

NEWSLETTERS

THOMAS PASCHOS & ASSOCIATES P.C. ATTORNEYS AT LAW

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THE PASCHOS LAW UPDATE NEWSLETTER

May, 2014

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I. FIRM NEWS

Thomas Paschos has been selected as a Pennsylvania Super Lawyer for 2014.

II. GENERAL LITIGATION

In an Issue of First Impression, the Pennsylvania Superior Court Held that Collateral Estoppel Doctrine Did Not Preclude Plaintiff from Proving Fraud in a Civil Suit after Fraud was Found in a Related Bankruptcy Action.

In *Weisberger v. Myers*, 2014 PA Super 80; 2014 Pa. Super. LEXIS 174 (April 22, 2014), the Weissbergers ("Plaintiffs") entered into a contract with Myers and SMC (collectively "the Contractors") to construct an addition and perform repairs and improvements to their home. As part of the contract, the Contractors agreed to follow the architectural design supplied by the plaintiffs. The Contractors allegedly performed improper and substandard work and deviated from the architectural design. The plaintiffs had paid the Contractors \$40,000; however, the work had not been completed and the Contractors never returned to the home. Plaintiffs filed a Complaint alleging various causes of action including breach of contract, a violation of the Unfair Trade Practices and Consumer Protection Law ("UTCPL"), and fraud. The Contractors filed an Answer.

Following discovery, Myers filed a Petition for Protection under Chapter 7 of the United States Bankruptcy Code, seeking to discharge his debts. In response to Myers's Petition, the Plaintiffs filed an Adversary Complaint against Myers, seeking a determination that Myers's debt is not dischargeable due to Myers's fraud in working on their home. Following a trial, the Bankruptcy Court found that the debt was not dischargeable because Myers had committed fraud.

SMC also filed for bankruptcy and the Bankruptcy Court approved SMC's plan. As a result of this finding in the Bankruptcy Court, Plaintiffs filed a Motion for Partial Summary Judgment against Myers on their breach of contract, violation of the UTCPL and fraud claims based upon res judicata and collateral estoppel. The trial court denied the Motion. Plaintiffs then filed a Motion for Reconsideration, which also was denied. Thereafter, Plaintiffs filed a Petition for Review with the Superior Court which was granted.

On appeal, Plaintiffs argued that the trial court committed an error of law and abused its discretion by denying their Motion for Partial Summary Judgment. They argued that summary judgment could be granted on their breach of contract, violation of the UTCPL and fraud claims based upon collateral estoppel because the Bankruptcy Court already had decided that Myers had committed fraud. They also argued that a finding of fraud would constitute a breach of the contract and a violation of the UTCPL. Plaintiffs asserted that the Bankruptcy Court's analysis of their fraud claim, in the context of dischargeability, is the same analysis that the trial court must undertake with regard to fraud.

The court noted that there is an exception to the collateral estoppel rule which holds that the doctrine does not apply when "the adversary has a significantly heavier burden than he had in the first action." Further, the court provided that to prove fraud in the common

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pleas court, Plaintiffs needed to meet the clear and convincing evidence burden of proof not the preponderance of the evidence standard used by the bankruptcy court. The court also provided that "...the minimal evidence on record does not establish a finding of fraud by clear and convincing evidence." As such, the court held that trial court did not err in denying the Plaintiffs' motion for partial summary judgment on their breach of contract and UTPCPL claims.

III. PROFESSIONAL LITIGATION

New Jersey's Affidavit of Merit Statute Applies to Claims of Fraud

The case *Nuveen Mun. Trust v. Withumsmith Brown P.C.*, 2014 U.S. App. LEXIS 8971 (3d Cir. (N.J.) May 14, 2014), stems from a loan transaction between Appellant Nuveen Municipal Trust ("Nuveen"), on behalf of its Nuveen High Yield Municipal Bond Fund, and Bayonne Medical Center ("Bayonne"). On October 11, 2006, Nuveen purchased a \$10 million Bond Anticipation Note ("BAN") from Bayonne. In connection with a loan, Bayonne provided Nuveen with an audit report by accounting firm, Withum and an opinion letter from Bayonne's counsel. Later, Bayonne filed a Chapter 11 bankruptcy petition. Nuveen claimed that the audit report and opinion letter concealed problems and filed a complaint asserting malpractice and negligent misrepresentation by Bayonne's counsel and fraud, aiding and abetting fraud and negligent misrepresentation by Withum. It asked for \$9.5 million in damages, less any amounts recovered in the bankruptcy, plus attorney fees incurred in the bankruptcy.

The district court granted summary judgment for the defendants dismissing the claims based on Nuveen's noncompliance with New Jersey's Affidavit of Merit Statute which requires an affidavit of merit for certain actions against professionals. On appeal, plaintiff argued that the Affidavit of Merit Statute, which covers actions for "damages for personal injuries, wrongful death or property damage" did not apply to the compensatory damages and related costs sought.

There were two prior appeals. The first related to subject matter jurisdiction, which was found to exist based on the relationship to the bankruptcy case. In the second appeal, the Third Circuit held, *inter alia*, that the District Court was correct in not affording Nuveen certain procedural protections with respect to the Affidavit of Merit statute. Additionally, the court stated that "[i]f the AOM Statute applies to the action, we believe that Nuveen's noncompliance with it calls for the action's dismissal." The court questioned, however, whether the action was subject to the Statute and thus reserved deciding whether the District Court was correct to dismiss the action with prejudice. Instead, it certified to the New Jersey Supreme Court questions relating to the "nature of the injury" and "cause of action" elements of the Affidavit of Merit Statute. The state court denied the petition for certification. Shortly thereafter, Appellees filed a supplemental brief addressing additional New Jersey state law and renewing their argument that an AOM was required in this case and that the Third Circuit should affirm the District Court's dismissal of the complaint.

In light of the New Jersey Supreme Court's denial of the petition for certification, the Third Circuit decided the question based on their understanding of how the New Jersey Supreme Court would rule. The court cited a series of New Jersey cases holding that negligence or malpractice claims for unspecified damages do trigger the statute. It also rejected Nuveen Municipal Trust's argument that the law did not encompass intentional torts such as its fraud and aiding and abetting claims against Withum.

The court concluded that the money damages sought by Nuveen were considered a claim for "property damage" and that the underlying factual allegations of Nuveen's fraud claims against Withum required proof of a deviation from the professional standard of care. Accordingly, the court held that the AOM Statute applies and that Nuveen's noncompliance with the Statute warranted dismissal of its case.

IV. EMPLOYMENT LAW

Pennsylvania Superior Court Holds When Non-Compete Agreement is Added to

an Existing Employment Relationship, the Employee Must Receive a Corresponding Benefit or a Change in Status

In *Socko v. Mid-Atlantic*, 2014 Pa. Super. LEXIS 702 (May 13, 2014), Mid-Atlantic, which is in the business of basement waterproofing services, originally hired Socko as a salesman in March 2007, at which time he signed an employment contract containing a two-year covenant not to compete. Socko resigned in February 2009, but was rehired in June 2009, at which time he signed a new employment agreement containing another two-year covenant not to compete. While still employed by Mid-Atlantic as an at-will employee, on December 28, 2010, Socko signed a third employment contract (hereinafter, "the Non-Competition Agreement") containing a covenant not to compete with Mid-Atlantic for two years after the termination of his employment in several states in which Mid-Atlantic does business. The Non-Competition Agreement expressly provides for the application of Pennsylvania law.

On January 16, 2012, Socko resigned from Mid-Atlantic, and a few weeks later he accepted a position with Pennsylvania Basement Waterproofing, Inc. in Camp Hill, Pennsylvania. On February 7, 2012, Mid-Atlantic sent a letter to Socko's new employer, attaching the Non-Competition Agreement and threatening litigation. Ten days later, Pennsylvania Basement Waterproofing, Inc. terminated Socko's employment.

On April 13, 2012, Socko filed a Complaint and Declaratory Judgment action against Mid-Atlantic, seeking, inter alia, a determination that the Non-Competition Agreement is unenforceable because it was not supported by sufficient consideration. Socko filed a motion for partial summary judgment. In its response, Mid-Atlantic did not dispute that the Non-Competition Agreement was signed during the course of Socko's employment. Mid-Atlantic also did not deny Socko's contention that he did not receive a benefit or beneficial change in his employment status in exchange for signing the Non-Competition Agreement. Instead, Mid-Atlantic argued that the Non-Competition Agreement contains the language "intending to be legally bound," and that as a result, the Uniform Written Obligations Act, ("UWOA"), prevents the avoidance of any written agreement for lack of consideration.

The trial court granted partial summary judgment to Socko, and Mid-Atlantic appealed contending the court erred in failing to give effect to UWOA as satisfying the requirement of consideration sufficient to support the employment agreement and its restrictive covenant. The appeal presented an issue of first impression: whether a non-competition restrictive covenant in an employment agreement entered into after the commencement of employment is unenforceable for lack of consideration.

In making its determination, the Superior Court reviewed the history of the enforcement of restrictive covenants in Pennsylvania to determine the precise nature of the consideration required to support them. The court found that it could not agree with Mid-Atlantic that application of the UWOA rectifies the lack of consideration in this case. The court noted that for most contracts, Pennsylvania appellate courts have historically held that while the existence of consideration is a necessary element for any enforceable contract, the adequacy of the consideration is not a factor to be considered in determining the validity and enforceability of a contract. However, with regard to restrictive covenants in employment contracts, the Pennsylvania Supreme Court has repeatedly inquired into the adequacy of consideration required to support them. The reasons for this differing approach is that restrictive covenants are disfavored in Pennsylvania because they are in restraint of trade and may work significant hardships on employees agreeing to them. For these reasons, the Supreme Court has held that only valuable consideration will support their enforcement, and has rejected as inadequate various forms of consideration that would support the enforcement of other types of contracts, including the benefit of the continuation of at-will employment, contracts under seal, and nominal consideration. Because a seal does not constitute adequate consideration to support a covenant not to compete, then clearly the UWOA is similarly inadequate in this context.

Therefore, because Mid-Atlantic conceded that it did not provide valuable consideration

to Socko when he executed the Non-Competition Agreement, the Superior Court held that the trial court did not err in its determination that the covenant not to compete is unenforceable.

Copies of the full text of any of the cases discussed in this Newsletter may be obtained by calling our office. The articles contained in this Newsletter are for informational purposes only and do not constitute legal advice.

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