

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

HC CONSULTING, INC.,	:	CIVIL ACTION
	:	
Plaintiff	:	
	:	
v.	:	NO. 05-2249
	:	
DAVID GOODMAN,	:	
	:	
Defendant	:	

MEMORANDUM OPINION

STRAWBRIDGE, M.J.

October 31, 2006

This matter has come before the Court as a dispute between plaintiff HC Consulting, Inc. (“HC”) and defendant David Goodman, M.D. (“Goodman”). It concerns a February 2004 contractual arrangement between the parties whereby HC was to serve as an “advisor and consultant” to Goodman in the development of a business which would acquire and lease medical scanners to various medical providers. By May 2005, the relationship between the parties had deteriorated to the point where HC initiated this action.

This Court held a bench trial on March 8, 2006. Following upon that trial, we received proposed findings of fact and conclusions of law from the parties. On August 31, 2006, we issued our findings and conclusions and entered judgment in the amount of \$55,107.92 in favor of plaintiff HC and against defendant Goodman. (Doc. No. 37.)

Defendant has now filed a “Motion to Alter and/or Amend Findings and Judgment pursuant to Fed.R.Civ.P. 52(b) and 59(e).” (Doc. No. 38.) In this motion, Goodman asserts that the Court has failed to make any findings about whether James McGonigle (“McGonigle”), the principal

of HC, “altered or caused to be altered the original consulting agreement.” (Def. Mem. at 1.) Defendant also asserts that the Court failed to make findings with respect to certain salary expenses of HC which arguably would have brought about a reduction in the damage award.

Plaintiff opposes the motion asserting that the Court, with support from the record, correctly concluded that the agreement was executed by HC as presented by Goodman and that the Court’s damages calculation properly took into account the expenses incurred by HC. (Doc. No. 39.)

The Court can deal with the first issue raised rather simply. In our August 31, 2006 Findings and Conclusions, we stated at Finding 7:

In or around February 2004, the parties sought to memorialize their existing relationship in writing. Dr. Goodman retained an attorney, who drafted a consulting agreement. (N.T. at 10, 34). The agreement was presented to McGonigle, who accepted the terms as drafted. (N.T. at 35, 102).

We concluded with respect to this issue (Conclusions 2 and 3):

Plaintiff has failed to prove that a confidential relationship existed between HC and Dr. Goodman that would have created a presumption that the agreement was voidable.

Dr. Goodman and HC knowingly and intelligently entered into a valid partially integrated written contract pursuant to which HC would serve as an advisor and consultant to Dr. Goodman for a period of three years in consideration of payments in the amount of \$6,500 per month.

(Doc. No. 37 at 3, 8.)

Pursuant to defendant’s request, the Court will make its findings more explicit. The Court accepts as credible the testimony of McGonigle that he did not alter or cause anyone else to alter the agreement (N.T. 102). The Court also finds that McGonigle is not computer savvy (N.T.

19) and accepts the testimony of Ms. Clark, his associate, that he would not even know how to enter an electronic version of the agreement (N.T. 264).

The second issue, concerning damages, is more difficult. While defendant does not appear to take issue with the Court's approach to damages, he asserts that we should deduct from the contract price an additional \$2,208 per month, representing sums going to McGonigle (\$1,708) and Kathleen Clark, McGonigle's treasurer and "girlfriend" (\$500) (*see* N.T. 259). Goodman characterizes these as payments that plaintiff "avoided by not having to perform." (Def. Mem. at 5.) We agree with plaintiff as to Clark. We disagree as to McGonigle.

We note that the preferred legal remedy for a breach of contract "seeks to protect an injured party's 'expectation interest' — that is, the interest in having the benefit of the bargain — and accordingly awards damages designed to place the aggrieved in as good a position as would have occurred had the contract been performed." *ATACS Corp. v. Trans World Communications, Inc.*, 155 F.3d 659, 669 (3d Cir. 1998). *See also Murray v. University of Pennsylvania Hosp.*, 490 A.2d 839 (Pa. Super. Ct. 1985) (citing Restatement (Second) of Contracts §§ 347, 348 (1979)). In our Conclusion No. 8, we referred to expectancy damages and stated:

As a result of Dr. Goodman's breach, HC is entitled to expectancy damages under the terms of their agreement, which amounts to contract payments less the cost of performance.

(Doc. No. 37 at 9.)

While we are satisfied that it would be proper to assume that the \$1,708.00 and \$500.00 monthly payments would have continued over the life of the contract, we are troubled over whether the sum "paid" to McGonigle should be considered, for the purpose of this calculation, an expense of HC as opposed to an expected return from the performance of the professional service

called for under the agreement. This question must be considered with reference to HC's status as a subchapter S corporation which, by its very nature, permits the pass through of any income from the corporation to the shareholder. *See Gitlitz v. Commissioner of Internal Revenue*, 531 U.S. 206, 215 n.6 (2001) ("The very purpose of Subchapter S is to tax at the shareholder level, not the corporate level. Income is determined at the S corporation level not in order to tax the corporation but solely to pass through to the S corporations's shareholders the corporation's income." (internal citations and parentheticals omitted)). Under these circumstances, we conclude that it would be inequitable to assess against this subchapter S corporation the sums paid to McGonigle as an expense. To do so would then run counter to the reasonable expectation of plaintiff and would effectively deprive it of the benefit of the bargain made at the time it entered into its agreement with Goodman.

We have found no authority in Pennsylvania or the Third Circuit dealing with this issue. There is, however, a useful discussion of the topic with reference to cases from other jurisdictions in Robert L. Dunn's text "Recovery of Damages for Lost Profits." Section 6.32 of that text deals specifically with subchapter S corporations and sections 6.13 and 6.14 deal with proprietors' compensation in small businesses and professional corporations. Recognizing the rationale behind both approaches, we are persuaded, given the facts of this case and the personal professional service being provided, that the only way to fairly compensate HC for its reasonable expectation is to not deduct the sums this professional services corporation passed through to its proprietor, or in this case, its 100% shareholder. *See, e.g., Landreth v. Barnard & Kinney, Inc.*, 561 P.2d 631 (Or. 1977); *Bettius & Sanderson, P.C. v. National Union Fire Ins. Co.*, 839 F.2d 1009 (4th Cir. 1988). We find that the rationale of distinguishing an organizational structure which rewards

shareholders based on services they provide as opposed to their ownership is applicable here and leads us to a more equitable result than that suggested by defendant. *See* Dunn, vol. 1, § 6.14.

We further conclude that it would be inequitable to allow defendant as the breaching party to benefit from the fortuitous (as to him) circumstance that McGonigle used the vehicle of the subchapter S corporation in this contractual arrangement. We conclude that the sums drawn by McGonigle clearly fall within the reasonable expectation of the benefit of the bargain he made with Goodman. We believe that conclusion is consistent with the measure of damages mandated by Pennsylvania law.

We agree with defendant, however, as to the sums paid to Kathleen Clark and will amend our findings, conclusions and judgment to reflect consideration of that expense.

We have further considered the issue of the appropriate measure of damages and conclude that plaintiff is entitled to pre-judgment interest on the portion of the damages award representing contractual payments not made for the period July 2005 to October 2006. We likewise conclude that defendant is entitled to a reduction to present value of contract payments due for future months. Our Amended Judgment Order thus takes into account the amount of interest that each month's payment would have accrued from the date the payment was due up to the present, and using as the interest rate the 1-year T-bill rate in effect as of the first day of that month. We reduce to present value the future damages using a rate of 4.53%, the average of the monthly T-bill rates used in our calculation of the prejudgment interest.

An appropriate Order and amended judgment follow.

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v.	:	NO. 05-2249
	:	
DAVID GOODMAN,	:	
	:	
Defendant	:	

**ORDER ON DEFENDANT’S MOTION
TO ALTER AND/OR AMEND FINDINGS AND JUDGMENT
PURSUANT TO FED.R.CIV.P. 52(b) AND 59(e)**

AND NOW, this 31st day of October, 2006, upon consideration of defendant’s Motion to Alter and/or Amend Findings and Judgment Pursuant to Fed.R.Civ.P. 52(b) and 59(e) (Doc. No. 38) and plaintiff’s reply thereto, IT IS ORDERED that said motion is GRANTED IN PART. IT IS FURTHER ORDERED that the Court’s Findings of Fact and Conclusions of Law of August 31, 2006 (Doc. No. 37) are amended as follows:

1. After Finding 7, add
 - 7.1 McGonigle’s testimony that he did not alter or cause anyone else to alter the agreement is credible and accepted by the Court (N.T. 102).
 - 7.2 McGonigle is not “computer savvy” (N.T. 19) and did not have the technical knowledge required to allow him to open an electronic document (N.T. 264).

2. After Finding 17, add

17.1 In addition to the \$963 average monthly performance costs incurred by plaintiff, HC also incurred an average monthly expense of \$500 on account of the work done by Kathleen Clark (N.T. 261).

17.2 HC drew from its account from April 2004 to December 2004 the sum of \$1,708 payable to McGonigle (N.T. 260).

17.3 HC operated as a subchapter S corporation with McGonigle as 100% shareholder (Exhibit 10C, Form 11025, Schedule A-1).

3. Delete conclusion 8 and substitute

8. As a result of Dr. Goodman's breach, HC is entitled to expectancy damages under the terms of their agreement, which amounts to contract payments less the cost of performance. We find credible the testimony of McGonigle who agreed that HC incurred approximately \$963.00 per month in performance costs from May 2004 through July 2004 and that he incurred similar expenses both before May 2004 and after July 2004. In addition, HC incurred the payroll expense of \$500 per month for sums paid to Kathleen Clark. We conclude that it is reasonable to assume that this sum represents a reasonable addition to the performance costs of HC for the life of the contract. The sums transferred to McGonigle (\$1,708) are not properly "performance costs" to be deducted from expectancy damages in that HC operated as a subchapter S corporation and passed its income through to

McGonigle as shareholder's income. We find that, as part of this expectancy damages calculation, HC is also entitled to an award of prejudgment interest totaling \$1,224.86 for the period July 2005 through October 2006. Damages for the period December 2006 through February 2007 are reduced by a total of \$57.32. The payment that would have been due on November 1, 2006 has not been subjected to any interest.

The Clerk is directed to close this matter for statistical purposes.

BY THE COURT:

/s/ David R. Strawbridge
DAVID R. STRAWBRIDGE
United States Magistrate Judge

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AMENDED JUDGMENT ORDER

AND NOW, this 31st day of October, 2006, upon consideration of the Court's Order granting in part defendant's Motion to Alter and/or Amend Findings and Judgment Pursuant to Fed.R.Civ.P. 52(b) and 59(e), it is **ORDERED** that **JUDGMENT** be entered in favor of HC and against Dr. Goodman in the amount of \$51,907.54.

BY THE COURT:

/s/ David R. Strawbridge
DAVID R. STRAWBRIDGE
United States Magistrate Judge