IN THE COURT OF COMMON PLEAS OF PHILADELPHIA COUNTY
FIRST JUDICIAL DISTRICT OF PENNSYLVANIA
TRIAL DIVISION-CIVIL

DOCKETED
OCT 28 2013
C. HART
CIVIL ADMINISTRATION

THOMAS and LINDA KNOX, h/w, Plaintiffs,	:	April Term 2013
v.	:	No. 3906
1701 JFK RESTAURANT, LP, 1701 JFK RESTAURANT, GP, LLC and CHRIS A. SCARDUZIO,	:	COMMERCE PROGRAM
Defendants.	:	Control Number 13070080

ORDER

AND NOW, this 28TH day of October 2013, upon consideration of Defendants 1701 JFK Restaurant, LP, JFK Restaurant, GP, LLC and Chris A. Scarduzio's Preliminary Objections and Plaintiffs' response in opposition, it hereby is **ORDERED** that the Preliminary Objections are **Sustained** as follows:

1. Counts I (breach of contract), II (fraudulent inducement), III (equitable rescission) V (injunctive relief), and VI (violation of Pennsylvania Securities Act) are dismissed.
2. Count VII (breach of fiduciary duty) is dismissed and Plaintiffs are granted leave to amend Count VII, only, within twenty (20) days of this order to allege, if possible, any harm suffered by plaintiffs as a result of the alleged breach of fiduciary duty.

The preliminary objections to Counts IV (equitable accounting) and VIII (judicial dissolution and accounting) are **Overruled**.

Knox Etal Vs 1701 Jfk R-ORDOP

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BY THE COURT:

JOHN W. HERRON, J.

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OPINION

This action arises from Plaintiffs Thomas and Linda Knox's ("Plaintiffs") investment in 1701 JFK Restaurant LP which owns Scarduzio's Table 31 Italian Steakhouse, an upscale restaurant in the Comcast Center, Philadelphia, Pa. Defendant 1701 JFK Restaurant LP ("Limited Partnership") is a Pennsylvania limited partnership formed on September 29, 2005 for the purpose of making an offering to accredited individuals for a limited partnership interest in a high-end gourmet restaurant known as "Table 31". Defendant 1701 JFK Restaurant GP, LLC ("General Partnership") is the General Partner of the Limited Partnership. Defendant Chris Scarduzio ("Scarduzio") is the principal of the General Partnership as well as a limited partner.

The Limited Partnership was comprised of general partners with a 1% initial percentage interest and Class A and Class B shares. The principals of the general partner and owners of the limited partnerships Class B shares were chefs and restaurateurs Georges Perrier and Chris Scarduzio.

In late 2007, Scarduzio began marketing a new restaurant concept known as "Table 31" which was described as a "redefined steakhouse Bistro" to be located in the Comcast Center. In April 2008, the Limited Partnership approached plaintiffs with an opportunity to invest in the Table 31 project and were provided with information regarding the offering.

On April 22, 2008, plaintiffs met with Scarduzio and the Limited Partnership's Chief Financial Officer ("CFO") to discuss the terms of the potential investment. Plaintiffs understood they were being offered Class A shares based upon their status as "Accredited Investors", that their shares would be non-transferable and that the shares would not be registered under the Securities Act of 1933 based upon an exemption.

Plaintiffs were allegedly assured the Limited Partnership complied with all Securities and Exchange reporting requirements in making the offer. In addition to a percentage of ownership interest in the Limited Partnership, plaintiffs allege Scarduzio and the CFO guaranteed a 50% discount on all of their food and beverage purchases at Table 31.

Plaintiffs allegedly invested $250,000 in the Limited Partnership in exchange for Class A Partnership shares consistent with the amount of their investment. The investment was accepted and the subscription became effective. The Subscription Agreement was executed by plaintiffs and accepted by the Limited Partnership on April 29, 2008. Pursuant to the terms of the Subscription Agreement, plaintiffs agreed to be bound by all the terms and provisions of the Limited Partnership Agreement.[1] The Subscription Agreement and the Limited Partnership Agreement did not include any mention of the 50% discount on food and beverage. The Subscription Agreement and the Limited Partnership Agreement are fully integrated agreements.[2]

At the time of the investment, plaintiffs were one of twelve investors contributing to a total investment of $4,000,000 in the Table 31 project. From 2008 to 2010, plaintiffs allegedly received a 50% discount on food and beverage. In 2010, the 50% discount on the food and

[1] Subscription Agreement ¶ 3.

[2] Subscription Agreement ¶ 8 (h); Limited Partnership Agreement ¶ 12.12.

beverage purchased was allegedly discontinued without explanation despite plaintiffs' repeated requests that it be reinstated.

Table 31 allegedly operated at a net loss in 2008, 2009, 2010 and 2011. The Limited Partnership advised plaintiffs and the other investors that it was taking certain cost saving measures, such as elimination of chef positions, reallocation of restaurant staff for greater efficiency and renegotiations on the lease agreement. During this time, the Limited Partnership continued to make annual guaranteed payments of $190,000 to Scarduzio and provided him other benefits such as $600 monthly car allowance and family health insurance.

In 2009 and 2010, two of the Limited Partnership's Class A investors, Bernie Spain and Herb Lotman advanced the Limited Partnership in excess of $1 million to assist with Table 31's operating needs as the Limited Partnership continued to operate at a loss. In July 2010, the Limited Partnership faced with additional need for working capital made a capital call asking plaintiffs along with other Class A investors to make supplemental equity contributions equal to 15% of their initial investment within four days. Plaintiffs' call contribution was for an additional equity contribution of $37,000.

In January 2011, the Limited Partnership was still in need of working capital and proposed amending the limited partnership agreement to convert more than $1 million in advances by other investors, Spain and Lotman, into capital contributions and to issue an additional partnership interest to a new investor in exchange for an additional $636,000 capital contribution. The amended agreement further proposed converting the Class A and B investor categories into a single investor share thus eliminating the Class A investor's priority return as originally set forth in section 5.01 of the Limited Partnership Agreement.

Plaintiffs allegedly refused to sign the amended documentation for the amended partnership agreement without assurances from the Limited Partnership that the 50% discount on food and beverage would be reinstated.

On January 25, 2011, the CFO wrote to plaintiffs to assure them that the 50% discount would be applied to all "Food and Beverage" charges going forward. In 2012, the food and beverage discount was discontinued without explanation or basis.

Plaintiffs further allege that they discovered that contrary to the representations made by the CFO and Scarduzio, the Limited Partnership failed to comply with the Securities and Exchange Commission's rules and regulations in making its offerings to the various limited partner investors including plaintiffs.

In April 2013, plaintiffs filed the instant complaint alleging claims for breach of contract, fraudulent inducement, violations of the Federal and State Securities Laws and breach of fiduciary duty. Plaintiffs seek as remedies injunctive relief, rescission, accounting and judicial dissolution of the Limited Partnership. Presently pending before the court are defendants' preliminary objections.

DISCUSSION

I. Plaintiffs' claim for breach of contract is barred by the parol evidence rule.

In count I of the complaint, plaintiffs purport to state a claim for breach of contract. Specifically, plaintiffs allege pursuant to the terms of their investment agreement, the defendants agreed plaintiffs would at all times receive a 50% discount on all food and beverage purchases they made at the Table 31 Restaurant. Despite the defendants' assurances, plaintiffs allege the defendants breached plaintiffs' investment agreement by failing to provide plaintiffs with the discount.[3] Plaintiffs' claim for breach of contract is barred by the parol evidence rule.

The parol evidence rule provides that where the parties, without any fraud or mistake, have deliberately put their agreements in writing, the law declares the writing to be not only the best, but the only evidence of their agreement. All preliminary negotiations, conversations and verbal agreements are merged in and superseded by the subsequent written contract. Unless fraud, accident or mistake is averred, the writing constitutes the agreement between the parties, and its terms cannot be added to nor subtracted from by parol evidence.[4]

Parol evidence is excludable where there is a writing that represents the parties' entire contract. Whether there exists such a writing is determined by assessing if the writing appears to be a contract complete in itself, importing a complete legal obligation without any uncertainty as to the object or extent of the parties agreement. An integration clause that states that the writing is meant to represent the parties' entire agreement is a clear sign that the writing is meant to be complete and thereby expresses all of the parties' negotiations, conversations and agreements made prior to its execution.[5]

There are exceptions to the parol evidence rule. Parol evidence may be introduced to vary a writing meant to be the parties' entire contract when the court finds that the contract is ambiguous or that a term was omitted from the contract because of fraud, accident or mistake. As it pertains to the fraud exception, parol evidence is permitted when fraud in the execution is found to have occurred, i.e. a term was fraudulently omitted from the contract. The parol

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[3] Complaint ¶¶ 43, 45.

[4] *Yocca v. Pittsburgh Steelers Sports, Inc.*, 578 Pa. 479, 854 A.2d 425, 436 (2004), quoting *Gianni v. Russel & Co.*, 281 Pa. 320, 126 A. 791 (1924).

[5] *Id.*

evidence rule also does not prohibit evidence of a subsequent modification of the parties' contract by writings, words or conduct which post-date the written agreement.[6] However, when fraud in the inducement of a contract is alleged, i.e. where an opposing party made false representations that induced the complaining party to agree to the contract, parol evidence is not permitted.[7]

In the case at bar, the investment agreement at issue herein, the Subscription Agreement, has an integration clause which provides as follows:

> "This Agreement contains the entire agreement and understanding of the parties with respect to the subject matter hereof. Any and all prior and contemporaneous discussions, negotiations, commitments, understandings, representations and warranties relating to the transactions contemplated herein are hereby superseded in all respects by this Agreement."[8]

The other investment agreements, the Limited Partnership Agreement and the Amended Limited Partnership Agreement, also have integration clauses which provide:

> "This Agreement contains the entire understanding of the parties hereto with respect to the subject matter hereof, and supersedes all prior and contemporaneous agreements and understanding, except as herein contained."[9]

Plaintiffs' allege that the 50% discount on food and beverage purchases made at Table 31 is a material term of the agreement. Yet, this term is absent from the Subscription Agreement as well as the Limited Partnership Agreement and the Amended Partnership Agreement. Since the Subscription Agreement, Limited Partnership Agreement and the Amended Partnership Agreement are fully integrated agreements, plaintiffs claim for breach of contract based on the

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[6] *Iron Workers Savings and Loan Association v. IWS, Inc.*, 424 Pa. Super. 255, 269, 622 A.2d 367, 374 (1993); *House of Pasta, Inc. v. Mayo*, 303 Pa. Super. 298, 312, 449 A.2d 697, 704 (1982).

[7] *Yocca*, supra.

[8] See ¶ 8 (h) of the Subscription Agreement.

[9] Limited Partnership Agreement ¶. 12.12 and Amended Limited Partnership Agreement p. 12.12.

absent term for a 50% discount for food and beverage is barred by the parol evidence rule. Consequently, count I for breach of contract is dismissed.[10]

II. The Parol Evidence rule bars plaintiffs' claim for fraud in the inducement.

In count II of the complaint, plaintiffs purport to state a claim for fraudulent inducement based upon the 50% discount on food and beverage purchases and compliance with the Security and Exchange Commission ("SEC") reporting requirements. As will be discussed below, the parol evidence rules bars plaintiffs' claims for fraud in the inducement.

As it pertains to the 50% discount, plaintiffs do not allege that the 50% discount was fraudulently omitted from the investment agreement. Rather, plaintiffs allege the discount was a material term of the agreement which fraudulently induced plaintiffs to make the investment. As discussed supra, the 50% discount on food and beverage purchases is not a term of the investment agreement and therefore constitutes parol evidence. Introduction of parol evidence is not permitted where, as here, plaintiffs allege they were fraudulently induced to enter into a contract.[11] Acknowledging the existence of a 50% discount on all food and beverage at Table 31 in the circumstances alleged here would compromise the parol evidence rule.[12] Accordingly, defendants' preliminary objection to the 50% discount in count II is sustained.

The fraud claim relating to compliance with SEC reporting requirements also fails. Count II of the complaint alleges defendants assured plaintiffs that the Limited Partnership had

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[10] Count I solely alleges a claim for breach of contract for the 50% discount on food and beverage. Plaintiffs attempt to argue that the 50% discount is an independent contract. The court is not persuaded. The complaint fails to allege any facts to support the existence of an independent contract. At best, the only reasonable inference that may be made from the allegations of the complaint is that the 50% discount is a gratuitous offering which is unenforceable.

[11] See, *Toy v. Metropolitan Life Insurance Compny*, 593 Pa. 20, 53, 928 A.2d 186, 207 (2007). See generally, *Yocca v. Pittsburgh Steelers Sports, Inc.*, 578 Pa. 479, 854 A.2d 425 (2004).

[12] *HCB Contractors v. Liberty Place Hotel Associates*, 539 Pa. 395, 652 A.2d 1278 (1995).

not filed and did not intend to file a Form D notice of sale of securities.[13] The Subscription Agreement specifically provides as follows:

> "THE SECURITIES ACQUIRED PURSUANT TO THIS SUBSCRIPTION AGREEMENT HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMNEDED ("1933 Act") IN RELIANCE UPON AN EXEMPTION FROM THE REGISTRATION WITH ANY STATE SECURITIES COMMISSION....THE AGREEMENT, ACKNOWLEGEMENTS, REPRESENTATIONS AND WARRANTIES MADE HEREIN WILL BE RELIED UPON BY 1701 JFK RESTAURANT, LP IN COMPLYING WITH ITS OBLIGATIONS UNDER APPLICALBE FEDERAL AND STATE SECURITIES LAWS."

Since the Subscription Agreement contains representations claiming an exemption from compliance with Securities Law, a claim for fraudulent inducement does not exist and is barred by the parol evidence rule. At best, any failure to comply with the Securities Law constitutes a claim for breach of contract, which has not been pled. As such defendants' preliminary objection to count II is sustained.[14]

III. Count V of the complaint seeking injunctive relief is dismissed.

In count V of the complaint captioned Injunctive Relief (violation of 17 CFR 230.500 et. seq.) plaintiffs seek an order disqualifying defendants from making future offerings under the rules. Disqualification, however, is expressly reserved for the Security Exchange Commission ("SEC") and therefore is not a proper remedy for this court to impose.

Title 17 C.F. R. § 230.507 (a), which plaintiffs rely upon to support their claim for relief, will disqualify any issuer found to have violated the Form D filing requirement from future use of Regulation D. Disqualification under Rule 507, however, arises only where the SEC has

[13] Complaint p. 50.

[14] Since the counts for breach of contract and fraud in the inducement are dismissed, the remedy for said claims, equitable rescission, is also dismissed.

sought and obtained a court order, judgment, or decree that temporarily, preliminarily or permanently enjoins a person for the violation.[15] In the case at hand, the complaint fails to allege the existence of an order for disqualification sought and obtained by the SEC. As such, this court finds it lacks authority to impose such a remedy. Consequently, defendants' preliminary objection to count V is sustained.

IV. Count VI alleging violations of the Pennsylvania Securities Act is Improper since the securities at issue are federally covered securities.

In count VI of the complaint, plaintiffs allege an alternative claim pursuant to the Pennsylvania Securities Act. Defendants argue the securities at issue herein are "federal covered securities" and therefore exempt from state reporting requirements. As will be discussed below, this court finds that the securities at issue here are "federal covered securities' and therefore exempt from Pennsylvania reporting requirements set forth within the Pennsylvania Securities Act.

Specifically, plaintiffs allege the following:

> 79. In the event the securities offered to Plaintiffs are not "federally covered" securities, Defendants then violated the Pennsylvania Securities Act ("PSA") by failing to register same under the PSA and otherwise filing (sic) to provide Plaintiffs with the required written notice pursuant to the provisions of the PSA, 70 P.S. section 1-201, et. Seq.
>
> 80. Upon information and belief, Defendants failed to properly register the securities offered to Plaintiffs under the PSA.
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> 81. Defendants further failed to provide Plaintiffs with the mandated notices pursuant to 70 P.S. §1-207 and 10 Pa. Code § 207.130, which requires offerors of securities to provide the written notices in order to qualify for registration exemption under the PSA.

[15] See 7A Exempted Trans. Under Securities Act 1933 section 7.24.

> 82. By failing to register the securities, and by failing to provide the mandated notices to Plaintiffs necessary to qualify the securities as exempted from registration of the PSA, Defendants violated 70 P.S. §1-201 by offering and selling non-exempted securities without registering same.
>
> 83. As a direct and proximate result of Defendants' violation of the PSA, Defendants are strictly liable to Plaintiffs for the "consideration paid for the securities, together with interest at the legal rate from the date the payment." 70 P.S. § 1-501.

State law registration requirements are preempted where the security is a "federal covered security".[16] To be considered a "federal covered security" and therefore exempt from the Pennsylvania Securities Law registration requirements, the offer and sale of the security at issue must first satisfy three general conditions of 230.502.[17]

The first condition, Rule 502 (a) deals with integration of later offerings. In the case at hand, the complaint alleges the existence of a second offering three years after the 2008 offering, however, that transaction is not at issue since plaintiffs took their interest during the 2008 offering. Although the offerings are separate they are integrated since plaintiffs received their interest at the first offering, received the same class of securities, the shares were issued for the same general purpose and the same type of consideration was received.[18] Based on the foregoing, the offering is considered integrated for purposes of rule 502 (a).

The second condition, 502 (b), outlines informational requirements that must be satisfied when a security is sold to someone other than an "accredited investor". An "accredited investor" refers to "any natural person whose individual net worth, or joint net worth with that person's

[16] *In re Ressler Hardwoods and Flooring, Inc.*, 2009 WL 975155 (M.D. Pa. 2009).

[17] See, 17 C.F.R. 230.506. Rule 506 also requires the condition of 17 C.F.R 230.501 to be satisfied. However aside from the definition of "accredited investor", the provision is not relevant.

[18] See § 230.502 (a) Note.

spouse, at that time of his purchase exceeds \$1,000,000."[19] Plaintiffs represented in the Subscription Agreement attached to the complaint that they met this threshold and thus are "accredited investors".

Finally, Rule 502 (c) prohibits a "covered security" from being offered through "general solicitation or general advertising." The securities at issue herein were not offered through general solicitation or general advertising, but were offered directly to plaintiffs.[20] Based on the foregoing, the general conditions set forth in 506 are satisfied.

The next step is to determine if the specific conditions of Rule 506 are satisfied. The specific conditions set forth in Rule 506 (b)(2)(i) and (ii) limit the number of purchasers to thirty-five and require certain information be given if the investor is not an accredited investor. These conditions are also satisfied. There were twelve purchasers in the initial offering and plaintiffs were accredited investors.

Since the general and specific conditions of 506 are satisfied, the securities at issue herein are "federal covered securities" and therefore exempted from the Pennsylvania Securities Law registration requirements. As such defendants' preliminary objections are sustained and count VI is dismissed.

V. Count VII for breach of fiduciary duty is dismissed for lack of factual specificity.

In count VII of the complaint plaintiffs purport to state a claim for breach of fiduciary duty. Plaintiffs allege defendants owed plaintiffs a fiduciary duty and breached that duty by failing to file the requisite Form D notice of sales and amended Form D notice of sales as required by the Securities and Exchange Commission's regulations. Plaintiffs allege they are harmed by the failure to file the Form D notice of sale since the Limited Partnership will be

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[19] 17 C.F.R. § 230.501 (a)(5).

[20] Complaint ¶ 16.

precluded from raising additional capital contributions in the future. For the reasons set forth below, plaintiffs' claim for breach of fiduciary duty is dismissed.

The test for surviving a demurrer is "whether it is clear and free from doubt from the facts pleaded that the pleader will be unable to prove facts legally sufficient to establish his right of relief."[21] All plaintiffs have to do is to plead facts that, if true, would be legally sufficient to gain them relief.

Here, although plaintiffs allege harm, albeit equivocal harm to the Limited Partnership, plaintiffs fail to allege any harm they suffered as a result of defendants' failure to file a Form D notice of sale. Based on the foregoing, defendants' preliminary objection is sustained and the claim for breach of fiduciary duty is dismissed. Plaintiffs are granted leave to amend count VII within twenty (20) to allege, if possible, any harm suffered by plaintiffs.

CONCLUSION

Based on the foregoing, Defendants' preliminary objections are sustained as follows: Counts I (breach of contract), II (fraudulent inducement), III (equitable rescission), V (injunctive relief), and VI (violation of Pennsylvania Securities Act) are dismissed. Count VII (breach of fiduciary duty) is dismissed and Plaintiffs are granted leave to amend Count VII only within twenty (20) days of this order to allege, if possible, any harm suffered by plaintiffs as a result of the alleged breach of fiduciary duty.

The preliminary objections to Counts IV (equitable accounting) and VIII (judicial dissolution and accounting) are Overruled.

[21] *Pennfield Corp. v. Meadow Valley Elec., Inc.*, 413 Pa. Super. 187, 201-02, 604 A.2d 1082, 1089 (1992).

Dated: October 28, 2013

BY THE COURT:

JOHN W. HERRON, J.