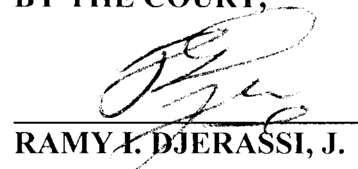
IN THE COURT OF COMMON PLEAS OF PHILADELPHIA COUNTY
FIRST JUDICIAL DISTRICT OF PENNSYLVANIA
TRIAL DIVISION-CIVIL

EDWARD H. ARNOLD and JEANNE D. ARNOLD,	:	December Term 2010
Plaintiff,	:	No. 1099
v.	:	
CHENERY MANAGEMENT, INC. et. al.,	:	Commerce Program
Defendants.	:	Control Number 16030676

ORDER

AND NOW, this 22nd day of August 2016, upon consideration of Defendant Grant Thornton LLP's Motion for Judgment on the Pleadings, Plaintiffs' response in opposition, and the Memorandum Opinion attached hereto, it hereby is **ORDERED** that the Motion for Judgment on the Pleadings is **GRANTED** and judgment is entered in favor of Grant Thornton, LLP on all claims in Plaintiffs' Amended Complaint which is dismissed with prejudice.

BY THE COURT,



RAMY I. DJERASSI, J.

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OPINION

In this Opinion we explain the reasons why Judgment on the Pleadings is granted in favor of Defendant Grant Thornton, LLP ("Grant Thornton").

In 2001, plaintiffs Edward and Jeanne Arnold ("the Arnolds") decided to sell their family trucking business. In June, a friend of theirs introduced them to promoters from an on line company called *myCFO.com* for an introduction to what the financial industry calls "distressed debt strategy." The term "distressed debt" refers to debt instruments that are purchased at significant discounts compared to face value. The chief features of distressed debt strategy are:

1) entities organized and existing under the law of a foreign county contribute high-basis, low-value assets (distressed debt) to a newly created LLC in exchange for 99% of the LLC's equity;

2) a specially created LLC transfers original distressed debt to a second specially created LLC. When the first LLC does this, it receives a 99% equity share in the second LLC;

3) investor/buyers like the Arnolds then go ahead and buy a financial interest in the second LLC. By doing so, investor/buyers like the Arnolds purchase an indirect financial interest in the first LLC in a percentage amount corresponding to the dollar value held by the

second LLC. Investor/buyers like the Arnolds may then add funds from other entities which are not part of the first or second LLC's, and/or add their own money directly;

4) the first LLC then sells the high basis low-value assets (discounted distressed debt) on open financial markets and does so at fair market value. Next, investor/buyers like the Arnolds claim an IRS tax loss which reduces their own personal or corporate IRS capital gains exposure. This tax loss is valued at the difference between the face value of the distressed debt (but not the actual amount investor/buyers like the Arnolds paid) compared to the amount actually on the open market.

MyCFO.com was a leader in promoting and implementing this tax shelter for qualified investor/buyers. *MyCFO.com* contracted with other companies to deliver this financial attraction and one of these companies is defendant Grant Thornton.

Grant Thornton's role in *MyCFO.com*'s discounted distressed debt enterprise was to prepare partnership tax returns for the many specially created LLCs. In Arnolds' case, according to pleadings, these partnership tax returns were incorporated by the Arnolds in their own tax returns. Through K-1's, the Arnolds reported specially created losses and benefitted from capital gain losses that yielded tax savings.

On December 21, 2001, the Arnolds entered into a contract with *myCFO.com* for "investment and estate planning services". The contract was an Engagement Letter for consulting services relating to an investment in "distressed Asian securities". The contract explains the structure of the investment and how specifically created partnerships would trade the underlying debt. For the tax year 2001, the Arnolds signed and filed their federal and state tax returns implementing the *myCFO.com* distressed debt strategy.

From 2002 through December 17, 2008, dozens of individuals and entities, some of whom are defendants in this action, participated in creating similar tax shelters. Many persons, individuals and corporations, have been investigated, indicted and convicted for doing so after the IRS concluded the distressed debt strategy was fraudulent.

As for the Arnolds specifically, the IRS audited their 2001 federal tax returns and disallowed claimed capital losses produced through the distressed debt strategy. On December 21, 2006, the IRS issued a Notice of Final Partnership Administrative Adjustment to the Arnolds on these 2001 tax returns. On July 8, 2009, plaintiff Ed Arnold met with two IRS attorneys and was again advised that fraudulent conduct by defendants and others caused the disallowance.

On July 14, 2010, the Arnolds filed suit against defendants in the U.S. District Court for the Middle District of Pennsylvania. On December 13, 2010, the Arnolds filed a praecipe to transfer the action to this court. After transfer, on February 21, 2011, the Arnolds filed an Amended Complaint. One of the defendants, Kam & Reinemann, Inc., d/b/a Cogent Valuation ("Cogent Valuation") filed preliminary objections which were sustained on grounds of lack of personal jurisdiction in this Common of Pleas Court, Philadelphia.

The Arnolds then filed suit against Cogent Valuation in the Superior Court of California, County of San Francisco, *Arnold et. al. v. Kam & Reinemann, d/b/a Cogent Valuation et.al, et. al.*, CGC- 11-516774 under the same facts. On June 19, 2013, the California court granted summary judgment in favor of defendants based on statute of limitations. The court found the applicable run date was December 21, 2006, the day the Arnolds received the IRS's Notice of Final Partnership Adjustment on their 2001 tax return. The California court ultimately entered final judgment against the Arnolds on April 18, 2014 and there has been no appeal.

Meanwhile, in Philadelphia, this case has continued without Cogent Valuation. Grant Thornton and other defendants filed motions to compel arbitration which were denied, appealed and affirmed.

Presently before the court is Grant Thornton's motion for judgment on the pleadings.

DISCUSSION

I. The claim for breach of contract (Count IX) is dismissed against Grant Thornton based on the Arnolds' admissions.

In Count IX of the Amended Complaint, the Arnolds aver a claim for breach of contract.[1] Specifically, they claim they had contracts with defendants for professionally competent "legal, accounting, and tax advice and services, tax preparation services, and investment advice and services". The Arnolds state they performed their obligations under the contracts but defendants breached and caused damages. (Amended Complaint ¶¶ 150-152). As it pertains to Grant Thornton, the allegation is Grant Thornton prepared partnership tax returns and the Arnolds relied on them when preparing their own 2001 individual tax returns---and did so wrongfully. (Amended Complaint ¶ 152).

In order to state a claim for breach of contract, it is necessary to allege the following: (1) the existence of a contract, (2) a breach of a duty imposed by the contract, and (3) damages. While every element must be pled specifically, contractual agreements may be made orally, in writing, or by inference from conduct of the parties.[2] Here, breach of contract must be dismissed because the Arnolds' previously admitted in their response to Grant Thornton's petition to compel

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[1] The claim for breach of contract is plead as an alternative to Counts V recission and VI declaratory judgment. Grant Thornton also moved for judgment on the pleadings as to the recission claim. The Arnolds have voluntarily conceded the rescission claim as to Grant Thornton only. (Plaintiff's response in opposition to Grant Thornton's Motion for Judgment on the Pleadings, p. 14 fn 3.)

[2] *Sullivan v. Chartwell Inv. Partners, LP,* 873 A.2d 710, 716 (Pa.Super.2005) (citations and quotation marks omitted).

arbitration that their claims against Grant Thornton did not arise from any contract with Grant Thornton---or any other contracts the Arnolds had with any codefendants.

Specifically, the Arnolds' Corrected Opposition to Defendant Grant Thornton's Petition to Compel Arbitration repeated averments about their relationship with Grant Thornton. These averments repeated previous admssions made by the Arnolds in their reply to Defendant Grant Thronton's new matter. Specifically, the Arnolds have made the following admissions in filings as cited:

> 193. In their verified corrected opposition the Arnolds stated: "Admitted that Plaintiffs *do not allege contractual privity with Grant Thornton."* Exhibit B, ¶ 24. (Italics Added) (GT's Answer and New Matter ¶ 193).
>
> 194. The Arnolds also stated in their verified Corrected Opposition to Defendant Grant Thornton's Petition to Compel Arbitration that the "claims against Grant Thornton do not arise from any engagement agreement between Plaintiffs and any other Defendant, *but rather from Grant Thornton's direct participation in the negligent, fraudulent, and wrongful conduct that led to Plaintiffs' injuries."* Exhibit B, ¶ 6.(Italics added) (GT's Answer and New Matter ¶ 194).
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> 193. Admitted. By way of further response, "Plaintiffs have alleged *distinct* conduct on the part of Grant Thornton that give rise to the claims against Grant Thornton in this case." (Italics added)(Plaintiffs' Reply to Answer and New Matter ¶ 193).
>
> 194. Admitted. (Plaintiffs' Reply to New Matter ¶ 194).

"[I]t is fundamental contract law that one cannot be liable for a breach of contract unless one is a party to that contract."[3] Under this principle, Grant Thornton cannot be held liable to the Arnolds on a breach of contract claim absent a contract between them. The admissions made by the Arnolds are clear and unequivocal. No contractual privity exists between the Arnolds and Grant Thornton and there is no other contractual commercial relationship between them. Instead,

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[3] *Electron Energy Corp. v. Short*, 408 Pa. Super. 563, 571, 597 A.2d 175, 178 (1991)

the Arnolds quite clearly allege tortious claims. As none are in contract, their breach of contract count against Grant Thornton is dismissed. [4]

In an attempt to overcome these admissions, the Arnolds argue that they are third party beneficiaries of a contract under which Grant Thornton prepared the partnership tax returns and the K-1s used by the Arnolds to claim their tax loss via distressed debt strategy.

As explained by the Pennsylvania Supreme Court, a party becomes a third party beneficiary only where both parties to the contract express an intention to benefit the third party in the contract itself. The only exception occurs when circumstances are so compelling that recognition of the beneficiary's right is appropriate to effectuate the intention of the parties, and the performance satisfies a promise that the beneficiary would receive certain specified benefits.[5]

The Arnolds' Amended Complaint, however, fails to allege these necessary elements and therefore fails to establish standing for third party beneficiary status. There are no allegations in the Amended Complaint expressly naming the Arnolds as a beneficiary of the contract between Grant Thornton and any unnamed individuals or corporations, such as *my.CFO.com*. Nor do the Arnolds allege that circumstances appropriately warrant their standing as third party beneficiaries. The fact that Grant Thornton prepared partnership returns does not establish their intention to create third party standing for the Arnolds. Grant Thornton's contract was with limited liability corporations---the LLC's established through the Arnolds relationship with *my.CFO.com* and its lawful successors. The Arnolds have not alleged nor shown that it was the

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[4]The Arnolds admission is a statement of fact that no contract exists upon which Grant Thornton may be liable to them. Statements of fact by one party in pleadings, stipulations, testimony, and the like, made for that party's benefit, are termed judicial admissions and are binding on the party. Judicial admissions are deemed true and cannot be contradicted by the admitting party. Such admissions are considered conclusive in the cause of action in which they are made and the opposing party need not offer further evidence to prove the fact admitted. *Cogley v. Duncan*, 32 A.3d 1288, 1292 (Pa. Super. 2011).

[5] *Scarpitti v. Weborg*, 530 Pa. 366, 372-73, 609 A.2d 147, 150 (1992).

intention of Grant Thornton to do anything other than perform legitimate partnership tax returns from information the Arnolds supplied to the LLC's. Because the Arnolds have not stated a claim under a third party beneficiary theory, they do not have standing to sue Grant Thornton in contract.

II. Grant Thornton is entitled to judgment as a matter of law on the Arnolds claim for violation of the Pennsylvania Unfair Trade Practices and Consumer Protection Law Claim.

In Count VII of the Amended Complaint, the Arnolds' aver a claim for violation of the Unfair Trade Practices and Consumer Protection Law ("UTPCPL"). The UTPCPL provides in pertinent part as follows:

> Any person who purchases or leases goods or services primarily for personal, family or household purposes and thereby suffers any ascertainable loss of money or property, real or personal, as a result of the use or employment by any person of a method, act or practice declared unlawful by section 3 of this act, may bring a private action to recover actual damages or one hundred dollars ($100.00) whichever is greater...[5]

According to the plain terms of this statute, only parties who have made purchases or leased goods and services for personal, family or household services may sue. Here, the Amended Complaint does not allege that the Arnolds' are purchasers as intended by the UTPCPL. The tax services performed by Grant Thornton were provided to limited liability companies, the LLC's in which the Arnolds had created investment interests through their contract with *my.CFO.com*. The purchaser of those services was not the Arnolds but the partnership as a whole. Since the Arnolds are not a purchaser as defined by statute, they are precluded from bringing a private cause of action under the UTPCPL.[6]

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[6] 73 Pa. C. S. § 201-9.2.

Indeed, the basis for the Arnolds' UTPCPL claim are the business tax returns of their distressed debt LLC. [7] As such, the partnership returns were not primarily for personal, family or household use but rather for use by the LLC businesses to satisfy their own reporting requirements with the Internal Revenue Service.

III. Collateral Estoppel bars tort claims against Grant Thornton.

The Arnolds assert six tort claims against defendant Grant Thornton including breach of fiduciary duty, negligence/professional malpractice, negligent misrepresentation, money disgorgement, fraud and civil conspiracy to commit fraud. Grant Thornton argues that it is entitled to judgment on the pleadings on these claims since the California Superior Court in the action filed by the Arnolds against Cogent Valuation, former defendants in this action, has already determined that these claims are time barred by the statute of limitations. Based on the rules of collateral estoppel, we agree that the tort claims filed by the Arnolds in this Philadelphia Common Pleas Court lawsuit are time barred.

Collateral estoppel prevents "a question of law or an issue of fact which has once been litigated and adjudicated finally in a court of competent jurisdiction from being re-litigated in a subsequent suit." [8] It is appropriate where (1) the issue decided in the prior action is identical with the one presented in the later action; (2) there is a final judgment on the merits; (3) the party against whom the plea is asserted is a party or in privity with a party to the prior adjudication;

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[7] *Valley Forge Towers South v. Ron-Ike Foam Insulators, Inc.*, 393 Pa. Super. 339, 574 A.2d 642 (1990).

[8] *Capobianchi v. BIC Corporation,* 446 Pa. Super. 130, 666 A.2d 344, 348 (1995), quoting *Day v. Volkswagenwerk 68 Aktiengesellschaft,* 318 Pa. Super. 225, 464 A.2d 1313, 1318 (1983).

and (4) the party against whom the plea is asserted has had a full and fair opportunity to litigate the issue in question in a prior action.[9] These requirements are met here.

On June 19, 2013, the judge in the California action entered an order granting summary judgment in favor of Cogent Valuation on grounds that the statute of limitations barred the Arnolds' claims. The California action was instituted by the Arnolds against Cogent Valuation and Kam after this court sustained preliminary objections based on lack of personal jurisdiction. The complaint filed in the California action alleged identical facts and almost identical causes of action.[10] In the summary judgment order, the California judge found that "the statute of limitations began to run no later than December 21, 2006, when the IRS concluded its audit process and issued a Notice of Final Partnership Administrative Adjustment relating to the Arnolds' 2001 tax returns The California court also ruled that no subsequent event tolled this time limitation. (California decision p. 2 l 3-6.).This decision became a final judgment on April 18, 2014.

Here, the statute of limitations decided in California relating to the date the limitation time begins to run is identical. Like the defendants in the California action, Grant Thornton raises statute of limitations as a defense. [11] And, as in California, the Arnolds have admitted in this Philadelphia case that they received the IRS' Notice of Final Partnership Administrative Adjustment on December 21, 2006.[12] Hence, the issue is identical and follows a California

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[9] *Capobianchi v. BIC Corp.,* 446 Pa. Super. 130, 137, 666 A.2d 344, 348 (1995), citing *Grant v. GAF Corp.,* 415 Pa. Super. 137, 149, 608 A.2d 1047, 1053 (1992), *aff'd,* 536 Pa. 429, 639 A.2d 1170 (1994) (*per curiam*).

[10] GT's answer and new matter Exhibit "D"- California action.

[11] GT's answer and new matter ¶ 166, 183-200).

[12] Amended Complaint, ¶ 98.

final judgment on a pre-trial sufficiency of claims motion. The first two collateral estoppel requirements are met.

The third and fourth requirements are also satisfied. The Arnolds were the plaintiffs in the California action and are the plaintiffs here. In California, the Arnolds had a full and fair opportunity to litigate the timeliness issue. Full and fair opportunity to litigate means the Arnolds were provided due process.[13] As seen in that court's summary judgment opinion, a reasoned judgment took place after the submission of briefs and argument. (See Grant Thornton's Answer and New Matter at Exhibit "D" filed in response to Arnold's California Complaint, Paragraph 78.) The Arnolds then declined their right to appeal, choosing instead to come back to Pennsylvania and relitigate the issue now.

Consequently, the decision of the California court on limitations timing stands. Under Pennsylvania law, a two year statute of limitations applies to all the Arnolds' tort claims. Applying the triggering event of December 21, 2006, the Arnolds are time barred in tort against Grant Thornton since the Arnolds filed this lawsuit in July 2010.[14]

IV. The claim for Disgorgement/Money had and Received is also dismissed.

In Count IV, the Arnolds aver a claim for disgorgement/money had and received. Specifically, the Arnolds allege that as a result of the defendants' breach of their fiduciary duties and fraudulent misrepresentations, defendants should be required to disgorge all payments received by them from plaintiffs or from any entity or individual for work performed in connection with plaintiffs' distressed debt strategy. (Amended Complaint ¶ 122-125). As pled,

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[13] Id at 1236.

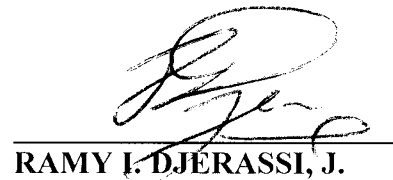
[14] The complaint in this action was filed in December 2010, however, the complaint in the Middle District was filed in July 2010.

the basis for the disgorgement/money had and received is Grant Thornton's breach of fiduciary duty and fraudulent misrepresentations. Disgorgement is a legal remedy where the plaintiff cannot assert title or right to possessing particular property. Disgorgement is also an equitable remedy when the plaintiff seeks "a constructive trust or an equitable lien or where money or property identified as belonging in good conscience to the plaintiff could clearly be traced to particular funds or property in the defendant's possession.[15] Since, as discussed in the above section, the claim for breach of fiduciary duty and fraudulent misrepresentation as well as others have been deemed time barred and the claim for disgorgement and money and received derives from those claims, there is no basis for Grant Thornton to disgorge any monies paid to it or return any monies had or received. Consequently, the motion for judgment on the pleadings is granted and Count IV is dismissed.

CONCLUSION

Based on the forgoing, it is hereby **ORDERED** that Grant Thornton, LLP's Motion for Judgment on the Pleadings is **GRANTED** and the Amended Complaint is dismissed with prejudice.

BY THE COURT,



RAMY I. DJERASSI, J.

[15]*Edmonson v. Lincoln Nat. Life Ins. Co.*, 777 F. Supp. 2d 869, 891–92 (E.D. Pa. 2011).