

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

RECONSTRUCTIVE ORTHOPAEDIC : CIVIL ACTION
ASSOCIATES II, P.C. :
 :
v. :
 :
SPECIALTY CARE NETWORK, INC. : 99-5329

MEMORANDUM AND ORDER

J. M. KELLY, J.

OCTOBER,

2000

Presently before the Court are Objections to Magistrate Judge's Order of June 27, 2000, filed by the Plaintiff, Reconstructive Orthopaedic Associates II, P.C. ("ROA"). ROA filed suit in this Court for declaratory relief, breach of contract, bad faith, fraud and negligent misrepresentation. Magistrate Judge Angell granted Defendant, Specialty Care Network, Inc. ("SCN"), a protective order that limited discovery to the literal terms of certain agreements between SCN and ROA's competitors. ROA now objects to that protective order pursuant to Federal Rule of Civil Procedure 72(a). For the following reasons, the Court will amend Magistrate Judge Angell's Order to allow limited discovery of the circumstances relating to the closing of those agreements.

I. BACKGROUND

ROA provides surgical and other medical treatment to its patients in Philadelphia, Pennsylvania. SCN, a Delaware

corporation with its principal place of business in Colorado, provided management services to medical practice groups like ROA. In 1996, SCN purchased some of ROA's assets. In exchange, ROA received cash and shares of SCN stock.

In November, 1996, SCN and ROA entered into an agreement, pursuant to which SCN would provide management services to ROA's Philadelphia office. SCN also entered into similar agreements throughout the country with other medical practice groups. One of these other groups was 3B Orthopaedics, P.C. ("3B"), a local competitor of ROA's comprised of its former business partners.

In 1998, SCN sought to restructure its business arrangements with ROA and other physician groups. On March 9, 1999, SCN and ROA finalized a contract that restructured their business relationship (the "Restructure Agreement"). The Restructure Agreement provided that ROA would repurchase the non-medical assets it had sold SCN in 1996. In exchange, ROA would make cash payments to SCN and would transfer to SCN some shares of SCN common stock held by the owners of ROA.

ROA also wanted assurances that no other practice group would receive better treatment during restructuring than ROA received. ROA's owners were particularly concerned that their former business partners, 3B, would strike a better deal with SCN. See Pls.' Mem. of Law in Opp'n to Def.'s Mot. for Prot. Order at 6. To prevent that from happening, SCN and ROA agreed

upon inserting a "most-favored nation clause" ("MFNC") in their contract. The clause reads:

In the event that SCN shall within a period commencing on the closing date and ending December 31, 1999 close a transaction with an Affiliated Practice which is substantially similar to the restructure transaction contemplated by this Agreement ("a Restructuring Transaction") and, taken as a whole, the financial terms of such other Restructuring Transaction are materially more favorable to any Affiliated Practice (and its Physician Owners) than the financial terms, taken as a whole, of the restructuring transaction contemplated by this Agreement, then in such event SCN shall modify the financial terms of this Agreement in such manner as SCN shall reasonably determine so that the financial terms of the restructuring transaction contemplated by this Agreement for ROA[] . . . shall be no less favorable, when taken as a whole, than the Restructure Transaction undertaken with respect to any other Affiliated Practice.

Restructure Agreement § 10.15. This MFNC does not prospectively prevent SCN from treating other practice groups better than ROA. It does require, however, that SCN adjust the Restructure Agreement if SCN does strike a better deal with another party.

ROA subsequently found evidence that led it to believe SCN had breached the MFNC. Specifically, ROA believes that SCN entered into better restructure agreements with other groups and refused to inform ROA about them or adjust the Restructure Agreement accordingly. ROA filed suit, alleging breach of contract, bad faith, fraud and negligent misrepresentation.

District Judge Shapiro, to whom this case was originally assigned, conducted a hearing on February 24, 2000. During that

hearing, Judge Shapiro expressed her concern that ROA not seek discovery of irrelevant or unnecessary information. In particular, Judge Shapiro noted that the parol evidence rule might preclude the use of certain evidence to construe the Restructure Agreement. Judge Shapiro stated, "[W]hat you are entitled to are the deals, the terms. Not all the negotiations and everything like that" or "what people had in their minds at some time." Hr'g, February 24, 2000 at 16. Judge Shapiro intimated, however, that she might permit discovery on these matters at a later stage of discovery. See id.

On April 19, 2000, ROA served a notice of deposition upon SCN. ROA sought discovery of the terms of any other restructure agreement entered into by SCN. Specifically, ROA sought discovery of the terms of these agreements, consideration paid, valuation methods, liabilities assumed, post-closing "true-up" procedures and any rebates made by or for SCN. See Pls.' Not. of Dep. of Def. In all, ROA sought discovery regarding twenty other restructure agreements. See id. ¶ 1(a)-(t). SCN sought a protective order on May 2, 2000, claiming that the deposition exceeded the scope of initial discovery set out by Judge Shapiro. On June 27, 2000, Magistrate Judge Angell granted SCN's Motion for Protective Order. Judge Angell's Order stated:

Plaintiff's scheduled deposition of Defendant's representative pursuant to Fed. R. Civ. P. 30(b)(6) shall be limited to the terms of the restructure agreements and the litigation

settlement agreements. . . . I conclude that the discovery requested by Plaintiff ROA . . . exceeds the intended scope of initial discovery permitted by Judge Shapiro.

Prot. Order, June 27, 2000 ¶ 1 (emphasis added). ROA subsequently filed its Objections to that Order.

II. STANDARD OF REVIEW

Federal Rule of Civil Procedure 72 governs objections to magistrate judges' orders, both dispositive and non-dispositive. A discovery order is considered non-dispositive because it does not dispose of a party's claim or defense. Haines v. Liggett Group, Inc., 975 F.2d 81, 92 (3d Cir. 1992). District courts must typically modify or set aside any non-dispositive magistrate judge order if it is "found to be clearly erroneous or contrary to law." Fed. R. Civ. P. 72(a). The Court has plenary power to alter Magistrate Judge Angell's Order, however, as that Order anticipated the Court's amending it. See Order, June 27, 2000 ¶ 4 ("[N]othing precludes Judge Kelly from expanding the scope of discovery prospectively as he deems appropriate.").

III. DISCUSSION

Judge Angell's Order limited discovery in this matter to the literal terms of the restructure agreements and the litigation settlement agreements between SCN and other medical practice groups. See Order, June 27, 2000 ¶ 1. For ROA to find evidence

supporting its fraud and breach of contract claims, however, discovery must extend beyond the four corners of those documents. Amending Magistrate Judge Angell's Order is appropriate for several reasons.

First, the very language of the Restructure Agreement instructs the Court that the terms of the other contracts must be "taken as a whole." Restructure Agreement § 10.15. It is axiomatic, however, that courts should consider a contract as a whole and, if possible, give effect to every provision. Atlantic Richfield Co. v. Razumic, 390 A.2d 736, 739 (Pa. 1978). The "taken as a whole" language in the Restructure Agreement would arguably be surplusage if it did not anticipate consideration of the circumstances surrounding these contracts that would affect the terms' favorableness.

Second, discovery of the circumstances surrounding the closing of these other contracts is vital to ROA's claims of fraud and breach of contract. For example, the breach of contract claim hinges on the favorableness of these other contracts. SCN could only breach the MFNC if it "closed" a contract within the relevant time period, if the contract was similar to the Restructure Agreement, and if the terms of both contracts, "taken as a whole," favored the other group more than ROA. See Restructure Agreement § 10.15. While the other restructure agreements might be more favorable to other groups on

their face, evidence tending to prove a breach of the MFNC might also be found outside the four corners of those documents. ROA alleges, for example, that SCN fraudulently "parked" its restructuring agreement with 3B in order to delay its closing and, consequently, avoid triggering the MFNC. Furthermore, the book value of SCN's accounts receivable, as well as SCN's post-closing "true-up" price adjustment procedures, may affect the favorableness of the other agreements in a way that the written documents themselves will not reflect. Merely examining the written documents will not afford ROA an opportunity to prove its case.

Finally, allowing limited discovery of the circumstances surrounding the closing of SCN's other restructure agreements would not run afoul of the parol evidence rule. Under Pennsylvania contract law,¹ where the parties to an agreement commit their understandings to writing and intend that the writing formally and comprehensively evidences the terms of their agreement, neither party can thereafter alter, contradict or vary the terms of the agreement by parol agreements entered into prior to or contemporaneous with the agreement. Scott v. Bryn Mawr Arms, Inc., 312 A.2d 592, 594 (Pa. 1973); International Milling

¹ The Restructure Agreement between ROA and SCN provides that it "shall be governed and construed in accordance with the domestic laws of the State of Pennsylvania." See Restructure Agreement § 10.8.

Co. v. Hachmeister, Inc., 110 A.2d 186, 189-90 (Pa. 1955). The parol evidence rule applies to the Restructure Agreement because it was fully integrated, that is, intended as the entire agreement of the parties. See Restructure Agreement § 10.3. Parol evidence may be used to alter, contradict or vary the terms of even a fully integrated agreement, however, in instances of fraud, accident or mistake. See International Milling Co., 110 A.2d at 189-90.

The discovery sought by ROA does not, as of yet, implicate the parol evidence rule. ROA does not seek, as Judge Shapiro feared, discovery of negotiations or "what the parties were thinking." Hr'g, February 24, 2000 at 16. ROA seeks discovery of information relating to the agreements between SCN and other medical practices, not the Restructure Agreement itself. See Pls.' Not. of Dep. of Def. Moreover, the information ROA seeks will not be used to vary, contradict or alter the terms of either the Restructure Agreement or any other restructure agreement of SCN's. Rather, the information will be used to put the favorableness of those contracts in their proper context. For example, a fully integrated contract for the sale of land would be more or less favorable to a party depending on the size of the parcel of land. The contract itself, however, might describe the parcel without reciting its acreage. Suchan v. Swope, 53 A.2d 116, 118 (Pa. 1947) (involving contract for sale of "my farm").

Although the language of that fully integrated contract could not be altered through parol evidence, a court could determine the quality of the contract through extrinsic evidence showing the size of the plot of land conveyed. See id.; see also Turner v. Hostetler, 518 A.2d 833, 836 (Pa. Super. 1986) (“[T]he court is neither rewriting the agreement of the parties nor adding to or varying its terms”).

Accordingly, to the extent that Magistrate Judge Angell’s Order of June 27, 2000 limited discovery to the literal terms of SCN’s other restructure agreements, the Court finds that Order clearly erroneous. The Court will amend the Order to allow limited discovery of beyond the four corners of those agreements.

Nevertheless, the Court is mindful that extensive discovery regarding twenty separate restructure agreements would be unduly burdensome to SCN. At this juncture, the burden on SCN of allowing discovery of every separate agreement outweighs the potential benefit to ROA. The Court does not want potentially legitimate discovery to become a fishing expedition that will only serve to increase the burdens on SCN. Pursuant to the Court’s powers under Federal Rules of Civil Procedure 26(c)(4) and 26(b)(2)(iii), the Court will limit discovery, for the time being, to the circumstances surrounding the 3B restructure agreement. The Court chooses the 3B restructure agreement because 3B was the impetus for the MFNC in the first place, and

because ROA claims to already have some evidence tending to show that SCN's dealings with 3B breached the MFNC. The Court will entertain an appropriate motion to expand or foreclose further discovery after ROA completes the permitted discovery in connection with the 3B restructure agreement.

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O R D E R

AND NOW, this day of October, 2000, in consideration of the Objections to the Magistrate Judge's Order of June 27, 2000, filed by the Plaintiff, Reconstructive Orthopaedic Associates II, P.C., and the response thereto filed by Defendant, Specialty Care Network, Inc., it is ORDERED that:

1. Paragraph One of Magistrate Judge's Order of July 27, 2000 is AMENDED to allow discovery in relation to the agreement described in paragraph 1(e) of Plaintiffs' Notice of Deposition.
2. ROA shall complete the newly permitted discovery by or before February 1, 2000. By or before February 14, 2000, ROA may file an appropriate motion with the Court to pursue further discovery if warranted by the evidence.
3. In all other respects, the Magistrate Judge's Order of July

27, 2000 is AFFIRMED.

BY THE COURT:

JAMES MCGIRR KELLY, J.