

COUNTERSTATEMENT OF CASEPROCEDURAL HISTORY

On March 10, 1991, Mortgage One Small Business Credit, hereafter referred to as Mortgage One filed three mortgage foreclosure actions against John and Jane Smith, hereafter referred to as the Smiths. The Smiths borrowed money to expand their retail space and eventually defaulted on the loans secured by mortgages held by Mortgage One. They now owe in excess of \$700,000.

On August 1, 1992, Mortgage One filed amended complaints and, on August 20, 1992, the Smiths filed answers with new matter and counterclaims to the amended complaints. The new matter alleged that Mortgage One violated the Small Business Credit Act, 12 U.S.C. §2001 - §2279AA-14, in various ways, and the Smiths wanted to “recoup” money they claim represented excessive interest rates charged by Mortgage One. The counterclaims alleged that Mortgage One violated the Unfair Trade Practices and Consumer Protection Law 73 Pa. C.S.A. §201-1 - §201-9.2.

On September 10, 1992, Mortgage One filed preliminary objections to the new matter and counterclaims. Following extensive briefing and two oral arguments, in an order and opinion dated October 1, 1993, the trial court sustained Mortgage One’s preliminary objections to the Smiths’ new matter counterclaims and dismissed them with prejudice. On November 20, 1994, the Superior Court affirmed the trial court’s order, dismissing the new matter and counterclaims. Mortgage One Small Business Credit, ACA v. John Smith, et al. On December 1, 1994, the Smiths filed a petition for allowance of appeal to the Supreme Court. On February 28, 1994, the petition for allowance of appeal was denied.

On July 5, 1994, Mortgage One moved for summary judgment because the Smiths had admitted they failed to repay the loans secured by mortgages and because they had no valid defenses remaining. On August 11, 1994, the Smiths' counsel filed a motion to withdraw because she refused to raise a new defense under the Small Business Credit Act that she believed was frivolous.

The Smiths retained new counsel and, on January 1, 1995, filed a response to Mortgage One's motion for summary judgment and an opposing affidavit, which raised a new defense under the Small Business Credit Act. On January 25, 1995, Mortgage One filed a reply brief and supplemental affidavits and, on January 30, 1995, the Smiths filed a counter-affidavit. On May 8, 1995, after oral argument, the trial court granted summary judgment to Mortgage One. On June 5, 1995, the Smiths filed this appeal, which the superior court has ordered to be placed on an expedited schedule.

ARGUMENTA. THE SMITHS DEFENSES BROUGHT UNDER THE SMALL BUSINESS CREDIT ACT ARE LEGALLY INVALID.

The Smiths argue that they have two defenses under the Small Business Credit Act that prevent Mortgage One from collecting the \$700,000 they owe Mortgage One. They argue that these defenses, one raised after Mortgage One's motion for summary judgment and the other raised for the first time on appeal, bar Mortgage One's foreclosure. Both these defenses, however, are invalid.

The law is well-settled that no duty exists under the Small Business Credit Act. Production Credit Ass'n of Worthington v. Van Iperen, 396 N.W. 2d 35, 38 (Minn. App. 1986); Griffin v. Federal Land Bank of Wichita, 902 F.2d 22, 24 (10th Cir. 1990). Moreover, courts have held that the Small Business Credit Act and its amendments are guidelines to be followed by a small business credit entity, violation of which subject the small business credit entity to penalties by its regulators, but not an action or defense by its borrowers. Federal Land Bank of Spokane v. Wright, 120 Idaho 32, 813 P.2d 371, 374 n.5 (Ct. App. 1991).

Therefore, the Small Business Credit Act does not create any obligation or duty on the part of Mortgage One to the Smiths. The regulations of the act do not create any affirmative duties or prohibitions. Production Credit Ass'n of Worthington v. Van Iperen, 396 N.W. 2d 35, 38 (Minn. App. 1986); see Griffin v. Federal Land Bank of Wichita, 902 F.2d 22, 24 (10th Cir. 1990).

B. THE SMITHS WAIVED THEIR CLAIM THAT A RECOUPMENT DEFENSE BASED ON THE SMALL BUSINESS CREDIT ACT CAN BE BROUGHT AS A BREACH OF CONTRACT CLAIM BECAUSE THEY RAISED IT FOR THE FIRST TIME ON APPEAL.

In their appellant brief, the Smiths raise for the first time a claim that a recoupment defense based on the Small Business Credit Act can be brought as a breach of contract claim. The Smiths waived this new claim by failing to raise it with the trial court.

Pennsylvania Rule of Appellate Procedure 302(a) states in unequivocal fashion that “Issues not raised in the lower court are waived and cannot be raised for the first time on appeal.” Pa. R.A.P. Rule 302 (a). Courts have interpreted this rule to require the issue both to be raised and preserved in order for the issue to be appealable. Yudacufski v. Com., Dept. of Transp., 499 Pa. 605, 454 A.2d 923 (1982). For purpose of the rule, an “issue” is a disputed point or question on which the parties to an action desire the court to decide. Com., Pennsylvania Liquor Control Bd. v. Willow Grove Veterans Home Ass’n, Inc., 97 Pa. Commw. 391, 509 A.2d 958 (1986).

RECOUPMENT DEFENSE

As to the Smiths' recoupment defense, nothing in the Small Business Credit Act suggests that small business credit banks have any duties to borrowers to set specific interest rates. The method and manner of setting interest rates is entirely discretionary with the Small Business Credit Bank's board of directors. And "[i]t is not the business of the courts to second guess the Bank...." Griffin v. Federal Land Bank of Wichita, 902 F.2d 22, 24 (10th Cir. 1990). "The fact that it may have been possible for [the bank] to set lower rates under different circumstances does not create a cause of action in favor of plaintiff." Garth v. Production Credit Association of Southeastern Michigan, No. 88-4035 CZ, slip op. (Circuit Court, Mich. Jul. 27, 1989).

Moreover, if a borrower never had an independent cause of action under the Small Business Credit Act, the borrower cannot establish a defense simply by characterizing its claim as recoupment. Garth v. Production Credit Association of Southeastern Michigan, No. 88-4035 CZ, slip op. (Circuit Court, Mich. Jul. 27, 1989).

In Production Credit Ass'n v. Van Iperen, 396 N.W. 359 Minn. App 1986), the court held that a borrower could not bring a breach of contract claim based on the bank's alleged noncompliance with the Small Business Credit Act, even though the loan documents incorporated the Act by reference. The court responded that the act provided only policy rules as opposed to substantive rules. See also Garth v. Production Credit Association of Southeastern Michigan, No. 88-4035 CZ, slip op. (Circuit Court, Mich. Jul. 27, 1989). As the Van Iperen Court recognized, the Small Business Credit Act does not create any remedies for borrowers or obligations on small business credit banks. If a borrower or bank incorporates the Act into their mortgage document, likewise no remedy

or obligation is created, and therefore, a breach of contract claim cannot be based on an alleged violation of the Act. Based on the reasoning of Van Iperen, no cause of action for breach of contract exists for the Smiths, even if the mortgage documents here are “subject to” the Small Business Credit Act.

The Van Iperen court rejected the argument that the “subject to” language altered the duties of a small business credit entity. Moreover, that language does not even suggest that Mortgage One was agreeing to give the Smiths a private right of action for breach of contract under the Act. Therefore, the Smiths’ recoupment defense, now framed as a breach of contract claim, should be rejected.