IN THE
SUPREME COURT OF PENNSYLVANIA

No. ________

BUSY BEE, INC., a Florida Corporation, BABY BEE, INC., a Florida Corporation, MLL CORP., a Florida Corporation, and JASAMI CORP., a Florida Corporation, trading as CENTURY SHOES, LTD., a Florida General Partnership, and CARLTON SHOES LTD., a Florida General Partnership, trading as BLS ASSOCIATES, a Pennsylvania General Partnership,

v.

WACHOVIA BANK, N.A., successor to CoreStates Bank, N.A.

PETITION OF WACHOVIA BANK, N.A.

PETITION FOR ALLOWANCE OF APPEAL

Appeal from the July 24, 2007 Memorandum and Decision of the Superior Court of Pennsylvania, No. 612 MDA 2006, affirming the February 28, 2006 Order and Judgment of the Court of Common Pleas for Lackawanna County, No. 97-CIV-5078

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INTRODUCTION

Pursuant to Pa. R. App. P. 1112, CoreStates Bank, N.A.[1] petitions for allowance of appeal from a final judgment of the Superior Court. This is a lender-liability action brought by the owners of a regional shoe company, who contended that their already-failing business was destroyed when defendant CoreStates declared the company to be in default of its loan agreement and refused to continue funding its operations. Although any duty to lend could have arisen only in contract, the trial court (and the Superior Court) allowed plaintiffs to proceed on theories of fraud, negligent misrepresentation, and breach of fiduciary duty — in addition to breach of contract — and to recover compensatory damages of $10.3 million, plus $7 million in punitive damages and $5.7 million in prejudgment interest, all for the same alleged injury.

The Superior Court's decision, which adopted *in toto* the flawed analysis of the trial court, creates grave uncertainty in several areas of Pennsylvania law that substantially affect banks and other commercial entities. CoreStates asks this Court to grant allowance of appeal to address four questions.

First, this action unquestionably sounds in contract: the question at the heart of the dispute was whether CoreStates violated either the loan agreement or an alleged oral promise to renew that agreement when it refused to advance additional funds. Yet the trial court permitted plaintiffs to recover substantial punitive damages by dressing up this run-of-the-mill contract dispute in the garb of tort. This Court has never addressed the scope or parameters of the gist-of-the-action doctrine, and this case presents an ideal vehicle for doing so: it squarely presents the question whether a plaintiff can recover punitive damages by tacking allegations of

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[1] On April 29, 2005, the parties stipulated that Wachovia Bank, N.A., the legal successor to CoreStates, would be substituted for CoreStates and that the caption would be amended to reflect that substitution. Because the relevant entity during the time of the events in question was CoreStates, we continue to refer to CoreStates (or "the bank") throughout this petition.

misrepresentations or breach of fiduciary duty on to a contract claim.

Second, in the face of a long line of cases and well-established legal principles governing the lender-borrower relationship, the Superior Court held that CoreStates owed its distressed borrower a fiduciary duty that was breached when the bank set conditions on the continued lending of money. This is the first and only Pennsylvania appellate decision to find that a lender owed its borrower a fiduciary duty. If left undisturbed, this unprecedented holding will dramatically expand the scope of banks' obligations to their borrowers in the Commonwealth. The impact of this troubling development is exacerbated by federal court decisions holding that under Pennsylvania law, the creditors of a failing company can sue the company's bank for continuing to lend money to it and thereby deepening the company's insolvency. These two developments together have placed banks in an untenable position: they may be exposed to liability (in amounts that greatly exceed the loans at issue) *either* for advancing additional funds to a distressed borrower *or* for refusing to do so.

Third, the Superior Court permitted plaintiffs to obtain an impermissible double recovery in this case: they were awarded $7 million in punitive damages *and* $5.7 in pre-judgment interest for what plaintiffs themselves characterized as a single injury. The pre-judgment interest award constituted an unwarranted windfall and, even assuming that any pre-judgment interest is warranted under these facts, was calculated in a manner contrary to this Court's precedents. And fourth, the courts below permitted plaintiffs to recover a $7 million punitive award for a supposed tort that occurred in the context of an arm's length business relationship in which both parties were represented by counsel. The substantial awards in this case make it an ideal one in which to address these important and recurring issues regarding the availability of prejudgment interest and punitive damages.

REFERENCE TO OPINIONS BELOW

The Superior Court's opinion (Stevens, Klein, and McCaffery, JJ.), No. 612 MDA 2006, entered July 24, 2007, is attached as Appendix A. The memorandum and order of the Superior Court denying CoreStates' post-trial motions, *Busy Bee, Inc. v. Wachovia Bank, N.A.*, No. 97-CV-5078, Mem. Op. (C.P. Lacka. Feb. 28, 2006) ("Op.") is attached as Appendix B.

TEXT OF THE ORDER IN QUESTION

Paragraphs 10 and 11 of the Superior Court's decision read: "Accordingly, we affirm the judgment entered on the verdict of the jury. Judgment Affirmed."

STATEMENT OF THE QUESTIONS PRESENTED

1. a. Whether a plaintiff can recover tort damages, including punitive damages, by adding allegations of misrepresentations or breach of fiduciary duty to a suit arising out of the lender's alleged breach of an agreement to lend the plaintiff money. *Suggested answer:* No.

b. If so, whether the allegedly tortious conduct relied upon by the courts below to uphold the tort verdict was sufficient to overcome the gist-of-the-action doctrine. *Suggested answer*: No.

2. Whether a bank assumes a fiduciary duty to its financially distressed borrower by placing conditions on the lending of additional funds. *Suggested answer:* No.

3. a. Whether a plaintiff may recover both punitive damages and prejudgment interest for the same injury. *Suggested answer:* No.

b. If so, whether pre-judgment interest on an entire award encompassing profits lost over several years should accrue from the date on which the first dollar of loss occurred. *Suggested answer:* No.

4. Whether it is proper to impose punitive damages in a business-against-business dispute involving purely economic harm, where the defendant's conduct was at least arguably authorized by the contract between the parties. *Suggested answer:* No.

STATEMENT OF THE CASE

The Parties. B. Levy & Son was owned indirectly by the four corporations that are the plaintiffs in this suit; each of those corporations was in turn owned by one of the four brothers of the Levy family's third generation in the shoe business: Benjamin, Bernard, Irwin, and Robert Levy. Op. at 3 n.1.[2] The company was managed by Benjamin and Bernard Levy and two members of the fourth generation of Levys, Fred and Rick. *Id.* at 4. Beginning in 1991, B. Levy was financed in part through a term loan and a line of credit from Third National Bank. When CoreStates acquired Third National in 1994, it assumed Third National's relationship with B. Levy. *Id.* at 5.

The Line of Credit Agreement. The Line of Credit Agreement at issue in this litigation (the "Agreement") allowed B. Levy and its subsidiary Shoeteria, Inc. (collectively, "B. Levy") to borrow up to $6.5 million, depending on B. Levy's financial condition; the debt was secured by all of B. Levy's inventory and accounts receivable. R. 2621a-23a. To ensure that the loan was adequately collateralized, the Agreement further limited the amount that B. Levy could be indebted to CoreStates at any particular time by means of a "borrowing formula" that took into account the company's current levels of inventory and accounts receivable. In order for the bank to be able to monitor B. Levy's compliance with the formula, B. Levy was required to report its inventory and receivable levels each month and its financial results each quarter. R. 2621a, 2647a-48a. B. Levy also covenanted, *inter alia*, to maintain minimum levels of tangible net worth and working capital, plus specified ratios of debt to net worth and cash flow to debt service coverage. R. 2634a-35a. The bank had the right to declare a default upon B. Levy's failure to perform any of those covenants or "[i]f either of the Borrowers or any Guarantor shall

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[2] "Plaintiffs" and "B. Levy" are used interchangeably, unless the context requires specificity.

apply for or consent to liquidation of itself or of all or [a] substantial part of its assets." R. 2636a-37a. The Agreement was set to expire on May 30, 1996, and was renewable "at the option of the Bank, using such criteria as the Bank shall, in its discretion, determine." R. 2873a. If CoreStates chose not to renew, B. Levy would have 90 days from May 30, 1996 to repay all outstanding loans. R. 2873a, 2620a.

B. Levy's Financial Condition and Violations of the Agreement. In B. Levy's 100-plus-year history, the company never earned annual profits of more than $700,000, and it consistently performed much worse than the industry overall. R. 1894a-95a, 1899a, 1902a, 2128a-30a, 2306a, 3193a, 3201a. The company's bottom line worsened each year from 1992 through 1995, and the company suffered net ***losses*** in each year from 1993 through 1995, culminating in losses of more than $1 million in 1995. R. 846a, 1788a, 1966a, 2100a-01a, 2101a. By early 1994, B. Levy was in violation of the key financial covenants in the Agreement, and it remained so thereafter. R. 2879a-80a. In addition, B. Levy repeatedly failed to meet its contractual obligation to report its financial results to CoreStates on a timely basis. R. 2879a-82a, 2887a, 719a, 721a-22a, 1080a, 1131a-32a, 1770a, 1771a-73a, 1784a-85a.

The Decision to Liquidate the Retail Business. On December 22, 1995, three CoreStates employees met with members of the Levy family (Benjamin, Fred, and Rick) to discuss the firm's financial troubles and the outlook for the following year. Plaintiffs' tort claims centered on that meeting. They claimed that CoreStates promised to continue to finance the wholesale business if B. Levy agreed to liquidate the retail operation, which the Levys ultimately did. The only evidence of such a promise was the uncorroborated testimony of Fred Levy. R. 903a. His own cousin and co-manager, Rick Levy, who was also present, did not testify that CoreStates promised future funding. Fred Levy's testimony was contradicted by all other testimony on the point (R. 660a, 1132a, 1147a-48a, 1155a), as well as the contemporaneous documentary

evidence. R. 2891a, 2894a-95a, 2892a, 3852a-57a.

The Declaration of Default. By the end of February, with the retail liquidation scheduled to begin on March 1, the Levys still had not provided any of the financial data that the bank had repeatedly requested (and to which it was entitled under the Agreement). R. 760a. On February 29, the bank sent B. Levy a written notice of default, invoking the provision of the Agreement that allowed the bank to declare a default if a substantial portion of the business was liquidated. R. 2905a-06a. This notice did not indicate an irrevocable decision to stop lending to B. Levy. *Id.* Rather, it emphasized that the bank would "consider the proposal for reducing the obligations to the Bank through an orderly liquidation of the retail operations" *if* B. Levy finally turned over the financial data that the bank had long sought. *Id.*

Six days after sending the default letter, CoreStates finally received the overdue financial information. R. 4237a-42a. It showed that B. Levy had borrowed substantially more than the maximum allowed under the borrowing formula: as of December 31, 1995, the over-advance had totaled $423,591, and by January 27, 1996, it had grown to $757,414. *Id.* And B. Levy projected that liquidating all assets of the retail operation would still leave a shortfall against the balance due to CoreStates of between $750,000 and $1,450,000. R. 2978a.

During the retail liquidation, which began on March 20, 1996, B. Levy was forced to price many shoes below their original cost. Accordingly, each sale reduced the value of the bank's collateral by more than it reduced the outstanding loan balance (R. 3899a-900a) — precisely the risk against which the liquidation default clause was intended to guard.

Negotiations for a New Line of Credit. After the liquidation began, and throughout the Spring, CoreStates negotiated with the Levys in an attempt to reach agreement on financing terms for the ongoing wholesale business. The Levys sought an additional $2 million in letters of credit on the existing line. *See* R. 1814a, 3861a-63a, 3880a-83a, 3012a-20a. CoreStates

refused to commit to such a large sum, but offered additional financing and $500,000 in letters of credit. R. 3786a-833a, 4307a-36a. The Levys' lawyer advised them to accept this deal, saying that "the Bank has made more concessions than [he had] anticipated." R. 3903a-05a. But the Levys decided that if they could not reach an agreement on the terms that they desired, they would plan "to set up [a] lender's liability suit" against the bank. R. 3907a. *See also* R. 1946a (testimony of Irwin Levy, a lawyer, that "the only thing left to do was to sue the bank" after it sent the default letter); R. 3921a (letter from Robert Levy, also a lawyer, that the brothers' corporations should "insulate themselves from debt collection" by putting their money in an "off-shore trust" to make it harder for CoreStates to recover the money it was owed).

In mid-July, after the Levys rejected the bank's final offer, the bank accelerated the outstanding balance on B. Levy's loans. R. 3912a-13a. B. Levy then declared bankruptcy on July 24, 1996. R. 3980a-94a. The bankruptcy proceeding was dismissed in early 1997, after the U.S. Trustee concluded that B. Levy had submitted a proposed disclosure statement that was "misleading, inaccurate, ambiguous and incongruent" and that the company was "not acting in good faith to accomplish a reorganization." R. 4303a, 3993a-94a.

Proceedings Below. In October 1997, four months after Fred and Rick Levy formed a new shoe company that took over the inventory, employees, brand name, customers, and offices of B. Levy (R. 3886a-87a, 1745a-46a, 2368a, 3878a, 3848a, 3942a, 4243a-58a, 4277a-78a), the Levys followed through on their plan to bring a lender-liability suit and filed an action against CoreStates in the Court of Common Pleas for Lackawanna County. They alleged breach of contract, fraudulent and negligent misrepresentation, and breach of fiduciary duty. Judge Terrence R. Nealon presided over the bifurcated trial. In the first phase, a jury found CoreStates liable on all counts. It also found that CoreStates' conduct was "outrageous," the prerequisite for an award of punitive damages. In the damages phase, plaintiffs claimed that CoreStates was

responsible for destruction of B. Levy's entire business, which they valued at more than $35 million. The jury awarded plaintiffs $10.3 million in compensatory damages and $7 million in punitive damages. The trial court denied CoreStates' motion for post-trial relief and added prejudgment interest of $5.7 million to the compensatory award, accruing from February 29, 1996. The court then entered judgment in the amount of $22,997,452 plus continuing interest. The Superior Court affirmed, adopting as its reasoning Judge Nealon's opinion on the post-trial motions.

REASONS FOR ALLOWING THE APPEAL

CoreStates seeks review of four aspects of the Superior Court's decision that are of broad and profound importance to the business community.

I. THIS COURT'S GUIDANCE IS NEEDED ON THE GIST-OF-THE-ACTION DOCTRINE.

The Superior Court has explained that the gist-of-the-action doctrine bars a tort claim that arises out of a contractual relationship unless "the wrong ascribed to the defendant [is] the gist of the action[,] with the contract being collateral." *Phico Ins. Co. v. Presbyterian Med. Servs. Corp.*, 444 Pa. Super. 221, 229, 663 A.2d 753, 757 (1995). This Court has never directly addressed the doctrine,[3] which was first established by the Superior Court 15 years ago. *See eToll, Inc. v. Elias/Savion Adver., Inc.*, 811 A.2d 10, 14 (Pa. Super. 2002) (noting that the doctrine was "recognized by this Court for the first time" in *Bash v. Bell Tel. Co.*, 411 Pa. Super. 347, 356, 601 A.2d 825, 830 (1992)). Since then, the doctrine has been discussed in 17 decisions of the Superior Court and 16 decisions of the Third Circuit. It has also been addressed in countless decisions of the federal district courts: the Eastern District of Pennsylvania alone has applied the doctrine more than a dozen times in the past year. In the absence of guidance from

[3] *See*, *e.g.*, *Sullivan v. Chartwell Inv. Partners, L.P.,* 873 A.2d 710, 718-19 (Pa. Super. 2005); *Jodek Charitable Trust, R.A. v. Vertical Net, Inc.*, 412 F. Supp. 2d 469, 478 (E.D. Pa. 2006).

this Court, the law has developed in a haphazard, confusing manner. The Superior Court's decisions cannot be reconciled with one another or with the federal cases on the subject. This Court should grant review in order to resolve the important question of whether a plaintiff can recover punitive damages by alleging that a breach of contract was also a tort.

A. The Doctrine Is Of Great Importance To The Commonwealth's Business Community.

To determine whether the gist of an action sounds in contract or tort, the courts distinguish duties imposed by social policy from those imposed by mutual agreement. *See Redevelopment Auth. v. Int'l Ins. Co.*, 454 Pa. Super. 374, 392, 685 A.2d 581, 590 (1996) (*en banc*); *Phico*, 444 Pa. Super. at 229, 663 A.2d at 757; *Bash*, 411 Pa. Super. at 356, 601 A.2d at 830. Tort claims are not cognizable when "the parties' obligations are defined by the terms of the contract, and not by the larger social policies embodied in the law of torts." *Bash*, 411 Pa. Super. at 356-57, 601 A.2d at 830.

This is not a matter of abstract legal theory. Rather, the doctrine serves a critically important purpose. "As a practical matter, the doctrine precludes plaintiffs from re-casting ordinary breach of contract claims into tort claims." *eToll*, 811 A.2d at 19. It thereby protects the predictability and certainty of contractual relations in two respects. First, the doctrine prevents one party to a contract from "disrupt[ing] the expectations of the parties by supplanting their agreement with a tort action that claims that the party misperformed the agreement in question." *Factory Mkt., Inc. v. Schuller Int'l, Inc.*, 987 F. Supp. 387, 394 (E.D. Pa. 1997). And second, it precludes a party from seeking damages that would be unavailable in contract — in particular, punitive damages. *See, e.g.*, *AM/PM Franchise Ass'n v. Atl. Richfield Co.*, 373 Pa. Super. 572, 579, 542 A.2d 90, 93-94 (1988) (rejecting plaintiffs' attempt "to convert this contract action into a tort action so that they can recover punitive damages"), *rev'd on other grounds*, 526 Pa. 110, 584 A.2d 915 (1990).

The doctrine also has particular significance because it tracks a distinction made in many contracts. Most insurance policies, for example, cover, and impose a duty on the insurer to defend, tort claims. But they do not cover claims for breach of contract. Permitting plaintiffs to dress up ordinary breaches of contract as torts would radically disrupt the expectations underlying these contracts and "would have the effect of making the insurer a sort of silent business partner subject to great risk in the economic venture without any prospects of sharing in the economic benefit. The expansion of the scope of the insurer's liability would be enormous without corresponding compensation." *Toombs NJ Inc. v. Aetna Cas. & Sur. Co*., 404 Pa. Super. 471, 476, 591 A.2d 304, 306 (1991); *see also*, *e.g.*, *Phico*, 444 Pa. Super. at 229, 663 A.2d at 757. The doctrine also prevents plaintiffs from circumventing contract clauses that provide for mandatory arbitration of breach-of-contract claims, but not tort claims. *See*, *e.g.*, *Dodds v. Pulte Home Corp.*, 909 A.2d 348, 350 (Pa. Super. 2006) (applying doctrine to dismiss fraud claim and order arbitration in case involving contract to build a home). Such clauses are commonplace, particularly in employment contracts and agreements relating to transfers of securities.

B. The Lower Courts Are In Conflict As To How The Doctrine Should Be Applied.

Without guidance from this Court, this area of the law — the principal purpose of which is to ensure predictability in contractual relations — has become muddled and unpredictable. The Superior Court has observed that "the determination as to whether causes of action sound in contract or in tort is difficult due to the somewhat confused state of our law." *Redevelopment Auth.*, 454 Pa. Super. at 391, 685 A.2d at 590; *see also*, *e.g.*, *Interwave Tech., Inc. v. Rockwell Automation, Inc.*, No. Civ. 05-398, 2005 WL 3605272, at *14 (E.D. Pa. Dec. 30, 2005) ("The endeavor of attempting to reconcile the results among the various trial level courts on this issue is challenging, to say the least."); *Grode v. Mut. Fire, Marine, & Inland Ins. Co.*, 154 Pa. Commw. 366, 369, 623 A.2d 933, 934 (1993) (lamenting the "somewhat confused state of

Pennsylvania law" regarding the "circumstances under which the facts of a contract claim may also support a recovery in tort"); *Weber Display & Packaging v. Providence Wash. Ins. Co.*, No. 02-cv-7792, 2003 WL 329141, at *3 (E.D. Pa. Feb. 10, 2003) ("Many courts have struggled with whether the 'gist of the action' doctrine applies to fraud cases.").

The Superior Court's discussion of the doctrine in *eToll* illustrates the awkward manner in which the law in this area has developed. *eToll* is the first and the leading opinion of the Superior Court on "the interplay between fraud and the gist of the action doctrine." 811 A.2d at 15-16. Accordingly, the Superior Court attempted "to resolve the issue as we predict our Supreme Court would do." *Id.* at 16 (citations and quotation marks omitted). In so doing, the court relied heavily on a series of decisions from federal district courts applying Pennsylvania law; those courts were themselves trying to predict what this Court would hold. *See* 811 A.2d at 17-20. As we discuss below (at 13-14), *eToll* cannot be reconciled with the decision of the Superior Court in this case: *eToll* held that a fraud claim arising from a contractual relationship and seeking the same damages that were available in contract was barred. Accordingly, the way in which the doctrine should be applied to fraud claims is still an open question.

There is also a split among the decisions of the Superior Court as to the circumstances under which the gist-of-the-action doctrine should be applied. The majority of decisions hold that tort claims — even if pled sufficiently — should be dismissed under the gist-of-the-action doctrine if they arise from the parties' contractual relationship and are "intertwined" with the plaintiff's breach-of-contract claim. *See*, *e.g.*, *Dodds*, 909 A.2d at 350 (doctrine bars "adding fraud allegations to what is essentially a contract claim"); *Hart v. Arnold*, 884 A.2d 316, 341 (Pa. Super. 2005) (dismissing "claims of fraud in the performance of the contract [that] are integrally related to [plaintiff's] breach of contract claims" and "essentially duplicate" those claims); *eToll*, 811 A.2d at 14. Other decisions, however, hold that pleading each element of any tort claim

automatically satisfies the gist-of-the-action doctrine. *See*, *e.g.*, *Reed v. Dupuis*, 920 A.2d 861, 867 (Pa. Super. 2007) (reversing dismissal and finding negligence claims "not barred by the gist of the action doctrine" because claims were viable under the Restatement); *Reardon v. Allegheny Coll.*, 926 A.2d 477, 487 (Pa. Super. 2007) (dismissing "negligence claim as legally defective" under gist-of-the-action doctrine because plaintiff failed to plead any applicable duty of care); *Rotunno v. Horace Mann Life Ins. Co.*, 81 Pa. D. & C. 4th 125, 128 (C. P. Lawrence 2007) (refusing to apply doctrine where "this court cannot say with certainty that no recovery is possible" in tort). Under this approach, of course, the doctrine has no independent meaning: the tort claims would be dismissed for failure to state a claim even if the doctrine did not exist. The very existence of a distinct doctrine thus remains in doubt. This Court should grant CoreStates' petition to address this confusion among the lower courts.

C. The Decision Below Is Wrong And Cannot Be Reconciled With Other Decisions Of The Superior Court: The Gist Of *This* Action Sounds In Contract.

This is a classic breach-of-contract action. Plaintiffs' core allegation was that their business was destroyed because CoreStates refused to lend money to them. Such a duty could have arisen from one of only two sources: (i) the Agreement, which obligated CoreStates to lend money to B. Levy under certain specified conditions; or (ii) the alleged promise, at the December 22 meeting, to renew the Agreement under other specified conditions. Either source could lead only to a contractual obligation, not to one arising from social policy. Yet the Superior Court upheld the imposition of liability in *tort*, which permitted plaintiffs to recover $7 million in punitive damages. This case thus squarely and concretely presents the question of how the gist-of-the-action doctrine should be applied: if plaintiffs' tort claims are barred by the doctrine, the $7 million punitive damages award must be vacated and a new trial ordered on the contract claim alone.

In *eToll*, the Superior Court held that a fraud claim is barred by the gist-of-the-action doctrine if the alleged fraud "concerned the performance of contractual duties" (811 A.2d at 19) — such as the duty to lend money alleged by plaintiffs here. In *eToll*, as here, the plaintiff alleged fraud, breach of fiduciary duty, and breach of contract. The Superior Court dismissed the plaintiff's fraud claim based on the gist-of-the-action doctrine, stating:

> All of these alleged acts of fraud arose in the course of the parties' contractual relationship. Moreover, the [defendants'] duties regarding billing and performance were created and grounded in the parties' contract. Finally, these are the types of damages which would be compensable in an ordinary contract action; thus, the claim would essentially duplicate a breach of contract action to recover the allegedly-overbilled charges. . . . [W]e conclude that the fraud claims are inextricably intertwined with the contract claims.

Id. at 20-21.

Under that test, the gist of plaintiffs' fraud claim in this case clearly lies in contract. The key question at the heart of this case — whether CoreStates had the right to declare a default or whether it instead had a continuing duty to provide financing — turns on the terms of the Agreement. Here, as in *eToll*, the alleged fraud "arose in the course of the parties' contractual relationship" (811 A.2d at 20): the alleged misrepresentations were made during a meeting between the parties to discuss the status of that relationship and the Levys' failure to comply with the contract's reporting requirements, and they concerned the conditions under which CoreStates would renew the Loan Agreement. Moreover, all of the bank's duties "were created and grounded in the parties' contract." *Id.* Indeed, at the root of the claim, and the source of all of the damages, was a duty — "failure to lend" — that can arise only out of a contract. *See Phico*, 444 Pa. Super. at 228, 663 A.2d at 757; *Bash*, 411 Pa. Super. at 356-57, 601 A.2d at 829-30. Finally, as in *eToll*, all of the compensatory damages sought by plaintiffs on their fraud claim were subsumed within, and hence "essentially duplicat[ed]" (811 A.2d at 21), the damages they sought for breach of contract. *See* R. 1448a (statement of plaintiffs' counsel during

summations that the jury should not find damages for tort and contract separately because "the answer is the same"). There simply is no way to distinguish the decision of the Superior Court below from that in *eToll*: the two decisions are irreconcilable.[4]

Nor can the decision below be reconciled with the long line of cases holding that where a tort claim is "intertwined" with, or could be brought as, a contract claim, only the contract claim can stand. *See*, *e.g.*, *Hart*, 884 A.2d at 340; *McCloskey v. Novastar Mortgage, Inc.*, No. 05-1162, 2007 WL 320287, at *7 (E.D. Pa. Jan. 29, 2007); *see also* cases cited at p. 11, *supra*. Plaintiffs here claimed that CoreStates promised to renew the Agreement and finance the wholesale division if B. Levy liquidated the retail operation and that the promise was fraudulent because all along the bank intended to declare a default instead. R. 548a-49a, 1298a-99a. A promise to renew a contract, like any promise, can be enforced in contract. *See MacCord v. Christian Academy*, No. CIV. A. 96-5479, 1997 WL 83756, at *2 (E.D. Pa. Feb. 20, 1997) ("To the extent that the plaintiff's claims for breach of contract and breach of the covenant of good faith and fair dealing implicate a promise to renew the contract based on an interpretation of the word 'tenure,' as used in the contract, plaintiff has stated claims for breach of contract and breach of the covenant of good faith and fair dealing.").

Plaintiffs' fiduciary-duty claim is likewise barred. Such a claim is precluded by the gist-of-the-action doctrine if the duty allegedly arose from the parties' contractual relationship rather than from a "relationship[] generally identified by Pennsylvania policy as fiduciary in nature." *Ginley v. E.B. Mahoney Builders, Inc.*, No. CIV. A. 04-1986, 2005 WL 27534, at *2-*3 (E.D. Pa.

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[4] The decision below also is irreconcilable with *Dodds*, the only other Superior Court case to apply the gist-of-the-action doctrine to a fraud claim. There, the Superior Court held that a claim "that the builder knew it would not build the homes as promised and would not make the necessary repairs when asked" arose in contract. 909 A.2d at 350. In this case, a different panel of the same court held that the claim that CoreStates knew that it would not lend money as promised arose in tort.

Jan. 5, 2005). B. Levy and CoreStates had no relationship at all other than the contractual one; their relationship was both established and governed by the Agreement. And, as we discuss in greater detail below (at 16), under Pennsylvania law the lender-borrower relationship is not one that is "generally identified . . . as fiduciary in nature." *Id.*

The trial court (whose opinion was adopted by the Superior Court) rejected CoreStates' gist-of-the-action argument for two reasons. First, it concluded that plaintiffs had established various purportedly tortious acts that occurred after CoreStates declared the default, at which point, the court believed, there was no contractual relationship. Op. at 37. Second, the court concluded that CoreStates could be liable in tort because, before the default declaration, it "asserted rights" and "demanded actions" not specified in the contract. *Id.* at 39.

Both of these theories ignore that the ***gist***-of-the-action doctrine is "not limited to discrete instances of conduct; rather, the test is, by its own terms, concerned with the nature of the action as a whole." *Pa. Mfrs.' Ass'n Ins. Co. v. L.B. Smith, Inc.*, 831 A.2d 1178, 1182 (Pa. Super. 2003) (internal quotation marks omitted). In this case, the core of the claim concerned the bank's actions under the contract: the declaration of default and refusal to renew. Even if some of the alleged conduct took place after the default notice, that circumstance cannot render the doctrine inapplicable. *See Haymond v. Lundy*, Nos. 99-5015, 99-5048, 2000 WL 804432, at *8 (E.D. Pa. June 22, 2000) (when "[t]he only difference between the tort and contract claims is *temporal*, not substantive," the tort claims must be dismissed) (emphasis added). Under the approach endorsed below, a plaintiff could circumvent the gist-of-the-action doctrine simply by alleging a discrete instance of tortious conduct that took place after the parties' contractual relationship ended.

It also merits mention that the acts in question were neither post-contractual nor tortious. The Agreement did not "terminate" upon a declaration of default. R. 2640a, 2624a-25a, 2628a-29a, 2630a-31a. And none of the alleged post-default acts referenced by the courts below —

even if proven — would have constituted a fraudulent or negligent misrepresentation or a breach of fiduciary duty, the only torts that plaintiffs pled. In fact, many (such as "failure to release credit information") were not torts at all. In any case, plaintiffs' tort claims and alleged injury were based entirely on conduct that took place prior to the declaration of default. R. 548a-49a, 1298a-99a, 247a, 507a-08a, 2384a-85a.

As for the courts' second theory: simply alleging (contrary to the record) that certain of the bank's actions were not authorized by the Agreement could not convert the gist of the action from contract to tort. *Every* breach of contract is necessarily either an action not authorized by the contract or a failure to act in a way that the contract requires. If left standing, this flawed reasoning will contribute significantly to the confusion among the lower courts in this area of the law.

II. THE LOWER COURTS REQUIRE GUIDANCE AS TO THE CIRCUMSTANCES UNDER WHICH A BANK BECOMES A FIDUCIARY OF ITS BORROWER.

It is well-established in Pennsylvania, as elsewhere, that banks and other lenders do not owe their borrowers a fiduciary duty. *Grace v. Moll*, 285 Pa. 353, 355, 132 A. 171, 171 (1926); *Buczek v. First Nat'l Bank*, 366 Pa. Super. 551, 553-54, 556, 531 A.2d 1122, 1123, 1124 (1987); *Henry v. First Fed. Sav. & Loan Ass'n*, 313 Pa. Super. 128, 133, 459 A.2d 772, 774 (1983). Rather, it is presumed that lenders and borrowers deal at arm's length and act in their own best interests. *Fed. Land Bank v. Fetner*, 269 Pa. Super. 455, 461, 410 A.2d 344, 348 (1979).

Plaintiffs claimed at trial that CoreStates breached a fiduciary duty by forcing B. Levy to liquidate its retail operation and to spend money on an unneeded financial consultant. Their theory was that CoreStates' right to refuse to renew the Agreement when it expired gave the bank leverage over B. Levy. That leverage, they claim, gave rise to a fiduciary relationship. The Superior Court agreed. Its decision represents a dramatic expansion of the duties that a bank owes to its borrower, and threatens to unsettle thousands of lender-borrower relationships

throughout the Commonwealth. This Court should grant review in order to clarify the circumstances under which a lender may become the fiduciary of its borrower.

The Pennsylvania courts have long imposed three requirements for finding a fiduciary duty when, as here, the relationship between the parties is one that is not generally viewed as confidential: (i) one party must repose trust and reliance in the other; (ii) the trusting party must seek the other's counsel; and (iii) the trusting party must *voluntarily surrender* substantial control over its affairs to the other. *See*, *e.g.*, *Frowen v. Blank*, 493 Pa. 137, 145, 425 A.2d 412, 416-17 (1981); *In re Estate of Scott*, 455 Pa. 429, 432, 316 A.2d 883, 885 (1974); *eToll*, 811 A.2d at 23; *Basile v. H&R Block, Inc.*, 777 A.2d 95, 102-03 (Pa. Super. 2001). Here, plaintiffs testified that they did *not* trust CoreStates; to the contrary, the relationship was adversarial. R. 2881a; 2883a-90a; 934a; 2852a-54a. Plaintiffs testified that they did *not* seek the bank's counsel, that they "wouldn't think of calling" the bank for advice (R. 1952a), and that theirs was a "business situation . . . [a] very arm's length relationship," in which both sides were represented by counsel. R. 1995a; *see also* R. 865a-67a; 989a-90a. And plaintiffs testified that they maintained control over B. Levy's affairs at all times and did *not* surrender such control to CoreStates. R. 2881a, 2900a-01a, 595a, 1727a. Thus, it is undisputed that Pennsylvania's traditional requirements for the imposition of a fiduciary duty were unmet in this case. The courts below, however, held that a fiduciary duty can be created — in the *absence* of trust and confidence — by a bank's unilateral exercise of "substantial control over the borrower's business affairs," *regardless of whether the borrower surrenders such control*. Op. at 40.[5]

In finding that CoreStates had exercised control over B. Levy, the courts below relied

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[5] The courts below also offered an alternative theory: that CoreStates assumed a fiduciary duty to B. Levy by "breaching banking industry standards." Op. at 41-42. But neither the courts nor the plaintiffs ever cited (i) the industry standards that CoreStates supposedly breached or (ii) any authority for the proposition that the breach of an industry standard can give rise to a fiduciary duty in the absence of a relationship of trust and confidence between the parties.

principally on the fact that B. Levy needed financing and therefore acquiesced in the bank's purported demands that it hire a financial consultant and that it liquidate the retail division. Op. at 23. This reasoning cannot be reconciled with *eToll*. There, the Superior Court explained that the mere fact that one company has leverage over another does ***not*** convert an arm's length commercial relationship into a fiduciary one:

> If parties to routine arms length commercial contracts for the provision of needed goods or services were held to have a "special relationship," virtually every breach of such a contract would support a tort claim.
>
> . . . . There is a crucial distinction between surrendering control of one's affairs to a fiduciary . . . and entering an arms length commercial agreement, however important its performance may be to the success of one's business.

eToll, 811 A.2d at 23 (internal quotation and citations omitted). Nor can the decision below be reconciled with *Temp-Way Corp. v. Continental Bank*, 139 B.R. 299 (E.D. Pa. 1992), in which the district court, applying Pennsylvania law, dismissed a fiduciary-duty claim in a lender-liability suit against a bank because the borrower had "failed to demonstrate that it justifiably depended on [the bank] for financial advice, direction and/or corporate strategy." *Id.* at 319. The court explained: "The mere monitoring of the borrower's operations and the proffering of management advice by lenders, without more, does not constitute control. Moreover, action taken by the creditor to minimize risk does not constitute total and absolute control." *Id.* at 318.

Under the decision below, a bank owes a fiduciary duty to any borrower that could not survive without financing. The clear implication of this rule is that *every* business in financial distress can impose on its lender a fiduciary duty to act in the borrower's interest at the lender's expense. But a bank owes duties to its depositors to safeguard their funds and to its shareholders to make prudent lending decisions. In order to fulfill those duties, the bank must sometimes act in a manner adverse to the interests of a borrower — by declaring a default, for example, or by refusing to extend additional funds to a distressed borrower. If a bank has, or can easily be

deemed to have, a fiduciary duty to its borrower — particularly a distressed borrower — it will frequently find itself caught between a rock and a hard place, unable to act simultaneously in the best interests of its depositors and shareholders on the one hand, and the borrower on the other.

The Superior Court's adoption of this rule is likely to make banks extremely reluctant to lend money to small businesses in Pennsylvania, particularly those that are not in perfect financial health. This issue thus has great practical significance not only for the banking community, but for all companies that rely on borrowed funds to finance their operations. As one commentator has observed, "a general imposition of a fiduciary duty on lenders would decrease the funds available to borrowers and would significantly increase the cost of those funds." 6A NORTON BANKR. L. & PRAC. 2d § 153:18 (2007); *see also*, *e.g.*, *Williams v. Fed. Land Bank of Jackson*, 954 F.2d 774, 777 (D.C. Cir. 1992) ("The costs of lending would rise sharply if lenders were obliged to give their borrowers' interests the sort of priority inherent in a fiduciary duty.").

Moreover, the Third Circuit has predicted that this Court would recognize a cause of action for "deepening insolvency" under Pennsylvania law. *See Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340, 344 (3d Cir. 2001). Such a claim alleges that a lender injured its insolvent borrower by issuing inappropriate amounts of debt, thereby permitting the borrower to continue operating at a loss — undermining its relationships with customers, suppliers, and employees, possibly forcing it into bankruptcy, and causing additional dissipation of corporate assets. "These harms can be averted, and the value within an insolvent corporation salvaged, if the corporation is dissolved in a timely manner, rather than kept afloat with spurious debt. . . . [T]he corporate body is ineluctably damaged by the deepening of its insolvency, through increased exposure to creditor liability." *Id.* at 349-50 (citations and quotation marks omitted). Decisions like *Lafferty* hold that a bank in Pennsylvania opens itself

up to liability if it continues to lend money to a distressed borrower, whereas the decision below imposes liability for the *refusal* to continue lending in insolvency. This Court should grant review in order to alleviate at least a portion of this quandary by providing guidance as to the circumstances — if indeed there are any — under which a bank becomes a fiduciary of its borrower.

III. THIS COURT SHOULD CLARIFY WHETHER A PLAINTIFF CAN RECOVER BOTH PREJUDGMENT INTEREST AND PUNITIVE DAMAGES FOR THE SAME INJURY.

The Superior Court affirmed the trial court's decision to award plaintiffs more than $5 million in prejudgment interest, accruing from February 29, 1996 (the date of the default notice), as "discretionary compensation for delay." Op. at 125. In imposing that award, the court made an error of law that will certainly recur in other cases if the opinion below is permitted to stand.

Prejudgment interest is not available in tort (*see Skurnowicz v. Lucci*, 798 A.2d 788, 797 (Pa. Super. 2002)), while punitive damages are not available in contract. *See Johnson v. Hyundai Motor Am.*, 698 A.2d 631, 639 (Pa. Super. 1997). Plaintiffs claimed only one legal injury: as noted, plaintiffs' counsel expressly conceded that the damages for contract and tort were "the same." R. 1448a. But they nevertheless received *both* punitive damages (which would be appropriate only if the compensatory award were for the tort claims) *and* prejudgment interest (which would be appropriate only for the contract claim). Those awards were duplicative, and the Superior Court erred in upholding both.

The rule governing compensation for delay is that "the aggrieved party [should] be put in *as good a position as if the other party had fully performed*." *Frank B. Bozzo, Inc. v. Elec. Weld Div. of Fort Pitt Div. of Spang Indus., Inc.*, 345 Pa. Super. 423, 429, 498 A.2d 895, 898 (1985) (quoting 13 PA. C.S. § 1106) (emphasis in *Bozzo*). Such damages are awarded only "as necessary to ensure that in the particular circumstances of the case, the plaintiff has been fully

compensated." *Id.* at 435, 498 A.2d at 901. In this case, plaintiffs were awarded not only the $10.3 million that the jury determined would compensate for their damages, but also $7 million in punitive damages, which the trial court recognized are "purely penal in nature." Op. at 12 (quoting *Hoy v. Angelone*, 554 Pa. 134, 142, 720 A.2d 745, 749 (1998)). Accordingly, *before* they were awarded $5.7 million in prejudgment interest, plaintiffs were already in a far better position than they would have been in had CoreStates fully performed, and the interest award therefore was purely a windfall.

The award of prejudgment interest is particularly inappropriate given that the trial court instructed the jury (over CoreStates' objection) that, when assessing punitive damages, the jury should consider the "trouble and expense" that it took plaintiffs to get a resolution of their lawsuit. R. 2405a. Thus, plaintiffs recovered $7 million in punitive damages, at least in part to compensate them for delay, and $5.7 million in interest, also to compensate them for delay. This Court should grant review in order to clarify that a plaintiff cannot recover both punitive damages and prejudgment interest for the same injury.[6]

IV. THIS COURT SHOULD GRANT REVIEW IN ORDER TO CLARIFY THE STANDARD FOR THE IMPOSITION OF PUNITIVE LIABILITY IN A CASE INVOLVING PURELY ECONOMIC HARM.

If allowed to stand, the $7 million punitive award will be the largest upheld on appeal in Pennsylvania since *State Farm Mutual Automobile Insurance Co. v. Campbell*, 538 U.S. 408 (2003). This is a singularly inappropriate case in which to uphold a record-breaking punitive

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[6] The lower courts made a second error in calculating the interest award: they used February 29, 1996 (the date of the default notice) as the accrual date for interest on the full $10.3 million compensatory damages award. Plaintiffs were clear that their losses "started" on that date. R. 2046a. But their expert's damages estimate was based on profits allegedly lost from 1996 to 2001, plus the expected terminal value of the business as of 2002; none of the future profits were discounted to present value. *See* R. 2070a, 2079a, 1442a, 1441a. Even had B. Levy stayed in business, therefore, the plaintiffs would not have received those amounts until well after 1996, and their pre-judgment interest award was therefore grossly excessive. *See*, *e.g.*, *Trizechahn Gateway, LLC v. Titus*, — A.2d —, 2007 WL 1894247, at *15 (July 3, 2007).

award. It is a commercial dispute between two corporate entities in an arm's length relationship. Each company has been represented by counsel at all times and has had both the incentive and the means to protect its own interests. Even taking every allegation plaintiffs have made as true, CoreStates did no more than promise future financing without intending to fulfill that promise — hardly the sort of egregious misconduct that warrants the "extreme remedy" of punitive damages. *Cf. Phillips v. Cricket Lighters*, 584 Pa. 179, 188, 883 A.2d 439, 445 (2005) (not every tort will support punitive liability). Applying the very general "willful, wanton or reckless" standard (*see Hutchison v. Luddy*, 582 Pa. 114, 121, 870 A.2d 766, 770 (2005)) to economic tort cases like this one simply waters down the standard for punitive liability. A run-of-the-mill misrepresentation made by one business to another, remediable in a suit for breach of contract, should not suffice to meet the standard even if that conduct can be described as "willful."

As the Texas Supreme Court has explained, overusing punitive damages leads to "overdeterrence and overcompensation." *Transp. Ins. Co. v. Moriel*, 879 S.W.2d 10, 18 (Tex. 1994). Moreover, because punitive damages are "quasi-criminal" in nature (*Cooper Indus., Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424, 432 (2001); *Moriel*, 879 S.W.2d at 16-17), they "can stigmatize the defendant in much the same way as a criminal conviction." *Masaki v. Gen. Motors Corp.*, 780 P.2d 566, 575 (Haw. 1989). Expanding the spectrum of punishable conduct also risks decreasing the stigma that rightly attaches to truly reprehensible conduct. *Tuttle v. Raymond*, 494 A.2d 1353, 1361 (Me. 1985). Allowing punitive damages in a case like this surely blunts the usefulness of punitive damages as a deterrent: if this kind of behavior in the context of an arm's length business relationship is enough to result in punitive liability (and a multi-million-dollar award), then businesses will surely conclude that there is no realistic way to avoid punitive damages in business-against-business cases and will make less, not more, effort to do so. *See*, *e.g.*, *Linthicum v. Nationwide Life Ins. Co.*, 723 P.2d 675, 681 (Ariz. 1986) (en banc)

(when punitive damages are "loosely assessed," their "deterrent impact is lessened"); *Owens-Illinois, Inc. v. Zenobia*, 601 A.2d 633, 656-57 (Md. 1992) (same); *Hodges v. S.C. Toof & Co.*, 833 S.W.2d 896, 901 (Tenn. 1992) ("[A]warding punitive damages only in clearly appropriate cases better effects deterrence.").

This Court should grant review in order to clarify the standard for the imposition of punitive liability in a dispute between businesses.

CONCLUSION

For all of the foregoing reasons, it is vitally important that this Court grant review in this case. CoreStates respectfully requests that this Court grant this Petition for Allowance of Appeal and vacate the Superior Court's judgment.

Respectfully submitted,

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August 23, 2007

IN THE SUPREME COURT OF PENNSYLVANIA

BUSY BEE, INC., a Florida Corporation,	**:**	
BABY BEE, INC., a Florida Corporation,	**:**	
MLL CORP., a Florida Corporation,	**:**	
and JASAMI CORP., a Florida Corporation,	**:**	**No. ___________**
trading as CENTURY SHOES, LTD.,	**:**	
a Florida General Partnership, and	**:**	
CARLTON SHOES LTD., a Florida General	**:**	
Partnership, trading as BLS ASSOCIATES,	**:**	
a Pennsylvania General Partnership,	**:**	
	:	
v.	**:**	
	:	
WACHOVIA BANK, N.A., successor	**:**	
to CoreStates Bank, N.A.,	**:**	
	:	
PETITION OF WACHOVIA BANK, N.A.	**:**	

PROOF OF SERVICE

Bruce P. Merenstein certifies that on this 23rd day of August, 2007, he served a true and correct copy of the foregoing Petition for Allowance of Appeal upon the following counsel by hand delivery, which service satisfies the requirements of Pa. R. App. P. 121:

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