

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

OWEN J. ROBERTS SCHOOL : CIVIL ACTION
DISTRICT :
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HTE, INC. et al. : NO. 02-7830

MEMORANDUM

Dalzell, J.

February 28, 2003

On May 15, 2000, the Owen J. Roberts School District (the "School District") entered into a software licensing and service agreement with defendant HTE-Phoenix Systems, Inc., a subsidiary of defendant HTE, Inc. ("HTE"¹). The School District has filed a four-count complaint against HTE, alleging that the software firm breached the terms of the contract, engaged in fraud both before and after the parties entered the contract, and improperly coerced an additional \$25,412.00 payment from it during the software implementation process.

Before us is HTE's motion to dismiss the School District's two fraud claims on the ground that they are barred by Pennsylvania's "gist of the action" doctrine. For the reasons stated below, we conclude that the doctrine bars the School District's claim for fraud in the inducement (Count II) but not the claim relating to HTE's allegedly fraudulent statements after it breached the contract (Count III).

¹ In this Memorandum, we refer to the defendants collectively as "HTE."

Discussion

The application of the gist of the action doctrine is a fact-intensive enterprise that is complicated by the seemingly inconsistent body of caselaw it has spawned over the past decade. We therefore begin by examining the contract itself² and the facts alleged in the complaint that are most pertinent to the School District's fraud claims. We shall then offer an overview of the gist of the action doctrine and explain our strategy for applying that doctrine at the Rule 12(b)(6) stage. Finally, we shall apply the doctrine to the fraud claims in the School District's complaint, a task that requires a close parsing of recent cases in this vexed area of Pennsylvania law.

A. Factual Background

According to the complaint, the School District's relationship with HTE began in the mid-1990s, when school authorities decided to adopt an integrated software package that could accommodate a variety of administrative and accounting functions. The School District concluded that software based on Microsoft SQL Server, rather than Microsoft Access, would best serve its needs. School District officials met with representatives of HTE but ceased those discussions upon learning that not all of HTE's programs were SQL-based.

The School District revived discussions with HTE in

² We consider the contract at some length below because it was attached to the complaint. See Compl. Ex. A.

1999, and in March 2000, HTE demonstrated an SQL version of its Student Administration System program, along with additional program modules that were still Access-based. When the School District stressed to HTE that it needed a fully integrated SQL-based package, HTE allegedly assured it that HTE would soon complete the conversion of all modules from Access to SQL. In reliance on these representations, the School District entered the licensing and service agreement with HTE.

We pause to describe the agreement in some detail because, as we explain below, the gist of the action doctrine requires us to examine the relationship between the tort claims alleged in the complaint and HTE's contractual obligations.

While the main body of the contract is, apparently, HTE's standard-form agreement, the contractual duties implicated in this case are found in several addenda. Schedule A lays out HTE's fees and procedures for licensing, training, conversion, and supporting its software. Schedule A, in turn, has two exhibits. Exhibit A obliges HTE to modify and improve certain features of the programs, and these contractual terms are recited as responses to some twenty-one questions and criticisms that the School District had posed during the negotiation process. As the School District notes in the complaint, these answers repeatedly affirm that HTE would provide SQL versions of its programs. Compl. ¶ 16. Exhibit B provides a preliminary implementation schedule and memorializes the parties' intention to create a more detailed project plan at an initial meeting following execution

of the contract. Finally, Schedule B describes the minimum hardware requirements for the software system. As the School District has emphasized, Schedule B presumes that HTE had the capacity to offer SQL-based versions of its programs. See id.; see also Compl. Ex. A, Schedule B, at 1 ("If the Customer is running the SQL version of the HTE-Phoenix licensed programs, additional software will be required . . .").

According to the complaint, the School District soon learned that HTE was not in a position to provide SQL versions of many programs the contract specified. HTE twice revised, and then missed, deadlines for delivering and implementing these modules. In detrimental reliance on the third set of deadlines, HTE did not seek alternative vendors and expended substantial money and resources in maintaining its old computer system. After HTE failed to meet the third set of deadlines for delivering these modules, the School District filed this suit.

B. The Gist of the Action Doctrine

The "gist of the action" doctrine bars a contracting party from pursuing a tort claim against the other party where the essential nature of the claim is contractual.³ Etoll, Inc.

³ Although the Pennsylvania Supreme Court has never adopted the gist of the action doctrine, the Pennsylvania Superior Court has repeatedly endorsed it. The School District apparently concedes that the gist of the action doctrine is Pennsylvania law, and we, too, predict that the Pennsylvania Supreme Court would adopt it. See, e.g., Caudill Seed & Warehouse Co. v. Prophet 21, Inc., 123 F.Supp.2d 826, 833 (E.D. Pa. 2000); accord Bohler-Uddeholm Am., Inc. v. Ellwood Group, Inc., 247 F.3d 79, 103 (3d Cir. 2001).

v. Elias/Savion Advertising, Inc., 811 A.2d 10, 14 (Pa. Super. 2002). As the Pennsylvania Superior Court has emphasized, "[t]he important difference between contract and tort actions is that the latter lie from the breach of duties imposed as a matter of social policy while the former lie for the breach of duties imposed by mutual consensus." Redev. Auth. of Cambria County v. Int'l Ins. Co., 685 A.2d 581, 590 (Pa. Super. 1996).

Courts have articulated two strategies for applying the doctrine that can be termed the "structural" and "genealogical" approaches. Under the former approach, the court looks at the structure of the plaintiff's complaint. If the tort claim "essentially duplicates a breach of contract claim," it is barred under the doctrine. Polymer Dynamics, Inc. v. Bayer Corp., No. 99-4040, 2000 WL 1146622, at *6 (E.D. Pa. Aug. 14, 2000); see also Factory Market, Inc. v. Schuller Int'l, Inc., 987 F.Supp. 387, 395 (E.D. Pa. 1997). Under the latter, the court examines the complaint, and, if possible, the contract itself, to determine the source of the duty that the defendant allegedly breached. If the duty arose from the parties' agreement, then the plaintiff cannot assert a tort claim and is limited to contractual remedies. If, however, the plaintiff alleges that the defendant breached a socially-imposed duty to which the contract is merely collateral, then the plaintiff can proceed on a tort theory of liability. See, e.g., Am. Guarantee & Liab. Ins. Co. v. Fojanini, 90 F.Supp.2d 615, 622 (E.D. Pa. 2000), citing Phico Ins. Co. v. Presbyterian Med. Serv. Corp., 663 A.2d

753, 757 (Pa. Super. 1995).

In principle, these structural and genealogical approaches should yield the same results, and courts often refer to them interchangeably. See, e.g., Etoll, 811 A.2d at 20-21 (noting that the defendants' duties were "created and grounded in the parties' contract" and that the plaintiff's "fraud claims are inextricably intertwined with the contract claims"). However, we note that reliance on the structural approach at the Rule 12(b)(6) stage could unduly prejudice the plaintiff. By focusing on the similarity between a plaintiff's breach of contract and tort claims, this approach has the unfortunate effect of penalizing the plaintiff for exercising his right under Fed. R. Civ. P. 8(e)(2) to "state as many separate claims or defenses as the party has regardless of consistency" To avoid this danger, we employ the genealogical approach, which recognizes that the plaintiff has not yet had an opportunity to develop the facts of the case while still honoring the doctrine's overarching concern with preventing plaintiffs from transmuting breaches of contract into tort claims.

C. Application of the Doctrine to
the School District's Fraud Claims

We now apply the general analytical framework described above to each of the School District's fraud claims.

1. Count II: Fraud in the inducement

Count II of the complaint alleges that HTE fraudulently

induced it to enter the contract by misrepresenting the status of its efforts to convert programs to SQL as well as its ability to provide the School District with fully functional SQL versions of all the modules.⁴ Compl. ¶ 39.

⁴ As a preliminary matter, we address the School District's contention that the gist of the action doctrine does not apply to its fraudulent inducement claim because this case is governed by Florida law, which is more tolerant toward the simultaneous assertion of breach of contract and fraudulent inducement claims. See Pl.'s Resp. at 7-8, quoting HTP, Ltd. v. Lineas Aereas Constarricenses, S.A., 685 So.2d 1238, 1239 (Fla. 1997) & Pulte Home Corp. v. Osmose Wood Preserving, Inc., 60 F.3d 734, 742 (11th Cir. 1995).

The School District relies on the contract's choice of law provision, which states that "[t]his Agreement shall be governed by laws of the State of Florida." Compl. Ex. A at 5. We read this language to mean that Florida law only governs the construction and enforcement of the contract, and as HTE correctly notes, the gist of the action doctrine is a creature of tort rather than contract law. Defs.' Reply at 2, citing Etoll, 811 A.2d at 14.

Because the contract's choice of law provision is inapplicable, we must use Pennsylvania's choice of law rules to determine whether Florida or Pennsylvania law applies. First, we examine whether there is a "false" or "true" conflict between the two states' policies and interests. A false conflict exists where only one state's governmental interests would be harmed by the application of the other state's laws, and in such cases we apply the laws of the state whose interests are truly implicated by the cause of action. A true conflict exists where the interests of each state would be impaired by giving effect to the other state's law, and in these cases we must decide "which state has the greater interest in the application of its law." Coram Healthcare Corp. v. Aetna U.S. Healthcare, 94 F.Supp.2d 589, 594 (E.D. Pa. 1999), quoting Cipolla v. Shaposka, 267 A.2d 854, 856 (Pa. 1970). In fraud cases involving a true conflict, we give weight to the place "where the false representations were made and received" if the "plaintiff's action in reliance took place in the same state." Coram, 94 F.Supp.2d at 594, quoting Restatement (Second) Conflict of Laws § 148(1).

Without the benefit of any briefing from the parties, we suspect that this case presents a true conflict. Pennsylvania's gist of the action doctrine serves the defendant-protective purpose of ensuring that a plaintiff cannot undermine the parties' contractual expectations by stating a claim in tort, even though, as one disappointed litigant in this area has

In recent years, state and federal courts have struggled with whether the gist of the action doctrine precludes a fraud claim based on the defendant's negotiation-stage statements. Based on our examination of these cases, we conclude that the doctrine does not categorically bar or exempt such a claim, but it does preclude the claim if the fraudulent statement became the basis for a contractual duty. The subtle distinction between negotiation-stage statements that foreshadow contractual duties and statements that do not concern such duties explains the results in cases that, at first glance, might seem irreconcilable. We illustrate this distinction by surveying five recent decisions that have applied the doctrine to claims of precontractual fraud.

complained, the doctrine gives some contractual parties a "license to steal" by shielding them from tortious liability for their fraudulent statements. Etol1, 811 A.2d at 19-20. By contrast, Florida law embraces the plaintiff-protective principle that

one who has been fraudulently induced into a contract may elect to stand by that contract and sue for damages for the fraud. When this happens and the defrauding party also refuses to perform the contract as it stands, he commits a second wrong, and a separate and distinct cause of action arises for the breach of contract. The same basic transaction gives rise to distinct and independent causes of action which may be consecutively pursued to satisfaction.

HTP, Ltd., 685 So.2d at 1239, quoting Bankers Trust Co. v. Pacific Employers Ins. Co., 282 F.2d 106, 110 (9th Cir. 1960).

We conclude that Pennsylvania has a greater interest in the application of its law because we discern no interest of Florida in protecting a Pennsylvania plaintiff who has filed its complaint in this Court. Second, and more importantly, HTE's representations were apparently made, received, and relied upon in Pennsylvania. Restatement (Second) Conflict of Laws § 148(1).

In Factory Market, defendant Schuller settled a lawsuit concerning a defective roofing system on Factory Market's building by agreeing to repair the roof. 987 F.Supp. at 395 When these repairs proved unsatisfactory, Factory Market brought a fraud claim against Schuller, alleging that at the time Schuller entered the settlement agreement it knew the roof could never be made watertight and would have to be replaced. Judge Newcomer dismissed the fraud claim because, in reality, the claim was grounded on the defendant's failure to perform its contractual obligation to provide Factory Market with a watertight roof. Id.

In Galdieri v. Monsanto Co., No. 00-1113, 2002 U.S. Dist. Lexis 11391 (E.D. Pa. May 7, 2002), the plaintiffs entered employment agreements with Monsanto that required the company to develop an incentive compensation plan. When Monsanto allegedly failed to develop such a plan, the plaintiffs claimed that Monsanto had fraudulently induced them to enter the employment agreements by falsely promising to create the incentive plan. Reasoning that "[t]he gist of Plaintiffs' claim is that Monsanto contractually agreed to establish a long term incentive plan and failed to perform," Judge Schiller held that the gist of the action doctrine barred the fraud claim, id. at *34.

In Werner Kammann Maschinenfabrik, GmbH v. Max Levy Autograph, Inc., No. 01-1083, 2002 WL 126634 (E.D. Pa. Jan. 31, 2002), Max Levy purchased a furnace from third-party defendant Lindberg based on Lindberg's express, but false, representations

that the furnace's heating elements were enclosed. Judge Reed dismissed Max Levy's fraudulent misrepresentation claim against Lindberg because the duty allegedly breached (i.e., the duty to supply a furnace with enclosed heating elements) was "created and grounded in the contract itself." Id. at *6.

The defendants in Factory Market, Galdieri, and Werner Kammann all made precontractual statements on topics that the parties ultimately addressed in the contract itself. In each case, the gist of the action doctrine precluded the fraud claim because, at bottom, the plaintiff was protesting the breach of the contractual duty rather than the defendant's breach of a tort-based duty at the negotiation stage.

However, precontractual statements do not necessarily ripen into contractual duties, and for this reason, the doctrine does not inevitably preclude a fraud in the inducement claim. Two recent decisions of Judge Reed neatly illustrate this proposition. In American Guarantee, a case involving a classic instance of carrying coals to Newcastle, Fojanini agreed to market an American firm's pizza vending machines in Italy. 90 F.Supp.2d at 617. Fojanini later sued the American firm for fraud, alleging that it had falsely represented that it was financially sound and had induced Fojanini to spend large amounts of time and energy marketing the pizza machine. Judge Reed concluded that the gist of the action doctrine did not bar the fraud claim because Fojanini was not, in fact, complaining that the American firm had breached a contractual duty. Id. at 623.

As Judge Reed has subsequently noted, the result in Fojanini was dictated by the fact that "the representations did not concern specific duties outlined in the contract." Werner Kammann, 2002 WL 126634, at *7.

Judge Reed employed similar analysis in Asbury Automotive Group LLC v. Chrysler Ins. Co., No. 01-3319, 2002 WL 15925 (E.D. Pa. Jan. 7, 2002). Asbury's fraud claim alleged that before it purchased an excess umbrella insurance policy, Chrysler Insurance had falsely represented that the policy would cover every form of liability included in Asbury's primary policy. Judge Reed declined to dismiss the fraud claim before discovery because, unlike a case in which the defendant's failure to perform its contractual duty is "inexplicably transformed" into a fraud claim, Asbury alleged that Chrysler Insurance had misrepresented the actual scope of its duties under the contract. Id. at *3.

After careful scrutiny of the complaint and contract here, we conclude that the gist of Count II is HTE's alleged breach of its contractual duties. Although Count II purports to focus on HTE's breach of a duty to refrain from deceitful, negotiation-stage statements regarding its SQL conversion efforts, the School District's concerns over this topic eventually resulted in specific contractual duties. As the School District has emphasized, the contract contemplates that HTE would install SQL-based software. Moreover, Schedule B provided a "preliminary implementation schedule," pending the

development of a "detail[ed] project plan" at an "initial meeting after contract execution." HTE's alleged failure to perform these duties is at the heart of Count II, and it is therefore barred by the gist of the action doctrine.⁵

2. Count III: Fraudulent inducement to continue the contractual relationship

Count III claims that after the parties entered the contract, HTE fraudulently induced the School District to forbear from terminating it by providing implementation schedules that intentionally misrepresented the status of the SQL conversion process and HTE's ability to install the programs in the near future. Compl. ¶ 47-50. Many Pennsylvania trial court decisions recognize that the gist of the action doctrine does not bar such a claim. See EGW Partners, L.P. v. Prudential Ins. Co. of Am., 2001 WL 1807416, at *6 n.16 (Pa. Com. Pl. June 22, 2001); Gregg v. Independence Blue Cross, 2001 WL 1807400, at *8 (Pa. Com. Pl. June 14, 2001); First Republic Bank v. Brand, 50 Pa. D. & C. 4th 329, 2000 WL 33394627, at *4 (Pa. Com. Pl. Dec. 19, 2000); Greater Philadelphia Health Services II Corp. v. Complete Care Services, L.P., 2000 WL 33711052, at *2 (Pa. Com. Pl. Nov. 20, 2000).

HTE contends that the Pennsylvania Superior Court's

⁵ Our conclusion is consonant with the results in the cases surveyed above. As in Factory Warehouse, where the defendant promised to fix a roof after (allegedly) misrepresenting that it was actually reparable, HTE obliged itself to install software after (allegedly) misrepresenting that it was in a position to provide the software in a timely manner. See Compl. ¶ 42.

recent decision in Etoll casts doubt on these decisions and is "clear and controlling" authority for the proposition that the gist of the action doctrine precludes Count III. Defs.' Reply at 3-4. However, Etoll is not binding on this Court, and in any event we do not find that its teaching can be applied in such absolute terms because it expressly notes there are no categorical imperatives in this area:

[C]ourts have not carved out a categorical exception [to the doctrine] for fraud, and have not held that the duty to avoid fraud is always a qualitatively different duty imposed by society rather than by the contract itself. Rather, the cases seem to turn on the question of whether the fraud concerned the performance of contractual duties. If so, then the alleged fraud is generally held to be merely collateral to a contract claim for breach of those duties. If not, then the gist of the action would be the fraud, rather than any contractual relationship between the parties.

Etoll, 811 A.2d at 19 (emphasis in original).⁶

Whether a fraud perpetrated after the execution of the

⁶ In other words, the gist of the action doctrine decidedly does not embody a Lochner-esque vision of the contract as a private legal regime insulated from "duties imposed as a matter of social policy." See Etoll, 811 A.2d at 14, quoting Redev. Auth., 685 A.2d at 590; see also Bash v. Bell Tel. Co. of Pennsylvania, 601 A.2d 825, 829 (Pa. Super. 1992) ("Although mere non-performance of a contract does not constitute a fraud . . . it is possible that a breach of contract also gives rise to an actionable tort.").

We further note that in applying the gist of the action doctrine to the facts of the case, the Superior Court explained that the defendant's alleged acts of fraud (various forms of overbilling) were in fact breaches of contractual duties regarding billing and performance. Etoll, 811 A.2d at 20. We take this to be a fairly unexceptional application of the gist of the action rule that belies HTE's efforts to read Etoll as a more sweeping restatement of the doctrine.

contract is "collateral" to the contract is a fact-intensive question we cannot resolve at the dismissal stage. As the School District concedes, if HTE merely strung it along with promises that it would soon be able to fulfill its contractual obligations, then the gist of the action doctrine will bar the claim. See Pl.'s Resp. at 6; see also Caudill Seed, 123 F.Supp.2d at 833-34. But if HTE first breached the contract and then made misrepresentations about the breach to prevent the School District from asserting its rights under the agreement, we would conclude that the School District's fraud claim is sufficiently disconnected from HTE's contractual duties to avoid the gist of the action doctrine. Because the School District confines Count III to the latter (and rather narrow) theory of liability and also alleges its detrimental reliance on HTE's misrepresentations, we decline to dismiss it at such an early point in this litigation.

Conclusion

For the foregoing reasons, Pennsylvania's gist of the action doctrine requires us to dismiss Count II of the complaint, but does not compel the dismissal of Count III.

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ORDER

AND NOW, this 28th day of February, 2003, upon consideration of defendants' motion to dismiss Counts II and III (docket entry # 3), plaintiff's response, and defendants' reply, and in accordance with the accompanying Memorandum, it is hereby ORDERED that defendants' motion is GRANTED IN PART, as follows:

1. Count II is DISMISSED; and
2. Defendants' motion is DENIED with respect to Count III.

BY THE COURT:

Stewart Dalzell, J.

