

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

FIRSTTRUST SAVINGS BANK,	:	AUGUST TERM, 2005
	:	
Plaintiff,	:	NO. 04385
	:	
v.	:	COMMERCE PROGRAM
	:	
CENTURY BUSINESS SERVICES, INC.,	:	Control No. 051796
MAYER HOFFMAN McCANN PC, and	:	
STEPHEN K. LEFF, CPA,	:	
	:	
Defendants.	:	

**ORDER**

**AND NOW** this 6<sup>th</sup> day of July, 2007, in accordance with the Opinion issued contemporaneously, it is hereby **ORDERED** that defendants' Motion for Partial Summary Judgment is **GRANTED** as to plaintiff's claim for "lost capital damages."

**BY THE COURT,**

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**MARK I. BERNSTEIN, J.**

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STEPHEN K. LEFF, CPA,	:	
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Defendants.	:	

**OPINION**

In November, 2003, plaintiff Firsttrust Savings Bank (“Firsttrust”) loaned approximately \$4 million dollars to Bucks County Nut & Coffee Company (“BCC”). BCC defaulted on the loans at which point approximately \$3.4 million remained unpaid. Defendants Century Business Services, Inc., Mayer Hoffman McCann, P.C. and Stephen K. Leff (collectively “CBIZ”) were BCC’s accountants. They prepared BCC’s financial statements and made representations upon which Firsttrust claims to have relied when making the loans. Firsttrust claims that the financial statements prepared by CBIZ “materially overstated BCC's physical inventory in excess of \$2.8 million.”<sup>1</sup> As a result, when BCC defaulted on the loan, the proceeds from the sale of collateral fell short of the amount due on the loan, by approximately \$2 million. Firsttrust asserts claims against CBIZ for fraud and negligent misrepresentation based on the inaccurate financial statements. Before the court is CBIZ’ Motion for Partial Summary Judgment on Firsttrust’s claim for “lost capital damages.”

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<sup>1</sup> Complaint, ¶ 2, attached as Exhibit A to defendants’ Motion for Partial Summary Judgment (hereinafter “Motion”).

In its Complaint, plaintiff made no specific claims for damages. Firsttrust simply demanded “compensatory damages and such other relief as the Court may deem proper.”<sup>2</sup> In interrogatories, defendants asked plaintiff to “describe in detail all damages claimed by type and amount you contend was caused by the conduct of defendants, specify the amount involved, and how it was calculated and by whom.”<sup>3</sup> In response, plaintiff stated:

As a result of the Defendants’ conduct, Plaintiff has sustained damages in the amount of \$5 million. Plaintiff’s damages consist of the following: BCC’s default on the \$3.675 million loan package approved in November of 2003, BCC’s default on the additional \$300,000 loan approved in March of 2004, and consequential damages in the amount of \$1.025 million.”<sup>4</sup>

Defendants subsequently deposed Eric Paul, Senior Credit Officer of Firsttrust, who had been identified in the Interrogatories as a damages witness.<sup>5</sup> In his testimony, he distinguished between “loan specific damages” and “other damages we incurred.”<sup>6</sup> The following exchange took place:

Q: Okay. What other damages are there that you incurred?

A: Well, in terms of the time we had to work on this, in terms of the opportunity and costs to have funds invested otherwise.

Q: Do you have any calculation for those numbers?

A: No, I do not.<sup>7</sup>

Three months after discovery closed, plaintiff sent defendants a settlement demand letter in which, for the first time, plaintiff claimed to have suffered “\$2,080,064.62 in lost cash

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<sup>2</sup> “Wherefore” Clause of Complaint, attached as Exhibit A to defendants’ Motion.

<sup>3</sup> Defendants’ First Set of Interrogatories, Question 9, attached as Exhibit B to defendants’ Motion.

<sup>4</sup> Plaintiff’s Responses to Defendants’ First Set of Interrogatories, Answer to Question 9, attached as Exhibit B to defendants’ Motion.

<sup>5</sup> *Id.*, Answers to Questions 5, 9.

<sup>6</sup> Deposition of Eric Paul, dated October 26, 2006, p. 142, attached as Exhibit C to defendants’ Motion.

<sup>7</sup> *Id.*

damages, plus \$300,092.16 in interest, and at least \$1,930,040.05 in lost capital damages.”<sup>8</sup>

Plaintiff subsequently asserted lost capital damages in its Pre-Trial Memorandum:

Firsttrust also endured at least \$1,602,870.24 in lost capital damages, as of January 31, 2007. The calculations leading to this figure are based on two notable facts: (1) The “legal lending limit” regulates the amount a bank can loan relative to capital. During the applicable period Firsttrust loaned out money against its capital at a minimum of 8.5 to 1 (and up to 16.67 to 1); and (2) the average income spread Firsttrust earned for money it loaned out during the applicable period was 4.64% per year.<sup>9</sup>

In their Motion for Summary Judgment, defendants state there is no evidence to support plaintiff’s claim for lost capital damages.<sup>10</sup> Plaintiff responded as follows:

Plaintiff’s pre-trial memorandum lists several trial exhibits that support Plaintiff’s claim for lost capital damages. For example, P-185 shows calculations regarding charge off balance for [BCC]. P-186 is an Interoffice Memorandum from Eric Paul to Joseph F. Mikolatis with attachments regarding final recovery on [BCC] loans. These documents support Plaintiff’s claim for lost capital damages and were attached to Plaintiff’s February 13, 2007 demand letter. Moreover, the pre-trial memorandum lists trial witnesses such as Eric Paul, Rick Meyers, and Peter Nolan who can testify about components of Plaintiff’s lost capital damages. Defendants have deposed and/or had the opportunity to [depose] these witnesses.<sup>11</sup>

Contrary to plaintiff’s representation, the cited documents present no evidence in support of plaintiff’s claim for lost capital damages. The documents merely indicate the amounts that Firsttrust was able to recover on the loan from the sale of collateral and the amount not recovered and subsequently charged off. It is absurd to claim that defendants “had the opportunity to depose” witnesses regarding a damages claim which had not been pled, had not been mentioned in interrogatory answers, and had not in any way been identified until all depositions had been

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<sup>8</sup> Letter from Kevin F. Berry to Kean K. McDonald, dated February 13, 2007, attached as Exhibit D to defendants’ Motion.

<sup>9</sup> Plaintiff’s Pre-Trial Memorandum, p. 5, attached as Exhibit E to defendants’ Motion.

<sup>10</sup> Motion, ¶ 26.

<sup>11</sup> Response to Motion, ¶ 26.

completed and discovery closed. These reasons alone are sufficient basis for granting partial summary judgment for defendant on plaintiff's claim for lost capital damages.<sup>12</sup>

Beyond the factual deficiencies, as a matter of law, such damages are too speculative to be awarded by a jury. Taking plaintiff's demand letter as if it had factual support, plaintiff detailed lost capital damages as follows:

On September 30, 2004, Firstrust took a \$2,000,000 charge-off to its capital because of Defendants' conduct concerning the BCC loans. Because Firstrust loaned out money against its capital at a minimum ratio of 8.5 to 1 between September 30, 2004 and June 1, 2005, Firstrust was unable to loan \$17,000,000 during that period. At an average spread of 4.75%, Firstrust lost at least \$542,020.55 during September 30, 2004 and June 1, 2005. On June 2, 2005, Firstrust added a \$366,985 recovery to its capital, lowering the net charge off related to the BCC loans to [\$]1,633,015.00. Because Firstrust loaned out money against its capital at a minimum of 8.5 to 1 between June 2, 2005 and April 27, 2006, Firstrust was unable to loan \$13,880,627.50 during that period. At an average spread of 4.75%, Firstrust lost at least \$752,976.51 between June 2, 2005 and April 27, 2006. Finally, on April 28, 2006 Firstrust added a \$4,013 recovery to its capital, lowering the net charge off related to the BCC loans to \$1,629,002. Because Firstrust loaned out money against its capital at a minimum of 8.5 to 1 between April 28, 2006 and January 31, 2007, Firstrust was unable to loan \$13,846,517.00 during that period. At an average spread of 4.75%, Firstrust lost at least \$635,043.00 between April 28, 2006 and January 31, 2007.<sup>13</sup>

“Under Pennsylvania law, in an action based on fraud, the measure of damages is ‘actual loss’, and not the benefit, or value, of that bargain. The victim is entitled to all pecuniary losses which result as a consequence of his reliance on the truth of the representations.”<sup>14</sup>

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<sup>12</sup> Summary Judgment may be granted “if, after the completion of discovery relevant to the motion . . . an adverse party who will bear the burden of proof at trial has failed to produce evidence of facts essential to the cause of action or defense which in a jury trial would require the issues to be submitted to a jury.” Pa. R. Civ. P. 1035.2(2). “To defeat this motion, the adverse party must come forth with evidence showing the existence of the facts essential to the cause of action or defense.” *Id.*, Commentary.

<sup>13</sup> Letter from Kevin F. Berry to Kean K. McDonald, dated February 13, 2007, attached as Exhibit D to defendants' Motion.

<sup>14</sup> Delahanty v. First Pa. Bank, N.A., 318 Pa. Super. 90, 117, 464 A.2d 1243, 1257 (1983). The law of Pennsylvania differs from that of other jurisdictions, under which “the recipient of a fraudulent misrepresentation in a business transaction is also entitled to recover additional damages sufficient to give him the benefit of his contract with the maker, if these damages are proved with reasonable certainty.” Restatement (Second) Torts § 549(2).

The damages recoverable for negligent misrepresentation are those necessary to compensate the plaintiff for the pecuniary loss to him of which the misrepresentation is a legal cause, including

(a) the difference between the value of what he has received in the transaction and its purchase price or other value given for it; and

(b) pecuniary loss suffered otherwise as a consequence of the plaintiff's reliance upon the misrepresentation.

[T]he damages recoverable for a negligent misrepresentation do not include the benefit of the plaintiff's contract with the defendant.<sup>15</sup>

The damages awarded to the victim of a misrepresentation may in some instances include lost profit or income.

It is well settled law in Pennsylvania that loss of profits are recoverable upon proper proof both in contract and in tort. The general rule of law applicable for loss of profits in both contract and tort actions allows such damages where (1) there is evidence to establish them with reasonable certainty, (2) there is evidence to show that they were the proximate consequence of the wrong . . . [L]ost income or profit is recoverable in an action for the destruction or interruption of an established business, whenever [such damages] are not merely speculative or conjectural.<sup>16</sup>

No Pennsylvania court has ever held "lost capital damages" recoverable by a bank when a borrower defaults on a loan. The Federal Circuit Court of Appeals has considered the issue.<sup>17</sup> In Wells Fargo Bank, N.A. v. U.S., a bank sued the federal government for breach of an agreement to guaranty a loan. The loan was eventually re-structured at a direct loss to the bank of \$389,423. The bank also claimed:

As a result of the Administration's refusal to issue the guarantee and the poor quality of the . . . loan, [the bank] charged off \$9.7 million on the loan, which resulted in an equal reduction to [the bank's] capital. This capital reduction lessened the ability of [the bank] to make loans of up to 15 times the amount of

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<sup>15</sup> Restatement (Second) Torts § 552B.

<sup>16</sup> Delahanty, 318 Pa. Super. at 120, 126, 464 A.2d at 1258, 1261

<sup>17</sup> Wells Fargo Bank, N.A. v. United States, 88 F.3d 1012 (Fed. Cir. 1996).

the charge-offs – the approximate capital leverage ratio for the bank at the time. The lost income on the allegedly foregone loans was quantified by [the bank’s] expert to be \$6,849,000.00, which was based on a 14% average rate of return on [the bank’s] lending business for the preceding years.<sup>18</sup>

The Circuit Court found that the bank could not recover lost capital as damages because it was too speculative. The Federal Circuit said: “The bank’s loss of interest on additional loans it allegedly could have made had there been no breach is too uncertain and remote to be taken into consideration as a part of the damages occasioned by the breach of contract in suit.”<sup>19</sup> The Court permitted the bank to recover as damages only the amount it lost on the loan.<sup>20</sup>

In this case, a similar result is mandated under Pennsylvania law. The \$1,602,870.24 in interest that Firstrust claims it would have made on loans to third parties if it had not charged off portions of the BCC loan is uncertain, remote, and speculative and may not to be recoverable as damages for CBIZ’s alleged overstatement of BCC’s assets on the financial statements. If Firstrust had not made the loan to BCC, it would have loaned that money to another borrower. Until that loan had been repaid, the loan principal was not capital and could not be reserved for leverage for other loans.<sup>21</sup> There is no proof whatsoever that Firstrust could have made the loans it claims to have lost, that it would have earned the rate of return on those loans it claims, or that those loans would even have been repaid. Firstrust’s lost capital damages are too speculative for jury determination at trial.

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<sup>18</sup> *Id.*, 88 F.3d at 1022.

<sup>19</sup> *Id.*, 88 F.3d at 1023.

<sup>20</sup> *Id.*, 88 F.3d at 1024.

<sup>21</sup> If Firstrust’s business decision would have been to use the funds it loaned to BCC as capital leverage, it is reasonable to ask why it did not. It cannot choose both to make what turns out to be a bad loan and not retain the funds as capital and then years later claim damages as if it would have used the funds it no longer had as leverage capital.

Assuming Firsttrust can prove CBIZ intentionally or negligently misrepresented BCC's assets, Firsttrust may recover only: 1) the amount of the loan principal lost after selling BCC's assets; 2) if appropriate, pre-judgment interest on that amount;<sup>22</sup> and 3) expenses incurred liquidating the loan collateral.

Defendants' Motion for Partial Summary Judgment as to plaintiff's claim for "lost capital damages" is granted.

**BY THE COURT,**

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**MARK I. BERNSTEIN, J.**

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<sup>22</sup> Pre-judgment interest may be awarded in a tort action if the recovery of such delay damages is necessary to make plaintiff whole. Robert Wooller Co. v. Fid. Bank, 479 A.2d 1027, 1035 (Pa. Super. 1984).