Nochumson Appointed To The Executive Committee Of The Philadelphia Bar Association’s Real Property Section

Alan Nochumson has been appointed to serve a three-year term to the Executive Committee of the Philadelphia Bar Association’s Real Property section.

The Philadelphia Bar Association, founded in 1802, is the oldest association of attorneys in the United States. The purpose of its Real Property section is to assist attorneys in the practice of real property law by developing and presenting continuing legal education programs and materials on both substantive and procedural aspects of the law.

Vertical Position 34%

Philadelphia Court Refuses To Set Aside Sheriff’s Sale

With the real estate market crashing and the recession otherwise hitting people hard, more and more properties are being subjected to sheriff’s sales every single month.

In *Rittenhouse Plaza Inc. v. Lichtman*, the Philadelphia Court of Common Pleas recently explained the difficulty in setting aside a sheriff’s sale that takes place in Pennsylvania under

state court rules.

Rule 3132 of the Pennsylvania Rules of Civil Procedure outlines the process in which to set aside a sheriff's sale. Under Rule 3132, a sheriff's sale may be set aside by petition, which must generally be filed prior to the issuance of the sheriff's deed.

"A petition to set aside a sheriff's sale is grounded in equitable principles and is addressed to the sound discretion of the court. The burden of proving circumstances warranting the exercise of the court's equitable powers is on the petitioner, and the request to set aside a sheriff's sale may be refused due to insufficient proof to support the allegations in the petition. The material allegations of the petition generally must be proved by clear evidence. After the sheriff's deed has been delivered, the only attacks permitted on the sheriff's sale are those based upon fraud or on lack of authority to make the sale."

In Lichtman, the trial court first addressed the timeliness of the petition. According to the trial court, the petition was not filed until after the issuance of the sheriff's deed.

While acknowledging that Rule 3132 only allows a trial court to set aside a sheriff's sale before delivery of the deed, the trial court still inquired into whether the property owner had actual notice of the sheriff's sale.

The trial court in *Lichtman* pointed out that the property owner was properly served with the writ of execution and notice of sale pursuant to the state court rules in effect and an order issued by the trial court allowing for alternative service on the property owner.

Since the property owner in *Lichtman* entered her appearance in the underlying lawsuit, service of the writ of execution and notice of sale was made by mailing at the address listed on the appearance, in accordance with state court rules, the

opinion said.

The trial court also noted that the plaintiff, in an overabundance of caution, sought and obtained the right from the trial court to serve the writ of execution and notice of sale by alternative means, which the plaintiff did as well with respect to notifying the property owner of the sheriff's sale.

Finally and most importantly, the trial court stated that the property owner in *Lichtman*, prior to the sheriff's sale taking place, had filed a motion seeking the postponement of the sheriff's sale, and thus obviously had actual notice of the sheriff's sale that occurred.

The trial court in *Lichtman* then looked into whether the property owner established fraud or lack of authority to make the sheriff's sale.

"A sheriff's sale may be set aside after delivery of the sheriff's deed based on fraud or lack of authority to make the sale." In doing so, "the petitioner must aver her claims of fraud with particularity," the opinion said.

In denying the petition, the trial court in *Lichtman* believed that the property owner "failed to provide any clear evidence as to why the sheriff's sale should be set aside."

Rather, the property owner only made vague allegations that the sale price of the property was inadequate, the opinion said. According to the trial court, in Pennsylvania, "mere inadequacy of price is insufficient to set aside a sheriff's sale, while gross inadequacy of price is a sufficient basis. Absent evidence of the actual or estimated value of the property sold, however, a determination of gross inadequacy cannot be made."

The trial court in *Lichtman* summarily rejected the argument made by the property owner about the adequacy of the

successful bid garnered at the sheriff's sale because the property owner provided no evidence whatsoever as to the value of the property. Absent evidence of the real or actual estimated value of the property, the trial court emphasized that it "could not make a determination of the gross inadequacy of the sale price."

In a clear bout of frustration, the trial court only stated its disgust with the property owner attempting to re-litigate the same issues that formed the basis of the judgment that was being executed upon. It is clear from the tone of the opinion that the trial court did not care for the property owner attempting to argue that the sheriff's sale should not have taken place at all.

LESSONS LEARNED

The trial court's ruling in *Lichtman* illustrates the difficulty in setting aside a sheriff's sale that takes place in Pennsylvania when the property owner has actual notice of the sheriff's sale prior to its occurrence. If there is actual notice of the sheriff's sale, most courts will overlook de minimus procedural defects with the sheriff's sale.

From a practical point of view, most attempts to set aside a sheriff's sale only delay the inevitable. Even if the sheriff's sale is set aside, unless the defendant can satisfy the underlying judgment, the sheriff's sale will merely be rescheduled and take place again.

Alan Nochumson

Vertical Position 100%

Klyashtorny Discusses Law Firm Workforce Issues For The 21st Century

Natalie Klyashtorny participated in a panel discussion concerning law firm workforce issues for the 21st century at a meeting of the Philadelphia Bar Association's Law Practice Management Committee.

During the panel discussion, Klyashtorny and others provided a primer on human resources issues and challenges confronted by small and medium sized law firms without formal human resources departments, including compliance with statutory requirements.

Vertical Position 14%

Klyashtorny Discusses Laws That Affect Employers Relationship With Employees

Natalie Klyashtorny served as a panelist in the Continuing Legal Eduction (CLE) program entitled "Laws That Affect Your Relationship With Your Employees".

At the CLE which took place at Morgan Stanley's offices in Center City, Philadelphia, Klyashtorny discussed the relevant

federal, state and local employment laws that all small and medium-sized business owners need to know in order to effectively manage their employees and minimize the risk of being sued in the future.

Vertical Position 14%

Gist Of The Action Doctrine Does Not Preclude Fraud In Inducement Claim

A recent decision handed down by the state Superior Court in *Mirizio v. Joseph* stresses the importance of placing the terms of real estate investments in writing rather than relying on the proverbial handshake.

In *Mirizio*, a brother-in-law, real estate attorney Stephen Mirizio, and sister-in-law, Cathy Joseph, found themselves involved in a condominium development project.

Mirizio entered into an agreement to purchase real estate consisting of land and a warehouse building as part of the condominium development project.

According to Mirizio, the opinion said, he had a casual conversation with Joseph in which he offered her the opportunity to purchase one of the condominium units he had intended to develop on the property in return for one-half the cost of acquiring and developing the property. In contrast, Joseph contended that they had verbally agreed that they would jointly purchase the building and side lots.

Mirizio purchased the property and placed it in his and his

wife’s name.

Soon after the construction work commenced, Joseph sent Mirizio a check in the amount of $40,000, which he accepted and placed into his attorney escrow account, the opinion said. According to Mirizio, he never asked for any money because he could not provide her with an agreement of sale until the condominium documents were completed.

Afterwards, Joseph engaged the services of several contractors, who worked on the building to make it suitable for her purposes. At the same time, the opinion said, she also made several significant payments to Mirizio. She also began storing some of her equipment in the building as well.

After Mirizio filed the declaration converting the property into two condominium units, he provided her with a proposed agreement of sale for one of the condominium units. The purchase price for the condominium unit equaled one-half of the acquisition costs and the common repair and renovation costs for the building as well as interest for the amount so advanced.

Joseph then questioned why the transaction excluded the side lots and why she was being charged for interest.

According to the opinion, Mirizio ultimately put his foot down and said she could sign the “agreements or not.”

In response, Joseph signed the agreement and made a last payment in full for the amount Mirizio claimed was due. On her check, she indicated that it was “payoff for building.”

Mirizio then returned the funds he had accepted from her and the check he had not cashed and offered her continued occupancy as a tenant only, the opinion said. He subsequently initiated an action in ejectment against her seeking possession of the property.

Joseph then filed a counterclaim against him for, among other things, breach of the joint venture agreement, breach of fiduciary duty, and for fraud and misrepresentation.

At the summary judgment stage, the trial court found that the statute of frauds barred the specific performance of the verbal agreement entered into between the parties regarding the sale of the real estate. In doing so, the trial court dismissed her claim for breach of contract and awarded him judgment on his ejectment claim.

The trial thus proceeded on the breach of contract, breach of fiduciary duty and fraud and misrepresentation claims.

Mirizio then tried unsuccessfully to have the fraud and misrepresentation claims dismissed as being barred by the gist of the action doctrine. Mirizio filed a motion in limine seeking to preclude evidence thereof, which was denied. At the close of Joseph's case, Mirizio moved for a directed verdict, which the trial court denied. Finally, after the jury's verdict in Joseph's favor, Mirizio filed a motion for judgment notwithstanding the verdict, which the trial court also denied.

On appeal, he claimed that the trial court erred as a matter of law in not entering a judgment notwithstanding the verdict in his favor.

In Pennsylvania, the Superior Court said, the gist of the action doctrine is "designed to maintain the conceptual distinction between breach of contract claims and tort claims. As a practical matter, the doctrine precludes plaintiffs from recasting ordinary breach of contract claims into tort claims."

The "central analysis is whether the tort claim is based on contractual duties, or conversely, whether the contract is collateral to a tort claim that is based on duties imposed by 'larger social policies embodied in the law of torts.'"

According to the Superior Court, “The cases seem to turn on the question of whether the fraud concerned the performance of contractual duties. If so, then the alleged fraud is generally held to be merely collateral to a contract claim for breach of those duties. If not, then the gist of the action would be the fraud, rather than any contractual relationship between the parties.”

The trial court in *Mirizio* ruled that the fraud and misrepresentation claim was not barred by the gist of the action doctrine because a fiduciary duty existed between the parties. The trial court stated: “It is the joint venture agreement that creates fiduciary duties that are distinct from the contractual duties contained in the joint venture agreement and thus not barred by the gist of the action doctrine.”

The Superior Court was not persuaded that the fraud and misrepresentation claim was related to the fiduciary duty between the parties. Instead, the Superior Court emphasized that the trial court conflated the claims for breach of fiduciary duty and fraud and misrepresentation together, “where in fact these are two separate and distinct claims.”

In reaching its conclusion, the Superior Court reasoned that there was no basis to believe that the fraud and misrepresentation claim arises from Mirizio’s fiduciary duty to Joseph, but rather from the agreement between the parties to jointly purchase and develop the property.

Having determined that the trial court erred in so ruling, the Superior Court nonetheless affirmed the trial court’s decision on an alternative basis.

According to the Superior Court, while the gist of the action doctrine bars a tort claim arising from the performance of a contract, it does not bar a fraud claim stemming from the fraudulent inducement to enter into a contract.

The Superior Court concluded that Mirizio never intended to perform the duties he agreed to. Rather, according to the Superior Court, the facts demonstrated that Mirizio "intended to purchase the property in his name, rehabilitate the property with substantial aid from" his sister-in-law "and develop it into a condominium with the intent of selling [her] one of the condominiums after she had expended significant sums on the property." The clear purpose of this scheme, the opinion said, was "to induce [her] to share the costs and risk of development and then cut her out of her share of the profit." The Superior Court further elaborated that "the facts indicate that Mirizio knew that after Joseph had been induced to sink substantial capital into the project, she would in essence be committed to the property and have few if any options other than to accept Mirizio's offer to purchase the property, which she had redeveloped, as a condominium."

Since the gist of her fraud claim is that he fraudulently induced her to enter into an agreement and the performance of his duties under the agreement was collateral to this fraudulent scheme, the Superior Court held that the fraud claim was not barred by the gist of the action doctrine.

LESSONS LEARNED

The litigation that took place between family members in *Mirizio* could have easily been avoided if they had merely memorialized their joint venture agreement in writing. From the tone of the opinion, the Superior Court clearly held Mirizio more accountable for the way things turned out given that he was an attorney who focused a significant portion of his practice on real estate.

Sadly, what happened in *Mirizio* is not very uncommon. In my practice, I repeatedly come across similar situations between family members and friends. Most times, the parties do not wish to incur the expense of retaining an attorney to draft up the agreement. The problem is that it is far more expensive to

unwind such a transaction after-the-fact.

Alan Nochumson

Vertical Position 100%

Klyashtorny Selected As A Member Of The Temple American Inn Of Court

Natalie Klyashtorny has been selected as a member of the Temple American Inn of Court.

The Temple American Inn of Court consists of judges, practicing attorneys, law professors and students who meet regularly to discuss and debate issues relating to legal ethics and professionalism.

Vertical Position 14%

Jury Allowed To Consider Testimony On Oral Modification Of Lease

In most leases, the landlord and tenant are specifically prohibited from orally modifying the lease. The purpose of such a prohibition is to protect them against a “he said, she said” scenario.

A decision recently handed down by the U.S. District Court for the Middle District of Pennsylvania in *Sabatini v. Its Amore Corp.*, however, illustrates how such a provision may be waived through the conduct of the parties.

According to the opinion, in the mid-1990s, Gino Sabatini purchased a parcel of land in South Abington Township. Sabatini subsequently constructed a restaurant on the property and opened the restaurant soon thereafter. Sabatini also entered into a leasing arrangement with the adjacent property owner to use the parking lot adjoining his property for the benefit of the restaurant. Sabatini closed the restaurant in early 2004.

Soon thereafter, Sabatini entered into an agreement with Alex Tarapchak and his company for the sale of the restaurant. The agreement did not cover the parking lot property, according to the opinion.

The parties then amended the agreement, in that the sale was contingent upon the assignment of the lease relating to the parking lot, the opinion said. Moreover, under the terms of the amendment to the agreement, if Sabatini purchased the parking lot and sold the parking lot to Tarapchak, the sales price to Tarapchak would equal the amount for which Sabatini purchased the parking lot, the opinion said.

After Sabatini sold the restaurant, he entered into a lease with Tarapchak for the parking lot. The lease granted Tarapchak the option of purchasing the parking lot. This option, however, was conditioned upon Tarapchak not committing any breaches of the lease.

Among other things, the lease provided that Tarapchak was required to maintain the parking lot in its existing condition.

The lease also provided that no modification could be made to the lease unless the parties specifically agreed to do so in writing.

When Tarapchak attempted to exercise his option to purchase the parking lot from Sabatini, Sabatini refused to sell the parking lot to him because of his alleged breaches of the lease. Sabatini claimed that Tarapchak breached the lease "by removing landscaped islands in the parking lot, by filling in the detention basin on the southerly side of the parking lot and by removing crown vetch from the front embankment of the parking lot," the opinion said.

After Tarapchak failed to cure these alleged breaches of the lease, Sabatini then terminated the lease and instituted an ejectment lawsuit against Tarapchak in federal court.

Tarapchak also instituted a suit for specific performance in state court. In that suit, Tarapchak sought the entry of an order compelling Sabatini to sell the parking lot to him.

In the state court action, Tarapchak denied that he was in breach of the lease for the parking lot. Rather, he alleged that Sabatini had authorized the changes to the parking lot during a conversation that took place between the parties prior to the commencement of the work.

Sabatini specifically denied having had such a conversation with Tarapchak. As a result, Sabatini believed that, since

Tarapchak's right to purchase the parking lot was specifically conditioned upon there existing no event of default by Tarapchak and on the continued existence of the lease, and because these conditions were not satisfied, he justifiably refused to sell the parking lot to Tarapchak.

The state court action was removed to federal court and the cases were consolidated.

The cases were tried before a jury. At the conclusion of the trial, the federal district court submitted special interrogatories to the jury. Based upon the jury's answers, the federal district court entered judgment for Tarapchak on Sabatini's ejectment claim and for Tarapchak on his claim for specific performance to purchase the parking lot.

Sabatini then filed a post-trial motion for judgment as a matter of law or, in the alternative, for a new trial.

In a memorandum opinion, the federal district court focused most of its attention on whether the Statute of Frauds and the lease itself precluded the jury from considering evidence at trial concerning whether Tarapchak was given permission to make changes to the parking lot.

In Pennsylvania, the Statute of Frauds requires all terms and conditions of a lease to be in writing. The purpose of the Statute of Frauds "is to prevent the assertion of verbal understandings in the creation of interests or estates in land and to obviate the opportunity for fraud and perjury,'" the opinion said, citing the state Supreme Court's 1987 ruling in *Kurland v. Stolker*. As such, it "is not a mere rule of evidence, but a declaration of public policy.'"

However, Tarapchak argued that "the law in Pennsylvania has long held that the parties to a written agreement, which contains provisions prohibiting oral modifications, may waive such a provision,'" citing the state Supreme Court's 1955 decision in *Warner v. MacMullen*.

Tarapchak, quoting from the 1994 Superior Court case of *Accu-Weather v. Prospect Communications*, noted: "An agreement prohibiting non-written modification may be modified by a subsequent oral agreement if the parties[] conduct clearly shows an intent to waive the requirements that amendments be in writing.'"

After reviewing the evidence presented at trial, the federal district court in *Sabatini* concluded that Sabatini had, indeed, waived the "non-modification" provision when he failed to object to the changes being made to the parking lot at the time the building permits were issued and when the work commenced.

At trial, Tarapchak testified to the conversation he had with Sabatini, which was prompted by Sabatini's observation of changes being done to the parking. During the conversation, according to Tarapchak, Sabatini expressed concerns as to whether the work was being performed with governmental approval. According to the opinion, Tarapchak testified that these concerns were laid to rest when Tarapchak assured Sabatini that he did receive such governmental approval.

Tarapchak concluded, and the federal district court agreed, that this exchange of information showed that Sabatini had no objection to the work being done on the parking lot.

Tarapchak also pointed to the existence of an e-mail exchange between Sabatini and his brother. Sabatini's brother took a photograph of the parking lot within the first few days of the work being performed and Sabatini and his brother discussed the photograph and their concerns about the parking lot over the course of several e-mails, the opinion said. Tarapchak emphasized that Sabatini nevertheless made no complaint to Tarapchak until the work was almost complete.

Through it all, the federal district court ultimately held that the jury should have been allowed to consider whether the

lease was modified through the conduct of the parties and the evidence introduced at trial was thus not barred by the Statute of Frauds.

LESSONS LEARNED

The federal district court's ruling in *Sabatini* is a cautionary tale for landlords across the commonwealth. Although the lease in *Sabatini* contained a provision disallowing any changes to be made to the parking lot by the tenant, the landlord's passiveness or indecisiveness was clearly used against him.

If the landlord in *Sabatini* did not wish for any changes to be made to the parking lot, the landlord should have stated so, orally and in writing. Rather, the landlord waited until the work was almost complete before expressing his displeasure with the situation. That, in essence, created an issue of fact as to whether the lease was breached, which the jury believed was not the case.

Alan Nochumson

Vertical Position 100%

Court: Landlord Is Not

Responsible To Tenant For Fire Damage

A recent decision by a federal district court in Western Pennsylvania stressed how most tenants in multiunit buildings do not clearly understand the legal ramifications when the leased premises are destroyed through no fault of their own and the difficulty of recovering against landlords for the resulting damages.

In *Community Preschool & Nursery of East Liberty LLC v. Tri-State Realty Inc.*, the U.S. District Court for the Western District of Pennsylvania focused its inquiry on what caused a fire at a building owned by the defendant landlord, the first floor of which was leased to the plaintiff tenant to use as a child-care facility.

According to the opinion, the child-care facility leased the bottom floor of a two-story commercial office building located in Pittsburgh.

The lease entered into by the parties contained provisions whereby the landlord guaranteed not to impair the child-care facility's quiet enjoyment of the leased premises and provided that, if the leased premises were partially damaged by fire or other casualty so as to render it unsuitable for use during the lease term, the landlord could terminate the lease without legal consequence.

After the lease was signed but before the child-care facility occupied the first floor of the building, the landlord received a certificate of occupancy from the city for the first floor of the building. That certificate of occupancy stated that "2nd floor to remain vacant," the opinion said.

The landlord leased the second floor of the building to tenants even though the landlord did not receive a certificate

of occupancy for use of the second floor or inspect the electrical system prior to giving possession to the tenants on the second floor, the opinion said.

Several months after one of the tenants on the second floor complained to the landlord about electrical outlets not working, a fire started there which overtook the entire building, damaging the first floor and rendering it unusable for the child-care facility, according to the opinion.

The investigative reports issued by the city’s fire department at the time of the incident and subsequent expert opinions retained by the parties were consistent in locating the start of the fire in the electrical wiring on the second floor, but no one ventured an opinion as to the actual cause of the malfunction, the opinion said.

After the landlord elected to terminate the lease pursuant to the fire and casualty provision, the child-care facility filed a complaint against the landlord in federal district court for negligence and breach of contract, among other things.

The federal district court dismissed these claims at the summary judgment stage of litigation.

In a nutshell, the court believed that both claims failed as a matter of law because the child-care facility did not and could not establish that the landlord proximately caused the fire.

The court first addressed the legal validity, or lack thereof, of the negligence claim.

The child-care facility argued that the landlord had a duty to maintain the leased premises, that the landlord breached that duty by failing to obtain a certificate of occupancy for the second floor and by allowing tenants to occupy the second floor, and that the breach caused the fire, which caused resulting damage to the first floor.

According to the opinion, while the landlord admitted that it had a duty and that damages resulted from the fire, the landlord disputed whether it breached its duty to the child-care facility by leasing the second floor to other tenants without obtaining a certificate of occupancy from the city.

The court pointed out whether the landlord breached its duty to the child-care facility was a red herring because, "assuming that [there] was a breach of duty, there [wa] s no evidence on record to support causation of the fire, an essential element of [the] plantiffs' negligence claim."

The court noted that, to determine whether any breach of duty proximately caused the child-care facility's damages, it would look at whether a reasonable person would infer that the injury was the natural and probable result of the landlord's breach of duty. The court closely reviewed the opinions issued by the fire investigators working for the city as well as the expert retained by the parties.

According to the court, the investigators and the experts all agreed that the cause of the fire was probably an electrical malfunction and none of them gave an opinion as to its specific cause. Rather, the court illustrated that "the experts described possibilities of what may have been the problem with the wiring, but none could say for certain what caused the electrical malfunction."

From the court's perspective, while there was some uncertainty as to the exact cause in-fact of the electrical fire, that factual dispute, although genuine, was not material because there was no evidence that the landlord's alleged breach of duty was the proximate cause of the fire, leaving a gaping hole in the causal chain.

The federal district court then quickly disposed of the child-care facility's argument that the doctrine of res ipsa loquitur, which in Latin translates to "the thing speaks for

itself," is sufficient to establish causation. In Pennsylvania, the doctrine of "res ipsa loquitur applies when there is no direct evidence to show cause of injury, and the circumstantial evidence indicates that the negligence of the defendant is the most plausible explanation for the injury," the opinion said.

Since the child-care facility failed to offer evidence regarding the specific cause and because other responsible causes could not be eliminated by the evidence, the federal district court emphasized that the doctrine of res ipsa loquitur did not establish the requisite causation and the negligence claim would thus be dismissed on those grounds as well.

The court then quickly disposed of the breach of contract claim.

The court pointed out that the child-care facility could not establish that the landlord caused the fire that burned the building.

Moreover, the court stressed that the lease itself, which was freely signed by the childcare facility, allowed the landlord to unilaterally terminate the lease if the leased premises were impaired because of fire.

LESSONS LEARNED

The federal district court's ruling in *Community Preschool* illustrates the perils a tenant faces when attempting to hold a landlord liable for the destruction of the leased premises.

In *Community Presch*ool, the court highlighted the difficulty of establishing causation in these situations.

Moreover, the court pointed out that the parties had already agreed to a mechanism in the lease should there be such a

destruction of the leased premises and that the landlord was merely exercising its rights under the lease. As such, the child-care facility, as implied by the court, had no one to blame but itself for the end result, which speaks volumes about the importance of fully understanding the terms and conditions of the lease prior to its execution.

Alan Nochumson

Vertical Position 100%

Klyashtorny Selected As A Rising Star In The Legal Profession

For 2010, Natalie Klyashtorny has been included in the list of Rising Stars – the top-up-and-coming attorneys in the Commonwealth of Pennsylvania – in the field of business litigation.

Each year, only 2.5% of attorneys practicing law in the Commonwealth of Pennsylvania receive the Rising Star honor.

Vertical Position 14%

Court Refuses To Look Beyond Written Agreement Of Sale

In most situations, before real estate is transferred from the seller to the purchaser, the parties to the real estate transaction enter into a written agreement of sale. Under the most ideal of circumstances, the seller and purchaser are competently represented either by a real estate agent or legal counsel so that all of the material terms and conditions of the agreement reached by the parties are neatly and methodically contained within such a written agreement of sale.

Most, if not all, written agreements of sale include an integration clause which declares it to be the complete and final agreement between the parties. The existence of such a clause is conclusive proof that no varied or additional conditions exist with respect to the performance of the contract beyond those that are in the writing. An agreement that has such a clause is deemed an integrated contract and any previous negotiations between or representations made by the parties are of no legal consequence.

A recent decision handed down by the U.S. District Court for the Eastern District of Pennsylvania in *Charlton v. Gallo* illustrates why a purchaser cannot rely on terms and conditions which are not provided for within an agreement of sale which contains an integration clause.

In the summer of 2006, Ryan Gallo Tree Service, Inc., a company wholly owned and operated by its namesake, entered into an agreement of sale to purchase three parcels of real estate located in Chester County, Pennsylvania from Vaughn and Deborah Charlton. According to the opinion, the total purchase

price for the parcels was $1.25 million which was financed through a loan in the amount of $1 million from Wilmington Savings Fund Society, secured by a first mortgage on the purchased properties and an interest-only balloon note in the amount of $250,000 to the Charltons secured by a second mortgage on the purchased properties and a mortgage on Mr. Gallo's personal residence in Delaware.

Although his company was purchasing the properties, both Mr. Gallo and his company agreed to become legally obligated to make the payments due under the balloon note, the opinion said.

When Mr. Gallo and his company ceased making the payments due under the balloon note, the Charltons filed a mortgage foreclosure action on his residence in the Superior Court of Delaware, the opinion said.

The parties eventually stipulated to dismissal of the state court action. Thereafter, the Charltons commenced an action in federal district court for breach of contract against Mr. Gallo and his company under the balloon note. Mr. Gallo and his company then filed an answer and counterclaim against the Charltons and, after a motion to dismiss, an amended counterclaim. The Charltons then moved to dismiss the amended counterclaim.

According to the opinion, the amended counterclaim was premised upon alleged misrepresentations made by the Charltons during the course of the negotiations and an alleged mistaken belief on the part of Mr. Gallo and his company regarding the "buildability" of the properties given the undisclosed wetlands and a protected flood zone, the ease with which to obtain zoning approval for development after the purchase, Mr. Charlton's relationship with the township allowing faster zoning approval, and the fair market value of the properties.

FRAUDULENT INDUCEMENT?

The federal district court first addressed whether the Charltons fraudulently induced Mr. Gallo and his company into consummating the real estate transaction.

As the federal district court explained, “fraud in the inducement occurs where ‘the party proffering evidence of additional prior representations does not contend that the representations were omitted from the written agreement, but, rather, claims that the representations were fraudulently made and that but for them he would never have entered into the agreement.”

“In Pennsylvania, the parol evidence rule bars evidence of prior representations in a fully integrated written agreement. Where a written contract contains an integration clause, ‘the law declares the writing to be not only the best, but the only evidence of the parties’ agreement. The purpose of an integration clause is to give effect to the parol evidence rule: Thus the written contract, if unambiguous, must be held to express all of the negotiations, conversations, and agreements made prior to its execution, and neither oral testimony, nor prior written agreements, or other writings, are admissible to explain or vary the terms of the contract.”

The federal district court pointed out that, since the written agreement of sale contained such an integration clause, the parol evidence rule barred any evidence of the alleged prior fraudulent misrepresentations or omissions. In doing so, the federal district court ruled that the claim for fraud in the inducement could not proceed as a matter of law.

Regardless, the federal district court was obviously persuaded by the fact that each of the representations Mr. Gallo and his company complained of in the amended counterclaim were expressly dealt with in the agreement, such as flood plains and wetlands issues, zoning issues, release of claims related to conditions of the property, and the property being sold as-is.

FRAUD IN EXECUTION?

The federal district court next confronted the claim of fraud in execution contained in the amended counterclaim. According to the opinion, Mr. Gallo and his company also alleged fraud in the execution of the agreement of sale because they mistakenly believed terms covering buildability and zoning were included in the written agreement itself.

In Pennsylvania, "[f]raud in the execution applies to situations where parties agree to include certain terms in an agreement, but such terms are not included, and the defrauded party is mistaken as to the contents of the physical document that it is signing. Fraud in the execution of a writing must be proven by clear and convincing evidence."

The federal district court determined that the allegations made by Mr. Gallo and his company in the amended counterclaim amounted to nothing more than a claim for fraudulent inducement and not for fraud in the execution. The federal district court stated that Mr. Gallo and his company did not specifically plead that the Charltons promised, or the parties agreed, that guarantees as to zoning or land use would be included in the agreement but were not, nor did they argue that they bargained for the terms to be included or that they did not understand the language of the agreement. As such, the federal district court held that the claim for fraud in the execution should be dismissed as well.

MUTUAL MISTAKE ALLEGED

In the amended counterclaim, Mr. Gallo and his company also alleged that the agreement should not be enforced as a result of mutual mistake committed by the parties.

"Mutual mistake exists where both parties to a contract are mistaken as to the existing facts at the time of execution. The doctrine only applies where the mistake: (i) relates to the basis of the bargain; (ii) materially affects the parties'

performance; and (iii) is not one as to which the injured party bears the risk."

In the amended counterclaim, Mr. Gallo and his company allege that the parties were mistaken as to the actual value of the purchased properties and that Mr. Charlton had the ability to obtain the zoning, variances and permits necessary for the properties to be used in the manner for which they were being purchased.

The federal district court pointed out that Mr. Gallo and his company did not allege any support for their blanket assertion that the actual value of the property was significantly less than the contract price.

Moreover, the federal district court flatly rejected the argument that an erroneous prediction of future events could even qualify as such a mistake.

LESSONS LEARNED

The federal district court's ruling in *Charlton* speaks volumes about why every material term and condition of a real estate purchase should be contained within the written agreement of sale itself. Most, if not all such written agreements include an integration clause, thus limiting the scope of the agreement reached by the parties to the four corners of the written document read and signed by the parties. Courts are unwilling to delve beyond these four corners, unless in the most drastic circumstances. For that reason, sellers and purchasers should ensure that the written agreement actually memorializes their meeting of the minds.

Alan Nochumson

Vertical Position 100%