SUPERIOR COURT

OF THE

STATE OF DELAWARE

RICHARD R. COOCH
RESIDENT JUDGE

NEW CASTLE COUNTY COURTHOUSE
500 N. KING STREET, SUITE 10400
WILMINGTON, DELAWARE 19801
(302) 255-0664

Kevin W. Gibson, Esquire
Gibson & Perkins P.C.
1326 King Street
Wilmington, Delaware 19801
Attorney for Plaintiffs

Gregory V. Varallo, Esquire
Lisa M. Zwally, Esquire
Richards, Layton & Finger, P.A.
One Rodney Square
P.O. Box 551
Wilmington, Delaware 19899
Attorneys for Defendant

Re: ***Coleman et al. v. PricewaterhouseCoopers LLC***
C.A. No. 03C-02-137 RRC

Submitted: January 28, 2005
Decided: February 8, 2005

Upon Defendant's Motion in Limine to Exclude Evidence Concerning Valuation.
GRANTED.[1]

Dear Counsel:

Defendant PricewaterhouseCoopers LLP ("PwC") in this alleged accounting

---

[1] This opinion expands upon a bench ruling made immediately after oral argument that granted Defendant's motion in limine to exclude evidence concerning valuation.

negligence action has moved to exclude any evidence at trial concerning either valuation or the "fair market value" of Plaintiffs' company, Digital Imaging & Technologies, Inc. ("DIT"). Plaintiffs respond that they should be able to present evidence of valuation. Both parties rely on Restatement (Second) of Torts: Damages for Negligent Misrepresentation §552B.

Plaintiffs' claim against PwC is for negligent misrepresentation, specifically the alleged negligence of a public accountant to a third party with whom there was no privity of contract and where the only harm suffered was economic in nature.[2] In their Complaint, Plaintiffs allege that PwC negligently audited the financial statements of its client, Lason; Plaintiffs aver that they relied upon those statements in subsequently deciding to sell their business, DIT, to Lason.

I. FACTS

Plaintiffs were the primary shareholders of DIT, a company whose purpose was to "provid[e] data/image capture for firms in the United States and Europe[ ]" and whose primary clients were involved in "transportation, health care[,] and

---

[2] This Court has earlier decided in a related case that the applicable standard for the tort of negligent misrepresentation in an accounting malpractice action lies in section 552 of the Restatement (Second) of Torts and that for an accounting firm to be held liable to plaintiffs who had no direct contractual relation to the accounting firm, "at the time [the accounting firm] was auditing [its client's] financial statements, [the accounting firm] would have had to have known (or have had reason to have known) that [its client] would share those statements with [a] class [of similarly-situated business owners who had sold their businesses to the client] or with [those] [p]laintiffs as part of a potential business transaction." *Carello v. PricewaterhouseCoopers LLP*, 2002 WL 1454111, at *4 (Del. Super.).

publishing."[3] Plaintiffs sold DIT to Lason through a transaction that closed in November 1998 and which involved a complicated deferred "Earn Out" formula that was apparently engineered to partly compensate Plaintiffs *in futuro*. Plaintiffs allege that in deciding to sell their business to Lason, they in part relied "on [a] review…of…statements [relating to Lason's financial health] and [PwC's] assessment of the financial condition of Lason as represented by such audited financial statements…."[4] Specifically, Plaintiffs allege that, as part of their decision, they "reviewed and relied on Lason's Annual Report, 10-K[,] and the audited financial statements accompanying such report for the period[ ] ending December 31, 1997…together with Lason's Quarterly Report on Form 10-Q, and the unaudited financial statements accompanying such report, for the period[ ] ending September 30, 1998."[5]

A further chronology drawn from the Complaint follows: "On December 9, 1999, in reaction to Lason's falling stock price, [Lason's C.E.O. Monroe]…announce[d] '[w]e are not aware of any reason for Lason's share price decline[ ]'";[6] "Approximately one week later…Lason announced that fourth-

[3] Compl. ¶ 9.

[4] Compl. ¶ 57.

[5] Compl. ¶ 41.

[6] Compl. ¶ 63.

quarter earnings w[ould] be between 31% and 38% lower than expected[ ]";[7] "On…the next trading day, Lason's common stock fell to $11 7/8ths, from a high for the year of $64.94…";[8] "On or about May 1, 2000, Plaintiffs…became aware…of the possibility that Lason earnings as reported…for fiscal years 1997, 1998, and 1999, and the 10Ks and 10Qs for such periods, may have been misstated by reason of accounting system deficiencies and accounting irregularities";[9] "On March 26, 2001, Lason announced that it had informed the U.S. Securities and Exchange Commission and the US [sic] Attorney for the Eastern District of Michigan of certain accounting irregularities…";[10] "Plaintiffs subsequently learned [after DIT was acquired by Lason] that Lason's reported revenues on its audited financial statements, and its 10Ks, and 10Qs, for the reporting fiscal years 1997, 1998, and 1999, which were prepared by…[PwC], were not based upon an accounting method which was in conformity with…GAAP…."[11]

On December 5, 2001, Lason filed a voluntary petition under Chapter 11 of

---

[7] Compl. ¶ 64.

[8] Compl. ¶ 66.

[9] Compl. ¶ 67.

[10] Compl. ¶ 75.

[11] Compl. ¶ 77.

the United States Bankruptcy Code.[12] As a result of the accounting irregularities that Plaintiffs allege existed in Lason's audited financial statements and (presumably) because of Lason's subsequent filing for bankruptcy protection, Plaintiffs aver that Lason "cannot and will not be able to" pay the "Earn Out" Plaintiffs argue is now due them as part of the DIT acquisition.[13] Plaintiffs assert that PwC is liable to them "in that had [PwC] not misstated the income of Lason contrary to [Generally Accepted Accounting Principles], Plaintiffs never would have agreed to sell DIT to Lason."[14]

II. THE PARTIES' ARGUMENTS

1. PwC's Motion in Limine to Exclude Evidence Concerning Valuation

PwC has moved in limine to exclude evidence concerning valuation of Plaintiffs' company because this Court has dismissed Plaintiffs' claim for "lost opportunity to rescind" the sale of DIT to Lason.[15] PwC had opposed Plaintiffs' claim for "lost opportunity to rescind" on the grounds that the claim was in fact a

---

[12] Compl. ¶ 89.

[13] Compl. ¶ 92.

[14] Compl. ¶ 103.

[15] The Court heard PwC's motion to dismiss on January 12, 2005: *Coleman v. PricewaterhouseCoopers LLC*, Del. Super., C.A. No. 03C-02-137, Cooch, J. (Feb. 8, 2005) (Letter Op. Mot. to Dismiss) (holding dismissal of Plaintiffs' Count III of the Amended Complaint on the grounds that "rescission" or "rescissory damages" are not available damages under a claim for negligent misrepresentation).

claim for rescission or rescissory damages, to which Plaintiffs were not entitled as PwC was a third party to the contract between Plaintiffs and Lason. PwC contends that Plaintiffs are improperly seeking the "fair market value" as the measure of DIT. PwC argues that Plaintiffs only claim is for "out-of-pocket" pecuniary damages arising from an alleged negligent misrepresentation under Restatement (Second) of Torts §552B and not for the 'fair market value" of DIT. PwC argues that Plaintiffs "have not articulated any legal basis on which they are entitled to recover the 'fair market value' of their company."[16]

2. Plaintiffs' Response

Plaintiffs respond that under Restatement (Second) of Torts §552B they are entitled to make a claim for valuation and to present evidence of the "fair market value" of their company to prove damages. Plaintiffs argue that they are entitled to the difference between the value of what they parted with and the value of what they had received. Plaintiffs aver that the sale price for DIT was a lump sum cash payment, stock and later partial payments under the "Earn Out" formula. Plaintiffs argue that what they parted with was the "fair market value" of DIT and that they are entitled to the difference between "the fair market price" of DIT and what they received (the lump sum cash payment, stock and partial payments under the "Earn Out" formula).

[16] Defendant's Motion in Limine at 2.

III. DISCUSSION

The Delaware Supreme Court has held that "[a] motion in limine typically concerns the admissibility of evidence and is a preliminary motion directed at establishing the "ground rules applicable at trial."[17] Moore's Federal Practice Civil §16.77[4][d], cited by the Supreme Court in *Hercules*, states:

> (i) Motions in limine "may be directed toward barring specified evidence or argument and may be based on any of the grounds available under the Federal Rules of Evidence."
> (ii) Motions in limine "may [also] be directed toward limiting the subjects about which testimony may be offered, or about which particular witnesses may testify. Motions with this purpose are often targeted on expert witnesses."[18]

"Typically, a party makes this motion when it believes that mere mention of the evidence during trial would be highly prejudicial and could not be remedied by an instruction to disregard."[19]

The parties agree, and this Court holds, that Restatement (Second) of Torts §552B is the applicable measure of damages in an action for negligent misrepresentation. The question before the Court then is whether §552B contemplates "fair market value" as part of the measure of a plaintiff's loss or

---

[17] *Hercules, Inc. v. AIU Insurance Co. et. al.*, 784 A.2d 481, 500 (Del. 2001) (quoting Black's Law Dictionary 1033 (7th 1999)).

[18] 3 Moore's Federal Practice Civil § 16.77[4][d]

[19] Black's Law Dictionary 828 (abridged 7th ed. 2000).

whether §552B measures the sale price (instead of “fair market value”) minus what a plaintiff has received from a defendant in trade. The Court finds that Plaintiffs’ valuation claim is, in essence, a claim for rescissory damages. Plaintiffs’ interpretation of §552B is incorrect; §552B states:

> (1) The damages recoverable for a 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.
> (2) the damages recoverable for a negligent misrepresentation do not include the benefit of the plaintiff's contract with the defendant.[20]

As evidenced by §552B(a), a plaintiff is entitled to the difference between the value of what the plaintiff received in the transaction and the purchase price. There is no reference in §552B to “fair market value” or recovery of what the value of a property (in this case DIT) was at the time of the sale.

Plaintiffs sold their company to Lason for a lump sum cash payment, stock and payments under the “Earn Out” formula. The only recovery that Plaintiffs are potentially entitled to is the difference between the money they have already received under the contract of sale and what they were supposed to have received. Plaintiffs sold their company for a price that included “Earn Outs,” which were unknown at the time of the sale. The “Earn Outs” could affect the final sale price

[20] Restatement (Second) of Torts §552B.

because, depending on how DIT performed after the sale, the final price might have ended up either being above what was the "fair market price" or below the "fair market price" of DIT at the time it was sold.

Plaintiffs rely on several cases from other jurisdictions to support their argument. Plaintiffs argue that the Iowa Supreme Court's holding in *Ryan v. Kanne* supports its position because the *Ryan* Court held that:

> [a] third party not in privity with defendant-accountants could recover to the same extent as a party in privity. The measure of damages in that instance is the amount necessary to place the injured third party in a position that it would have been had the erroneous account been properly prepared.[21]

The Iowa Supreme Court held that "the test to be adopted is whether the third party to whom the accountant owes a duty of care is actually foreseen and a member of a limited class of persons contemplated."[22] The *Ryan* Court then noted that "[this test] also seems to be the tenor of the Restatement of Torts [Second] §552, tentative draft number eleven."[23] The *Ryan* Court did not address the measure of damages under §552. This Court declines to follow the Iowa Supreme Court's holding in *Ryan* because that Court was not interpreting Restatement (Second) of

---

[21] *Ryan v. Kanne*, 170 N.W.2d 395 (Iowa 1969) (holding that "[t]his being a case of first impression in Iowa, we are disposed to reject the rule that third parties not in privity of contract or in a fiduciary relationship are always barred from recovery for negligence of the party issuing the instrument upon which the third party relies, to his detriment").

[22] *Ryan*, 170 N.W.2d at 403.

[23] *Ryan*, 170 N.W.2d at 403.

Torts §552B, as is the case in the instant claim.

Plaintiffs, citing a case from the Seventh Circuit, also contend that "[t]he out-of-pocket rule 'looks to the loss which the plaintiff has suffered in the transaction, and gives him difference between the value of what he has parted with and the value of what he has received'."[24] In *Trytko*, the United States Court of Appeals for the Seventh Circuit distinguished between "out-of-pocket" damages and "benefit-of-the-bargain" damages.[25] The *Trytko* Court held that Restatement (Second) of Torts §552B is the proper measure of damages for negligent misrepresentation.[26] The *Trytko* Court also held that "[t]he 'out-of-pocket' rule 'looks to the loss which the plaintiff has suffered in the transaction, and gives him the difference between the value of what he has parted with and the value of what he has received'."[27] When the *Trytko* Court used the term "the value of what [a plaintiff] has parted with" it presumably meant the agreed upon sale price between the parties; to hold otherwise would be to award a plaintiff a type of "benefit-of-

---

[24] *Trytko v. Hubbell*, 28 F.3d 715, 722 (7th Cir. 1994) (adopting Restatement (Second) of Torts §552B as the proper measure of damages in a negligent misrepresentation claim and holding that "[a]s the Commentary to § 552B makes clear, the Restatement adopts the 'out-of-pocket' rule as the appropriate measure of damages for negligent misrepresentation and specifically excludes 'benefit-of-the-bargain' damages").

[25] *Trytko v. Hubbell*, 28 F.3d 715, 722 (7th Cir. 1994).

[26] *Trytko v. Hubbell*, 28 F.3d 715, 722 (7th Cir. 1994).

[27] *Trytko v. Hubbell*, 28 F.3d 715, 722 (7th Cir. 1994).

the-bargain" damages based on what a plaintiff might have sold their property for to another buyer and not what was the actual sale price.

Plaintiffs further argue, relying a case from the Massachusetts Court of Appeals, that "a buyer who sustains losses as a result of a negligent misrepresentation ' . . . would be entitled to recover damages equal to the difference between the value of what she received and the purchase price, plus any other pecuniary loss suffered as a consequence of her reliance'."[28] The Massachusetts Court of Appeals in *Anzalone* held that "the proper method for assessing damages is to calculate the plaintiff's 'out of pocket' losses, i.e., the difference between the purchase price and the actual value of the property."[29] To put it in terms consistent with §552B, the measure of damages was held in *Anzalone* to be the difference between what the buyer gave up (the purchase price) and what she received (the actual value of the property (which was of a smaller square footage than she was promised)). *Anzalone's* measure of "out-of-pocket" damages is consistent with this Court's holding. This Court finds that the two cases relied upon by Plaintiffs, *Trytko v. Hubbell* and *Anzalone v. Strand* are not contrary to the Court's reading of Restatement (Second) Torts §552B.

---

[28] *Anzalone v. Strand*, 436 N.E.2d 960 (Mass. 1982) (holding that "the proper method for assessing damages is to calculate the plaintiff's 'out of pocket' losses, i.e., the difference between the purchase price and the actual value of the property [received]").

[29] *Anzalone v. Strand*, 436 N.E.2d 960, 963 (Mass. 1982).

This Court has granted Defendant's motion to dismiss Plaintiffs' claim for "lost opportunity to rescind" on the grounds that "rescission" or "rescissory damages" are not available under Plaintiffs' claim for negligent misrepresentation. The Court's ruling excluding any evidence by Plaintiffs to establish valuation or the "fair market value" of their company has "rendered legally irrelevant . . . any evidence concerning valuation of DIT."[30] As Defendant correctly states, there is no basis for allowing Plaintiffs to claim valuation or "fair market price" of DIT as part of their damages; therefore, Plaintiffs are precluded from introducing at trial any evidence concerning "valuation" or "fair market value" of DIT.

IV. CONCLUSION

For the foregoing reasons, PwC's motion to "exclude evidence concerning valuation" is **GRANTED.**

IT IS SO ORDERED.

Very truly yours,

oc: Prothonotary

[30] Defendant's Motion in Limine at 2.