

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

STONE ENTERTAINMENT, INC. :
AND ELLIOT STONE :
 :
v. : CIVIL ACTION
 :
BARRY C. GEFTMAN, THE RIVER : NO. 98-6123
CAFE, INC., ADVERTISING BY :
BY DESIGN, INC., GEFTMAN :
GEFTMAN ORGANIZATION, INC. :
AND U.S. SMALL BUSINESS :
ADMINISTRATION :

MEMORANDUM ORDER

Plaintiffs allege the following. They agreed to purchase The River Cafe, a bar and restaurant, from defendant Geftman for \$2,500,000. The agreement provided for the execution of a note for \$200,000 in favor of Mr. Geftman, the assumption of the sellers' outstanding obligations under three SBA mortgages totaling \$841,700 and payment of the balance of the purchase price in cash. The mortgage payment obligations were assumed by plaintiff Stone Entertainment and guaranteed by plaintiff Elliot Stone. With the consummation of the transaction, the SBA released its lien on Mr. Geftman's residence which served as collateral for its loans. A year after the sale, plaintiffs realized that representations about the revenues of the business made by Mr. Geftman as the sole shareholder of each corporate defendant were false and that the fair market value of the business was only \$1,500,000.

Plaintiffs seek to recover \$1,000,000 in damages for fraud from Mr. Geftman and the defendant corporations. Plaintiffs also seek a declaration that the \$200,000 note, mortgage assumption and guarantees are void because they were fraudulently induced and that Stone Entertainment is no longer obligated to make payments to the SBA on the mortgages it assumed and Mr. Stone guaranteed.

Federal jurisdiction is predicated solely on 28 U.S.C. § 1346. Plaintiffs assert that the court has "ancillary jurisdiction" over the claims against the other defendants.¹ Presumably, plaintiffs mean to invoke supplemental jurisdiction. See 28 U.S.C. § 1367.

"Federal courts have an ever-present obligation to satisfy themselves of their subject matter jurisdiction and to decide the issue sua sponte." Liberty Mut. Ins. Co. v. Ward Trucking Corp., 48 F.3d 742, 750 (3d Cir. 1995). See also American Policyholders Ins. v. Nyacol Products, 989 F.2d 1256, 1258 (1st Cir. 1993) ("a federal court is under an unflagging duty to ensure that it has jurisdiction"); Steel Valley Authority v. Union Switch & Signal Div., 809 F.2d 1006, 1010 (3d Cir. 1987) ("lack of subject matter jurisdiction voids any decree entered in a federal court"); Wisconsin Knife Works v. National Metal

¹ There is not complete diversity of citizenship among the parties.

Crafters, 781 F.2d 1280, 1282 (7th Cir. 1986) ("[t]he first thing a federal judge should do when a complaint is filed is check to see that federal jurisdiction is properly alleged"). If anything, this principle applies with even greater force where a question of sovereign immunity is involved.

There is no federal jurisdiction under 28 U.S.C. § 1346 which provides subject matter jurisdiction only for certain claims for monetary relief against the United States. See United States v. Mitchell, 463 U.S. 206, 216 (1983) (only claims for money damages cognizable under § 1346); Richardson v. Morris, 409 U.S. 464, 465 (1973) (§ 1346 does not authorize suits for equitable relief against the United States); United States v. Woods, 986 F.2d 669, 680 n.23 (3d Cir. 1993) (§ 1346 authorizes only claims for money damages); 14 Charles Alan Wright et al., Federal Practice and Procedure § 3657 (3d ed. 1998) (§ 1346 authorizes suits against the United States only for money damages and not for declaratory or other forms of equitable relief).

Although not cited by plaintiffs, 15 U.S.C. § 634(b) confers jurisdiction on the state and federal courts to entertain suits against the Administrator of the SBA. The statute, however, does not waive immunity as to any claim for an "attachment, injunction, garnishment or other similar process ... against the Administrator or his property."

The "other similar process" language has been read to preclude a claim for declaratory relief. See Murray v. Kleppe, 424 F. Supp. 108, 109 (E.D. Pa. 1977) (holding no jurisdiction under § 634(b) or otherwise to adjudicate claim for declaratory relief against Administrator of SBA). This view has some force in view of the admonition of the Supreme Court that "waiver of the Federal Government's sovereign immunity must be unequivocally expressed in statutory text" and that "a waiver of the Government's sovereign immunity will be strictly construed in terms of its scope in favor of the sovereign." Lane v. Pena, 116 S. Ct. 2092, 2096 (1996).

Some courts have entertained suits against the administrator for declaratory relief regarding the exercise of his powers or the performance of his duties and the legality of his actions under applicable statutes and regulations. See Palmer v. Weaver, 512 F. Supp. 281, 285 (E.D. Pa. 1981). Where a plaintiff frames his claim as one for declaratory relief but really seeks the equivalent of injunctive relief, the court is without authority to grant it and the claim must be dismissed. Id. A declaration that plaintiffs are no longer legally obligated to make payments to the SBA under the mortgages or guarantees would effectively preclude the agency from enforcing these obligations and would thus be the equivalent of injunctive relief. See Mar v. Kleppe, 520 F.2d 867, 869 (10th Cir. 1975)

(request for order releasing plaintiffs from liability to SBA as guarantors on lease agreement must be construed as effectively seeking to enjoin SBA from enforcing guarantees and thus is not encompassed by waiver in § 634).²

Plaintiffs also seem to suggest that the court has jurisdiction "because the United States is a necessary party defendant." The short answer, of course, is that the United States cannot be a defendant unless it has explicitly waived sovereign immunity with regard to the claim. Moreover, even if it were a private mortgagee, the SBA would not be a necessary party to this action. See, e.g. Cajun Electric Power

² While "sovereign immunity deprives the courts of jurisdiction irrespective of the merits of the underlying claim," Koehler v. United States, 153 F.3d 263, 267 (5th Cir. 1998), the court does not mean to suggest that plaintiffs have pled a cognizable claim for declaratory relief against the SBA. They have not, but this is not a basis for dismissal at this juncture. Fraud in the inducement renders a contract voidable but not void ab initio. Levin v. Garfinkle, 492 F. Supp. 781, 807 (E.D. Pa. 1980) ("A contract induced by fraud is not void, but only voidable.") See also Associated Hardware Supply Co. v. Big Wheel Distributing Co., 355 F.2d 114, 120 (3d Cir. 1965); Crummer v. Berkman, 499 A.2d 1065, 1066 (Pa. Super. 1985). Further, plaintiffs do not allege that the SBA had reason to know of the fraud when it materially changed its position by releasing the lien on the Geftman residence and agreed to look to plaintiffs for payment. Indeed, plaintiffs allege it took them a year to discern that defendants' representations were fraudulent. In such circumstances, plaintiffs' contractual obligations to the SBA are also not voidable. See Restatement of Contracts § 477; Taxin v. Food Fair Stores, Inc., 287 F. 2d 448, 450 (3d Cir. 1961); Blum v. Goldman, 164 F.2d 192, 196-97 (3d Cir. 1947); Hardinge v. Kuntz, 122 A. 509, 511 (Pa. 1923); Sonnenstein v. Massachusetts Mut. Life Ins. Co., 310 A.2d 371, 374 (Pa. Super. 1973).

Cooperative, Inc. v. Gulf States Utilities Co., 132 F.R.D. 42, 46-47 (M.D. La. 1990) (mortgagee who provided financing for business venture not necessary party in suit to void transaction for fraud); Bosteve Ltd. v. Marauszski, 110 F.R.D. 257, 260 (E.D.N.Y. 1986) (mortgagee not necessary party to claim plaintiff was fraudulently induced to assume future mortgage payments). One reason is that the right of the mortgagee to receive repayment is not impaired. Id.³

It is possible that plaintiffs can in good faith and consistent with Fed. R. Civ. P. 11 plead a claim against the SBA administrator over which the court would have jurisdiction. Moreover, plaintiffs have asserted claims against the other defendants which are cognizable in the state courts. The court will thus dismiss plaintiffs' complaint without prejudice.

³ Of course, the amount plaintiffs have been obligated to pay the SBA may be recoverable in damages from defendants. The court notes, however, that plaintiffs seek money damages plus the benefit of rescission without relinquishing the business. If they were to obtain the relief they request, they would be relieved of their obligations under the mortgages and promissory note and would receive \$1,000,000 in damages from defendants. As a result, plaintiffs would effectually have obtained for less than \$500,000 a business they acknowledge was worth \$1,500,000. If plaintiffs obtain the \$1,000,000 in damages claimed from defendants, plaintiffs will have recovered the difference between what they paid and the value of what they received, the conventional measure of damages recoverable for fraud.

ACCORDINGLY, this day of December, 1998, **IT IS**
HEREBY ORDERED that the complaint in the above action is
DISMISSED without prejudice.

BY THE COURT:

JAY C. WALDMAN, J.