically, plaintiffs allege that Westinghouse and WCC failed in several Form 10–Ks and 10–Qs to (1) report their aggregate troubled debt restructurings, and (2) disclose the amount of interest that would have been earned if its restructured loans had been performing in accordance with their original terms, and the amount of commitments defendants made "to lend additional funds to debtors owing receivables whose terms have been modified in troubled debt restructurings." ¶¶ 197–98. Under Financial Accounting Standards Board (FASB) Statement No. 15, this information should have been disclosed, and defendants do not dispute that it was not disclosed. Plaintiffs' allegation is pled with sufficient particularity, as it states when and where the omissions were made, and how defendants failed to comply with GAAP. This claim withstands defendants' motion to dismiss.

2. *"Westinghouse and WCC Concealed Real Estate Foreclosures and Losses Through Special Arrangements with the Tontis"*

Plaintiffs' allegations regarding WCC's "joint venture" with Edmond and Robert Tonti, ¶¶ 65–76, 330–42, are similar to their allegations that defendants concealed non-earning receivables by reclassifying them as reduced earning receivables. WCC allegedly restructured nonperforming commercial real estate loans in such a way that, in economic substance, WCC, and not the Tontis, was the owner of the underlying property in a kind of "joint venture" arrangement. In form, however, this alleged "joint venture" was characterized as an ordinary receivable investment, permitting WCC to understate its joint venture portfolios. ¶¶ 330–340. In this manner, plaintiffs aver, Westinghouse and WCC also avoided reporting losses and taking write-downs on collateral which was in-substance foreclosed, and the "effect . . . was to materially inflate the earnings, assets and net worth of Westinghouse and WCC during the Class Period. . . ." ¶ 342.

Plaintiffs' allegations of fraud are derived from the Tontis' own allegations in an action brought against Westinghouse in another district to prevent Westinghouse from enforcing loan obligations, ¶ 65.[9] As such, it is more akin to hearsay than the type of *facts* that must accompany plaintiffs' allegations "indicating why the charges against defendants are not baseless." *Craftmatic*, 890 F.2d at 646.

[16–18] A more serious flaw in this claim is that it primarily alleges mismanagement. A fraud allegation based upon failure to disclose a devalued asset base, or failure to timely foreclose in substance upon devalued property is inadequate unless it explains the wrongfulness of defendants' course of action. Plaintiffs do not allege why under GAAP the Tonti properties should have been foreclosed rather than recognized as possible income. Similarly, plaintiffs baldly state but do not allege how, under GAAP, the economic substance of the restructured loans compels the conclusion that WCC actually entered into a joint venture with the Tontis. Making additional commercial real estate loans at below market rates to a struggling debtor who "rarely invested any capital in the [underlying] properties," ¶ 70, is risky, may be wrongheaded, may even be gross mismanagement, but it is not fraudulent. *Shapiro*, 964 F.2d at 283 (improper loan collateralization and insufficient loan management prac-

9. *Creekwood Property Corp., et al. v. Westinghouse Credit Corp.*, Civil Action No. 92–109 (District of New Mexico).

tice not actionable under securities laws). Tacking the phrase "in order to conceal losses" onto the end of such an allegation does not convert it from an allegation of mismanagement into a fraud claim any more than does "inserting the words 'defendants failed to disclose that . . .' before the claimed mismanagement." *Fox v. Equimark Corp.*, 782 F.Supp. at 301.

3. *"Westinghouse and WCC Misrepresented the Adequacy of Their Loan Loss Reserves"*

When "[i]t is probable that as of the date of the financial statements," one or more future events will occur confirming that the value of "an asset has been impaired or a liability incurred, based on information available before the actual issuance date of the financial statements," and "the amount of loss can be reasonably estimated," the loan loss reserve[10] established for that asset should be "accrued as a charge to income as of the date of the financial statements." *See* Martin A. Miller, *GAAP Guide 1992* 6.02–6.03 (1992). If the loss appears only "reasonably possible" or "remote," as of the date of the financial statements, GAAP requires that the loan loss reserve be disclosed by footnote, or not disclosed at all, respectively. *Id.*

Plaintiffs allege that "Westinghouse and WCC failed to follow Generally Accepted Accounting Principles in setting their loan loss reserves," by failing to "make estimates of specific losses whenever possible, using optimistic assumptions in estimating certain losses, and bas[ing] their overall loss reserves not on a loan-by-loan analysis but on historical benchmark percentages of total loans outstanding, which was inappropriate. . . ." ¶ 249. These failings allegedly caused Westinghouse and WCC to misrepresent the adequacy of loss reserves for WFSI in several of its SEC reports, registration statement and prospectus during the proposed class period. ¶¶ 250–263.

In ¶¶ 250–257, plaintiffs allege that Westinghouse and WCC "knowingly or recklessly misrepresented in the Notes to the Financial Statements . . . the adequacy of [their] loss reserves" in their Form 10–Ks and 10–Qs during the period covering the last quarter of 1988 through the second quarter of 1991. Each of the allegedly misleading statements from those SEC reporting forms represents essentially that: (1) Westinghouse or WCC maintains an allowance for possible losses on financing receivables; (2) at a level which provides adequately for future losses that may develop in the portfolio; (3) which allowance or reserve is "based on historical trends" and "past chargeoff experience," "current delinquencies, the characteristics of the accounts, the value of the underlying collateral and general economic conditions and trends." *See* ¶¶ 252–257; Exhibit N to Westinghouse Memo at 21.

Plaintiffs also aver that the defendants' misrepresentations in their SEC reports were exacerbated by individual Westinghouse officials. In particular, plaintiffs point to the October 24, 1990 statement made by Westinghouse Chairman Paul Lego to a gathering of securities analysts allegedly mischaracterizing WFSI's reserves as "adequate," ¶¶ 258–59, and to a statement by another Westinghouse spokesman, in June 1991, allegedly responding to statement by George Fraise, a market analyst for Smith Barney, that a $500 million write off for Westinghouse was "very possible" by saying: "Our position on that is that we believe that we have taken an adequate reserve, and at this time we don't believe that any further reserve is necessary." ¶ 262.

[19] Since the late–1980s, federal courts in the northeast region of the United States, where the downturn in real estate markets has been especially severe, have become familiar with Section 10(b) claims alleging loan loss reserve misrepresentations, and the law

10. Loan loss reserves are defined in the banking trade as a "statement of condition, or balance sheet, account set up by a bank based on its expectations about future loan losses. As losses occur, they are charged against this reserve. That is, the loan account is credited and the reserve account is debited. The reserve is established by a debit to an expense account called the loan loss provision, with a corresponding credit to the loan loss reserve." American Bankers Association, *Banking Terminology* 215 (1989), *quoted in Shapiro v. UJB Financial Corp.*, 964 F.2d at 281.

in this area is well-developed. The mere fact that loan loss reserves are discovered, *ex post*, to be inadequate, does not provide the basis for a securities fraud claim. *Shapiro*, 964 F.2d at 283 ("it is not a violation of the securities laws to simply fail to provide adequate loan loss reserves; properly collateralize or secure a loan portfolio; or provide sufficient internal controls or loan management practices"). However, where the defendant has commented on the

> "nature and quality of the management practices that it has used to reach a particular statement of loan loss reserves,"

or has otherwise

> "characterize[d] loan loss reserves as 'adequate' or 'solid' even though it knows they are inadequate or unstable, it exposes itself to possible liability for securities fraud. By addressing the quality of a particular management practice, a defendant declares the subject of its representation to be material to the reasonable shareholder, and thus is bound to speak truthfully."

See Shapiro, 964 F.2d at 281–82.

Westinghouse, through spokesmen and in its SEC reports, undeniably used such language to describe its loan loss reserves, *see e.g.*, Exhibit M to Westinghouse Memo at 42 ("The financial statements were prepared in accordance with generally accepted accounting principles appropriate in the circumstances...." "We believe that the Corporation's policies and procedures, including its system of internal accounting controls, provide reasonable assurance that the financial statements are prepared in accordance with the applicable securities laws and with a corresponding standard of business conduct"), which, *under Shapiro* would put its loan loss reserves "in play."

a. *Scienter*

[20–22] If a corporation's agents' projections or opinions with respect to data such as loan loss reserves are reasoned and justified, with a sound factual or historical basis, they are not actionable even if inaccurate. *Eisenberg v. Gagnon*, 766 F.2d 770, 776 (3d Cir.), *cert. denied*, 474 U.S. 946, 106 S.Ct. 342, 88 L.Ed.2d 290 (1985). However, when such opinions are "issued without a genuine belief or reasonable basis," are made knowingly or recklessly, *and* are inaccurate, *see Virginia Bankshares Inc. v. Sandberg*, 498 U.S. ——, 111 S.Ct. 2749, 115 L.Ed.2d 929, 948 (1991) ("disbelief or undisclosed motivation, standing alone, [is] insufficient to satisfy the element of fact" in a securities fraud action), they constitute "culpable conduct actionable under § 10(b) and Rule 10b–5." *Eisenberg*, 766 F.2d at 776 (citations omitted). The issuer's alleged recklessness in issuing the baseless opinions or projections is sufficient to establish the scienter element of a Section 10(b) claim. *Id.* at 777.

Where the corporate director or officer has "greater access to information or [ ] a special relationship to investors making use of the information, there is an obligation to disclose data indicating that the opinion or forecast may be doubtful." *Id.* at 776 (citations omitted). However, management does not have a duty to paint a dark picture of its mismanaged operations, so long as a "reasonably detailed account of past operations and complete financial statements" are disclosed. *See Craftmatic*, 890 F.2d at 640 (affirming dismissal of claims that management failed to characterize "its financial reporting and accounting controls as inadequate and ineffective").

Defendants argue that the loan loss reserves allegations cannot support a cause of action, because the allegedly necessary loss reserves were not established for many individual accounts until Westinghouse abandoned its hold for the long term strategy on February 27, 1991. Westinghouse alleges that prior to that time the adequacy of WFSI's and WCC's loan loss reserves was properly determined primarily by analyzing past chargeoff experience and historical trends, though defendants' SEC reports purport that other, more individualized factors were considered as well. In addition, defendants say, Westinghouse and its subsidiaries truly believed its representations regarding the adequacy of their loan loss reserves, and unless plaintiffs can allege facts showing otherwise, plaintiffs' claims are not actionable.

Loan loss reserves are a type of "soft information," consisting essentially of predic-

tions about the future performance of receivables portfolios. As such, characterizations of reserves as adequate are necessarily a matter of opinion and belief. *Shapiro*, 964 F.2d at 281 ("No matter what method is used, the economic judgments made in setting loan loss reserves can be validated only at some future date"). Such characterizations can be both material, *see Virginia Bankshares*, 498 U.S. at ——, 111 S.Ct. at 2757, 115 L.Ed.2d at 944; *Flynn v. Bass Bros., Inc.*, 744 F.2d 978, 988 (3d Cir.1984), and factual, for "conclusory terms in a commercial context are reasonably understood to rest on a factual basis ... and expressions of such judgments can be uttered with knowledge of truth or falsity just like more definite statements." *Virginia Bankshares*, 498 U.S. at ——, 111 S.Ct. at 2758, 115 L.Ed.2d at 946.

[23] Plaintiffs have alleged the lack of reasonable basis for failure to take loss reserves in the individual cases with sufficient particularity to put defendants on notice of the nature of plaintiffs' claim. Defendants' argument that plaintiffs are merely quibbling over one of at least two proper methods of establishing reserves for commercial real estate under GAAP, Westinghouse Memo at 34, loses some force under the combined weight of standards promulgated by the American Institute of Certified Public Accountants,[11] and the Third Circuit Court of Appeals' opinion in *Bradford-White Corp. v. Ernst & Whinney*, 872 F.2d 1153 (3d Cir.), *cert. denied*, 493 U.S. 993, 110 S.Ct. 542, 107 L.Ed.2d 539 (1989) (upholding jury finding that auditor who claimed to comply with generally accepted auditing standards but did not was liable under Rule 10b–5), and would be a matter more properly raised on a motion for summary judgment.

b. *Materiality*

Plaintiffs discuss six particular accounts and list seven others in WCC's commercial real estate portfolio, alleging that even though each of the accounts was underperforming no reserve was established. *See DiLeo*, 901 F.2d at 626; *Fox v. Equimark Corp.*, 782 F.Supp. at 300 (in order to state an actionable claim under the securities laws, the plaintiff must specify how the defendant knew its reserves were inadequate or why it should have increased its reserves earlier). Plaintiffs contend that defendants failed to establish reserves for these accounts without reasonable basis, and that that constitutes fraud.

[24] Still, to survive a motion to dismiss, Rule 9(b) requires that a plaintiff plead a specific false representation of a *material* fact. *See Christidis*, 717 F.2d at 99. Applying the Supreme Court's definition of materiality in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976), "[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding" whether to trade shares of the corporation's stock. "Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Id.*

11. The AICPA provides:

> 2.67. Receivables from consumer loans usually are evaluated in total rather than on the basis of individual loans because they consist of large volumes of relatively small balances. In such situations, it is more difficult to judge collectibility of specific loans than to evaluate collectibility of portfolios taken as a whole.... Ratio analyses, historical statistics, current aging conditions, and other general trends are particularly important in evaluating collectibility.
>
> 2.68 Many commercial loans are tailor-made and relatively large. The size and uniqueness of commercial receivables necessitates a greater focus on specific loans and problems than is required for more homogeneous direct cash loans and retail sales contracts. Thus, *auditing procedures in connection with commercial lending tend to place less emphasis on statistical data and historical trends and focus more on current collateral values*, industry concentration, and financial conditions of individual borrowers. Particular attention should be given to loans in economically distressed industries.

American Institute of Certified Public Accountants, *Audits of Finance Companies* 31–32 (1988). (Emphasis added).

[25–28] The adequacy of loan loss reserves is the type of information that would significantly influence a reasonable investor, *Shapiro,* 964 F.2d at 281. But the legal materiality of a fact does not turn solely upon the *type* of information that fact represents. Materiality has both a qualitative and a quantitative dimension. If a particular fact alleged is relevant in terms of the sort of information that investors care about, i.e., information concerning the management and financial position of a corporation, but trifling as a matter of consequence, the information is not legally material. The failure to disclose that a loan portfolio is likely to be impaired by some *de minimis* amount may be "relevant" in that it is the type of information that investors care about, but of such "dubious significance," *TSC Industries,* 426 U.S. at 448, 96 S.Ct. at 2132, as to be "trivial," and "hardly conducive to informed decisionmaking," *id.* at 448–49, 96 S.Ct. at 2132, so that to reasonable shareholders, such omission must be immaterial as a matter of law.

[29] Instantly, plaintiffs cite examples of problem loans for which WCC allegedly should have, but did not, establish reserves, from periods including the fourth quarter of 1989 through the fourth quarter of 1990. Using plaintiffs' *highest* suggested numbers, the total dollar amount of reserves plaintiffs allege were wrongfully not established for each quarter represents a miniscule portion of WCC's current assets [12] for that quarter.

For example, plaintiffs allege that, during the fourth quarter of 1989, Westinghouse should have reserved between $10 million and $25 million to cover expected losses on its loan to Focus Financial Group Inc., ¶ 277, and an unspecified substantial amount to cover expected losses on its non-recourse first mortgage on the Daniel Building, an office building in Greenville, South Carolina. ¶ 283. Westinghouse's financial statement in its Form 10–K annual report for the fiscal year ended December 31, 1989 represented current assets [13] of $6,779,000,000. Assuming that the reserves plaintiffs allege defendants should have established during the fourth quarter of 1989 totalled $31 million, the reserves would have represented only 0.46 percent of Westinghouse's current assets for the same period. Similar calculations for successive quarters yield percentages of 0.21% for the first quarter of 1990,[14] 1.06% for the second quarter of 1990,[15] 0.24% for the third quarter of 1990,[16] and 1.28% for

12. Plaintiffs challenge defendants' utilization of "total assets" rather than "current assets" in defendants' discussion of materiality and in the appendices to the Westinghouse Memo. *See* Plaintiffs' Memorandum at 66–67. Viewing all allegations in a light most favorable to the nonmovants, comparing defendants' alleged failure to establish loss reserves for particular loans to current assets is a more accurate indicator of materiality.

> "Current assets" may be defined as:
> Economic resources of an entity that are in the form of cash and those that are reasonably expected to be sold, consumed, or converted into cash during the normal operating cycle of the business or within one year if the operating cycle is shorter than one year. Typical items included among current assets include cash, temporary investments, accounts and notes receivable, inventory, and prepaid expenses. In the balance sheet, current assets are usually listed in the order of their liquidity....

Glenn G. Munn, F.L. Garcia, Charles J. Woelfel, *Encyclopedia of Banking and Finance* 238 (9th ed. 1991).

13. The Court accepts as an accurate statement of Westinghouse's current assets in its SEC Form 10–K reports, "Westinghouse's 'Total Current Assets' plus WFSI's 'Cash and Short–Term Investments' and 'Marketable Securities'." *See* Notes to Appendix 2 of Westinghouse Defendants' Reply Memorandum in Support of Motion to Dismiss Consolidated Amended Class Action Complaint (Westinghouse Reply Memo).

14. Total reserves allegedly wrongfully not established in the amount of $10,200,029. *See* Hunt Energy loan ($4.5 million), ¶ 288, Oakhaven loan ($1,120,542), Windsong loan ($4,418,439) and Woodlake loan ($161,048), ¶ 290. Westinghouse current assets calculated at $4,936,000,000.

15. Total reserves allegedly wrongfully not established in the amount of $54,800,000. *See* Focus loan ($40 million), ¶ 277, La Jolla Village loan ($8 million), ¶ 279, and ECJV loan ($6.8 million), ¶ 389. Westinghouse current assets calculated at $5,161,000,000.

16. Total reserves allegedly wrongfully not established in the amount of $12 million. *See* Flagship loan (estimate of $10 million is four times the reserve Westinghouse recommended establishing in October, 1990, and represents a "substantial" reserve on a $60 million loan secured by $33 million in mortgages and $18 million in

the fourth quarter of 1990.[17] In fact, by the end of the fourth quarter of 1990, all the loan loss reserves that plaintiffs allege should have been established, *added together*, amounted to only 3.0% of Westinghouse's current assets at that time.

Given these small numbers, it would seem doubtful that plaintiffs have alleged facts showing a *material* misrepresentation or omission, especially since they have had the benefit of conducting discovery on some 536 loan files *before* filing their amended complaint.

[30, 31] However, the focus on loan loss reserves as a percentage of current assets is misplaced. When it appears "probable" (as opposed to "reasonably possible" or "remote") that an asset has been impaired by an amount that can be reasonably estimated, the previously established loss reserve, or "loss contingency," should be treated as an actual loss. At that point, the proper accounting response is to accrue the loss reserve as a charge against income as of the date of the financial statements. FASB, Statement of Financial Accounting Standards, No. 5 at ¶ 8. What is affected most immediately by the development of a loss reserve for accounting purposes is income, not assets. In order to determine the materiality of allegedly inadequate loan loss reserves, the focus then must be the amount of loan loss reserves alleged to have been wrongfully not posted as a percentage of income during the relevant period, rather than as a percentage of current assets. *See Securities and Exchange Comm'n v. Shared Medical Systems Corp.*, 1992 WL 208029 n. 5 (E.D.Pa.1992) (rejecting defendants' argument that an absolute rule of 10 percent defines materiality in securities fraud cases, and considering effect of alleged misstatement on income).

[32, 33] In 1989, Westinghouse had net income of $922 million, of which $270 million was earned in the fourth quarter. Exhibit L to Westinghouse Memo at 9. Westinghouse's 1990 net income, unadjusted for the February 27, 1991 $975 million pretax charge against 1990 fourth quarter earnings, was $1,001,000,000. After the charge, Westinghouse's 1990 net income was $268 million. Westinghouse's unadjusted 1990 fourth quarter net income was $284 million. After the charge, Westinghouse experienced a 1990 fourth quarter net loss of $449 million. Exhibits K and M to Westinghouse Memo at 7 and 22 (1990 Form 10–K.)

Plaintiffs have identified $26 million and $76,442,237 in loan loss reserves wrongfully not established for the fourth quarters of 1989 and 1990. These amounts represent 9.6% of reported 1989 fourth quarter income, and 26.9% of 1990 fourth quarter income (unadjusted), respectively. For the 1990 fiscal year, plaintiffs have identified $153,442,237 of reserves that they allege should have been posted. These amounts represent approximately 15% of Westinghouse's 1990 net income, unadjusted for the February 27, 1991 charge against 1990 fourth quarter earnings.

At the motion to dismiss stage of litigation, doubts about materiality should be resolved in favor of the non-movant. *See TSC Industries, Inc.*, 426 U.S. at 450, 96 S.Ct. at 2132. With that in mind, and without deciding the applicability of Item 103 of the Securities and Exchange Commission's Regulation S–K, 17 C.F.R. § 229.103 (requiring disclosure of extraordinary legal proceedings involving claims exceeding 10 percent of current assets), to actions for allegedly misrepresented loan loss reserves, the Court believes that plaintiffs' specific allegations of wrongfully understated reserves are sufficiently substantial, in relation to Westinghouse's net income for the relevant time periods, to be deemed legally material.

c. *"Bespeaks Caution"*

[34] I stated above that defendants' representations in their SEC reports, and in

first mortgage liens), ¶ 281, and Great Meadow Gardens loan ($2 million reserve recommended in September, 1990 was allegedly never posted), ¶ 286. Westinghouse current assets calculated at $5,094,000,000.

17. Total reserves allegedly wrongfully not established in the amount of $76,442,208. *See* Focus loan ($59 million as of December 31, 1990), ¶ 277, Great Meadow Gardens loan ($3 million on December 31, 1990), ¶ 286, Marsh Pointe loan ($1,328,208), Friendly Ice Cream loan ($6,700,000), Tracor loan ($5,750,000) and Woodcreek loan ($590,000), ¶ 290. Westinghouse current assets calculated at $5,955,000,000.

public statements by Westinghouse officials, would, *ceteris paribus*, put the adequacy of defendants' loan loss reserves "in play," in which case plaintiffs have pled their claims with sufficient particularity and materiality to withstand defendants' motion to dismiss. *See* ¶¶ 246–290. However, when Westinghouse's and WCC's statements about the adequacy of their loan loss reserves are considered *in toto*, *see Cortec Industries, Inc. v. Sum Holding L.P.*, 949 F.2d at 47 ("when a district court decides a motion to dismiss a complaint alleging securities fraud, it may review and consider public disclosure documents required by law to be and which actually have been filed with the SEC"), it is apparent that the statements are not misleading.

Defendants did not, as plaintiffs' allegations suggest, tender to the investing public only confident statements of fact that Westinghouse and WCC's loan loss reserves were adequate and without risk of future increase. Rather, in their annual and quarterly reports filed with the SEC, defendants consistently hedged their statements of belief about the adequacy of Westinghouse and WCC loan loss reserves, and the prospects of future operations, with qualifying remarks transparent enough to raise red flags for even the least sophisticated investor. For example, after noting the February 27, 1991 special provision for losses charged against 1990 fourth quarter earnings, the Management Discussion and Analysis section of Westinghouse's 1990 Form 10–K annual report warned:

> Management expects earnings for the first quarter of 1991 to be approximately 50% lower than the comparable period in 1990, because of lower operating profit due to deteriorating economic conditions and reduced non-recurring income. Second quarter earnings are expected to be higher than the first quarter, but significantly lower than the second quarter of 1990....
>
> For the remainder of the year, it is difficult to predict the depth and duration of the current economic downturn and the effects of the current worldwide economic and political uncertainty, particularly in the area of the Persian Gulf, on the economy and, consequently, on corporate performance. Assuming no further deterioration in the Corporation's markets, the second half of 1991 is expected to outperform the comparable period of 1990.

Exhibit M to Westinghouse Memo at 17. Referring specifically to the adequacy of loan loss reserves, the report stated:

> Management believes that, under current economic conditions, the allowance for losses at December 31, 1990 will be adequate to cover future losses that may develop in the various portfolios. However, no assurance can be given that a further or more prolonged downturn in the economy will not have a negative effect on the ability of borrowers to repay and on asset values generally.

Id. at 19. WCC's 1990 Form 10–K contained almost identical language. *See* Exhibit N to Westinghouse Memo at 4, 9.

In its Form S–3 Registration Statement, filed with the SEC on or about April 18, 1991 in preparation for a public offering of common stock, Westinghouse disclosed that:

> The $3.4 billion in higher-risk and underperforming assets reclassified as held for sale or restructuring [pursuant to Westinghouse's restructuring plan announced on February 27, 1991] included $2.4 billion in receivables. As such, these receivables had and continue to have a high probability of becoming non-earning assets during the expected period of liquidation. Although changes in these assets between earning, reduced earning, non-earning or real estate owned have occurred since December 31, 1990, management does not believe that such changes have had a material effect on the net realizable value of these receivables.
>
> At March 31, 1991, WFSI's valuation allowances related to assets held for sale or restructuring, and the allowances for credit losses related to the assets in the ongoing portfolio, amounted to $1,013 million and $306 million, respectively. Management believes that under current economic conditions such allowances should be adequate to cover future losses that may occur. However, a further or more prolonged downturn in the economy or in the

real estate, securities or certain other markets could have a negative effect on the ability of WFSI's borrowers to repay and on asset values generally and could result in additional increases in non-earning assets, restructured loans and, ultimately, increases in allowances for losses in both assets held for sale or restructuring and receivables in the balance of WFSI's portfolio.

Exhibit O to Westinghouse Memo at 8, 9.

On or about May 14, 1991 and, Form 10–Q, August 14, 1991, Westinghouse and WCC filed quarterly reports for the first and second quarters, respectively, of 1991. Exhibits R, S, T and U to Westinghouse Memo. Westinghouse stated:

> Management believes that under current economic conditions, [WFSI's valuation] allowances should be adequate to cover future losses that may occur. However, a further or more prolonged downturn in the economy or in the real estate, securities or certain other markets could have a negative effect on the ability of WFSI's borrowers to repay and on asset values generally, and could result in additional increases in nonearning assets, restructured loans and, ultimately, increases in allowances for losses in both assets held for sale or restructuring and receivables in the balance of WFSI's portfolio.

Exhibit R to Westinghouse Memo at 8. WCC's Form 10–Q also cautioned that:

> The majority of receivables held for sale or restructuring are underperforming. Results of sale and restructuring activities related to these receivables were not material for the quarter because implementation of the downsizing plan began late in the quarter. Although management intends to liquidate these assets over the next three years, declining liquidity in credit markets may affect management's ability to achieve the desired results. Furthermore, Westinghouse Credit may be required to continue to provide financing for certain of these assets, either to existing borrowers to restructure loans or to new borrowers to finance the sale of real estate properties.
>
> Nonearning assets at March 31, 1991 included $261 million due from companies that have filed for bankruptcy. A continued downturn in the economy and certain markets served by borrowers may have an effect on the ability of some borrowers to comply with their agreements. This could result in additional increases in nonearning receivables, restructured loans and credit losses.

Exhibit S to Westinghouse Memo at 13, 15; Exhibit U to Westinghouse Memo at 16.

Westinghouse further disclosed that:

> Management expects earnings for the second half of 1991 to be down 25% or more from the 1990 second-half results,

and that

> [t]he decline in operating profit [for the first six months of 1991] was due to significantly higher levels of nonearning and reduced earning receivables and a reduction in gains from sales of equity interests in financing transactions. The markets, particularly commercial real estate, served by Financial Services are expected to remain depressed over the last six months of 1991 causing the results to be down, with the possibility of an operating loss, compared with the same period of 1990.

Exhibit T to Westinghouse Memo at 10, 11.

With respect to WFSI's loan loss reserves, Westinghouse stated that:

> Management believes that under current economic conditions, [WFSI's] allowances should be adequate to cover future losses that may occur. A further or more prolonged downturn in the economy or in real estate, securities, or certain other markets could have a negative effect on the ability of WFSI's borrowers to repay and on asset values generally, and could result in additional increases in nonearning assets, restructured loans and, ultimately, increases in allowances for losses in both assets held for sale or restructuring and receivables in the balance of WFSI's portfolio.

Id. at 12.

In its Form 10–Q report for the second quarter of 1991, WCC disclosed that although "Management believes that the revised strategy will reduce portfolio risk and

improve Westinghouse Credit's future financial position", [a] lack of liquidity in the markets in which Westinghouse Credit's customers operate is a continuing concern. Also, a further or more prolonged downturn in these markets or in the economy could have a negative effect on the ability of borrowers to repay and on asset values generally, and could result in increased credit losses." Exhibit U to Westinghouse Memo at 9–10.

Similarly, after noting that nonearning assets included $186 million due from companies that had filed for bankruptcy, WCC warned that "[a] continued downturn in the economy and certain markets in which Westinghouse Credit's customers operate may have an effect on the ability of some borrowers to comply with their agreements. This could result in additional increases in nonearning receivables, restructured loans and credit losses." *Id.* at 16.

[35] These remarks, far from being Pollyanish, pointed to still darker clouds on the horizon if the economy generally, and real estate markets specifically, did not improve. It was common knowledge that the likelihood of a prompt rebound in commercial real estate markets was not great during 1990 and 1991, and the reasonable investor would be doubly forewarned after reading Westinghouse's and WCC's SEC reports. Furthermore, the professional securities analyst, who is not easily bamboozled by elliptic references to adverse contingencies, would surely take notice of Westinghouse's disclosures. These professional analysts are generally the first and foremost source of information to the market; their specialized ferreting activity is the primary means by which capital markets are made "efficient," and stock prices relatively accurate. *See generally,* Ronald J. Gilson and Reinier H. Kraakman, *The Mechanisms of Market Efficiency,* 70 Va.L.Rev. 549, 569–79 (1984); *cf. Basic Inc. v. Levinson,* 485 U.S. 224, 241–45, 108 S.Ct. 978, 988–90, 99 L.Ed.2d 194 (1988); *Peil v. Speiser,* 806 F.2d 1154, 1160–63 (3d Cir.1986) (citing market efficiency as basis for adopting "fraud on the market" theory of reliance in securities fraud actions). Plaintiffs do not allege that they actually read any of Westinghouse's public disclosures, but are instead relying on the alleged fraud on the efficient securities market practiced by Westinghouse. Plaintiffs cannot simultaneously claim that the market participants who at the margin make the market efficient by sophisticated analysis of available information would have naively overlooked Westinghouse's cautions.

Accordingly, despite sufficient allegations of scienter and materiality, defendants' alleged misrepresentations about the adequacy of Westinghouse and WCC loan loss reserves were so strongly qualified by clear warnings about the future that plaintiffs' causes of action based on the averments in ¶¶ 246–90, except ¶ 258 and ¶ 262, must be dismissed under the "bespeaks caution" doctrine. This doctrine has been expressly adopted by the courts of appeals for the First, *see Romani v. Shearson Lehman Hutton,* 929 F.2d 875, 879 (1st Cir.1991), Second, *see Luce v. Edelstein,* 802 F.2d 49, 56 (2d Cir.1986), Sixth, *see Sinay v. Lamson & Sessions Co.,* 948 F.2d 1037, 1040 (6th Cir.1991) and Eighth Circuits, *see Moorhead v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 949 F.2d 243, 245–46 (8th Cir.1991), and by at least one district court in the Ninth Circuit, *see In re Worlds of Wonder Securities Litigation,* 814 F.Supp. 850 (N.D.Cal.1993), one in the Fifth Circuit, *see Porter v. Shearson Lehman Bros. Inc.,* 802 F.Supp. 41, 57 (S.D.Tex.1992), and two district courts in the Third Circuit, *see In re Goodyear Tire & Rubber Co. Securities Litigation,* 1993 WL 130381 (E.D.Pa.1993); *In re Donald J. Trump Casino Securities Litigation,* 793 F.Supp. 543, 552–53 (D.N.J.1992). As stated by the court in *In re Donald J. Trump Casino Securities Litigation,* "adequate cautionary language ... is the equivalent of full disclosure pertaining to forecasts and predictions, relieving defendants of securities fraud liability, [and] plaintiffs' claims are not actionable. In essence, the 'bespeaks caution' analysis would subsume or obviate the analysis regarding adequate allegations of falsity or misrepresentation." *Id.* at 552. Put another way, defendants' statements concerning the adequacy of Westinghouse's loan loss reserves cannot have been made recklessly, as they were accompanied by sufficiently detailed warnings with respect to future contingencies. *Id.* at 553 (discussing

"bespeaks caution" doctrine in light of *In re Craftmatic Securities Litigation*).

[36] The cause of action based on the allegations in ¶¶ 258 and 262, shall not be dismissed. Lego's October 24, 1990 statement ("We believe our reserves are adequate. We see no major problems there"), and the unidentified Westinghouse spokesman's unqualified statement on June 24, 1991 contradicting Smith Barney securities analyst George Fraise's opinion about the necessity of another write-off in 1991 lacks the "bespeaks caution" language running through Westinghouse's and WCC's SEC reports.

4. *"Westinghouse and WCC Overstated Net Receivables and Understated Real Estate Owned"*

[37] Plaintiffs allege at ¶¶ 291–349 that, throughout the proposed class period, defendants (1) carried as receivables real estate investments that should have been considered foreclosed in substance and therefore accounted for as real estate owned, and (2) misrepresented the value of real estate owned by carrying such assets at the outstanding amounts due under the secured loans, rather than at the fair (market) value of the underlying property—all in violation of GAAP. In this manner, plaintiffs aver, Westinghouse and WCC knowingly or recklessly misrepresented their net receivables and real estate owned in several SEC annual and quarterly reports. ¶¶ 294, 295, 311–17.

Defendants contend that plaintiffs have not stated actionable claims with respect to five of eight properties that allegedly should have been foreclosed in substance, and that the three other properties, ¶¶ 324–29, involve dollar amounts so small as to be immaterial. Defendants raise the same immateriality argument in response to plaintiffs' allegations that Westinghouse overstated net receivables in ¶¶ 330–42. Westinghouse Memo at 34–39; Westinghouse Reply Memo at 21–25.

Defendants argue that "[r]eflecting the difference between the original loan amount and the fair value by adjusting a valuation allowance rather than 'writing down' the asset is an entirely appropriate, and, indeed, correct procedure." Westinghouse Memo at 34–5 (citing American Institute of Certified Public Accountants, *Statement of Position, Accounting for Foreclosed Assets* 92–3 ¶ 12 at 9, Exhibit H to Westinghouse Memo.[18] The provision of the AICPA Statement of Position cited by defendants does not support their argument. The sentence quoted by defendants prescribes that the deficiency between (a) the fair value of foreclosed assets held for sale minus estimated cost to sell and (b) the cost of foreclosed assets held for sale, be recognized as a valuation allowance. The language quoted by defendants does not even address the difference between the original loan amount and the fair value of underlying property, let alone provide a proper method of accounting for it. In fact, the preferable accounting procedure for actual or in substance foreclosures is to carry the asset at its fair value, and recognize the difference between fair value and the recorded investment in the receivable as a loss against net income. FASB, *Statement of Financial Accounting Standards No. 15* at ¶¶ 28, 35.

However, FASB Statement No. 15 also "recognizes that creditors use allowances for uncollectible amounts. Thus, a loss from reducing the recorded investment in a receivable may [be] recognized before the restructuring by deducting an estimate of uncollectible amounts in measuring net income and increasing an appropriate valuation allowance. If so, a reduction in the recorded investment in the receivable in a troubled debt restructuring is a deduction from the valuation allowance rather than a loss in measuring net income for the period of restructuring." *Id.* at ¶ 35. Under GAAP,

18. After foreclosure, foreclosed assets held for sale should be carried at the lower of (a) fair value minus estimated costs to sell or (b) cost. Such determination should be made on an individual asset basis. If the fair value of the asset minus the estimated costs to sell the asset is less than the cost of the asset, the deficiency should be recognized as a valuation allowance. If the fair value of the asset minus the estimated costs to sell the asset subsequently increases and the fair value of the asset minus the estimated costs to sell the asset is more than its carrying amount, the valuation allowance should be reduced, but not below zero. Increases or decreases in the valuation allowance should be charged or credited to income. (footnotes omitted)

then, creditors may in fact recognize fluctuating asset values by adjusting valuation allowances, and need not *necessarily* write down assets, though that appears to be the preferred course. Accordingly, the causes of action based on ¶¶ 318–323 which allege only failure to write down assets, will be dismissed for failure to state a claim.

5. *"Westinghouse and WCC Overstated Net Income and Asset Values"*

Plaintiffs' allegations regarding net income and asset values in ¶¶ 343–49 are not independent, particular allegations of wrongdoing. Rather, these paragraphs represent the total effect of their previous allegations upon Westinghouse and WCC's financial statements, which allegations the Court has addressed, *supra*.

B. *Westinghouse's Alleged Misrepresentations Regarding the Adequacy of Its Internal Controls*

In ¶¶ 350–73, plaintiffs aver that, throughout the proposed class period, Westinghouse and WCC misrepresented (by overstating) the quality of their internal controls. Defendants' representations about their internal controls were made in their SEC Form 10–K annual reports, and consisted of the following statement:

> The Corporation maintains a system of internal accounting controls, supported by adequate documentation, to provide reasonable assurance that assets are safeguarded and that the books and records reflect the authorized transactions of the Corporation. Limitations exist in any system of internal accounting controls based upon the recognition that the cost of the system should not exceed the benefits derived. Westinghouse believes its system of internal accounting controls, augmented by its corporate auditing function, appropriately balances the cost-benefit relationship.
>
> * * * * * *
>
> We believe that the Corporation's policies and procedure, including its system of internal accounting controls, provide reasonable assurance that the financial statements are prepared in accordance with the applicable securities laws and with a corresponding standard of business conduct.

Exhibit M to Westinghouse Memo at 42.

Plaintiffs also allege liability based on two statements by William A. Powe, Westinghouse's Executive Vice President and the CEO of WFSI and WCC until October, 1991, which were published in WCC's 1988 and 1989 annual report in the "Message to Security Holders." The statement in the 1988 report assures investors that WCC management had "strengthened the Company's evaluation and monitoring of credit and portfolio risks;" the 1989 report states that WCC had given "particular attention to monitoring the quality and performance of the Commercial real estate financing portfolio, and ... made strategic changes to take advantage of market conditions." ¶¶ 352–53.

Finally, in Complaint ¶¶ 355–73, plaintiffs aver that, sometime prior to August 1990,[19] WCC management received from an anonymous WCC employee a tip that WCC's internal accounting controls were not adequate to ensure the reliability of their reported financial condition. WFSI internal auditors conducted their own investigation, and submitted to Westinghouse a special audit report, dated November 28, 1990. Exhibit Z to Westinghouse Memo. Assessing the validity of the anonymous allegations, the report concluded:

> Primary Allegation: Receivable balances are not sufficiently supported by underlying collateral values.
>
> Conclusion: No exceptions.
>
> Allegation: An independent appraisal for the ECJV property was suppressed because the resultant valuation was significantly less than the outstanding loan balance.
>
> Conclusion: No evidence to support allegation. Real estate management considered the appraiser's underlying assumptions inaccurate and unsupportable.

Memo at 1.

19. The anonymous communication was made in April, 1990. *See* Exhibit Z to Westinghouse

Allegation: Negative information was received from a Leventhal study that was "pushed aside by top management."

Conclusion: No evidence to support allegation.

Allegation: Underwriters are paid bonuses based on production.

Conclusion: Allegation does not raise concern; controls are reflected in the approval process to prevent abuse.

Id. at 2. The report then offered, in detail, "comments and recommendations to improve internal controls" addressing "some overall concerns" that the internal auditors had identified. *Id.* at cover and 2.

[38–41] The causes of action based on the allegations in ¶¶ 350–73 must be dismissed. Plaintiffs have not pled with particularity facts that would put defendants on notice of any claim of alleged fraud, and Fed.R.Civ.P. 9(b) is meant to foreclose precisely the sort of make-do pleading that this portion of plaintiffs' Complaint represents. WCC's internal auditors clearly denied the anonymous allegation that defendants' internal controls were inadequate. The fact that the internal auditors also recommended improvements in valuation methods and tighter standards for internal valuations does not support plaintiffs' claim that in its Form 10–Ks Westinghouse fraudulently or even inaccurately represented its internal controls as adequate "to provide reasonable assurance that assets are safeguarded and that the books and records reflect authorized transactions of the corporation." ¶ 351. Further, the allegations in the complaint that the internal controls were inadequate in fact do not even contradict Powe's statements in the annual reports that management was strengthening internal controls, much less permit an inference that Powe's statement was fraudulent. Plaintiffs may not cite confidential communications, policy recommendations and internal memoranda identifying measures by which Westinghouse could improve some area of operations and allege that the corporation had previously committed actionable fraud. Section 10(b) is designed to ensure full and accurate disclosure and may not be used to punish firms for identifying and implementing improvements to corporate policies.

C. *Section 10(b) and Rule 10b–5 Claim Against the Secondary Defendants*

1. *Lazard Freres*

The additional allegations against Lazard may be summarized as follows: (1) Lazard was retained to advise Westinghouse as to its options, ¶ 103 *et seq.;* (2) Lazard conducted a study; (3) Lazard executives Rohatyn and Wilson prepped Lego for the securities analysts meeting of October, 1990 using the Niemcyk memo and attached documents, Exhibit A to Compendium; and (4) Lazard drafted a document, the Question and Answer Memo, relative to proposals to restructure Westinghouse, including by taking a charge against 1990 earnings. ¶¶ 155–159.

Plaintiffs argue that by taking these actions (1) Lazard advised Lego "to mislead analysts by describing reserves as adequate because '[m]ost analysts are probably unaware of the full extent of the problem'," Plaintiffs' Brief at 18; and (2) Lazard prepared the Question & Answer Memo "which demonstrated its ... awareness that the $975 million provision was inadequate to protect against likely losses in WCC's portfolio[,]" Plaintiffs' Brief at 18–19; and "effectively orchestrat[ed] a two-step write-down ... by failing to disclose what, at best, was the highly contingent nature of the February 1991 write-down." *Id.* at 89.

[42] Neither of the documents on which plaintiffs base their claim against Lazard will bear the construction placed on it. Nowhere in the Niemczyk memo is there any advice to "mislead analysts." The quotation, "most analysts are probably unaware of the full extent of the problem," is extracted by plaintiffs from a discussion of WCC's position which makes no recommendations:

> WCC's earnings are under pressure. The most obvious problem is a high level of non-performing real estate. Most analysts probably are unaware of the full extent of the problem. This is because part of WCC's real estate owned (REO) is warehoused at the parent (WFSI) and also because WCC does not publicly disclose renegotiated or "less than carry" loans. To some extent, the level of non-perform-

> ing assets can be managed by lowering interest rates and returning non-earning loans to performing status. The end result is the same—the overall yield of the portfolio declines, squeezing interest margins.

Exhibit A to Compendium at 1. The portion of the memo containing Lazard's proposed answer concerning loss reserves, designed to prepare Lego for analysts' questions, is set out in full: [20]

> *Possible Questions*
>
> Is WCC considering a special charge to earnings to increase loan loss reserves? A restructuring charge?
>
> *Possible Answers/Approach*
>
> We believe that our reserves are adequate at the present time. However, we continue to monitor the situation closely and will take whatever steps are necessary to maintain a strong credit profile.
>
> We have no plans at present to take a restructuring charge. [Revise if appropriate for anticipated reductions in branch office staff.] We are undertaking a comprehensive review of our business and will be considering a range of options, [some of which might involve a restructuring charge]. This review is in an early stage and it would be premature to speculate at this time whether a restructuring charge is necessary or even desirable.

Id. at 7. The proposed answer regarding the adequacy of reserves, prepared only weeks after Lazard was retained, is rendered innocuous by the qualification: "However we continue to monitor...." Further, there are no allegations in the Complaint that even Lego or the other Westinghouse defendants themselves *believed* at this point that the loss reserves were inadequate, only that the reserves were inadequate *in fact* and that Price Waterhouse, Lazard and the Westinghouse defendants were either aware of the facts that should have caused them to recognize this inadequacy but did not, or were negligent or reckless in failing to provide internal controls adequate to discover the true state of affairs. *See* ¶ 182.

[43, 44] Insofar as Lazard (or Price Waterhouse) is alleged to have failed to draw the proper conclusions from known facts, the claims are purely negligence allegations, not claims that Lazard participated with intent to bring about, *see Landy v. FDIC*, 486 F.2d at 163, Lego's unqualified statement. The claim that Lazard (or the other secondary defendants) provided insufficient internal controls to detect the true state of Westinghouse's affairs only weeks after being retained is also meritless.

[45–47] In fact, Lazard had flagged the issue of loss reserves in the Earnings Outlook portion of its report:

> We believe Price Waterhouse (WCC's auditors) will challenge the adequacy of reserves and argue strongly for additional provisions in the fourth quarter.

Exhibit A to Compendium at 3.

No reasonable person could conclude from the language of this document (and plaintiffs allege no other actions on Lazard's part) that Lazard attempted to mislead the securities analysts, or aided and abetted Lego's alleged attempt to do so. In an attempt to state a claim against Lazard, plaintiffs allege that in the actual presentation to the analysts Lego "followed Lazard's recommended script precisely." ¶ 131. Simple comparison of Lazard's proposed answer and Lego's alleged actual statements reveals that this characterization is simply not supportable. Even at the pleading stage an allegation which is refuted by the document from which it is derived cannot support a cause of action. The allegation in ¶ 131 that Rohatyn, Wilson and Niemczyk believed that Lego's statements to the analysts were false when made still does not satisfy the requirements for a cause of action against Lazard because La-

20. Lazard had previously cautioned Westinghouse in the overview section of the memo entitled "Recommended 'Script' for the Analysts Meeting:"

> There are enough uncertainties in the outlook not to discount the possibility of quarterly losses or a step decline in earnings. An overly optimistic assessment of WCC, followed soon after by disappointing earnings, could seriously damage Lego's credibility.

Exhibit A to Compendium at 3.

zard neither made nor counselled making these statements.

[48] In ¶ 136, plaintiffs allege that Lazard recommended that Westinghouse release its fourth-quarter 1990 earnings results without disclosing any of Lazard's acquired knowledge concerning WCC's troubled real estate loans or the allegedly planned charge against income. Plaintiffs base this allegation on a document entitled "Westinghouse Financial Services: Discussion Materials," dated January 9, 1991. Exhibit B to Compendium. The Discussion Materials likewise simply cannot bear the construction placed on them, for there are literally no recommendations at all in the document, and the only mention of a charge against income is posed as an alternative strategy option: "Choose between one-time restructuring charge versus pay-as-you-go alternative." Exhibit B at 4.

[49] However, even if Lazard recommended a charge against income to the Westinghouse board, plaintiffs' allegations would not state a cause of action, because Lazard had no duty to disclose its recommendation to the marketplace of investors.[21]

[50] Finally, plaintiffs attempt to state a Section 10(b) claim directly against Lazard based on the May 1991 stock offering by arguing in their brief that Lazard orchestrated a two-step write-down—i.e. advised Westinghouse to take the February 1991 write-down knowing that the $975 million charge was inadequate. Plaintiffs' allegations bely their conclusions. Plaintiffs' allege at ¶ 145, that Lazard completed a Model Plan calling for a $1.0 billion–$1.2 billion charge to increase the loan loss reserves, that Westinghouse management decided on a $975 million charge, ¶ 148, and that Lazard Freres prepared the Board Meeting Q & A which stated that the $975 million charge was, in Lazard Freres's opinion, "clearly reasonable but at the low end of the range," was based on an unstable economic environment, and was contingent on the success of disposing of WCC assets. ¶ 157. These documents are the only basis for plaintiffs' claim against Lazard. *See* ¶ 158. Plaintiffs make additional allegations concerning Lazard's knowledge at ¶ 182–83, but the allegations simply are not relevant to a securities fraud claim. At ¶ 182, plaintiffs allege that Lazard knew as of the February 27, 1991 board meeting "that the conditions which Lego cited [in ¶ 181] for the [$1.68 billion charge] in October of 1991 existed." That much is not even in dispute. Asserting Lazard's knowledge that the economy was weak, the real estate credit market was weak, and the market for commercial properties was weak is in no way equivalent to asserting that Lazard was responsible for Westinghouse's February 1991 $975 million charge knowing that it was inadequate, and planning an undisclosed second charge for October 1991.

2. *Price Waterhouse*

Price Waterhouse was Westinghouse' independent accountant during the class period, and as auditor expressed its unqualified opinions on the financial statements of Westinghouse, WFSI, and WCC in 1988, 1989, and 1990. ¶ 14. The unqualified opinions were published in Westinghouse and WCC's 1988, 1989, and 1990 Form 10–Ks. The 1990 financial statements were also referenced in the prospectus for the May 1991 stock offering by Westinghouse.

Additionally, Price Waterhouse reported to the Westinghouse board of directors' Audit Review Committee on January 23, 1991, and audited the adequacy of the February 1991 charge.

Plaintiffs allege that Price Waterhouse violated Section 10(b) and Rule 10b–5 by certifying in each of these financial documents that Price Waterhouse's audits were conducted in accordance with GAAS and that the statements were prepared in conformity with GAAP, even though Price Waterhouse violated GAAS as alleged in ¶ 351, ¶¶ 365*–69*, ¶¶ 374–88.

21. To accept plaintiffs' allegations as sufficient to state a cause of action for securities fraud would imply that whenever a company or its financial consultants identified a charge against income as a possible course of action, all reports of earnings by that company must be suspended until the decisions about whether to take a charge against income and if so, in what amount, have been finalized.

Plaintiffs, in addition to the allegations based on the documents, allege that Price Waterhouse "agreed to maintain reserves at a capped 2.5% (later increased to a grossly inadequate 2.8%) despite known massive increases in problem loans," *see* ¶ 77–90, and "participated in the scheme to defraud by recklessly disregarding the lack of internal controls, failing to obtain sufficient competent evidential matter, failing to broaden the scope of its audit where circumstances required, and failing to maintain independence," *See* ¶ 371*; *see generally* Plaintiffs' Brief at 19.

Plaintiffs do not allege that Price Waterhouse expressed any opinions or was retained or consented to render opinions in any other public disclosures. *See* ¶¶ 137–62. Nor do plaintiffs allege that Price Waterhouse was party to Lazard's review of Westinghouse's options in late 1990, nor in the Westinghouse board of directors' decision to take the $975 million charge. Finally, plaintiffs do not allege that Price Waterhouse was involved in or commented on the $1.68 billion charge taken in October, 1991.

[51–53] Plaintiffs' claim that Price Waterhouse's unqualified opinions on Westinghouse's financial statements in the class period directly violate Section 10(b) and Rule 10b–5 are sufficient to state a claim at this stage of the proceedings. Plaintiffs must allege, in order to state a direct claim, that Price Waterhouse knowingly or with reckless indifference made a false statement of material fact intending to induce the plaintiffs' reliance thereon. *Lewis v. Chrysler Corp.*, 949 F.2d at 649. It is not actionable that a financial statement is incorrect or even that the party audited is committing a fraud which the auditor does not detect, because the expression of the auditor's opinion does not make the auditor an insurer of every investor who purchases in reliance on the financial statement.

Nevertheless, the Court of Appeals has approved, although in a distinguishable procedural context, liability based on allegations that an auditing firm misrepresented its adherence to GAAS. *See Bradford–White Corp. v. Ernst & Whinney, supra.*

[54] Measured by the pleading standards of Rule 9, however, the complaint is inadequate to state any cause of action against Price Waterhouse for aiding and abetting. Plaintiffs' aiding and abetting allegations, for example that Price Waterhouse "agreed" that WCC's loss reserves would be 2.5%, *see* ¶ 80, and "approved" an inadequate level of loss reserves so that the individual Westinghouse defendants could garner performance bonuses, ¶ 90, are inherently improbable as a matter of fact and insufficient as a matter of law. In the absence of any allegation that would support an inference that Price Waterhouse had either the legal power or a factual incentive to agree to or approve loss reserves, plaintiffs' aiding and abetting claim is based on two allegations: (1) that Price Waterhouse received fees from Westinghouse, ¶ 78, and that it acted as CFO of Brad Cable at the time of some of its audits, ¶ 405.

[55] Accounting firms do not offer their services to large corporations *gratis*, and there is nothing improper in Price Waterhouse receiving fees for its services. Nevertheless, a different situation might be presented if plaintiffs alleged that Price Waterhouse's compensation was well above the market rate or that it was somehow bartered for a favorable opinion. Paragraph 78 makes no such allegations, and adds nothing to plaintiffs' other allegations.

[56] The allegation that Price Waterhouse's audit integrity was compromised because it was also acting as CFO of Brad Cable is also rejected. Regulation S–X requires an accountant's independence, but considers independence to be impaired only by a "direct financial interest" or a "material indirect financial interest." 17 C.F.R. § 210.2–01(b). Price Waterhouse's alleged indirect financial interest in Brad Cable is, on the facts alleged, immaterial as a matter of law.

VI. *COUNTS TWO, THREE, FOUR and FIVE*

A. *Westinghouse Defendants*

[57, 58] In order to state a claim under Sections 11 and 12(2), plaintiffs need only allege that they acquired a security which

was accompanied by a registration statement, any part of which contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, regardless of scienter. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382, 103 S.Ct. 683, 687, 74 L.Ed.2d 548 (1983). Allegations of § 11 and § 12(2) violations that sound in fraud must be pled with the particularity required by Rule 9(b). *Shapiro*, 964 F.2d at 287.

In ¶¶ 423–466, plaintiffs allege that all defendants including the individual defendants, violated Sections 11, 12(2) and 15 of the Securities Act by making misrepresentations of fact in the registration statement and prospectus filed with the SEC on April 18, 1991 in connection with the May 1991 public offering, and by offering or selling Westinghouse securities by the use of a misleading prospectus. Specifically, plaintiffs aver that the registration statement and prospectus misrepresented Westinghouse's earnings, assets, net worth and loan loss reserves. Plaintiffs also aver that Westinghouse falsely predicted in its prospectus that the restructuring plan announced February 27, 1991 would "reduce risk and improve the financial position and results of operations of WFSI and WCC in future periods," and that "management believe[d] that under current economic conditions [WFSI's valuation allowances] should be adequate to cover future losses that may occur." ¶ 432. Finally, plaintiffs allege that Westinghouse's 1990 Form 10–K annual report, referred to in the prospectus, contained false statements about the adequacy of Westinghouse's loan loss reserves and internal controls, misleading characterizations about the February 27, 1991 restructuring, and falsely represented that, "Management believes that, under current economic conditions, the allowance for losses at December 31, 1990 will be adequate to cover future losses that may develop in the various portfolios." ¶ 433.

1. *Control Person Liability*

[59] Plaintiffs' claims against the individual defendants are premised upon the allegation that Messrs. Lego, Stern, Hollinshead, Faust, Powe and Pugliese were "controlling persons," pursuant to Section 15 of the Securities Act. Section 15 defines "controlling person" as every person who "controls any person liable under section 11 or 12...." 15 U.S.C. 77*o* (1988). The Securities and Exchange Commission defines "control" in this context as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." 17 C.F.R. § 240.12b–2. In *Rochez Bros., Inc. v. Rhoades*, 527 F.2d 880, 890–91 (3d Cir.1975), the United States Court of Appeals for the Third Circuit stated that "heavy consideration" is given "to the power or potential power to influence and control the activities of a person, as opposed to the actual exercise thereof." The court held that a person who owned fifty per cent of the outstanding stock, was Chairman, CEO and President of the company, and ran the day-to-day business activities was a "controlling person." *Id.* at 891.

None of the individual defendants in the instant matter bear as many incidents of control as did the defendant in *Rochez Bros.*; they are each, however, "controlling persons." Each of the individual defendants is alleged to have possessed the power, or the potential power, to control the activities of Westinghouse and/or WFSI and WCC. ¶¶ 9, 11. At the motion to dismiss stage, such alleged influence, even "short of actual direction," is sufficient to make one a controlling person, *see Gould v. American–Hawaiian S.S. Co.*, 535 F.2d 761, 779 (3d Cir.1976). The ultimate question "[w]hether a defendant is a controlling person within the meaning of federal securities law is a question of fact," and may therefore be raised again in a motion for summary judgment. *See Wiley v. Hughes Capital Corp.*, 746 F.Supp. 1264, 1283 (D.N.J.1990) (*citing In re Worlds of Wonder Securities Litigation*, 694 F.Supp. 1427, 1435 (N.D.Cal.1988)).

2. *Rule 12(2) "Offers or Sells" Requirement*

The Westinghouse Defendants argue that Counts Three and Five should be dismissed as to them because plaintiffs have not pled facts demonstrating that the Westinghouse

defendants offered or sold securities, an essential element of any claim under Section 12(2) of the Securities Act.[22] In ¶¶ 442 and 461, plaintiffs allege in wholly conclusory terms that defendants "were sellers of Westinghouse securities within the meaning of Section 12(2) of the Securities Act and either sold or promoted the sale of said securities directly to plaintiffs and other Class members or solicited plaintiffs and other Class members to buy such securities." Relying on the Third Circuit Court of Appeals' holding on this issue in *Craftmatic*, 890 F.2d at 637, plaintiffs argue that their legal conclusion, *unsupported by any allegation of fact*, establishes that the Westinghouse defendants, acting out of their own financial interests, either sold, or solicited the purchase of, Westinghouse securities as part of the May 19, 1991 public offering.

[60] The Supreme Court in *Pinter v. Dahl*, 486 U.S. 622, 108 S.Ct. 2063, 100 L.Ed.2d 658 (1988), held that § 12(1) liability extends both to sellers and to those who solicit securities purchases, motivated by their own or the securities owners's financial interests. *Id.* at 642–47, 108 S.Ct. at 2076–78. The *Craftmatic* court, applying the rule from *Pinter*, to Section 12(2) claims, 890 F.2d at 635, held that an issuer who itself sold nearly two-thirds of an initial public offering of common stock, *Craftmatic*, 890 F.2d at 630, was not immunized from § 12 liability.

> In *Craftmatic*, the plaintiffs alleged that: Each of the defendants ... either sold said securities directly to plaintiffs ... or solicited plaintiffs ... to buy Craftmatic common stock ... and in so acting were motivated by a desire to serve their own financial interests or the financial interests of the owner[s] of Craftmatic securities, and they ... conspired with and aided and abetted one another in connection with the preparation of the false and misleading Prospectus and Registration Statement used in conjunction with the sale of Craftmatic securities.

Id. at 637. The court found "that plaintiffs' claim that the Craftmatic defendants were 'sellers' for purposes of § 12(2) is sufficient to survive a Rule 12(b)(6) motion to dismiss." *Id.* at 637. The operative word in the *Craftmatic* plaintiffs' complaint was "sold," because it accurately described the facts underlying that case. Instantly, plaintiffs[23] have not alleged that the Westinghouse defendants in fact sold or solicited the purchase of Westinghouse securities, but attempt nonetheless to analogize their allegations to the allegations and holding in *Craftmatic* by pointing to the similarity of language employed. Plaintiffs' Memorandum at 95 n. 44. But *Craftmatic* does not stand for the proposition that a Section 12(2) plaintiff states a claim simply by repeating the *Craftmatic* plaintiffs' allegations, or that a plaintiff can avoid alleging facts that would support a legal conclusion, viz., that defendants were statutory offerors or sellers, by pleading the legal conclusion itself. The conclusory allegation that defendants sold or solicited the purchase of securities will withstand a motion to dismiss only if accompanied by allegations of *fact* that defendants did sell or solicit the purchase of securities.

[61] Plaintiffs' have not alleged that the Westinghouse and individual defendants sold or solicited the purchase of Westinghouse securities. Instead, plaintiffs allege that the defendants "aided and abetted one another in connection with the preparation of the false and misleading Registration Statement/Prospectus and documents incorporated therein by reference and used in conjunction with the sale of Westinghouse securities to plaintiffs and members of the Class." ¶¶ 442, 461. This allegation does not state a claim under Section 12(2). The *Craftmatic* court specifically held that "persons who fail to qualify as sellers under the *Pinter* standard may not be held liable under § 12(2) on an aiding and

22. Section 12(2) provides in part:

> Any person who offers or sells a security ... by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact ..., and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him.... 15 U.S.C. § 77*l* (1981).

23. Excluding Donald McLennan and Ruth Stepak, the DRP plaintiffs, *see* ¶¶ 449, 459.

abetting theory." *Craftmatic*, 890 F.2d at 636.

[62] The only remaining question, then, is whether "preparation of [a] false and misleading Registration Statement/Prospectus and documents incorporated therein by reference used in conjunction with the sale of . . . securities" brings one within the scope of a Section 12 seller. *Pinter* and *Craftmatic* are clear on this point: absent "direct and active participation in the solicitation of the immediate sale," an issuer is not "liable under § 12(2) solely on the basis of its involvement in preparing the prospectus." 890 F.2d at 636. *See Pinter*, 486 U.S. at 651, 108 S.Ct. at 2080 ("[Section] 12's failure to impose express liability for mere participation in unlawful sales transactions suggests that Congress did not intend that the section impose liability on participants collateral to the offer or sale"). Thus, preparation of financial statements and prospectuses, a requirement of any stock issue, *see* Section 7 of the Securities Act, 15 U.S.C. § 77g; *see also* Securities and Exchange Commission Form S–3, are not considered part of the solicitation process, which is, as the Fifth Circuit has noted, akin to an intensive marketing campaign to convince the public to buy a product. *Abell v. Potomac Ins. Co.*, 858 F.2d 1104, 1114 n. 8 (5th Cir.1988), *cert. denied*, 492 U.S. 918, 109 S.Ct. 3242, 106 L.Ed.2d 589 (1989).

3. *The Bespeaks Caution Doctrine*

[63, 64] When considering whether a claim has been stated under Sections 11 and 12(2) for false and misleading statements in a registration statement or prospectus, courts are not limited to the quotations and allegations contained on the face of the complaint, and can examine the registration statement and prospectus themselves. *See I. Meyer Pincus & Assoc. v. Oppenheimer & Co.*, 936 F.2d 759, 762 (2d Cir.1991); *In re Donald J. Trump Casino Securities Litigation*, 793 F.Supp. at 546 n. 1. Westinghouse's May 9, 1991 prospectus, Exhibit Q to Westinghouse Memo, issued approximately one week before the public offering, "virtually bristles with warnings" about Westinghouse's competitive position, and more importantly, about the risk of further deterioration in real estate markets (information which, this Court judicially notes, was widely reported and generally known to the investing public, *see In re Donald J. Trump Casino Securities Litigation*, 793 F.Supp. at 562), which could (1) negatively affect Westinghouse's ability to sell assets under its restructuring plan, and (2) strain the adequacy of WFSI's loan loss reserves.

With respect to WFSI's competitive status, Westinghouse disclosed in the prospectus that:

> The Financial Services group operates in a highly competitive environment. Commercial finance companies, commercial banks, leasing companies and other financial institutions compete in varying degrees in the several markets in which WFSI does business. In view of the market fragmentation resulting from numerous local and regional competitors, it is not possible to provide a meaningful description of the group's competitive position to individual markets. Its activities are also subject to a variety of federal and state regulations.

Exhibit Q at 6.

Westinghouse's statements concerning the adequacy of its February 27, 1991 restructuring plan, and reclassification of assets as being held for sale or restructuring, and of its loan loss reserves, are among the strongest warnings in the entire record:

> As part of the reclassification of $3.4 billion of assets, the Company reclassified for sale approximately $654 million of marketable securities. In accordance with its decision to liquidate this portfolio, the Company recognized a special provision of $163 million in addition to the $15 million pre-existing valuation allowance. This $178 million valuation allowance reflects the difference between the cost of those investments and their estimated market values as of December 31, 1990. This portfolio will be liquidated as soon as practicable; however, *future deterioration in market value could result in additional losses prior to sale and appreciation, if any, in market values will not be recognized currently.* At March 31, 1991, the difference between the cost and estimated

market values of the marketable securities was approximately $130 million, reflecting improved conditions in the markets for high-yield securities.

The $3.4 billion in higher-risk and underperforming assets reclassified as held for sale or restructuring included $2.4 billion in receivables. As such, *these receivables had and continue to have a high probability of becoming non-earning assets during the expected period of liquidation.* Although changes in these assets between earning, reduced earning, non-earning or real estate owned have occurred since December 31, 1990, management does not believe that such changes have had a material effect on the net realizable value of these receivables.

* * * * * *

At March 31, 1991, WFSI's valuation allowances related to assets held for sale or restructuring, and the allowances for credit losses related to the assets in the ongoing portfolio, amounted to $1,013 million and $306 million, respectively. *Management believes that under current economic conditions such allowances should be adequate to cover future losses that may occur. However, a further or more prolonged downturn in the economy or in the real estate, securities or certain other markets could have a negative effect on the ability of WFSI's borrowers to repay and on asset values generally and could result in additional increases in non-earning assets, restructured loans and, ultimately, increases in allowances for losses in both assets held for sale or restructuring and receivables in the balance of WFSI's portfolio.*

Id. at 8–9 (emphasis added).

Westinghouse's statement about the sufficiency of its reserves is remarkably equivocal. The statement that "[m]anagement believes that under current economic conditions such allowances *should* be adequate to cover future losses that may occur" is even less confident than Westinghouse and WCC's similar representations about the adequacy of loan loss reserves in prior annual reports. In its Form 10–K for the financial year ended December 31, 1990, Westinghouse stated: "Management believes that, under current economic conditions, the allowance for losses at December 31, 1990 *will* be adequate to cover future losses that may develop in the various portfolios." Exhibit M to Westinghouse Memo at 19 (emphasis added). WCC's Form 10–K for the same year stated: "A special provision for losses of $925 million was recognized in the fourth quarter of 1990 to reflect the decline in estimated realizable value of affected assets. Management believes that this change in strategy *will* reduce portfolio risk and improve Westinghouse Credit's future financial position and results of operations." Exhibit N to Westinghouse Memo at 9 (emphasis added). In light of these relatively confident declarations, which were themselves qualified by additional language that bespoke caution, the replacement of the word "will" with "should" in Westinghouse's May 9, 1991 prospectus (prepared within two months of the 1990 Form 10–Ks) could only have been interpreted by the hypothetical reasonable investor as a step in the direction of greater caution.

If that were not enough, Westinghouse went on to spell out exactly what result might follow from a "prolonged downturn in the economy" generally, or in a comprehensive list of markets, including the real estate, securities, or "certain other" markets: WFSI's borrowers might default on their loans, which "could result in additional increases in non-earning assets, restructured loans, and ultimately increases in allowances for losses in both assets held for sale or restructuring and receivables in the balance of WFSI's portfolio." Exhibit Q at 9. This straightforward language communicated a clear caveat about the future adequacy of Westinghouse reserves. Such disclosures are precisely what the federal securities laws are designed to produce, for they remove any misleading effect more positive statements about company performance may have. Accordingly, Counts Two, Three, Four and Five, plaintiffs' claims under Sections 11 and 12(2) against the Westinghouse defendants, as well as against the individual defendants pursuant to Section 15 of the Securities Act, will be dismissed with prejudice.

B. *Secondary Defendants*

Lazard, Shearson Lehman Brothers, Inc.; Lehman Brothers International, Ltd; Goldman Sachs & Co.; Goldman Sachs International, Ltd.; Lazard Brothers & Co., Ltd; and the unnamed proposed class of underwriter defendants' motions to dismiss Counts Two through Five will also be granted. Little additional discussion is necessary.

[65] In Count Two, plaintiffs allege that they acquired securities in the May 1991 public offering accompanied by a prospectus and registration statement that contained untrue statements of material fact. *See* ¶¶ 430–434. Comparison of those statements with those in the sections of the Complaint alleging causes of action under Section 10(b) and Rule 10b–5 reveals that the bases for the Section 11 claims are virtually the same as the Section 10(b) claims. Pursuant to Section 11(a)(5), these would state a prima facie case against "every underwriter with respect to such security," except that as discussed above, Part VI.A, the statements alleged to be actionable are accompanied by statements bespeaking caution.

[66–68] In Count Three, plaintiffs must allege, to state a viable Section 12(2) cause of action, that the underwriter defendants were "sellers" within the meaning of Section 12(2). That is, there must be an allegation that a particular proposed defendant sold or solicited the sale of Westinghouse securities to the individual plaintiffs. *Pinter v. Dahl*, 486 U.S. at 643–47, 108 S.Ct. at 2076. This element is lacking. Plaintiffs may not rely on what in other contexts might be called market share liability. *See e.g. City of Philadelphia v. Lead Industries Association, Inc.*, 994 F.2d 112 (3d Cir.1993). Nor may the plaintiffs rely on the underwriter defendants' alleged aiding and abetting of one another, to attribute the actions by one defendant to all other defendants. *See Craftmatic*, 890 F.2d at 635–37.

[69] In short, an additional deficiency of Count Three as to the proposed underwriter class is that plaintiffs attempt to bring a plaintiff's class action against a proposed class of defendants without alleging facts which would establish standing by a plaintiff against each defendant. Plaintiffs cite district court decisions from California dispensing with the requirements of standing, but in this circuit it is established that before the question of class status can be addressed there must be a representative plaintiff who alleges sale or solicitation by each proposed defendant. *Haas v. PNB*, 526 F.2d 1083, 1096 n. 18 (3d Cir.1975) *Kauffman v. Dreyfus Fund, Inc.*, 434 F.2d 727, 734 (3d Cir.1970), *cert. denied*, 401 U.S. 974, 91 S.Ct. 1190, 28 L.Ed.2d 323 (1971).

VII. *COUNT SIX*

A. *Westinghouse Defendants*

In ¶¶ 467–71, plaintiffs base a claim for negligent misrepresentation under Pennsylvania common law on allegations that "defendants negligently misrepresented ... that Westinghouse had adequately reserved against under-performing assets, that the book value of Westinghouse accurately reflected its financial condition, and also failed to disclose the fact that Westinghouse had not established adequate reserves for its underperforming or non-performing assets." ¶ 469.

[70, 71] Defendants argue that plaintiffs' claim for negligent misrepresentation must be dismissed where there is no allegation of contractual privity between plaintiffs [24] and the Westinghouse defendants. Contractual privity is not required under Pennsylvania law. *Eisenberg v. Gagnon*, 766 F.2d at 779–80; *Wilder v. Williams*, 1989 WL 67821 (W.D.Pa.1989). In Pennsylvania, negligent misrepresentation is a tort, the elements of which are set forth in the Restatement (Second) of Torts § 552, *see Eisenberg v. Gagnon*, 766 F.2d at 778; *J.E. Mamiye & Sons, Inc. v. Fidelity Bank*, 813 F.2d 610, 615 (3d Cir.1987), which provides in relevant part:

> (1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the

24. Defendants do not dispute contractual privity between Donald McLennan and Ruth Stepak, the DRP plaintiffs, and Westinghouse. *See* Westinghouse Memo at 48.

guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

(2) [T]he liability stated in subsection (1) is limited to loss suffered

(a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and

(b) through reliance upon it in a transaction that he intends the information to influence or know that the recipient so intends or in a substantially similar transaction.

(3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.

Restatement (Second) of Torts § 552.

[72, 73] Defendants, relying principally upon *In re Delmarva Securities Litigation*, 794 F.Supp. 1293 (D.Del.1992), argue that plaintiffs' claim for negligent misrepresentation must be dismissed because the class of potential claimants is not "a limited group of persons for whose benefit" the allegedly misleading information was intended. Westinghouse Memo at 48–9. I agree with Judge Schwartz' reasoning in *In re Delmarva Securities:* imposing liability upon the Westinghouse defendants for their allegedly negligent misrepresentations in the SEC forms would, in the words of Judge Cardozo in *Ultramares Corp. v. Touche*, 255 N.Y. 170, 189, 174 N.E. 441, 448 (1931), subject them to "potential liability in an indeterminate amount for an indeterminate time to an indeterminate class," contrary to the language and intent of Section 552(2). Public disclosures made in SEC reports are representations made not to a specific, limited group of persons, but to the world at large. Where a corporation does not and cannot know the identity of the recipients of its disclosures at the time those disclosures are made, liability under Section 552(2) does not obtain. *See also In re Par Pharmaceutical, Inc. Securities Litigation*, 733 F.Supp. 668, 686 (S.D.N.Y.1990).

[74] Plaintiffs argue that the defendants' negligent misrepresentation liability is based upon Section 552(3), which creates an exception to the limitation of Section 552(2) where the defendant is under a public duty to supply the information in question. Subsection (3)'s broader scope of liability "may apply to private individuals or corporations who are required by law to file information for the benefit of the public." *See* Comment k to Section 552(3). Public corporations are certainly required by law to file information for public benefit, but application of Section 552(3) to alleged misrepresentations in public corporations' SEC reports would threaten such firms with the prospect of liability to an almost unlimited class of persons: all potential investors in the firm's stock. This position requires an assumption about the Restatement drafters' view of liability that one federal district court has disapprovingly termed "extraordinary," *see In re Crazy Eddie Securities Litigation*, 812 F.Supp. 338, 359 (E.D.N.Y.1993), and that another (the only other reported decision on point) rejected outright. *See In re Delmarva Securities Litigation*, 794 F.Supp. at 1310–11. Lacking any indication that Pennsylvania courts would adopt so expansive a basis of corporate liability, this Court will decline to impose negligent misrepresentation liability upon the Westinghouse defendants under Restatement (Second) of Torts § 552(3). Because plaintiffs lack standing to make a state law claim for negligent misrepresentation under both Restatement (Second) of Torts §§ 552(1) and 552(3), Count Six will be dismissed with prejudice.

B. *Secondary Defendants*

[75] Plaintiffs assert that Lazard, Price Waterhouse and the underwriters are liable to them for any negligent misrepresentations made either in the financial statements or in the registration statement for the May 1991 public offering. Plaintiffs do not allege that Lazard, Price Waterhouse, or the underwriters made representations to them individual-

ly. Nor do plaintiffs allege reliance on any particular representation or on the prospectus or registration statement as a whole. The fraud on the market theory has never been made applicable to a common law claim of negligent misrepresentation, and it is not reasonable to predict that Pennsylvania's Supreme Court, which has adopted Restatement of Torts (Second) § 552(1)'s requirement that the loss be caused by "their justifiable reliance upon the information" would so weaken the causation requirement.

[76] Plaintiffs argue that liability for common law misrepresentation is alleged under Subsection 552(3) because "each of the defendants here is under a public duty to give information to the class of plaintiffs before this Court." Plaintiffs' Brief at 104. That is an overstatement of the law. Westinghouse is under a public duty imposed by the Securities Act and Securities Exchange Act to provide information to shareholders, and in the case of the May 1991 public offering, to prospective shareholders. The disclosure of information by Westinghouse's investment banker, accountant, and underwriters, however, is purely a matter of contract between Westinghouse and Lazard, Price Waterhouse, or the underwriters, not a public duty. Liability against the secondary defendants therefore cannot be premised upon subsection (3). *See In re Crazy Eddie Securities Litigation*, 812 F.Supp. at 359.

[77] Plaintiffs' claim of negligent misrepresentation against the underwriter defendants must also be dismissed for lack of subject matter jurisdiction. There are no federal claims against the underwriter defendants to which any tort claims could be pendent. Even assuming that diversity exists in the case of the claims of any of the named plaintiffs against any of the defendants, there is no allegation that the jurisdictional threshold is met, nor is it likely that it could be. *See generally Packard v. Provident Mutual Bank*, 994 F.2d 1039 (3d Cir.1993). It is therefore unnecessary to address further any questions of standing or the sufficiency of the allegations as to this cause of action against the underwriters.

ORDER

AND NOW, this 27th day of July, 1993, in accordance with the foregoing Opinion, plaintiffs' Consolidated Amended Class Action Complaint (Docket No. 84) is dismissed. Count One, is dismissed without prejudice to repleading. Counts Two, Three, Four, and Five are dismissed with prejudice. Count Six is dismissed with prejudice as to the Westinghouse defendants, Lazard, Freres & Co., and Price Waterhouse, and dismissed for lack of subject matter jurisdiction as to the underwriter defendants without prejudice to proceeding pursuant to 42 Pa.C.S. § 5103(b).

Plaintiffs' Second Amended Complaint shall be filed on or before August 20, 1993. Because, as stated in the foregoing opinion, some of plaintiffs' causes of action are sufficient to withstand a motion to dismiss, the stay of discovery previously ordered in this matter is dissolved. For clarity's sake, however, the defendants need not respond to the allegations of the Complaint until the Second Amended Complaint is filed.

In re WESTINGHOUSE SECURITIES LITIGATION.

This Order Relates to the Derivative Action.

Civ. A. Nos. 91–354, 91–624.

United States District Court, W.D. Pennsylvania.

July 27, 1993.

Shareholders brought action individually and derivatively on behalf of corporation against corporation and members of boards of directors of corporation or its subsidiaries, alleging issuance of materially false and misleading proxy statements in violation of Securities Exchange Act of 1934 and Securities Exchange Commission (SEC) rule, breach of

In re WESTINGHOUSE SECURITIES LITIGATION.

Margaret Alessi, Gloria Bertinato, Michael C. Christner, Anna Marie Eroshevich, Toby Feuer, Kanwal K. Gupta, M.D., Matthew Harlib, Stanley Hershfang, Arnold M. Jacob, Louise Jacob, David Jaroslawicz, David Kirschner, Nathan Kleinhandler, Gerry Krim, Peter Lagorio, Nelson Lovins, Donald McLennan, Jacob Joseph Miller, Dr. Alexander Miller, Thomas Mitchell, Edward Murabito, Michael E. Nogay, Joseph Raschak, Richard Schwartzchild, Dr. Michael Slavin, Dr. Michael Solomon, Selma Solomon, Spring Creek Cardiomedical Center, Ruth Stepak, Jim Thompson, Patricia J. Vanartsdalen, Albert Zucker, Appellants.

No. 95-3156.

United States Court of Appeals, Third Circuit.

Argued Nov. 2, 1995.

Decided July 18, 1996.

Securities Action was brought alleging misstatements and omissions in connection with stock offering. The United States District Court for the Western District of Pennsylvania, D. Brooks Smith, J., 832 F.Supp. 948, dismissed second amended complaint, and plaintiffs appealed. The Court of Appeals, Alito, Circuit Judge, held that: (1) district court properly dismissed various section 10(b) claims for failure to provide "a short and plain statement of the claim showing that the pleader is entitled to relief"; (2) allegations of misstatements regarding adequacy of company's loan loss reserves stated securities claims, despite other cautionary language; (3) claim that defendants' statements regarding nonearning loans were false and misleading stated section 10(b) claim; but (4) allegations regarding loan loss reserves and nonearning loans were quantitatively immaterial; (5) complaint sufficiently alleged that defendants were sellers to state securities claim based on material misstatements or omissions in prospectus; (6) complaint adequately alleged that underwriter defendants were sellers to state claim based on material misstatements or omissions in prospectus; (7) district court did not abuse its discretion in denying plaintiffs' motion to supplement second amended complaint; and (8) plaintiffs were not entitled to reassignment of case to new district judge on remand.

Affirmed in part, reversed in part and remanded.

1. **Federal Courts ⇐818**

District court's decision to dismiss claims for failure to provide "a short and plain statement of the claim showing that the pleader is entitled to relief" is reviewed for abuse of discretion. Fed.Rules Civ.Proc. Rule 8(a)(2), 28 U.S.C.A.

2. **Federal Civil Procedure ⇐636**

Particularity demands of pleading fraud in no way negate requirement of providing "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed.Rules Civ.Proc.Rules 8(a)(2), 9(b), 28 U.S.C.A.

3. **Federal Civil Procedure ⇐1772, 1838**

District court did not abuse its discretion in dismissing viable portion of count of second amended complaint, without prejudice to repleading, for failure to provide "a short and plain statement of the claim showing that the pleader is entitled to relief," where second amended complaint was unnecessarily complicated and verbose, rambling for more than 600 paragraphs and 240 pages. Fed. Rules Civ.Proc.Rule 8(a)(2), 28 U.S.C.A.

4. **Federal Civil Procedure ⇐1837.1**

District court, having expressly warned plaintiffs that failure to replead remaining claims in compliance with Rule 8 would result in dismissal of those claims, did not abuse its discretion when it dismissed with prejudice otherwise viable claims following plaintiffs' decision not to replead those claims in accordance with Rule 8. Fed.Rules Civ.Proc.Rule 8, 28 U.S.C.A.

5. **Federal Courts ⇐589**

District court order dismissing with prejudice the last of a plaintiff's claims is final and appealable; Court of Appeals' sub-

sequent determination during consideration of appeal from that order that dismissal of one claim was not proper does not render district court's order any less final than it was when district court entered it. 28 U.S.C.A. § 1291.

6. Federal Courts ⇐589, 769

When plaintiffs elected to stand on second amended complaint rather than replead claims that had been dismissed without prejudice, subsequent dismissal of those claims with prejudice was reviewable, final order, and the prior interlocutory orders merged with that order and could be reviewed on appeal; moreover, there were no prudential grounds for declining to review merits of prior rulings. 28 U.S.C.A. § 1291.

7. Federal Courts ⇐769

Under "merger rule," prior interlocutory orders merge with final judgment in a case, and interlocutory orders, to extent that they affect final judgment, may be reviewed on appeal from final order.

See publication Words and Phrases for other judicial constructions and definitions.

8. Federal Courts ⇐763.1, 794

Court of Appeals exercises plenary review over dismissal for failure to state a claim, accepting plaintiffs' factual allegations as true. Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

9. Federal Courts ⇐763.1

Court of Appeals may affirm district court's dismissal for failure to state a claim only if it appears certain that plaintiffs can prove no set of facts entitling them to relief. Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

10. Federal Civil Procedure ⇐1832

In ruling on defendants' motions to dismiss, district court could consider various undisputedly authentic documents attached to plaintiffs' complaint or defendants' motions. Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

11. Securities Regulation ⇐60.27(1)

"Bespeaks caution" is essentially shorthand for well-established principle of securities law that statement or omission must be considered in context, so that accompanying statements may render it immaterial as a matter of law. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

See publication Words and Phrases for other judicial constructions and definitions.

12. Securities Regulation ⇐25.18, 25.56, 60.27(1), 60.46

Allegations that registration statement, prospectus and other documents made material misstatements regarding adequacy of company's loan loss reserves stated securities fraud claims, despite cautionary language contained in various filings with Securities and Exchange Commission (SEC); if defendants knowingly or recklessly misrepresented adequacy of loss reserves to protect against known losses and known risks in light of then-current economic conditions, defendants' cautionary statements about the future did not render those misrepresentations immaterial. Securities Act of 1933, § 11, 15 U.S.C.A. § 77k; Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Securities Act of 1933, § 12(2), 15 U.S.C.(1988 Ed.) § 77*l*(2).

13. Securities Regulation ⇐60.18

To state securities fraud claim under section 10(b) and rule 10b–5, private plaintiff must plead: that defendant made misrepresentation or omission of material fact; that defendant acted with knowledge or recklessness and that plaintiff reasonably relied on the misrepresentation or omission and consequently suffered damage. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5.

14. Federal Civil Procedure ⇐636

Because section 10(b) claims sound in fraud, circumstances constituting the fraud must be stated with particularity. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

15. Federal Civil Procedure ⇐636

Section 10(b) claim that defendants' statements regarding nonearning loans were false and misleading alleged sufficient facts

to permit inference that defendants intentionally concealed loan losses; complaint alleged that defendants arbitrarily moved loans from nonearning to earning status just before mandated public reporting when, in fact, nothing had changed regarding likelihood of collection. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Fed. Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

16. **Federal Civil Procedure ⇐636**

Plaintiffs failed to plead any facts supporting their conclusory allegation that company fraudulently misrepresented adequacy of its internal controls. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

17. **Federal Civil Procedure ⇐636**

Plaintiffs failed to allege any facts supporting inference that accountant made fraudulent misrepresentations in its audit opinions in violation of section 10(b); although plaintiffs cited various Generally Accepted Accounting Standards (GAAS) standards, they nowhere explained how accountant knowingly or recklessly violated those standards in performing its audits. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Fed.Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

18. **Federal Civil Procedure ⇐636**

Documents on which plaintiffs relied did not support their conclusory allegations and plaintiffs failed to allege facts supporting their section 10(b) claim that underwriter knew that company's charge to earnings was inadequate to protect against known and likely losses. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); Fed. Rules Civ.Proc.Rule 9(b), 28 U.S.C.A.

19. **Securities Regulation ⇐60.28(11)**

Omitted fact is material, as required to support securities fraud claim, if there is substantial likelihood that, under all the circumstances, omitted fact would have assumed actual significance in deliberations of reasonable shareholder. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

20. **Securities Regulation ⇐60.70**

For purposes of securities fraud claim, materiality of omitted fact is mixed question of law and fact, and delicate assessments of inferences a reasonable shareholder would draw from given set of facts are peculiarly for trier of fact; therefore, only if alleged misrepresentations or omissions are so obviously unimportant to an investor that reasonable minds cannot differ on question of materiality is it appropriate for district court to rule that allegations are inactionable as a matter of law. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

21. **Securities Regulation ⇐60.46**

Question of materiality of misstatements regarding loan loss reserves and nonearning receivables must be considered on case-by-case basis, even though "rule of thumb" of 5–10 percent of net income is widely used as general materiality criterion in accounting profession. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

22. **Securities Regulation ⇐60.46**

Allegation challenging adequacy of loan loss reserves was not sufficiently material to be actionable securities fraud; charge that would have followed write-down would have amounted to merely 0.54% of company's net income. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

23. **Securities Regulation ⇐60.46**

Allegation that certain assets should have been classified as nonearning was not sufficiently material to be actionable securities fraud; accounts amounted to just 0.51% of company's current assets for first and second quarters and only 1.2% of company's current assets for third quarter. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

24. **Securities Regulation ⇐11.15**

Both direct seller and one who engages in active solicitation of offer to buy can be "seller" for purposes of section of Securities Act imposing liability for sale of unregistered

security. Securities Act of 1933, § 12(1), 15 U.S.C.(1988 Ed.) § 77*l*(1).

See publication Words and Phrases for other judicial constructions and definitions.

25. Securities Regulation ⇐25.61(2)

Under section of Securities Act imposing liability for material misstatements or omissions in prospectuses or oral communications, "seller" may be one who passes title to buyer for value, or one who successfully solicits the purchase, motivated at least in part by desire to serve his own financial interests or those of the securities owner. Securities Act of 1933, § 12(2), 15 U.S.C.(1988 Ed.) § 77*l*(2).

26. Securities Regulation ⇐25.61(2)

Complaint sufficiently alleged that defendants were sellers to state securities claim based on material misstatements or omissions in prospectus; complaint alleged that defendants "solicited plaintiffs" to purchase securities and that in so doing they were motivated by desire to serve their own financial interests. Securities Act of 1933, § 12(2), 15 U.S.C.(1988 Ed.) § 77*l*(2).

27. Federal Civil Procedure ⇐636

Although fraud is not a necessary element of securities claim alleging material misstatement or omission in prospectus or oral communication, such claims that do sound in fraud must be pled with particularity. Securities Act of 1933, § 12(1), 15 U.S.C.(1988 Ed.) § 77*l*(1); Fed.Rules Civ. Proc.Rule 9(b), 28 U.S.C.A.

28. Securities Regulation ⇐25.61(6)

Plaintiffs adequately alleged that underwriter defendants were statutory sellers to state securities claim based on material misstatements or omissions in prospectus; complaint alleged that each underwriter defendant sold securities directly to plaintiffs and that each plaintiff purchased securities directly from an underwriter defendant, and it was not necessary that complaint allege which underwriter sold securities to each plaintiff. Securities Act of 1933, § 12(2), 15 U.S.C.(1988 Ed.) § 77*l*(2).

29. Securities Regulation ⇐25.61(2)

Plaintiff alleging securities claim based on material misstatement or omission in prospectus or oral communication must show that plaintiff bought from or was solicited by specified statutory seller. Securities Act of 1933, § 12(2), 15 U.S.C.(1988 Ed.) § 77*l*(2).

30. Federal Civil Procedure ⇐1838

Even if securities claims alleging material misstatements or omissions in prospectus was lacking for failure to specify which underwriter sold to each plaintiff, district court should have dismissed claims without prejudice and with leave to amend. Securities Act of 1933, § 12(2), 15 U.S.C.(1988 Ed.) § 77*l*(2); Fed.Rules Civ.Proc.Rule 12(b)(6), 28 U.S.C.A.

31. Federal Courts ⇐12.1

Having dismissed second amended complaint, district court did not abuse its discretion in dismissing, as moot, plaintiffs' motion to supplement second amended complaint because plaintiffs were presumably going to be submitting third amended complaint and would include the newly discovered allegation in that complaint.

32. Federal Courts ⇐951.1

On remand of securities action following reversal of dismissal of several of the claims, plaintiffs were not entitled to reassignment of case to new district court judge, despite statements by court which allegedly indicated that plaintiffs' damages were attributable to downturn in real estate market rather than defendants' fraudulent scheme; plaintiffs did not allege that judge derived his bias from extrajudicial source or identify anything suggesting favoritism or antagonism.

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Before NYGAARD, ALITO, and SAROKIN, Circuit Judges.

OPINION OF THE COURT

ALITO, Circuit Judge:

This is an appeal from three orders dismissing all of the plaintiffs' claims in a consolidated class action securities fraud complaint. The orders were based on Federal Rules of Civil Procedure 8, 9(b), and 12(b)(6). We affirm in part, reverse in part, and remand for further proceedings.

I.

A. Plaintiffs in this case are all purchasers of publicly traded Westinghouse Electric Corporation ("Westinghouse") securities. Plaintiffs purchased Westinghouse common stock between March 28, 1989, and October 22, 1991 ("the class period").

Defendants include Westinghouse, Westinghouse Financial Services, Inc. ("WFSI") (a wholly owned subsidiary of Westinghouse), Westinghouse Credit Corporation ("WCC") (which is owned by WFSI), and certain directors and senior officers of these companies (the "individual defendants"). (We will refer to the above defendants collectively as the "Westinghouse defendants.") The other defendants are Price Waterhouse (the independent accountant for the Westinghouse companies), and a proposed defendant class of underwriters (the "underwriter defendants") involved in a May 1991 public offering of Westinghouse common stock.

B. The relevant allegations of plaintiffs' complaint, which were set forth in detail by the district court, *see In re Westinghouse Securities Litigation*, 832 F.Supp. 948 (W.D.Pa.1993), may be summarized as follows. During the 1980's, WCC grew rapidly by committing substantial funds to the financing of real estate developments and highly leveraged transactions. In the late 1980's, however, WCC experienced an increase in defaults in its real estate loans and in delinquencies in other transactions. As a result, WCC suffered billions of dollars of losses, and the Westinghouse defendants feared a drop in WCC's commercial paper ratings. To protect those ratings, they concealed the losses, which allegedly totalled between $2.6 and $5.3 billion, through improper accounting and reporting techniques.

Prior to February 1991, Westinghouse management decided that WCC needed a cash infusion if it was to maintain its commercial paper ratings. Westinghouse developed a major restructuring plan, which it announced on February 27, 1991. Under that plan, Westinghouse decided to "downsize" WCC by selling or restructuring nearly one-third of its assets that had previously been held on a long-term basis. Westinghouse knew that selling and restructuring so many non-performing or under performing assets in the market that existed at the time would result in significant losses. Westinghouse thus took a $975 million pre-tax charge against fourth quarter 1990 earnings to be

applied to loan loss reserves [1] and to cover estimated losses. The press release and other documents issued by Westinghouse in connection with these actions stated that they decisively addressed WFSI's and WCC's problems. Plaintiffs allege that these statements were materially false when made in that defendants knew (or recklessly disregarded facts demonstrating) that reserves remained inadequate as of that time. Plaintiffs point to a statement by James Focareta, WCC's president from early 1990 to early 1991, in which he acknowledged that the $975 million writeoff was known to be insufficient. Focareta said: "The number that was used ($975 million) was a number developed for something else.... Every Westinghouse credit manager knew that was not sufficient.... The Keystone Kops were involved, clearly." App. 1134.

Plaintiffs assert that Westinghouse further compounded the harm to investors by raising $500 million through a May 1991 stock offering. Westinghouse offered 19 million shares of its common stock for sale to the investing public at $26.50 per share on May 9, 1991. Plaintiffs allege that the Prospectus and Registration Statement filed with the Securities and Exchange Commission ("SEC") in May 1991, as well as other documents (including the Annual Report) that were incorporated by reference therein, contained material misrepresentations and omissions.

In October 1991, Westinghouse determined and announced that the restructuring plan had to be accelerated. Additional assets of $3.1 billion were designated as being held for sale or restructuring. Westinghouse took a $1.68 billion pre-tax charge in anticipation of further losses it expected to suffer. Plaintiffs allege that defendants knew as early as October 1990 that a charge of this magnitude was inevitable and that defendants' statements to the contrary over the course of that year and contemporaneous with the October 1991 announcement were materially false. Plaintiffs claim that they paid artificially inflated prices of from $21.75 to $39.375 per share in contrast to Westinghouse's closing price of $15.875 after the announcement of the October 1991 charge.

C. The first of the class action complaints consolidated herein was filed in February 1991, just after Westinghouse announced the restructuring plan. In May 1991, the magistrate judge granted plaintiffs limited discovery to prepare a consolidated complaint. In March 1992, the magistrate judge ordered that Westinghouse make available to plaintiffs documents related to over 500 active investment files. Plaintiffs filed the Consolidated Amended Class Action Complaint ("the first amended complaint") in June 1992.

The first amended complaint alleged violations of the following provisions: sections 10(b) and 20 of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. §§ 78j(b), 78t, and Rule 10b–5, 17 C.F.R. § 240.10b–5, against all defendants (count I); sections 11 and 15 of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. §§ 77k, 77*o*, against all defendants (count II); section 12(2) of the Securities Act, 15 U.S.C. § 77*l* (2), against all defendants except Price Waterhouse (count III); separate violations of sections 11 and 15 against all defendants except for the underwriter defendants (count IV); separate violations of section 12(2) against the Westinghouse defendants (count V); and negligent misrepresentation against all defendants (count VI).

In August 1992, defendants moved to dismiss all counts of the first amended complaint under Federal Rules of Civil Procedure 9(b) and 12(b)(6). In an opinion and order entered on July 29, 1993, the district court granted defendants' motion. *See In re Westinghouse Securities Litigation*, 832 F.Supp. 948 (W.D.Pa.1993) (*Westinghouse I*). Count I and a small piece of count VI

1. A loan loss reserve, also known as an allowance for loan losses, is "[a] statement of condition, or balance sheet, account set up by a bank based on its expectations about future loan losses. As losses occur, they are charged against this reserve. That is, the loan account is credited and the reserve account is debited. The reserve is established by a debit to an expense account called the loan loss provision, with a corresponding credit to the loan loss reserve." American Bankers Association, *Banking Terminology* 215 (3d ed. 1989); *see also Shapiro v. UJB Financial Corp.*, 964 F.2d 272, 281 (3d Cir.), *cert. denied*, 506 U.S. 934, 113 S.Ct. 365, 121 L.Ed.2d 278 (1992).

were dismissed without prejudice to repleading, while counts II–V and most of count VI were dismissed with prejudice.[2]

Plaintiffs filed the Second Consolidated Amended Class Action Complaint ("the second amended complaint") in September 1993. Plaintiffs repled all of their claims, including those that had been dismissed with prejudice (stating that such claims were being repled verbatim solely to preserve their appellate rights). In December 1993, defendants moved to dismiss the second amended complaint under Federal Rules of Civil Procedure 8, 9(b), and 12(b)(6). In March 1994, plaintiffs cross-moved to supplement the second amended complaint.[3]

In January 1995, the district court granted defendants' motion to dismiss the second amended complaint. *See In re Westinghouse Securities Litigation*, Civ. No. 91–354, Opinion and Order entered January 23, 1995, App. 310–46 (*Westinghouse II*). Counts II–VI were dismissed without discussion, since they had already been dismissed with prejudice in *Westinghouse I*. Many of the claims in count I were dismissed with prejudice, and the remainder of the claims in count I were dismissed without prejudice to repleading in accordance with Rule 8. The district court also denied as moot plaintiffs' motion to supplement the second amended complaint.

Plaintiffs filed a "Notice of Intention to Stand on Second Consolidated Amended Class Action Complaint," in which they informed the district court that they would not be amending the complaint; rather, plaintiffs stated that they were going to "stand" on the complaint and seek immediate appellate review. App. 347. The district court then dismissed plaintiffs' remaining claims from count I with prejudice and closed the case. *See* App. 350–51 (Memorandum Order entered March 1, 1995). This appeal followed.

On appeal, plaintiffs argue that the district court improperly dismissed various of their section 10(b) claims under Rule 8; misapplied the "bespeaks caution" doctrine; improperly found that plaintiffs failed to plead fraud with particularity; mistakenly found that plaintiffs failed to plead materiality; and erroneously dismissed the section 12(2) claims. Plaintiffs also argue that the district court should have granted their motion to supplement the second amended complaint. Finally, plaintiffs argue that this case should be assigned to a new district judge.

II.

A. We turn first to plaintiffs' challenge to the district court's Rule 8 dismissal. Rule 8(a) provides that any pleading that includes a claim for relief shall contain "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed.R.Civ.P. 8(a)(2). Rule 8(e) further provides that "[e]ach averment of a pleading shall be simple, concise, and direct." Fed.R.Civ.P. 8(e)(1). "Taken together, Rules 8(a) and 8(e)(1) underscore the emphasis placed on clarity and brevity by the federal pleading rules." 5 Charles A. Wright & Arthur R. Miller, *Federal Practice and Procedure* § 1217 at 169 (2d ed. 1990).

[1] We review the district court's decision to dismiss claims under Rule 8 for an abuse of discretion. *E.g., Kuehl v. F.D.I.C.*, 8 F.3d 905, 908 (1st Cir.1993), *cert. denied*, — U.S. ——, 114 S.Ct. 1545, 128 L.Ed.2d 196 (1994); 5 Wright & Miller, § 1217 at 175. "It is well settled that the question on review 'is not whether we would have imposed a more lenient penalty had we been sitting in the trial judge's place, but whether the trial judge abused his discretion in imposing the penalty he did.'" *Kuehl v. F.D.I.C.*, 8 F.3d at 908–09 (citation omitted).

The district court's January 1995 opinion and order provided that "with respect to those aspects of Count One that survive the instant Opinion and Order, plaintiffs are granted 30 days from this date within which to replead in conformity with the requirements of Rule 8." *Westinghouse II*, Op. at 21,

2. The dismissal of count VI is not challenged on appeal.

3. In July 1994, plaintiffs filed a motion to reconsider the July 1993 opinion and order and to reinstate certain claims. The court denied plaintiffs' motion for reconsideration in an order entered September 28, 1994. App. 309.

App. 330; Order at 35, App. 344. The district court added that "[f]ailure to comply with this Order will result in the dismissal of plaintiffs' claims with prejudice." *Id.*

On February 21, 1995, plaintiffs filed a "Notice of Intention to Stand on Second Consolidated Amended Class Action Complaint." Plaintiffs stated as follows:

> Plaintiffs have carefully weighed the merits of repleading against seeking immediate appellate review. They respectfully give notice of their intention to stand on the Complaint. *See, Shapiro v. UJB Financial Corp.*, 964 F.2d 272 (3d Cir.1992).

App. 348. The district court then dismissed with prejudice all of plaintiffs' remaining claims, stating as follows:

> On January 20, 1995, this Court dismissed plaintiffs' Second Amended Class Action Complaint. As that Opinion and Order explained, with respect to those aspects of Count One of plaintiffs' Second Amended Complaint that survived the January 20, 1995 Opinion and Order, plaintiffs were granted 30 days from that date within which to replead in conformity with the requirements of Rule 8 of the Federal Rules of Civil Procedure. The Opinion and Order specifically stated that failure to replead within 30 days would result in the dismissal of plaintiffs' claims with prejudice.
>
> Instead of filing an amended complaint, plaintiffs filed a Notice of Intention to Stand on Second Consolidated Amended Class Action Complaint, indicating that they had "carefully weighed the merits of repleading against seeking immediate appellate review."
>
> Accordingly, ... it is hereby ORDERED that all remaining claims in plaintiffs' Second Amended Class Action Complaint are dismissed with prejudice.

App. 350–51 (Memorandum Order entered 3/1/95).

B. Plaintiffs argue first that the Rule 8 dismissal without prejudice in *Westinghouse II* should be reversed because the district court imposed inconsistent pleading standards on them. Plaintiffs contend that the *Westinghouse I* opinion required them to draft the second amended complaint with tremendous specificity. They argue that the district court in effect required that they violate Rule 8 (if they violated Rule 8 at all) in order to comply with Rule 9(b). *See* Plfs' Br. at 44–46. We disagree.

[2] It is well settled that "the particularity demands of pleading fraud under Rule 9(b) in no way negate the commands of Rule 8." *Vicom, Inc. v. Harbridge Merchant Services, Inc.*, 20 F.3d 771, 776 (7th Cir.1994) (citations omitted); *see generally* 5 Wright & Miller, § 1281 at 520–21 (pleading fraud with particularity under Rule 9(b) should be done consistently with the general philosophy of Rule 8); 2A *Moore's Federal Practice* ¶ 8.13, at 8–58 (2d ed. 1995) (the requirements of Rule 8 apply "even where the Rules command particularity, as in the pleading of fraud under Rule 9(b)") (footnote omitted).

[3] Having reviewed plaintiffs' second amended complaint, we cannot say that the district court abused its discretion in dismissing the viable portion of count I, without prejudice to repleading, pursuant to Rule 8. The second amended complaint is unnecessarily complicated and verbose. The text of the complaint rambles for more than 600 paragraphs and 240 pages, including a 50–plus page "overview" of the alleged wrongful conduct. The district court, through the two rounds of difficult motions, had narrowed plaintiffs' claims. The court then ordered plaintiffs to submit a third amended complaint containing only those allegations relevant to what were, in the court's view, the remaining viable claims. This does not seem to us to constitute an abuse of discretion; indeed, it makes a tremendous amount of sense. *See generally In re GlenFed, Inc. Securities Litigation*, 42 F.3d 1541, 1544 (9th Cir.1994) (en banc) ("We see nothing to prevent the district court, on remand, from requiring, as a matter of prudent case management, that plaintiffs streamline and reorganize the complaint before allowing it to serve as the document controlling discovery, or, indeed, before requiring defendants to file an answer.").

[4] C. We further hold that the district court did not abuse its discretion when it

dismissed with prejudice the otherwise viable claims from count I following plaintiffs' decision not to replead those claims in accordance with Rule 8. The district court expressly warned plaintiffs that failure to replead the remaining claims in compliance with Rule 8 would result in the dismissal of those claims. The dismissal with prejudice that followed plaintiffs' decision not to amend was not an abuse of discretion. *See, e.g.,* 5 Wright & Miller, § 1217 at 178 (dismissal with prejudice appropriate where party refuses to file an amended and simplified pleading). As we recently stated in a different but analogous context, "it is difficult to conceive of what other course the court could have followed." *Spain v. Gallegos,* 26 F.3d 439, 455 (3d Cir.1994) (affirming dismissal with prejudice where plaintiff refused to go forward with remaining claims).

D. Defendants attempt to go further. They argue that all of plaintiffs' claims—including those that had been dismissed with prejudice under Rules 9(b) and 12(b)(6) in *Westinghouse I* and *Westinghouse II*—were also dismissed with prejudice on Rule 8 grounds and that this dismissal was proper. Thus, according to defendants,

> [e]ven if this Court were to reverse any portion of the District Court's ruling dismissing portions of [the second amended complaint] with prejudice on grounds other than Rule 8, plaintiffs still would be bound by their irrevocable election to stand on their Second Amended Complaint, which still will constitute "a flagrant violation of the requirements of Rule 8."

West. Br. at 20 (quoting *Westinghouse II,* Op. at 20, App. 329). There is slim support for defendants' argument in *Westinghouse II,* where the court stated that "plaintiffs' Second Amended Complaint shall be dismissed in its entirety for failure to plead in conformity with the requirements of Rule 8." Op. at 21, App. 330. On the whole, however, we do not agree with defendants' characterization of what the district court did. As we understand the record, the district court, having already dismissed certain claims with prejudice on non-Rule 8 grounds in *Westinghouse I* and *Westinghouse II,* did not later dismiss those claims again for failure to comply with Rule 8.

First, we note that the district court specifically ordered plaintiffs not to include in the third amended complaint any claims except for those that survived *Westinghouse II. Westinghouse II,* Op. at 21, App. 330; Order at 35, App. 344. Thus, even if plaintiffs had repled and filed a third amended complaint, the claims that had been dismissed on grounds other than Rule 8 could not have been included. Because plaintiffs were permitted to replead only those claims that survived *Westinghouse II,* it seems implausible to suggest that their decision not to replead could have had any effect on any claims other than those that the district court sustained in *Westinghouse II.*

Second, the district court's Memorandum Order of March 1, 1995, is the only order in the record that dismisses any claim or claims with prejudice under Rule 8, and that order quite clearly applies to only those claims that had survived dismissal with prejudice on other grounds in *Westinghouse I* and *Westinghouse II.* That order explicitly states that "it is hereby ORDERED that *all remaining claims* in plaintiffs' Second Amended Class Action Complaint are dismissed with prejudice." App. 350–51 (emphasis added). Thus, we reject defendants' argument that either *Westinghouse II* or the court's March 1, 1995 Memorandum Order dismissed any claims with prejudice under Rule 8 that had already been dismissed on their merits.

[5] E. Defendants next argue that if we do not hold that all of the plaintiffs' claims were properly dismissed under Rule 8, we should nevertheless decline to review the dismissal of claims in *Westinghouse I* and *Westinghouse II* on non-Rule 8 grounds. Defendants contend that "interlocutory orders—such as the District Court's July 1993 and January 1995 Orders, which contain all of the District Court's non-Rule 8 rulings appealed by plaintiffs—do *not* merge into and are *not* encompassed by final orders where plaintiffs engage in a strategy intended to create an avenue for this Court to reach issues not subject to interlocutory appeals." [4]

4. Defendants advance an additional jurisdictional argument. They maintain that if we do not

West. Br. at 21 (emphasis in original). Defendants rely on *Marshall v. Sielaff*, 492 F.2d 917 (3d Cir.1974) (affirming dismissal for lack of prosecution and choosing not to reach underlying substantive issue decided in prior interlocutory order) and *Sullivan v. Pacific Indem. Co.*, 566 F.2d 444 (3d Cir. 1977) (dismissing for lack of an appealable order where appellant did not challenge dismissal for failure to prosecute but attempted to appeal prior interlocutory order denying motion for class certification). Plaintiffs counter that they followed the procedure expressly approved by this court in *Shapiro v. UJB Financial Corp.*, 964 F.2d at 278–79 ("a plaintiff can convert a dismissal with leave to amend into a final order by electing to stand upon the original complaint") (citing *Borelli v. City of Reading*, 532 F.2d 950, 951–52 (3d Cir.1976)). *See* Plfs' Rep. Br. at 8. We find the defendants' argument unpersuasive.

First, we reject the suggestion (see Westinghouse Br. at 20) that we lack jurisdiction to review the district court's rulings in *Westinghouse I* and *Westinghouse II*. "The principle is well-settled in this circuit that an order dismissing a complaint without prejudice is not a final and appealable order, unless the plaintiff no longer can amend the complaint because, for example, the statute of limitations has run, *or the plaintiff has elected to stand on the complaint.*" *Newark Branch, N.A.A.C.P. v. Harrison*, 907 F.2d 1408, 1416–17 (3d Cir.1990) (citations and footnotes omitted) (emphasis added); *see also Bethel v. McAllister Brothers, Inc.*, 81 F.3d 376, 381 (3d Cir.1996); *Deutsch v. United States*, 67 F.3d 1080, 1083 (3d Cir.1995); *Welch v. Folsom*, 925 F.2d 666, 668 (3d Cir. 1991); *Trevino-Barton v. Pittsburgh National Bank*, 919 F.2d 874, 877–78 (3d Cir.1990). In *UJB*, the plaintiffs stood on their complaint with respect to claims that had been dismissed without prejudice under Rule 9(b). They argued that their allegations satisfied Rule 9(b) and that they were not required to make any further amendments. This court concluded that it had jurisdiction to consider the merits of the Rule 9(b) dismissal and explained:

> [W]e have held that a plaintiff can convert a dismissal with leave to amend into a final order by electing to stand upon the original complaint. *See, e.g., Borelli v. City of Reading*, 532 F.2d 950, 951–52 (3d Cir. 1976) ("Only if the plaintiff . . . declares his intention to stand on his complaint . . . the order becomes final and appealable"). Plaintiffs here stood on their complaint, but defendants contend that this was not enough. They maintain that we lack jurisdiction because plaintiffs failed to obtain an explicit dismissal with prejudice. We do not agree.

964 F.2d at 278 (alterations in *UJB*). The court thus considered whether plaintiffs' allegations that had been dismissed without prejudice actually satisfied Rule 9(b).

[6] Here, when plaintiffs elected to stand on the second amended complaint rather than replead the remaining claims in compliance with Rule 8, the remaining claims were dismissed with prejudice, and the case was closed in the district court. Under the authorities discussed above, there is no doubt that the district court's dismissal of the case with prejudice was a reviewable, final order. We therefore reject the defendants' contentions to the extent that they challenge our appellate jurisdiction.[5]

affirm the dismissal of plaintiffs' entire complaint on Rule 8 grounds, then "as in any other case where some but not all claims are dismissed . . ., plaintiffs would have claims not dismissed in the District Court and thus no right to an interlocutory appeal." West. Br. at 21. By its own terms, this argument would apply only if we held that at least one claim had not been properly dismissed on *any* ground, and consequently our conclusion in part IID of this opinion (that the claims dismissed on non-Rule 8 grounds in *Westinghouse I* and *Westinghouse II* were not also dismissed on Rule 8 grounds) would not be enough to make this argument applicable here. But in any event, defendants' argument—for which *no* supporting authority is cited—is plainly incorrect. We have jurisdiction under 28 U.S.C. § 1291 to review "final" decisions of the district courts; a district court order dismissing with prejudice the last of a plaintiff's claims is unquestionably final; and our subsequent determination during the consideration of an appeal from that order that the dismissal of one claim was not proper does not render the district court's order any less final than it was when the district court entered it.

5. The decision in *Sullivan v. Pacific Indem. Co.* is not to the contrary. It is true that the court in *Sullivan* dismissed the appeal "for lack of an

[7] Furthermore, we see no prudential grounds for declining to review the merits of the district court's dismissal of claims on non-Rule 8 grounds in *Westinghouse I* and *Westinghouse II*. Under the "merger rule," prior interlocutory orders merge with the final judgment in a case, and the interlocutory orders (to the extent that they affect the final judgment) may be reviewed on appeal from the final order. *See, e.g., Silver v. Mendel*, 894 F.2d 598, 601 (3d Cir.), *cert. denied*, 496 U.S. 926, 110 S.Ct. 2620, 110 L.Ed.2d 641 (1990); *Elfman Motors, Inc. v. Chrysler Corp.*, 567 F.2d 1252, 1253 (3d Cir. 1977) ("the appeal from a final judgment draws in question all prior non-final orders and rulings which produced the judgment") (citation omitted). Under this rule, the district court's orders in *Westinghouse I* and *Westinghouse II* merged with the final order dismissing the remaining claims with prejudice and closing the case and thus would ordinarily be subject to review on appeal from the final order.

Defendants, however, invoke an exception to the merger rule pursuant to which courts decline to reach prior interlocutory rulings where to do so would undermine the policy against piecemeal appeals. *See generally, e.g., Sere v. Board of Trustees of Univ. of Illinois*, 852 F.2d 285, 288 (7th Cir.1988) ("Although the general rule is that rulings on interlocutory orders are encompassed within a subsequent final judgment and may be reviewed as part of that judgment, the rule is inapplicable where adherence would reward a party for dilatory and bad faith tactics.") (citations omitted). The line of cases relied upon by defendants stands for the proposition that a dismissal with prejudice for failure to prosecute frequently bars review of previously entered interlocutory orders.[6] Without addressing the potential scope of this exception to the merger rule, *see Fassett v. Delta Kappa Epsilon (New York)*, 807 F.2d 1150, 1155 n. 6 (3d Cir.1986) (dictum declining to extend *Sullivan* holding beyond class certification context), *cert. denied*, 481 U.S. 1070, 107 S.Ct. 2463, 95 L.Ed.2d 872 (1987), we conclude that the exception has no application here. The failure-to-prosecute cases upon which defendants rely are distinguishable from plaintiffs' decision in this case to stand on the second amended complaint—a decision that we regard as squarely governed by our holding in *UJB*. We are confident that our review of the merits of the orders in *Westinghouse I* and *Westinghouse II* will not "invite the inundation of appellate dockets with requests for review of interlocutory orders [or] undermine the ability of trial judges to achieve the orderly and expeditious disposition of cases." *Cf. Marshall v. Sielaff*, 492 F.2d at 919.

To summarize our holdings thus far, we have concluded that the district court did not err in dismissing with prejudice under Rule 8 those claims that were not dismissed with prejudice on other grounds in *Westinghouse I* and *Westinghouse II*; that the claims that were dismissed with prejudice in *Westinghouse I* and *Westinghouse II* on non-Rule 8 grounds were not later dismissed with prejudice under Rule 8 as well; and that it is jurisdictionally proper and appropriate for us to consider whether the district court erred in dismissing these claims pursuant to Federal Rules of Civil Procedure 9(b) and 12(b)(6) in *Westinghouse I* and *Westinghouse II*.

[8, 9] We exercise plenary review over these dismissals. *See, e.g., UJB*, 964 F.2d at 279. Moreover, we must accept as true plaintiffs' factual allegations, and we may affirm the district court's dismissals only if it appears certain that plaintiffs can prove no set of facts entitling them to relief. *Id.* at 279–80 (citation omitted).

appealable order." 566 F.2d at 445–46. But the appellants in that case did not challenge the underlying final order of dismissal, but only the prior interlocutory decision. *Id.* at 445; *see generally Bethel v. McAllister Brothers, Inc.*, 81 F.3d at 380; *Huey v. Teledyne, Inc.*, 608 F.2d 1234, 1239–40 n. 5 (9th Cir.1979).

6. In addition to our decisions in *Sullivan* and *Marshall*, defendants cite *DuBose v. State of Minn.*, 893 F.2d 169, 171 (8th Cir.1990); *Sere v. Board of Trustees of Univ. of Ill.*, 852 F.2d 285, 288 (7th Cir.1988); *Ash v. Cvetkov*, 739 F.2d 493, 497 (9th Cir.1984), *cert. denied*, 470 U.S. 1007, 105 S.Ct. 1368, 84 L.Ed.2d 387 (1985); and *Huey v. Teledyne, Inc.*, 608 F.2d 1234, 1239 (9th Cir.1979).

[10] In ruling on the two rounds of motions, the district court considered various undisputedly authentic documents attached to plaintiffs' complaint or defendants' motions to dismiss. Because plaintiffs' claims are based upon these documents, they were properly considered as part of defendants' motions to dismiss. *E.g., In re Donald J. Trump Casino Securities Litigation*, 7 F.3d 357, 368 n. 9 (3d Cir.1993), *cert. denied*, 510 U.S. 1178, 114 S.Ct. 1219, 127 L.Ed.2d 565 (1994) (citing *Pension Benefit Guar. Corp. v. White Consol. Indus., Inc.*, 998 F.2d 1192, 1196 (3d Cir.1993), *cert. denied*, 510 U.S. 1042, 114 S.Ct. 687, 126 L.Ed.2d 655 (1994)).

III.

Plaintiffs' claims under section 10(b) of the Exchange Act and under sections 11 and 12(2) of the Securities Act all require, among other things, that plaintiffs allege a *material* misstatement or omission. *See Trump*, 7 F.3d at 368 n. 10. Defendants argued in the district court that any misstatements they may have made with respect to the adequacy of WCC's loan loss reserves were not material. Defendants contended, under the "bespeaks caution" doctrine, that their cautionary language regarding the adequacy of WCC's loan loss reserves rendered immaterial any alleged misrepresentations. The district court largely accepted this argument. In *Westinghouse I*, the court dismissed most of the allegations regarding loan loss reserves contained in the first amended complaint, *see* 832 F.Supp. at 973–77, 985–86,[7] and in *Westinghouse II*, the court clarified that no cautionary language immunized defendants' alleged misstatements occurring prior to February 27, 1991. Thus, under the two opinions and orders, the allegations regarding alleged misstatements about loan loss reserves that were made on or after February 27, 1991, were dismissed under the "bespeaks caution" doctrine. We now turn to plaintiffs' challenge to this dismissal.

[11] As we explained in *Trump*, " 'bespeaks caution' is essentially shorthand for the well-established principle that a statement or omission must be considered in context, so that accompanying statements may render it immaterial as a matter of law." 7 F.3d at 364.[8] We described the doctrine as follows:

> The application of bespeaks caution depends on the specific text of the offering document or other communication at issue, i.e., courts must assess the communication on a case-by-case basis. Nevertheless, we can state as a general matter that, when an offering document's forecasts, opinions or projections are accompanied by meaningful cautionary statements, the forward-looking statements will not form the basis for a securities fraud claim if those statements did not affect the "total mix" of information the document provided investors. In other words, cautionary language, if sufficient, renders the alleged omissions or misrepresentations immaterial as a matter of law.
>
> . . . Of course, a vague or blanket (boilerplate) disclaimer which merely warns the reader that the investment has risks will ordinarily be inadequate to prevent misinformation. To suffice, the cautionary statements must be substantive and tailored to the specific future projections, estimates or opinions in the prospectus which the plaintiffs challenge.
>
> . . . [T]he prospectus here truly bespeaks caution because, not only does the prospectus generally convey the riskiness of the investment, but its warnings and cautionary language directly address the substance of the statement the plaintiffs challenge.

7. Specifically, the court dismissed counts II–V, which alleged violations of sections 11 and 12(2) premised upon the May 1991 prospectus, as well as plaintiffs' section 10(b) claims based upon alleged misstatements regarding loan loss reserves.

8. "Although materiality is a mixed question of law and fact which the trier of fact ordinarily decides, 'if the alleged misrepresentations or omissions are so obviously unimportant to an investor that reasonable minds cannot differ on the question of materiality [it is] appropriate for the district court to rule that the allegations are inactionable as a matter of law.' " *Id.* at 369 n. 13 (citations omitted) (brackets in *Trump*).

7 F.3d at 371–72 (citation omitted); *see also Kline v. First Western Government Securities, Inc.*, 24 F.3d 480, 489 (3d Cir.) ("*Trump* requires that the language bespeaking caution relate directly to that by which plaintiffs claim to have been misled.") (citation omitted), *cert. denied*, —— U.S. ——, 115 S.Ct. 613, 130 L.Ed.2d 522 (1994). In *Trump*, we concluded that given the "extensive yet specific cautionary language, a reasonable factfinder could not conclude" that the alleged misrepresentation "would influence a reasonable investor's investment decision." *Trump*, 7 F.3d at 369; *see also id.* at 373 ("no reasonable jury could conclude that the subject projection materially influenced a reasonable investor").

[12] Plaintiffs' loan loss reserves claims under sections 11 and 12(2) are based solely on alleged misstatements in Westinghouse's May 1991 Registration Statement and Prospectus and documents incorporated therein. The reserves claims under section 10(b) are based upon those documents as well as other alleged misstatements addressing the adequacy of the loan loss reserves. The essence of plaintiffs' allegations is that defendants knowingly or recklessly misrepresented (i) the adequacy of WCC's loan loss reserves and (ii) compliance with Generally Accepted Accounting Principles ("GAAP") in establishing the reserves.

With regard to plaintiffs' section 10(b) claims, the district court concluded that the warnings, "far from being Pollyanish, pointed to still darker clouds on the horizon if the economy generally, and real estate markets specifically, did not improve.... Accordingly, despite sufficient allegations of scienter and materiality, defendants' alleged misrepresentations about the adequacy of Westinghouse and WCC loan loss reserves were so strongly qualified by clear warnings about the future that plaintiffs' causes of action ... must be dismissed under the 'bespeaks caution' doctrine." 832 F.Supp. at 976. The court reached a similar conclusion with regard to plaintiffs' claims under sections 11 and 12(2). *See id.* at 985–86 (finding that Westinghouse's prospectus " 'virtually bristles with warnings' " and that its statements regarding the adequacy of its reserves were "remarkably equivocal") (citation omitted).

Defendants contend that all of the above claims were properly dismissed because any alleged misstatements are immaterial when considered in the context of cautionary language contained in various filings with the SEC. *See Westinghouse I*, 832 F.Supp. at 974–76 (summarizing non-prospectus warnings and quoting from numerous Westinghouse filings). In defense of the district court's decision, Westinghouse's brief highlights the following excerpts from the May 1991 Registration Statement and Prospectus, which typify the warnings on which the defendants rely:

> As part of the reclassification of the $3.4 billion of assets, the Company reclassified for sale approximately $654 million of marketable securities.... This portfolio will be liquidated as soon as practicable; however, *future deterioration in market value could result in additional losses prior to sale* ....
>
> The $3.4 billion in higher-risk and underperforming assets reclassified as held for sale or restructuring included $2.4 billion in receivables. As such, *these receivables had and continue to have a high probability of becoming non-earning assets* during the expected period of liquidation....
>
> Of the $2.4 billion of receivables held for sale or restructuring, at March 31, 1991, approximately $700 million were non-earning, up from $481 million at December 31, 1990.... Real estate owned in assets held for sale or restructuring was approximately $335 million at March 31, 1991, up from $285 million at December 31, 1990.
>
> Of the remaining $8.0 billion in receivables in WFSI's ongoing portfolio, non-earning receivables totaled approximately $180 million at March 31, 1991, up from $71 million at December 31, 1990. Reduced earning receivables totaled approximately $725 million at March 31, 1991, up from $605 million at December 31, 1990. Real estate owned was approximately $175 million at March 31, 1991, up from $85 million at December 31, 1990.
>
> At March 31, 1991, WFSI's valuation allowances related to assets held for sale or

restructuring, and the allowances for credit losses related to the assets in the ongoing portfolio, amounted to $1.013 million and $306 million, respectively. Management believes that under current economic conditions such allowances should be adequate to cover future losses that may occur. However, *a further or more prolonged downturn in the economy or in the real estate, securities or certain other markets could have a negative effect on the ability of WFSI's borrowers to repay and on asset values generally and could result in additional increases in non-earnings assets, restructured loans and, ultimately, increases in allowances for losses in both assets held for sale or restructuring and receivables in the balance of WFSI's portfolio.*

Westinghouse Br. at 29–30 (quoting App. 748–49) (emphasis and ellipses in Westinghouse brief).

Plaintiffs argue that this and other similar cautionary language was insufficient because it implied, consistently with the alleged misstatements by Westinghouse officials, that defendants believed, as of February 1991 and thereafter, that the loan loss reserves were and would remain adequate "under current economic conditions." Plaintiffs contend that defendants' statements regarding the adequacy of the loan loss reserves were materially false when made because defendants knew that the reserves were and would remain inadequate, even without any future or prolonged economic downturn. Plaintiffs allege that Westinghouse management and other defendants knew that the February 1991 charge was inadequate to cover current and expected future losses. Plaintiffs assert that defendants knew that WCC's loan portfolio was overstated by between $2.6 billion and $5.3 billion immediately prior to the first writedown of $975 million in February 1991. Pointing to internal documents suggesting that Westinghouse believed that the $975 million charge was "credible" and "affordable," plaintiffs argue that defendants should have been concerned with whether the charge complied with GAAP.[9] Plaintiffs also point to the statement by former WCC President James Focareta, in which he allegedly acknowledged that Westinghouse officials knew in February 1991 that the $975 million charge was insufficient. *See* App. 1134.

Having carefully reviewed the cautionary language on which the defendants and the district court relied, we find that these statements do not sufficiently counter the alleged misrepresentations, i.e., that the defendants knowingly or recklessly misrepresented the adequacy of the loan loss reserves and compliance with GAAP. If, as plaintiffs say, defendants knowingly or recklessly misrepresented the adequacy of the loss reserves to protect against known losses and known risks in light of the then-current economic conditions, it follows that defendants' cautionary statements about the *future* did not render those misrepresentations immaterial. In our view, a reasonable investor would be very interested in knowing, not merely that future economic developments might cause further losses, but that (as plaintiffs allege) current reserves were known to be insufficient under current economic conditions. A reasonable investor might well be willing to

9. Plaintiffs allege that GAAP required defendants to set their loss reserves based on the value of the collateral supporting each loan in the portfolio under current economic and market conditions. *E.g.*, App. 1193–96. Plaintiffs further claim that Westinghouse's failure to comply with GAAP resulted in a gross overvaluing of assets and grossly inadequate loss reserves. Defendants contend that plaintiffs cite no generally accepted accounting principles that would have required Westinghouse to value assets that had probably become impaired at actual value under current economic and market conditions. West. Br. at 26–27. Defendants cite to the Emerging Issues Task Force, Issue No. 88–25, at 6, App. 531–46, and urge that this source dispositively provides that defendants were not required to consider present collateral values unless and until they had decided to sell the relevant asset. On the contrary, however, plaintiffs cite a number of provisions suggesting that defendants should have focused on current collateral values. *See* App. 1194–95. Indeed, the district court cited one of these standards and appropriately instructed defendants to raise their GAAP arguments, if at all, on a motion for summary judgment. *Westinghouse I*, 832 F.Supp. at 971 & n. 11. Defendants' reliance on the Emerging Issues Task Force publication—as a ground for affirmance of the district court's bespeaks caution decision—is misplaced. Resolution of a battle of expert sources—as defendants expect to occur here—is inappropriate on a motion to dismiss.

take some chances with regard to the future of the economy, but might be quite unwilling to invest in a company that knew that its reserves were insufficient under current conditions and knew it would be taking another major write-down in the near future (as plaintiffs allege). Thus, notwithstanding the cautionary language stressed by defendants, we think that there is a substantial likelihood that defendants' alleged misrepresentations—i.e., that the loan loss reserves were established in compliance with GAAP and were believed to be adequate to cover expected future losses given the then-existing economic conditions—would have assumed actual significance to a reasonable investor contemplating the purchase of securities.[10] We therefore cannot say that the cautionary language rendered the alleged misrepresentations immaterial as a matter of law. *See Kline,* 24 F.3d at 489 (rejecting bespeaks caution argument where purported cautionary language did not sufficiently counter alleged misstatements and omissions); *see also Fecht v. The Price Company,* 70 F.3d 1078, 1082 (9th Cir.1995) ("Inclusion of *some* cautionary language is not enough to support a determination as a matter of law that defendants' statements were not misleading.") (emphasis in original) (citation omitted), *cert. denied,* —— U.S. ——, 116 S.Ct. 1422, 134 L.Ed.2d 547 (1996); *Rubinstein v. Collins,* 20 F.3d 160, 171 (5th Cir.1994) (reiterating view that " '[t]o warn that the untoward may occur when the event is contingent is prudent; to caution that it is only possible for the unfavorable events to happen when they have already occurred is deceit' ") (footnote omitted). In short, we cannot conclude that the alleged misrepresentations would have been "so obviously unimportant to an investor that reasonable minds cannot differ on the question of materiality." *UJB,* 964 F.2d at 281 n. 11 (citation omitted). Dismissal of the loan loss reserves claims for the period after February 27, 1991 was thus improper, and we reverse this aspect of the orders entered in *Westinghouse I* and *Westinghouse II.*[11]

IV.

[13, 14] Plaintiffs next challenge the district court's dismissal of various other portions of their section 10(b) claims. To state a securities fraud claim under section 10(b) and rule 10b–5, a private plaintiff must plead the following elements: (1) that the defendant made a misrepresentation or omission of (2) a material (3) fact; (4) that the defendant acted with knowledge or recklessness and (5) that the plaintiff reasonably relied on the misrepresentation or omission and (6) consequently suffered damage. *E.g., UJB,* 964 F.2d at 280. Also, because section 10(b) claims sound in fraud, the circumstances constituting the fraud must be stated with particularity. *See id.* at 284; *In re Craftmatic Securities Litigation,* 890 F.2d 628, 645 (3d Cir.1989); Fed.R.Civ.P. 9(b). "Rule 9(b) requires a plaintiff to plead (1) a specific false representation of material fact; (2) knowledge by the person who made it of its falsity; (3) ignorance of its falsity by the person to whom it was made; (4) the intention that it should be acted upon; and (5) that the plaintiff acted upon it to his damage." *UJB,* 964 F.2d at 284 (citing *Christidis v. First Pennsylvania Mortgage Trust,* 717 F.2d 96, 99 (3d Cir.1983)).

Plaintiffs argue first that the district court improperly dismissed the section 10(b) claims against the Westinghouse defendants relating to Westinghouse's alleged concealment of

10. This materiality standard is essentially adapted from the Supreme Court's decision in *TSC Indus., Inc. v. Northway, Inc.,* 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976). *See Trump,* 7 F.3d at 369 ("The Supreme Court in *TSC Indus., Inc. v. Northway, Inc.,* 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976), defined materiality within the proxy-solicitation context of § 14(a) of the 1934 Act. Subsequently the Court expressly made the *TSC* standard applicable to actions under § 10 and Rule 10b–5, and we have made it applicable as well to claims under §§ 11 and 12(2) of the 1933 Act.") (citations omitted).

11. We note that defendants' reliance on *UJB*'s discussion of loan loss reserves is misplaced. Although it is true that "the economic judgments made in setting loan loss reserves can be validated only at some future date," *UJB,* 964 F.2d at 281, we made clear in *UJB* that "if a defendant characterizes loan loss reserves as 'adequate' or 'solid' even though it knows they are inadequate or unstable, it exposes itself to possible liability for securities fraud." *Id.* at 282.

nonearning receivables and inadequate internal controls. Plaintiffs further contend that the district court erred in dismissing the section 10(b) claim against Price Waterhouse. Plaintiffs also challenge the district court's dismissal of their claim that one of the underwriter defendants intentionally misled the public in the May 1991 offering. We will consider each of plaintiffs' arguments.

[15] A. Nonearning receivables, also known as nonaccrual loans or nonearning loans, are defined as "[l]oans on which accrual of interest has been suspended because collectibility is doubtful." American Institute of Certified Public Accountants ("AICPA"), *Audits of Finance Companies* 108 (1994); *see also* American Bankers Association, *Banking Terminology* 244 (3d ed. 1989) (defining nonearning asset as "[a]n asset that does not produce income, such as ... required reserves, or a nonaccrual loan"). Plaintiffs allege that Westinghouse manipulated its nonearning receivables accounts to overstate the quality of its receivables portfolio.

The district court essentially found that plaintiffs had not pled facts explaining with particularity how Westinghouse's statements concerning nonearning receivables were false and misleading or violated GAAP. The district court thus dismissed these allegations under Rules 12(b)(6) and 9(b) as "conclusory rather than factual." 832 F.Supp. at 967–68; *see also Westinghouse II,* Op. at 4–6, App. 313–15. The court found that plaintiffs, with the benefit of hindsight, were merely challenging Westinghouse's judgment as to when collectibility on the loans became doubtful. *Id.* We disagree.

Plaintiffs allege that the Westinghouse defendants arbitrarily moved loans from nonearning to earning status just before mandated public reporting when, in fact, nothing had changed regarding the likelihood of collection. Plaintiffs contend that they have pled specific facts permitting the inference that defendants were intentionally concealing loan losses. We agree. Plaintiffs are not merely challenging defendants' judgment regarding when collectibility became doubtful; instead, plaintiffs allege that defendants changed the classification of the loans when nothing regarding collectibility had occurred. Plaintiffs allege that specific loans had at least three of the eight AICPA earmarks for nonearning status both before and after they were removed from nonearning status. On a motion for summary judgment, defendants may be able to show why the status of these loans consistently changed just prior to the time of reporting, and they may be able to establish that no reasonable factfinder could find for plaintiffs. At this stage, however, we cannot say that plaintiffs have failed to state a claim or have failed to plead fraud with sufficient particularity. We therefore reverse this aspect of the district court's orders.

B. Plaintiffs also allege that Westinghouse fraudulently overstated the quality of its internal controls, in violation of section 10(b). Westinghouse indisputably made representations throughout the class period regarding the adequacy of its internal controls. Plaintiffs essentially contend that those statements were made without a reasonable basis and with knowledge of or in reckless disregard of facts suggesting their falsity.

Plaintiffs' claim is based primarily on an internal report prepared following an anonymous tip alleging inadequate internal accounting controls. After rejecting the assertions of the anonymous tip, the November 1990 report discussed recommendations for improving internal controls and addressing some overall concerns that the auditors had identified. *See* App. 939–53.

[16] The district court found that "[t]he fact that the internal auditors also recommended improvements in valuation methods and tighter standards for internal valuations does not support plaintiffs' claim that in its Form 10K's Westinghouse fraudulently or even inaccurately represented its internal controls as adequate." 832 F.Supp. at 979; *see also Westinghouse II,* at 8–9 ("plaintiffs' assertions amount to nothing more than 'fraud by hindsight' allegations, based on the premise that the internal controls turned out to be inadequate."). We agree that plaintiffs have failed to plead any facts supporting their conclusory allegation that Westinghouse fraudulently misrepresented the adequacy of its internal controls. We therefore

affirm dismissal of this aspect of the section 10(b) claim.

C. Plaintiffs argue that the district court, by "compartmentalizing the evidence and wiping the slate clean after considering each component," failed to give weight to the "totality of the pleadings." Plfs' Br. at 25. We have instructed that the district courts should engage in precisely the sort of analysis undertaken by the district court in this case, *see, e.g., UJB,* 964 F.2d at 284; *Craftmatic,* 890 F.2d at 640, and we therefore find no merit in this argument.

In addition, plaintiffs' discussion of Rule 9(b) suggests that the district court improperly required them to plead defendants' state of mind with particularity. *See* Plfs' Br. at 18–20 (relying on *In re GlenFed, Inc. Securities Litigation,* 42 F.3d 1541 (9th Cir.1994) (en banc)). We do not see any evidence of such a requirement in the district court's opinions, and we therefore find plaintiffs' legal argument irrelevant.

D. Plaintiffs also appeal from dismissal of certain aspects of their section 10(b) claim against Price Waterhouse arising out of Price Waterhouse's 1988 and 1989 audits. The district court granted Price Waterhouse's motion to dismiss in *Westinghouse II* based on plaintiffs' failure to plead any facts suggesting fraud on the part of Price Waterhouse with respect to the 1988 and 1989 audits. *Westinghouse II,* at 21–30, App. 330–39. The district court concluded that plaintiffs failed to state a fraud claim both with respect to whether Price Waterhouse fraudulently violated Generally Accepted Accounting Standards ("GAAS") in its 1988 and 1989 audits and with respect to whether Price Waterhouse knew that Westinghouse's 1988 and 1989 financial statements failed to comply with GAAP and fraudulently stated otherwise. The district court found that the only factual allegations contained in the second amended complaint relevant to plaintiffs' section 10(b) claims against Price Waterhouse related to the 1990 audit.

[17] Although plaintiffs cite various GAAS standards, they nowhere explain how Price Waterhouse knowingly or recklessly violated those standards in performing its 1988 and 1989 audits. For example, plaintiffs' complaint fails to allege any facts supporting their conclusory allegation that Price Waterhouse failed to follow GAAS in determining whether Westinghouse's 2.5% loss reserves were reasonable in 1988 and 1989. Moreover, as Price Waterhouse properly argues, plaintiffs do not allege that Price Waterhouse failed to consider the adequacy of Westinghouse's internal controls in planning the scope of or in executing the 1988 and 1989 audits; nor do plaintiffs allege that Price Waterhouse opined on the adequacy of Westinghouse's internal controls in those audits.

Plaintiffs' GAAP arguments are similarly unavailing. Under *Christidis,* plaintiffs must allege facts that give rise to an inference that Price Waterhouse knew or was reckless in not knowing that Westinghouse's financial statements failed to comply with GAAP. 717 F.2d at 100; *see also Eisenberg v. Gagnon,* 766 F.2d 770, 776–78 (3d Cir.), *cert. denied,* 474 U.S. 946, 106 S.Ct. 342, 88 L.Ed.2d 290 (1985). There are no facts cited in plaintiffs' second amended complaint supporting an inference that Price Waterhouse knew or was reckless in not knowing that Westinghouse was using speculative, inflated values in valuing receivables. Moreover, although Price Waterhouse concedes that it knew that Westinghouse set its loss reserves at 2.5% of total assets in audit years 1988 and 1989, this fact provides no support for plaintiffs' allegation that Price Waterhouse knew that Westinghouse was violating GAAP in those years. Assuming that Westinghouse violated GAAP during 1988 and 1989, plaintiffs nonetheless fail to allege facts suggesting that Price Waterhouse intentionally or recklessly misrepresented Westinghouse's compliance with GAAP.

In short, plaintiffs fail to allege any facts supporting an inference that Price Waterhouse made fraudulent misrepresentations in its 1988 and 1989 audit opinions. Plaintiffs' allegations do not support an inference that Price Waterhouse could not reasonably and in good faith have opined that the financial statements as a whole fairly presented the financial condition of Westinghouse in accordance with GAAP. We therefore affirm the district court's order dismissing the section

10(b) claims against Price Waterhouse arising out of Price Waterhouse's 1988 and 1989 audits.

[18] E. Plaintiffs also challenge the district court's dismissal of their section 10(b) claims against Lazard Freres ("Lazard"), one of the underwriter defendants. In addition to dismissing these claims under the "bespeaks caution" doctrine, the district court dismissed them on the ground that plaintiffs failed to plead any facts supporting section 10(b) liability against Lazard. *See Westinghouse I,* 832 F.Supp. at 979–81; *Westinghouse II,* at 33–34, App. 342–43. In *Westinghouse I,* the district court found that the documents upon which plaintiffs relied could not bear the construction placed on them by plaintiffs. 832 F.Supp. at 979–81; *see also Westinghouse II,* at 33, App. 342. We agree.

Plaintiffs place primary reliance on Lazard's December 2, 1990, Progress Report and on a document entitled "Westinghouse Electric—Board Meeting Q & A," developed for use at the February 27, 1991, Board meeting. *See* App. 1428–41 (Progress Report); App. 1134–36 (Q & A). Plaintiffs also rely on a report prepared by Westinghouse in September 1990. *See* App. 918–36.

In the Progress Report, Lazard recommended "serious consideration of a comprehensive restructuring program which could include a one-time charge to earnings." App. 1435. Lazard also explained that "[t]he possible restructuring outlined earlier implies the ultimate disposition of roughly *$3.2 billion or 55% of non-real estate assets and at least $1.5 billion of real estate* (problem real estate totalled $1.5 billion or 37% of the portfolio at September 30, 1990)." App. 1440 (emphasis in original). In the proposed question and answer script, Lazard suggested the following response to the question, "Are the reserves adequate?": "Given the results of each of these review processes, the charge taken today is clearly reasonable but was at the low end of the range identified by management in conjunction with the strategic review performed by Lazard." App. 1135.

Based on the above sources, plaintiffs argue that Lazard knew that the February 1991 charge was inadequate to protect against known and likely losses. We agree with the district court, however, that the documents on which plaintiffs rely simply do not support their conclusory allegations and that plaintiffs fail to allege facts supporting their section 10(b) claims against Lazard.[12] These claims were properly dismissed in *Westinghouse I* and *Westinghouse II.*

V.

Defendants argued in the district court that plaintiffs' allegations regarding loan loss reserves and nonearning loans in count I were subject to dismissal as being quantitatively immaterial as a matter of law (separate and apart from the "bespeaks caution" doctrine). In *Westinghouse I,* the district court rejected defendants' argument, finding that the allegations of wrongfully understated reserves were sufficiently substantial when compared to Westinghouse's net income for the relevant time periods. 832 F.Supp. at 971–73. In *Westinghouse II,* defendants argued that plaintiffs failed to allege a material misrepresentation or omission during the time period of March 28, 1989, through March 28, 1990 (i.e., the first year of the class period) with respect to their allegations regarding the loan loss reserves and nonearning loans. *Westinghouse II,* Op. at 13–18, App. 322–27. The district court agreed and dismissed these claims for the first year of the class period. *Id.*

Plaintiffs challenge this aspect of *Westinghouse II,* Plfs' Br. at 34–38, and defendants counter that *all* of the allegations regarding nonearning assets and loan loss reserves (not merely those for the first year of the class period) could and should have been dismissed on quantitative materiality grounds. West. Br. at 39–45. Assuming without deciding that defendants' latter argument (which was

12. For example, plaintiffs' reply brief asserts that "Lazard had alerted the Westinghouse Board to the fact that reserves were inadequate, even after the special provision of $975 million under existing asset disposition strategies." Plfs' Rep. Br. at 18 (citing 2nd Am. Comp. ¶ 152, App. 1135). But the proposed questions and answers to which plaintiffs cite simply do not suggest that Lazard believed the charge to be inadequate as of or after February 1991.

not raised on defendants' motion to dismiss the second amended complaint) is properly before us, we find it to be without merit.[13] We thus turn to the dismissal of plaintiffs' claims for the first year of the class period.

[19, 20] As referred to earlier in our discussion of the "bespeaks caution" doctrine, "[a]n omitted fact is material if there is a 'substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder.'" *UJB*, 964 F.2d at 281 n. 11 (quoting *T.S.C. Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976)). "In other words, the issue is whether there is a substantial likelihood that the disclosure would have been viewed by the reasonable investor as having 'significantly altered the "total mix" of information' available to that investor." *Id.* Moreover, "[m]ateriality is a mixed question of law and fact, and the delicate assessments of the inferences a reasonable shareholder would draw from a given set of facts are peculiarly for the trier of fact." *Id.* (citing *T.S.C.*, 426 U.S. at 450, 96 S.Ct. at 2132–33). Therefore, "[o]nly if the alleged misrepresentations or omissions are so obviously unimportant to an investor that reasonable minds cannot differ on the question of materiality is it appropriate for the district court to rule that the allegations are inactionable as a matter of law." *Id.*

[21] The district court recognized that the adequacy of loan loss reserves is generally the type of information that would significantly influence a reasonable investor. *Westinghouse I*, 832 F.Supp. at 972 (citing *UJB*, 964 F.2d at 281). However, the court also tested plaintiffs' complaint to determine whether the allegations regarding loan loss reserves were quantitatively material in this particular case. The district court stated that "[t]he failure to disclose that a loan portfolio is likely to be impaired by some *de minimis* amount may be 'relevant' in that it is the type of information that investors care about, but of such 'dubious significance' as to be 'trivial,' and 'hardly conducive to informed decisionmaking,' so that to reasonable shareholders, such omission must be immaterial as a matter of law." *Id.* at 972 (quoting *TSC Industries*, 426 U.S. at 448–49, 96 S.Ct. at 2131–32). We agree. *See generally* Loss & Seligman, *Fundamentals of Securities Regulation* 137–41, 479–80 (1995) (quantitative materiality analysis is generally appropriate, though not when "such matters as a conflict of interest or criminal violations are at issue"); *see also Ferber v. Travelers Corp.*, 802 F.Supp. 698, 708 (D.Conn.1992) (omission of extent of second mortgages not material in relation to overall real estate, investment, and asset portfolios); *In re First Chicago Corp. Securities Litigation*, 769 F.Supp. 1444, 1454 (N.D.Ill.1991) (total value of alleged bad loan immaterial in relation to size of defendant's real estate loan portfolio).[14]

[22] Plaintiffs do not dispute that their only allegation challenging the adequacy of loan loss reserves prior to the fourth quarter

13. Defendants rely on Instruction 2 to Item 103 of S.E.C. Regulation S–K, 17 C.F.R. § 229.103, in support of their argument that materiality should in all circumstances be quantified at 10% of current assets. Instruction 2 states in relevant part that "[n]o information need be given with respect to any [legal] proceeding that involves primarily a claim for damages if the amount involved, exclusive of interest and costs, does not exceed 10 percent of the current assets of the registrant and its subsidiaries on a consolidated basis." *Id.* This regulation has no application here, and not surprisingly, defendants do not point to any cases extending this instruction beyond its intended scope.

14. We thus reject plaintiffs' argument that all misstatements regarding loan loss reserves and nonearning receivables are inherently material. But we also reject defendants' similarly categorical assertion that materiality must be quantified at a specified percentage of income or assets. Although "a 'rule of thumb' of 5–10 percent of net income is widely used as a general materiality criterion" in the accounting profession, *see* Financial Accounting Standards Board, *Accounting Standards:* Statements of Financial Accounting Concepts No. 2, App. C, ¶ 167, at 81 (1989) (citing James W. Pattillo, *The Concept of Materiality in Financial Reporting* (1976)), the question of materiality must be considered on a case-by-case basis under the standards set forth in *T.S.C. Industries* and our cases. *See also* Pattillo, *supra*, at 12 (advocating consideration of various factors in determining materiality in the accounting profession and concluding that "the single rule-of-thumb materiality criterion of 5%–10% of net income or loss should be used—if at all, and by itself—with extreme caution").

of 1989 has to do with one asset that allegedly was improperly not written down by $1.278 million during the third quarter of that year. *See* App. 1234. The charge that would have followed the write-down of this asset would have amounted to merely 0.54% of Westinghouse's net income of $234 million for that quarter.[15] We agree with the district court that this allegation is not sufficiently material to be actionable, i.e., there is not a substantial likelihood that this information would have assumed actual significance in the deliberations of a reasonable investor. Plaintiffs thus allege no actionable reserves claims for the period prior to the fourth quarter of 1989. The first actionable disclosures alleged in the second amended complaint relating to loan loss reserves for the fourth quarter of 1989 occurred on March 29, 1990. The district court thus properly dismissed the reserves allegations that concern the period prior to the March 29, 1990, disclosures.

[23] The district court also dismissed the nonearning loans allegations relating to the first year of the class period. The court found that the assets identified in plaintiffs' complaint that allegedly should have been classified as nonearning through the fourth quarter of 1989 were barely 1% of Westinghouse's current assets for any quarter during that period and were thus immaterial.[16] The second amended complaint alleges that prior to the fourth quarter of 1989, eight assets were improperly not classified as nonearning assets. *See* App. 1169–76. These accounts amount to just 0.51% of Westinghouse's current assets for the first and second quarters of 1989 and only 1.2% of Westinghouse's current assets for the third quarter of 1989. We again agree with the district court that these allegations are not sufficiently substantial to be material, and plaintiffs therefore allege no actionable nonearning loans claims for the period prior to the fourth quarter of 1989.[17] As with the reserves claims, the first actionable disclosures alleged in the second amended complaint relating to nonearning loans for the fourth quarter of 1989 occurred on March 29, 1990. The district court thus properly dismissed the nonearning loans allegations that relate to the period prior to the March 29, 1990, disclosures.

VI.

A. As discussed above, the district court dismissed the section 12(2) claims under the "bespeaks caution" doctrine. The district court also dismissed the section 12(2) claims on the ground that plaintiffs failed to allege that defendants "offered or sold" Westinghouse securities to plaintiffs within the meaning of section 12(2). We turn now to plaintiffs' challenge to this determination.

[24] Section 12(2) provides that a person who "offers or sells" newly issued securities by means of a prospectus or oral communication that misrepresents or omits material facts is liable to the person "purchasing such security from him." 15 U.S.C. § 77*l*(2). In *Pinter v. Dahl*, 486 U.S. 622, 108 S.Ct. 2063, 100 L.Ed.2d 658 (1988), the Supreme Court stated that although the language of section 12(1) "contemplates a buyer-seller relationship not unlike traditional contract privity," *id.* at 642, 108 S.Ct. at 2076, its scope is not limited only to those who pass title. *Id.* at

15. As the district court stated, "[w]hat is affected most immediately by the development of a loss reserve for accounting purposes is income not assets. In order to determine the materiality of allegedly inadequate loan loss reserves, the focus then must be the amount of loan loss reserves alleged to have been wrongfully not posted as a percentage of income during the relevant period, rather than as a percentage of current assets." *Westinghouse I*, 832 F.Supp. at 973 (citation omitted).

16. As the district court noted, plaintiffs "themselves allege that the effect of 'artificially reducing the reported level of non-earning receivables' is to 'overstate the quality (and, hence, the value) of the receivables portfolio' as a whole. As a result, the materiality of plaintiffs' allegations regarding Westinghouse's non-earning assets is properly measured by comparison with Westinghouse's total current assets." *Westinghouse II*, Op. at 15 n. 8, App. 324 n. 8 (quoting 2nd Am. Comp.) (brackets omitted).

17. Plaintiffs argue that they should not be required to support their claims through loan-by-loan allegations. At least in the circumstances of this case, where plaintiffs have had the benefit of reviewing the relevant loan files prior to filing their amended complaint, we think it is entirely appropriate to require such a level of specificity. *See also Westinghouse I*, 832 F.Supp. at 973.

642–47, 108 S.Ct. at 2076–78. The Court held that the term "seller" in the context of section 12(1) includes (1) "the owner who passed title, or other interest in the security, to the buyer for value" and (2) "the person who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner." *Id.* at 642, 647, 108 S.Ct. at 2076, 2078–79. Under *Pinter*, both direct sellers and those who engage in the active solicitation of an offer to buy can be "sellers" for purposes of section 12(1). *See id.* at 646–47, 108 S.Ct. at 2078–79.

[25] In *In re Craftmatic Securities Litigation*, 890 F.2d 628 (3d Cir.1989), we held that the Supreme Court's definition of the term "seller" under section 12(1) applies in actions brought under section 12(2). *Id.* at 634–36, 108 S.Ct. at 2071–73; *see also UJB*, 964 F.2d at 286–87. Thus, under *Pinter* and our cases, a section 12(2) seller may be one who passes title to the buyer for value (a direct seller) or one "who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner" (a solicitor seller). *Pinter*, 486 U.S. at 643, 108 S.Ct. at 2076–77.

In *Craftmatic*, we cautioned that "the language of § 12, which makes a participant liable to the 'person purchasing such a security from him . . .,' precludes actions against remote sellers, and focuses the inquiry on the relationship between the purchaser and the participant, rather than on the latter's degree of involvement in the transaction." *Craftmatic*, 890 F.2d at 636 (citation omitted). We added with regard to solicitation liability that "although an issuer is no longer immunized from § 12 liability, neither is an issuer liable solely on the basis of its involvement in preparing the prospectus. The purchaser must demonstrate direct and active participation in the solicitation of the immediate sale to hold the issuer liable as a § 12(2) seller." *Id.* (citations omitted).

[26] B. Plaintiffs do not claim that any of the Westinghouse defendants were direct sellers. Rather, plaintiffs allege that the underwriter defendants purchased the shares from Westinghouse and resold them to the public, including plaintiffs. *E.g.*, App. 362–63, 366–67. The Westinghouse defendants therefore cannot be liable under section 12(2) as direct sellers. *Cf. UJB*, 964 F.2d at 287 (plaintiffs not required to allege direct and active solicitation where newly offered shares were purchased directly through defendant UJB). Plaintiffs further allege as follows:

> 593. The section 12 Defendants were sellers of Westinghouse securities within the meaning of Section 12(2) of the Securities Act and either sold or promoted the sale of said securities directly to plaintiffs and other Class members or solicited plaintiffs and other Class members to buy such securities. In so acting, the Section 12 Defendants were motivated by a desire to serve their own financial interests.

App. 506 (count III); *see also* App. 511–12 (count V). Plaintiffs allege no facts suggesting how any Westinghouse defendants directly and actively participated in the solicitation of plaintiffs' immediate purchases of Westinghouse stock.

The district court dismissed the section 12(2) claims, explaining as follows:

> [P]laintiffs have not alleged that the Westinghouse defendants in fact sold or solicited the purchase of Westinghouse securities, but attempt nonetheless to analogize their allegations to the allegations and holding in *Craftmatic* by pointing to the similarity of language employed.... The conclusory allegation that defendants sold or solicited the purchase of securities will withstand a motion to dismiss only if accompanied by allegations of *fact* that defendants did sell or solicit the purchase of securities.

Westinghouse I, 832 F.Supp. at 984 (citation and footnote omitted) (emphasis in original).[18] Plaintiffs argue that because the facts alleged in their complaint are so similar to

18. Westinghouse concedes here, as it did in the district court, that it directly sold securities pursuant to the DRP prospectus, and that the two named plaintiffs who purchased pursuant to that prospectus stated section 12(2) claims against Westinghouse itself in count V. *See Westinghouse I*, 832 F.Supp. at 984 n. 23 & 987 n. 24; *see also* West. Br. at 47.

the factual allegations of the complaint sustained in *Craftmatic*, they stated a section 12(2) claim. *See* Plfs' Br. at 40–41. We are constrained to agree.

It is certainly true that plaintiffs' section 12(2) allegations are not clearly drafted. Plaintiffs do not, for example, make clear which defendants are alleged to be direct sellers as opposed to solicitor sellers. *See UJB*, 964 F.2d at 287 n. 17. Nor do plaintiffs allege how the Westinghouse defendants, assuming they are alleged to be solicitor sellers, directly and actively participated in the solicitation of the immediate sales.[19] Further, plaintiffs' allegation that defendants "promoted the sale of" securities would not, standing alone, give rise to any section 12(2) liability. The district court could certainly require that plaintiffs clear up these ambiguities on remand.

Taken in the light most favorable to plaintiffs, however, the complaint does allege that the Westinghouse defendants "solicited plaintiffs" to purchase Westinghouse securities and that in so doing they were motivated by a desire to serve their own financial interests. Contrary to the district court's statement, these are factual allegations—allegations plaintiffs will have to prove—and not bare legal conclusions. Under *Craftmatic*, plaintiffs' allegations are sufficient to survive a motion to dismiss under Rule 12(b)(6): "It cannot be said at this juncture that plaintiffs can prove no set of facts that would entitle them to relief." *Craftmatic*, 890 F.2d at 637 (citations omitted); but cf. *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1216 (1st Cir. 1996). For these reasons, we reverse the district court's order dismissing the section 12(2) claims against the Westinghouse defendants.

[27] We note that although fraud is not a necessary element of a claim under section 12(2), section 12(2) claims that do sound in fraud must be pled with particularity. *UJB*, 964 F.2d at 288–89. The district court did not decide, nor do defendants argue, that plaintiffs' section 12(2) claims sound in fraud.[20] To the extent, if any, that the section 12(2) claims in fact sound in fraud, plaintiffs could justifiably be required to plead the circumstances constituting fraud with the particularity required by Rule 9(b).[21] This is not, however, the theory on which the district court rested its decision; nor has it been advanced by the parties in this court.

C. As to the underwriter defendants, the first amended complaint alleges that "[e]ach member of the Underwriter Class sold Westinghouse stock to members of the Prospectus Subclass during the Class Period." App.

19. An allegation of direct and active participation in the solicitation of the immediate sale is necessary for solicitation liability, i.e., where the section 12(2) defendant is not a direct seller. *See UJB*, 964 F.2d at 287. Such an allegation is crucial so as to ensure a direct relationship between the purchaser and the defendant, without which a defendant is simply not a statutory seller. *See Pinter*, 486 U.S. at 651, 108 S.Ct. at 2080–81 ("The 'purchase from' requirement of § 12 focuses on the defendant's relationship with the plaintiff-purchaser.").

20. It seems to us that the district court effectively imposed a heightened pleading requirement on plaintiffs and that the court implicitly required plaintiffs to plead their section 12(2) claims with the particularity required by Rule 9(b). Absent a determination that plaintiffs' claims sounded in fraud, or some analysis explaining why Rule 9(b) should apply when a section 12(2) claim does not sound in fraud, *see UJB*, 964 F.2d at 288 ("By its plain wording, Rule 9(b) would not appear to apply to claims that a defendant negligently violated §§ 11 and 12(2); we need not and do not decide this issue."); *see also In re Phar-Mor, Inc. Litigation*, 848 F.Supp. 46, 50 (W.D.Pa.1993); *In re Chambers Development Securities Litigation*, 848 F.Supp. 602, 624 (W.D.Pa.1994), this constitutes legal error. As mentioned, defendants have not attempted to defend the district court's order on these alternative grounds, and we do not reach these issues.

21. Unlike the complaint in *UJB*—where the section 12(2) count sounded in fraud essentially because it incorporated all prior factual allegations, including those alleging intentional, knowing, and reckless conduct, *UJB*, 964 F.2d at 287–88—count III of the first amended complaint in this case incorporates only paragraphs 1–28 (jurisdiction/venue, parties, and class action allegations) and paragraphs 423–38 (section 11 allegations). App. 505. The section 12(2) count itself alleges that the Westinghouse defendants "knew or, in the exercise of reasonable care, should have known of the misstatements and omissions contained in the Registration Statement/Prospectus and the documents incorporated therein by reference." App. 507; *see also* PW Br. at 37 ("In opposing Price Waterhouse's motion to dismiss their Section 11 claims, plaintiffs expressly disavowed *any* reliance on the allegations supporting the fraud claims in an effort to avoid having Rule 9(b) apply to these claims.") (emphasis in PW brief).

367. Plaintiffs further allege that the underwriter defendants sold Westinghouse securities "directly to plaintiffs and other Class members." App. 506.

The district court dismissed the section 12(2) claims against the underwriter defendants, finding that plaintiffs failed to allege that the underwriter defendants were statutory sellers under section 12(2). The district court explained as follows:

> In Count Three, plaintiffs must allege, to state a viable Section 12(2) cause of action, that the underwriter defendants were "sellers" within the meaning of Section 12(2). That is, there must be an allegation that a particular proposed defendant sold or solicited the sale of Westinghouse securities to the individual plaintiffs. *Pinter v. Dahl*, 486 U.S. at 643–47, 108 S.Ct. at 2076–77. This element is lacking.

Westinghouse I, 832 F.Supp. at 987.[22]

[28, 29] We agree with the district court that plaintiffs must allege that the underwriter defendants were section 12(2) sellers, but we do not find support in *Pinter* for the district court's statement that, in order to achieve this, plaintiffs are required to allege which underwriter sold securities to each plaintiff. Under *Pinter*, a plaintiff will not succeed on a section 12(2) claim unless the plaintiff shows, among other things, that the plaintiff bought from or was solicited by a specified statutory seller. But *Pinter* does not address what allegations are necessary to plead that a defendant is a seller within the meaning of the statute.[23] Absent a particularity requirement,[24] plaintiffs must provide a short and plain statement showing that the underwriter defendants are statutory sellers and that plaintiffs purchased securities from them.

[30] We find that plaintiffs satisfied this requirement and stated a section 12(2) claim against the underwriter defendants. Taken in the light most favorable to plaintiffs, the first amended complaint alleges that each of the underwriter defendants sold Westinghouse securities directly to plaintiffs and that each plaintiff purchased Westinghouse securities directly from an underwriter defendant. *Cf. Jackson v. First Federal Savings of Arkansas*, 709 F.Supp. 863, 884 (E.D.Ark. 1988) (dismissing section 12(2) claim where plaintiff did not allege that any defendant sold him his shares or solicited him to buy his shares). The defendants and the district court have not pointed to any authority requiring anything further. Although plaintiffs did not submit a model pleading, we cannot say they failed to state a claim under Rule 12(b)(6).[25] *Compare Craftmatic*, 890 F.2d at

22. The district court also found that plaintiffs were attempting to bring a class action against a proposed class of defendants "without alleging facts which would establish standing by a plaintiff against each defendant." *Id.* The court stressed that "there must be a representative plaintiff who alleges sale or solicitation by each proposed defendant." *Id.* (citations omitted). While these concerns might be relevant on a motion for class certification, they do not address whether, as a threshold matter, plaintiffs properly stated a section 12(2) claim under Rule 12(b)(6).

23. *Pinter* reached the Supreme Court following an affirmance by the Fifth Circuit of a judgment for investors entered after a bench trial in the district court. *Pinter*, 486 U.S. at 628–29, 108 S.Ct. at 2068–69. The opinion concerns the burden of proving that a defendant is a statutory seller, not the burden of pleading such an allegation.

24. We note that some of the authorities relied upon by defendants dismissed section 12(2) claims under Rule 9(b). *E.g., Friedman v. Arizona World Nurseries Ltd. Partnership*, 730 F.Supp. 521, 542 (S.D.N.Y.1990) (section 12(2) claim not pled with particularity required by rule 9(b)), *aff'd*, 927 F.2d 594 (2d Cir.1991) (Table). We again emphasize that the district court did not find, nor do defendants argue, that plaintiffs' section 12(2) claims sound in fraud. These authorities are thus inapposite. Also, defendants rely on cases in which there was *no* allegation that plaintiffs purchased directly from defendants, *e.g., In re Newbridge Networks Securities Litigation*, 767 F.Supp. 275, 280–81 (D.D.C.1991) ("nowhere does the complaint state that plaintiffs 'purchased from' defendants, or that defendants sold directly to plaintiffs"), as distinguished from this case, where there is indisputably a general allegation to that effect.

25. We alternatively hold that the district court's dismissal of plaintiffs' section 12(2) claims based on plaintiffs' failure to specify which underwriters sold to each plaintiff should have been without prejudice and with leave to amend. *See generally, e.g., District Council 47, American Federation v. Bradley*, 795 F.2d 310, 316 (3d Cir. 1986); *Cortec Industries, Inc. v. Sum Holding*

637; *see also Moore v. Kayport Package Express, Inc.*, 885 F.2d 531, 538–39 (9th Cir. 1989) ("While this is not a model form of pleading a section 12(2) claim, it satisfies the short and plain statement rule of Rule 8(a)(2) which provides that a pleading which sets forth a claim for relief shall contain 'a short and plain statement of the claim showing that the pleader is entitled to relief.' ") (citation omitted); *In re Chambers Development Securities Litigation*, 848 F.Supp. 602, 625 (W.D.Pa.1994) (sustaining section 12(2) allegations not unlike those in this case); *Miller v. New America High Income Fund*, 755 F.Supp. 1099, 1105 (D.Mass.1991) ("Applying the appropriate standard of scrutiny for a Rule 12(b)(6) motion, a set of facts establishing the underwriter defendants as 'sellers' is clearly plausible, although the plaintiffs must later produce facts to prove the underwriter defendants' actual participation in the activity.") (citation omitted), *aff'd*, 36 F.3d 170 (1st Cir.1994). We therefore reverse the district court's order dismissing the section 12(2) claims against the underwriter defendants.

VII.

After defendants filed the motions to dismiss that led to *Westinghouse II*, plaintiffs cross-moved to supplement the second amended complaint. *See* App. 1582–83. Plaintiffs sought to add an additional alleged misrepresentation—Lego's alleged October 1990 statement that Westinghouse had only an immaterial amount of restructured receivables.

[31] Plaintiffs' motion is not discussed at any length in *Westinghouse II*. It is addressed in one sentence of the opinion and one sentence of the order. *See Westinghouse II*, Op. at 21, App. 330 (dismissing second amended complaint under rule 8; granting plaintiffs 30 days within which to replead surviving claims in compliance with rule 8; and denying as moot the cross-motion to supplement); *Westinghouse II*, Order at 35, App. 344 ("Plaintiffs' cross-motion to supplement the Second Amended Complaint (Docket No. 174) is denied as moot."). In their brief on appeal, plaintiffs state that "[t]he only possible basis for the finding of mootness was the blanket dismissal of the Second Complaint under Rule 8." Plaintiffs' Br. at 47. It seems to us that this is in fact why the district judge dismissed the motion as moot—because plaintiffs were presumably going to be submitting a third amended complaint and would include the newly-discovered allegation in that complaint.

We find no abuse of discretion in this ruling. The plaintiffs could have included (and were expected to include) the allegation at issue in the third amended complaint. They chose not to submit that complaint. The allegation at issue is relevant to claims that survived the district court's orders in *Westinghouse I* and *Westinghouse II*, claims that were dismissed with prejudice under Rule 8 only after plaintiffs' decision to stand on the second amended complaint. Plaintiffs therefore abandoned this allegation when they chose not to submit a third amended complaint.

VIII.

[32] Plaintiffs argue that on remand this case should be reassigned to a new district court judge. Plaintiffs rely primarily upon the following statement from *Westinghouse I*:

> In the early 1980's, WCC hit its stride when it tapped into the booming commercial and residential real estate markets.
>
> Such success, however, was short-lived. WCC's fortunes collapsed along with the real estate market in the late–1980's, and the price of Westinghouse stock tumbled during the class period from a high of $39.75/share to a low of $15.875/share.

L.P., 949 F.2d 42, 48 (2d Cir.1991) (dismissal for curable pleading defect should generally be without prejudice and with leave to amend), *cert. denied*, 503 U.S. 960, 112 S.Ct. 1561, 118 L.Ed.2d 208 (1992). At oral argument, defense counsel indicated that the dismissal of these claims may have been with prejudice because the claims were dismissed with prejudice on the independent "bespeaks caution" ground. We have already reversed that determination, and we now hold that even assuming that the district court properly found plaintiffs' complaint lacking for failure to specify which underwriter sold to each plaintiff, it should have dismissed the claims without prejudice and with leave to amend.

> Now, like so many lending institutions battered by the late–1980's real estate bust, Westinghouse, along with its outside accountant and investment bankers, is defending against shareholders who allege that the company made false and misleading statements regarding the health of its financial services units, thereby artificially inflating the price of Westinghouse stock and damaging plaintiffs who purchased that stock at what they claim to have been an artificially high price.

Westinghouse I, 832 F.Supp. at 958 (citations omitted).

According to plaintiffs, "[t]his statement suggests that plaintiffs' claims have no merit and that their damages were caused not by defendants' fraud, but by an economic environment visited on defendants." Plfs' Br. at 48. Plaintiffs argue that although it was proper for the judge to take judicial notice of the downturn in the real estate market, "it was improper for [the judge] to attribute plaintiffs' extensive damages to this trend rather than to defendants' fraudulent scheme as alleged in the Complaints." Plfs' Rep. Br. at 24. Plaintiffs seem to us to read too much into the judge's statement, and we note that the district judge's comment was not unlike others found in other reported decisions. *See, e.g., UJB,* 964 F.2d at 274 ("This case is one of a number of federal securities actions against financially troubled banking institutions. After a sharp downturn in the financial condition of defendant UJB Financial Corporation, its shareholders filed a complaint[.]"); *see also Serabian v. Amoskeag Bank Shares, Inc.,* 24 F.3d 357, 360 (1st Cir.1994) ("The complaint depicts an increasingly familiar saga of a bank that boomed with the real estate market of the early 1980s, but suffered in the recession and deteriorating market that followed.") (citations omitted).

As in *United States v. Bertoli,* 40 F.3d 1384, 1412 (3d Cir.1994), plaintiffs here make "no allegation that [the district judge] derived his bias from an extrajudicial source." Rather, all the incidents cited involve rulings and statements made in deciding motions. "Thus, these incidents will not support recusal unless, looked at objectively, 'they display a deep-seated favoritism or antagonism that would make fair judgment impossible.' " *Id.* (quoting *Liteky v. United States,* 510 U.S. 540, 555, 114 S.Ct. 1147, 1157, 127 L.Ed.2d 474 (1994)). Plaintiffs have not identified anything suggesting such a favoritism or antagonism, and our review of the record reveals none. Finally, we note that, as a practical matter, the judge sustained a number of the section 10(b) claims asserted in count I in both *Westinghouse I* and *Westinghouse II.* For these reasons, we reject all of plaintiffs' contentions raised in support of their reassignment argument. We wish to emphasize that requesting reassignment is a grave step; it should not be taken lightly or for the purpose of seeking some strategic advantage.

IX.

For the foregoing reasons, we affirm in part and reverse in part the district court's orders entered on July 29, 1993 (*Westinghouse I*), January 23, 1995 (*Westinghouse II*), and March 1, 1995 (Memorandum Order dated 2/28/95), and we remand for further proceedings consistent with this opinion.

Margaret GARES

v.

WILLINGBORO TOWNSHIP; Willingboro Township Council; Willingboro Township Police Dept.; Gary Owens, Willingboro Township, Appellant.

No. 95–5269.

United States Court of Appeals,
Third Circuit.

Argued Dec. 8, 1995.

Decided July 23, 1996.

Female former employee brought sexual harassment claim against township, her former employer. The United States District

REFLECTIONS ON THE WESTERN DISTRICT OF PENNSYLVANIA

Select materials on Circuit Judge Thomas Hardiman

es that the Neutrality Agreement is void because it was entered into under economic duress. This economic duress was allegedly caused by the City's threat to revoke its contribution toward the $3.6 million in TIF.

[6] In order to raise the defense of duress, a party must prove three elements: (1) a wrongful threat; (2) fear that induces a loss of free will and judgment; and (3) that there was no immediate legal remedy available as an alternative to executing the agreement. *Warner–Lambert Pharmaceutical Co. v. Sylk*, 471 F.2d 1137, 1143 (3d Cir.1972); *Levin v. Garfinkle*, 492 F.Supp. 781, 807 (E.D.Pa.1980), aff'd, 667 F.2d 381 (3d Cir.1981).

[7, 8] Defendant's assertion of economic duress amounts to little more than a conclusory statement without adequate support. Financial distress is not enough to necessitate a finding of economic duress. *See Harsco Corp. v. Zlotnicki*, 779 F.2d 906, 911 (3d Cir.1985). Also, there is a presumption under Pennsylvania law against finding duress where a party is free to consult with legal counsel. *Carrier v. Wm. Penn Broadcasting, Co.*, 426 Pa. 427, 233 A.2d 519, 521 (1967). Defendant's own timeline of events proves that this case lacks the immediacy needed to find economic duress.

[9, 10] Furthermore, economic duress merely makes a contract voidable, not void. *Agathos v. Starlite Motel*, 977 F.2d 1500, 1506 (3d Cir.1992). Even if economic duress could be shown at the time of formation, the undisputed facts of the case show that defendant never complained of duress until plaintiff attempted to procure defendant's participation in the card check. By remaining silent, defendant ratified the contract. A party cannot sit idly by and receive benefits under a contract and then later raise claims of economic duress. *Seal v. Riverside Savings Bank*, 825 F.Supp. 686, 696 (E.D.Pa.1993) (citing *National Auto Brokers Corp. v. Aleeda Dev. Corp.*, 243 Pa.Super. 101, 364 A.2d 470, 476 (1976)).

IV. *CONCLUSION*

For the reasons stated above, we find that defendant cannot avoid the Neutrality Agreement. Because the parties concede that the agreement, if valid, requires that the parties' dispute be resolved in arbitration, we find that plaintiff's requested order to compel arbitration should be granted. Plaintiff's motion for summary judgment is granted. Defendant's motion for summary judgment is denied. The parties are ordered to resolve their dispute through arbitration. The clerk shall mark the docket as closed.

VIAD CORPORATION, Plaintiff,

v.

C. Alan CORDIAL, Clifford Hellberg, and Calan Communications, Inc., Defendants.

No. CIV.A.03–1408.

United States District Court, W.D. Pennsylvania.

Dec. 24, 2003.

Background: Employer brought diversity action against former employees alleging breach of covenant not to compete.

Holdings: On employer's motion for preliminary injunction, the District Court, Hardiman, J., held that:

(1) former employees' efforts to develop software that could have been sold to exhibit houses did not constitute "aiding" competitors under covenant not to compete, and

(2) employer failed to show that it would suffer irreparable injury by alleged breach of covenant not to compete.

Motion denied.

1. Federal Courts ⇐412.1

Federal law governed whether preliminary injunction was appropriate, although request for injunctive relief was based on state law cause of action, i.e., breach of restrictive covenants ancillary to the sale of a business. Fed.Rules Civ.Proc.Rule 65(a), 28 U.S.C.A.

2. Injunction ⇐138.1

To obtain a preliminary injunction, the moving party must prove likelihood of success on the merits of its claim and irreparable harm if relief is not granted; if these first two threshold showings are made, a court must then consider, to the extent relevant, whether an injunction would harm the defendant more than denying relief would harm the plaintiff and whether granting relief would serve the public interest.

3. Federal Courts ⇐409.1

A federal court sitting in diversity is bound by the choice of law rules of the forum state.

4. Contracts ⇐202(2)

Under Pennsylvania law, restraints on trade are strictly construed, and must be carefully reviewed to assure that they are reasonable.

5. Contracts ⇐116(2)

Generally, a restrictive covenant may be enforced under Pennsylvania law if it is ancillary to the sale of a business and if it is necessary to protect the legitimate interests of the purchaser of a business.

6. Contracts ⇐65(2), 116(2), 117(3)

To be enforceable under Pennsylvania law, a covenant not to compete must be: (1) ancillary to an employment contract or to a contract for the sale of goodwill or other subject property; (2) supported by adequate consideration; (3) reasonably necessary to protect legitimate interests of the purchaser; and (4) reasonably limited in duration and geographic extent.

7. Contracts ⇐141(1)

Under Pennsylvania law, the party accused of breaching a covenant not to compete has the burden of proving that the covenant is unreasonable.

8. Contracts ⇐117(4)

Geographic scope of non-compete clause that included all of North America was reasonable under Pennsylvania law, where employer marketed and sold its products and services to customers throughout the United States and Canada, and agreement only limited employee's ability to work for or aid employer's competitors, or solicit employer's customers in North America.

9. Contracts ⇐116(2)

Restrictive covenants ancillary to sale of business were reasonably necessary under Pennsylvania law for protection of purchaser's legitimate business interests, to extent that purchaser sought to preserve customer relationships and goodwill, where part of seller's job with purchaser before and after purchase was to nurture and develop goodwill with existing and potential customers in order to secure contractual business relationships.

10. Contracts ⇐147(2)

If the language of a contract is unambiguous and susceptible of only one inter-

pretation under Pennsylvania law, a court will determine the parties' intentions on the basis of the clear wording of the contract.

11. Contracts ⚿312(4)

Former employees' efforts to develop software that could have been sold to exhibit houses did not constitute "aiding" competitors under covenant not to compete under Pennsylvania law, although employees took overt acts that laid groundwork to aid competitors of employer who was engaged in exhibit house industry; employer failed to show that employees actually aided employer's competitors or that such aid was forthcoming prior to expiration of restrictive covenant.

12. Injunction ⚿138.39

Employer failed to show on motion for preliminary injunction that it would suffer irreparable injury by alleged breach of covenant not to compete by former employees, on allegation that it stood to lose its "competitive advantage" in industry if former employees were not enjoined.

13. Injunction ⚿138.6

A preliminary injunction cannot be granted absent a showing of irreparable harm.

14. Injunction ⚿138.6

In order to prove irreparable harm, as required for a preliminary injunction to issue, a moving party must demonstrate potential harm which cannot be redressed by a legal or an equitable remedy following trial.

15. Injunction ⚿138.6

In order for a preliminary injunction to issue, more than the mere risk of irreparable harm must be demonstrated; the moving party must demonstrate that the alleged harm is imminent, not merely in the indefinite future.

16. Injunction ⚿147

Although irreparable harm is by its nature unquantifiable, it is nevertheless incumbent upon the moving party to make a clear showing that the threat of loss, however undefined, is both immediate and a presently existing actual threat, in order for a preliminary injunction to issue.

Timothy P. Ryan, Daniel B. McLane, Eckert, Seamans, Cherin & Mellott, Pittsburgh, PA, Sid Leach, Snell & Wilmer, Phoenix, AZ, for plaintiff.

Robert M. Linn, Alyze L. Pierce, Cohen & Grigsby, Pittsburgh, PA, for defendants.

OPINION

HARDIMAN, District Judge.

Introduction

This case involves claims of unfair competition brought by Viad Corporation ("Viad") against two of its former employees, C. Alan Cordial ("Cordial") and Clifford E. Hellberg ("Hellberg") and the company they founded, calan communications ("calan"). Cordial and Hellberg were employed by a division of Viad known as Exhibitgroup, which is one of the nation's largest exhibit houses. The gravamen of Viad's Complaint is that Defendants Cordial and Hellberg violated contracts which prohibited them from competing with Exhibitgroup directly or indirectly, or aiding its competitors, for a period of one year following the termination of their employment. On December 3 and 4, 2003, the Court held a hearing on Plaintiff's Motion for Preliminary Injunction at which the parties were represented by counsel who tried the matter skillfully and efficiently. For the reasons that follow, Plaintiff's Mo-

tion for Preliminary Injunction will be denied.

Findings of Fact

Based on the testimony and documents admitted into evidence, and upon consideration of the proposals and stipulation submitted by the parties, the Court makes the following findings of fact:

1. Plaintiff Viad commenced this action by Complaint on September 23, 2003. On October 22, 2003, Viad filed the Motion for Preliminary Injunction that is the subject of this Opinion.

2. Viad is a Delaware corporation with its principal place of business at 1850 North Central Avenue, Phoenix, Arizona 85077. (Second Joint Proposed Findings of Fact for Preliminary Injunction Hearing, hereafter "Stip." ¶ 1). According to its Form 10–K for Fiscal Year Ending December 31, 2002, Viad had total revenues of over $ 1.6 billion.

3. This action involves a division of Viad called Exhibitgroup/Giltspur ("Exhibitgroup"). (Stip.¶ 4). Exhibitgroup accounted for $217 million of Viad's $1.6 billion in total annual revenue (or approximately 13.5%). (Trial Transcript ("Tr."), Vol. I at p. 96, ll. 21–23).

4. Exhibitgroup is an exhibit house that provides services to companies participating in trade shows and conventions, including exhibit design, construction, transportation, installation and storage. (Stip.¶ 5).

5. Exhibitgroup has approximately 800–1,000 employees, with operations in more than a dozen locations in the United States, Canada and Europe. (Stip.¶ 6).

6. Defendant calan communications is a Pennsylvania corporation with a registered address at the residence of Defendant Hellberg, 319 Blue Run Road, Cheswick, Pennsylvania 15024. Calan was incorporated in late March, 2003 by Defendants Cordial and Hellberg, as well as former Exhibitgroup Vice–President of Sales and Marketing, Cindy Provencher ("Provencher"). (Stip. ¶¶ 20, 21; Cordial Aff. ¶ 4; Hellberg Aff. ¶¶ 3–4). Calan has three principals and no other employees. (Stip.¶ 21).

7. Calan is in the business of developing computer software programs that will be marketed to exhibit houses and companies with similar software needs in other industries. (Stip. ¶ 22; Cordial Aff. ¶ 6; Hellberg Aff. ¶ 6).

8. Calan is not an exhibit house. It does not design, or construct exhibits, and does not sell products or services to any of Exhibitgroup's customers. (Cordial Aff. ¶ 7; Hellberg Aff. ¶ 7).

9. Defendant Cordial is an individual residing at 405 Fern Hollow Lane, Wexford, Pennsylvania 15090. (Stip.¶ 2). Cordial has more than 27 years of experience in the exhibit house industry, and gained extensive experience, skill and expertise in marketing and customer account management. (Cordial Aff. ¶ 10).

10. Defendant Hellberg has 21 years of experience in the exhibit house industry and in sales, marketing and business management. (Hellberg Aff. ¶¶ 11–12). Hellberg also has substantial skill, experience and expertise in computer software program development. *Id.*

11. Prior to February 22, 2000, Cordial and Hellberg were both employees and shareholders of a Pittsburgh-area company called Gardner Displays Company ("GDC"), which conducted business under the trade name of Creative Productions. (Stip.¶ 7). Like Exhibitgroup, GDC was in the business of designing, constructing and installing exhibits for companies planning to promote or display their products or services at trade shows and similar events. (Cordial Aff. ¶ 9).

12. Cordial was employed by GDC from 1981 through February 22, 2000, (Stip.¶ 8), serving as President from 1997 to 2000. (Cordial Aff. ¶ 10). At GDC, Cordial secured and managed major customer accounts. *Id.*

13. Cordial has been active as a member of the board of directors of the Exhibit Designers & Producers Association, an exhibit house trade group. (Cordial Aff. ¶ 11). In that capacity, Cordial gained substantial exposure to the use of software targeted at the exhibit house industry, including a broad range of commercial computer software providers. *Id.*

14. Hellberg was employed by GDC from 1989 through February 22, 2000. (Stip.¶ 9). He was promoted to General Manager of GDC in 1998. (Hellberg Aff. ¶ 13).

15. During his employment at GDC, Hellberg managed customer accounts and oversaw the development and writing of a GDC software program that was used to coordinate customer services and facilitate accounting of expenditures (the "GDC software program"). (Hellberg Aff. ¶ 14).

16. The GDC software program also made it possible to work collaboratively with customers on documents, including exhibit plans. (Hellberg Aff. ¶ 15).

17. GDC had developed software useful in designing, building, and installing convention, trade show, museum and other exhibits and displays. The GDC software program allowed the company to compete effectively with larger companies like Exhibitgroup. (Tr., Vol. I at pp. 10–11).

18. The GDC software program was developed for and in cooperation with the Ford Motor Company, which was then a major GDC customer. (Hellberg Aff. ¶ 16). The use of the software was later expanded to other GDC customers. *Id.*

19. In 1994, Ford moved its business from GDC to a competitor company called Exhibit Works. As part of that transition, the functions and capabilities of GDC's software program were fully disclosed in or about 1994. (Hellberg Aff. ¶ 17).

20. From 1989 through February, 2000, GDC increased its annual revenues from approximately $8 million to more than $30 million. (Cordial Aff. ¶ 12; Hellberg Aff. ¶ 18).

21. By February 2000, GDC was one of the leading exhibit houses in Western Pennsylvania and serviced valuable national accounts, including, Sony, AT & T, Mitsubishi, Volvo and Polaroid. (Cordial Aff. ¶ 12; Hellberg Aff. ¶ 19). Cordial's accounts at GDC collectively generated $17 million of GDC's annual revenue. (Cordial Aff. ¶ 12).

22. Exhibitgroup first proposed a potential merger of Exhibitgroup and GDC in 1998. (Cordial Aff. ¶ 13; Hellberg Aff. ¶ 20). After subsequent negotiation, Exhibitgroup and GDC entered into a Merger Agreement on February 22, 2000. (Stip.¶ 10).

23. Pursuant to the terms of the Merger Agreement, Exhibitgroup paid $22,000,000 to acquire all the assets of GDC. As GDC shareholders, Hellberg received $3,672,461 and Cordial received $978,099 pursuant to the merger. (Stip.¶ 11).

24. GDC's shareholders understood that Exhibitgroup wanted to acquire the company in order to obtain its customer accounts and goodwill. (Cordial Aff. ¶ 14; Hellberg Aff. ¶ 23), and that the GDC software program was not a significant factor in the negotiations between the parties to the merger. (Ex. 3; Cordial Aff. ¶ 14; Hellberg Aff. ¶ 23).

25. GDC's shareholders expressly represented to Exhibitgroup that the GDC

software program was not a trade secret. (Ex. A, Schedule 4.1(k)). Specifically, the Merger Agreement's description of the intangible assets being acquired by Exhibitgroup stated that the management of GDC believed and represented that the technical and business information collected by GDC during its 60 years' of operation was not, "in and of itself, a material invention, development, discovery, technology, improvement, process, formula, design [or] trade secret . . . which is licensed to or owned in whole or in part by the Company." *Id.*

26. In connection with the merger, Cordial and Hellberg were offered employment at Exhibitgroup to help ensure that GDC's former clients did not defect to Exhibitgroup competitors. (Cordial Aff. ¶ 16; Hellberg Aff. ¶ 25).

27. On February 22, 2000, Cordial entered into an Employment, Covenant Not to Compete and Confidentiality Agreement with Exhibitgroup ("Cordial Contract"), pursuant to which he was named Senior Vice President—Strategic Global Accounts, reporting to the President and Chief Executive Officer. (Stip.¶ 12). Cordial later served as Executive Vice President of Sales and Marketing for Exhibitgroup. (Cordial Aff. ¶ 20).

28. Cordial's Contract provided an initial employment term with Exhibitgroup of three years, from February 22, 2000 until February 21, 2003. (Stip.¶ 13).

29. Like Cordial, Hellberg entered into an Employment, Covenant Not to Compete and Confidentiality Agreement ("Hellberg Contract") on February 22, 2000, pursuant to which he was named Vice President of Operations for the Pittsburgh region. (Stip.¶ 14).

30. Hellberg's Contract provided an initial employment term with Exhibitgroup of three years, from February 22, 2000 until February 21, 2003. (Stip.¶ 15).

31. Both Cordial and Hellberg each executed an agreement entitled "Joinder to Merger Agreement," by which they agreed to join in and be bound by the terms of the Merger Agreement. (Ex. 9).

32. A material portion of the consideration paid to Cordial and Hellberg pursuant to the Merger Agreement and their employment agreements (collectively, the "Employment Agreements") was paid in order to obtain the restrictive covenants. (Exs. B and C at § 8.1).

33. The Employment Agreements defined the term "Employer's Business" as follows: "[Exhibitgroup] designs, builds and installs convention, trade show, museum and other exhibits and displays." (Exs. B and C at Recitals, ¶ B). The Employment Agreements incorporated by reference the definition of GDC's Business from the Merger Agreement. (Exs. B and C at Recitals, ¶ A and Definition, § 1). The Merger Agreement, in turn, defined GDC's "Business" as: "the design, engineering, fabrication, shipment, installation, dismantling and storage of trade show exhibit and trade show displays." (Ex. A, Schedule 1.1).

34. The Employment Agreements also provide, in pertinent part:

Non–Competition Covenants:

> Employee hereby covenants and agrees that for a period of three (3) years following the Closing [of the Merger] and for an additional period of one (1) year thereafter or, if longer, for a period of one (1) year following expiration of the [three-year] Term . . . Employee shall not, within the E/G Business Territory, engage directly or indirectly, either for himself or for another, or as an employee, partner, consultant, affiliate, or controlling shareholder of any person or entity so engaged, in any business that owns or operates any activity which

competes with the Business or Employer's Business, nor compete, or aid another to compete, nor solicit or induce any other employee of Employer or GDC to terminate employment with Employer or GDC or compete in any way with the Business or Employer's Business.

(Exs. B and C at § 8.1).

35. When Cordial and Hellberg joined Exhibitgroup, the company indicated that it planned to expand the GDC software program and invest in improvements to expand its capabilities. (Cordial Aff. ¶ 27; Hellberg Aff. ¶ 35). Those plans were not carried out. *Id.*

36. The GDC software did not have the capacity to support additional users, and was incompatible with Exhibitgroup's existing technology. (Hellberg Aff. ¶ 35). Accordingly, the use of the GDC software was phased out by Exhibitgroup. (Cordial Aff. ¶ 27; Hellberg Aff. ¶ 36; Tr., Vol. II at pp. 180–82).

37. Instead of using the GDC software as a platform for further software development, Exhibitgroup developed separate technology, employing third-party vendors to write the programs. (Cordial Aff. ¶ 28; Hellberg Aff. ¶ 37).

38. Cordial provided written notice on January 16, 2003 that he expected to leave Exhibitgroup's employ when his Employment Agreement expired on February 22, 2003. (Cordial Aff. ¶ 39). Exhibitgroup did not ask Cordial to reconsider or offer him any position in the company. *Id.* ¶ 40.

39. On or about February 20, 2003, Cordial informed Exhibitgroup management, including its President and CEO Kim Fracalossi ("Fracalossi"), that he was considering forming a new company to develop on-line software applications that would be offered to exhibit houses. *Id.* ¶ 41.

40. At the same meeting, Cordial discussed his plans to conduct a survey to determine whether there was a market for such software and to determine what functions and capabilities were attractive to the market (the "Survey"). *Id.* ¶ 42. The Survey was designed to gauge the viability of entering the software market. *Id.*

41. Also at the same meeting, Cordial invited Exhibitgroup to participate in the Survey. (Stip.¶ 17). Ms. Fracalossi instructed Mr. Cordial to meet the following day with Exhibitgroup's Chief Information Officer, Stephen Barry ("Barry"), to discuss the Survey. (Cordial Aff. ¶ 44). Ms. Fracalossi authorized Mr. Barry to "do the survey and help with the gap analysis." (Tr., Vol. I at p. 70, ll. 23–25, p. 71, l. 1). On February 21, 2003, Mr. Cordial met with Mr. Barry and described his idea for the proposed Survey. (Cordial Aff. ¶ 44). Neither Mr. Barry nor any other Exhibitgroup representative objected to Cordial's proposal; to the contrary, they at least tacitly encouraged him to pursue his plans further by advising him that Exhibitgroup might purchase software from Mr. Cordial's new company. *Id.*

42. Exhibitgroup formally terminated Hellberg's employment by letter dated February 18, 2003 and signed by Ms. Fracalossi. (Ex. H). Mr. Hellberg had asked to continue working for Exhibitgroup, but was advised that his employment was terminated. (Exs. G and H).

43. Upon their departure, Cordial and Hellberg did not remove or retain copies of any Exhibitgroup software and do not have in their possession any codes, program copies, backup tapes or documentation relating to any Exhibitgroup software program. (Cordial Aff. ¶ 36; Hellberg Aff. ¶ 47; Tr., Vol. II at p. 159, ll. 10–20; p. 174, ll. 15–24).

44. During the week following February 22, 2003, Cordial, Hellberg and Pro-

vencher met to formulate the Survey. (Cordial Aff. ¶ 47; Hellberg Aff. ¶ 51).

45. Neither Cordial nor Hellberg had discussions with Provencher about going into business together prior to Provencher's resignation from Exhibitgroup in January 2003. (Provencher Aff. ¶ 6; Cordial Aff. ¶ 48; Hellberg Aff. ¶ 52).

46. In a March 14, 2003 letter to participants in the Survey, including Exhibitgroup, Cordial stated calan was exploring market interest in software that would provide customer collaboration, account management and e-commerce capabilities to purchasers or users. (Cordial Aff. ¶ 50, and Cordial Letter, attached thereto as Exhibit 2; Shockley Aff. ¶¶ 4–10; Gentile Aff. ¶¶ 4–10; Montague Aff. ¶¶ 4–10).

47. Cordial conducted the Survey beginning on March 15, 2003, and contacted approximately 20 exhibit houses, including Exhibitgroup. (Cordial Aff. ¶ 49). Exhibitgroup provided detailed responses to the Survey, identifying (1) the features and capabilities of its software; and (2) the features it would like to see included in a commercially available product. (Ex. K). The results of the Survey were incorporated into a white paper, copies of which were given to each participant, including Exhibitgroup. (Stip.¶ 18).

48. On March 25, 2003, calan communications issued a press release announcing that it was working on the development of software for use by exhibit houses. (Ex. 8). The March 25, 2003 press release quotes Hellberg as follows: "It is no longer necessary for trade show/event suppliers to write expensive, customized code in an attempt to meet the requirements of their customers. Trade show/event suppliers are not in the software development business, but until now they had no choice but to develop their own technology solutions." (Exs. 8 and 11).

49. Calan thereafter hired a third-party to write software based on concepts developed through the Survey and from Defendants' independent review of publicly available information about current technologies. The company hired to write the software for calan was not involved in formulating or writing the GDC software program. (Cordial Aff. ¶ 55; Hellberg Aff. ¶ 53).

50. Calan's product, which is called "e-info," is expected to have applications within the exhibit house industry and in other industries, including building trades and the museum, advertising, marketing and public relations industries. (Cordial Aff. ¶ 57; Cordial Aff. ¶ 55).

51. E-info is neither on the market nor has calan entered into any contracts to sell or lease the software. (Cordial Aff. ¶ 58; Cordial Aff. ¶ 55).

52. Although the software that is being developed by Cordial, Hellberg and calan communications does not compete with Exhibitgroup, either directly or indirectly, one of its purposes is to provide information technology solutions that would enable event industry suppliers to compete with Exhibitgroup. (Ex. 11).

53. The software being developed by Cordial and Hellberg is designed to give Exhibitgroup's competitors, *inter alia*, access to state of the industry technology, enabling them to manage corporate customers' events programs in a collaborative, on-line environment where all of the numerous providers needed for a successful event can share scheduling and budgetary information. (Exs. 8 and 11).

54. The competitive impact of the software that is being developed by calan was described by Cordial in an article that appeared in the July/August 2003 issue of Exhibit Builder magazine as follows:

> In the current climate, client demand is for deployment and improvement of e-tool offerings to manage exhibit programs. As a matter of fact, in an independent survey conducted by calan communications, 86% of all exhibit houses interviewed had received such a request by at least one of their customers in the recent past. As more of their clients request technology, exhibit builders are looking for solutions to respond appropriately.
>
> It is clear that e-tools are becoming an expectation on the part of exhibit house customers. For medium sized and even smaller portable display distributors, e-tools can change the competitive landscape because these companies can deliver services once offered only by their larger competitors. Although capabilities to meet client expectations vary by company, recognition of the importance of offering technology applications for program management is almost universal.
>
> (Ex. 10 at p. 3).

55. Cordial further described the competitive landscape as follows:

> Why e-tools? There are many reasons.
>
> First of all, if customers are asking for such technology, their demands can be ignored only at the risk of losing competitive advantage. Secondly, an exhibit house will be able to improve customer service and internal communications on a 24/7 basis. Technology is not time-dependent—and as global programs become more and more the norm, access to program elements can be available at all times. And finally, technology is an integral part of daily reality for all of us, no matter what our business segment. As suppliers and strategic partners, exhibit builders cannot afford to look less technologically sophisticated than the client base they serve.

Id.

56. Cordial also indicated that technology such as the software calan is developing has made a difference between winning and losing business:

> Exhibit houses have reported that e-tool capabilities have made a difference between winning and losing business: 80% of the $20M+ houses and 40% of the 10–20M houses claim to have won business because of e-tools, while 20% of the 20M+ exhibit houses say they have lost business because of lack of the correct electronic capabilities.

Id. at 5.

57. Finally, Cordial stated that "e-tools are becoming increasingly state-of-the-art in managing programs, creating a demand for the exhibit builder to provide these services." *Id.* He concluded: "Regardless of the direction a company chooses, the data points to an inevitable conclusion: to survive in a highly competitive environment, exhibit builders are going to not only offer Web-enabled technology but embrace it and link it to internal systems. Customers expect nothing less." *Id.*

58. On June 11, 2003, while e-info was still in its early stages of development, calan performed an on-line demonstration for companies that had participated in the Survey, including Exhibitgroup. (Cordial Aff. ¶ 59). Exhibitgroup representatives, including its Chief Information Officer, Mr. Stephen Barry, viewed the demonstration. (*Id.*; Barry Aff. ¶ 6).

59. The software calan is developing is not currently targeted toward and is not being marketed to customers of Exhibitgroup. (Cordial Aff. ¶ 60; Hellberg Aff. ¶ 56).

60. To the extent the calan software performs functions that overlap with Exhi-

bitgroup programs eg@work, EgXpress or the Exhibitgroup Workflow Software, those "similarities" relate solely to features that are widely available in existing "off-the-shelf" programs that are currently on the market and already available to Exhibitgroup's competitors. (Cordial Aff. ¶ 63).

61. Although Exhibitgroup had been aware since at least March 2003 that Defendants intended to develop software marketed to, *inter alia*, the exhibit design industry, Exhibitgroup did not advise Defendants until on or about August 11, 2003 that it believed they were violating their non-compete covenants. (Cordial Aff. ¶ 64; Hellberg Aff. ¶ 58).

62. Since leaving Exhibitgroup's employ, Cordial and Hellberg have made a substantial personal investment of funds and time in the development of e-info, in reliance on Exhibitgroup's expressions of support and its failure to object to the venture. (Cordial Aff. ¶ 65; Hellberg Aff. ¶ 60). Cordial has invested over $500,000 in calan during the past year. (Tr., Vol. II at p. 74, ll. 20–22).

63. Defendants Cordial and Hellberg acted in good faith vis-à-vis Exhibitgroup during their employment, after their departure from Exhibitgroup, and in conjunction with the formation of calan communications. (Tr., Vol. II at p. 24, ll. 8–21).

64. To her credit, Exhibitgroup President and CEO Kim Fracalossi testified candidly that neither Exhibitgroup nor Viad can demonstrate any lost revenue or the loss of any existing customers as a result of the Defendants' conduct. (Tr., Vol. I at p. 97, ll. 21–24).

65. In its Form 10–Q filed November 13, 2003 for the period ending September 30, 2003, Viad did not disclose any potential loss as a result of Defendants' conduct. (Ex. M).

66. The restrictive covenants signed by Cordial and Hellberg will expire by their own terms on February 22, 2004. (Stip.¶ 19).

Discussion

I. Legal Standards for Injunctive Relief

[1] An injunction "is an 'extraordinary remedy, which should be granted only in limited circumstances.'" *Instant Air Freight Co. v. C.F. Air Freight, Inc.*, 882 F.2d 797, 800 (3d Cir.1989) (*quoting Frank's GMC Truck Center, Inc. v. General Motors Corp.*, 847 F.2d 100, 102 (3d Cir.1988)). Although Viad's request for injunctive relief is based on a state law cause of action, *viz.*, breach of restrictive covenants ancillary to the sale of a business, federal law governs whether an injunction is appropriate:

> We utilize a federal standard in examining requests to federal courts for preliminary injunctions.... 'Although the right upon which this cause of action is based is state-created, Rule 65(a) of the Federal Rules of Civil Procedure contemplates a federal standard as governing requests addressed to federal courts for preliminary injunctions.'

Instant Air Freight Co., 882 F.2d at 799 (*quoting System Operations, Inc. v. Scientific Games Dev. Corp.*, 555 F.2d 1131, 1141 (3d Cir.1977)).

[2] To obtain a preliminary injunction, the moving party must prove four things: (1) likelihood of success on the merits of its claim and (2) irreparable harm if relief is not granted; if these first two threshold showings are made, the Court must then consider, to the extent relevant, (3) whether an injunction would harm the defendant more than denying relief would harm the plaintiff and (4) whether granting relief

would serve the public interest. *A.C.L.U. v. Ashcroft*, 322 F.3d 240, 250 (3d Cir. 2003); *Acierno v. New Castle County*, 40 F.3d 645, 653 (3d Cir.1994).

A. Likelihood of Success on the Merits

[3] In order to satisfy the exacting standard necessary for the imposition of injunctive relief, Viad must demonstrate a reasonable likelihood of success on the merits. To determine whether Viad is likely to succeed on the merits of its claim for breach of Defendants' Employment Agreements, the Court must first determine whether, under Pennsylvania law, the non-competition covenants at issue are enforceable, and if they are, whether Defendants have breached them. *See, e.g., Westec Security Services, Inc. v. Westinghouse Electric Corp.*, 538 F.Supp. 108, 117 (E.D.Pa.1982).[1]

[4] Restrictive covenants are disfavored under Pennsylvania law because they are restraints on trade that "clash .... with the common law's policy of encouraging free competition." *Id. (citing Hayes v. Altman*, 438 Pa. 451, 266 A.2d 269, 271 (1970)). As such, they are strictly construed, and must be carefully reviewed to assure that they are reasonable. *Morgan's Home Equipment Corp. v. Martucci*, 390 Pa. 618, 136 A.2d 838, 846 (1957); *see also Westec*, 538 F.Supp. at 121. When non-competition covenants are executed ancillary to the sale of a business, however, they are held to a less "stringent test of reasonableness" than those that are merely ancillary to employment contracts. *Id. (citing Alabama Binder & Chem. v. Pennsylvania Indus. Chem.*, 410 Pa. 214, 189 A.2d 180, 184 (1963)).

[5] The determination of whether a restrictive covenant is reasonable, and therefore enforceable, requires the court to consider all the facts and circumstances. *See Insulation Corp. of America*, 446 Pa.Super. 520, 667 A.2d 729, 734 (1995); *Jacobson & Co. v. International Environment Corp.*, 427 Pa. 439, 235 A.2d 612, 619 (1967); *see* Restatement of Contracts, § 18, Comment A. Generally, a restrictive covenant may be enforced if it is ancillary to the sale of a business and if it is necessary to protect the legitimate interests of the purchaser of a business. *Westec*, 538 F.Supp. at 121. Restrictive covenants ancillary to the sale of a business are designed to protect goodwill, in addition to physical assets and investments. *Morgan's Home Equipment*, 136 A.2d at 846.[2] These covenants promote "goodwill [as] a saleable asset 'by protecting the buyer in the enjoyment of that for which he pays.' " *Westec*, 538 F.Supp. at 121 (*quoting* 6A Corbin, The Law of Contracts, §§ 1385, 1387). Frequently, the interference with or the destruction of the goodwill purchased with the physical assets of the business is unascertainable and unquantifiable. *Geisinger Clinic v. Di Cuccio*, 414 Pa.Super. 85, 606 A.2d 509, 518 (1992) (*citing*

1. The Merger Agreement and Employment Agreements contain choice-of-law provisions expressly stating that their enforcement is governed by Pennsylvania substantive law. *See* Exs. B and C, ¶¶ 14, 19. A federal court sitting in diversity is bound by the choice of law rules of the forum state. *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941). Neither party disputes that Pennsylvania law applies here.

2. The Pennsylvania Supreme Court has expressed this rationale thusly:

> General covenants not to compete which are ancillary to the sale of a business serve the asset known as "good will" which the purchaser has bought. Indeed, in many businesses it is the name, reputation for service, reliability, and the trade secrets of the seller rather than the physical assets which constitute the inducements for a sale. Were the seller free to reenter the market, the buyer would be left holding the proverbial empty poke.

Morgan's Home Equipment, 136 A.2d at 846.

John G. Bryant Co., Inc. v. Sling Testing and Repair, Inc., 471 Pa. 1, 369 A.2d 1164 (1977)).

[6, 7] Thus, to be enforceable under Pennsylvania law, a covenant not to compete must be: (1) ancillary to an employment contract or to a contract for the sale of goodwill or other subject property, (2) supported by adequate consideration, (3) reasonably necessary to protect legitimate interests of the purchaser and (4) reasonably limited in duration and geographic extent. *Fraser v. Nationwide Mut. Ins. Co.*, 352 F.3d 107, 2003 U.S.App. LEXIS 24856 (3d Cir.2003); *Westec*, 538 F.Supp. at 121; *Piercing Pagoda, Inc. v. Hoffner*, 465 Pa. 500, 351 A.2d 207, 210 (1976); *Volunteer Firemen's Ins. Servs., Inc. v. CIGNA Property and Casualty Ins. Agency*, 693 A.2d 1330, 1337 (1997). The defendant has the burden of proving that the covenant not to compete is unreasonable. *ProtoComm Corp. v. Fluent, Inc.*, 1995 WL 3671, *1, 1995 U.S. Dist. LEXIS 40, *5 (E.D.Pa.1995); *Westec*, 538 F.Supp. at 122; *John G. Bryant Co.*, 369 A.2d at 1169.

1. The Non–Competition Covenants Signed By Defendants Are Enforceable

[8] Although the restrictive covenants at issue in this case are contained in the Employment Agreements of Cordial and Hellberg, it is clear from the evidence that these covenants were ancillary to the February 22, 2000 acquisition of GDC by Exhibitgroup. As executives and shareholders of GDC, Defendants Cordial and Hellberg exercised considerable influence over the negotiations between GDC and Exhibitgroup. Cordial testified to this influence, stating that various contractual provisions were either introduced by Defendants, or were the result of negotiations involving them. (Tr., Vol. II at p. 22, ll. 2–5, 8–11). Cordial was told by Exhibitgroup executives that the ultimate consummation of the merger was contingent upon his participation in Exhibitgroup, as he had client responsibility for major accounts of GDC, such as AT & T and Ford. (Tr., Vol. II at p. 17, ll. 6–11). Finally, Cordial and Hellberg received $978,099 and $3,672,461, respectively, pursuant to the merger. (Stip.¶ 11). Accordingly, Defendants did not deny that their non-competition covenants were supported by adequate consideration. Nor have Defendants challenged the reasonableness of the temporal or geographic scope of the restrictive covenants.[3]

[9] As to whether the restrictions are reasonably necessary for the protection of

3. Both the temporal and geographic scopes of the restrictive covenant are reasonable. Pennsylvania state and federal courts have routinely upheld one year covenants not to compete. *See, e.g., Diversey Lever, Inc. v. Hammond*, 1997 U.S. Dist. LEXIS 648, at *52, 1997 WL 28711, *1, *23 (E.D.Pa. Jan.24, 1997) (upholding employer's one year covenant not to compete), *aff'd* 116 F.3d 467 (1997); *Admiral Services, 1995 WL 134812* at *6 (upholding employer's two year covenant not to compete); *Worldwide Auditing Services, Inc. v. Richter*, 402 Pa.Super. 584, 587 A.2d 772, 776 (1991) (upholding employer's two year covenant not to compete).

Similarly, the geographic scope of the non-compete clause is reasonable as well. Exhibitgroup markets and sells its products and services to customers throughout the United States and Canada. Accordingly, restricting Cordial and Hellberg's ability to work for or aid Exhibitgroup competitors, or solicit Exhibitgroup customers in North America is reasonable. *See, e.g., QVC, Inc. v. Bozek*, 1996 U.S. Dist. LEXIS 4770, *10, 1996 WL 179993, *1, *4 (E.D.Pa. Apr.12, 1996) (upholding national geographic scope of restrictive covenant); *Kramer v. Robec, Inc.*, 824 F.Supp. 508, 512 (E.D.Pa.1992) (nationwide bar on competition reasonable "because Robec and its competitors market their products in all fifty states"); *Volunteer Firemen's Insurance Services, Inc. v. CIGNA Property and Casualty Insurance Agency*, 693 A.2d 1330 (Pa.Su-

the employer, "Pennsylvania cases have recognized that trade secrets of an employer, customer good will and specialized training and skills acquired from the employer are all legitimate interests protectable through a general restrictive covenant." *Thermo-Guard, Inc. v. Cochran*, 408 Pa.Super. 54, 596 A.2d 188 (1991). Exhibitgroup argues that enforcement of the covenant is necessary for the protection of its competitive advantage in the marketplace, as well as its client accounts and customer relationships. It stresses the testimony of Cordial, who stated that the majority of his time while employed with Exhibitgroup was spent in client development and sales presentations to major accounts. Exhibitgroup maintains that while employed, Cordial developed relationships of trust and confidence with its customers. The evidence supports the proposition that part of Cordial's job was to nurture and develop goodwill with existing and potential customers in order to secure contractual business relationships, and that he excelled in that role. (Tr., Vol. II at p. 17, ll. 5–11). Therefore, to the extent that it seeks to preserve customer relationships and goodwill purchased during the GDC merger, the restrictive covenants in the agreement are reasonably necessary for the protection of Exhibitgroup's legitimate business interests.

2. Viad Has Not Carried Its Burden Of Proving That Defendants Breached the Restrictive Covenants

[10, 11] In order to determine whether Defendants' activities constitute a breach of the non-competition covenant, we first look to the contract. *Westec*, 538 F.Supp. at 117. "If the language of the contract is unambiguous and susceptible of only one interpretation, a court will determine the parties' intentions on the basis of the clear wording of the contract." *Id.* Section 8.1 of the Employment Agreements provides:

> Employee hereby covenants and agrees that for a period of three (3) years following the Closing [of the Merger] and for an additional period of one (1) year thereafter or, if longer, for a period of one (1) year following expiration of the [three-year] Term ... **Employee shall not, within the E/G Business Territory, engage directly or indirectly,** either for himself or for another, or as an employee, partner, consultant, affiliate, or controlling shareholder of any person or entity so engaged, **in any business that owns or operates any activity which competes with the Business or Employer's Business, nor compete, or aid another to compete,** nor solicit or induce any other employee of Employer or GDC to terminate employment with Employer or GDC or compete in any way with the Business or Employer's Business.

(Exs. B and C at § 8.1) (emphasis added).

As discussed above, Exhibitgroup is an exhibit house that provides services to companies participating in trade shows and conventions, including exhibit design, construction, transportation, installation and storage. (Stip.¶ 5). The Employment Agreements defined the term "Employer's Business" as follows: "[Exhibitgroup] designs, builds and installs convention, trade show, museum and other exhibits and displays." (Exs. B and C, Recitals ¶ B).

Calan communications, by contrast, is a software development company. (Stip.¶ 22). There was no evidence introduced at the hearing to demonstrate that Defendants were in any way competing with Exhibitgroup in the "desig[n], build[ing] and install[ation] [of] convention,

per.1997) (upholding nationwide noncompete agreement).

trade show, museum and other exhibits and displays," selling such products or services to current or potential Exhibitgroup customers, or otherwise involved in the management or operations of an exhibit house competitor. The record is also devoid of evidence that Defendants are indirectly competing with Exhibitgroup, whether as intermediaries, agents or brokers to current or potential Exhibitgroup customers. Defendant Cordial testified credibly that calan has no customers, no sales contracts, and no revenue. (Tr., Vol. II at p. 74, ll. 9–15).

Although the Defendants are not competing directly or indirectly with Viad, their activities implicate the non-competition covenants of their Employment Agreements which state that "Employee shall not ... aid another to compete." (Exs. B and C at § 8.1).[4] Recognizing that the covenants involved in this case expressly prohibit Defendants from aiding Exhibitgroup's competitors, the pivotal issue is whether Defendants' efforts to develop software (e-info) that could be sold to exhibit houses, constitutes "aiding" competitors under the Employment Agreements.

It is clear that one of the primary targets of e-info is the exhibit house industry, which includes competitors of Exhibitgroup. By incorporating calan, issuing press releases, conducting market research, issuing a white paper, and conducting a webcast for potential customers, there can be no doubt that Defendants have taken overt acts that have laid the groundwork to, at some time in the future, aid competitors of Exhibitgroup. Despite these preparatory steps, however, Viad adduced no evidence to show that calan has *actually* aided Exhibitgroup's competitors or that such aid is forthcoming prior to the expiration of the restrictive covenants less than two month hence. Defendant calan has no customers, revenue, or even a product on the market. Indeed, it remains unclear when or if e-info will be available for sale. (Tr., Vol. II at p. 78, ll.4–11).

No controlling authority was cited by either party—and this Court has found none—on the issue of "aiding" competitors in violation of a restrictive covenant. However, Plaintiff relies upon *De Long Corp. v. Lucas,* 278 F.2d 804 (2d Cir.1960) for the proposition that preparing to aid competitors constitute a breach of similar "aiding" or "assisting" provisions of restrictive covenants. In *De Long,* the Court of Appeals for the Second Circuit held that a former employee violated the contractual prohibition not to "to assist anyone to compete" in a manner related to his former employment, which consisted of specialized engineering and sales of equipment for marine exploration. *Id.* at 805–6. The former employee was paid a fee of $100,000 by a competitor of his former employer to perform engineering and design work to develop a jack that was essential in securing a government contract to the detriment of his former employer. *Id.* at 809–10.

Unlike the former employee in *De Long*—who provided direct, tangible assis-

4. Defendants argue that attempts by the Plaintiff to apply the language and scope of the "aiding" provision of the Employment Agreements to the software development activities of Defendants is overbroad and constitutes an unreasonable restraint of trade, rendering the covenant unenforceable. Defendants argue that the application of this provision would prohibit Defendants from engaging in *any* activities which might assist or further the business interests of competitors, including teaching marketing courses to a competitor's employees, opening a travel agency, or selling cellular telephones to competitors. These arguments are factually inapposite and legally irrelevant because Viad has failed to demonstrate breach of the "aiding" provision of the Employment Agreements.

tance to a competitor of his former employer—here the activities of Defendants are most fairly characterized as "preparing to aid" Plaintiff's competitors. Although it is a close question, the Court holds that mere preparations by Defendants to potentially aid competitors of Exhibitgroup do not rise to the level of breach of their restrictive covenants. Accordingly, based on the evidence adduced to date, the Court finds that Viad has not carried its burden of proving likelihood of success on the merits regarding Defendants' breach of the Employment Agreements.

B. Irreparable Harm

[12–14] Even assuming, *arguendo*, that Viad were able to carry its burden of proving likelihood of success on the merits, it cannot demonstrate irreparable injury caused by or resulting from Defendants' actions. A preliminary injunction cannot be granted absent a showing of irreparable harm. *Instant Air Freight Co.*, 882 F.2d at 800; *Frank's GMC Truck Center*, 847 F.2d at 102. In order to prove irreparable harm, the moving party must "demonstrate potential harm which cannot be redressed by a legal or an equitable remedy following trial." *Acierno*, 40 F.3d at 653 (*quoting Instant Air Freight Co.*, 882 F.2d at 801). The moving party must offer a "clear showing of immediate irreparable injury," *ECRI v. McGraw-Hill, Inc.*, 809 F.2d 223, 226 (3d Cir.1987) (district court's preliminary injunction vacated due to plaintiff's failure to show irreparable harm).

Furthermore, the harm created by a failure to issue the requested injunction must "be of a peculiar nature, so that compensation in money cannot atone for it." *Acierno*, 40 F.3d at 653 (citations and internal quotations omitted). The word "irreparable connotes 'that which cannot be repaired, retrieved, put down again, atoned for.'" *Id.* (citations omitted). Economic loss "does not constitute irreparable harm." *Id.* Additionally, "[t]he possibility that adequate compensatory or other corrective relief will be available at a later date, in the ordinary course of litigation, weighs heavily against a claim of irreparable harm." *Id.* (*quoting Sampson v. Murray*, 415 U.S. 61, 90, 94 S.Ct. 937, 39 L.Ed.2d 166 (1974)).

[15] In addition, the claimed injury cannot merely be possible, speculative or remote. The proof required for injunctive relief has been characterized as a "clear showing of immediate irreparable injury;" or a "presently existing actual threat; [an injunction] may not be used simply to eliminate a possibility of a remote future injury...." *Acierno*, 40 F.3d at 655 (citations omitted); *see also Continental Group, Inc. v. Amoco Chemicals Corp.*, 614 F.2d 351, 359 (3d Cir.1980) (injunctions not issued to allay fears and apprehensions or to soothe anxieties of parties). More than the mere risk of irreparable harm must be demonstrated. *ECRI*, 809 F.2d at 226. The moving party must demonstrate that the alleged harm is imminent, not merely in the "indefinite future." *Campbell Soup Co. v. ConAgra, Inc.*, 977 F.2d 86, 91 (3d Cir.1992).

[16] Although Viad has stated repeatedly that it stands to lose its "competitive advantage" in the exhibit house industry if Defendants are not enjoined from pursuing software development, it has offered no evidence in support of this conclusion. Viad presented no market analyses, expert reports or testimony concerning the exhibit industry or potential losses due to the distribution of software such as e-info to its competitors. Although irreparable harm is by its nature unquantifiable, it is

nevertheless incumbent upon the moving party to make a "clear showing" that the threat of loss, however undefined, is both "immediate" and a "presently existing actual threat." *Acierno*, 40 F.3d at 655. Plaintiff has failed to meet this exacting standard. Indeed, the only testimony impacting the irreparable harm analysis belied Viad's claim. To her credit, Exhibitgroup President and CEO Kim Fracalossi candidly acknowledged that Exhibitgroup had suffered ***no lost revenue or sales*** due to the actions of Defendants. (Tr., Vol. I at p. 97, ll. 16–24).

Viad argues in its post-trial brief that covenants not to compete are *prima facie* enforceable in equity where a breach in the employment context is present, relying on several Pennsylvania Supreme Court cases, including *Bettinger v. Carl Berke Assoc., Inc., et al.*, 455 Pa. 100, 314 A.2d 296 (1974) and *John G. Bryant Co. v. Sling Testing & Repair, Inc.*, 471 Pa. 1, 369 A.2d 1164, 1167 (1977). Additionally, Viad relies on *Hillard v. Medtronic, Inc.*, 910 F.Supp. 173 (M.D.Pa.1995), for the general proposition that in the context of restrictive employment covenants, the "potential loss of customers" is sufficient to prove irreparable harm.

Two aspects of these cases make them readily distinguishable from the instant case, however. First, although the enforceability of a restrictive employment covenant is governed by Pennsylvania substantive law, federal law governs the standards for injunctive relief, including the irreparable harm requirement. *Instant Air Freight Co.*, 882 F.2d at 799. Viad has cited no case from the Court of Appeals for the Third Circuit—and the Court is unaware of such authority—which holds that breach of a restrictive covenant is *prima facie* evidence of irreparable harm.

Second, the cases cited by Viad are factually distinguishable from this case. In each of the cases Viad cited, the plaintiffs introduced evidence that the defendants had been engaged in direct competition with their former employers, including the active solicitation of existing clients. *See Bettinger v. Carl Berke Assoc., Inc., supra; John G. Bryant Co. v. Sling Testing & Repair, Inc., supra; Hillard v. Medtronic, Inc., supra.* In *Bettinger*, the defendant had established a competing business immediately upon leaving the plaintiff's employ, recruited two of its employees to work with him (who pilfered copies of customer lists), and was actively engaged in the solicitation of existing clients. *Bettinger*, 314 A.2d at 297–99. In *Bryant*, the defendant admitted that he had made direct sales to plaintiff's accounts in violation of his covenant not to compete. *John G. Bryant Co.*, 369 A.2d at 1166. Finally, in *Hillard*, the court found that the defendant was "acting on behalf of a competitor of [his former employer] and pursuing business relationships with customers of [his former employer] that he serviced while employed there." *Hillard*, 910 F.Supp. at 179. In stark contrast to the facts presented in the foregoing cases, here Viad offered no evidence of the actual or imminent loss of customers. Nor could such evidence be offered because calan has no product available for sale, and it has neither solicited Exhibitgroup customers nor made any sales. Absent this essential evidence, the harm to Exhibitgroup, if any at all, is too attenuated to justify the extraordinary relief of an injunction.

Additionally, the Court is unpersuaded that Viad will suffer harm not compensable in monetary damages if the injunction is not granted. If Exhibitgroup loses business as a consequence of Defendants' breaches of their restrictive covenants,

damages can be ascertained by comparing the customer lists of Exhibitgroup with customers who have purchased calan software, and determine whether Defendants' breaches caused the loss of business. *See, e.g., Mettler–Toledo, Inc. v. Acker*, 908 F.Supp. 240, 248 (M.D.Pa.1995) (loss of customers to a rival could be quantified and compensated by money damages).[5]

IV. Conclusion

Upon their departure from Viad, Defendants Cordial and Hellberg incorporated calan communications in good faith and not in direct or indirect competition with Exhibitgroup. Nevertheless, the marketing and promotion of e-info to competitors of Exhibitgroup comes perilously close to crossing the line between "preparing to aid" and actually "aiding" competitors of Exhibitgroup. Accordingly, although the Court will deny Viad's Motion for Preliminary Injunction for failure to prove likelihood of success on the merits and irreparable harm, it will do so without prejudice to Viad's right to renew the Motion in accordance with the Order of Court entered herewith.

ORDER OF COURT

AND NOW, this 24th day of December, 2003, in accordance with the foregoing Opinion, it is HEREBY ORDERED that:

Plaintiff Viad's Motion for Preliminary Injunction (document # 10) is DENIED without prejudice to its right to renew the motion should Defendants enter into any agreements, partnerships, ventures, or make any sales to Exhibitgroup customers or competitors prior to the February 22, 2004 expiration of the non-competition period.

5. As Plaintiff has failed to carry its burden concerning success on the merits or irreparable harm, it is unnecessary to address the balancing of the equities or the public interest. Additionally, Defendants argue that Plaintiff is barred from the relief it seeks by the doctrines of laches and equitable estoppel. Although the Court need not decide these issues given the Plaintiff's inability to prove the requirements for equitable relief, the Court notes that Plaintiff waited a full seven months (in the context of a one-year restrictive covenant) following the departure of Defendants Cordial and Hellberg to first notify them that their actions surrounding the incorporation of calan communications and the development of e-info might be in breach of their restrictive covenants. The instant action was not brought until September 23, 2003, and the Motion for Preliminary Injunction was not filed until October 22, 2003, eight months following the termination of Defendants' employment with Exhibitgroup.

Additionally, Defendant Cordial was candid and forthright to Exhibitgroup and its executives concerning his plans to develop a software product for use in the exhibit house industry. This transparency continued as Exhibitgroup participated in calan's technological survey in March, 2003. During this participation (at the behest of Viad CEO Fracalossi and with the full knowledge of Viad CIO Barry), Exhibitgroup indicated that it would be interested in purchasing and potentially investing in calan's software. In April, 2003, Exhibitgroup received calan's white paper, which again clearly demonstrated its stated mission and target market. In June, 2003, Exhibitgroup participated in the webcast of e-info, which again demonstrated that calan sought to develop a software package with specific application to the exhibit house industry. Only after this webcast did Exhibitgroup act to inform Defendants of a potential violation by letter dated August 11, 2003.

[6] The government may also elicit testimony from Dr. Garrison related to testimony from the patients themselves. For example, he has said that some of the procedures were not done because the patients said then they only spent fifteen or twenty minutes with the doctors and the procedures could not be done within that time frame. Dr. Garrison may testify about the length of time it takes to do the procedures. He may also testify that certain patient charts do not reflect the actual teeth in the patient's mouth. He may talk about when anesthesia is used and when it is not used.

An appropriate Order follows.

ORDER

AND NOW, this 14th day of May, 2004, upon consideration of the defendants' motion to exclude the testimony of Dr. Scott Garrison, the government's opposition thereto, after a hearing held on July 30, 2003, and after a review of prior post-hearing submission of the parties, it is hereby ORDERED and DECREED that said motion is granted in part and denied in part as stated in a memorandum of today's date.

any opinions derived from such examinations. Nor did the government elicit such testimony from Dr. Garrison at the *Daubert* hearing. It may be that the defendants do not at this point have proper notice of these opinions. The Court will meet with counsel to discuss these and other issues presented by the Court's decision.

LEXINGTON INSURANCE COMPANY, Plaintiff,

v.

WESTERN PENNSYLVANIA HOSPITAL, et al., Defendants.

Civil Action No. 03–1675.

United States District Court, W.D. Pennsylvania.

Feb. 6, 2004.

Background: Umbrella liability insurer sought declaratory judgment of no duty to indemnify insured hospital in connection with medical malpractice action. Insurer moved for summary judgment.

Holdings: The District Court, Hardiman, J., held that:

(1) fact that umbrella insurance policy contained endorsement continuing insurer's excess liability where state assumed primary liability for malpractice claims did not negate separate endorsement making clear that policy provided claims-made malpractice coverage, and

(2) claims-made endorsement controlled over notice clause of policy's general-liability coverage provision.

Motion granted.

1. Insurance ⇐2266, 2396

Under Pennsylvania law, fact that hospital's umbrella liability insurance policy contained endorsement requiring insurer to remain liable for excess medical malpractice coverage if state-sponsored medical malpractice fund assumed responsibility from primary insurer did not ne-

gate separate endorsement explicitly stating that policy provided follow-form, claims-made medical malpractice coverage; thus, policy did not cover claim that state fund had taken over from primary insurer and that exceeded state fund's limit, but that had not been timely reported to umbrella insurer according to claims-made criteria. 40 P.S. §1301.605 (Repealed).

2. Insurance ⇐2266

Under Pennsylvania law, umbrella liability insurance policy's endorsement making clear that policy provided claims-made coverage of medical malpractice claims controlled over policy's general-liability coverage provision requiring notice to insurer "as soon as practicable of an Occurrence."

3. Insurance ⇐2266

Under Pennsylvania law, notice-prejudice rule applicable to occurrence-based liability insurance policy does not apply to claims-made policy.

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Edward B. Wood, Douglas L. Price, Harry S. Cohen & Associates, Pittsburgh, PA, for Defendants.

OPINION

HARDIMAN, District Judge.

I. Introduction

This declaratory judgment action was brought by Lexington Insurance Company ("Lexington") against its insured, Western Pennsylvania Hospital ("West Penn"), as well as Elizabeth and Harry Lieb (the "Liebs"), who filed a medical malpractice action in state court against West Penn (the "Lieb Claim"). Although there is no dispute that West Penn has primary insurance coverage for the Lieb Claim, Lexington claims that it has no obligation to provide coverage under its umbrella policy because West Penn failed to report the Lieb Claim during the effective policy period.

The Court agreed to hear this case on an expedited basis because the Lieb Claim is listed on the March 2004 trial list of the Court of Common Pleas of Allegheny County. The parties have filed cross motions for summary judgment under Rule 56 of the Federal Rules of Civil Procedure and the case is ripe for adjudication. For the reasons that follow, the Court will grant Lexington's Motion for Summary Judgment.

II. Standard of Review

Summary judgment is appropriate when "the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed.R.Civ.P. 56(c); *see also Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 250–52, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986); *Saldana v. Kmart Corp.*, 260 F.3d 228, 231–32 (3d Cir.2001). "Summary judgment procedure is properly regarded not as a disfavorable procedural shortcut, but rather as an integral part of the Federal Rules as a whole, which are designed to secure the just, speedy and inexpensive determination of every action." *Celotex Corp. v. Catrett*, 477 U.S. 317, 327, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986) (internal quotation marks omitted).

In resolving a motion for summary judgment, courts must "consider all evidence in the light most favorable to the non-moving party" to determine whether "the evidence is such that a reasonable jury could return a verdict for the nonmoving party."

Schnall v. Amboy Nat'l Bank, 279 F.3d 205, 209 (3d Cir.2002). Summary judgment is appropriate when a party "fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." *Celotex*, 477 U.S. at 322–23, 106 S.Ct. 2548.

III. Statement of Undisputed Facts

On May 24, 1990, Elizabeth Lieb gave birth to a daughter, Kathryn, at West Penn Hospital. Eleven years later, on May 25, 2001, the Liebs filed a state court medical malpractice action against West Penn for negligence related to the birth of Kathryn Lieb. Three weeks before the Liebs filed suit, West Penn submitted a "Notice of Claim" to its primary professional liability carrier, PHICO Insurance Company ("PHICO"), which provided claims-made professional liability coverage during 2001. Because the Lieb Claim was first asserted more than four years after the occurrence giving rise to it, however, PHICO referred the case to the Medical Professional Liability Catastrophe Fund (the "Fund") pursuant to 40 P.S. § 1301.605.[1] The Fund assumed West Penn's defense of the Lieb Claim, and is responsible for the first million dollars of any indemnity payments. *Id.*

During the same period that PHICO provided primary coverage to West Penn, Plaintiff Lexington provided umbrella liability coverage (the "Lexington Policy").[2] The Lexington Policy is comprised of a declarations page, a forms schedule, a schedule of underlying insurance, a preprinted commercial umbrella policy form, and twelve endorsements. Lex. Pol. at 000001–000035. Although the Lexington Policy provides *general* liability coverage on an "occurrence" basis (*id.* at 000005), it provides "follow form" claims-made coverage for *medical professional* liability. *Id.* at 000025 (Endorsement # 007).

On December 31, 2001, the last day of the PHICO and Lexington policy periods, West Penn advised Lexington's agent of 23 claims under the Lexington Policy, but the Lieb Claim was not among them. West Penn concedes that it did not report the Lieb Claim to Lexington until February 12, 2003, over a year after the Lexington Policy expired with respect to claims for medical professional liability. By letter dated August 13, 2003, Lexington's agent reserved its rights to deny coverage of the Lieb Claim.

IV. Legal Analysis

A. *Insurance Contract Interpretation*

A federal court sitting in diversity must apply state substantive law. *Chamberlain v. Giampapa*, 210 F.3d 154, 158 (3d Cir. 2000) (citing *Erie R.R. v. Tompkins*, 304 U.S. 64, 78, 58 S.Ct. 817, 82 L.Ed. 1188 (1938)). Under Pennsylvania law, insurance coverage "is a question of law for the Court." *Snyder Heating Co., Inc. v. Pennsylvania Mfr. Ass'n Ins. Co.*, 715 A.2d 483, 485 (Pa.Super.1998). The insured has the burden to prove that a particular claim falls within the coverage of an insurance policy. *Jacobs Constructors, Inc. v. NPS Energy Services, Inc.*, 264 F.3d 365, 376 (3d Cir.2001) (citing *Erie*

1. The Medical Professional Liability Catastrophe Fund, known colloquially as the "CAT Fund," was created by the Pennsylvania General Assembly in 1975. In 2002, the General Assembly reconstituted the CAT Fund as the Medical Care Availability and Reduction of Error Fund (the "M–Care Fund"). Claims subject to section 605 of the Health Care Act are commonly referred to as "605 Claims."

2. In 2000, Lexington issued an umbrella policy to West Penn Allegheny Health System, a network of health care providers of which West Penn is a part. The umbrella policy was renewed in 2001 by Lexington.

Ins. Exch. v. Transamerica Ins. Co., 516 Pa. 574, 583, 533 A.2d 1363, 1368 (Pa. 1987)). Contract terms that are clear and unambiguous are to be given their "plain and ordinary meaning." *St. Paul Fire & Marine Ins. Co. v. Lewis*, 935 F.2d 1428, 1431 (3d Cir.1991). Whether a contract term is ambiguous is a question of law for the court. *Id. See also Martin v. Monumental Life Ins. Co.*, 240 F.3d 223, 232 (3d Cir.2001).

"A contract is not rendered ambiguous by the mere fact that the parties do not agree on the proper construction." *Bohler–Uddeholm America Inc. v. Ellwood Group Inc.*, 247 F.3d 79, 93 (3d Cir.2001). A contract term is ambiguous "if, and only if, it is reasonably or fairly susceptible of different constructions and is capable of being understood in more senses than one and is obscure in meaning through indefiniteness of expression or has double meaning." *Pizzini v. American Int'l Specialty Lines Ins. Co.*, 210 F.Supp.2d 658 (E.D.Pa. 2002). In order to be ambiguous, each of the proffered interpretations must be reasonable; an unreasonable interpretation does not create ambiguity. *Reliance Ins. Co. v. Moessner*, 121 F.3d 895, 900 (3d Cir.1997). In interpreting a policy, the document must be read as a whole. *Contrans, Inc. v. Ryder Truck Rental, Inc.*, 836 F.2d 163, 169 (3d Cir.1987). Accordingly, a proffered interpretation cannot create ambiguity if it renders another provision meaningless. *Id.* Finally, in ascertaining the intent of the parties, the Court is to interpret the policy with an eye toward avoiding ambiguity. *USX Corp. v. Adriatic Ins. Co.*, 99 F.Supp.2d 593, 609 (W.D.Pa.2000). Mindful of these principles of insurance contract interpretation, the Court turns to the contracts at issue.

B. *The Lexington Policy*

In respect to medical professional liability, the Lexington Policy is a follow form, claims-made policy. *See* Lex. Pol. at Endorsement # 007. As such, for coverage to exist any and all claims must be reported during the policy period. *See St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531, 535 n. 3, 98 S.Ct. 2923, 57 L.Ed.2d 932 (1978). The distinction between a claims-made and an occurrence policy is critical. As Judge Caldwell of our sister court noted:

> With claims-made policies, the very act of giving an extension of reporting time after the expiration of the policy period, as the district court proposes, negates the inherent difference between the two contract types.... Claims-made or discovery policies are essentially reporting policies. If the claim is reported to the insurer during the policy period, then the carrier is legally obligated to pay; if the claim is not reported during the policy period, no liability attaches. If a court were to allow an extension of reporting time after the end of the policy period, such is tantamount to an extension of coverage to the insured gratis, something for which the insurer has not bargained. This extension of coverage, by the court, so very different from a mere condition of the policy, in effect rewrites the contract between the two parties.

City of Harrisburg v. International Surplus Lines Ins. Co., 596 F.Supp. 954, 961 (M.D.Pa.1984) *aff'd without opinion*, 770 F.2d 1067 (3d Cir.1985) (quoting *Gulf Insurance Co. v. Dolan, Fertig and Curtis*, 433 So.2d 512, 515–16 (Fla.1983)). *See also Clemente v. Home Insurance Co.*, 791 F.Supp. 118, 121–22 (E.D.Pa.1992), *aff'd without opinion*, 981 F.2d 1246 (3d Cir. 1992).

Endorsement # 007 explicitly states: "*PROVIDES CLAIMS–MADE COVERAGE—PLEASE READ CAREFULLY* .... All of the terms and conditions of said underlying insurance shall apply to

this insuring agreement except as otherwise expressly stated herein." *See* Lex. Pol. at 000025 (emphasis in original). According to the Lexington Policy's schedule of underlying insurance, the primary professional liability carrier is PHICO. *Id.* at 000004. Consistent with the language of Endorsement # 007, the PHICO Policy is a claims-made policy, requiring that claims be reported to the insurer during the policy period for coverage to exist. *See* PHICO Pol. at PHI 0076. The fact that the schedule of underlying insurance lists the PHICO Policy by reference rather than specific policy number is immaterial.[3]

In addition, Endorsement # 007 provides an automatic extension of the reporting period for sixty days as well as an optional extended reporting period which West Penn could purchase prior to the expiration of the automatic extension. *See* Lex. Pol. at 000027–28. The automatic and optional extension provisions of Endorsement # 007 are consistent with the reporting requirement that followed form with the PHICO Policy, *viz.*, that all claims for which coverage is sought must be reported during the policy period. To hold otherwise would render the automatic and optional extension provisions meaningless in violation of Pennsylvania law. *See Contrans*, 836 F.2d at 169; *Girard Trust Bank v. Life Ins. Co. of No. Amer.*, 243 Pa.Super. 152, 364 A.2d 495, 498 (1976).

C. *West Penn's Arguments*

[1] West Penn makes several arguments in support of its claim that the language of the Lexington Policy requires coverage. The crux of West Penn's position is that Endorsement # 007 does not apply to the Lieb Claim because it is a 605 Claim. West Penn relies upon Endorsement # 001 of the Lexington Policy—which is entitled "Coverage Amendment—Section 605 Claims"—and provides that if the CAT Fund assumes responsibility, Lexington's umbrella coverage will apply to 605 Claims immediately over the CAT Fund's limit of liability. *See* Lex. Pol. at 000019. Although the Court agrees that Endorsement # 001 requires Lexington to provide umbrella coverage to West Penn for liability over the CAT Fund's limit, nothing in Endorsement # 001 suggests that Endorsement # 007 is ineffective when Endorsement # 001 is implicated. Contrary to West Penn's claim, the Court finds that these two endorsements are complementary. Endorsement # 007 requires Lexington to provide excess claims-made professional liability coverage while Endorsement # 001 makes explicit that Lexington remains liable for coverage even if the CAT Fund supplants PHICO as underlying insurer. As the Court of Appeals for the Third Circuit directed in *Contrans*, the Lexington Policy must be read as a whole and a proffered interpretation cannot create ambiguity if it renders

3. The omission of a specific policy reference is common in respect to contracts for excess or umbrella insurance:

> Excess insurers frequently agree to provide coverage to an insured in excess of agreed types and amounts of underlying insurance, without having seen copies of the underlying policies or, in many cases, without even knowing the name of the company that is to provide the underlying insurance, leaving such matters 'to be advised.' ... [A] following form excess policy often incorporates by reference the terms and conditions of the underlying policy. It is well settled that the obligations of following form excess insurers are defined by the language of the underlying policies, except to the extent that there is a conflict between the two policies, in which case the wording of the excess policy will control.

Barry R. Ostrager, *et al., Handbook on Insurance Coverage Disputes*, 817–18 (11th ed., Aspen L. & Bus.2002) (citations omitted).

another provision meaningless. *Contrans*, 836 F.2d at 169.

[2] In addition to its argument that Endorsement # 001 vitiates Endorsement # 007, West Penn claims that Condition F of the Lexington Policy mandates coverage of the Lieb Claim. Condition F requires West Penn to give notice to Lexington "as soon as practicable of an Occurrence which may result in the claim under this policy." *See* Lex. Pol. at 16. Significantly, the word "Occurrence" is capitalized, relating to a specific occurrence that would trigger coverage under an occurrence-based policy. The "occurrence" language in Condition F is inconsistent with the follow form, claims-made language in Endorsement # 007 and the PHICO Policy. According to the Court of Appeals, whenever a conflict exists between the body of the policy and an endorsement thereto, the endorsement controls. *St. Paul Fire & Marine Ins. Co. v. United States Fire Ins. Co.*, 655 F.2d 521, 524 (3d Cir.1981). Therefore, West Penn's argument that Condition F requires coverage is erroneous.[4]

In the alternative, West Penn argues that even if the Court found Endorsement # 007 effective, the notice-prejudice rule established by the Pennsylvania Supreme Court in *Brakeman v. Potomac Ins. Co.*, 472 Pa. 66, 371 A.2d 193, 198 (1977) applies in this case. Consistent with this position, the Liebs urge the Court to apply *Brakeman* based on the decision of the Court of Appeals for the Third Circuit in *Trustees of Univ. of Penn. v. Lexington Ins. Co.*, 815 F.2d 890 (3d Cir.1987). The Court finds both *Brakeman* and *Trustees* to be factually inapposite to this case.

[3] In *Brakeman*, the Pennsylvania Supreme Court held that the insurer was required to show prejudice before it could deny coverage based on late notice. *Brakeman*, 371 A.2d at 197–98. However, the policy at issue in *Brakeman* was an occurrence policy. *Id.* at 194. West Penn has cited no case in which a court has applied a notice-prejudice rule to a claims-made policy. In fact, there is overwhelming authority to the contrary. *See, e.g., Pizzini*, 210 F.Supp.2d at 669–670 ("under Pennsylvania law the *Brakeman* notice-prejudice rule does not apply to claims made policies"); *Pension Trust Fund v. Fed. Ins. Co.*, 307 F.3d 944, 956 (9th Cir. 2002) (California notice-prejudice rule governs occurrence policies not claims-made policies); *Matador Petroleum Corp. v. St. Paul Surplus Lines Ins. Co.*, 174 F.3d 653, 659 (5th Cir.1999) (applying notice-prejudice to claims-made policies would interfere with public's right to contract); *DiLuglio v. New England Ins. Co.*, 959 F.2d 355, 359 (1st Cir.1992); *City of Harrisburg*, 596 F.Supp. at 961. The decision of the Court of Appeals for the Third Circuit in *Trustees* is consistent with the foregoing authorities because an occurrence policy, rather than a claims-made policy, was at issue in that case. *Trustees*, 815 F.2d at 893. Therefore, *Trustees* is inapposite and the Court declines to apply the *Brakeman* rule to the Lexington Policy.

Simply put, West Penn's arguments fail because they ignore the essential fact that the Lexington Policy is a claims-made policy rather than an occurrence policy. In a claims-made policy, notice is a condition precedent to coverage. *Andy Warhol*

4. West Penn also argues that because the PHICO Policy requires West Penn to report claims to the "Company" and defines "Company" as PHICO, West Penn became entitled to umbrella coverage when it notified PHICO of the Lieb Claim. If the Court were to accept this argument, however, Lexington would be obliged to cover any claim in excess of the underlying insurance without ever having received any notice from West Penn. This result is plainly contradictory to Endorsement # 007 and the Court rejects it for the same reason it rejects West Penn's argument regarding Endorsement # 001.

Found. for the Visual Arts, Inc. v. Federal Ins. Co., 189 F.3d 208, 214 (2d Cir.1999) (applying New York law); *Cohen & Co. v. North River Ins. Co.*, No. 93–1860, 1994 WL 105561, *2, 1994 U.S. Dist. LEXIS 3646, at *7 (E.D.Pa. March 29, 1994) (applying Pennsylvania law). Because West Penn admittedly failed to make a claim under the Lexington Policy until well after that policy expired, the Court holds that no coverage exists under Lexington policy number 6332691.

V. Conclusion

For all the foregoing reasons, the Court will grant Lexington's Motion for Summary Judgment, deny West Penn's Motion for Summary Judgment, and dismiss West Penn's Counterclaim.

An appropriate order follows.

ORDER OF COURT

Based on the accompanying opinion, it is HEREBY ORDERED as follows:

1. Plaintiff's Motion for Summary Judgment (Document No. 26) is GRANTED.

2. Defendant's Motion for Summary Judgment (Document No. 27) is DENIED.

3. Defendant's Counterclaim is DISMISSED with prejudice.

4. The clerk is directed to mark this case CLOSED.

TRANSCONTINENTAL INSURANCE COMPANY Plaintiff,

v.

CENTURY STEEL ERECTORS, INC. Defendant.

No. CIV.A. 01–2376.

United States District Court, W.D. Pennsylvania.

March 9, 2004.

Background: Workers' compensation insurer brought suit against insured to recovery unpaid balance on retrospective premium policy. Insured counterclaimed, alleging breach of contract, negligent performance, and bad faith. Insurer moved for summary judgment.

Holding: The District Court, Ambrose, J., held that "deems expedient" clause gave insurer right to settle claim within policy limits against insured's wishes, even if financial impact of that decision might be borne by insured, in form of a premium adjustment.

Motion for summary judgment granted.

1. Workers' Compensation ⇐1042

Under retrospective premium policy that contained "deems expedient" clause, insured had no claim for bad faith under Pennsylvania law premised on worker's compensation carrier's decision to settle claim within limits of policy against insured's wishes, notwithstanding that financial impact of that decision might be borne by insured, in form of a premium adjustment.

2. Insurance ⇐3348

With a "deems expedient" clause under Pennsylvania law, an insurer may settle a suit within policy limits that presents no valid claim, is fraudulent, or is ground-

the Court denies Defendant's Motion to Dismiss Count One.

An appropriate order follows.

ORDER

AND NOW, this 29th day of September, 2004, **IT IS HEREBY ORDERED** that the Defendant's Motion to Dismiss Plaintiff's Complaint at Counts One and Two is hereby granted in part and denied in part. The Defendant's Motion to Dismiss Plaintiff's Complaint at Count Two is granted, and the Defendant's Motion to Dismiss Plaintiff's Complaint at Count One is denied.

Patricia A. PATSAKIS, et al., Plaintiffs,

v.

GREEK ORTHODOX ARCHDIOCESE OF AMERICA, et al., Defendants.

Civil Action No. 03–1851.

United States District Court, W.D. Pennsylvania.

Oct. 6, 2004.

Background: Church employees brought action against diocese and archdiocese under Title VII alleging gender discrimination and hostile work environment. Defendants moved to dismiss.

Holdings: The District Court, Hardiman, J., held that:

(1) registrar's claims did not fall within Title VII's ministerial exception, and

(2) administrative vicar's claims did not fall within ministerial exception.

Motion denied.

1. Constitutional Law ⇐84.5(10)

Free Exercise Clause protects right of religious organizations to choose ministers without government restriction. U.S.C.A. Const.Amend. 1.

2. Civil Rights ⇐1114

Statutory exemption of religious employers from Title VII's prohibition of religion-based discrimination does not relieve religious employers of liability for employment discrimination pertaining to other protected classes enumerated in Title VII, such as race, sex, or national origin. Civil Rights Act of 1964, § 702, 42 U.S.C.A. § 2000e–1.

3. Civil Rights ⇐1114

For purposes of determining applicability of ministerial exception to Title VII's prohibition against religious discrimination, employees whose duties are important to spiritual and pastoral mission of church are deemed "ministers." Civil Rights Act of 1964, § 702, 42 U.S.C.A. § 2000e–1.

See publication Words and Phrases for other judicial constructions and definitions.

4. Civil Rights ⇐1114

Registrar for diocese did not perform pastoral or ministerial duties, and thus registrar's gender discrimination and hostile work environment claims against diocese did not fall within Title VII's ministerial exception, where registrar collected and maintained church documents and ensured that they contained all necessary information, but she could not independently rule on doctrinal legitimacy of documents submitted to her. Civil Rights Act of 1964, § 702, 42 U.S.C.A. § 2000e–1.

5. Civil Rights ⇐1114

Administrative vicar for diocese did not perform pastoral or ministerial duties, and thus vicar's gender discrimination and hostile work environment claims against diocese did not fall within Title VII's ministerial exception, even though vicar drafted letters for bishop and posted them herself, vicar served as liaison between bishop and clergy and laity, vicar mediated dispute between two parishes, and vicar served as church camp coordinator, where church doctrine precluded women from serving as chancellor or from performing religious ceremonies, letters posted by vicar were form letters or were drafted by bishop, vicar sent no correspondence to general populace, vicar never exercised independent judgment to solve problems that came to bishop's attention, mediation was not one of vicar's principal duties, and vicar only handled finances and performed other administrative functions related to camp's establishment. Civil Rights Act of 1964, § 702, 42 U.S.C.A. § 2000e–1.

6. Civil Rights ⇐1114

Mere fact that lay employee discharges episodic religious duties does not shield religious employer from Title VII liability under ministerial exception per se. Civil Rights Act of 1964, § 702, 42 U.S.C.A. § 2000e–1.

Samuel J. Cordes, Colleen Ramage Johnston, OGG, Cordes, Murphy & Ignelzi, Pittsburgh, PA, for Plaintiffs.

OPINION

HARDIMAN, District Judge.

In this Title VII action, plaintiffs Patricia A. Patsakis and Angela Sklavos allege gender discrimination and hostile work environment against the Greek Orthodox Archdiocese of America (Archdiocese) and Greek Orthodox Diocese of Pittsburgh (Diocese of Pittsburgh). Although defendants answered Sklavos' claims, they seek dismissal of Patsakis' claims, arguing lack of subject matter jurisdiction under the "ministerial exception" to Title VII. The court held an evidentiary hearing on May 6, 2004 and the parties submitted proposed findings of fact and conclusions of law. After careful consideration of the evidence presented at the hearing and the submissions of counsel, the court finds that subject matter jurisdiction exists over Patsakis' claims.

I. Findings of Fact

The Greek Orthodox Church (Church), like most religious organizations, is hierarchical in structure. The Archdiocese of the United States is governed by an archbishop and eight metropolitan bishops who oversee their respective metropolises, of which Pittsburgh is one. The Pittsburgh metropolis includes fifty-two parishes in most of Pennsylvania, West Virginia and parts of Ohio. In addition, a Greek women's philanthropic organization known as the Philoptochos Society is usually present at each parish. The Metropolitan of the Diocese of Pittsburgh, Maximos Aghiorgousis (Bishop), has served in that role for the past twenty-five years. He has ultimate authority over the Pittsburgh Diocese, and his staff acts on his behalf. From time to time the Bishop delegates his authority to members of his staff, such as the registrar and chancellor.

The position of registrar largely involves the administrative review and record-keeping of sacramental documents submitted to the Bishop by priests within the Diocese. The registrar ensures that baptisms, chrismations, weddings, divorces, and funerals are conducted, reported, processed, and

recorded correctly. The registrar also reviews and organizes files for parish council ratifications. While the registrar position is administrative, the position of chancellor involves both administrative and pastoral responsibilities. Consequently, a chancellor is normally a priest and is never a layperson. When the position of chancellor is vacant, a layperson may fill it as administrative assistant, but a layperson cannot hold the title of chancellor. Accordingly, women cannot hold the title of chancellor and are not allowed to perform divine liturgies, masses, weddings, baptisms, or funerals in the Greek Orthodox Church.

Patsakis was hired on December 1, 2001 as Registrar of the Pittsburgh Diocese (Registrar). At this time, Father John Panagiotou was serving as Chancellor of the Pittsburgh Diocese (Chancellor). As Registrar, Patsakis received sacramental documents, read them, and then reported to the Bishop if anything was missing or incorrect. Also, all materials for parish council ratifications were sent to Patsakis and she was required to review them, organize the files numerically, and enter the information into a spreadsheet. Patsakis did not complete church sacramental documents; instead, she issued blank documents to priests, who completed the information and returned them. Upon their return, she reviewed the documents on their face to ensure that the information was completed as required based on a checklist that was given to her. If the sacramental documents contained all the requisite information, Patsakis catalogued and filed them without submitting them to the Bishop. If a priest made a mistake, however—for example, by failing to include a birth certificate on a marriage application or by allowing a proposed best man at a wedding to be of a faith other than Greek Orthodox—Patsakis notified that priest and/or the Bishop that the document was missing or incorrect. She never exercised her discretion to determine if any documents were correct under Church doctrine.

Some three months after Patsakis became Registrar, in March of 2002, Father Panagiotou left his position as Chancellor. Faced with a vacancy in the Chancellor's position with no one immediately available to fill it, the Bishop devised a solution. He temporarily split the Chancellor position into two separate positions: a "Pastoral Vicar," who would perform the spiritual functions formerly performed by the Chancellor, and an "Administrative Vicar," who would perform the administrative functions. Deacon Euripides Christiludes was appointed Pastoral Vicar and Patsakis was appointed Administrative Vicar. Neither of these positions, nor even the title "Vicar" itself, is formally recognized in the Greek Orthodox faith, however. The Bishop split the position out of necessity; he wanted Patsakis to fulfill the administrative duties of Chancellor but, consistent with the teachings of the Church, Patsakis could not perform the position's spiritual functions because she is not ordained. Thus, as Pastoral Vicar, Deacon Euripides handled questions from priests regarding religious matters, and Patsakis, as Administrative Vicar, was, in the Bishop's words, his "administrative helper." Furthermore, the Bishop periodically referred to Patsakis as his "Chancellorette," though that title is not officially recognized by the Church.

As Administrative Vicar, Patsakis reviewed the mail with the Bishop on a daily basis, and drafted letters for his signature. Some letters were signed by the Bishop, his signature stamp was affixed to others, and Patsakis signed some letters under her own name. For example, she prepared letters to judges regarding the inability of the Bishop and parish priests to sit as jurors in civil or criminal matters,

and she wrote thank you letters to donors. Generally, these were form letters found in the computer and she gave them to the Bishop for his approval. The Bishop normally reviewed and approved all correspondence sent from the Diocese, but on at least one occasion, Patsakis prepared a letter to the parish council in York, Pennsylvania on behalf of the Bishop, which the Bishop directed but did not review before it was sent.

Patsakis also liaised between the Bishop on the one hand and clergy and laity on the other hand. Patsakis corresponded with parish priests regarding the Bishop's schedule and the clergy-laity assemblies. Similarly, she received complaints and repeated them to the Bishop, who then decided how to handle them. Patsakis also corresponded with parishes regarding their annual monetary commitments/assessments under the Total Commitment Program, though there is no indication that she had authority to set the amounts of such commitments. Finally she handled the finances for the youth ministry.

In an Archdiocese "Employee Profile," Patsakis listed her job as Administrator/Registrar and listed her responsibilities as follows: overseeing administrative operations, working with His Eminence (the Bishop), registry, coordinating office resources, and working on parish assessments. For most of Patsakis' time at the Diocese of Pittsburgh, the Bishop was her immediate and only supervisor.

Worried that some within the Diocese felt she was not performing all the tasks she was given, Patsakis composed a memorandum in June 2002 in which she documented her concerns and frustrations. Patsakis noted that she was hired ostensibly as Registrar but was advised that she would also serve informally as "Camp Coordinator for the Camp at Mount Tabor." She also stated that after Father Panagiotou's departure, she had been called upon to assume the duties of Chancellor in addition to her duties as Registrar and Mount Tabor Camp Coordinator. The Bishop called her his "Chancellorette" and announced on many occasions that she had become "Diocesan Administrator." Patsakis lamented that, in addition to her duties as Registrar, "[b]udget and assessment tasks were heaped upon [her] from the Archdiocese" and that she had been called upon to "mediate parochial problems" at parishes in Youngstown, Cleveland, and York. She also complained that taking the Bishop to doctors' appointments and arranging his health insurance coverage had distracted her from her many other duties.

II. Standard of Review

Under Rule 12(b)(1) of the Federal Rules of Civil Procedure, the movant may make a facial or a factual challenge to subject matter jurisdiction. *Mortensen v. First Fed. Sav. & Loan Ass'n*, 549 F.2d 884, 891 (3d Cir.1977). A factual challenge, like the one defendants make here, challenges the court's power to hear the case. In *Mortensen*, the Court of Appeals for the Third Circuit articulated the standard of review as follows:

> [I]n a factual 12(b)(1) motion ... there is substantial authority that the trial court is free to weigh the evidence and satisfy itself as to the existence of its power to hear the case. In short, no presumptive truthfulness attaches to plaintiff's allegations, and the existence of disputed material facts will not preclude the trial court from evaluating for itself the merits of jurisdictional claims. Moreover, the plaintiff will have the burden of proof that jurisdiction does in fact exist.

Id. The propriety of asserting the "ministerial exception" defense through a

12(b)(1) motion, as defendants have done here, is well-established. *See Alicea–Hernandez v. Catholic Bishop of Chi.*, 320 F.3d 698 (7th Cir.2003); *Bollard v. Cal. Province of the Soc'y of Jesus*, 196 F.3d 940 (9th Cir.1999); *Combs v. Cent. Tex. Annual Conference of the United Methodist Church*, 173 F.3d 343 (5th Cir.1999); *Bryce v. Episcopal Church in the Diocese of Colo.*, 121 F.Supp.2d 1327 (D.Colo.2000); *Smith v. Raleigh Dist. of the N.C. Conference of the United Methodist Church*, 63 F.Supp.2d 694 (E.D.N.C.1999); *EEOC v. Roman Catholic Diocese*, 48 F.Supp.2d 505 (E.D.N.C.1999).

III. Analysis

[1] This case presents a potential clash between essential civil and constitutional rights. Title VII of the Civil Rights Act of 1964 bars discrimination against employees on the basis of race, religion, gender, and national origin. 42 U.S.C. § 2000e–2(a). The First Amendment to the United States Constitution states that "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof...." U.S. CONST. amend. I. The Free Exercise Clause has been interpreted to allow religious organizations the "power to decide for themselves, free from state interference, matters of church government as well as those of faith and doctrine." *Kedroff v. St. Nicholas Cathedral*, 344 U.S. 94, 116, 73 S.Ct. 143, 97 L.Ed. 120 (1952). The Free Exercise Clause also protects the right of religious organizations to choose ministers without government restriction. *Id.; Rayburn v. Gen. Conference of Seventh–Day Adventists*, 772 F.2d 1164, 1167 (4th Cir.1985) ("perpetuation of a church's existence may depend upon those whom it selects to preach its values, teach its message, and interpret its doctrines"). The question presented here is whether Patsakis' claims under Title VII would violate defendants' First Amendment rights under the Free Exercise Clause such that the court lacks jurisdiction to hear her complaint.

[2] Congress addressed the inherent tension between Title VII and the Free Exercise Clause when it exempted religious employers from the statute's prohibition of religion-based discrimination. 42 U.S.C. § 2000e–1(a); *see also Little v. Wuerl*, 929 F.2d 944, 947–49 (3d Cir.1991) (subjecting religious employer to a claim of religious discrimination would raise substantial questions under the Religion Clauses). But the statutory exemption does not relieve religious employers of liability for employment discrimination pertaining to the other protected classes enumerated in Title VII, such as race, sex, or national origin. *Rayburn*, 772 F.2d at 1166–67. Thus, Congress left to the judiciary the task of deciding how Title VII applies to religious organizations. The judiciary's response, first articulated by the Court of Appeals for the Fifth Circuit in *McClure v. The Salvation Army*, 460 F.2d 553 (5th Cir.1972), was to create a "ministerial exception," which exempted the employment relationship between churches and their ministers from Title VII. The *McClure* court reasoned:

> We find that the application of the provisions of Title VII to the employment relationship existing between ... a church and its minister would result in an encroachment by the State into an area of religious freedom which it is forbidden to enter by the principles of the free exercise clause of the First Amendment.... Congress did not intend, through the non-specific wording of the applicable provisions of Title VII, to regulate the employment between church and minister.

Id. at 557.

McClure has been cited with approval by almost all courts of appeals, but its

ministerial exception, now thirty-two years old, has never been considered by the Supreme Court. *See generally,* Janet S. Belcove–Shalin, *Ministerial Exception and Title VII Claims: Case Law Grid Analysis,* 2 NEV. L.J. 86 (1999); Laura L. Coon, *Employment Discrimination by Religious Institutions: Limiting the Sanctuary of the Constitutional Ministerial Exception to Religion–Based Employment Decisions,* 54 VAND. L.REV. 481 (2001). It is clear that certain civil rights claims are barred by the Free Exercise Clause under the ministerial exception, but the boundaries of the doctrine remain murky. Although the phrase "ministerial exception" would seem to apply only to clergy, several courts have extended the doctrine to claims by lay employees of religious institutions when they serve a function sufficiently similar to that served by clergy. *See, e.g., Shaliehsabou v. Hebrew Home of Greater Wash.,* 363 F.3d 299, 307, *reh'g en banc denied* 369 F.3d 797 (4th Cir.2004) (kosher food supervisor deemed a minister); *Alicea–Hernandez,* 320 F.3d at 704 (Hispanic communications manager deemed a minister); *EEOC v. Roman Catholic Diocese of Raleigh,* 213 F.3d 795, 805 (4th Cir.2000) (music director deemed a minister). However, "the exception does not apply to the religious employees of secular employers or to the secular employees of religious employers." *Shaliehsabou,* 363 F.3d at 307.

Although the Court of Appeals for the Third Circuit has not addressed the issue presented in this case, it has followed *McClure* and approved of the ministerial exception in the context of religious discrimination. *See Little,* 929 F.2d at 947; *Geary v. Visitation of the Blessed Virgin Mary Parish Sch.,* 7 F.3d 324, 329 (3d Cir.1993). Furthermore, this court is unaware of any case that has declined to apply the ministerial exception to other federal employment statutes such as the Americans with Disabilities Act (ADA), the Age Discrimination in Employment Act (ADEA) or the Fair Labor Standards Act (FLSA). *See, e.g., Starkman v. Evans,* 198 F.3d 173, 175 (5th Cir.1999) (ADA); *Weissman v. Congregation Shaare Emeth,* 38 F.3d 1038, 1039 (8th Cir.1994) (ADEA); *Shaliehsabou,* 363 F.3d at 301 (as applied to FLSA); *but see Shaliehsabou v. Hebrew Home of Greater Wash.* 369 F.3d 797, 798 (4th Cir.2004) (Luttig, J., dissenting from denial of rehearing *en banc*) (objecting to application of ministerial exception in FLSA cases).

[3] In determining whether an employee is barred from bringing a civil rights claim by the ministerial exception, courts have looked beyond the title of plaintiff's employment and scrutinized the "primary duties" of the position. *Alicea–Hernandez,* 320 F.3d at 703; *Shaliehsabou,* 363 F.3d at 307. Employees whose duties are "important to the spiritual and pastoral mission of the church" are deemed ministers. *Rayburn,* 772 F.2d at 1168–69; *EEOC v. Southwestern Baptist Theological Seminary,* 651 F.2d 277 (5th Cir.1981). "If the employee's primary duties consist of teaching, spreading the faith, church governance, supervision of a religious order, or supervision or participation in religious ritual and worship, he or she should be considered clergy." *Rayburn,* 772 F.2d at 1169 (internal quotation marks omitted).

More recently, the Court of Appeals for the Fifth Circuit articulated an alternative three part test, directing courts to weigh: (1) whether employment decisions regarding the position at issue are made largely on religious criteria; (2) whether the plaintiff was qualified and authorized to perform the ceremonies of the church; and (3) whether the plaintiff engaged in activities traditionally considered ecclesiastical or religious, including whether the plaintiff

"attends to the religious needs of the faithful." *Starkman*, 198 F.3d 173, 176–77 (citing *Southwestern Baptist*, 651 F.2d at 284). The tripartite test enunciated by the Fifth Circuit Court is an expansion of the "primary duties" test, which is subsumed by its third prong.

In the instant case, there is little dispute about Patsakis' actual duties, although the parties characterize them quite differently. The crux of Patsakis' argument is that her duties were merely administrative and that she had no authority to make policy, interpret doctrine, perform religious rituals, or to compose the communications that bore her signature. Defendants argue that Patsakis was the gatekeeper to marriages and other religious ceremonies, that she spoke for and represented the Diocese and the Bishop, and was integral to Church governance.

A. Patsakis is not a minister under the "primary duties" test.

1. *Patsakis' duties as Registrar do not make her a minister.*

In her role as Registrar, Patsakis acted principally as a record-keeper. She collected and maintained Church documents and ensured that they contained all of the necessary information. Ultimately, it was each individual priest's responsibility to ensure that the documents were accurate; Patsakis could not independently rule on the doctrinal legitimacy of documents submitted to her.

[4] The court finds that these duties are primarily clerical and do not rise to the level of pastoral or ministerial duties. Filing and organizing documents, whether they are religious documents or tax forms, is a clerical function. Though defendants correctly note that Patsakis was responsible for ensuring that documents were in order, she performed a primarily clerical role in doing so. There is no evidence that Patsakis' duties as Registrar required any heightened religious knowledge or spiritual involvement. She had no authority to make judgment calls in borderline cases and any nonconforming documents were brought to the attention of the Bishop. Accordingly, Patsakis' duties as Registrar were not sufficiently important to the spiritual and pastoral mission of the Church to make her a minister.

2. *Patsakis' duties as Administrative Vicar do not make her a minister.*

[5] By the time Patsakis became Administrative Vicar of the Diocese, she wore many hats. She discharged a congeries of administrative duties, including managing the offices, drafting letters, relaying problems to the Bishop, and handling finances for the youth ministry. In her June 2002 memorandum, Patsakis claimed to be overwhelmed with her many responsibilities for the Church. That memorandum, which was clarified at the evidentiary hearing, shows the significance of Patsakis' role in the administrative functioning of the Church, but it does not indicate any pastoral or spiritual significance. Furthermore, she complains in the letter that she had to take the Bishop to doctor's appointments and call to arrange for his insurance coverage. Such duties, while undoubtedly helpful to the Bishop, are neither pastoral nor spiritual.

In addition, Patsakis' role in communication does not rise to the level of ministerial function. Defendants argue that because Patsakis drafted letters for the Bishop and posted them herself, she is akin to the plaintiff in *Alicea–Hernandez, supra*. Unlike Patsakis, however, the plaintiff in *Alicea–Hernandez* had a seminal role in communications; she was responsible for press releases and church publications in addi-

tion to representing the church at community events. *Id.* at 700. The Seventh Circuit Court of Appeals relied heavily on the fact that the plaintiff was "the primary communications link to the general populace." *Id.* at 704. Here, though Patsakis drafted letters for the Bishop and occasionally sent form letters under her own name, such duties are essentially clerical and do not rise to the level of the communications director function in *Alicea–Hernandez.* There is no evidence that Patsakis drafted or sent any correspondence to the general populace, and no evidence that any of the correspondence with which she was involved was of nearly the significance of the press releases and church publications deemed significant by the Seventh Circuit Court in *Alicea–Hernandez.*

Likewise, the court finds *Shaliehsabou* and *Diocese of Raleigh* factually inapposite, as both involve participation in religious rituals. *See Shaliehsabou,* 363 F.3d at 309 (as kosher inspector, plaintiff "supervised and participated in religious ritual and worship"); *Diocese of Raleigh,* 213 F.3d at 802 (music director deemed minister because music is "an integral part of Catholic worship and belief"). Here, there is no evidence that Patsakis performed or participated in any religious ritual. In fact, there is substantial evidence that she could not have done so because of her gender; though not a prerequisite to the application of the exception, *see Diocese of Raleigh,* 213 F.3d at 801, the fact that Patsakis is not ordained is probative.

Additionally, Patsakis' role as liaison between the Bishop and his flock does not rise to the ministerial level. Although Patsakis was informed of problems that required the Bishop's attention, there was no evidence that she ever exercised any independent judgment to solve them. She merely relayed problems to the Bishop and then acted as he instructed.

In sum, despite the fact that Patsakis was heavily involved in the administration of the Church as Administrative Vicar, there is no indication that she was ever involved in spiritual or pastoral matters. As Bishop Maximos testified at the hearing: "an Administrative Assistant (Vicar) cannot handle spiritual matters."

3. *Patsakis' other duties do not render her a minister.*

[6] Defendants maintain that Patsakis mediated a dispute between two parishes and argue that she should be deemed a minister as a result. The court disagrees for two reasons. First, despite the fact that Patsakis claimed in her June memorandum that she mediated a dispute, the Bishop testified that he did not send Patsakis to mediate parish problems because a parish would not have respected her. Second, even if Patsakis had acted as a mediator in this one case, there is no evidence that this was one of her principal duties. The mere fact that a lay employee discharges episodic religious duties does not shield a religious employer under the ministerial exception *per se;* under the *McClure* test, the court scrutinizes the employee's *primary* duties as a whole. *Accord Weissman,* 38 F.3d at 1045 (holding the mere fact that a claimant under the ADEA has some religious duties does not pose a significant risk of infringement upon First Amendment rights). If Patsakis in fact mediated a dispute between parishes, it was an isolated event and is not sufficient to make her a minister under the "ministerial exception."

Likewise, Patsakis' additional roles in the Total Commitment Program and as camp coordinator of the Mount Tabor Youth Ministry do not make her a minister. There is no evidence that Patsakis was involved with setting monetary commitments for the Total Commitment Pro-

gram. Had she coordinated a religious message for the youth ministry as camp coordinator, this case might be different. The camp is in the planning stages and does not yet exist, and Patsakis merely handled the finances and performed other administrative functions related to its establishment. These tasks, while important, are not vital to the spiritual or pastoral care of the Church. *See id.* (holding the "overwhelming majority" of a Jewish temple administrator's responsibilities, which included maintaining financial records, were "wholly secular").

B. Patsakis is not a minister under the *Starkman* test.

Alternatively, the court finds that Patsakis is not a minister under the test enunciated by the Court of Appeals for the Fifth Circuit in *Starkman*. Under that test, courts must weigh: (1) whether employment decisions regarding the position at issue are made largely on religious criteria; (2) whether the plaintiff was qualified and authorized to perform the ceremonies of the church; and (3) whether the plaintiff engaged in activities traditionally considered ecclesiastical or religious, including whether the plaintiff "attends to the *religious* needs of the faithful." *Starkman*, 198 F.3d at 176–77 (emphasis added). First, there is no indication that decisions regarding either position Patsakis held were made on religious criteria. In fact, the decision to *exclude* Patsakis from consideration as Chancellor was dictated by religious doctrine, which requires that only men hold the position. Additionally, Administrative Vicar is not a title recognized by the Greek Orthodox Church. Second, it is undisputed that Patsakis was not authorized to perform religious ceremonies. Third, as stated previously, Patsakis' duties were primarily administrative rather than religious, and her role in attending to the religious needs of the faithful, if any, was *de minimis*. Accordingly, the court finds that Patsakis was not a minister under the *Starkman* test.

IV. Conclusion

For purposes of the ministerial exception, whether an individual is important to the administrative functioning of the Church is critically less significant than whether she is important to the spiritual functioning of the Church. The lowest ranking nun or monk in the abbey is still a minister, whereas a clerical or administrative employee, no matter how indispensable, is not. Patsakis had many important roles within the Church, and the Bishop delegated significant responsibilities to her. But her primary duties were not sufficiently "important to the spiritual and pastoral mission of the church," *Rayburn*, 772 F.2d at 1168–69, to render her a "minister" for purposes of the ministerial exception.[1]

An appropriate order follows.

ORDER OF COURT

AND NOW, this 6th day of October, 2004, it is hereby ORDERED that Defendants shall file a response to the claims of Plaintiff Patsakis on or before October 27,

1. Finally, the court notes that, on the present state of the record, defendants have not provided a religious reason for Patsakis' termination, and the court makes no determination at this time on that issue. Indeed, to delve into the reasons for Patsakis' termination before deciding whether she is a "minister" would enmesh the court in the very investigation and review of church matters that the ministerial exception was designed to prevent. *See Alicea–Hernandez*, 320 F.3d at 703 (emphasizing that the only question before the court is the appropriate characterization of employee's position, and not the secular or religious reason for alleged mistreatment).

2004; it is further ORDERED that an initial case management conference in this case will be held at 1:30 p.m. on November 1, 2004 in Room 1014 of the United States Post Office and Courthouse, 700 Grant Street, Pittsburgh, Pennsylvania, 15219. Pursuant to Rule 26(f), the attorneys of record who have appeared in the case are jointly responsible for submitting to the Court on or before October 29, 2004, a written report outlining their discovery plan. (A form of discovery plan is attached hereto as Exhibit A). ***This Court requires strict compliance with Rule 26.***

Counsel should be familiar with this Court's Practices and Procedures (see Court Practices and Procedures at *www.pawd.uscourts.gov*, link "court practice.")

FIELDSTONE INVESTMENT CORPORATION

v.

SID R. BASS MANAGEMENT TRUST, et al.

No. CIV. JFM-04-1707.

United States District Court, D. Maryland.

Oct. 14, 2004.

Background: Corporation sought declaratory judgment that former shareholders who had redeemed their stock were not entitled to additional payment under terms of parties' redemption agreement. Former shareholders moved to dismiss or, in the alternative, for stay, based on former shareholders' previously filed Texas state-court action against corporation arising from same agreement.

Holding: The District Court, Motz, J., held that District Court would decline to exercise jurisdiction, since issues could be more efficiently resolved in Texas, permitting action to go forward would result in unnecessary entanglement, and corporation was using action as device for procedural fencing.

Stay granted.

1. Declaratory Judgment ⇐45

Maryland federal district court would decline to exercise its jurisdiction to decide corporation's declaratory judgment action against former shareholders concerning dispute over parties' redemption agreement, in favor of previously filed Texas state-court action by same shareholders against corporation arising from same agreement, even though agreement provided that it was governed by Maryland law; auditor that was key figure in dispute was clearly subject to jurisdiction in Texas but might not be subject to joinder as counter-defendant in Maryland, there was issue as to whether Maryland action could be maintained under Anti-Injunction Act, permitting action to go forward would result in unnecessary entanglement between federal and state courts because of overlapping issues, and corporation was using action as device for procedural fencing. 28 U.S.C.A. §§ 2201(a), 2283.

2. Declaratory Judgment ⇐45

Factors in whether federal court should exercise its discretion to grant relief under Declaratory Judgment Act, despite pending state action, are: (1) strength of state's interest in having issues raised in federal action decided in state courts; (2) whether issues raised in federal action can more efficiently be resolved in court in which state action is pending; (3) whether

Patricia A. PATSAKIS, et al., Plaintiffs,

v.

GREEK ORTHODOX ARCHDIOCESE OF AMERICA, et al., Defendants.

No. Civ.A. 03-1851.

United States District Court, W.D. Pennsylvania.

April 21, 2006.

Background: Former employees brought Title VII action against employer, alleging that their employment was terminated in retaliation for their complaints about sex discrimination. Employer moved for summary judgment.

Holdings: The District Court, Hardiman, J., held that:

(1) employees made prima facie showing that they engaged in protected activity when they complained to supervisors about discrimination, and

(2) genuine issue of material fact as to whether employer's proffered reason for discharging employees was pretextual precluded summary judgment.

Motion denied.

1. **Civil Rights** ⇐1244

For purposes of a Title VII retaliation claim, protesting what an employee believes in good faith to be a discriminatory practice is clearly protected conduct; thus, a plaintiff need not prove the merits of the underlying discrimination complaint, but only that she was acting under a good faith, reasonable belief that a violation existed. Civil Rights Act of 1964, § 701 et seq., 42 U.S.C.A. § 2000e et seq.

2. **Civil Rights** ⇐1244

Church diocese female employees' subjective belief that they were being discriminated against could have been found to be objectively reasonable, and thus, employees made prima facie showing that they engaged in protected activity when they complained to supervisors about discrimination, for purposes of establishing prima facie case that termination of their employment was retaliatory, in violation of Title VII; one employee claimed to have overheard supervisor complaining that he had to work with two "damn women," and both employees read email from office volunteer quoting supervisor as saying that all diocese employees needed "to get laid," and that none of the priests wanted to work with women and that women had to accept that. Civil Rights Act of 1964, § 701 et seq., 42 U.S.C.A. § 2000e et seq.

3. **Civil Rights** ⇐1247

Employer's proffered reason for discharging employees, which was that employees had been clandestinely tape-recording fellow employees and supervisors, constituted legitimate, nondiscriminatory reason for discharge, for purposes of satisfying employer's burden to respond to employees' prima facie showing that they were discharged in retaliation for their complaints of sex discrimination, in violation of Title VII. Civil Rights Act of 1964, § 701 et seq., 42 U.S.C.A. § 2000e et seq.

4. **Federal Civil Procedure** ⇐2497.1

Genuine issue of material fact as to whether employer's proffered reason for discharging employees, which was that employees had been clandestinely tape-recording fellow employees and supervisors, was pretextual precluded summary judgment on employees' claim that they were discharged in retaliation for their complaints of sex discrimination, in violation of Title VII. Civil Rights Act of 1964, § 701 et seq., 42 U.S.C.A. § 2000e et seq.

Colleen Ramage Johnston, Rothman Gordon, P.C., Pittsburgh, PA, for Plaintiffs.

Donna J. Geary, Mark Goldner, Martin J. Saunders, Jackson Lewis LLP, Pittsburgh, PA, for Defendants.

OPINION

HARDIMAN, District Judge.

I. Introduction

Plaintiffs Patricia A. Patsakis (Patsakis) and Angela Sklavos (Sklavos) sued the Greek Orthodox Archdiocese of America (Archdiocese) and the Greek Orthodox Diocese of Pittsburgh (Pittsburgh Diocese or Diocese) for discrimination in violation Title VII of the Civil Rights Act of 1964 alleging wrongful termination in retaliation for complaining about sexual discrimination in the workplace. Defendants filed a motion for summary judgment, arguing that Plaintiffs cannot prove a *prima facie* case of retaliation and, even if they could, Plaintiffs cannot prove that the legitimate nondiscriminatory reasons Defendants have articulated to justify Plaintiffs' terminations were pretextual. For the reasons that follow, the Court will deny the motion.

II. Factual Background

The Archdiocese is a branch of the Greek Orthodox Church, with its headquarters in New York, New York. The head of the Archdiocese is Archbishop Demetrios, who is assisted by a Chancellor and Assistant Chancellor. Father Michael Kontogiorgis (Fr. Michael) has served as the Assistant Chancellor from 1998 until the present. The Archdiocese consists of eight dioceses, or metropolises, and the Pittsburgh Diocese covers most of Pennsylvania, West Virginia, and Ohio. Each diocese is run by a bishop, or metropolitan, who in the Pittsburgh Diocese is Bishop Maximos Aghiorgousis (the Metropolitan). The Metropolitan has ultimate authority in the Diocese, and his staff acts on his behalf. He is responsible for administering to the spiritual and secular needs of the members of the Diocese. The Metropolitan is assisted in these endeavors by various staff members, including the Chancellor and the Registrar. In the Greek Orthodox Church, only priests serve as chancellors; any lay person holding the position is called Administrative Assistant or Vicar.

Plaintiff Patsakis began working for the Diocese on December 1, 2001 as Registrar. She was also hired as the Mt. Tabor Coordinator, which meant she was responsible for fundraising, bookkeeping, and the production of official correspondence. Plaintiff Sklavos began working for the Diocese as Executive Secretary in August 2001. In that capacity, she performed various clerical duties and assisted with the publication of the Diocesan newspaper. On March 1, 2002, Father John Panagiotu (Fr. John), the Chancellor of the Diocese, was relocated to South Carolina and Patsakis was made Temporary Administrative Vicar, in addition to her other positions. Father Ryan Gzikowski (Fr. Ryan) became Assistant to the Metropolitan on May 1, 2002, after having worked in the Diocese for several summers. As Assistant to the Metropolitan, Fr. Ryan assumed the duties of Chancellor, including those assigned to the Vicar.

Not long after Fr. Ryan began serving as Assistant to the Metropolitan, disagreements arose between Fr. Ryan and Plaintiffs. It is clear from the record that there was already a larger conflict ongoing within the Diocese, and that the allegedly discriminatory behavior occurred in the context of this existing struggle. The record concerning the dispute that existed in the Diocese is voluminous, and the salient facts for purposes of the pending motion relate to the complaints of discrimination made by Patsakis and Sklavos and their subsequent termination.

Patsakis and Sklavos both believed that Fr. Ryan treated them differently because

they were women. The factual support they offer to buttress this contention falls into two categories: gender neutral behavior they interpreted as discriminatory based on the target and gender specific comments they believe are discriminatory based on their content. With respect to gender neutral conduct, Plaintiffs allege that Fr. Ryan was intimidating towards them, and would frequently slam doors and break pencils. He was also dismissive by ignoring them when they spoke or passed him in the hallway. At the same time, however, Patsakis acknowledged that Fr. Ryan is friendly to other women in the office, and Sklavos testified that he routinely ignores priests, who are all male.

Plaintiffs emphasize two incidents of gender specific comments in support of their complaints of discrimination. First, Patsakis overheard Fr. Ryan telling someone in the Diocese kitchen that he "had to work with two damn women." Second, on August 20, 2002, Patsakis received an email from office volunteer Cindy Balouris (Balouris), which purports to relay the content of a conversation that Balouris had with Fr. Ryan several days earlier. In the email, Balouris quotes Fr. Ryan saying that he "was the only one that was having sex," that "everyone in the Diocese needs to get laid," and that Vasie–Leigh Androitis (Vasie–Leigh), another female working at the Diocese, was "another one that needed a good screw." Balouris also claims in her email that Fr. Ryan said "he was going to show everyone there that he is the only one with Balls." In addition, the email quotes Fr. Ryan saying that "none of the priests want to work with women and it's not up to our Diocese to straighten Greek men out on that fact. He said I am sorry that Greek men are the way they are, but us women have to accept it." When confronted by the Metropolitan about the foregoing email, Fr. Ryan denied making the comments attributed to him.

Based on what they perceived to be sexual discrimination by Fr. Ryan, Patsakis and Sklavos complained repeatedly to various members of the Archdiocese, including the Metropolitan. In addition, Patsakis complained to Linda Petersen (Petersen), the Human Resources Manager for the Archdiocese, and Jerry Dimitriou (Dimitriou), the Executive Director of Administration.

Less than two months after Patsakis received the email from Balouris, on October 4, 2002, Fr. Ryan went into Patsakis' office looking for the Metropolitan's signature stamp. While doing so, Fr. Ryan opened a drawer and found a tape recorder and several cassette tapes. He listened to part of the tapes and found that they were conversations among, *inter alia*, Patsakis, Sklavos, Fr. Michael, and the Metropolitan. Fr. Ryan reported his discovery to Fr. Michael, who in turn told the Metropolitan. Based on the voices on the tapes and the meetings and conversations they included, Fr. Ryan became convinced that Sklavos and Patsakis were responsible for the recordings and that they were motivated by the ongoing struggle within the Diocese. Patsakis claims that she taped a meeting in accordance with her responsibilities, and that the recorder was obvious to everyone in the room at the time.

On October 7, 2002, the Metropolitan prepared two letters stating that Patsakis and Sklavos were being terminated because of the restructuring of staff positions and instructed Fr. Ryan to terminate them. On October 8, 2002, when Patsakis arrived at work, Fr. Ryan informed her that she was terminated and ordered her to collect her belongings and depart. Patsakis then telephoned Sklavos and informed her that they had both been terminated. Sklavos arrived at the Diocese, collected her things, and left as well. When asked for a reason why they were

being fired, both Plaintiffs were told by Fr. Ryan to contact the Executive Director of Administration, Jerry Dimitriou.

Patsakis and Sklavos asked Dimitriou why they had been fired, but never received an answer from him. Thereafter, Plaintiffs received the termination letters drafted by the Metropolitan on October 7, which indicate that their terminations were because of a staff restructuring. Consistent with the Metropolitan's letter, in the employment questionnaire submitted to the Archdiocese after Sklavos filed for unemployment benefits, Human Resources Manager Petersen cited office restructuring as the reason for Sklavos' termination. Peterson testified that she could not remember being aware of the tape recording at the time she completed the questionnaire. In a letter to the Equal Employment Opportunity Commission (EEOC) written August 28, 2003, Defendants stated that Patsakis was fired because she was disloyal and insubordinate to the Metropolitan, and listed surreptitious tape-recording as an example of her disloyalty. In their letter to the EEOC concerning Sklavos' termination, Defendants wrote that she was fired because of a staff restructuring intended to improve the functioning of the office and remove disloyal employees.

III. Standard of Review

Summary judgment is required on an issue or a claim when "the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed.R.Civ.P. 56(c); *see also Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 250–52, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986); *Saldana v. Kmart Corp.*, 260 F.3d 228, 231–32 (3d Cir.2001). An issue is "material" only if the factual dispute "might affect the outcome of the suit under the governing law." *Anderson*, 477 U.S. at 248, 106 S.Ct. 2505.

"Summary judgment procedure is properly regarded not as a disfavorable procedural shortcut, but rather as an integral part of the Federal Rules as a whole, which are designed to secure the just, speedy and inexpensive determination of every action." *Celotex Corp. v. Catrett*, 477 U.S. 317, 327, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986) (internal quotation marks omitted). The parties have a duty to present evidence; neither statements of counsel in briefs nor speculative or conclusory allegations satisfy this duty. *Ridgewood Bd. of Educ. v. N.E. for M.E.*, 172 F.3d 238, 252 (3d Cir.1999). After the moving party has filed a properly supported motion, the burden shifts to the non-moving party to set forth specific facts showing that there is a genuine issue for trial. Fed.R.Civ.P. 56(e). The non-moving party must make a showing sufficient to establish the existence of each element essential to her case on which she will bear the burden of proof at trial. *Celotex*, 477 U.S. at 322–23, 106 S.Ct. 2548.

IV. Analysis

Defendants argue that Plaintiffs have failed to state a *prima facie* case of retaliation and, alternatively, have failed to rebut the legitimate non-discriminatory reasons for termination offered by Defendants.

A. *Prima Facie* Case

To prove a Title VII retaliation claim, a plaintiff "must show that (1)[she] was engaged in protected activity; (2)[she] was discharged subsequent to or contemporaneously with such activity; and (3) there is a causal link between the protected activity and the discharge." *Woodson v. Scott Paper Co.*, 109 F.3d 913, 920 (3d Cir.1997).

[1] With respect to the first criterion—engaging in protected activity—"protest-

ing what an employee believes in good faith to be a discriminatory practice is clearly protected conduct. Thus, a plaintiff need not prove the merits of the underlying discrimination complaint, but only that [s]he was acting under a good faith, reasonable belief that a violation existed." *Aman v. Cort Furniture Rental Corp.*, 85 F.3d 1074, 1085 (3d Cir.1996) (internal citations omitted).

In *Clark County School Dist. v. Breeden*, 532 U.S. 268, 121 S.Ct. 1508, 149 L.Ed.2d 509 (2001), the Supreme Court found that a Title VII plaintiff had not engaged in protected activity because "no reasonable person could have believed that the single incident recounted above violated Title VII's standard." *Id.* at 271, 121 S.Ct. 1508. In an unpublished opinion, the Court of Appeals for the Third Circuit cited the *Clark County* decision, recognizing this objective reasonableness requirement. "A plaintiff's belief may be mistaken, but employer retaliation is prohibited if the allegations of discrimination have an objectively reasonable basis in fact." *Fogleman v. Greater Hazleton Health Alliance*, 122 Fed.Appx. 581, 583 (3d Cir.2004) *citing Clark County Sch. Dist. v. Breeden*, 532 U.S. 268, 121 S.Ct. 1508, 149 L.Ed.2d 509 (2001) *and Weeks v. Harden Mfg. Corp.*, 291 F.3d 1307 (11th Cir.2002). Similarly, the Court of Appeals for the Seventh Circuit has held that "only a groundless claim resting on facts that no reasonable person possibly could have construed as a case of discrimination could not constitute a statutorily protected activity. And a mistake as to the merits of a complaint does not cost an employee the protection of Title VII." *Firestine v. Parkview Health System, Inc.*, 388 F.3d 229, 234 (7th Cir.2004) (internal citations omitted).

[2] In the instant case, there is ample evidence that Patsakis and Sklavos subjectively believed that they were being discriminated against. Thus, the question presented here is whether their subjective belief could be found objectively reasonable by a jury.

Initially, the Court agrees with Defendants that merely slamming doors or breaking pencils could not form the basis of an objectively reasonable belief that Fr. Ryan was discriminating against Plaintiffs. But the record reveals more. For example, Patsakis claims to have overheard Fr. Ryan complaining that he has to work with two "damn women," and both Patsakis and Sklavos read the email from Balouris in which Fr. Ryan reportedly stated that "everyone in the Diocese needs to get laid," that "he is the only one with balls," and that another female employee "needed a good screw." Defendants attempt to minimize the impact of the Balouris email by claiming that the phrase "everyone in the Diocese" referred to every practicing member of the Diocese, rather than the employees of the Diocese. This contention is belied, however, by the previous statement that Fr. Ryan was "the only one that was having sex." Considering the context of the email and viewing the inferences in favor of the Plaintiffs, as the Court must at this stage of the case, it is clear that Fr. Ryan was talking about the employees of the Diocese and not the congregation at large. In addition, Fr. Ryan not only insisted that "none of the priests want to work with women" but also lamented that "it's not up to our Diocese to straighten Greek Men out" and the "women have to accept it."

Although the comments attributed to Fr. Ryan in the aforementioned email were neither directed at nor made in the presence of Plaintiffs, they relate directly to sex, gender, and plainly could be deemed offensive to a reasonable listener. The Court finds that the statement overheard by Patsakis, in conjunction with the content of the email, could be sufficient to

support a reasonable belief, even if erroneous, that Fr. Ryan had engaged in discrimination prohibited by Title VII. Thus, Plaintiffs satisfy the first element of a *prima facie* case of retaliation.

The record also demonstrates that Plaintiffs have satisfied the second and third elements, namely that they were discharged after engaging in protected activity and some causal link exists between the activity and the discharge. The discharges in this case clearly occurred after the protected activity, and thus the second requirement is satisfied. As to the casual connection, the Third Circuit stated in *Woodson* that "temporal proximity between the protected activity and the termination is sufficient to establish a causal link." *Woodson*, 109 F.3d at 920. Here, Plaintiffs were terminated less than a month after their last complaints, thus satisfying the third requirement for a *prima facie* case.

B. Pretext

[3] Once a *prima facie* case is established, the burden shifts to the defendant. "The employer satisfies its burden of production by introducing evidence which, taken as true, would permit the conclusion that there was a nondiscriminatory reason for the unfavorable employment decision." *Fuentes v. Perskie*, 32 F.3d 759, 763 (3d Cir.1994) (internal citations omitted). Here, Defendants insist that Patsakis and Sklavos were terminated because they were discovered clandestinely tape-recording fellow employees and superiors, including the Metropolitan. There can be no doubt that the surreptitious tape recording of the Metropolitan and others constitutes a legitimate, nondiscriminatory reason for Plaintiffs' discharge.

[4] "Once the employer answers its relatively light burden by articulating a legitimate reason for the unfavorable employment decision, the burden of production rebounds to the plaintiff, who must now show by a preponderance of the evidence that the employer's explanation is pretextual...." *Id.* at 763. In *Fuentes*, the Court of Appeals explained:

> This basic framework under Title VII illustrates that, to defeat summary judgment when the defendant answers the plaintiff's prima facie case with legitimate, non-discriminatory reasons for its action, the plaintiff must point to some evidence, direct or circumstantial, from which a factfinder could reasonably either (1) disbelieve the employer's articulated legitimate reasons; or (2) believe that an invidious discriminatory reason was more likely than not a motivating or determinative cause of the employer's action.

Id. at 764.

In *Smith v. Borough of Wilkinsburg*, 147 F.3d 272 (3d Cir.1998), the Court of Appeals held that an employer's shifting justifications for termination can constitute sufficient evidence of pretext. In *Smith*, the district court did not instruct the jury regarding their ability to use the defendant's changing reasons as sufficient proof of pretext and the Third Circuit reversed, based on this failure:

> [The Borough] had advised the EEOC and the Pennsylvania Commission on Human Relations that it didn't renew Smith's employment contract because he failed to file a formal application, in contrast to its explanation at trial which emphasized Smith's poor job performance. While this variation in articulated reasons did not compel the jury to disbelieve the Borough, the inconsistency was sufficient for a reasonable jury to view it as evidence of pretext leading to an inference of discrimination if the jury had been adequately charged.

Id. at 281.

In the instant case, Patsakis and Sklavos were not given any reason for their termi-

nation on October 8, 2002. In both the letters Plaintiffs received from the Metropolitan and in the correspondence sent to the Unemployment Commission by Human Resources Manager Petersen, the proffered justification for Plaintiffs' terminations was office restructuring. The nondiscriminatory reason given by Defendants in this case, the surreptitious tape recording, does not surface until Defendants' letter to the EEOC. Reviewing the record and drawing all inferences in favor of Plaintiffs, as the Court must at this stage, the vehemence with which the Defendants now insist that the tape recording was the sole motivation for firing Patsakis and Sklavos is inconsistent with their failure, in the intervening months, to cite that reason. Accordingly, the Court finds, pursuant to *Fuentes* and *Smith*, that a jury could, but need not, conclude that Defendants' proffered nondiscriminatory reason is pretextual.

C. Pittsburgh Diocese as an Employer under Title VII

Defendants also argue that the Pittsburgh Diocese is not an employer within the meaning of Title VII. Citing testimony from Dimitriou and others, Defendants insist that the Plaintiffs were employees of the Archdiocese, and in fact all employees working in the Pittsburgh Diocese were hired and paid by the Archdiocese. Plaintiffs contest this, and assert that the two Defendants are a single employer. Because material facts in are dispute concerning the status of the Pittsburgh Diocese as an employer, the Court will reserve judgment on this issue.[1]

V. Conclusion

In sum, the Court finds that there are sufficient material facts in dispute regarding the perceived discriminatory treatment complained of by Plaintiffs and the justifications for their termination, to preclude summary judgment in this case.

An appropriate Order follows.

1. Defendants also argue that Plaintiffs' damages are minimal. The issue is not appropriately decided at the summary judgment stage, and thus the Court will not address it.

Celeste TAYLOR, Richard King, Richard D. McWilliams, Tim Stevens, Constance Parker, Wali Jamal Abdullah, Robert Alan Robertson, and People for the American Way, Plaintiffs,

v.

Dan ONORATO, Allegheny County Chief Executive, Pedro A. Cortes, Secretary of the Commonwealth, Harry Vansickle, Commissioner, Pennsylvania Bureau of Legislation, Elections, and Commissions, The Allegheny County Board of Elections, James M. Flynn Jr., County Manager for Allegheny County, Wan J. Kim, Assistant Attorney General, Alberto Gonzales, Attorney General for the United States, Defendants.

Civil Action No. 06–481.

United States District Court,
W.D. Pennsylvania.

April 28, 2006.

Background: Registered voters and advocacy group brought action seeking to preliminarily enjoin use of touch screen voting machines in upcoming primary election.

Holdings: The District Court, Lancaster, J., held that:

Pinson v. Berkley Med. Res., Inc.

United States District Court for the Western District of Pennsylvania

June 21, 2005, Decided

Civil Action No. 03-1255

Reporter
2005 U.S. Dist. LEXIS 13045 *

TRUDI PINSON, Plaintiff, v. BERKLEY MEDICAL RESOURCES INC., Defendant.

Core Terms

disability, termination, attendance, Machine, neck, light-duty, panic attack, violations, excuses, major life activity, mental condition, impairment, healthcare provider, employees, absences, days, fact-finder, episodic, reasons, substantial limitation, accommodation, lifting, serious health condition, interactive process, sufficient evidence, prima facie case, retaliation, depression, rights, pain

Case Summary

Procedural Posture
Plaintiff former employee filed suit against defendant former employer alleging that her treatment and discharge violated the Americans with Disabilities Act (ADA), the Family and Medical Leave Act (FMLA), and the Pennsylvania Human Relations Act (PHRA). The employer moved for summary judgment.

Overview
The employee suffered from depression and migraine headaches. Regarding the discrimination claim, the court first found that the employee's failure to continue counseling and her apparent improvement after leaving the employer did not demonstrate that no material issue of fact existed as to the continuing nature of her disability. Next, the court found that the employee's termination was plainly an adverse employment action, and there was sufficient evidence to permit the conclusion that her termination was the result of disability discrimination. Moreover, the employer provided shifting justifications for the termination decision. Regarding the retaliation claim, the court found that because the employee failed to show a material issue of fact as to whether her neck and back injury made her a "qualified individual with a disability," the employee failed to trigger the employer's duty to engage in the interactive process. Finally, the employee's FMLA retaliation claim survived summary judgment. A reasonable fact-finder could find the employer's asserted reasons for termination pretextual or could find that discriminatory animus in fact motivated the employer's decision.

Outcome
The employer's motion for summary judgment was granted as to the employee's claim for failure to engage in the interactive process, and denied in all other respects.

LexisNexis® Headnotes

Civil Procedure > ... > Discovery > Methods of Discovery > General Overview

Civil Procedure > ... > Summary Judgment > Entitlement as Matter of Law > General Overview

Civil Procedure > ... > Summary Judgment > Entitlement as Matter of Law > Genuine Disputes

Civil Procedure > ... > Summary Judgment > Entitlement as Matter of Law > Materiality of Facts

Civil Procedure > ... > Summary Judgment > Supporting Materials > General Overview

HN1[] **Discovery, Methods of Discovery**

Summary judgment is required on an issue or a claim when the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. *Fed. R. Civ. P. 56(c)*. An issue is "material" only if the factual dispute might affect the outcome of the suit under the governing law.

Civil Procedure > ... > Summary Judgment > Entitlement as Matter of Law > Genuine Disputes

Civil Procedure > ... > Summary Judgment > Burdens of Proof > General Overview

Civil Procedure > ... > Summary Judgment > Burdens of Proof > Movant Persuasion & Proof

Civil Procedure > ... > Summary Judgment > Burdens of Proof > Nonmovant Persuasion & Proof

Civil Procedure > ... > Summary Judgment > Entitlement as Matter of Law > General Overview

HN2 **Entitlement as Matter of Law, Genuine Disputes**

Summary judgment procedure is properly regarded not as a disfavorable procedural shortcut, but rather as an integral part of the Federal Rules as a whole, which are designed to secure the just, speedy and inexpensive determination of every action. The parties have a duty to present evidence; neither statements of counsel in briefs nor speculative or conclusory allegations satisfy this duty. After the moving party has filed a properly supported motion, the burden shifts to the non-moving party to set forth specific facts showing that there is a genuine issue for trial. *Fed. R. Civ. P. 56(e)*. The non-moving party must make a showing sufficient to establish the existence of each element essential to his case on which he will bear the burden of proof at trial. The facts derived from the evidence of record must be taken in the light most favorable to the nonmovant.

Business & Corporate Compliance > ... > Labor & Employment Law > Discrimination > Accommodation

Labor & Employment Law > ... > Disability Discrimination > Scope & Definitions > Qualified Individuals With Disabilities

Labor & Employment Law > Discrimination > General Overview

Labor & Employment Law > ... > Disability Discrimination > Scope & Definitions > General Overview

HN3 **Discrimination, Accommodation**

Under the Americans with Disabilities Act, an employer cannot discriminate against a qualified individual with a disability because of the disability of such individual with regard to job application procedures, the hiring, advancement, or discharge of employees, employee compensation, job training, and other terms, conditions, and privileges of employment. *42 U.S.C.S. § 12112(a)*. Discrimination comes in two forms: (1) subjecting the employee to an adverse employment action motivated by prejudice or fear; or (2) failing to provide a reasonable accommodation for a disability.

Labor & Employment Law > ... > Evidence > Burdens of Proof > Employee Burdens of Proof

Labor & Employment Law > Discrimination > General Overview

Labor & Employment Law > ... > Disability Discrimination > Scope & Definitions > General Overview

Business & Corporate Compliance > ... > Discrimination > Disability Discrimination > Federal & State Interrelationships

Labor & Employment Law > ... > Disability Discrimination > Evidence > General Overview

Labor & Employment Law > ... > Evidence > Burdens of Proof > General Overview

Labor & Employment Law > Discrimination > Title VII Discrimination > General Overview

Labor & Employment Law > ... > Title VII Discrimination > Scope & Definitions > General Overview

HN4[↓] Burdens of Proof, Employee Burdens of Proof

The McDonnell Douglas analytical burden-shifting framework, first used in Title VII discrimination suits, applies to Americans with Disabilities Act (ADA) discrimination claims as well. Therefore, to establish a prima facie case of ADA discrimination, a plaintiff must establish: (1) she is a disabled person within the meaning of the ADA; (2) she is otherwise qualified to perform the essential functions of the job; and (3) she has suffered an adverse employment decision as a result of discrimination. If she establishes a prima facie case, the burden shifts to the employer to articulate some legitimate, nondiscriminatory reason for the adverse employment action. If the employer can articulate such a reason, the burden shifts back to the employee, who must produce sufficient evidence to raise a genuine issue of fact as to whether the employer's proffered reasons were not its true reasons for the challenged employment actions.

Civil Rights Law > ... > Protection of Disabled Persons > Americans With Disabilities Act > Legislative Intent

Labor & Employment Law > ... > Disabilities Under ADA > Mental & Physical Impairments > Major Life Activities

Labor & Employment Law > ... > Disability Discrimination > Scope & Definitions > General Overview

Labor & Employment Law > ... > Disability Discrimination > Employment Practices > Medical Inquiries

HN5[↓] Americans With Disabilities Act, Legislative Intent

The Americans with Disabilities Act (ADA) defines disability as a physical or mental impairment that substantially limits one or more of the major life activities of such individual. 42 U.S.C.S. § 12102(2). The United States Supreme Court has noted that the terms substantially and major, as used in the ADA provision defining disability need to be interpreted strictly to create a demanding standard for qualifying as disabled. Similarly, the United States Court of Appeals for the Third Circuit has written: the purpose of the ADA would be undermined if protection could be claimed by those whose relative severity of impairment was widely shared.

Labor & Employment Law > ... > Disabilities Under ADA > Mental & Physical Impairments > Major Life Activities

Labor & Employment Law > ... > Disability Discrimination > Scope & Definitions > General Overview

Labor & Employment Law > ... > Disabilities Under ADA > Mental & Physical Impairments > Substantial Limitations

HN6[↓] Mental & Physical Impairments, Major Life Activities

In the context of the Americans with Disabilities Act, the phrase "substantially limits" means unable to perform a major life activity that the average person in the general population can perform or significantly restricted as to the condition, manner or duration under which an individual can perform a particular major life activity as compared to the condition, manner, or duration under which the average person in the general population can perform that same major life activity. In assessing whether a major life activity has been substantially limited, a court should consider the following factors: (i) the nature and severity of the impairment; (ii) the duration or expected duration of the impairment; and (iii) the permanent or long term impact, or the expected permanent or long term impact of the impairment or resulting from the impairment. Major life activities include caring for oneself, performing manual tasks, walking, seeing, hearing, speaking, breathing, learning, and working, although this list is not exhaustive.

Labor & Employment Law > ... > Disabilities Under ADA > Mental & Physical Impairments > Major Life Activities

Labor & Employment Law > ... > Disability Discrimination > Scope & Definitions > General Overview

HN7[↓] Mental & Physical Impairments, Major Life Activities

In the context of the Americans with Disabilities Act, with regard to the major life activity of working, a court must look to whether an individual is significantly restricted in the ability to perform either a class of jobs or a broad range of jobs in various classes as compared to the average person having comparable training, skills and abilities. 29 C.F.R. § 1630.2(j)(3)(i). As this regulation suggests, a court must consider the individual's training, skills, and abilities to evaluate whether the particular impairment constitutes for the particular person a significant barrier to employment. 29 C.F.R. pt. 1630, app. § 1630.2(j). Because a person's expertise, background, and job expectations are relevant factors in defining the class of jobs used to determine whether an individual is disabled, the court must consider the effect of the impairment on the employment prospects of that individual with all of his or her relevant personal characteristics. Thus, a substantially limiting impairment for one individual may not be substantially limiting for another individual with different characteristics. 29 C.F.R. pt. 1630, app. § 1630.2(j).

Labor & Employment Law > ... > Disability Discrimination > Scope & Definitions > General Overview

HN8[↓] Disability Discrimination, Scope & Definitions

In the context of the Americans with Disabilities Act, the United States Court of Appeals for the Third Circuit follows the two-step analysis recommended by the Equal Employment Opportunity Commission's interpretive guidelines for determining whether a plaintiff is substantially limited in her ability to perform a major life activity. First, a court must determine whether the plaintiff is significantly limited in a life activity other than working. Only if a plaintiff is not limited in a life activity other than working should the court consider whether the plaintiff is substantially limited in the major life activity of working.

Education Law > ... > Disability Discrimination > Americans With Disabilities Act > General Overview

Labor & Employment Law > ... > Disability Discrimination > Evidence > General Overview

Labor & Employment Law > ... > Disability Discrimination > Scope & Definitions > General Overview

HN9[↓] Disability Discrimination, Americans With Disabilities Act

In the context of the Americans with Disabilities Act, the United States Court of Appeals for the Third Circuit, has suggested that plaintiffs with mental impairments are not precluded from showing a disability under the statute merely because of the episodic nature of their condition.

Labor & Employment Law > ... > Disability Discrimination > Scope & Definitions > General Overview

HN10[↓] Disability Discrimination, Scope & Definitions

There is substantial support for the proposition that temporary disabilities from which an employee fully recovers do not fall within the purview of the Americans with Disabilities Act.

Business & Corporate Compliance > ... > Labor & Employment Law > Discrimination > Accommodation

Labor & Employment Law > ... > Disability Discrimination > Scope & Definitions > Qualified Individuals With Disabilities

Labor & Employment Law > ... > Disability Discrimination > Scope & Definitions > General Overview

HN11[↓] Discrimination, Accommodation

In the context of the Americans with Disabilities Act, a two-part test is used to determine whether one is qualified to perform the essential functions of a job. First, a court must consider whether the individual satisfies the prerequisites for the position, such as possessing the appropriate educational background, employment experience, skills, licenses, etc. Second, the court must consider whether or not the individual can perform the essential functions of the position held

or desired, with or without reasonable accommodation. Also, the determination of whether an individual with a disability is qualified is made at the time of the employment decision.

Evidence > Burdens of Proof > Burdens of Production

Labor & Employment Law > ... > Evidence > Burdens of Proof > Burden Shifting

Labor & Employment Law > ... > Disability Discrimination > Evidence > General Overview

Labor & Employment Law > ... > Evidence > Burdens of Proof > General Overview

Labor & Employment Law > ... > Evidence > Burdens of Proof > Employee Burdens of Proof

HN12 **Burdens of Proof, Burdens of Production**

In the context of the Americans with Disabilities Act, where a plaintiff has proffered evidence sufficient to establish a prima facie case, the burden of production shifts to defendant to articulate some legitimate, nondiscriminatory reason for its actions. The burden at this stage is relatively light: it is satisfied if the defendant articulates any legitimate reason for the discharge and the defendant need not prove that the articulated reason actually motivated the discharge.

Labor & Employment Law > ... > Disability Discrimination > Evidence > General Overview

HN13 **Disability Discrimination, Evidence**

In the context of the Americans with Disabilities Act, where articulate some legitimate, nondiscriminatory reason for its actions, the burden shifts back to plaintiff, who must produce sufficient evidence to raise a genuine issue of fact as to whether the employer's proffered reasons were not its true reasons for the challenged employment actions. The employee must point to some evidence, direct or circumstantial, from which a fact-finder could reasonably either (1) disbelieve the employer's articulated legitimate reasons; or (2) believe that an invidious discriminatory reason was more likely than not a motivating or determinative cause of the employer's action.

Business & Corporate Compliance > ... > Unfair Labor Practices > Employer Violations > Interference With Protected Activities

Labor & Employment Law > ... > Retaliation > Statutory Application > Americans With Disabilities Act

Labor & Employment Law > Discrimination > General Overview

Labor & Employment Law > ... > Disability Discrimination > Scope & Definitions > General Overview

Labor & Employment Law > ... > Disability Discrimination > Evidence > General Overview

Labor & Employment Law > ... > Evidence > Burdens of Proof > General Overview

Labor & Employment Law > ... > Evidence > Burdens of Proof > Employee Burdens of Proof

Labor & Employment Law > Discrimination > Retaliation > General Overview

HN14 **Employer Violations, Interference With Protected Activities**

Americans with Disabilities Act (ADA) retaliation claims are analyzed under the same McDonnell Douglas burden-shifting framework as ADA discrimination claims. A plaintiff must first show (1) protected employee activity; (2) adverse action by the employer either after or contemporaneous with the employee's protected activity; and (3) a causal connection between the employee's protected activity and the employer's adverse action. Once a plaintiff has established these elements of his prima facie case, the burden shifts to the employer to advance a legitimate, non-retaliatory reason for its adverse employment action. If the employer satisfies that burden, the plaintiff must then prove that retaliatory animus played a role in the employer's decisionmaking process and that it had a

determinative effect on the outcome of that process. Unlike an ADA discrimination plaintiff, an ADA retaliation plaintiff is not required to establish that he is a qualified individual with a disability, but rather that he engaged in protected activity under the ADA. The right to request an accommodation in good faith is protected activity under the ADA.

Labor & Employment
Law > Discrimination > Retaliation > General Overview

HN15 **Discrimination, Retaliation**

In the context of a retaliation claim, timing in conjunction with other types of suggestive evidence, is clearly sufficient to demonstrate the causal link.

Business & Corporate Compliance > ... > Labor & Employment
Law > Discrimination > Accommodation

Labor & Employment Law > ... > Disability Discrimination > Scope & Definitions > General Overview

Business & Corporate Compliance > ... > Disability Discrimination > Reasonable Accommodations > Interactive Process

HN16 **Discrimination, Accommodation**

The ADA regulations establish the circumstances that trigger the employer's duty to engage in the interactive process: Once a qualified individual with a disability has requested provision of a reasonable accommodation, the employer must make a reasonable effort to determine the appropriate accommodation.

Business & Corporate Compliance > ... > Disability Discrimination > Reasonable Accommodations > Interactive Process

Labor & Employment Law > ... > Disability Discrimination > Scope & Definitions > General Overview

HN17 **Reasonable Accommodations, Interactive Process**

It is, of course, an axiom of any Americans with Disabilities Act claim that the plaintiff be disabled and that the employer be aware of the disability.

Business & Corporate Compliance > ... > Discrimination > Disability Discrimination > Federal & State Interrelationships

Labor & Employment
Law > ... > Retaliation > Statutory Application > Americans With Disabilities Act

Labor & Employment Law > ... > Disability Discrimination > Scope & Definitions > General Overview

Labor & Employment
Law > ... > Retaliation > Statutory Application > Family & Medical Leave Act

HN18 **Disability Discrimination, Federal & State Interrelationships**

The Pennsylvania Human Relations Act's (PHRA) definition of "handicap or disability" is substantially the same as the definition of "disability" under the Americans with Disabilities Act. Moreover, Pennsylvania courts generally interpret the PHRA in accord with its federal counterparts.

Business & Corporate Compliance > ... > Labor & Employment Law > Leaves of Absence > Family & Medical Leaves

Labor & Employment Law > Wrongful Termination > Remedies > Reinstatement

HN19 **Leaves of Absence, Family & Medical Leaves**

The Family and Medical Leave Act (FMLA) makes it unlawful for an employer to interfere with, restrain, or deny the exercise of or the attempt to exercise, any right provided under the statute. *29 U.S.C.S. § 2615(a)(1)*. Claims pursued under this section are referred to as "interference" claims. and are based on the prescriptive sections of the FMLA which create substantive rights for eligible employees. Employers are strictly liable for interfering with the FMLA rights of their employees, and the primary issue is whether the employer provided its

employee the entitlements set forth in the FMLA - for example, a 12-week leave or reinstatement after taking a medical leave.

Labor & Employment Law > Leaves of Absence > Family & Medical Leaves > Burdens of Proof

Business & Corporate Compliance > ... > Labor & Employment Law > Leaves of Absence > Family & Medical Leaves

HN20[] Family & Medical Leaves, Burdens of Proof

To state a Family and Medical Leave Act (FMLA) claim of interference, a plaintiff must demonstrate by a preponderance of the evidence that he or she was entitled to the benefit denied. When an employer has failed to advise an employee of a right under the FMLA, the employee must also show prejudice as a result thereof.

Business & Corporate Compliance > ... > Labor & Employment Law > Leaves of Absence > Family & Medical Leaves

Labor & Employment Law > ... > Family & Medical Leaves > Scope & Definitions > Serious Health Conditions

Labor & Employment Law > ... > Family & Medical Leaves > Scope & Definitions > General Overview

HN21[] Leaves of Absence, Family & Medical Leaves

Under the Family and Medical Leave Act, a "serious health condition" is defined in the statute as an illness, injury, impairment, or physical or mental condition that involves either inpatient care or continuing treatment by a healthcare provider. *29 U.S.C.S. § 2611(11)*.

Business & Corporate Compliance > ... > Labor & Employment Law > Leaves of Absence > Family & Medical Leaves

HN22[] Leaves of Absence, Family & Medical Leaves

See *29 C.F.R. § 825.114(a)(2)(i)*.

Business & Corporate Compliance > ... > Labor & Employment Law > Leaves of Absence > Family & Medical Leaves

HN23[] Leaves of Absence, Family & Medical Leaves

See 29 C.F.R. § 925.114(a)(2)(iii).

Business & Corporate Compliance > ... > Labor & Employment Law > Leaves of Absence > Family & Medical Leaves

HN24[] Leaves of Absence, Family & Medical Leaves

A Family and Medical Leave Act plaintiff must demonstrate that a health provider made a professional assessment of plaintiff's condition and determined, based on that assessment, that an extended absence from work was necessary.

Labor & Employment Law > Leaves of Absence > Family & Medical Leaves > Burdens of Proof

Business & Corporate Compliance > ... > Labor & Employment Law > Leaves of Absence > Family & Medical Leaves

HN25[] Family & Medical Leaves, Burdens of Proof

There is nothing to suggest that an Family and Medical Leave Act plaintiff must prove that he is unable to perform not only his regularly assigned duties, but also any alternative duties that an employer might reasonably assign. Indeed, the statutory language, which specifies that the condition must make the employee unable to perform the functions of the position of such employee suggests that only the duties of the employee's regular position are relevant. *29 U.S.C.S. § 2612(a)(1)(D)*.

Business & Corporate Compliance > ... > Labor &

Employment Law > Leaves of Absence > Family & Medical Leaves

HN26 **Leaves of Absence, Family & Medical Leaves**

The Department of Labor's regulations require employers to communicate with employees regarding their Family and Medical Leave Act rights.

Business & Corporate Compliance > ... > Labor & Employment Law > Leaves of Absence > Family & Medical Leaves

HN27 **Leaves of Absence, Family & Medical Leaves**

See *29 C.F.R. § 825.302(c)*.

Business & Corporate Compliance > ... > Labor & Employment Law > Leaves of Absence > Family & Medical Leaves

HN28 **Leaves of Absence, Family & Medical Leaves**

See *29 C.F.R. § 825.303(b)*.

Business & Corporate Compliance > ... > Labor & Employment Law > Leaves of Absence > Family & Medical Leaves

HN29 **Leaves of Absence, Family & Medical Leaves**

Once the circumstances suggest that Family and Medical Leave Act leave may be involved, the employer has an obligation to inquire further in order to ascertain the specific details.

Business & Corporate Compliance > ... > Labor & Employment Law > Leaves of Absence > Family & Medical Leaves

Labor & Employment
Law > ... > Retaliation > Statutory Application > Americans With Disabilities Act

Labor & Employment
Law > ... > Evidence > Burdens of Proof > General Overview

Labor & Employment
Law > ... > Evidence > Burdens of Proof > Employee Burdens of Proof

Labor & Employment
Law > ... > Evidence > Burdens of Proof > Burden Shifting

Labor & Employment
Law > ... > Retaliation > Statutory Application > Family & Medical Leave Act

HN30 **Leaves of Absence, Family & Medical Leaves**

The Family and Medical Leave Act (FMLA) makes it unlawful for an employer to discharge or in any other manner discriminate against any individual for exercising any right provided by the Act. *29 U.S.C.S. § 2615(a)(2)*. So-called "retaliation" claims under the FMLA are analyzed under the identical McDonnell Douglas burden-shifting framework used in Title VII and ADA discrimination and retaliation claims.

Counsel: **[*1]** For TRUDI PINSON, Plaintiff: Gregory T. Kunkel, Kunkel & Fink, Pittsburgh, PA.

For BERKLEY MEDICAL RESOURCES, INC., Defendant: Albert S. Lee, Sunshine R. Fellows, Bechtol & Lee, Pittsburgh, PA.

Judges: Thomas M. Hardiman, United States District Judge.

Opinion by: Thomas M. Hardiman

Opinion

Plaintiff Trudi Pinson (Pinson) filed this action against her former employer, Berkley Medical Resources, Inc. (BMR), alleging that her treatment and discharge violated the *Americans with Disabilities Act* (ADA), the Family and Medical Leave Act (FMLA), and the *Pennsylvania Human Relations Act* (PHRA). Pinson's five-count Complaint states claims for disability discrimination and retaliation in violation of both the ADA and the PHRA as well as interference and retaliation in violation of the FMLA. Defendant BMR has

filed a Motion for Summary Judgment, which is the subject of this Opinion.

I. Standard of Review

HN1[↑] Summary judgment is required on an issue or a claim when "the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a **[*2]** matter of law." Fed. R. Civ. P. 56(c); see also Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 250-52, 91 L. Ed. 2d 202, 106 S. Ct. 2505 (1986); Saldana v. Kmart Corp., 260 F.3d 228, 231-32, 43 V.I. 361 (3d Cir. 2001). An issue is "material" only if the factual dispute "might affect the outcome of the suit under the governing law." Anderson, 477 U.S. at 248.

HN2[↑] "Summary judgment procedure is properly regarded not as a disfavorable procedural shortcut, but rather as an integral part of the Federal Rules as a whole, which are designed to secure the just, speedy and inexpensive determination of every action." Celotex Corp. v. Catrett, 477 U.S. 317, 327, 91 L. Ed. 2d 265, 106 S. Ct. 2548 (1986) (internal quotation marks omitted). The parties have a duty to present evidence; neither statements of counsel in briefs nor speculative or conclusory allegations satisfy this duty. Ridgewood Bd. of Educ. v. N.E. for M.E., 172 F.3d 238, 252 (3d Cir. 1999). After the moving party has filed a properly supported motion, the burden shifts to the non-moving party to set forth specific facts showing that there is a genuine issue for trial. Fed. R. Civ. P. 56(e) **[*3]** . The non-moving party must make a showing sufficient to establish the existence of each element essential to his case on which he will bear the burden of proof at trial. Celotex, 477 U.S. at 322-23. The facts derived from the evidence of record must be taken in the light most favorable to the nonmovant. Schnall v. Amboy Nat'l Bank, 279 F.3d 205, 209 (3d Cir. 2002).

II. Statement of Facts

A. Pinson's Position at BMR

Pinson was employed from August 14, 2000 until her discharge on September 25, 2002 at BMR's plant in Fayette County, Pennsylvania, which manufactures handiwipes and employs about 120 people. Initially hired as a bagger, Pinson later became a Hudson-Sharp operator, which required her to run a 15-foot long machine that cut materials into individual wipes.

B. BMR's Attendance Policy

BMR has had a written attendance policy, developed in conjunction with Pinson's union, since approximately November 2000. The policy permits one unexcused absence or two unexcused "tardies" every month before disciplinary action is taken. Absences for work-related injuries or conditions protected under the FMLA or ADA and absences authorized **[*4]** by a doctor's note are excused. However, the use of doctor's excuses is subject to a limit of three "occurrences" per month. Therefore, if one misses work because of an illness after submitting doctor's excuses for three or more prior absences, the employee will be charged with an attendance policy violation regardless of whether a valid doctor's excuse is submitted. BMR employees are given seven days from the date of an absence in which to provide a doctor's note, and consecutive days of missed work are considered one occurrence.

Discipline under the attendance policy is meted out progressively as follows: (1) verbal reprimand; (2) written reprimand; (3) suspension; and (4) discharge. Attendance is checked monthly and the progressive discipline policy resets every calendar year. The record demonstrates that Pinson had received two disciplinary warnings for attendance policy violations prior to 2002: a verbal reprimand on January 31, 2001 and a suspension on February 23, 2001, for successive violations the previous month.

C. Pinson's Mental Condition

At the time Pinson interviewed for a position with BMR, she informed its Human Resources Manager, Suzanne Herman, that she suffered **[*5]** from depression and migraine headaches. Pinson's depression sometimes causes her to feel that she does not want to get out of bed. She has trouble sleeping at night, has difficulty getting motivated, and does not have much strength or energy. She also struggles to read books or follow some television programs because of her depression.

Approximately one year after starting work at BMR, Pinson also began experiencing panic attacks, during which she is unable to breathe, becomes lightheaded, experiences chest pain, and feels like she is about to pass out. The attacks themselves last a few minutes, but Pinson feels her entire day is ruined because she is

frightened and experiences further chest pain. Pinson sought treatment for her panic attacks and depression at Chestnut Ridge Counseling Services. The doctor's notes Pinson submitted to BMR indicate that she attended a total of 18 counseling sessions between April 2001 and September 2002.

Pinson admits that Human Resources Manager Herman and other staff at BMR initially were understanding and accommodating of her panic attacks. Pinson testified in her deposition that Herman was aware of her condition and had told Pinson that she could **[*6]** leave the plant and return home if she felt a panic attack coming on. Herman's recollection is somewhat different. She testified that she told Pinson to leave work if she felt an attack coming on and that as long as she stated that the absence was related to family medical leave, it would be excused "no questions asked." Yet this was only after Pinson was granted leave for her condition under the FMLA in July 2002. Both sides agree that prior to July 2002, Pinson presented excuses from Chestnut Ridge for panic attack-related absences, as would be required under the attendance policy.

Pinson first noticed a change in Herman's attitude towards her in June 2002. After an absence related to her panic attacks, Pinson claimed that Herman informed her that she would have to produce an excuse within seven days or she would be terminated. According to Pinson's testimony, Herman's attitude "wasn't as friendly" as it had been in the past. Pinson also testified that although she knew a doctor's excuse was required for medical absences under the attendance policy, she was unaware of the seven-day requirement until the June 2002 conversation with Herman. But BMR's records indicate that Pinson's **[*7]** excuse from Chestnut Ridge for an absence on May 14, 2002 (approximately a month before), had been rejected precisely because Pinson had submitted it more than seven days after the absence.

Shortly after her June 2002 conversation with Herman, Pinson submitted an excuse from Chestnut Ridge for the absence in question, and this excuse was accepted. Around that same time, Pinson requested that her mental condition, *viz.,* depression, panic attacks and migraine headaches, be recognized by BMR as FMLA-qualifying. BMR granted this request in a letter dated July 15, 2002, and asked Pinson to advise when she reported off work because of the condition and to obtain doctor's excuses for those times she treated with a physician.

Pinson believes that her immediate supervisor, Joe Dankle, and her co-workers treated her differently after she was granted FMLA leave for her mental condition. Pinson testified that she never had any complaints with Dankle before June 2002, when he began approaching her about "every little thing" such as not wearing glasses or earplugs. Pinson testified that Dankle never talked to her about these violations on his own, but only after co-workers -- "busybodies" **[*8]** and "troublemakers" in Pinson's words -- had brought them to his attention. Dankle also talked to Pinson after quality assurance employees repeatedly found that she was taking improper measurements on her machine. On July 23, 2002, Pinson was issued a written warning regarding improper measurements, and on at least one occasion Dankle called her into his office and verbally warned her about improper measurements. Dankle also talked to Pinson after another employee complained to him that she was taking too long on her "code change." Pinson acknowledged that Dankle had counseled other employees about earplugs and glasses, but felt that he singled her out about measurements and code change, even though she knew others performed their jobs similarly. Dankle testified that he knew he had verbally warned other workers regarding measurements, but could not remember if he had administered a disciplinary report to any other workers for the same violation. Pinson also acknowledged that she was not suspended and did not lose pay as a result of Dankle's actions. Finally, Pinson testified that nothing her supervisors or co-workers said indicated to her that their actions were motivated by her exercise **[*9]** of FMLA rights.

D. Pinson's Physical Condition

In addition to subjecting her work to increased scrutiny, Pinson also testified that Dankle refused to move her off a specific machine that was causing her neck and back pain. [1] Pinson began experiencing back and neck pain shortly after she started working Machine No. 2. After

[1] Pinson testified that Dankle had assigned her to work alone on Machine No. 2 at some point in June 2002. Dankle testified that Machine No. 2 is a faster-paced machine, and he wanted to make sure he assigned workers who could keep pace. Pinson's testimony regarding the timing of this assignment is internally contradictory. First, she testified that it had occurred before the FMLA issue arose; later she testified that it had occurred after her FMLA certification and that prior to that event she had worked on Machine No. 2 only a few times, with co-workers assisting her.

spending most of a weekend lying down on a heating pad, Pinson requested that Dankle move her to another machine. According to Pinson, Dankle said nothing and merely pointed in the direction of Machine No. 2. Dankle recalls that Pinson requested to be moved off Machine No. 2 at some point, but that he did not do so until the next day because Pinson said she could finish her current shift. Pinson claims that she continued to work Machine No. 2, although BMR's Product Inspection Sheets, which are completed and signed by each machine operator at the end of each shift, indicate that she was not assigned to Machine No. 2 during the month of September.

[*10] At the end of August 2002, Pinson began treating with Ewing M. Miller, D.C., a chiropractor, to help her deal with the pain in her neck and back. Pinson testified that she had first attempted to treat with one of the worker's compensation panel doctors at BMR, but that she was denied treatment for reasons unknown to her. Dr. Miller diagnosed Pinson with post traumatic cervicalgia, cervical muscle spasms, cervical segmental dysfunction, cervical strain/sprain, dorsal strain/sprain, lumbar strain/sprain, lumbar muscle spasms, and lumbago. Pinson periodically visited Dr. Miller both during and after her employment with BMR, and he began treating her twice a week using psychotherapeutic modalities such as electrical muscle stimulation, heat, and massage to her cervical, thoracic, and lumbar spine. The treatments gave her temporary pain relief, but Dr. Miller testified that she is still subject to "flare-ups" and "exacerbations" that require further treatments. He believed that Pinson's neck and back condition had not improved from a functional standpoint in the year and a half between her first treatment and the date of his deposition.

On September 3, 2002, Pinson provided a note to **[*11]** Shift Supervisor Dankle from Dr. Miller that restricted her to light-duty work for one week because of her neck and back pain. But Dankle and Human Resources Manager Herman sent Pinson home for the week because only work-related injuries qualified for light-duty work. Herman claims that she explained to Pinson that she would have to treat with a "panel physician" under BMR's worker's compensation plan if she wanted her injury to be considered work-related. Pinson testified that Dankle had refused to move her off Machine No. 2 because "people would talk" and that he repeatedly told her she would have to see a panel doctor if she wished to be moved off Machine No. 2 and on to easier machines. According to Herman, Pinson stated on September 3 that she preferred not to treat with a panel doctor and wished to continue seeing Dr. Miller, who was not on BMR's panel of doctors.

Herman also testified that Dankle had the discretion to provide light-duty work for non-work-related injuries if it were available, but that BMR does not "create jobs" for non-work injuries. Pinson does not dispute the fact that there was no light-duty work to be done on September 3. However, she did testify, albeit **[*12]** vaguely, that Dankle once refused to provide her light-duty work when she believed some was available. Dankle had previously accepted doctor's excuses for Pinson's neck and back pain, but on this occasion stated she would have to see a panel physician before she could qualify for reassignment. Pinson stated she had "no clue" why Dankle rejected her request for light-duty work on this occasion and does not know if he was retaliating against her for something she had done. She testified that Dankle usually had "no problem" with people who requested light-duty work.

Pinson maintains that she sought FMLA leave for her neck and back pain, but that Herman informed her she could not receive FMLA leave for her physical injury because she was already receiving leave for her mental condition. Pinson's recollection of the timing of this conversation is somewhat vague and contradictory. Pinson believes this conversation occurred "around the time when the pain and stuff was happening with me" and that Herman referenced her prior FMLA application. Yet Pinson also stated that it occurred "before I even got this last FMLA," presumably referencing her FMLA application for her mental condition. Herman **[*13]** testified that she did not discuss with Pinson the possibility of FMLA leave for her neck and back condition and that she treated the issue exclusively as a work-related injury.

E. The September 25 Termination

Prior to September 2002, Pinson had received a number of disciplinary warnings regarding work absences and had been informed that she was in danger of termination under the attendance policy. On March 19, 2002, she was issued a verbal reprimand for missing work without a doctor's excuse. On June 26, 2002, Pinson received a written suspension which specifically put her on notice that she was on "the third level of discipline" and that, "any future violation of the Attendance Policy will result in further discipline up to and including termination of employment." This suspension came after a month in which Pinson missed

four full days of work and left work prematurely three times. On four of these occasions, Pinson submitted excuses from Chestnut Ridge or Uniontown Hospital indicating she had treated with a physician for panic attacks, and BMR accepted these excuses. However, BMR rejected a doctor's excuse from Chestnut Ridge for the absence of May 14, 2002 because Pinson **[*14]** submitted it late. Pinson submitted no excuses for the remaining two absences.

BMR's records initially indicated that Pinson's attendance problems had continued in August 2002: she had on two occasions in August left work early without providing a doctor's excuse or indicating the absence was FMLA-related. Human Resources Manager Herman testified that she first noticed this apparent attendance policy violation on September 11, 2002, when she generated Pinson's attendance report for the prior month, and that she reached a decision to terminate Pinson on that day. However, because she typically "double-checks" terminations and the report must first be signed by Ted Michaelis, the Plant Manager, and then forwarded to Shift Supervisor Joe Dankle, Herman testified that Pinson was not to be informed of the termination until September 25.

On September 25, Pinson arrived at work with a note from Dr. Miller that excused her absence the previous day and restricted her to lifting fewer than ten pounds. Pinson gave the note to Shift Supervisor Dankle, who in turn gave it to Herman. Because Pinson was to be terminated for the August attendance policy violations, however, Herman stated that she **[*15]** and Dankle did not at that time consider the validity of the excuse under the attendance policy. Instead, they proceeded to terminate Pinson for the August attendance violations. This occurred approximately an hour and a half after Pinson submitted the excuse to Dankle.

Pinson's September 25 termination was eventually rescinded, however, after she successfully challenged BMR's action through the union grievance process, arguing that BMR had erroneously read her August 23 timecard. In an October 22, 2002 memorandum to Pinson's union, Plant Manager Michaelis expressed some skepticism about Pinson's argument. He also noted that Pinson's attendance problems had continued in September and that she would have been terminated for these absences as well. Yet after Herman and Michaelis examined Pinson's timecard and determined that it was difficult to decipher the time she had punched out, BMR concluded that it could not be sure whether Pinson had left work early and therefore reversed its decision to terminate her for the August 2002 attendance violations. Michaelis informed Pinson's union of this decision in a November 18, 2002 memorandum. BMR then issued Pinson a check for lost wages arising **[*16]** from her September 25 termination.

F. The October 15 Termination

Despite the reversal of her initial termination, Pinson did not return to work because BMR reviewed Pinson's attendance record for September while her grievance was pending and concluded that she also had violated the attendance policy that month. Pinson had missed seven full days of work and portions of a work shift on four other occasions during that month; she missed work September 3-5, 16-17, 20, and 24, while arriving late or leaving early on September 9, 11, 12, and 23. Because of Dr. Miller's September 3 note restricting Pinson to light-duty work, the September 3-5 absence and tardiness of September 9 were considered one "occurrence" and not counted against her. Pinson also provided an excuse from Dr. Miller for the tardiness of September 11 and the missed work days of September 16-17, using her second and third permitted "occurrences" under the policy. Pinson informed BMR that the absence of September 20 was related to her mental condition, and this was counted neither as an unexcused absence nor as an "occurrence." Pinson provided no excuse for leaving work early on September 12 and September 23, but these **[*17]** absences fell within the two tardies permitted per month.

Because Pinson already had three "occurrences" for which she had provided a doctor's note, however, the September 24 absence was counted as an unexcused absence, even though she submitted a doctor's excuse. This violation, in conjunction with Pinson's third-step status in the progressive discipline policy, authorized BMR to terminate her pursuant to the attendance policy. On October 15, 2002, BMR issued a disciplinary report for Pinson's September attendance violations and officially terminated her.

After Pinson's attempt to challenge the October 15 termination through the union grievance procedure was rejected as untimely, she then filed a complaint with the Equal Employment Opportunity Commission (EEOC). In its position statement before the EEOC, BMR continued to assert that Pinson was terminated for the September attendance policy violations. However, in a petition for appeal of a state unemployment compensation decision dated October 21, 2002, Human Resources Manager

Herman wrote that Pinson was discharged because she failed to "obtain and submit a medical slip to support the absence" and that the absence would have been **[*18]** excused "had she [Pinson] subsequently submitted a medical excuse." Herman testified that she was probably referring to the August attendance violation, but is not sure. She acknowledged that Pinson was not terminated for failing to submit a medical excuse, but because she had exceeded the number of "occurrences" under the policy.

III. Discussion

A. ADA Discrimination

HN3[↑] Under the ADA, an employer cannot discriminate "against a qualified individual with a disability because of the disability of such individual with regard to job application procedures, the hiring, advancement, or discharge of employees, employee compensation, job training, and other terms, conditions, and privileges of employment." *42 U.S.C. § 12112(a)*. Discrimination comes in two forms: (1) subjecting the employee to an adverse employment action motivated by prejudice or fear; or (2) failing to provide a reasonable accommodation for a disability. *Taylor v. Phoenixville Sch. Dist., 184 F.3d 296, 306 (3d Cir. 1999)*.

HN4[↑] The analytical burden-shifting framework of *McDonnell Douglas Corp. v. Green, 411 U.S. 792, 36 L. Ed. 2d 668, 93 S. Ct. 1817 (1973)*, first used in Title VII discrimination **[*19]** suits, applies to ADA discrimination claims as well. *See Shaner v. Synthes, 204 F.3d 494, 500 (3d Cir. 2000)*; *Walton v. Mental Health Ass'n. of Southeastern Pennsylvania, 168 F.3d 661, 668 (3d Cir. 1999)*. Therefore, to establish a *prima facie* case of ADA discrimination, Pinson must establish: (1) she is a disabled person within the meaning of the ADA; (2) she is otherwise qualified to perform the essential functions of the job; and (3) she has suffered an adverse employment decision as a result of discrimination. *Gaul v. Lucent Technologies, Inc., 134 F.3d 576, 580 (3d Cir. 1998)*. If she establishes a *prima facie* case, the burden shifts to the employer to articulate some legitimate, nondiscriminatory reason for the adverse employment action. *See Fuentes v. Perskie, 32 F.3d 759, 763 (3d Cir. 1994)*. If the employer can articulate such a reason, the burden shifts back to the employee, who must produce "sufficient evidence to raise a genuine issue of fact as to whether the employer's proffered reasons were not its true reasons for the challenged employment actions." *Sheridan v. E.I. DuPont de Nemours & Co., 100 F.3d 1061, 1067 (3d Cir. 1996)*. **[*20]** In this case, Defendant BMR argues that Pinson cannot establish a *prima facie* case because neither her mental condition nor her neck and back pain render her disabled under the statute.

HN5[↑] The ADA defines disability as "a physical or mental impairment that substantially limits one or more of the major life activities of such individual." *42 U.S.C. § 12102(2)*. The Supreme Court has noted that "the terms substantially and major, as used in the ADA provision defining disability . . . need to be interpreted strictly to create a demanding standard for qualifying as disabled." *Toyota Motor Mfg., Kentucky, Inc. v. Williams, 534 U.S. 184, 197-98, 151 L. Ed. 2d 615, 122 S. Ct. 681 (2002)*. Similarly, the Third Circuit Court of Appeals has written: "the purpose of the ADA would be undermined if protection could be claimed by those whose relative severity of impairment was widely shared." *Taylor v. Pathmark Stores, Inc., 177 F.3d 180, 186 (3d Cir. 1996)*.

HN6[↑] The phrase "substantially limits" means "unable to perform a major life activity that the average person in the general population can perform" or "significantly restricted as to the condition, manner or duration under **[*21]** which an individual can perform a particular major life activity as compared to the condition, manner, or duration under which the average person in the general population can perform that same major life activity." *Mondzelewski v. Pathmark Stores, 162 F.3d 778, 782-83 (3d Cir. 1998)* (*citing 29 C.F.R. § 1630.2(j)(1)(i), (ii)*). In assessing whether a major life activity has been substantially limited, a court should consider the following factors: (i) the nature and severity of the impairment; (ii) the duration or expected duration of the impairment; and (iii) the permanent or long term impact, or the expected permanent or long term impact of [the impairment] or resulting from the impairment. *Id. at 783* (*citing 29 C.F.R. § 1630.2(j)(2)(i)-(iii)*). Major life activities include "caring for oneself, performing manual tasks, walking, seeing, hearing, speaking, breathing, learning, and working," although this list is not exhaustive. *Id.* at n.2.

HN7[↑] With regard to the major life activity of working, a court must look to whether an individual is "significantly restricted in the ability to perform **[*22]** either a class of jobs or a broad range of jobs in various classes as compared to the average person having comparable training, skills and abilities." *29 C.F.R. § 1630.2(j)(3)(i)*. As this regulation suggests, a court must

consider the individual's training, skills, and abilities to evaluate "whether the particular impairment constitutes for the particular person a significant barrier to employment." *Mondzelewski, 162 F.3d at 784* (internal citation omitted); *see also 29 C.F.R. Pt. 1630, App. § 1630.2(j)* (determination whether individual is limited in working must be conducted on case-by-case basis). Because a "person's expertise, background, and job expectations are relevant factors in defining the class of jobs used to determine whether an individual is disabled," the court must consider the effect of the impairment on the employment prospects of that individual with all of his or her relevant personal characteristics. *Id.* (internal citations omitted). Thus, a substantially limiting impairment for one individual may not be substantially limiting for another individual with different characteristics. *29 C.F.R. Pt. 1630, App. § 1630.2(j)*.

[*23] Finally, ***HN8***[↑] the Court of Appeals for the Third Circuit follows the two-step analysis recommended by the EEOC's interpretive guidelines for determining whether a plaintiff is substantially limited in her ability to perform a major life activity. *Mondzelewski, 162 F.3d at 783*. First, a court must determine whether the plaintiff is significantly limited in a life activity other than working. Only if a plaintiff is not limited in a life activity other than working should the court consider whether the plaintiff is substantially limited in the major life activity of working.

BMR argues that Pinson's depression and panic attacks were not substantially limiting in light of the standards set forth above. It argues that Pinson's medical excuses demonstrate that she missed only 10 days of work in the last seventeen months of her employment, and that she attended only 18 counseling appointments during that same period. BMR notes that Pinson identified only one missed day of work because of her mental condition during her last month of employment, and that none of the doctor's excuses indicated that her mental condition restricted her ability to perform her job. Concluding that **[*24]** these facts establish at most that Pinson experienced episodic bouts with depression and panic attacks, BMR cites *Soileau v. Guilford of Maine, Inc., 105 F.3d 12 (1st Cir. 1997)*, in support of its argument that she is not substantially limited in any major life activity.

Defendant's reliance upon*Soileau* is unpersuasive for two reasons. First, Pinson's alleged mental impairment differs substantially from the "inability to get along with others" described by the plaintiff in *Soileau*. Second, ***HN9***[↑] the Court of Appeals for the Third Circuit has suggested that plaintiffs with mental impairments are not precluded from showing a disability under the statute merely because of the episodic nature of their condition. In *Taylor v. Phoenixville School District, 184 F.3d 296 (3d Cir. 1999)*, a public school secretary suffering from bipolar disorder sued the school district for disability discrimination under the ADA. Plaintiff had been hospitalized for a month because she was suffering from paranoid delusions and was hyperactive and psychotic. *Id. at 302-03*. Plaintiff eventually returned to work, taking lithium to reduce the risk of further **[*25]** psychotic episodes. *Id. at 308*. In arguing that she was disabled under the ADA, plaintiff argued that, even though the lithium had improved her condition and reduced the risk of psychotic episodes, the drug did not perfectly control her symptoms and left her substantially limited in her ability to think. *Id.* She pointed to physician's notes indicating she continued to suffer from paranoia and one note indicating she was temporarily unable to work because of her condition. *Id.* Over the course of the academic year, the plaintiff demonstrated that she had seen a physician for her condition 25 times. *Id.* There was also evidence in the record of lithium's potential side effects, such as nausea and impaired concentration and memory problems. *Id. at 309*.

The Court of Appeals for the Third Circuit held that the plaintiff had presented sufficient evidence to require a trial as to whether she was substantially limited while receiving lithium. *Id.* The court found that "thinking" was a major life activity, and that plaintiff's paranoia and distorted mood could have a substantial or considerable impact upon her thinking. *Id.* The Third Circuit **[*26]** Court observed further that the plaintiff had to temporarily leave work only a few months after returning to her position, that she had sought medical treatment 25 times during the academic year, and that she took medication requiring careful monitoring every day. *Id.* Importantly for purposes of the instant case, the Court of Appeals rejected the argument that the episodic nature of plaintiff's condition precluded recovery under the ADA:

> That she may not have experienced problems every day does not defeat her claim. Chronic, episodic conditions can easily limit how well a person performs an activity as compared to the rest of the population: repeated flare-ups of poor health can have a cumulative weight that wears down a person's resolve and continually breaks apart longer-term projects.

Id.

Reviewing Pinson's case in light of Taylor, she has cited sufficient evidence from which a reasonable trier of fact could find that she is disabled under the ADA. Her depression and panic attacks could limit her ability to perform the major life activity of thinking, even if only in an episodic manner. Pinson testified that she struggles to read books or follow television **[*27]** programs because of her depression. During panic attacks she is unable to breathe, becomes lightheaded, experiences chest pain, and feels like she is about to pass out. The more severe physical symptoms of her panic attacks may last only a few minutes, but Pinson testified that her ability to concentrate is affected the rest of the day because she is frightened and experiences further chest pain. The doctor's notes Pinson submitted to BMR indicate that she attended a total of 18 counseling appointments at Chestnut Ridge between April 2001 and September 2002. Although Pinson did not seek medical advice as frequently as the plaintiff in *Taylor*, the number of Pinson's counseling sessions is not insubstantial and could be viewed by a reasonable fact-finder as evidence of a persistent and serious condition.

BMR points to evidence that Pinson is no longer attending counseling sessions at Chestnut Ridge and that she had experienced only one panic attack in the several months before her deposition, arguing that this apparent improvement in her mental condition demonstrates the absence of a serious disability. Indeed, ***HN10***[↑] there is substantial support for the proposition that temporary disabilities **[*28]** from which an employee fully recovers do not fall within the purview of the ADA. Hamilton v. Southwestern Bell Telephone Co., 136 F.3d 1047 (5th Cir. 1998) (temporary episode of post traumatic stress disorder not a disability under ADA); Halperin v. Abacus Technology Corp., 128 F.3d 191, 199 (4th Cir. 1997) (plaintiff suffering from temporary back injury not disabled for purposes of ADA because "it is evident that the term 'disability' does not include temporary medical conditions"); Roush v. Weastec, Inc., 96 F.3d 840, 843 (6th Cir. 1996) (kidney obstruction requiring multiple operations and long absences from work not considered disability because of subsequent recovery); Sanders v. Arneson Products, Inc., 91 F.3d 1351, 1354 (9th Cir. 1996) (temporary psychological impairment that lasted less than four months not a disability under the ADA); McDonald v. Commonwealth of Pennsylvania, 62 F.3d 92, 95 (3d Cir. 1995) (plaintiff who required abdominal surgery and an absence of almost two months not disabled because of temporary nature of injury). However, the evidence here does not demonstrate that Pinson **[*29]** has fully recovered from her panic attacks. First, Pinson testified that the sole reason she is no longer treating at Chestnut Ridge is because she lost her insurance after her termination by BMR. Furthermore, the fact that she has experienced only one panic attack in the last several months is consistent with the episodic nature of her condition and would not necessarily suggest to a reasonable fact-finder that Pinson has fully recovered or been "cured" of her panic attacks. Therefore, Pinson's failure to continue counseling and her apparent improvement after leaving BMR do not demonstrate that no material issue of fact exists as to the continuing nature of her disability.

BMR also argues that Pinson's neck and back pain do not constitute a protected disability under the ADA because she treated with her chiropractor only five times while employed with BMR and saw him for the first time less than a month before her discharge. Although Dr. Miller's note of September 3 limited Pinson to light-duty work for a week and his note of September 25 limited her to lifting no more than ten pounds, none of Dr. Miller's excuses indicate that she was restricted in her ability to perform her job. **[*30]** Indeed, Pinson admitted that she had never been hospitalized, had surgery, or undergone physical therapy for her neck or back in the fall of 2002. She also testified that at the time of her termination she could perform basic functions such as showering, driving, shopping, running errands, cooking, cleaning, and doing laundry, and could still perform these functions unassisted at the time of her deposition.

In support of its argument that Pinson does not suffer from any physical disability, BMR relies heavily upon Marinelli v. City of Erie, 216 F.3d 354 (3d Cir. 2000), in which the Court of Appeals for the Third Circuit found that a municipal worker with an arm injury that resulted in a ten-pound lifting restriction was not disabled under the ADA. While acknowledging that "lifting" was a major life function, the court rejected plaintiff's contention that a 10-pound lifting restriction significantly limited his ability to lift and therefore rendered him disabled under the ADA. Id. at 363-64. The Third Circuit Court cited a number of opinions from other circuit courts of appeals holding that similar lifting restrictions did not constitute a disability **[*31]** under the statute. Id. at 364. In addition, the court rejected plaintiff's contention that the lifting restriction substantially limited his ability to work. Noting that plaintiff sought only to be removed from driving the municipality's sophisticated snow plows, the court found that plaintiff's condition fell far short of being unable to

perform a "broad range of jobs," as required under the statute and the interpretive EEOC guidelines. *Id. at 365*. Although plaintiff was unable to drive the type of snow plows used by the municipality, he had presented no evidence that his injury would preclude him from driving any other truck used by any other employer, including the municipality. *Id. at 366*.

The rationale of *Marinelli* applies to the facts of Pinson's case. Pinson cannot show that her ability to perform the major life activity of "lifting" was substantially affected by her injury, as the only lifting restrictions placed upon her were identical to those placed upon the plaintiff in *Marinelli*. Pinson's own testimony indicates that she is not substantially limited in any other major life activity outside of work, such as showering, **[*32]** driving, shopping, running errands, cooking, cleaning, and doing laundry. With regard to the major life activity of working, Pinson has fallen far short of demonstrating that her neck and shoulder injury preclude her from an entire class of jobs. Pinson's initial requests were to be removed from a specific drill (Machine No. 2) and on to other Hudson-Sharp machines used by BMR. On two occasions she requested light-duty work, although it is unclear if that would have precluded her from operating any of the Hudson-Sharp machines. Even assuming that her condition sometimes prevented her from operating any Hudson-Sharp machines at her workplace, Pinson has not shown that she could not operate other machinery used by BMR or other employers in the broader economy. There is simply no evidence upon which a rational trier of fact could conclude, as Pinson argues, that she is "disabled from performing any type of medium or heavy-duty laborer type jobs." Accordingly, Pinson has failed to establish that her neck and back injury is a qualifying disability under the statute.

Because the Court finds that Pinson has established a material question of fact as to whether her mental condition qualifies **[*33]** as a disability under the statute, however, it is necessary to consider the remaining two elements of her *prima facie* case. Neither party presented argument regarding these elements. However, the Court finds that Pinson has presented sufficient evidence to establish a material issue of fact concerning both whether she is otherwise qualified to perform the essential functions of the job and has suffered an adverse employment action as a result of discrimination.

HN11[↑] A two-part test is used to determine whether one is qualified to perform the essential functions of a job. *Gaul, 134 F.3d at 580*. First, a court must consider whether "the individual satisfies the prerequisites for the position, such as possessing the appropriate educational background, employment experience, skills, licenses, etc." *Id.* Second, the court must consider "whether or not the individual can perform the essential functions of the position held or desired, with or without reasonable accommodation." *Id.* Also, "the determination of whether an individual with a disability is qualified is made at the time of the employment decision." *Id.* Here, there is little evidence to suggest that Pinson **[*34]** was not qualified for her position. Although she received minor warnings concerning code changes, measurements, and failure to wear proper safety equipment, Pinson appears to have been a competent employee. In fact, the evidence suggests BMR initially placed Pinson on Machine No. 2 because of her skill and experience. Nor does the evidence prevent a rational trier of fact from concluding that Pinson could have performed the essential functions of her position, with or without a reasonable accommodation. Pinson apparently performed satisfactorily while on the job, and simply required FMLA leave for those occasions when she missed work. There is no evidence that BMR provided any "on-the-job" accommodations for Pinson, for example, by restricting her to certain machines, giving her more frequent breaks, or limiting her hours. A reasonable fact-finder thus could determine that Pinson was qualified under the statute to perform the essential functions of her job.

Pinson has also satisfied the third prong of her *prima facie* case. Her termination is plainly an adverse employment action, and there is sufficient evidence to permit the conclusion that her termination was the result of disability **[*35]** discrimination. Although Pinson's allegations of "attitude" changes in her supervisors and co-workers generally are vague and self-serving, some of those allegations are supported either by documentary evidence or the testimony of BMR employees. For instance, Pinson submitted a copy of the disciplinary report given to her for improper measurements, issued July 23, 2002, just days after BMR granted her FMLA leave for her mental condition. Shift Supervisor Dankle confirmed that he had issued the warning, and could not remember whether he had ever issued a written disciplinary report to other employees for similar violations. Dankle also confirmed that he had approached Pinson regarding other violations, such as failing to wear proper safety equipment or make proper code changes. BMR has submitted no evidence to suggest that other employees were disciplined similarly for improper measurements,

or to counter Pinson's allegations that Dankle began to criticize her work more often after she was granted FMLA leave. Considering this evidence, and crediting Pinson's self-serving testimony regarding her supervisors' unfriendly attitude and Dankle's failure to provide light-duty work when she **[*36]** believed some was available, a reasonable fact-finder could conclude that animus against Pinson motivated BMR's management to be uncooperative with regard to her shoulder and neck condition, thereby inducing her fourth and final violation of the attendance policy.

Because Pinson has ***HN12***[↑] proffered evidence sufficient to establish a *prima facie* case, the burden of production shifts to BMR to "articulate some legitimate, nondiscriminatory reason" for its actions. McDonnell Douglas, 411 U.S. at 802; Fuentes v. Perskie, 32 F.3d 759, 763 (3d Cir. 1994). The burden at this stage is relatively light: it is satisfied if the defendant articulates any legitimate reason for the discharge and the defendant need not prove that the articulated reason actually motivated the discharge. *Id.* BMR has asserted that it fired Pinson for multiple violations of its attendance policy. A reasonable fact-finder could easily find that repeated and persistent absences from work were a legitimate and non-discriminatory reason to terminate an employee.

Therefore,***HN13***[↑] the burden shifts back to Pinson, who must produce "sufficient evidence to raise a genuine issue of fact as to whether **[*37]** the employer's proffered reasons were not its true reasons for the challenged employment actions." Sheridan, 100 F.3d at 1067. The employee must "point to some evidence, direct or circumstantial, from which a fact-finder could reasonably either (1) disbelieve the employer's articulated legitimate reasons; or (2) believe that an invidious discriminatory reason was more likely than not a motivating or determinative cause of the employer's action." *Id.* (internal citation omitted). Here, Pinson notes that BMR has asserted three different reasons for her termination: attendance policy violations in August, attendance policy violations in September, and failure to produce a doctor's excuse to justify her absence from work.

Standing alone, BMR's correction of Pinson's initial termination for the August violations, and subsequent decision to terminate her for violations in September, may be insufficient to establish that BMR's proferred reasons were pretextual. The mere fact that an employer acknowledges that it was mistaken concerning an employee's conduct in one instance does not preclude it from reasonably disciplining the same employee for subsequent conduct that **[*38]** is plainly improper. However, in its petition for appeal before the state agency, BMR provided shifting justifications for the termination decision. Although the language used by BMR is ambiguous, Human Resources Manager Herman admitted that she was probably referring to the August violations. Furthermore, BMR explicitly stated that Pinson was fired for failing to "obtain and submit a medical slip to support the absence," even though Herman acknowledged that Pinson had presented a medical excuse and this was not the reason for her termination. At a minimum, BMR's inattentiveness to these important details suggests that Pinson's attendance violations may not have been the true reasons for her termination, and a reasonable finder of fact could disbelieve BMR's articulated reasons. Crediting Pinson's testimony concerning the growing hostility of her co-workers, increased scrutiny of her work, and unwillingness to consider her requests to be moved off Machine No. 2 and given light-duty work, a reasonable fact-finder could also conclude that animus toward her mental disability was more likely than not a motivating or determinative cause of BMR's action. Accordingly, Pinson has established **[*39]** a material issue of fact as to her ADA discrimination claim, and BMR's motion for summary judgment will be denied on this claim.

B. ADA Retaliation

HN14[↑] ADA retaliation claims are analyzed under the same *McDonnell Douglas* burden-shifting framework as ADA discrimination claims. A plaintiff must first show: (1) protected employee activity; (2) adverse action by the employer either after or contemporaneous with the employee's protected activity; and (3) a causal connection between the employee's protected activity and the employer's adverse action. Shellenberger v. Summit Bancorp, Inc., 318 F.3d 183, 187 (3d Cir. 2003). Once a plaintiff has established these elements of his *prima facie* case, the burden shifts to the employer to advance a legitimate, non-retaliatory reason for its adverse employment action. *Id.* If the employer satisfies that burden, the plaintiff must then prove that "retaliatory animus played a role in the employer's decisionmaking process and that it had a determinative effect on the outcome of that process." *Id.* (citing Krouse v. Am. Sterilizer Co., 126 F.3d 494, 501 (3d Cir. 1997)). Unlike an ADA discrimination plaintiff, **[*40]** an ADA retaliation plaintiff is not required to establish that he is a "qualified individual with a disability," but rather that he engaged in

protected activity under the ADA. *Id. at 188*. *Krouse, 126 F.3d at 498*. The right to request an accommodation in good faith is protected activity under the ADA. *Williams v. Phila. Hous. Auth. Police Dep't, 380 F.3d 751, 759 n.2 (3d Cir. 2004)*; *Shellenberger, 318 F.3d at 191*.

Here, there is no suggestion that Pinson did not have a good faith belief in the seriousness of her mental and physical problems and the need for BMR to provide an accommodation. Her termination after the company granted her FMLA leave for her panic attacks and after she requested to be moved off Machine No. 2 in favor of light-duty work was clearly an adverse action by BMR taken after Pinson's protected activity. Finally, Pinson may establish a causal connection between her protected activity and her termination, for many of the same reasons outlined in the discussion of her ADA discrimination claim, *supra*. In addition to increasing hostility from her supervisors and co-workers, Pinson can point to the close temporal **[*41]** proximity between her September 25 request for light work and her termination by BMR a mere hour and a half later. ***HN15***[⬆] "Timing . . . in conjunction with other types of suggestive evidence, is clearly sufficient to demonstrate the causal link." *Sabbrese v. Lowe's Home Centers, Inc., 320 F. Supp.2d 311, 323 (W.D. Pa. 2004)* (citing *Farrell v. Planters Lifesavers Co., 206 F.3d 271, 280-81 (3d Cir. 2000)*. [2] Accordingly, Pinson has submitted sufficient evidence to establish her *prima facie* case as to the retaliation claim.

The Court's reasoning as to the application of the second and third **[*42]** prongs of the *McDonnell Douglas* framework to Pinson's ADA discrimination claim, *supra*, applies with equal force to her ADA retaliation claim. BMR has asserted the same legitimate, non-discriminatory reason for Pinson's termination, and Pinson has responded by pointing to the same inconsistencies in BMR's proferred explanation. Accordingly, a reasonable fact-finder could conclude that a retaliatory animus played a role in BMR's decision-making process and had a determinative effect on the outcome, so summary judgment is inappropriate.

[2] Defendants have cited to *Farrell* and other Third Circuit precedents to suggest that temporal proximity between protected activity and termination is generally insufficient to establish a causal link. In this case, Pinson is relying upon more than temporal proximity, and *Farrell* suggests that temporal proximity may be sufficient when combined with additional evidence of retaliatory animus.

C. Failure to Engage in the Interactive Process

Pinson next claims that BMR failed to engage in the interactive process as required by ADA regulations. ***HN16***[⬆] The regulations "establish the circumstances that trigger the employer's duty to engage in this interactive process: 'Once a qualified individual with a disability has requested provision of a reasonable accommodation, the employer must make a reasonable effort to determine the appropriate accommodation.'" *Jones v. UPS, 214 F.3d 402, 407 (3d Cir. 2000)* (citing *29 C.F.R. Pt. 1630, App. § 1630.9* at 361).

Pinson maintains that BMR failed to engage in the interactive **[*43]** process with regard to her neck and back injury. Because she has failed to show a material issue of fact as to whether this injury makes her a "qualified individual with a disability," however, Pinson has failed to trigger BMR's duty to engage in the interactive process. ***HN17***[⬆] "It is, of course, an axiom of any ADA claim that the plaintiff be disabled and that the employer be aware of the disability." *Jones, 214 F.3d at 407* (dismissing claim against employer for failure to engage in the interactive process because employee was not disabled under the statute and failed to inform employer of the alleged disability). Accordingly, BMR's motion for summary judgment will be granted on this claim.

D. PHRA Claims

Pinson also has asserted claims for disability discrimination and retaliation under the PHRA. ***HN18***[⬆] The PHRA's definition of "handicap or disability" is substantially the same as the definition of "disability" under the ADA. *Fehr v. McLean Packaging Corp., 860 F. Supp. 198, 200 (E.D. Pa. 1994)*. Moreover, Pennsylvania courts "generally interpret the PHRA in accord with its federal counterparts." *Kelly v. Drexel Univ., 94 F.3d 102, 105 (3d Cir. 1996)*. **[*44]** Therefore, the denial of summary judgment as to Pinson's ADA discrimination and retaliation claims requires that summary judgment also be denied as to Pinson's PHRA claims.

E. FMLA Interference Claim

HN19[⬆] The FMLA makes it unlawful for an employer "to interfere with, restrain, or deny the exercise of or the attempt to exercise, any right provided" under the

statute. 29 U.S.C. § 2615(a)(1). Claims pursued under this section are referred to as "interference" claims. Marrero v. Camden City Bd. of Soc. Servs., 164 F. Supp.2d 455, 463 (D. N.J. 2001), and are based on the prescriptive sections of the FMLA which create substantive rights for eligible employees. See Hodgens v. Gen Dynamics Corp., 144 F.3d 151, 159 (1st Cir. 1998) (citing Diaz v. Fort Wayne Foundry Corp., 131 F.3d 711, 712-13 (7th Cir. 1997)). Employers are strictly liable for interfering with the FMLA rights of their employees, Williams v. Shenango, Inc., 986 F. Supp. 309, 317-318 (W.D. Pa. 1997), and the primary issue is "whether the employer provided its employee the entitlements set forth in the FMLA - for example, a twelve-week **[*45]** leave or reinstatement after taking a medical leave." Hodgens, 144 F.3d at 159 n.4.

HN20[↑] To state a claim of interference, a plaintiff must demonstrate by a preponderance of the evidence that he or she was entitled to the benefit denied. Callison v. City of Philadelphia, 2004 U.S. Dist. LEXIS 6770, at *9-10 (E.D. Pa. March 31, 2004) (citing Strickland v. Water Works & Sewer Bd. of the City of Birmingham, 239 F.3d 1199, 1206-07 (11th Cir. 2001). When an employer has failed to advise an employee of a right under the FMLA, the employee must also show prejudice as a result thereof. Conoshenti v. Public Service Elec. & Gas Co., 364 F.3d 135, 144 (3d Cir. 2004).

Pinson claims she was entitled under the FMLA to up to twelve weeks of leave for a "serious health condition that makes the employee unable to perform the functions of the position of such employee," 29 U.S.C. § 2612(a)(1)(D), and that she was entitled to take this leave intermittently. 29 U.S.C. § 2612(b)(1). BMR responds that Pinson cannot establish a right to this statutory entitlement because her neck and back pain were **[*46]** not a "serious health condition" as defined by the Act.

HN21[↑] A "serious health condition" is defined in the statute as an "illness, injury, impairment, or physical or mental condition that involves" either inpatient care or continuing treatment by a healthcare provider. 29 U.S.C. § 2611(11). As Pinson received no inpatient care for her neck and back pain, she must demonstrate that her condition involved continuing treatment by a healthcare provider. Under the applicable Department of Labor regulations, "a serious health condition involving continuing treatment by a health care provider" includes:

> HN22[↑] (i) A period of incapacity (i.e., inability to work, attend school or perform other regular daily activities due to the serious health condition, treatment therefor, or recovery therefrom) of more than three consecutive calendar days, and any subsequent treatment or period of incapacity relating to the same condition, that also involves:
>
> (A) Treatment two or more times by a health care provider, by a nurse or physician's assistant under direct supervision of a health care provider, or by a provider of health care services (e.g., physical therapist) under orders **[*47]** of, or on referral by, a health care provider; or
>
> (B) Treatment by a health care provider on at least one occasion which results in a regimen of continuing treatment under the supervision of the health care provider.

29 C.F.R. § 825.114(a)(2)(i). It may also include:

> HN23[↑] (iii) Any period of incapacity or treatment for such incapacity due to a chronic serious health condition. A chronic serious health condition is one which:
>
> (A) Requires periodic visits for treatment by a health care provider, or by a nurse or physician's assistant under direct supervision of a health care provider;
>
> (B) Continues over an extended period of time (including recurring episodes of a single underlying condition); and
>
> (C) May cause episodic rather than a continuing period of incapacity (e.g., asthma, diabetes, epilepsy, etc.).

29 C.F.R. § 825.114(a)(2)(iii). BMR argues that Pinson's FMLA claims must fail because the only evidence of incapacitation is her own testimony that she was unable to work. Olsen v. Ohio Edison Co., 979 F. Supp. 1159, 1166 (N.D. Ohio 1997) (one's own claim of incapacitation insufficient under FMLA); **[*48]** Brannon v. OshKosh B'Gosh, Inc., 897 F. Supp. 1028, 1037 (M.D. Tenn. 1995) (plaintiff's testimony that she was too sick to work insufficient to satisfy burden at summary judgment).

This argument is correct insofar as HN24[↑] an FMLA plaintiff must demonstrate that "a health provider made a professional assessment of [plaintiff's] condition and

determined, based on that assessment, that an extended absence from work was necessary." *Olsen, 979 F. Supp. at 1166*. However, Pinson has presented substantially more than her own testimony regarding the nature of her neck and back condition. Specifically, Pinson has presented a number of notes from Dr. Miller excusing her from work because of treatment or restricting her to light-duty work. She also presented Dr. Miller's deposition testimony regarding his diagnosis and continuing treatment. At a minimum, Pinson has established sufficient evidence to allow a conclusion that her treatment by Dr. Miller was for "treatment for such incapacity due to a chronic serious health condition." *29 C.F.R. § 825.114(a)(2)(iii)*. The record indicates that Pinson periodically visited Dr. Miller and he testified that he treated her **[*49]** twice a week using psychotherapeutic modalities such as electrical muscle stimulation, heat, and massage to her cervical, thoracic, and lumbar spine. Dr. Miller also testified that the treatments gave her temporary relief from the pain, but that she is still subject to "flare-ups" and "exacerbations" that require further treatments. Significantly, in Dr. Miller's opinion, Pinson's neck and back condition had not improved from a functional standpoint in the year and a half between her first treatment and the date of his deposition. A rational fact-finder could conclude from this evidence that Pinson's condition required "periodic visits for treatment by a healthcare provider," that it "continued over an extended period of time," and "caused episodic rather than a continuing period of incapacity." *Id.* Pinson has therefore established a material issue of fact as to whether her condition was "a serious health condition involving continuing treatment by a health care provider," entitling her to leave under the FMLA.

Whether Pinson was incapacitated for "more than three calendar days," *29 C.F.R. § 825.114(a)(2)(i)*, is a closer question. BMR argues that Pinson **[*50]** was sent home the week of September 3, 2002, because she failed to submit a proper doctor's excuse, and not because she was unable to work. This is true in the sense that BMR generally gave light-duty work only to employees with work-related injuries, and Pinson had failed to submit the doctor's excuse from a panel-approved physician as required for an injury to be considered work-related. However, BMR does not dispute that Pinson was unable to fulfill her usual work duties as a Hudson-Sharp operator. Furthermore, Herman testified that BMR often provided light-duty work for employees suffering from non-work-related injuries if it was readily available, but that it would not "create jobs" for such employees. Pinson does not argue that any light-duty work was available the week of September 3. A reasonable fact-finder could therefore conclude that, at a minimum, Pinson was unable to work at her usual position or fulfill any other role that BMR could have reasonably offered her at the time, and that Pinson could have worked the week of September 3 only if BMR had undertaken an effort to "create jobs" that would be considered light-duty work. The parties have submitted no statute, case, **[*51]** or regulation addressing whether an employee with a light-duty work restriction, employed in a workplace where no light-duty work is available, is incapacitated under the FMLA, and independent research has discovered no such authority. Yet ***HN25***[↑] there is nothing to suggest that an FMLA plaintiff must prove that he is unable to perform not only his regularly assigned duties, but also any alternative duties that an employer might reasonably assign. Indeed, the statutory language, which specifies that the condition must make "the employee unable to perform the functions of *the position of such employee*" suggests that only the duties of the employee's regular position are relevant. *29 U.S.C. § 2612(a)(1)(D)* (emphasis added). Pinson has submitted evidence adequate to support the conclusion that Dr. Miller's light-duty work restriction prevented her from operating the Hudson-Sharp Machine No. 2 for at least three days, that she was treated two or more times by Dr. Miller for her neck and back condition, and that her visits to Dr. Miller resulted in a regimen of continuing treatment.

In addition, Pinson could establish that BMR acted to "interfere with, restrain, or **[*52]** deny the exercise" of her FMLA rights. *29 U.S.C. § 2615(a)(1)*. Even putting aside her vague and self-serving testimony regarding her request for FMLA leave and Human Resources Manager Herman's denial of the request, the evidence suggests that BMR may have failed to investigate adequately Pinson's condition and inform her of possible FMLA entitlements. ***HN26***[↑] The Department of Labor's regulations require employers to communicate with employees regarding their FMLA rights. *Conoshenti, 364 F.3d at 142*. In particular, *29 C.F.R. § 825.302(c)*, which governs notice requirements where the need for leave is foreseeable, states:

> ***HN27***[↑] (c) An employee shall provide at least verbal notice sufficient to make the employer aware that the employee needs FMLA-qualifying leave, and the anticipated timing and duration of the leave. The employee need not expressly assert rights under the FMLA or even mention the FMLA, but may only state that leave is needed for an expected birth or adoption, for example. The employer should

> inquire further of the employee if it is necessary to have more information about whether FMLA leave is being sought **[*53]** by the employee, and obtain the necessary details of the leave to be taken.

Similarly, the regulation governing notice requirements for leave that is not foreseeable states:

> ***HN28***[↑] (b) The employee should provide notice to the employer either in person or by telephone, telegraph, facsimile ("fax") machine or other electronic means. Notice may be given by the employee's spokesperson (e.g., spouse, adult family member or other responsible party) if the employee is unable to do so personally. The employee need not expressly assert rights under the FMLA or even mention the FMLA, but may only state that leave is needed. The employer will be expected to obtain any additional required information through informal means.

29 C.F.R. § 825.303(b). Thus, whether Pinson's absences for her neck and back condition were foreseeable or not, the regulations clearly provide that ***HN29***[↑] "once the circumstances suggest that FMLA leave may be involved, the employer has an obligation to inquire further in order to ascertain the specific details." *Williams, 986 F. Supp. at 320*.

In the instant case, Pinson's attempt to submit Dr. Miller's excuse for her September **[*54]** 24 absence was tantamount to a request for leave. Moreover, Pinson had repeatedly informed BMR of her condition, had requested light-duty work because of her condition, and had been absent several days in September for treatments with Dr. Miller. That Pinson may never have mentioned the FMLA is irrelevant so long as she provided sufficient indication that FMLA leave may be implicated. Here, a reasonable fact-finder could conclude that Herman and other BMR representatives should have known that Pinson's condition might entitle her to leave under the FMLA, and were therefore obligated to investigate further. Instead, Herman testified that nothing about Pinson's requests indicated to her that FMLA leave was implicated, and that she never requested more information or informed Pinson that FMLA leave might be a possibility.

Finally, Pinson can show prejudice arising from BMR's failure to investigate and advise, as required under *Conoshenti*. Herman herself testified that if the absences relating to Pinson's neck and back condition had been covered under the FMLA, she would not have been in violation of the attendance policy and therefore would not have been discharged. Accordingly, **[*55]** BMR's motion for summary judgment on the FMLA interference claim will be denied.

F. FMLA Retaliation Claim

HN30[↑] The FMLA also makes it unlawful for an employer "to discharge or in any other manner discriminate against any individual for" exercising any right provided by the Act. *29 U.S.C. § 2615(a)(2)*. So-called "retaliation" claims under the FMLA are analyzed under the identical *McDonnell Douglas* burden-shifting framework used in Title VII and ADA discrimination and retaliation claims. *Wilson v. Lemington Home for the Aged, 159 F. Supp.2d 186, 194 (W.D. Pa. 2001)*. Thus, much of the Court's analysis regarding Pinson's ADA discrimination and retaliation claims, *supra,* applies with equal force here. Just as with her ADA claims, Pinson can establish her *prima facie* case. She clearly exercised her rights under the FMLA by requesting and receiving leave for her mental condition, and the evidence could suggest to a reasonable fact-finder that the exercise of her rights motivated BMR's alleged increased antagonism, selective enforcement of workplace rules against her, and ultimate termination. As with Pinson's ADA claims, BMR has asserted **[*56]** its attendance policy as a legitimate, non-discriminatory reason for her termination. Likewise, Pinson has submitted sufficient evidence from which a reasonable fact-finder could find BMR's asserted reasons for termination pretextual or could find that discriminatory animus in fact motivated BMR's decision. Pinson's FMLA retaliation claim will therefore also survive summary judgment.

IV. Conclusion

In sum, Pinson has demonstrated a material issue of fact as to her claims for disability discrimination and retaliation under the ADA and interference and retaliation under the FMLA. However, the only evidence of record to suggest that BMR failed to engage in the interactive process, as required under the ADA, relates to her neck and back condition. Because Pinson has failed to demonstrate a material issue of fact as to whether her neck and back condition constitute a disability under the statute, she is unable to show that BMR had a duty to engage her as to an appropriate accommodation. BMR's motion for summary judgment will therefore be granted as to Pinson's claim for failure to engage in the interactive process, and denied in all

other respects.

An appropriate order follows.

[*57] Thomas M. Hardiman

United States District Judge

ORDER

AND NOW, this 21st day of June, 2005, upon consideration of Defendant's Motion for Summary Judgment (Doc. No. 19), it is hereby ORDERED that said motion is GRANTED as to Plaintiff's claim for failure to engage in the interactive process under the Americans with Disabilities Act (ADA). The Motion is DENIED in all other respects.

BY THE COURT:

Thomas M. Hardiman

United States District Judge

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Lewis v. Sheridan Broad. Network, Inc.

United States District Court for the Western District of Pennsylvania

November 7, 2005, Decided ; November 7, 2005, Filed

No. 2:04-cv-1015

Reporter
2005 U.S. Dist. LEXIS 26762 *; 97 Fair Empl. Prac. Cas. (BNA) 34

MARY ANNE LEWIS, Plaintiff, v. SHERIDAN BROADCASTING NETWORK, INC., Defendant.

Disposition: [*1] Sheridan's motion for summary judgment granted with respect.

Core Terms

retaliation, reasons, summary judgment, questionnaires, hostile work environment, termination, violations, incidents, charges, gender, intake, Timeliness, statute of limitations, willful violation, performing, citations, disparity, proffered, alleges, shifts

Case Summary

Procedural Posture
Plaintiff former employee filed an action against defendant former employer, which alleged gender discrimination, race discrimination, and retaliation under Title VII of the Civil Rights Act of 1964, *42 U.S.C.S. § 2000e et seq.*, violations of the Equal Pay Act (EPA), and violations of the Pennsylvania Human Relations Act (PHRA). The employer filed a motion for summary judgment.

Overview
The employee contended that she was subject to gender and racial discrimination. After she complained to human resources, she was fired based on an alleged reduction in work force. Later, she filed a charge with the Equal Employment Opportunity Commission (EEOC). In partially granting summary judgment, the court determined that the employee was required to comply with the time requirements in *42 U.S.C.S. § 2000e-5(e)(1)*. The questionnaires submitted to the EEOC constituted a timely filing. However, there was no evidence that the Pennsylvania Human Rights Commission actually received the charge within the applicable time period. The employee's EPA action was timely filed because the three-year period applied in cases alleging willful violations. Also, the employee presented evidence that discrimination was the actual reason behind the pay disparity. The hostile work environment claim was time barred because the incidents were outside of the applicable time frame; moreover, the conduct in question did not amount to a continuing violation. Finally, there were material disputed facts regarding whether the employer's reasons for the termination were pretextual.

Outcome
The employer's motion for summary judgment was granted with respect to the claims for hostile work environment and violations of the PHRA. The rest of the claims proceeded to trial.

LexisNexis® Headnotes

Civil Procedure > ... > Summary Judgment > Burdens of Proof > General Overview

Civil Procedure > ... > Summary Judgment > Entitlement as Matter of Law > General Overview

HN1[] **Summary Judgment, Burdens of Proof**

Summary judgment is required on an issue or a claim when the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. Fed. R. Civ. P. 56(c). An issue is "material" only if the factual dispute might affect the outcome of the suit under the governing law. Summary judgment procedure is properly regarded not as a disfavorable procedural shortcut, but rather as an

integral part of the Federal Rules of Civil Procedure as a whole, which are designed to secure the just, speedy and inexpensive determination of every action. The parties have a duty to present evidence; neither statements of counsel in briefs nor speculative or conclusory allegations satisfy this duty. After the moving party has filed a properly supported motion, the burden shifts to the non-moving party to set forth specific facts showing that there is a genuine issue for trial. *Rule 56(e)*. The non-moving party must make a showing sufficient to establish the existence of each element essential to her case on which she will bear the burden of proof at trial.

Labor & Employment Law > ... > Civil Actions > Exhaustion of Remedies > Filing of Charges

HN2 **Exhaustion of Remedies, Filing of Charges**

The language of Title VII of the Civil Rights Act of 1964 , *42 U.S.C.S. § 2000e et seq.*, is sparse in its guidance on what constitutes a formal charge with the Equal Employment Opportunity Commission (EEOC), stating merely that charges shall be in writing under oath or affirmation and shall contain such information and be in such form as the Commission requires. *42 U.S.C.S. § 2000e-5(b)*. Similarly, the Code of Federal Regulations states that a charge shall be in writing and signed and shall be verified and it shall name the prospective respondent and shall generally allege the discriminatory act(s). Charges received in person or by telephone shall be reduced to writing. *29 C.F.R. §§ 1601.9* and *1626.6*. In order to constitute a charge that satisfies the requirement of § 1626(d), notice to the EEOC must be of a kind that would convince a reasonable person that the grievant has manifested an intent to activate the Title VII's machinery.

Labor & Employment Law > ... > US Equal Employment Opportunity Commission > Civil Actions > Time Limitations

HN3 **Civil Actions, Time Limitations**

A charge satisfying the requirements must be timely filed with the Equal Employment Opportunity Commission (EEOC). In a case of an unlawful employment practice with respect to which the person aggrieved has initially instituted proceedings with a State or local agency such charge shall be filed by or on behalf of the person aggrieved within three hundred days after the alleged unlawful employment practice occurred. *42 U.S.C.S. § 2000e-5(e)(1)*. Recognizing the widespread interest in pursuing fair employment practices, *29 C.F.R. § 1626.10* permits the EEOC to enter into agreements with state and local fair employment practices agencies. Under such agreements, the requirement of *§ 2000e-5(e)(1)* that a charge must first be filed with the state to trigger the 300 day limitations period is satisfied by filing with the EEOC. When a worksharing agreement with a state agency is in effect, the state agency will act on certain charges and the Commission will promptly process charges which the state agency does not pursue. Charges received by one agency under the agreement shall be deemed received by the other agency for purposes of *29 C.F.R. § 1626.7*. In a state such as Pennsylvania, which has an agency performing functions similar to those of the EEOC, the time for filing is extended to 300 days.

Labor & Employment Law > ... > Civil Actions > Exhaustion of Remedies > Filing of Charges

HN4 **Exhaustion of Remedies, Filing of Charges**

A worksharing agreement allows a plaintiff to proceed in court under Title VII of the Civil Rights Act of 1964 , 42 U.S.C.S. § 2000e et seq., without first filing with the Pennsylvania Human Rights Commission (PHRC). That, however, does not mean that a plaintiff can initiate PHRC proceedings as required by the PHRA merely by filing with the Equal Employment Opportunity Commission (EEOC). Whether a plaintiff has initiated PHRC proceedings under the PHRA is a state law issue. The worksharing agreement says nothing about whether a plaintiff has invoked PHRC procedures if the PHRC has never received his or her claim, nor could it, given that the Pennsylvania Supreme Court has held that EEOC procedures are not a sufficient surrogate for PHRC remedies. in certain circumstances, equitable arguments could be made to allow a plaintiff to proceed under the PHRA even if the claim was not actually received by the PHRC. Absent such circumstances, however, if the PHRC does not receive a complainant's claim, then that complainant cannot bring suit under the PHRA.

Business & Corporate Compliance > ... > Wage & Hour Laws > Equal Pay > Equal Pay Act

Governments > Legislation > Statute of Limitations > Time Limitations

HN5[] Equal Pay, Equal Pay Act

Claims arising under the Equal Pay Act must be filed within two years of accrual of the cause of action, except in cases of willful violations, in which the limitations period is three years.

Business & Corporate Compliance > ... > Wage & Hour Laws > Equal Pay > Equal Pay Act

Governments > Legislation > Statute of Limitations > Time Limitations

HN6[] Equal Pay, Equal Pay Act

Sex-based, discriminatory wage payments constitute a continuing violation of the Equal Pay Act. To hold otherwise would permit perpetual wage discrimination by an employer whose violation of the Equal Pay Act had already lasted without attack for over two years. Thus, the statute of limitations begins to run on the date of the last occurrence of discrimination, rather than the first.

Labor & Employment Law > ... > Equal Pay > Equal Pay Act > Burdens of Proof

HN7[] Equal Pay Act, Burdens of Proof

Equal Pay Act claims are viewed under a two-step burden shifting process. The plaintiff must first establish a prima facie case by demonstrating that employees of the opposite sex were paid differently for performing "equal work"--work of substantially equal skill, effort and responsibility, under similar working conditions. The burden of persuasion then shifts to the employer to demonstrate the applicability of one of the four affirmative defenses specified in the Act.

Labor & Employment Law > ... > Equal Pay > Equal Pay Act > Burdens of Proof

Labor & Employment Law > Wage & Hour Laws > Statutory Application > General Overview

HN8[] Equal Pay Act, Burdens of Proof

An employer's burden is significantly different in defending an Equal Pay Act claim for an additional reason. The Equal Pay Act prohibits differential pay for men and women when performing equal work except where such payment is made pursuant to one of the four affirmative defenses. *29 U.S.C.S. § 206(d)(1)* The highlighted language of the statute requires that the employer submit evidence from which a reasonable factfinder could conclude not merely that the employer's proffered reasons could explain the wage disparity, but that the proffered reasons do in fact explain the wage disparity. Where employers seek summary judgment as to the Equal Pay Act claim, they must produce sufficient evidence such that no rational jury could conclude but that the proffered reasons actually motivated the wage disparity of which the plaintiff complains.

Labor & Employment Law > Discrimination > Actionable Discrimination

HN9[] Discrimination, Actionable Discrimination

To establish that a claim falls within the continuing violations theory, the plaintiff must do two things. First, she must demonstrate that at least one act occurred within the filing period: The crucial question is whether any present violation exists. Next, the plaintiff must establish that the harassment is more than the occurrence of isolated or sporadic acts of intentional discrimination. The relevant distinction is between the occurrence of isolated, intermittent acts of discrimination and a persistent, on-going pattern.

Labor & Employment Law > Discrimination > Retaliation > Burdens of Proof

HN10[] Retaliation, Burdens of Proof

Title VII of the Civil Rights Act of 1964, *42 U.S.C.S. § 2000e et seq.*, retaliation claims follow the standard McDonnell Douglas three-part burden shifting analysis. The plaintiff first must establish a prima facie case of retaliation: she must show that (1) she was engaged in protected activity; (2) she was discharged subsequent to or contemporaneously with such activity; and (3) there is

a causal link between the protected activity and the discharge. If the plaintiff succeeds, the burden of production shifts to the defendant to articulate some legitimate, nondiscriminatory reason for the employee's rejection. The employer satisfies its burden of production by introducing evidence which, taken as true, would permit the conclusion that there was a nondiscriminatory reason for the unfavorable employment decision. Once the employer answers its relatively light burden by articulating a legitimate reason for the unfavorable employment decision, the burden of production rebounds to the plaintiff, who must now show by a preponderance of the evidence that the employer's explanation is pretextual.

Counsel: For MARY ANNE LEWIS, Plaintiff: Samuel P. Kamin, Goldberg, Kamin & Garvin, Pittsburgh, PA; Walter G. Bleil, Pittsburgh, PA.

For SHERIDAN BROADCASTING NETWORKS, INC., Defendant: George Basara, Lisa M. Passarello, Buchanan Ingersoll, Pittsburgh, PA.

Judges: Thomas M. Hardiman, United States District Judge.

Opinion by: Thomas M. Hardiman

Opinion

I. Introduction

Plaintiff Mary Anne Lewis (Lewis) brought this action against her former employer, Sheridan Broadcasting Network (Sheridan), for gender and race discrimination and retaliation under Title VII of the Civil Rights Act of 1964 (Title VII), violations of the Equal Pay Act (EPA), and violations of the Pennsylvania Human Relations Act (PHRA).

Presently before the Court is Sheridan's Motion for Summary Judgement on all Counts. For the reasons that follow, the Court will grant the motion for summary judgment as to Counts I and II (Title VII Hostile Work Environment) and Count V (PHRA). However, the Court will deny the motion as to Count III (Title VII Retaliation) and Count IV (Equal Pay Act).

II. Facts

The following facts are derived from the evidence of record **[*2]** and are taken in the light most favorable to Lewis, the nonmovant. *See Strozyk v. Norfolk Southern Corp., 358 F.3d 268, 277 n.7 (3d Cir. 2004)*. Lewis is a 45 year-old Caucasian woman who was hired temporarily by Sheridan to work as a news anchor for its American Urban Radio Networks in December 1997. From March 1998 until February 1999, Lewis again worked for Sheridan on a part-time basis. In May 1999, she returned as a part-time anchor and received a full-time position in August of that year.

During her employment with Sheridan, Lewis experienced what she believes was discrimination based on her race and gender. She claims that Sheridan denied her certain employment opportunities and benefits that it extended to African-American employees. Specifically, Sheridan did not send Lewis to cover certain news stories, offer her yearly reviews, or choose her to substitute for a prominent radio host. In addition, Lewis alleges that co-workers made comments to her and to others that constitute race and gender discrimination. Specifically, she claims that Gerry Scott, another anchor and a member of the management team, told Lewis that she did not understand the station's "core **[*3]** audience" and she asked too many questions. Scott said she was "stubborn and hardheaded," and that her desk was a "pile of chaos." Ty Miller, who was not a supervisor, asked Lewis if her parents let her listen to "black music" and told her that the only reason white people would see a certain movie was to "see a black man in chains." In addition, Lewis overheard Miller make a comment to an African-American co-worker, whose wife is Caucasian, about a "white woman whipping a slave."

Lewis complained about her experiences to Sheridan's Human Resources Director on November 9, 2001. Less than two months later, on January 7, 2002, Sheridan terminated Lewis because of what it claims was a reduction in force for financial reasons. On July 5, 2002, Lewis filed both intake and witness questionnaires with the Equal Employment Opportunity Commission (EEOC), alleging retaliation under Title VII and violations of the Equal Pay Act. On March 5, 2003, the EEOC completed the formal charge, which it then sent to the Pennsylvania Human Relations Commission (PHRC).

III. Discussion

HN1[↑] Summary judgment is required on an issue or a claim when "the pleadings, depositions, answers to

interrogatories **[*4]** and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." *Fed. R. Civ. P. 56(c)*; *see also Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 250-52, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986)*; *Saldana v. Kmart Corp., 260 F.3d 228, 231-32, 43 V.I. 361 (3d Cir. 2001)*. An issue is "material" only if the factual dispute "might affect the outcome of the suit under the governing law." *Anderson, 477 U.S. at 248*.

"Summary judgment procedure is properly regarded not as a disfavorable procedural shortcut, but rather as an integral part of the Federal Rules as a whole, which are designed to secure the just, speedy and inexpensive determination of every action." *Celotex Corp. v. Catrett, 477 U.S. 317, 327, 106 S. Ct. 2548, 91 L. Ed. 2d 265 (1986)* (internal quotation marks omitted). The parties have a duty to present evidence; neither statements of counsel in briefs nor speculative or conclusory allegations satisfy this duty. *Ridgewood Bd. of Educ. v. N.E. for M.E., 172 F.3d 238, 252 (3d Cir. 1999)*. After the moving party has **[*5]** filed a properly supported motion, the burden shifts to the non-moving party to set forth specific facts showing that there is a genuine issue for trial. *Fed. R. Civ. P. 56(e)*. The non-moving party must make a showing sufficient to establish the existence of each element essential to her case on which she will bear the burden of proof at trial. *Celotex, 477 U.S. at 322-23*.

A. Timeliness of Plaintiff's Title VII Claims

HN2[↑] The language of Title VII is sparse in its guidance on what constitutes a formal charge with the EEOC, stating merely that "charges shall be in writing under oath or affirmation and shall contain such information and be in such form as the Commission requires." *42 U.S.C. § 2000e-5(b)*. Similarly, the Code of Federal Regulations states that "a charge shall be in writing and signed and shall be verified" and it "shall name the prospective respondent and shall generally allege the discriminatory act(s). Charges received in person or by telephone shall be reduced to writing." *29 C.F.R. §§ 1601.9* and *1626.6*. In *Bihler v. Singer Co., 710 F.2d 96, 99 (3d Cir. 1983),* **[*6]** the Court of Appeals for the Third Circuit interpreted the statute in considering the types of allegations that satisfy the charge requirement: "in order to constitute a charge that satisfies the requirement of *section 626(d)*, notice to the EEOC must be of a kind that would convince a reasonable person that the grievant has manifested an intent to activate the Act's machinery." *Id. at 99*.

HN3[↑] A charge satisfying the foregoing requirements must be timely filed with the EEOC. "In a case of an unlawful employment practice with respect to which the person aggrieved has initially instituted proceedings with a State or local agency . . . such charge shall be filed by or on behalf of the person aggrieved within three hundred days after the alleged unlawful employment practice occurred." *42 U.S.C. § 2000e-5(e)(1)*. Recognizing the widespread interest in pursuing fair employment practices, *29 C.F.R. § 1626.10* permits the EEOC to enter into agreements with state and local fair employment practices agencies. Under such agreements, the requirement of *§ 2000e-5(e)(1)* that a charge must first be filed with the State to trigger the **[*7]** 300 day limitations period is satisfied by filing with the EEOC. "When a worksharing agreement with a State agency is in effect, the State agency will act on certain charges and the Commission will promptly process charges which the State agency does not pursue. Charges received by one agency under the agreement shall be deemed received by the other agency for purposes of *§ 1626.7*." The Third Circuit, in addressing the timeliness of charges filed in States with such agreements, held that "in a state such as Pennsylvania which has an agency performing functions similar to those of the EEOC, the time for filing is extended to 300 days . . . ." *Callowhill v. Allen-Sherman-Hoff Co., Inc., 832 F.2d 269, 271 (3d Cir. 1987)*.

Although Lewis filed an intake questionnaire and a witness questionnaire on July 5, 2002, an official charge was not filed with the EEOC until March 5, 2003. Based on these facts, Sheridan argues that all of Lewis' claims are time-barred because she failed to file a proper charge with the EEOC within 300 days of the alleged violation. In support of this argument, Sheridan cites Third Circuit precedent, along with cases from other jurisdictions, which **[*8]** hold that intake questionnaires are insufficient to satisfy Title VII's charge requirement. Sheridan argues that the holding of the Court of Appeals in *Michelson v. Exxon Research & Eng'g Co., 808 F.2d 1005 (3d Cir. 1987)* stands for the broad proposition that intake questionnaires are insufficient to evidence an intent to activate the machinery of Title VII. But the Court in *Michelson,* as conceded by Sheridan's counsel at oral argument, merely applied the *Bihler* standard to the particular facts of that case and held that the plaintiff had not shown facts that would "convince a reasonable person that the grievant has manifested an intent to activate the Act's machinery." *Bihler, 710 F.2d at 99*. The Court in *Michelson* did not hold that intake

questionnaires are *per se* insufficient to satisfy the charge requirement. Rather, the Court found that correspondence between the plaintiff and the EEOC failed to, in the words of the *Bihler* decision, "allow the EEOC to investigate immediately [instead of] await further communication from the plaintiff before investigation." *Michelson 808 F.2d at 1010* (internal citations omitted).

[*9] In *Michelson*, the plaintiff contacted the EEOC and was told that the Commission needed more facts before it could begin to investigate his claim. The plaintiff never made further contact with the EEOC, however. Unlike the plaintiff in *Michelson*, here Lewis gave a detailed account of the alleged conduct, including a sworn statement and witness information. Moreover, she promptly answered a subsequent request from the EEOC, which itself referred to her action as a "charge." Therefore, Lewis "manifested an intent to activate the Act's machinery," and the Court finds that the questionnaires submitted to the EEOC constitute a timely filing under *Bihler*. Accordingly, the Court will consider conduct that occurred within 300 days of July 5, 2002, dating back to September 8, 2001, in its consideration of Lewis' claims for hostile work environment and retaliation under Title VII.

B. Timeliness of Plaintiff's PHRA Claim

Lewis claims that Sheridan's behavior also violated the PHRA. Sheridan responds that any claim under the PHRA is time-barred, since the PHRC did not receive the EEOC charge until well after the 300 day statutory period. In support of this argument, Sheridan **[*10]** cites *Woodson v. Scott Paper Co., 109 F.3d 913 (3d Cir.), cert. denied, 522 U.S. 914, 118 S. Ct. 299, 139 L. Ed. 2d 230 (1997)*. The Court of Appeals in *Woodson* addressed the effect of the work sharing agreement between the EEOC and PHRC on the timeliness of charges:

> . . . ***HN4***[↑] the worksharing agreement allows a plaintiff to proceed in court under Title VII without first filing with the PHRC. That, however, does not mean that a plaintiff can initiate PHRC proceedings as required by the PHRA merely by filing with the EEOC. Whether a plaintiff has initiated PHRC proceedings under the PHRA is a state law issue. The worksharing agreement says nothing about whether a plaintiff has invoked PHRC procedures if the PHRC has never received his or her claim, nor could it, given that the Pennsylvania Supreme Court held in *Fye v. Central Transportation Inc., 487 Pa. 137, 409 A.2d 2 (1979)*, that EEOC procedures are not a sufficient surrogate for PHRC remedies.

Id. at 926-7. At the same time, the Court recognized that, in certain circumstances, equitable arguments could be made to allow a plaintiff to proceed under the PHRA even if the claim was not actually received **[*11]** by the PHRC. Absent such circumstances, however, "if the PHRC does not receive a complainant's claim, then that complainant cannot bring suit under the PHRA." *Id. at 927*.

Lewis has not made any colorable equitable argument in this case. Her official charge, with the indication that she desired to cross-file with the PHRC, was submitted on March 5, 2003. Although the intake questionnaire filed on July 5, 2002 satisfies the requirement of a charge for Title VII statute of limitations purposes, Lewis has offered no evidence that the PHRC actually received her charge prior to March 5, 2003. She has provided the Court with no case law which suggests an applicable exception to the language of *Woodson*. Thus, Lewis' claim under the PHRA is time-barred.

C. Timeliness of Plaintiff's EPA Claim

Lewis claims that Sheridan violated the EPA by paying her significantly less than it paid male employees for performing comparable jobs. Sheridan counters that Plaintiff's claim is untimely based on the statute of limitations for EPA violations. ***HN5***[↑] "Claims arising under the EPA must be filed within two years of accrual of the cause of action, except in cases of willful violations, in which **[*12]** the limitations period is three years." *Miller v. Beneficial Management Corp. 977 F.2d 834, 842 (3d Cir. 1992)*. Sheridan argues both that the two year statute of limitations should apply, and that the statute should run from the time Lewis became aware of the pay discrepancy. Lewis responds that the behavior was a willful violation and argues that infringements of the EPA are "continuing violations" such that the statute of limitations begins to run from the date of the last act of discrimination.

In *Miller*, the Court of Appeals stated unequivocally that ***HN6***[↑] "sex-based, discriminatory wage payments constitute a continuing violation of the Equal Pay Act . . . To hold otherwise would permit perpetual wage discrimination by an employer whose violation of the Equal Pay Act had already lasted without attack for over

two years." *Id. at 843*. Thus, the "statute of limitations begins to run on the date of the last occurrence of discrimination, rather than the first." *Id. at 844*.

In the instant case, Lewis alleges that Sheridan willfully violated the EPA, so the three year statute of limitations applies. She received her last paycheck from **[*13]** Sheridan after her termination in January 2002, which is within three years of July 7, 2004, the date on which this action was filed. Thus, the EPA claim is timely with respect to a willful violation claim.

Despite the timeliness of Lewis' claim that Sheridan willfully violated the EPA, Sheridan seeks summary judgment on the merits, claiming that Lewis has failed to prove that the differences in pay were based on gender. In doing so, Sheridan misconstrues the proper analysis of an alleged EPA violation. ***HN7***[↑] EPA claims are viewed under a two-step burden shifting process. "The plaintiff must first establish a prima facie case by demonstrating that employees of the opposite sex were paid differently for performing "equal work"--work of substantially equal skill, effort and responsibility, under similar working conditions. The burden of *persuasion* then shifts to the employer to demonstrate the applicability of one of the four affirmative defenses specified in the Act." *Stanziale v. Jargowsky 200 F.3d 101, 107 (3d Cir. 2000)*(emphasis in original). Lewis has alleged, and cited record evidence to support the allegation, that she was paid tens of thousands of dollars less **[*14]** than a male anchor who was performing a substantially similar job. Sheridan responds that market factors and unequal qualifications led to the disparity, rather than gender. To prevail on summary judgment, however, Sheridan must meet a higher burden:

> ***HN8***[↑] The employer's burden is significantly different in defending an Equal Pay Act claim for an additional reason. The Equal Pay Act prohibits differential pay for men and women when performing equal work "except where such payment is *made pursuant to*" one of the four affirmative defenses. *29 U.S.C. § 206(d)(1)* We read the highlighted language of the statute as requiring that the employer submit evidence from which a reasonable factfinder could conclude not merely that the employer's proffered reasons could explain the wage disparity, but that the proffered reasons do in fact explain the wage disparity . . . . More to the point, where, as here, employers seek summary judgment as to the Equal Pay Act claim, they must produce sufficient evidence such that no rational jury could conclude but that the proffered reasons actually motivated the wage disparity of which the plaintiff complains.

Id. at 107-8 **[*15]** (emphasis in original). Sheridan has not met that demanding burden, and Lewis has alleged facts from which a reasonable jury could conclude that discrimination was the actual reason behind the pay disparity. Specifically, Lewis has pointed to deposition testimony from one of Sheridan's witnesses indicating that the job Lewis performed was essentially the same as the job performed by a male employee who was paid considerably more than Lewis. Thus, Sheridan is not entitled to summary judgment on Lewis' EPA claim.

D. Hostile Work Environment

Lewis contends that Sheridan discriminated against her on the basis of gender and race in violation of Title VII, *42 U.S.C. § 2000e et seq.* Specifically, as alleged in the complaint and explained by counsel at oral argument, Lewis claims that Sheridan created a hostile work environment through the comments and behavior of its employees.

First, the record demonstrates that the incidents complained of fall outside the 300 day statute of limitations period prior to Lewis' filing of the intake questionnaire with the EEOC. Of the various incidents mentioned in her deposition, those identified specifically by date **[*16]** occurred in 2000 and early 2001. Lewis claims that her meeting with Human Resources, which precipitated the retaliation on January 7, 2002, occurred on November 9, 2001. Although both of these dates fall within the 300 day period, Lewis' counsel conceded at oral argument that these incidents are alleged to be part of the retaliation claim, rather than the hostile work environment claims.

Even if one of the alleged acts occurred during the 300 day period, in order for the incidents outside that time frame to be considered, Lewis would have to prove that they were part of a continuing violation:

> ***HN9***[↑] To establish that a claim falls within the continuing violations theory, the plaintiff must do two things. First, she must demonstrate that at least one act occurred within the filing period: 'The crucial question is whether any present violation exists.' Next, the plaintiff must establish that the harassment is 'more than the occurrence of isolated or sporadic acts of intentional discrimination.' The relevant distinction is between the occurrence of

> isolated, intermittent acts of discrimination and a persistent, on-going pattern.

West v. Philadelphia Elec. Co., 45 F.3d 744, 754-5 (3d Cir. 1995) **[*17]** (internal citations omitted). The record demonstrates that the conduct of which Lewis complains consisted of, at most, "isolated, intermittent acts of discrimination" rather than "a persistent, on-going pattern." *Id.* Therefore, Counts I and II alleging hostile work environment violations under Title VII are time-barred.

Even assuming, *arguendo,* that Lewis' claims for hostile work environment were timely, she has failed to marshal evidence of a *prima facie* case. As the Court of Appeals stated recently in *Caver v. City of Trenton, 420 F.3d 243 (3d Cir. 2005)*: "Under Title VII, the evidence must establish that: (1) [she] suffered intentional discrimination because of [her race]; (2) the discrimination was pervasive and regular; (3) it detrimentally affected [her]; (4) it would have detrimentally affected a reasonable person of the same protected class in [her] position; and (5) there is a basis for vicarious liability." *Id. at 262*. Furthermore, the Court emphasized the stringency of the pervasiveness requirement. "In evaluating a hostile work environment claim under . . . Title VII . . . we are mindful that offhanded comments, and **[*18]** isolated incidents (unless extremely serious) are not sufficient to sustain a hostile work environment claim. Rather, the conduct must be extreme to amount to a change in the terms and conditions of employment." *Id. at 262-3* (internal citations omitted).

> In determining whether the conduct at issue is sufficiently extreme, we consider the totality of the circumstances. As such, a discrimination analysis must concentrate not on individual incidents, but on the overall scenario . . . . The types of circumstances we consider may include the frequency of the discriminatory conduct; its severity; whether it is physically threatening or humiliating, or a mere offensive utterance; and whether it unreasonably interferes with an employee's work performance.

Id. at 263 (internal citations omitted).

In this case, Lewis has failed to allege behavior that is sufficiently pervasive to be actionable under Title VII. First, the record does not evidence any behavior that was physically threatening or humiliating. Moreover, the actions of which Lewis complains consist of sporadic and individual incidents that fall well short of the requirements noted **[*19]** in *Caver*. Therefore, Sheridan is entitled to summary judgment on Lewis' hostile work environment claims.

E. Title VII Retaliation

Finally, Lewis claims that she was terminated in retaliation for complaints she made regarding race and gender discrimination to Sheridan's Human Resources Department. ***HN10***[↑] Title VII retaliation claims follow the standard *McDonnell Douglas* three-part burden shifting analysis. "The plaintiff first must establish a prima facie case of retaliation: [she] must show that (1) [she] was engaged in protected activity; (2) [she] was discharged subsequent to or contemporaneously with such activity; and (3) there is a causal link between the protected activity and the discharge." *Woodson, 109 F.3d. at 920*. "If the plaintiff succeeds, the burden of production shifts to the defendant to articulate some legitimate, nondiscriminatory reason for the employee's rejection. The employer satisfies its burden of production by introducing evidence which, taken as true, would permit the conclusion that there was a nondiscriminatory reason for the unfavorable employment decision." *Fuentes v. Perskie, 32 F.3d 759, 763 (3d Cir. 1994)* **[*20]** (internal citations omitted). "Once the employer answers its relatively light burden by articulating a legitimate reason for the unfavorable employment decision, the burden of production rebounds to the plaintiff, who must now show by a preponderance of the evidence that the employer's explanation is pretextual . . . ." *Id.*

> This basic framework under Title VII illustrates that, to defeat summary judgment when the defendant answers the plaintiff's prima facie case with legitimate, non-discriminatory reasons for its action, the plaintiff must point to some evidence, direct or circumstantial, from which a factfinder could reasonably either (1) disbelieve the employer's articulated legitimate reasons; or (2) believe that an invidious discriminatory reason was more likely than not a motivating or determinative cause of the employer's action.

Id. at 764.

Although Sheridan has proffered non-discriminatory reasons for Lewis' termination, there are material disputed facts regarding whether those reasons are pretextual. Sheridan terminated Lewis on January 7, 2002, less than two months after her complaint to Human Resources. Sheridan alleges that the

termination **[*21]** was part of a financial restructuring of its newsroom, but it has yet to identify the termination of another permanent employee. In sum, Lewis has satisfied her burden by demonstrating the temporal relationship between her complaint and termination, as well as challenging the scope of the alleged restructuring, such that a factfinder could reasonably disbelieve the proffered reasons or believe discrimination was probably a motivating or determinative cause of the employer's action.

III. Conclusion

For the foregoing reasons, Sheridan's motion for summary judgment will be granted with respect to Counts I and II for hostile work environment and Count V for violation of the PHRA. However, Lewis' claim for Title VII retaliation (Count III) and violation of the Equal Pay Act (Count IV) will proceed to trial.

An appropriate order follows.

Thomas M. Hardiman

United States District Judge

Dated: November 7, 2005

ORDER

AND NOW, this 7th day of November, 2005, upon consideration of Defendant's Motion for Summary Judgment (Doc. No. 11), it is hereby ORDERED that said motion is GRANTED with respect to Counts I, II (Title VII Hostile Work Environment), and V (Pennsylvania **[*22]** Human Relations Act) of Plaintiff's Complaint and DENIED as to Counts III (Title VII Retaliation) and IV (Equal Pay Act).

BY THE COURT:

Thomas M. Hardiman

United States District Judge

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2006 WL 360642
United States District Court,
W.D. Pennsylvania.

In re: DYCOAL, INC. Debtor.
DYCOAL, INC., et al., Plaintiffs,
v.
INTERNAL REVENUE SERVICE, et al., Defendants.

No. 05-679, 99-24594.
|
Feb. 15, 2006.

Attorneys and Law Firms

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OPINION

HARDIMAN, J.

***1** This case pits a debtor, some of its secured creditors, and privies in contract (collectively, Plaintiffs) against the Internal Revenue Service (IRS or Service). Plaintiffs have prosecuted this adversary proceeding with urgency because they stand to gain millions of dollars if they can monetize tax credits potentially available under § 29 of the Internal Revenue Code. In stark contrast, the IRS has demonstrated little desire to bring to a definitive conclusion the issues Plaintiffs have pressed upon it. Indeed, from October 2000 until November 2003, the Service refrained from issuing any private letter rulings (PLR's) regarding § 29 credits. When a PLR finally was issued, it not only failed to provide Plaintiffs and their prospective investors with the comfort they sought, but the content of the PLR was such that Plaintiffs wish the IRS had remained silent. Accordingly, Plaintiffs now seek a judicial remedy. For the reasons that follow, however, the Court finds that the IRS is entitled to judgment on the pleadings.

I. Parties

Plaintiffs in this case can be divided into three groups: (1) Dycoal, Inc. (Dycoal), which is a debtor in bankruptcy; (2) three secured creditors of Dycoal known as KI Development LLC (KI), successor-in-interest to Komar Industries, Startec Energy, Inc. (Startec Energy), and Startec Processing LLC (Startec Processing) (collectively, Secured Creditors); and (3) nine single-purpose entities formed to receive from Dycoal ownership of five synthetic fuel production facilities, known as briquetters (Briquetters): Northwestern Synfuels LLC, H 1 Synfuels LLC, H 2 Synfuels LLC, H 3 Synfuels LLC, I Synfuels LLC, P Synfuels LLC, H. Briquetters Ltd., I. Briquetter Ltd, and P. Briquetters Ltd. Also involved in this case, though not a party, is Dycoal's parent, Fairview Inc. (Fairview).

Defendants are the IRS and ARK Technology Design, a secured creditor of Dycoal that is a nominal Defendant.

II. Procedural History

On June 16, 1999, Dycoal filed a petition for reorganization under Chapter 11 of the Bankruptcy Code, 11 U.S.C. § 301(a), with the U.S. Bankruptcy Court for the Western District of Pennsylvania. Approximately one year later, on June 6, 2000, the Bankruptcy Court entered an order (Confirmation Order) confirming Dycoal's plan of reorganization (Plan).

Almost five years after Dycoal's Plan was confirmed, on February 10, 2005, Plaintiffs filed an adversary proceeding against Defendants seeking: (1) a determination of the ownership of the Briquetters; (2) a declaration that the Plaintiffs qualify for tax credits under § 29 of the Internal Revenue Code; and (3) enforcement of the Plan against the IRS.

In response, on April 20, 2005, the IRS filed a motion for judgment on the pleadings, arguing that the Bankruptcy Court lacked jurisdiction to hear the case. The IRS also claimed that the issue of Plaintiffs' entitlement to § 29 credits was not ripe for adjudication and the Service was not bound by either the Plan or the Confirmation Order.

Before the Bankruptcy Court ruled on the matter, on May 17, 2005, the IRS filed a motion requesting this Court to withdraw the reference. In an order issued on May 27, 2005 the Bankruptcy Court granted the Service's motion for judgment on the pleadings as to Count III of the adversary complaint. On June 30, 2005, the Bankruptcy Court issued an opinion likewise dismissing Count II. *See In re Dycoal,* 327 B.R. 220 (Bankr.W.D.Pa.2005). In *Dycoal,* Chief Bankruptcy Judge McCullough granted the Service's motion for judgment on the pleadings, holding that Plaintiffs could not obtain a declaration that their pre-confirmation tax credits were valid because no tax return seeking such credits had been filed and the IRS had not challenged such credits. *Id.* at 227.

***2** Following the Bankruptcy Court's decision, Plaintiffs then filed an amended complaint on July 19, 2005 which the IRS answered on August 4, 2005. After conferring with the parties and concluding that the cause would eventually be presented to this Court, the undersigned withdrew the reference from the Bankruptcy Court on October 18, 2005 to avoid delay and duplicative litigation. After the reference was withdrawn, the IRS filed a motion for judgment on the pleadings on November 7, 2005. The parties have briefed the issues extensively and the Court heard oral argument on the Service's motion on December 21, 2005.

III. Standard of Review

A motion for judgment on the pleadings pursuant to Rule 12(c) of the Federal Rules of Civil Procedure is analyzed using the same standard as a motion to dismiss for failure to state a claim under Rule 12(b)(6). *Turbe v. Gov't of the Virgin Islands,* 938 F.2d 427, 428 (3d Cir.1991); *Regalbuto v. City of Philadelphia,* 937 F.Supp. 374, 376-77 (E.D.Pa.1995). In deciding a Rule 12(c) motion, the district court must view the facts and inferences to be drawn from the pleadings in the light most favorable to the non-moving party. *Janney Montgomery Scott, Inc. v. Shepard Niles, Inc.,* 11 F.3d 399, 406 (3d Cir.1993). Judgment will be granted only "if it is clearly established that no material issue of fact remains to be resolved and that the movant is entitled to judgment as a matter of law." *Institute for Scientific Information, Inc. v. Gordon and Breach, Science Publishers, Inc.,* 931 F.2d 1002, 1005 (3d Cir.1991) (citing *Jablonski v. Pan American World Airways,* 863 F.2d 289, 290-91 (3d Cir.1988)).

IV. Facts

A. Background

In December of 1996, Startec Energy entered into agreements to supply, construct, and install the Briquetters to produce synthetic fuel from coal feedstock. Such "synfuels" were intended to be deemed "Qualified Fuels" within the meaning of § 29(c)(1)(C) and (f) of the Internal Revenue Code, which provide for lucrative tax credits under certain conditions. There is no dispute that the Briquetters were financed and built for the principal purpose of monetizing the tax credits potentially available under § 29.

In June of 1998, the Briquetters were assigned to Dycoal and installed in their present locations. The production of synthetic fuel then was tested and the parties responsible for the Briquetters agreed that they were fully operational. Plaintiffs also allege that synthetic fuel, differing significantly in chemical composition from the coal feedstock used to produce it, was produced prior to July 1, 1998. This synthetic fuel, along with additional fuel produced in 1999, was sold to unrelated third parties. Dycoal and its parent, Fairview, took a depreciation deduction for the Briquetters on their consolidated 1998 tax return (Depreciation Deduction), believing they were placed in service before July 1, 1998. Absent the Depreciation Deduction, Dycoal and Fairview would have received taxable income of $52,221 that year.

***3** Dycoal filed for Chapter 11 bankruptcy protection in June of 1999 because of disputes with Startec Energy and Komar. Dycoal did not list the IRS as a creditor on its bankruptcy schedules and the IRS did not file a proof of claim. The disputes that precipitated the bankruptcy filing were resolved by the distribution of ownership interests in the Briquetters to various interested parties. In an agreement included in the Confirmation Order entered on June 6, 2000, Startec Energy and Komar took Dycoal's three Briquetters, with the option to return title to them in exchange for payment on their existing claims. The Plan also provided that all other creditors, except Dycoal's parent Fairview, would be paid in full. The foregoing agreements were acceptable to the parties based on the Briquetters' prospective value to investors who would monetize them to take advantage of the § 29 credits. Most important to this dispute, the Confirmation Order made factual findings that the Briquetters were operational and placed in service prior to July 1, 1998. In addition,

the Confirmation Order expressly bound governmental agencies who were served with the Plan.

Consistent with the Plan confirmed by the Bankruptcy Court, Komar and Startec Energy elected to receive title to the H 2 Briquetter, the I Briquetter, and the P Briquetter rather than receive payment of $4.5 million from the Debtor. In addition, Startec Energy and Komar paid $370,673 to satisfy half of the outstanding claims against Dycoal, while Fairview paid the remainder, including all administrative claims. Thus, all of Dycoal's creditors have been paid in full, except Fairview, which possesses a subordinated claim under the Plan.

Once the creditors were paid, Plaintiffs sought earnestly to monetize the Briquetters by pursuing investors to produce synfuels and reap millions of dollars of tax credits pursuant to § 29 of the Internal Revenue Code. Accordingly, Komar spent more than $3.5 million to refurbish the Briquetters and prepare them for monetization.

To facilitate their efforts, Plaintiffs asked the IRS to issue a private letter ruling that consented to the critical "placed in service" findings contained in the Bankruptcy Court's Confirmation Order. Armed with such a PLR, Plaintiffs reasonably believed that the Briquetters would be a more viable investment opportunity for those who might be able to take advantage of § 29 credits. To the Plaintiffs' dismay, however, the IRS elected not to issue any PLR's relating to § 29 credits from October 2000 until November 2003.

After much prodding and negotiating by Plaintiffs, in early 2004 the IRS issued a PLR regarding the § 29 credits and the Briquetters. Instead of unequivocally accepting the propriety of § 29 credits, however, the PLR provided no such comfort. Even worse, Plaintiffs claim that the IRS included in the PLR language that disregards the factual findings of the Confirmation Order as irrelevant to any future determination regarding the placed in service dates for the Briquetters. Consequently, Plaintiffs argue that the ambiguity associated with the PLR and the Service's view of the validity and binding effect of the Bankruptcy Court's factual findings have prevented monetization of the tax credits, thereby denying them the benefit of the bargain and threatening the success of the Plan.

B. The Amended Complaint

***4** Faced with what they found to be an untenable position in light of the Bankruptcy Court's June 30, 2005 decision, Plaintiffs filed a eight-count amended complaint on July 19, 2005. Count I claims that there is a cloud over title to the Briquetters insofar as the IRS may be a pre-petition creditor if the placed in service findings included in the Confirmation Order are invalid. Count II claims that if the placed in service findings are not binding on the Service, then the Depreciation Deduction was improper, Dycoal owes tax to the IRS, and the Court should determine that tax liability. Count III asks the Court to find that Dycoal has no non-dischargeable obligations to the IRS based on the potential invalidation of the Depreciation Deduction. Count IV seeks enforcement of the Confirmation Order against the IRS, specifically binding the Service to the factual determinations concerning the placed in service dates based on the potential claim it would have against Dycoal if the Depreciation Deduction were invalid. Count V seeks enforcement of the Confirmation Order against the IRS pursuant to several different provisions of federal law. Counts VI, VII and VIII request declaratory relief, with Count VI requesting a determination of the placed in service dates, Count VII arguing for the application of *res judicata* to the Confirmation Order, and Count VIII asking the Court to estop the IRS from challenging the factual findings of the Plan.

The Service's motion for judgment on the pleadings argues that Counts I and III of the amended complaint do not present a ripe case or controversy. In addition, the Service argues that Counts II, and IV through VIII are barred by the jurisdictional provision of the Declaratory Judgment Act. 28 U.S.C. § 2201(a). The IRS also argues that the Federal Government has not waived sovereign immunity for the counts that do not rely on the jurisdictional grant of § 505(a) of the Bankruptcy Code. Finally, in the alternative, the Service argues that it is entitled to judgment as a matter of law if the Court finds jurisdiction to be proper.

V. Analysis

As noted previously, the Bankruptcy Court refused to hold as a matter of law that the pre-confirmation § 29 credits were valid or viable because that request implicated future tax liabilities. In recognition of that decision, Plaintiffs now take a different tack by requesting only a declaration that the Bankruptcy Court's factual determination that the Briquetters were placed in service

before July 1, 1998 is valid and binding on the IRS. Accordingly, Plaintiffs disclaim any request for prospective legal relief: "the 'placed in service' findings alone, do not entitle the Plaintiff's [sic] to § 29 tax credits. Indeed, there are many other factual predicates necessary for Plaintiffs to show to be entitled to § 29 tax credits, which factual predicates are subject to the consideration of the Internal Revenue Service...." Am. Compl. at ¶ 8. Although such a declaration does not resolve finally the question of the validity of § 29 credits, Plaintiffs reasonably believe that it will provide sufficient comfort for investors to monetize the Briquetters. Thus, Plaintiffs' various and sundry claims are all paths to the same destination: a judgment from this Court, binding on the IRS, that the Briquetters were placed in service before July 1, 1998.

A. Sovereign Immunity

*5 Plaintiffs' first obstacle to recovery is the Service's entitlement to sovereign immunity. "It is well settled that the United States enjoys sovereign immunity from suits and, accordingly, may be sued only if it has waived that immunity. The IRS, as an agency of the United States, is thus shielded from private actions unless sovereign immunity has been waived." *Beneficial Consumer Discount Co. v. Poltonowicz,* 47 F.3d 91, 93-94 (3d Cir.1995) (internal citations omitted). "Moreover, when the plaintiff seeks to sue the United States or an instrumentality thereof, he may not rely on the general federal question jurisdiction of 28 U.S.C. § 1331, but must identify a specific statutory provision that waives the government's sovereign immunity from suit. A waiver of immunity must be unequivocally expressed, and is construed strictly in favor of the sovereign." *Clinton County Com'rs v. U.S. E.P.A.,* 116 F.3d 1018, 1021 (3d Cir.1997) (internal citations omitted).

Section 106 of the Bankruptcy Code provides, in pertinent part:

> (a) Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to the following:
>
> (1) Sections 105, 106, 107, 108, 303, 346, 362, 363, 364, 365, 366, 502, 503, 505, 506, 510, 522, 523, 524, 525, 542, 543, 544, 545, 546, 547, 548, 549, 550, 551, 552, 553, 722, 724, 726, 728, 744, 749, 764, 901, 922, 926, 928, 929, 944, 1107, 1141, 1142, 1143, 1146, 1201, 1203, 1205, 1206, 1227, 1231, 1301, 1303, 1305, and 1327 of this title.
>
> (2) The court may hear and determine any issue arising with respect to the application of such sections to governmental units.
>
> (3) The court may issue against a governmental unit an order, process, or judgment under such sections or the Federal Rules of Bankruptcy Procedure, including an order or judgment awarding a money recovery, but not including an award of punitive damages....

11 U.S.C. § 106(a). Counts I through VI of Plaintiffs' amended complaint point to one or more of the foregoing sections as grants of jurisdiction in this case, and thus the Court finds that sovereign immunity has been waived as to these six counts. However, the Court is unaware of any valid waiver with regard to Counts VII and VIII, and thus the IRS is immune from suit on those two counts.

B. Subject Matter Jurisdiction

1. Counts I and III-Validity of the Depreciation Deduction

Having addressed the waiver of sovereign immunity, the Court must next determine whether it has subject matter jurisdiction.

> To satisfy Article III's 'case or controversy' requirement, an action must present (1) a legal controversy that is real and not hypothetical, (2) a legal controversy that affects an individual in a concrete manner so as to provide the factual predicate for reasoned adjudication, and (3) a legal controversy so as to sharpen the issues for judicial resolution. The case or controversy requirement must be met regardless of the type of relief sought, including declaratory relief.

*6 *Armstrong World Industries, Inc. by Wolfson v. Adams,* 961 F.2d 405, 411 (3d Cir.1992) (internal citation and punctuation omitted).

Plaintiffs argue that a case or controversy exists relative to Counts I and III of the amended complaint because the validity of the Depreciation Deduction is in dispute. Specifically, they claim that the Depreciation Deduction was invalid if the Briquetters were not placed in service prior to July 1, 1998, as found in the Confirmation Order. If the Depreciation Deduction was invalid, the Service possesses a pre-petition tax claim which is a cloud on title to the Briquetters.

Count I states: "in order to determine that the IRS did not have a Class 2 claim it is necessary to determine that Fairview and the Debtor were entitled to claim a deduction for depreciation of the Briquetters in the 1998 return, which requires *inter alia* a finding that the Briquetters were placed in service before July 1, 1998." Am. Compl. at ¶ 72. Similarly, Count III argues that:

> the only way the IRS did not have a nondischargeable claim against the Debtor as of the filing of the Debtor's Chapter 11 Petition was if the Debtor and Fairview were entitled to claim a deduction for depreciation on Briquetters as set forth in the 1998 return. In order for the Debtor and Fairview to be entitled to claim the depreciation deduction, it is necessary that the Debtor had been engaged in business and that the Briquetters have been placed in service before July 1, 1998.

Am. Compl. at ¶¶ 91-92.

The Court first notes that the amended complaint lacks any averment that the IRS has expressly challenged, by audit or otherwise, the Depreciation Deduction taken by Fairview and Dycoal. In fact, counsel for the IRS made clear at oral argument that the IRS has no intention of contesting the 1998 return, and is almost certainly prevented from doing so by the applicable statute of limitations, which is three years. 26 U.S.C. § 6501(a). Furthermore, in its brief in support of its motion for judgment on the pleadings, the IRS reiterated that it allowed the Depreciation Deduction and offered to stipulate that there is no liability, dischargeable or otherwise, for the fiscal year ending February 1999. Nevertheless, Plaintiffs claim that the Service's PLR-which arguably undermines the Bankruptcy Court's factual finding regarding the placed in service dates for the Briquetters-constitutes a *bona fide* challenge to the Depreciation Deduction. The Court disagrees for several reasons.

First, the alleged controversy relates entirely to the Service's view that it is not bound by the Confirmation Order. The IRS admits that its PLR "contained qualifying language (again unique to Plaintiffs) that effectively disregards the validity and binding effect of the Plan Confirmation Order's 'placed in service' findings." Am. Compl. at ¶ 53. It is also undisputed that "the IRS has maintained that the 'placed in service' findings contained in the Plan Confirmation Order are irrelevant...." Am. Compl. at ¶ 54. Count I points to "the IRS' failure to recognize the 'placed in service' findings contained in the Plan Confirmation Order as valid findings." Am. Compl. at ¶ 63. Thus, Plaintiffs claim that these assertions by the IRS created "fatal uncertainty" that precluded the monetization of the Briquetters because no rational investor would assume the risk that the § 29 tax credits might be disallowed.

*7 Although Plaintiffs have made clear that the IRS does not believe itself bound by the Confirmation Order's factual findings, they do not allege that the IRS has directly contested or denied the *facts* underlying those findings. In fact, the IRS has stated no definitive opinion regarding the placed in service dates for the Briquetters. The Service's refusal to agree to be bound by the Confirmation Order is not equivalent to an unfavorable determination of the facts contained therein. To the contrary, the Service has taken the position that it is forensic in nature and will only assess the appropriateness of synfuels produced by the Briquetters for § 29 credits if and when such credits are taken.

Even if the Court were to interpret the actions of the IRS as contesting the facts underlying the findings made by the Bankruptcy Court, Counts I and III still fail to present a case or controversy. Plaintiffs' insistence notwithstanding, the requirements necessary for § 29 credits are not the same as those required for valid depreciation deductions. Thus, the IRS could find that the placed in service dates do not support § 29 credits without calling into question the Depreciation Deduction.

The Internal Revenue Code provides that "there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)-(1) of property used in the trade or business, or (2) of property held for the production of income." 26 U.S.C. § 167(a). In defining the scope of the deduction, § 168 states: "[e]xcept as otherwise provided in this section, the depreciation deduction provided by section 167(a) for any tangible property shall be determined by using-(1) the applicable depreciation method, (2) the applicable recovery period, and (3) the applicable convention." 26 U.S.C. § 168(a). In this case, Dycoal used the half-year convention to calculate the Depreciation Deduction. Under this method, "all property placed in service during any taxable year (or disposed of during any taxable year)" is treated as "placed in service (or disposed of) on the mid-point of such taxable year." 26 U.S.C. § 168(d)(4)(A). Therefore, so long as the Briquetters were placed in service at *any time* prior to the conclusion of Dycoal's fiscal year on January 31, 1999, they would have qualified for the Depreciation Deduction. Accordingly, the IRS could choose to disagree that the Briquetters were placed in service before July 1, 1998 without contesting the validity of the Depreciation Deduction. Accordingly, Plaintiffs' premise that a challenge to the Depreciation Deduction necessarily follows from a challenge to the Confirmation Order's placed in service dates is fallacious.

In light of the foregoing, the record is devoid of any challenge to the Depreciation Deduction by the IRS. Even assuming the Service now were to change course, the statute of limitations would preclude any challenge to the Depreciation Deduction. *See* 26 U.S.C. § 6501. Section 6501(a) of the Internal Revenue Code states: "[e]xcept as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed)...." In this case, Plaintiffs have not cited any exception under which the statute of limitations period would be tolled or extended and the Court is unaware of one that applies.[1] Thus, regardless of any disagreement with the facts underlying Dycoal's 1998 tax return, the time for the IRS to challenge the Depreciation Deduction has long since passed.

***8** In an effort to counter the Service's argument on the statute of limitations, Dycoal asserted at oral argument that 26 U.S.C. § 6503(h) stayed the IRS from assessing tax. As the Service correctly notes, however, the automatic stay triggered by Dycoal's Chapter 11 petition does not apply to: "A) an audit by a governmental unit to determine tax liability; (B) the issuance to the debtor by a governmental unit of a notice of tax deficiency; (C) a demand for tax returns; or (D) the making of an assessment for any tax and issuance of a notice and demand for payment of such an assessment...." 11 U.S.C. § 362(b)(9). Thus, at any time before or during the Dycoal bankruptcy proceeding, the IRS could have challenged Dycoal's 1998 tax return. Because it did not do so, the statutory period lapsed several years ago. In sum, because Plaintiffs have not alleged that the IRS challenged the Depreciation Deduction, there is no case or controversy.

Plaintiffs also argue that "absent valid 'placed in service findings,' the IRS is a Class 2 creditor holding an unpaid, pre-petition claim." This is incorrect as a matter of law for the myriad reasons stated previously. Furthermore, even if the IRS had a pre-petition claim against Dycoal because the Depreciation Deduction was invalid, any such claim was discharged by the Confirmation Order, which states:

> Debtor is discharged effective on the Consummation date from any liability on any 'claim' and from all 'debt' (as those terms are defined in Section 101 of the Bankruptcy Code) that arose before the Confirmation Date, except for claims and debts that are reinstated by the express provisions of the Plan, or this Order, and Debtor's liabilities in respect thereof are extinguished completely, whether or not reduced to judgment, liquidated or unliquated, contingent or non-contingent, asserted or unasserted, fixed or unfixed, matured or unmatured, disputed or undisputed, legal or equitable, known or unknown that arose from any agreement of the Debtor entered into or obligation of the Debtor incurred before the Confirmation Date....

Confirmation Order at ¶ 15. Plaintiffs argue that a potential claim on behalf of the IRS could be exempted from this general discharge by 11 U.S.C. § 523(a)(1). As the IRS correctly notes, § 523(a)(1) applies to individuals, not corporations. *See In re Pelkowski,* 990 F.2d 737, 742 (3d Cir.1993) (citing *Garrie v. James L. Gray, Inc.,* 912 F.2d 808 (5th Cir.1990)).

Not only did the IRS not have a claim against the Debtor based on the Depreciation Deduction, any claim it would have had has been discharged. Because there is no controversy regarding Dycoal's 1998 tax return or the Depreciation Deduction contained therein, the Court lacks jurisdiction over Counts I and III of the amended complaint.

2. Count II-Declaratory Judgment on the Depreciation Deduction

In Count II, Plaintiffs seek a declaratory judgment that Dycoal is entitled to the Depreciation Deduction. Pursuant to Article III of the Constitution, "the case or controversy requirement must be met regardless of the type of relief sought, including declaratory relief." *Armstrong,* 961 F.2d at 411. "Basically, the question in each case is whether the facts alleged, under all the circumstances, show that there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment." *Step-Saver Data Systems, Inc. v. Wyse Technology,* 912 F.2d 643, 647 (3d Cir.1990) (quoting *Maryland Casualty Co. v. Pacific Coal & Oil Co.,* 312 U.S. 270, 273, 61 S.Ct. 510, 85 L.Ed. 826 (1941)).

***9** In *Step-Saver,* the Court of Appeals enunciated a three-part test to analyze whether district courts possess jurisdiction over declaratory judgment actions. Judge Becker noted in *Step-Saver:*

> As many commentators have noted, it is difficult to define the contours of the ripeness doctrine with precision. The task is even more problematic when defining ripeness in the context of declaratory judgment actions, for two reasons. First, there is the considerable amount of discretion built into the Declaratory Judgment Act itself. Even when declaratory actions are ripe, the Act only gives a court the *power* to make a declaration regarding 'the rights and other legal relations of any interested party seeking such declaration,' 28 U.S.C. § 2201; it does not *require* that the court exercise that power. Second, declaratory judgments are issued before 'accomplished' injury can be established, *see* E. Borchard, *Declaratory Judgments* 29 (1941), and this *ex ante* determination of rights exists in some tension with traditional notions of ripeness. Nonetheless, because the Constitution prohibits federal courts from deciding issues in which there is no 'case' or 'controversy,' U.S. Const. art. III, § 2, declaratory judgments can be issued only when there is an actual controversy, 28 U.S.C. § 2201. The discretionary power to determine the rights of parties before injury has actually happened cannot be exercised unless there is a legitimate dispute between the parties.

Step-Saver, 912 F.2d at 646-47.

In the instant case, Plaintiffs claim that 28 U.S.C. § 1334, 11 U.S.C. §§ 105(a) and 1142, and Bankruptcy Rule 3020 confer jurisdiction upon this Court to issue the declaratory judgment sought in Count II. With one exception, however, the statutes upon which Plaintiffs rely address the broad power afforded courts to consider matters related to bankruptcy proceedings and enforce plans of reorganization and confirmation orders. Plaintiffs argue that the relief sought in Count II falls within the Court's power, under § 505(a) of the Bankruptcy Code, to determine the "amount or legality of any tax...." Although it is true that the Declaratory Judgment Act excepts cases brought under 11 U.S.C. § 505(a) from the general prohibition on declaratory relief in tax cases, § 505(a) does not vitiate the case or controversy requirement; indeed, it plainly states that the relief must be sought "in a case or actual controversy."

As stated previously, the Court does not believe that the Depreciation Deduction is the subject of any actual case or controversy. Plaintiffs have neither shown that Dycoal's tax liability was in controversy during the bankruptcy proceedings, nor alleged that a disallowance of the uncontested Depreciation Deduction would determine the success of the Plan. In short, because Count II asks the Court to determine the "amount or legality" of a tax not in dispute, it does not satisfy the case or controversy requirement articulated by the Court of Appeals in *Step-Saver.*

***10** Furthermore, to the extent that Plaintiffs seek any determination relating to future § 29 credits under § 505(a), the Court is likewise without jurisdiction. "Pursuant to section 505, a bankruptcy court has the jurisdiction only to determine tax liabilities; there is no grant of jurisdiction to decide issues that are antecedent to the determination of tax liability.... The ripeness doctrine was meant to prevent just such a situation." *In re Grand Chevrolet, Inc.* 153 B.R. 296, 299 (Bankr.C.D.Cal.1993). Thus, because the Depreciation Deduction is not in controversy and the question of the validity of § 29 credits is not ripe, the Court lacks jurisdiction to make any determination under § 505(a).

3. Count VII-*Res Judicata*

In Count VII, Plaintiffs claim that because the IRS issued a PLR denying that the factual findings of the Confirmation Order are binding on the Service, a controversy exists regarding the application of the doctrine of *res judicata.* Thus, Plaintiffs ask the Court to "enter an Order determining that the IRS is bound by the *res judicata* consequences of the Confirmation Order." Am. Compl. at ¶ 134. Stated another way, Plaintiffs seek an order that would preclude the IRS from challenging the placed in service dates for the Briquetters in some future case. As discussed previously, Count VII does not indicate an express waiver of sovereign immunity that allows Plaintiffs to proceed against the IRS. However, even assuming *arguendo,* that such a waiver were found, the Court still would lack jurisdiction over Count VII.

Res judicata applies when there is a final judgment on the merits involving the same parties and the same underlying facts and cause of action. *In re Continental Airlines, Inc.,* 279 F.3d 226 (3d Cir.2002). As the Supreme Court has stated, "there is little to be added to the doctrine of *res judicata* as developed in the case law of this Court. A final judgment on the merits of an action precludes the parties or their privies from relitigating issues that were or could have been raised in that action." *Federated Dept. Stores, Inc. v. Moitie,* 452 U.S. 394, 398, 101 S.Ct. 2424, 69 L.Ed.2d 103 (1981). Here, the IRS does not seek to litigate, or relitigate, the placed in service dates established in the Confirmation Order. Indeed, the crux of Plaintiffs' complaint is that the IRS has assiduously avoided doing just that. Rather, Plaintiffs fear that the Service may, at some future time, contest the facts established by the Confirmation Order and disallow § 29 credits taken on a future tax return filed by an unknown taxpayer. While such a future dispute is foreseeable, if the unknown taxpayer takes § 29 tax credits and is challenged by the IRS, that taxpayer can argue that *res judicata* prevents the IRS from relitigating the "claim" determined by the Confirmation Order. In sum, this Court is powerless to issue orders confirming or denying the prospective application of legal doctrines in proceedings not yet filed by parties not yet known. Accordingly, the Court lacks jurisdiction over Count VII.

C. Judgment as a Matter of Law

***11** Although the Court lacks jurisdiction over Counts I-III and VII, Counts IV, V, VI, and VIII present closer questions. Plaintiffs claim that the Court can grant the relief sought by these Counts pursuant to its broad powers to give effect to and enforce the Plan and Confirmation Order. The Court agrees with Plaintiffs that such broad jurisdiction exists under 11 U.S.C. § 105 to carry out the provisions of Title 11. In addition, "the court may direct the debtor and any other necessary party ... to perform any other act, including the satisfaction of any lien, that is necessary for the consummation of the plan." 11 U.S.C. § 1142(b).[2] Furthermore, Bankruptcy Rule 3020(d) states "[n]otwithstanding the entry of the order of confirmation, the court may issue any other order necessary to administer the estate." Thus, the Court has jurisdiction over Plaintiffs' remaining claims, the merits of which are considered next.

1. Count IV-Enforcing Confirmation Order Against IRS as Creditor/Interested Party

In Count IV, Plaintiffs allege that the IRS is bound by the Confirmation Order. To the extent Plaintiffs advance this claim by again alleging that the IRS was a creditor based on the possible claim relating to the Depreciation Deduction, the Court remains unpersuaded.

The Bankruptcy Code states that

> the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such

> creditor, equity security holder, or general partner has accepted the plan.

11 U.S.C. § 1141(a). A creditor is defined as an "(A) entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor; (B) entity that has a claim against the estate of a kind specified in section 348(d), 502(f), 502(g), 502(h) or 502(i) of this title; or (C) entity that has a community claim." 11 U.S.C. § 101(10). With respect to the Dycoal bankruptcy proceeding, the IRS is none of the foregoing entities.

Plaintiffs argue that because the PLR cast doubt on the factual findings of the Confirmation Order, Dycoal owes taxes for 1998, thereby rendering the IRS a creditor. This argument is unpersuasive. Initially, the Court notes that no proof of claim was filed either by the IRS or on its behalf by Dycoal. Had Dycoal believed that the IRS possessed a claim for unpaid taxes, it could have filed a proof of claim on behalf of the Service and sought determination of the amount owed. Having failed to do so, and hoping to ascribe preclusive effect to the Confirmation Order, Plaintiffs now claim that the IRS was a creditor based on a claim that neither party recognized or asserted at any time during the bankruptcy proceeding.

Plaintiffs claim that cases similar to the one at bar demonstrate that the Service can be deemed a creditor, bound by a Confirmation Order, even in the absence of a proof of claim or alleged debt. In support of this argument, Plaintiffs cite *Matter of Century Vault Co.,* 416 F.2d 1035 (3d Cir.1969), where the Court of Appeals stated that "the fact that a proof of claim has or has not been filed is immaterial." *Id.* at 1041. Although this quotation is accurate, when read in the context of the facts in *Century Vault,* the quotation does not support Plaintiffs' argument.

***12** In *Century Vault,* three different government entities, including the Pennsylvania Department of Revenue, asserted corporate tax lien claims against the debtor. Because the lien had not been reduced to judgment, however, the referee held that the Commonwealth did not possess a valid claim because its lien was inchoate. *Id.* at 1037. The district court reversed the referee in bankruptcy and held that the claim was valid. *Id.* On appeal, immediately after the statement regarding the immateriality of the filing of a proof of claim, the Court of Appeals stated that "there is no question here that the corporation taxes are unpaid or that the bankrupt did not contest their amount prior to bankruptcy." *Id.* at 1041. It is unsurprising that the Court of Appeals found immaterial the fact that no proof of claim was filed in a case in which the taxing body and the corporate debtor both agreed that taxes were due. Precisely the opposite is true in the instant case, however. Here, the record is clear that the IRS has not asserted, and has no intention of asserting, any lien, charge, or claim against Dycoal for unpaid taxes. Accordingly, *Century Vault* is inapposite.

Plaintiffs' other appellate authorities, *Gwilliam v. United States,* 519 F.2d 407 (9th Cir.1975) and *Bostwick v. United States,* 521 F.2d 741 (8th Cir.1975), are inapposite for the same reason that *Century Vault* does not apply. In *Gwilliam,* the debtor admitted that he owed income taxes to the United States, but requested a discharge because the taxes were due for more than three years prior to the bankruptcy. *Gwilliam,* 519 F.2d at 408. In *Bostwick,* the debtors listed the IRS as a creditor for back taxes in the amount of $68,400. *Bostwick,* 521 F.2d at 743. Like *Century Vault,* there was no dispute in *Gwilliam* or *Bostwick* that taxes were due. In stark contrast, in the instant case the IRS has not claimed, does not claim, and cannot claim that Dycoal owes any tax for 1998.

Likewise, Plaintiffs' reliance upon *In re Kilen,* 129 B.R. 538 (Bankr.N.D.Ill.1991), is misplaced. In *Kilen,* after the debtor filed a proof of claim on behalf of the IRS, the Court stated that "the controversy can be concrete even if it is the debtor who files the proof of claim on behalf of the creditor." *Id.* at 547. Unlike *Kilen,* here neither party filed a proof of claim on behalf of the IRS.

As a fallback to their argument that the IRS is bound by the Confirmation Order as a creditor, Plaintiffs claim that even if the Service is not a creditor, "pursuant to Section 1109(b) of the Bankruptcy Code, the IRS was a party in interest with a practical stake in the outcome of this matter and therefore bound by the Plan." Am. Compl. at ¶ 102. In support of this contention, Plaintiffs cite *In re K.D. Co., Inc.,* 254 B.R. 480 (10th Cir.2000), which recognized that "the Confirmed Plan and the Confirmation Order are binding on the parties under § 1141 and principles of *res judicata,* regardless of whether [the parties] agreed

with their provisions." *Id.* at 490. Plaintiffs also cite *In re Justice Oaks II, Ltd.*, 898 F.2d 1544 (11th Cir.1990), where the Court of Appeals for the Eleventh Circuit applied *res judicata* to bind a non-creditor to a confirmation order. *Id.* at 1550.

***13** The Court agrees generally with Plaintiffs' argument that confirmation orders, like all final judgments on the merits, can have binding effect under *res judicata,* provided all of its essential elements are satisfied. In refusing to find the Dycoal Confirmation Order binding against the IRS in the instant case, Chief Bankruptcy Judge McCullough quoted extensively from *In re Union Golf of Florida,* 242 B.R. 51 (Bankr.M.D.Fla.1998) where it distinguished *Justice Oaks:*

> Finally, the decision of the Eleventh Circuit Court of Appeals in *In re Justice Oaks II, Ltd.,* 898 F.2d 1544 (11th Cir.1990) is not dispositive of this case. The Debtor cited *Justice Oaks* to support its position that the County is barred by the doctrine of *res judicata* from seeking to prohibit the Debtor from operating its golf course as a public course. The Debtor relied on the Eleventh Circuit's finding that all four elements of "claim preclusion" were present in an order confirming a chapter 11 plan. In *Justice Oaks,* however, the parties challenging the order of confirmation had been recognized as potential claimants in the chapter 11 case since its commencement, had actively participated in the case, and had been party to prior orders entered by the bankruptcy court while the case was pending. Consequently, the Eleventh Circuit's findings with respect to the 'identity of the parties,' the 'identity of the issues,' and the 'full and fair opportunity to litigate' arose in a factual and procedural context that is readily distinguishable from the case under consideration.

Id. at 59. The fact that courts have given confirmation orders preclusive effect against parties not statutorily bound by the Bankruptcy Code is unavailing to Plaintiffs in this case. The foregoing cases do not offer exceptions to the language of § 1141(a), which holds that the "the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor...." Rather, they recognize that the doctrine of *res juducata,* in addition to § 1141(a), can bind parties to the provisions of a confirmed plan. Unlike the cases upon which they rely, however, Plaintiffs have not satisfied any of the requirements for *res judicata* to apply. *Moitie,* 452 U.S. at 398. Finally, the Court observes that if the potential future disallowance of income tax deductions were sufficient to render the IRS a creditor, then the Service would be a creditor in every bankruptcy case. The Court is unaware of any statutory or case support for such an expansive, counter-intuitive proposition.

In sum, because Plaintiffs can point to no valid reason why the Court should deem the IRS within the ambit of parties included in § 1141(a) of the Bankruptcy Code, the Court refuses to declare the Confirmation Order binding on the Service.

2. Counts V and VI-Enforcement of Confirmation Order and Determination of Placed in Service Dates to Consummate the Plan

***14** In Counts V and VI, Plaintiffs argue that the feasibility of the Plan hinges on the future availability of § 29 credits, which in turn requires that the factual findings contained in the Confirmation Order be accepted by the IRS. In Count V, Plaintiffs ask the Court to enforce the Confirmation Order against the IRS and insist that "the value delivered by the Plan and the feasibility of the Plan were grounded on these 'placed in service' findings." Am. Compl. at ¶ 110. In Count VI, Plaintiffs ask the Court to make an independent and binding determination of the placed in service dates because "the Debtor's ability to confirm a feasible plan was founded on the Briquetter facilities' ability to generate credits which could be monetized." Am. Compl. at ¶ 122. For several reasons, the Court is not persuaded that the feasibility of the Plan depends on binding placed in service findings.

In an Order dated May 27, 2005, Chief Bankruptcy Judge McCullough refused to bind the IRS to the Confirmation Order and granted the Service's motion for judgment on the pleadings on this issue. Although Judge McCullough's decision is not binding here, it is noteworthy since he presided over the creation and implementation of Dycoal's Plan. That Judge McCullough refused to bind the IRS undermines Plaintiffs' contention that the success of Plan depends upon the binding effect of the placed in service findings.

Moreover, the feasibility requirement of the Bankruptcy Code does not mandate the complete victory Plaintiffs

seek. A plan of reorganization requires that "confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan." 11 U.S.C. § 1129(a)(11). Here, Dycoal has not argued that liquidation or further financial reorganization will be necessary. Rather, Plaintiffs have repeatedly maintained that all creditors have been paid in full, with the exception of Fairview. Thus, whether Plaintiffs can monetize the tax credits associated with the Briquetters will determine only whether Fairview is paid.

Plaintiffs insist further that the only reason Komar, Startec, and Fairview agreed to pay the outstanding creditors and accept ownership of the Briquetters in lieu of cash was the prospect of reaping the benefit of future § 29 tax credits. But this demonstrates only that those companies have placed their bets and the chips will fall one way or the other, depending upon the market conditions relative to their efforts to monetize the tax credits. While undoubtedly true that the interested companies will suffer some financial loss or gain, it seems to the Court an exaggeration to claim that the Plan itself cannot be consummated, and is not feasible within the meaning of § 1129, especially when all creditors except the Debtor's parent have been paid in full.

Finally, and perhaps most significantly, the Court notes that partial monetization of one of the briquetters *has already occurred.* Plaintiffs admitted that "one synthetic fuel facility has been partially monetized because the monetizers were able to structure a hedge to minimize the consequences of a successful challenge to the availability of tax credits to this facility." Pl. Br. at p. 9, n. 2. Thus, by their own admission, Plaintiffs' ability to monetize the facilities depends not on binding the IRS to the Confirmation Order, but on the risk tolerance of the market. While a binding order of this Court might assuage the concerns of potential investors, and perhaps even dramatically reduce the risk of monetizing the Briquetters, such an order is neither required nor appropriate under § 1142(a) or § 1129(a)(11) of the Bankruptcy Code. Therefore, Counts V and VI must be dismissed.

3. Count VIII-Equitable Estoppel

***15** In Count VIII, Plaintiffs claim that the IRS is equitably estopped from contesting the placed in service dates. Even assuming, *arguendo,* that the IRS had waived sovereign immunity as to this count, Plaintiffs' claim still fails.

Equitable estoppel is appropriate in the usual case when a party proves (1) a misrepresentation by another party; (2) which he reasonably relied upon; (3) to his detriment. *U.S. v. Asmar,* 827 F.2d 907 (1987). In *Asmar,* the Court of Appeals recognized that it is "well-settled that the Government may not be estopped on the same terms as any other litigant." *Id.* at 912 (internal citations omitted). Instead, "a litigant must prove 'affirmative misconduct' to succeed on an estoppel claim against the government." *Id.* Plaintiffs fail to allege such misconduct on behalf of the IRS, although they do insist that they detrimentally relied on the failure of the IRS to appear and challenge the factual basis for the findings entered in the Confirmation Order. Plaintiffs do not allege, however, that the IRS was obliged even to participate in Dycoal's bankruptcy, much less to take a position regarding the placed in service dates of the Briquetters. Indeed, the Service correctly argues that it has no obligation to consider the Briquetters' placed in service dates unless and until a taxpayer files a return claiming entitlement to the § 29 credits. In sum, the facts alleged here are not remotely close to the sort of affirmative misconduct required under *Asmar. See Walsonavich v. U.S.,* 335 F.2d 96, 100 (3d Cir.1964); *U.S. v. Zorger,* 407 F.Supp. 25, 28 (W.D.Pa.1976). Therefore, equitable estoppel does not apply and the IRS is entitled to judgment on the pleadings.

VI. Conclusion

In sum, viewing the averments in the amended complaint in the light most favorable to Plaintiffs, all eight counts fail. The Court lacks jurisdiction over Counts I, II, III, and VII because they fail to present a valid case or controversy. Although the Court possesses subject matter jurisdiction over Counts IV, V, VI, and VIII, they fail to state a claim upon which relief can be granted. Finally, Counts VII and VIII are not grounded in a valid waiver of sovereign immunity. Thus, the IRS is entitled to judgment as a matter of law.

An appropriate Order follows.

All Citations

Not Reported in F.Supp.2d, 2006 WL 360642, 97 A.F.T.R.2d 2006-1172, 2006-1 USTC P 50,185

Footnotes

1 26 U.S.C. § 6501(c)(1) and (2) provide for limitless assessment periods in the cases of "a false or fraudulent return with the intent to evade tax" or "a willful attempt in any manner to defeat or evade tax," both of which 26 U.S.C. § 7206 classifies as a felony. There is no suggestion here that Dycoal's 1998 return constituted felony tax evasion.

2 In Count VI, Plaintiffs list several statutory provisions allegedly granting jurisdiction: 28 U.S.C. §§ 1334 and 157(a), 11 U.S.C. §§ 105, 1123, 1129, 1141 and 1142. Sections 1334 and 157(a) are the general grants of federal jurisdiction over bankruptcy cases, while Sections 105, 1123, 1129, 1141, and 1142 detail the power of courts to preside over bankruptcy proceedings. Section 1142 is the only operative statutory source for jurisdiction over the remaining claims.

End of Document

2006 WL 2466095
Only the Westlaw citation is currently available.
United States District Court,
W.D. Pennsylvania.

TSAI-YI YANG, Petitioner,
v.
FU-CHIANG TSUI, Respondent.

No. 2:03-cv-1613.
|
Aug. 25, 2006.

Synopsis

Background: Mother petitioned for return of her minor child, under the Hague Convention on the Civil Aspects of International Child Abduction (Hague Convention). The District Court abstained, pending state court custody proceedings. Mother appealed. The Court of Appeals, 416 F.3d 199, reversed and remanded.

Holdings: The District Court, Hardiman, J., held that:

[1] Canada was habitual residence of child, as required for return under Hague Convention;

[2] mother had custody of child in Canada, even though child had resided with father in United States for years;

[3] mother was exercising custody rights over child when she turned child over to father before undergoing serious surgery;

[4] mother neither consented to or acquiesced in father's continued custody over child; and

[5] court would not take wishes of child into consideration in ordering return to mother.

Child return petition granted.

West Headnotes (7)

[1] Child Custody

Wrongful Retention or Removal

In determining whether there has been wrongful removal or retention of child, under the Hague Convention on the Civil Aspects of International Child Abduction (Hague Convention), courts are to consider (1) when the removal or retention at issue occurred, (2) the country in which the child was habitually resident prior to the removal or retention, (3) whether the removal or retention breached the custody rights of the petitioner, and (4) whether the petitioner was exercising those custody rights at the time of the removal or retention. 42 U.S.C.A. § 11603 et seq.

Cases that cite this headnote

[2] Child Custody

Habitual Residence

Canada was habitual residence of six year-old child, for purposes of determining whether custody should be transferred from father to mother pursuant to Hague Convention on the Civil Aspects of International Child Abduction (Hague Convention), even though child resided with mother in Canada for only six months before father took child to United States, with permission of mother, while mother underwent serious surgery; it was understanding of parents that child would be returned to mother after a few months, unless mother died. 42 U.S.C.A. § 11603 et seq.

Cases that cite this headnote

[3] Child Custody

Return of Child

In determining whether there should be transfer of child custody, under Hague Convention on the Civil Aspects of International Child Abduction (Hague Convention), court is to examine custody laws of country where child originally resided to ascertain whether party seeking return of child had custody rights in that country, and was exercising them at time of removal. 42 U.S.C.A. § 11603 et seq.

Cases that cite this headnote

[4] **Child Custody**
Return of Child

Mother had custody of six year-old daughter, under law of British Columbia, as required in order for child to be returned from custody of father living in United States, under Hague Convention on the Civil Aspects of International Child Abduction (Hague Convention); even though child lived with father in United States for years, at time father assumed custody, while mother underwent serious surgery in Canada, child had been under care of mother for her entire life, and it was understanding of parents that child would be returned to mother after period of few months, when mother completed her convalescence. 42 U.S.C.A. § 11603 et seq.

1 Cases that cite this headnote

[5] **Child Custody**
Return of Child

Mother was exercising custody rights over her six year-old daughter, up to time she allowed father to remove child from Canada to United States to care for child while mother recovered from serious surgery, as required for return of child under Hague Convention on the Civil Aspects of International Child Abduction (Hague Convention), even though mother was incapable of caring for child during recuperation period. 42 U.S.C.A. § 11603 et seq.

Cases that cite this headnote

[6] **Child Custody**
Acquiescence to Removal

Mother neither consented to nor acquiesced in permanent removal of six year-old daughter from Canada to United States, to live with father, so as to preclude return of child under Hague Convention on the Civil Aspects of International Child Abduction (Hague Convention); understanding with father was that child would return after mother recuperated from serious surgery, which was reason for transfer of child to father. 42 U.S.C.A. § 11603 et seq.

1 Cases that cite this headnote

[7] **Child Custody**
Grounds and Factors in General

Court would not take into consideration wishes of ten-year-old female to remain with her father in United States, in determining whether to order return of child to her mother in Canada, under Hague Convention on the Civil Aspects of International Child Abduction (Hague Convention); while child expressed desire to remain in United States, where she had lived for four years after mother relinquished custody only for period of few months to allow for recuperation from serious surgery, desire to remain in comfortable setting was insufficient reason to overcome rights of mother under Hague Convention, and there was evidence father had misinformed child regarding health of mother and ability to take care of her in Canada. 42 U.S.C.A. § 11603 et seq.

3 Cases that cite this headnote

Attorneys and Law Firms

Walter A. Angelini, Angelini & Angelini, Weirton, WV, for Petitioner.

Andrew D. Glasgow, AAI Law Firm, P.C., Pittsburgh, PA, for Respondent.

OPINION

HARDIMAN, District Judge.

I. Introduction

*1 This case involves the alleged wrongful retention of a child under the Hague Convention on the Civil Aspects of International Child Abduction, 19 I.L.M. 1501 (1980) (Hague Convention or Convention), which was codified by Congress in the International Child Abduction

Remedies Act, 42 U.S.C. § 11603 *et seq.* Petitioner Tsai-Yi "Elly" Yang (Yang), claims that Respondent Fu-Chiang "Rich" Tsui (Tsui), wrongfully retained their 10 year-old daughter Raeann Tsui (Raeann) in contravention of the Convention. Yang has filed a Petition for Return of Child, which is the subject of this Opinion.

II. Procedural History

On October 23, 2003, Yang filed a Petition for Return of Child under the Hague Convention. On November 11, 2003, the Court entered an order abstaining from the exercise of jurisdiction pursuant to the *Younger* abstention doctrine, and closed the case. On August 3, 2005, the Court of Appeals for the Third Circuit reversed and remanded the case for further proceedings. The Court then reopened the case, directed the parties to submit a position letter detailing the pending issues, and held an evidentiary hearing on June 30, 2006.

III. Findings of Fact

Yang and Tsui were raised in the same town in Taiwan, attended elementary school together, and were classmates during their university studies at Tatung Institute of Technology in Taipei, where they became romantically involved. In 1988, Tsui earned a Bachelor of Science in electrical engineering and Yang earned a Bachelor of Arts in business management. Yang then went to work while Tsui served a mandatory term of service in the Taiwanese military.

Upon completion of his military service, Tsui moved to the United States to continue his studies at the University of Pittsburgh, where he earned a Ph.D. in electrical engineering in 1997. In approximately 1992, while Yang was still living in Taiwan, Tsui called her and proposed marriage, but Yang rejected the proposal. In 1994, Yang also moved to the United States to pursue a master's degree in information science. She attended Penn State University for a short time and then transferred to the University of Pittsburgh. Upon her arrival in Pittsburgh, Tsui met Yang at the airport and arranged for her to rent an apartment in Squirrel Hill, in the building next to Tsui's residence, where he lived with his mother. Tsui informed Yang that he was engaged to another woman, Ms. Fen-Fang Chen (Chen), with whom he had fathered a child a month before, and Tsui married Chen about a month after Yang arrived in the United States in 1994. In spite of Tsui's marriage to Chen, Tsui and Yang again became involved romantically in 1995 and that same year, Yang became pregnant by Tsui. In December of 1995, Yang graduated from the University of Pittsburgh with a Master of Science in information science and at the invitation of Tsui and his mother, Yang moved in with their family as of January 1996. Tsui also told Yang that she would be his "number two wife." [1]

*2 On June 11, 1996, Yang gave birth to Raeann Tsui in Pittsburgh. Yang and Raeann continued to live with Tsui and his family until December of 1996, when they visited Taiwan. They remained in Taiwan for five or six months and Tsui accompanied them for the first two weeks of this visit. In May 1997, Yang and Raeann returned to Pittsburgh and again lived with Tsui and his mother for some three months. Tsui's wife, Chen, had previously moved back to Taiwan after a dispute with Tsui.

On August 15, 1997, Yang and Raeann returned to Taiwan both for the funeral of Yang's niece and because of the imminent expiration of Yang's visa. Although initially intending to stay in Taiwan for only a short time, Yang and Raeann remained there for four years. Meanwhile, Chen returned to Pittsburgh and resumed living with Tsui. Yang found work in Taiwan as a computer systems analyst, which utilized her graduate degree in information science. Although Yang attempted to continue the relationship with Tsui by phone, he did not wish to do so, although they spoke at least once a month. Because of Raeann's age, however, she and Tsui did not establish a relationship by phone. As a result of their conversations, Tsui was informed of where Yang and Raeann were living. Tsui traveled to Taiwan at least twice during this period to visit relatives, who lived in a town approximately 40 kilometers from where Yang and Raeann were living. Despite knowing that Yang and Raeann were living nearby, Tsui did not visit them during his two trips to Taiwan. Throughout this period, Yang asserts that Tsui made no financial contribution to support Raeann, but Tsui claims that he gave Yang about $6,000 while she and Raeann were in Taiwan.

In 2000, Yang sought to immigrate with Raeann from Taiwan to Canada because of the stigma that attached to an unwed mother in Taiwan, her inability to return to the United States, and her belief that the clean air in Canada would be beneficial to Raeann, who had developed a skin condition. Tsui disputes this, believing that Yang wished to be closer to him. As evidence of this he argues that if

Yang really wanted to find a home with cleaner air for Raeann, they could have moved to China.

On July 13, 2000, Yang traveled to Canada for a few days to activate her landed immigrant visa and then returned to Taiwan to prepare to move to Canada. In April 2001, Yang and Raeann immigrated to Canada, moving into an apartment in Surrey, British Columbia, a city of about 400,000 people. After initially living on her savings, Yang sought a job in which she could utilize her graduate degree, but she was unsuccessful. Accordingly, Yang began working part-time as a cashier and counter crew member at McDonald's, where she earned approximately $17,000 per year, before taxes, while she cared for Raeann. Yang has since received a promotion and is still employed at McDonald's today.

In addition to her own efforts, Yang also relied on friends and neighbors to help care for Raeann. In September 2001, Raeann began kindergarten at Holly Elementary School, where Yang met parents with whom she could share child care duties. In April 2001, at Yang's prodding, Tsui began to provide financial support for Raeann, contributing about $6,000 as well as a computer and some other gifts. There continued to be little contact between Tsui and Raeann, but he and Yang were in contact by phone or email at least once a month. Tsui also gave Yang a digital camera so she could send pictures of Raeann to him.

*3 In August 2001, Yang began experiencing blurred vision and was prescribed glasses. Soon thereafter she developed muscle weakness and difficulty swallowing, speaking, and breathing. After researching her symptoms independently on the internet, Yang again sought medical attention. In September 2002, Yang was diagnosed with malignant thymoma. A tumor had developed in Yang's chest and was causing myasthenia gravis, a condition which resulted in muscle weakness in her chest and neck. The tumor also interfered with Yang's ability to speak properly and swallow. Yang was told by her doctor that she must undergo major surgery to remove the tumor and she would be hospitalized for seven to ten days and then be unable to work for two to three months while she recovered.

In light of her medical problems, Yang contacted Tsui to suggest that he take care of Raeann during her surgery and recovery. On October 9, 2002, Yang sent Tsui an email that stated: "[i]t would be better if you can pick up and take care of Raeann. I can't work for at least two and a half months ... if anything happens to me, at least you can still raise Raeann." By this time, Tsui and his wife Chen had two sons, Raeann's half-brothers. Tsui was resistant to Yang's proposal at first and suggested that Raeann remain in Canada with a friend. Yang had considered this, but believed her anticipated incapacitation would be too burdensome on a friend. Tsui eventually agreed to come to Surrey and take Raeann back to Pittsburgh with him until Yang recovered. Tsui suggested that if he was going to take Raeann from mid-October, Raeann should stay with him until the end of that school term. Yang agreed, although she was unaware that the school term in Tsui's school district runs until late January.

On October 23, 2002, Yang entered the hospital and sent the following email to Tsui:

> I packed Raeann's stuff. There will be three packs. I'll put it in the living room. Please check first before you leave. Probably some of the stuff is unnecessary. My friend gave me some VCD's. I also put them in. If you don't want them, just take them out. First, the green bag is winter clothes and shoes. Second, the smallest bag is play stuff. Three, the bigger bag is summer clothes. P.S. Raeann doesn't like long sleeves.

Yang underwent surgery on October 24, 2002 and a friend of Yang took care of Raeann until Tsui arrived in Canada on October 26, 2002. Yang's friend and Raeann met Tsui at the airport in Vancouver and brought them to the hospital where they visited with Yang. Yang also provided documents needed to register Raeann in her new school and a letter permitting Tsui to travel to the United States with Raeann. Tsui claims that there was no limit placed on the amount of time Raeann would spend with him, but agrees that the arrangement was that Raeann would stay with him until Yang fully recovered unless Yang died, in which case Raeann would live with him permanently. Tsui and Raeann returned to Pittsburgh the next day, October 27, 2002 and Tsui left $1,000 cash with Yang. This was the first time Raeann had seen her father since August of 1997.

*4 Yang was discharged from the hospital on November 2, 2002. Although she initially spoke to Raeann daily, this changed after Tsui's wife, Chen, complained that Yang's daily calls were burdensome to their family. Consequently, Tsui allowed Yang to speak to Raeann only every other night. Yang claims that Raeann asked to return to Canada at this time and Yang was worried that Raeann was homesick and unhappy. Yang told Tsui to return Raeann to Canada, and threatened legal action if he refused. In fact, Yang offered to travel to Pittsburgh to retrieve her daughter. Tsui insists that Yang did not demand Raeann's return until April 4, 2003 in a letter from her Canadian attorney, Andrew Sandilands (Sandilands). The Court finds Yang credible regarding this factual dispute.

Although Yang intended to travel to Pittsburgh to retrieve Raeann, on November 20, 2002, she returned to the emergency room at Vancouver Hospital because she had difficulty breathing. She was told that her myasthenia gravis was not resolved and, on November 22, was moved into the Intensive Care Unit, where she remained for seven days. Because Yang was unable to speak at this time, she did not talk to Raeann or Tsui. Others did contact Tsui on Yang's behalf, however. Linda Lougheed, a social worker at the hospital, spoke to Tsui on November 23, 2002 at which time Tsui indicated that he was willing to bring Raeann to Vancouver if Yang's condition worsened, or otherwise at the end of the school term. Additionally, Yang's brother and her friend, Sherry Hsu (Hsu), also spoke to Tsui by phone and he assured both that he would bring Raeann back to Vancouver in December. Hsu's request for Raeann to visit was at least in part because of the possibility that Yang might pass away as a result of her illness. Tsui and Raeann never did visit Yang in the hospital, however.

After a week in the Intensive Care Unit, Yang was transferred to the "step-down" ward, where she stayed for two days before being transferred to the General Neurology ward, where she remained until December 28, 2002. Throughout this hospital stay, Yang was barely able to talk and had great difficulty carrying on a conversation. On or about December 2, 2002, Yang called Tsui, concerned about his intentions regarding Raeann. Tsui told her he would return Raeann at the end of the school term, which Yang then knew was the end of January. Yang continued to call every other day and became concerned when she was unable to reach Raeann or Tsui for approximately a week. Yang learned later that, unbeknownst to her, Tsui's family had taken Raeann on vacation. Around the second week of December, Sherry Hsu told Yang that she had spoken on the telephone to Tsui and that he had asked for her address so that he could send some photographs of Raeann. Tsui sent the photographs on December 18, 2002.

The day before Tsui sent photographs and while Yang remained in the hospital, on December 17, 2002, a cover letter and "Complaint for Custody, Order for Generations Education/Mediation Seminar" arrived at Hsu's house. Tsui filed the Complaint in Pennsylvania state court on December 11, 2002 and received a Court Order granting him custody on February 6, 2003. Included with the Complaint was information regarding the "Generations" seminar, which is an adjunct service provided by the Court of Common Pleas of Allegheny County to parents involved in custody mediations. This information instructed Yang that she was required to attend an educational seminar in Pittsburgh on January 4, 2003 at 9:00 a.m., prior to a mediation session scheduled for February 11, 2003. Yang contacted the "Generations" office in Pittsburgh and advised that she was unable to attend for health reasons and based on her conversation Yang believed that the "Generations" seminar was adjourned. After she was released from the hospital on December 28, 2003, Yang then underwent twenty sessions of radiation therapy. Neither Yang nor her attorneys ever contacted the Pennsylvania courts directly or appeared at the proceeding.

*5 Yang then hired Canadian attorney Sandilands who, by letter dated January 6, 2003, demanded that Raeann be returned to Yang immediately. Sandilands initiated custody proceedings in Canada, where from the end of January to March 11, 2003 there were five custody proceedings. Yang attended all but the first session. Tsui was represented by Canadian counsel for all of the hearings except for the first, but did not appear himself. Neither Yang nor Tsui testified at the Canadian proceeding, but Tsui did file an affidavit. After the Supreme Court of British Columbia granted interim custody to Yang on March 25, 2003, Sandilands then sent another letter on April 4, 2003 requesting that Tsui return Raeann pursuant to the Canadian custody order.

In May 2003, Sandilands filed an application with the Canadian Attorney General's office to have Raeann returned under the Hague Convention. Subsequently,

there was a Petition for Return of Child filed in this Court on October 23, 2003. Yang did not see Raeann until November of 2005, when she was in Philadelphia to attend oral argument before the Third Circuit Court of Appeals. While in the United States for these proceedings, Yang attempted to see Raeann at school and at Tsui's home. Additionally, she went to the homes of two of Tsui's neighbors in an attempt both to see Raeann and to leave gifts for her. Tsui stated at trial that Yang left threatening messages on his family's answering machine and followed his wife's car. As a result, Tsui obtained a Protection From Abuse Order from the Court of Common Pleas of Allegheny County on October 8, 2004, prohibiting Yang from seeing or speaking to Raeann without Tsui's permission. There was a proposed written schedule of visitation in conjunction with the Pennsylvania proceeding, but Yang did not agree to it. After returning to Canada, Yang was served with the Protection From Abuse Order, which resulted in even less contact with Raeann, although Yang eventually was permitted to talk to Raeann every Monday and Friday from 8:00 to 8:30 p.m.

In November 2005, Yang came to the Pittsburgh area and attempted to schedule visitation with Raeann. The parties were unable to amicably craft a visitation schedule, and Yang filed a motion, enlisting the help of this Court in structuring the visit. Visitation was conducted in chambers for several hours on two weekdays, and then at another location over the weekend.

Yang's myasthenia gravis has now been in remission for three years. During the hearing, Yang exhibited no signs of physical illness or weakness and her testimony was lucid, articulate, and credible.

IV. Analysis

A. Introduction

The Hague Convention on the Civil Aspects of International Child Abduction was passed on October 25, 1980. 19 I.L.M. 1501. The United States Congress ratified the Hague Convention in the International Child Abduction Remedies Act. 42 U.S.C. § 11601 *et seq.* The Court of Appeals for the Third Circuit recently stressed the broad goals of the Convention:

> *6 The two main purposes of the Hague Convention are to ensure the prompt return of children to the state of their habitual residence when they have been wrongfully removed and to ensure that rights of custody and of access under the law of one Contracting State are effectively respected in the other Contracting States. The Convention's procedures are not designed to settle international custody disputes, but rather to restore the status quo prior to any wrongful removal or retention, and to deter parents from engaging in international forum shopping in custody cases.

Karkkainen v. Kovalchuk, 445 F.3d 280, 287 (3d Cir.2006) (internal citation omitted). This action presents a prototypical case of international forum shopping to which the Court of Appeals adverted in *Karkkainen.*

B. Petitioner's Burden

[1] Under the Hague Convention, "an applicant seeking return of a child must demonstrate by a preponderance of the evidence that he or she had and was exercising custody rights over the child under the country of origin's laws and that the country of origin was the child's habitual residence." *In re Application of Adan,* 437 F.3d 381, 390 (3d Cir.2006) (internal citations omitted); 42 U.S.C. § 11603(e)(1)(A). Thus, "wrongful removal or retention claims under article 3 of the Convention typically raise four issues for analysis: when the removal or retention at issue occurred, the country in which the child was habitually resident prior to the removal or retention, whether the removal or retention breached the custody rights of the petitioner, and whether the petitioner was exercising those custody rights at the time of the removal or retention." *Baxter v. Baxter,* 423 F.3d 363, 368 (3d Cir.2005) (internal citations omitted).

1. Date of Retention

The Court must first determine when the allegedly wrongful retention occurred in this case, because the necessary habitual residence and custody determinations relate to the time of retention. Hague Convention, art. 3, 19 I.L.M. 1501. Yang testified that sometime between her initial discharge from the hospital following surgery