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

SCHUYLKILL SKYPORT INN, INC., et al.,	:	
Plaintiffs,	:	
v.	:	**Civil No. 95-3128**
JOHN W. RICH, JR., et al.,	:	
Defendants.	:	

M E M O R A N D U M

Cahn, C.J. January _____, 1998

INTRODUCTION

The parties[1] to the within case settled the case on June 20, 1997. The mechanics of the settlement were that an Outline of Settlement Agreement was executed on behalf of the parties and read into the record in their presence. The Outline of Settlement Agreement provided in paragraph 13 as follows:

> "13. The terms set forth in this Outline of Settlement Agreement are subject to full documentation and agreements which the parties agree to provide and execute. Any disputes concerning the finalization of the terms of the Settlement Agreement will be resolved by Chief Judge Cahn without a jury or right of appeal."

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1. James J. Curran, Jr. ("Curran, Jr.") is the principal plaintiff in this controversy. He is a minority shareholder of both Reading Anthracite Company ("RAC") and Schuylkill Energy Resources, Inc. ("SER"). He brought the within action alleging, inter alia, violations of RICO legislation based upon claimed breaches of fiduciary duties by the individual defendants, who together make up the controlling majority of both RAC and SER.

A dispute has now arisen involving paragraph 10 of the Outline of Settlement Agreement. Paragraph 10 provides:

> "10. Curran acknowledges and admits that RAC and SER are Subchapter "S" corporations and agrees that he will take all action and execute and deliver any and all documentation necessary to ratify, confirm and continue their Subchapter "S" status, and that he will take no action to revoke or jeopardize their Subchapter "S" status."

Curran, Jr. is satisfied with the precise language of paragraph 10 of the Outline of Settlement Agreement. Defendants insist that paragraph 10 should be expanded into a new paragraph 11 in the final Settlement Agreement. Defendants' proposed paragraph 11 provides as follows:

> "11. **SUBCHAPTER "S" CONFIRMATION AND AGREEMENT**.
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> A. Curran, Jr. acknowledges, agrees and admits that RAC and SER are Subchapter "S" corporations, and that he is and always has been the owner of all stock registered in his name as reflected on the books of RAC and SER.
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> B. Further, Curran, Jr. acknowledges, agrees and admits that the By-Laws of RAC, SER, Knickerbocker Coal Company and Mahanoy City Coal Company (collectively, the "Companies") prevent the transfer of any shares of stock without first offering such shares to the other shareholders of the Companies. Except in accordance with the July 18, 1992 Settlement Agreement, neither he nor Netta Barrett ever offered any of the shares in the Companies formerly held by Netta Barrett ("Barrett Shares") to the other shareholders of the Companies. Further, Curran, Jr. agrees that the sole offer by him in regard to the transfer of the Barrett Shares was by him, individually, and not by or on behalf of the Minersville Safe Deposit Bank and Trust Company, Custodian for the James J. Curran, Jr. Individual Retirement Account ("IRA"), as reflected by his offer letter dated September 14, 1992, which was consistent with the requirements of the Settlement Agreement dated July 18, 1992. Accordingly, Curran, Jr. admits that no transfer of shares to his IRA could have been

or was effective at any time and, as such, despite any prior understandings or representations by him, which were mistaken, that he personally purchased the Barrett Shares and, except for such RAC shares as he sold to John W. Rich, Sr., he has not transferred any of his shares, including any of the Barrett Shares, and, as reflected by the books and records of RAC and SER, he always has been, and he continues to be, the sole owner of all RAC or SER stock as issued in his name by the Companies. Finally, in light of the By-Laws' restriction on transfer, Curran, Jr. agrees that such RAC or SER stock never has been owned by any other entity including, but not limited to, the IRA or any other retirement plan.

C. To the extent that Curran, Jr. has made any prior statements or representations to the IRS that are inconsistent with the representations set forth in Paragraph 11, or that the Barrett Shares were acquired by his IRA, he acknowledges that they were mistaken.

D. Curran, Jr. agrees that he will take no action to revoke or jeopardize the Subchapter "S" status of RAC and SER at any time in the future without the consent and agreement of all of the stockholders of RAC and SER, and that he will cooperate with the Internal Revenue Service and any related examination to confirm and continue the Subchapter "S" status of both RAC and SER.

E. Curran, Jr. further agrees that he will take all action, and promptly execute and deliver any and all documentation, necessary to ratify, confirm and continue the Subchapter "S" status of both RAC and SER."

DISCUSSION

The parties do not dispute that there was a contract of settlement. What this court must decide is what were the terms of settlement in regard to the Subchapter "S" status of RAC and SER.

Curran, Jr. suggests that paragraph 10 of the Outline of Settlement Agreement obligates him to acknowledge only the

Subchapter "S" status of RAC and SER in futuro. He urges that paragraph 10 is ambiguous and that it must be construed against the scrivener who was the attorney for the defendants. Because of this claim of ambiguity, and at the suggestion of the plaintiffs and the defendants, the court has held several hearings to take testimony on Curran, Jr.'s claim of ambiguity and has afforded the parties extensive oral argument in regard to their contentions. All of this was done in accordance with the procedure set forth in Mellon Bank, N.A. v. Aetna Bus. Credit, Inc., 619 F.2d 1001, 1009-1013 (3d Cir. 1980); see also In re Unisys Corp. Long-Term Disability Plan ERISA Litigation, 97 F.3d 710, 715 (3d Cir. 1996) (citing Mellon).

Curran, Jr.'s position at the hearing and argument in regard to paragraph 10 of the Outline of Settlement Agreement is that the language set forth therein, when construed against the defendants, permits him to take the position that RAC and SER were not, as of June 20, 1997, Subchapter "S" corporations but could assume that status by a subsequent election. In order to understand Curran, Jr.'s position in this regard, more background is necessary.

On July 11, 1989, at a special meeting of SER's shareholders, Curran, Jr. was ousted from SER management. On July 18, 1989, at a special meeting of RAC's shareholders, a majority of RAC's shareholders voted to oust Curran, Jr. from RAC management. The issue of management control of RAC was litigated in the state court system and Curran, Jr.'s ouster

was confirmed by the courts of this Commonwealth. Therefore, on September 6, 1990, at a special meeting of RAC's shareholders, Curran, Jr.'s ouster from RAC management was ratified.

In a maneuver related to but not determinative of the control issue of RAC and SER, Curran, Jr. individually, and another shareholder of RAC and SER, one Netta Barrett, purportedly entered into a Stock Option Agreement dated May 30, 1990, which provided for the payment by Curran, Jr. of $2,500,000.00 to acquire an option to purchase Barrett's shares (the "Barrett shares") in RAC, SER and two other companies (the "Companies"). The option was coupled with an irrevocable proxy to Curran, Jr. enabling him to vote the shares covered by the option. Under the terms of the Stock Option Agreement, Curran, Jr. could secure the shares upon written demand within ten years without further payment. With one exception,[2] the Stock Option Agreement was not disclosed to the other shareholders of the Companies. It appears that Curran was using the option in an attempt to avoid by-law restrictions which required a selling shareholder to offer his stock pro rata to the other shareholders in the Companies (the foregoing requirement conferred on the non-selling shareholders, a "right of first offer").

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2. The Stock Option Agreement was disclosed to Lawrence F. Tornetta, a minority shareholder of the Companies.

Curran, Jr. obtained the consideration to pay for the option for the Barrett shares from his IRA (Individual Retirement Account). All of the parties to this litigation recognize that, if an IRA is a shareholder of a corporation, that corporation under the Internal Revenue Code and Regulations cannot be a valid Subchapter "S" corporation.[3]

In 1992, it became known to the defendants that Curran, Jr. had obtained the option from Barrett. This resulted in litigation by other shareholders to enforce their right of first offer with regard to the Barrett shares. That litigation was settled on July 18, 1992, and pursuant to the settlement the Barrett shares were offered pro rata to the other shareholders. Only one shareholder, John W. Rich, Sr., purchased some of the Barrett shares following such offer. The Barrett shares were thereafter transferred to Curran, Jr. and John W. Rich, Sr. John W. Rich, Sr. issued Curran, Jr. a check in the amount of $277,295.00 for the shares Rich was to receive. Curran, Jr.'s portion of the Barrett shares was issued to Curran, Jr. in his name and without reference to Curran, Jr.'s IRA.

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3. See Rev. Rul. 92-73, 1992-2 C.B. 224 (holding that "[a] trust that qualifies as an individual retirement account under section 408(a) of the Code is not a permitted shareholder of an S corporation under section 1361," and that accordingly, a shareholder "causes a termination of an S corporation by transferring stock to [such] a trust"); see also, e.g., Priv. Ltr. Rul. 9741028 (Oct. 10, 1997) (citing and applying Rev. Rul. 92-73, 1992-2 C.B. 224).

On March 19, 1993, the Companies received a notice from Curran, Jr., claiming that prior to the July 18, 1992 settlement, he had assigned the Barrett stock option to his IRA.[4] Curran, Jr.'s position was that the Barrett shares issued to him pursuant to the July 18, 1992 settlement were held by his IRA, which he claimed had exercised the Barrett stock option after implementation of the July 18, 1992 settlement. By letter dated March 23, 1993, the Companies' corporate counsel, Martin J. Cerullo, Esquire, rejected Curran, Jr.'s purported transfer of his portion of the Barrett shares to his IRA. Cerullo's position was that, inter alia, the July 18, 1992 settlement contemplated the issuance of Barrett shares to Curran, Jr. individually, and thus Curran, Jr.'s subsequent attempt to transfer the shares to his IRA was invalid because it triggered the other shareholders' right of first offer. Cerullo therefore refused to comply with Curran, Jr.'s request that the Companies issue Curran, Jr.'s portion of the Barrett shares to Curran, Jr.'s IRA. To date, the books and records of the Companies have never reflected any assignment or transfer of shares to Curran, Jr.'s IRA.

Curran, Jr. points to this extrinsic evidence in support of his claim that he did not intend to acknowledge and admit that RAC and SER were Subchapter "S" corporations as of June 20, 1997. In Curran, Jr.'s view, this background explains

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4. At the time, Curran, Jr. did not submit a copy of the purported assignment.

why he could not have intended to ratify the Subchapter "S" status of RAC and SER as of June 20, 1997 by agreeing to paragraph 10 of the Outline of Settlement Agreement, insofar as this background allegedly shows that he assigned shares in RAC and SER to his IRA long before June 20, 1997, resulting in the termination of RAC's and SER's Subchapter "S" status.

In discovery taken after June 20, 1997, it became known to defendants that on December 17, 1996, Curran, Jr. sought a private letter ruling from the IRS as to whether RAC and SER are "properly classified as small business corporations for tax years 1992 and thereafter" given his alleged assignment of the Barrett stock option to his IRA. Pages 2-3 of Curran, Jr.'s letter request to the IRS provided in relevant part:

> "The Taxpayer was fully aware at the time that he directed that his I.R.A. exercise the Barrett Option that ownership by the I.R.A. of these subchapter-S entities would cause a revocation of such subchapter-S filing status.... Such exercise of this Option was purposeful and was not inadvertent."

Furthermore, on October 28, 1997, Curran, Jr. filed a petition with the United States Tax Court contesting a Notice of Deficiency, dated September 18, 1997, of income tax, penalties, and interest for tax year 1990 totalling $1,297,310.00. This notice of deficiency was based on the determination by the IRS that the withdrawal of $2,500,000.00 from Curran, Jr.'s IRA was premature, taxable, and subject to penalties. Curran, Jr. in his petition to the United States Tax Court is contesting this determination. Curran, Jr.'s

position with the IRS is that he assigned the Barrett stock option to his IRA and therefore there was no withdrawal of IRA funds for his personal use.

While the background of this controversy may be complex, the parsing of paragraph 10 of the Outline of Settlement Agreement is not. The plain language of paragraph 10 does not allow Curran, Jr. to take the position he now takes. It is sufficiently important in this analysis that I quote paragraph 10 again verbatim.

> "10. Curran acknowledges and admits that RAC and SER are Subchapter "S" corporations and agrees that he will take all action and execute and deliver any and all documentation necessary to ratify, confirm and continue their Subchapter "S" status, and that he will take no action to revoke or jeopardize their Subchapter "S" status."

In paragraph 10, Curran, Jr. acknowledges and admits RAC and SER are Subchapter "S" corporations. He also agrees "to ratify, confirm, and continue their Subchapter "S" status." (Emphasis added.) No rational argument can be made that, as Curran, Jr. argues, this language is ambiguous, and moreover reflects Curran, Jr.'s current position that RAC and SER were not Subchapter "S" corporations as of June 20, 1997, but could assume that status subsequently. It is similarly unavailing for Curran, Jr. to argue in the alternative that he agreed in paragraph 10 that RAC and SER were Subchapter "S" corporations as of June 20, 1997, but only insofar as the IRS had not, as of that date, decided whether to terminate their Subchapter "S" status following Curran, Jr.'s December 17, 1996 request for a

private letter ruling.[5] Even if this were so, Curran, Jr. cannot reasonably reconcile his agreement in paragraph 10 to "take no action to revoke or jeopardize their Subchapter "S" status" with his filing of the October 28, 1997 IRS petition.[6]

Curran, Jr. contends that his prior acts are consistent with his position that RAC and SER lost their Subchapter "S" status prior to July 20, 1997. He then argues that in light of what transpired he could not have intended to agree that RAC and SER were Subchapter "S" corporations as of June 20, 1997. Notwithstanding Curran, Jr.'s assertions, however, I find that Paragraph 10 of the Outline of Settlement Agreement is not ambiguous on the Subchapter "S" issue. Thus, in construing paragraph 10, I must reject the extrinsic evidence.[7]

It is important to note that, at the time the Outline of Settlement Agreement was entered into, the defendants knew

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5. In November, 1997, the IRS notified the Companies that it had terminated their Subchapter "S" status effective January 1, 1994.

6. I reject Curran, Jr.'s argument that because the alleged facts upon which the October 28 petition is based predate the Outline of Settlement Agreement, his filing of the October 28 petition does not violate his obligations under this provision of paragraph 10.

7. See Mellon, 619 F.2d at 1012 & n.13 ("If no 'reasonable' alternative meanings [of the contested contractual language] are put forth, then the writing will be enforced as the judge reads it on its 'face.'"); see also Compass Tech., Inc. v. Tseng Lab., Inc., 71 F.3d 1125, 1131 ("If [the parties'] intent can be cleanly extracted from the clear and unambiguous words that the parties have used, it is . . . conventional wisdom that they are held to those words contained in the contract.") (citing Mellon).

that Curran, Jr. had been attempting to destroy the Subchapter "S" status of RAC and SER and, because of their concern over his actions, insisted on the inclusion of paragraph 10 in the Outline of Settlement Agreement.[8] In addition, Curran, Jr., in the Outline of Settlement Agreement, insisted upon the inclusion of a provision, set forth in paragraph 9, that with regard to SER, shareholder distributions be made to the extent loan documentation permits, so that if taxable Subchapter "S" income were passed through to the individual shareholders, there would be actual cash distributions (as opposed to paper distributions) sufficient to cover any tax on such paper distributions. Finally, I note that the 1980 Stockholders Agreement, to which Curran, Jr. is a party, commits the shareholders

> to bind themselves irrevocably to each other in conjunction with various matters . . . with the foreknowledge that such commitments are a condition precedent to the approval by every other Stockholder of the election to be taxed under the provisions of Sub-Chapter S of the Internal Revenue Code, which act is being taken in reliance hereon.

See 1980 Stockholders Agreement ¶¶ C, 3 (emphasis added).[9]

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8. To the extent that Curran, Jr.'s prior acts are inconsistent with the unambiguous language of paragraph 10, I note that before entering into the Outline of Settlement Agreement, Curran, Jr.'s counsel informed me in open court that he would deal with any problems with the IRS arising from such inconsistency.

9. Gloria Rich, a signatory to the Stockholders Agreement, claims her signature was forged and various signatories have disputed the validity and/or meaning of the Agreement, depending on what was in issue at the time. However, it is not disputed that Curran, Jr. signed the Stockholders Agreement.

CONCLUSION

After considering the contentions of the parties, it is clear to the court that paragraph 10 of the Outline of Settlement Agreement prohibits Curran, Jr. from taking the position he now wishes to take. Consequently, an order will be entered substantially in the form suggested by the defendants. The terms of the order are consistent with what Curran, Jr. agreed to on June 20, 1997.

An appropriate order will be entered.

BY THE COURT:

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Edward N. Cahn, C.J.