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

SCHOOL LANE HOUSE PHILADELPHIA, LLC, et al., Plaintiffs,	:	**CIVIL ACTION**
v.	:	**NO. 04-3821**
RAIT PARTNERSHIP, L.P., et al., Defendants.	:	

MEMORANDUM AND ORDER

Tucker, J. **September 27, 2005**

Presently before this Court are Defendants' Motions to Dismiss pursuant to FED. R. CIV. P. 12(b)(6) (Docs. 4,5 and 9), Plaintiffs' Memoranda in Opposition (Docs. 8 and 13), Defendants' Replys (Docs. 14,15, 17, 19 and 23) and Plaintiffs' Surreply (Doc. 21). For the reasons set forth below, the Court will grant in part and deny in part Defendants' Motions to Dismiss.

I. FACTUAL BACKGROUND

Plaintiffs are commercial real estate investors in the Philadelphia, Pennsylvania area. Plaintiff, RAIT SLH, L.P. ("RAIT SLH") is the owner of School Lane House Apartments (the "Property"), the residential apartment building that is the subject of this action.[1] Plaintiff, School Lane House Philadelphia, LLC ("SLH") currently owns eighty-eight percent (88%) of the limited partnership interest of RAIT SLH. Plaintiff School Lane House General, LLC ("SLH General") is the general partner of RAIT SLH. Plaintiff Michael Axelrod ("Axelrod") is a principal of SLH and SLH General as well as a "Key Principal" in RAIT SLH. Defendants RAIT Partnership, L.P., RAIT General, Inc., and RAIT Investment Trust (the "RAIT Defendants") are in the business of making

[1] The Court takes this factual narrative from the Complaint.

bridge loans to finance commercial real estate purchases, as well as purchasing distressed real estate and selling it for profit after making repairs and renovations. Defendant Brandywine Construction & Management, Inc. ("Brandywine") manages properties for RAIT Investment Trust and was the manager of the Property until January 2004. Defendant Mark Berman ("Berman") is an officer of Defendant Brandywine.[2] Defendants Capri Capital Finance, LLC ("Capri") and Federal National Mortgage Association ("Fannie Mae") are both mortgage lenders with interests in the Property.

On September 30, 1999, Plaintiff RAIT SLH purchased the Property at a foreclosure sale. In early 2002, the RAIT Defendants estimated the Property to be worth approximately twenty-five million dollars ($25,000,000). The property was subject to two mortgages held by Defendant Fannie Mae, giving the property an equity value of approximately eight million dollars ($8,000,000). According to Plaintiffs, the RAIT Defendants and the Brandywine Defendants knew that the Property had numerous problems that would require several million dollars to repair, decreasing the value of the Property. Plaintiffs contend that instead of disclosing these defects, the RAIT Defendants and the Brandywine Defendants conspired to conceal the true condition of the property.

Scott Schaeffer, president of RAIT Partnership and RAIT General, contacted Plaintiff Axelrod's broker in order to interest Axelrod in the Property. Later, Schaeffer and Axlelrod met to discuss the Property. At the meeting, Schaeffer represented that the Property was in good condition both financially and physically. Schaeffer also indicated that the occupancy rate was very high and that income exceeded expenditures. Plaintiffs believe that Schaeffer knew at that time that these statements were false.

[2] Brandywine and Brennan are hereinafter reffered to as (the "Brandywine Defendants").

Axelrod asserts that he was not interested in the Property unless the RAIT Defendants agreed to make certain repairs. Defendant Berman also took Axelrod on a tour of the Property, where he stressed the maintenance of the building. Specifically, Berman represented that the boilers, HVAC, roof and elevators were in excellent condition. Plaintiffs contend that the other RAIT Defendants knew that these statements were false as well. Subsequently, Plaintiffs agreed to purchase the Property.

The sale of the of the Property proceeded in two stages. The first stage closing occurred on December 20, 2002; the second closing took place on April 1, 2003. In the first closing, RAIT Partnership transferred a forty-nine percent (49%) interest in RAIT SLH in exchange for four million one hundred thirty-three thousand dollars ($4,133,000). The RAIT Partnership transferred the remaining interests in the property in exchange for the proceeds from a loan from Defendant Capri in the amount of one million eight hundred fifty-two thousand dollars ($1,852,000). This loan, known as the Third Mortgage Loan, was initially made by Capri under an arrangement with Fannie Mae. Capri later sold and assigned the mortgage and mortgage note to Fannie Mae.

As part of the first closing, the RAIT Defendants obtained and forwarded to both Axelrod and Capri a Property Condition Assessment by Hillman Environmental Group, LLC (the "Hillman Report"). According to the Hillman Report, Brandywine represented that the boilers in the Property had been installed ten years earlier. The Hillman Report further indicated that the HVAC systems and equipment appeared to be in fair condition. The Hillman Report also recommended that a mechanical contractor provide an evaluation of the existing boiler plant and boiler room.

The RAIT Defendants obtained a letter from Industrial Boiler, Inc., which represented that the boiler was in "remarkably good condition" and that "the burners...should not give any problems

other than normal working related problems." Compl. Ex. B. The RAIT Defendants forwarded this letter to Plaintiffs and Defendants Capri and Fannie Mae. The RAIT Defendants allegedly made representations pertaining to the Property in the Purchase Sale Agreement as well. Plaintiffs contend that the statements in the letter and the Purchase Sale agreement were false.

After the second stage closing, Plaintiffs began to hear complaints from tenants. When Plaintiffs brought these complaints to the attention of Brandywine and Brennan, they were assured that the complaints were being addressed. However, the tenants' complaints were not addressed. In fact, Plaintiffs contend that the Brandywine Defendants continued to misrepresent the condition of the Property, leaving Plaintiffs unaware of the tenants' complaints and the true condition of the property.

In October 2003, Plaintiffs learned Brandywine was not addressing the complaints from the tenants as the tenants began withholding rent. As a result, Plaintiffs terminated Brandywine as manager of the Property and began to actively manage the Property in January 2004. At that time, Plaintiffs discovered problems that they claim the RAIT and Brandywine Defendants actively concealed from them, namely problems with the boilers, elevators and numerous other violations. These problems damaged the reputation of the Property, allegedly reducing its occupancy and causing Plaintiffs to suffer economic harm.

Plaintiffs also claim that the RAIT Defendants misrepresented the Property's rental stream. Plaintiffs contend that prior to the second stage closing, the RAIT Defendants offered free first month's rent to prospective tenants. These agreements resulted in less cash flow than Plaintiffs anticipated, which caused them to suffer economic harm. Furthermore, the RAIT Defendants did not perform the necessary credit and background checks on the prospective tenants - a failure that

led to a high number of lease defaults and required Plaintiff RAIT SHL to engage in costly eviction proceedings. Lastly, Plaintiffs assert that the RAIT Defendants agreed to make several repairs to the Property, including door and roof replacements, which were never completed. As a result of the above, Plaintiffs brought this action for breach of contract, fraud and conspiracy.

II. LEGAL STANDARD

In considering a motion to dismiss under FED. R. CIV. P. 12(b)(6), the Court "must take all the well pleaded allegations as true, construe the complaint in the light most favorable to the plaintiff, and determine whether, under any reasonable reading of the pleadings, the plaintiff may be entitled to relief." *Colburn v. Upper Darby Twp.*, 838 F.2d 663, 665-66 (3d Cir. 1988) (citations omitted), *cert. denied*, 489 U.S. 1065 (1989); *see Rocks v. City of Philadelphia*, 868 F.2d 644, 645 (3d Cir. 1989). The Court must decide whether "relief could be granted on any set of facts which could be proved." *Ransom v. Marrazzo*, 848 F.2d 398, 401 (3d Cir. 1988). A motion to dismiss may be granted only "if it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957).

III. DISCUSSION

A. Contract Recision (Counts I-III)[3]

Counts I, II and III are claims for recision against all Defendants. Compl. ¶¶ 79-99. In Pennsylvania, recision is available in cases of fraud or material breach. *See e.g. Baker v. Cambridge Chase, Inc.*, 725 A.2d 757 (Pa. Super. 1999). Defendants argue that the Court should dismiss the

[3] Defendants also argue that the Court should dismiss the recision claims based on the election of remedies doctrine, which prevents a plaintiff from recovering under two inconsistent remedies. *Wedgewood Diner, Inc. v. Good*, 534 A.2d 537, 538 (Pa. Super. 1987). The Court disagrees with Defendants' point. Plaintiffs are allowed to plead alternative theories of relief under FED. R. CIV. P. 8.

recision claims because Plaintiffs have failed to state a claim for fraud. RAIT Mem. at 23; Brandywine Mem. at 18-19. However, the Court finds that Plaintiffs have stated a valid claim, for which contract recision is an appropriate remedy. The Complaint contains the prima facie elements for fraud, which are: (1) a misrepresentation, (2) a fraudulent utterance of it, (3) the maker's intent that the recipient be induced to act, (4) the recipient's justifiable reliance on the misrepresentation, and (5) damage to the recipient proximately caused by the alleged fraud. *Sevin v. Kelshaw*, 611 A.2d 1232, 1236 (Pa. Super. 1992). Plaintiffs have pled, *inter alia*, that the Defendants knew about the alleged flaws in the property and misrepresented those flaws to Plaintiffs. Compl. ¶¶ 22-26, 30-31, 42-52. Furthermore, the RAIT Defendants misrepresented the rental stream and occupancy of the property. Compl. ¶¶ 65-71. Plaintiffs contend that these misrepresentations induced them into contracting with Defendants for the sale of the Property and that they lost money as a result of the transaction. Compl. ¶¶ 75-77, 81-82. These facts are sufficient to plead fraud in Pennsylvania, and if true, entitle Plaintiffs' to the remedy of recision.

Plaintiffs have also sufficiently pled the elements for material breach. A cause of action for breach of contract is established by pleading: (1) the existence of a contract, (2) a breach of a duty imposed by the contract and (3) resultant damages. *Corestates Bank, N.A. v. Cutillo*, 723 A.2d 1053, 1058 (Pa. Super. 1999). In the Complaint, Plaintiffs contend that the Defendants breached the Purchase and Sale Agreement by failing to replace the doors and roof of the Property as agreed. Compl. ¶¶ 86-87. As a result, Plaintiffs may be entitled to recision. Defendants' Motion is denied.

B. Fraud (Count IV)

Count IV is a tort claim for fraud against the RAIT Defendants and the Brandywine Defendants. Compl. ¶¶ 89-90. As stated above, this Court finds that Plaintiffs have stated a valid

claim for fraud.[4] The RAIT Defendants raise many issues as to the sufficiency of the fraud claims. Defendants reason that the Plaintiffs' claims are essentially contract actions, and consequently should not survive a motion to dismiss pursuant to the gist of the action doctrine, the economic loss doctrine and the parol evidence rule. Therefore, this Court must determine whether Plaintiffs state an independent fraud claim based on the actions of the RAIT and Brandywine Defendants.

1. Gist of the Action Doctrine

Initially, Defendants argue that the fraud claim asserted in Count IV should be dismissed pursuant to the gist of the action doctrine as it does nothing more than set forth a breach of contract claim. RAIT Mem. at 11-16; Brandywine Mem. at 10-14. The gist of the action doctrine bars claims for allegedly tortious conduct where the gist of the conduct alleged sounds in contract rather than tort. *See Quorum Health Resources, Inc. v. Carbon-Schuylkill Community Hosp., Inc.*, 49 F. Supp. 2d 430, 432 (E.D. Pa. 1999); *see also Sunquest Info. Sys., Inc. v. Dean Witter Reynolds, Inc.*, 40 F. Supp. 2d 644, 651 (W.D. Pa. 1999). The doctrine precludes a tort claim that essentially duplicates a breach of contract claim where the success of which is wholly dependent on the terms of a contract. *See Sunquest*, 40 F. Supp. 2d at 651 (citations omitted). The doctrine does not apply if the tortious conduct is collateral to contract. *See Quorum*, 49 F. Supp. 2d at 432; *Sunquest*, 40 F. Supp. 2d at 651.

The Court finds that the gist of the action doctrine does not bar Plaintiffs' claims. In Pennsylvania, fraud in the inducement of a contract is not covered by the doctrine because fraud to

[4] One of the arguments set forth by the RAIT Defendants is that the Court should dismiss the fraud claim due to a failure to plead justifiable reliance, which is an element of fraud. RAIT Mem. at 16-22. The Court rejects the RAIT Defendants' argument for the same reasons stated above. Plaintiffs have sufficiently plead justifiable reliance because they relied on the representations of Defendants when executing the agreements at issue in this case. *See* Compl. ¶¶ 81-82. Defendants' Motion here is denied.

induce a person to enter into a contract is generally collateral to the terms of the actual terms of contract. *Etoll, Inc. v. Elias/Savion Adver.*, 811 A.2d 10, 17 (Pa. Super. 2002) (citations omitted). Pennsylvania courts distinguish fraud within the performance of a contract, from fraud to induce a party to enter a contract. *Id.* Here, Plaintiffs claim that they would not have contracted with Defendants "had [they] known the true facts." Compl. ¶¶ 81-82. These representations related to alleged flaws in the property (Compl. ¶¶ 22-26, 30-31, 42-52) and the rental stream and occupancy of the property (Compl. ¶¶ 65-71). If true, these representations could sustain an independent action for fraud.

2. Economic Loss Doctrine

Similarly, the economic loss doctrine also does not support Defendants' Motion to Dismiss Plaintiffs' fraud claim. The economic loss doctrine precludes recovery of economic losses in tort by a plaintiff whose entitlement to such recovery "flows only from a contract." *Duquesne Light Co. v. Westinghouse Electric Corp.*, 66 F.3d 604 at 618; *Factory Mkt. v. Schuller Int'l*, 987 F. Supp. 387, 395 (E.D. Pa. 1997). The doctrine recognizes that tort law "is not intended to compensate parties for losses suffered as a result of a breach of duties assumed only by agreement." *Factory Mkt.*, 987 F. Supp. at 395-96 (quoting *Palco Linings, Inc. v. Pavex, Inc.*, 755 F. Supp. 1269, 1271 (M.D. Pa. 1990)). The doctrine precludes recovery of damages in tort which "were in the contemplation of the parties at the origination of the agreement." *Id.* at 396 (quoting *Auger v. Stouffer Corp.*, 1993 U.S. Dist. LEXIS 12719, at *3 (E.D. Pa. 1993)). From the face of the pleadings, the Court concludes that the fraud Plaintiffs allege is not based on the duties assumed in performing the contract, but based on the representations Defendants made before the parties formed the contract. Therefore, the economic loss doctrine cannot support Defendant Motion to Dismiss.

3. Parol Evidence Rule

Lastly, the parol evidence rule does not bar Plaintiffs' claim. Pennsylvania law prohibits the use of any such prior or contemporaneous representations concerning a matter specifically dealt with in a written integrated agreement to prove a claim alleging fraud in the inducement. *See Coram Healthcare Corp. v. Aetna U.S. Healthcare Inc.*, 94 F. Supp. 2d 589 (E.D. Pa. 1999) (citations omitted). The purpose of the parol evidence rule is ". . . to preserve the integrity of written agreements by refusing to permit the contracting parties to attempt to alter the import of their contract through the use of contemporaneous [or prior] oral declarations." *Le Donne v. Kessler*, 389 A. 2d 1123, 1126-27 (Pa. Super. 1978) (quoting *Rose v. Food Fair Stores, Inc.*, 262 A.2d 851, 853 (1970)). "Where parties... have deliberately put their engagements in writing, the law declares the writing to be... the only, evidence of their agreement." *Id.* (quoting *Gianni v. Russell & Co.*, 126 A. 791, 792 (1924)). An exception exists if the representations were fraudulently omitted from the contract. *Dayhoff Inc. v. H.J. Heinz Co.*, 86 F.3d 1287, 1300 (3d Cir. 1996).

Upon examining the submissions of the parties, it is clear that the Agreement was integrated. Thus the parol evidence rule should bar this Court from considering any evidence that affects the integrity of the written agreement unless a party demonstrates the existence of representations fraudulently omitted from the contract. Plaintiffs have alleged that Defendants failed to disclose material facts regarding the Property prior to entering into the Agreement. The Court finds that the Complaint, viewed in the light most favorable to Plaintiffs, sufficiently alleges that Defendants fraudulently omitted material facts from the Agreement. Defendants' Motion is therefore denied.

C. Specific Performance (Counts VI - VIII)

The RAIT Defendants argue that counts VI-VIII are not ripe for adjudication because they

are contingent upon a default of the Third Mortgage, which has yet to occur. RAIT Mem. at 25. The Court disagrees. Claims VI-VII arise out of the alleged fraud in the other counts. *See* Compl. ¶¶ 95, 100, 102; Pl.'s Mem. at 36. Plaintiffs allege that Defendants' acts of fraud constitute default and that they are entitled to enforce the provisions of the Agreement. Pl.'s Mem. at 36. This is enough to create a ripe claim under Article III of the United States Constitution. Defendants' Motion is Denied.

D. Conspiracy (Count IX)

In Count IX, Plaintiffs plead civil conspiracy against the RAIT Defendants. Compl. ¶¶ 107-109. Defendants argue that the intra-corporate conspiracy doctrine should bar this claim because of the agency relationship between the RAIT Defendants and the Brandywine Defendants. *See* RAIT Mem. at 23-25.; Brandywine Mem. at 20-21. According to the intra-corporate conspiracy doctrine, a corporation cannot conspire with itself or with its agents when those agents are acting on behalf of the corporation. *Gen. Refractories Co. v. Fireman's Fund Ins. Co.*, 337 F. 3d 297, 313 (3d Cir. 2003). An exception to the intra-corporate conspiracy doctrine may exist if the agents are acting in a personal capacity and outside the scope of their authority. *Heffernan v. Hunter*, 189 F.3d 405 (3d Cir. 1999). Plaintiffs contend that the conspiracy claim should survive because the corporate Defendants in this case are all separate entities not acting in the interests of the other organizations. *See* Compl. ¶¶ 4, 6-7, 9; Pl.'s Mem. at 32-33 . Alternatively, Plaintiffs reason that the exception to the doctrine should apply because the Defendants "personally benefitted from their actions." Pl.'s Mem. at 33. This Court disagrees.

The Court finds that intra-corporate conspiracy doctrine bars recovery in this case. The face of the Complaint makes it clear that there is an agency relationship between all of the RAIT and

Brandywine Defendants. Berman is an agent of Brandywine (Compl. ¶ 11), Brandywine was "an agent of, and acted on behalf of, [RAIT Investment] Trust, [RAIT] Partnership and...[RAIT General] Corporation" and manages "only properties...owned ...by [RAIT] Trust" (Compl. ¶ 9), and the RAIT Defendants all have common ownership (Compl. ¶ 10). Furthermore, Plaintiffs have not pled any facts to support their conclusion that any of the Defendants were acting outside the scope of their authority or for personal benefit. Defendants' Motions to dismiss are granted as to Plaintiffs' conspiracy claim.

E. Punitive Damages and Attorneys' Fees

Punitive damages are available for fraud and the Court will not dismiss those claims at this time. *See e.g. Delahanty v. First Pa. Bank, N.A.*, 464 A.2d 1243 (Pa. Super. 1983). With respect to the claims for attorneys' fees, the Court finds that the plain language of the attorneys fees provision in the Purchase Agreement, which covers "any dispute between the parties" does include claims for contract and tort. *See* Compl. Ex. C. Defendants' Motions here are denied.

F. Defendants Fannie Mae and Capri as Necessary Parties

The Court will grant Defendants Fannie Mae and Capri's Motion to dismiss because they are not necessary parties. Plaintiffs claim that Fannie Mae and Capri are necessary parties under FED R. CIV. P. 19(a)[5] and 20(a)[6] because Plaintiffs are "*essentially* seeking to quiet title to the Property"

[5] FED R. CIV. P. 19(a) states that "[a] person...shall be joined as a party in the action if (1) in the person's absence complete relief cannot be accorded among those already parties, or (2) the person claims an interest relating to the subject of the action and is so situated that the disposition of the action in the person's absence may (i) as a practical matter impair or impede the person's ability to protect that interest or (ii) leave any of the persons already parties subject to a substantial risk of incurring double, multiple, or otherwise inconsistent obligations by reason of the claimed interest."

[6] FED R. CIV. P. 20(a) states that "[a]ll persons...may be joined in one action as defendants if there is asserted against them...any right to relief in respect of or arising out of the same transaction, occurrence, or series of transactions or occurrences and if any question of law or fact common to all defendants will arise in the action."

and therefore "as a matter of law, Fannie Mae...and Capri are proper and necessary parties." Pl.'s Mem. at 5 (emphasis added). The Court disagrees. This is not an action to quiet title to the Property. Plaintiffs seek to rescind the Agreement they entered with the RAIT Defendants and the Brandywine Defendants. The terms of the Mortgage are not in dispute. Defendants' Motion is granted and the claims against Fannie Mae and Capri are dismissed.

CONCLUSION

For the reasons stated above, this Court will, deny the RAIT and Brandywine Defendants' Motions to Dismiss Counts I, II and III of Plaintiffs' Complaint, deny the RAIT and Brandywine Defendants' Motions to Dismiss Count IV of Plaintiffs' Complaint, deny the RAIT and Brandywine Defendants' Motions to Dismiss Counts VI, VII and VIII of Plaintiffs' Complaint, and deny Defendants' Motions to Dismiss Plaintiffs' claims for punitive damages and attorneys' fees. The Court will grant the RAIT and Brandywine Defendants' Motions to Dismiss Count IX of Plaintiffs' Complaint and grant Defendants Fannie Mae and Capri's Motion to Dismiss. An appropriate order follows.

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v.	:	**NO. 04-3821**
RAIT PARTNERSHIP, L.P., et al., Defendants.	:	

ORDER

AND NOW, on this 27th day of September, 2005, upon consideration of Defendants' Motions to Dismiss (Docs. 4,5 and 9), Plaintiffs' Memoranda in Opposition (Docs. 8 and 13), Defendants' Replys (Docs .14,15, 17, 19 and 23) and Plaintiffs' Surreply (Doc. 21) **IT IS HEREBY ORDERED** that:

1. The RAIT and Brandywine Defendants' Motions to Dismiss Counts I, II and III of Plaintiffs' Complaint are **DENIED**;

2. The RAIT and Brandywine Defendants' Motions to Dismiss Count IV of Plaintiffs' Complaint are **DENIED;**

3.The RAIT and Brandywine Defendants' Motions to Dismiss Counts VI, VII and VIII of Plaintiffs' Complaint are **DENIED;**

4.The RAIT and Brandywine Defendants' Motions to Dismiss Count IX of Plaintiffs' Complaint are **GRANTED**;

5. Defendants' Motions to Dismiss Plaintiffs' claims for punitive damages and attorneys' fees are **DENIED;**

6. Defendants Fannie Mae and Capri's Motion to Dismiss is **GRANTED** .

IT IS FURTHER ORDERED that the RAIT Defendants and the Brandywine Defendants shall file an Answer to Plaintiffs' Complaint within twenty (20) days of the date of this Order.

BY THE COURT:

/S/ Petrese B. Tucker

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Hon. Petrese B. Tucker, U.S.D.J.