

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

EMTEC, INC. : CIVIL ACTION
 :
 v. :
 :
 CONDOR TECHNOLOGY SOLUTIONS, INC, :
 SCM LLC d/b/a THE COMMONWEALTH :
 GROUP, J. MARSHALL COLEMAN :
 and KENNARD F. HILL : NO. 97-6652

MEMORANDUM AND ORDER

HUTTON, J.

May 5, 1999

Presently before the Court are Defendants' Motion to Preclude the testimony of Plaintiff's Expert Witness, Candace L. Preston (Docket No. 37), Plaintiff's reply (Docket No. 38), and Defendants' sur reply (Docket No. 39). For the following reasons, the Defendants' motion is **DENIED**.

I. BACKGROUND

In late 1996, Plaintiff Emtec, Inc. and Legg Mason Wood Walker, Inc. ("Legg Mason"), Emtec's investment banker, began considering the feasibility of a corporate "roll-up" of certain computer companies. A roll-up is a process whereby one corporate structure acquires other companies, generally within a similar field of business, while at the same time stock in the acquiring corporation is offered to the public through an initial public offering ("IPO"). Emtec considered nine companies to be possible

participants in the roll-up. Eventually, Emtec shortened this list to three: Computer Hardware Maintenance Corporation ("CHMC"), Corporate Access, Inc. ("Corporate Access"), and PCNet.

Prior to being introduced to Emtec, CHMC and Corporate Access were already interested in being acquired. Corporate Access acted through a corporate broker, Ross Crossland Weston & Co. ("RCW"), in an attempt to find an acquisition partner. RCW sent summary descriptions of Corporate Access a larger descriptive memorandum to numerous potential acquisition companies. Along the same lines, CHMC was also interested in acquisition prior to its discussions with Emtec. CHMC had acquisition discussions with a number of other firms before meeting with Emtec.

In early 1997, Emtec, Corporate Access, and CHMC signed letters of intent. These letters of intent stated that Emtec would acquire Corporate Access and CHMC. Due to market conditions, Emtec was unable to proceed with the roll-up of these three companies in March of 1997. Marshall Coleman, a principal of Defendant Commonwealth Group, Inc. ("Commonwealth"), discovered Emtec's failed roll-up. Coleman and a representative of Legg Mason, Seth Lehr, met and signed a confidentiality agreement on April 28, 1997. Coleman and Lehr then exchanged financial information about the prospects that each were considering concerning the roll-up.

In late May of 1997, Commonwealth sent letters of intent to Emtec, CHMC, and Corporate Access. These letters of intent set

forth the terms pursuant to which Defendant Condor Technology Solutions, Inc. ("Condor") proposed to purchase each of the three companies in their roll-up. On May 13, 1997, Commonwealth and Condor signed a supplemental agreement with Legg Mason and Emtec. Emtec agreed to disclose the identities of CHMC and Corporate Access. The parties also agreed that in no event would Commonwealth enter into any transactions with either CHMC or Corporate Access without Emtec's approval before May 13, 1999.¹

With the May 13, 1997 agreement signed, Legg Mason and Emtec introduced representatives of Condor and Commonwealth to the presidents of CHMC and Corporate Access. During these introductions, Emtec's CEO, Thomas Dresser, told CHMC and Corporate Access that Emtec planned to roll-up with Condor. On July 3, 1997, Emtec and Condor signed a letter of intent providing for the

¹ The May 13, 1997 letter agreement, attached as Exhibit B to the complaint, states in part:

Commonwealth and Legg Mason have determined to continue to explore a possible business transaction relating to Legg Mason's client EMTEC, Inc. ("EMTEC") and Commonwealth's client The Condor Group ("Condor"). Each of EMTEC and Condor have been having discussions with potential acquisition candidates ("Founding Companies") which are engaged in their respective lines of business. Commonwealth and Legg Mason and representatives of EMTEC and Condor propose to meet to discuss a potential business transaction which would require disclosure of information relating to EMTEC's and Condor's Founding Companies.

Commonwealth and Legg Mason each hereby agrees that neither it nor Condor or EMTEC, as the case may be, will seek, directly or indirectly, to enter into a business transaction with any of the other's Founding Companies for a period of two years from the date hereof, without the prior written consent of the other party.

Pl.'s Compl. at Ex. B.

acquisition of Emtec by Condor.

On July 17, 1997, however, Dresser told CHMC and Corporate Access that Emtec might not be included in the Condor roll up. Defendants contend that Dresser also stated that Emtec had no objection if CHMC and Corporate Access went ahead with the Condor roll-up. Plaintiff responds that Dresser only stated that Emtec could not legally prevent CHMC and Corporate Access from joining the Condor roll-up without them. On July 24, 1997, Condor withdrew the letter of intent providing for its acquisition of Emtec. As the roll-up transaction approached its target date, the Defendants excluded Emtec and completed the transaction with the other acquirees--including CHMC and Corporate Access--on February 5, 1998. The Defendants argue that they excluded Emtec, among other reasons, because it failed to provide them with audited 1997 financial statements establishing a "clean bill of financial health."

Subsequently, Emtec brought suit against the Defendants. Emtec claims that the roll-up was an outright breach of the May 13, 1997 agreement and sues for breach of contract (Count I), tortious interference with business relations (Count II), and misappropriation of a trade secret (Count III). Defendants filed a motion for partial summary judgment seeking dismissal of Counts II and III. After Defendants filed their summary judgment motion, Plaintiff filed a motion to amend the complaint. On November 24,

1998, the Court denied Plaintiff's motion to amend the complaint to add an unjust enrichment count. See Emtec, Inc. v. Condor Tech. Solutions, Inc., No. CIV.A.97-6652, 1998 WL 834097, at *3 (E.D. Pa. Nov. 30, 1998). The Court also dismissed Plaintiff's claim for misappropriation of a trade secret (Count III). See id. at *7.

As a remedy, Plaintiff seeks "disgorgement of the benefit defendants received as a result of their wrongful inclusion of CHMC and Corporate Access in the Condor roll-up transaction." Pl.'s Mem. of Law in Opposition at 2. In other words, Plaintiff requests that the Defendants be required to give up the benefits received from using CHMC and Corporate Access in the Condor roll-up. In support of such a claim, Emtec commissioned Candace L. Preston as their damage expert. In her report, Ms. Preston opined that Defendants wrongfully obtained a benefit as a result of the Condor roll-up. Ms. Preston states that this benefit consisted of the "promote" or the difference between what was paid for the companies and the total capital raised in the IPO. Ms. Preston then used the promote to calculate the Plaintiff's fair share. In her initial report, Ms. Preston calculated the promote to be 666,591 shares of Condor stock worth \$8,665,680. After subsequent discovery, Ms. Preston calculated the promote to be 1,325,994 shares of Condor stock worth \$17,237,278. On February 22, 1999, the Defendants filed this motion to preclude the testimony of Ms. Preston.

II. DISCUSSION

Federal Rule of Evidence 702 governs the admission of expert testimony in federal court. Rule 702 provides:

If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise.

The Rule has three major requirements: (1) the proffered witness must be a qualified expert; (2) the expert must testify about matters requiring scientific, technical, or specialized knowledge; and (3) the expert's testimony must "fit" the facts of the case. See Kannankeril v. Terminix Int'l, Inc., 128 F.3d 802, 806 (3d Cir. 1997) (citing In re Paoli R.R. Yard PCB Litigation, 35 F.3d 717, 741-42 (3d Cir. 1994)). A Rule 702 determination is a preliminary question of law for the Court, under Federal Rule of Evidence 104(a). See Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579, 592 (1993).

Under the Supreme Court's Daubert decision, the Court assumes a "gatekeeping" function to protect against the admission of expert testimony that is unreliable or unhelpful to the trier of fact. See id. at 592-95; United States v. Velasquez, 64 F.3d 844, 850 (3d Cir. 1995). "This entails a preliminary assessment of whether the reasoning or methodology underlying the testimony is scientifically valid and of whether that reasoning or methodology properly can be applied to the facts in issue." Daubert, 509 U.S. at 592-93.

Although first announced as an approach in the context of scientific testimony, the Supreme Court subsequently extended the Daubert "gatekeeping" obligation to the evaluation of all forms of expert knowledge. See Kumho Tire Co., Ltd. v. Carmichael, 119 S. Ct. 1167, 1174 (1999). Accordingly, the Court will apply Daubert in evaluating the admissibility of Plaintiff's damages testimony.

Returning to Rule 702, the Defendants do not contest the first requirement that the expert be qualified to testify. See Paoli, 35 F.3d at 741. Rather, the Defendants challenge Ms. Preston's testimony based on the Rule's second requirement-- that the expert testimony be reliable-- and third requirement-- that the testimony "fit" under the facts of the case. See Kannankeril, 128 F.3d at 806. Defendants contend that Ms. Preston's testimony is not reliable nor fits the facts of this case because disgorgement is not an available remedy to the Plaintiff under Virginia breach of contract law or Pennsylvania tortious interference with contract law.

A. Applicable Law

Plaintiff's breach of contract claim, Count I, is governed by Virginia law pursuant to the confidentiality agreement between the parties. Plaintiff's tortious interference with contractual relations, Counts II, is a tort action and therefore governed by Pennsylvania law. Neither party disputes the application of Virginia law to the contract action and Pennsylvania law to the

tort action.

B. The Court's November 24, 1998 Memorandum and Order

The Defendants first argue that Ms. Preston's testimony should be excluded because this Court's Memorandum and Order of November 24, 1998 recognized that the equitable remedies Ms. Preston's report addresses are not available. Plaintiff responds that this Court's Memorandum and Order of November 24, 1998 specifically recognizes that the Plaintiff may seek disgorgement of the roll-up benefits. This Court cannot agree with either party. In its November 24, 1998 Memorandum and Order, the Court held only that Plaintiff could not amend the complaint to add an unjust enrichment claim and that there was a genuine issue of material fact as to Plaintiff's breach of contract and tortious interference with contractual relations claims. See Emtec, Inc., 1998 WL 834097, at *3, *7. Thus, the Court rejects the parties' arguments with respect to the November 24, 1998 Memorandum and Order and now turns to whether the remedies Plaintiff seeks are available under Virginia breach of contract law.

C. Remedies for Breach of Contract Under Virginia Law

Because Ms. Preston's report concerns the disgorgement of the benefits received by the Defendants as a result of the roll-up, the critical issue is whether Virginia law permits this type of remedy for breach of contract. Defendants maintain that Virginia law does not permit such a remedy and, therefore, Ms. Preston's testimony should be excluded. Plaintiff counters that Virginia law does permit the disgorgement remedy and cites Eden Hannon & Co. v. Sumitomo Trust & Banking Co., 914 F.2d 556 (4th Cir. 1990) as support.

In Eden Hannon, the Plaintiff Eden Hannon & Co. (EHC) was an investment company and the Defendant, Sumitomo Trust & Banking Co., was a subsidiary of a Japanese bank. See id. at 557. EHC valued, bid on, and sold the income rights of investment portfolios to institutional investors. See id. In 1988, Sumitomo signed a "Nondisclosure and Noncircumvention" agreement with EHC. See id. In this agreement, Sumitomo indicated an interest in purchasing a Xerox Corporation portfolio through EHC. See id. EHC then provided Sumitomo with confidential information concerning the Xerox portfolio. See id. In violation of that agreement, Sumitomo won a bid to make a direct purchase of the portfolio. See id.

EHC subsequently filed suit for breach of contract, misappropriation of trade secrets, breach of fiduciary duty, and breach of the duty of good faith and fair dealing. See id. The

district court found that EHC failed to prove a misappropriation of trade secrets, but also concluded that Sumitomo's actions constituted breach of contract. See id. The district court enjoined Sumitomo from repeating its breach of contract in violation of the "Nondisclosure and Noncircumvention" agreement with EHC. See id. Both parties appealed to the United States Court of Appeals for the Fourth Circuit. See id.

The Fourth Circuit held that, under Virginia law, EHC was entitled to a "constructive trust on Sumitomo's profits from the portfolio purchase as an equitable remedy for their breach of the agreement." Id. In so holding, the Fourth Circuit stated that "[t]he Virginia courts have . . . adopted a policy of great flexibility in fashioning appropriate equitable remedies to address the violation of noncompetition agreements" Id. at 564. The Eden Hannon court also noted that Virginia courts will often turn to equitable remedies when money damages are speculative. See id. Thus, because "[i]t [was] difficult to determine the extent of EHC's loss, and far easier to determine the extent of Sumitomo's benefit from the breach of the Agreement," the Fourth Circuit remanded the case with instructions that the district court should determine the amount of Sumitomo's profits on the portfolio and enter an order awarding that amount to EHC. See id. at 564, 565.

Based upon the Eden Hannon case, the Court must conclude, therefore, that equitable remedies are available under Virginia law

in this case.² The facts of this case are very similar to that of Eden Hannon. Emtec signed a noncompetition agreement with the Defendants, CHMC, and Corporate Access to prevent its disclosures from creating new competitors. After the parties signed the noncompetition agreement, Emtec provided the Defendants with confidential information concerning the roll-up and introduced Defendants to CHMC and Corporate Access. Emtec alleges that Defendants then breached the noncompetition agreement by proceeding with the Condor roll-up without Emtec. Thus, because the Fourth Circuit concluded that the Virginia courts have adopted a policy of "great flexibility in fashioning appropriate equitable remedies to address the violation of noncompetition agreements," the Court must conclude that Emtec may be entitled to disgorgement of-- or at the very least a constructive trust over-- the benefits of the Condor roll-up.

Defendants argue that the Eden Hannon case is both an incorrect statement of Virginia law and distinguishable from this case. These arguments lack merit. First, while the Eden Hannon court acknowledged that there was no precedent for its equitable remedy in that case, this is not a basis for concluding that the court incorrectly stated Virginia law. See id. at 560 n.2. Indeed, the court found that Virginia law provided appropriate

² Because the Court finds that Virginia breach of contract law provides for equitable remedies, it does not address whether equitable remedies are available under Pennsylvania tortious interference with contracts law.

guidance to support its decision. See id. Second, far from being distinguishable, the Court finds that this case is highly analogous to Eden Hannon. Therefore, the Court rejects the Defendants' arguments with respect to Eden Hannon.

Turning to expert testimony in this case, the Court finds that Ms. Preston's testimony should not be excluded. Ms. Preston will opine that the Defendants received certain benefits when it wrongfully proceeded with the Condor roll-up. Ms. Preston will also state what she believes is the Plaintiff fair share of the promote, or the difference between what was paid for the companies and the total capital raised in the IPO. If the Plaintiff proves that the Defendants breached the noncompetition agreement, this damage testimony will be helpful in determining whether a constructive trust should be placed over the benefits received from the Condor roll-up. Accordingly, the Court denies the Defendants' motion.

An appropriate Order follows.

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O R D E R

AND NOW, this 5th day of May, 1999, upon consideration of the Defendants' Motion to Preclude the Testimony of Plaintiff's Expert Witness, Candace L. Preston, IT IS HEREBY ORDERED that the Defendants' motion is **DENIED**.

BY THE COURT:

HERBERT J. HUTTON, J.