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

PROPERTY ACCEPTANCE CORP., Plaintiff,	:	CIVIL ACTION
v.	:	
MERTON H. ZITIN, et al., Defendants	:	NO. 04-3920

MEMORANDUM AND ORDER

McLaughlin, J. August 15, 2007

The plaintiff brings this suit to collect on a guaranty signed by the defendants. After twice denying the parties' cross-motions for summary judgment, the Court held a bench trial on July 12, 2007. For the reasons stated below, the Court will enter judgment in favor of the plaintiff and against the defendants.

I. Background

The Court incorporates the factual discussion from its prior memoranda. To summarize briefly: the Court's Memorandum and Order of September 26, 2005 held that each monthly payment missed by the debtor was a separate event of default and that the plaintiff was under an obligation to make a demand for payment under the guaranty within a reasonable time following each missed payment. Op. at 10. The Court, and the parties, assumed that the note was first accelerated in 2003 so that each prior month

represented a missed payment.

The defendants claimed for the first time in May of 2006, more than a year after this suit was filed, that the records of the Small Business Administration ("SBA") revealed that this assumption was incorrect and that the note was accelerated in 1993 after the SBA honored its guaranty of the debenture that was used to fund the note. Defs.' Br. in Supp. of May 17, 2006 at 2. If this is true, then the last "missed payment" would have occurred immediately after acceleration in 1993. The parties agree that if the note was in fact accelerated in 1993, the gap between acceleration and the plaintiff's demand under the guaranty was unreasonable. The parties also agree on the amount owed by the defendants if the note was not accelerated.

In a Memorandum and Order of March 20, 2007, the Court denied both parties' motions for summary judgment because of the existence of a dispute of material fact about whether there was an acceleration of the note in 1993. This was the sole factual issue contested at trial.

II. Analysis

Because the parties concede that liability turns on whether the note was accelerated in 1993, this case presents a single legal question: who bears the burden of proving that

acceleration did or did not occur? The parties agree that whoever bears the burden of proving that the plaintiff's demand was or was not made within a "reasonable time" after each missed payment also bears the burden on acceleration. Each asserts that the other bears this burden.

The plaintiff bases its argument on the fact that the statute of limitations on an action under a guaranty does not begin to run until a demand is made. Courts require a demand within a reasonable time after default, it asserts, to prevent the indefinite forestalling of the statute of limitations. It argues that because of the "reasonable time" requirement's relation to the statute of limitations, it too is an affirmative defense that must be proven by the defendants.

The defendants, meanwhile, point out that the plaintiff must show that it made a demand in order to recover for breach of the guaranty. They argue that proving that the demand was made within a reasonable time is "part and parcel" of this showing. Defs.' Br. at 2.

The Court finds it unnecessary to resolve this issue. The Court assumes that the plaintiff bears the burden of proving non-acceleration and finds that it has done so. The following represents the Court's findings of fact.

The note guaranteed by the defendants states that the entire amount due under the note shall immediately become due and

payable, subject to the terms of the loan agreement, if the debtor fails to make payments. Pl.'s Ex. 3. The loan agreement provides that if the debtor remains in default for fifteen days, "[t]he entire unpaid principal of the Note, and the interest then accrued thereon, shall become and be immediately due and payable upon the written demand of the Lender or its Assigns." Pl.'s Ex. 2 at 24-25.

Under the note, therefore, acceleration occurs only when the lender sends a letter to the borrower (in this case, the Sandy Mac Food Company) demanding immediate payment of the principal of the note and all accrued interest. In the absence of an acceleration, the note proceeds along its payment plan of monthly payments for 25 years.

In this case, there is no direct evidence of acceleration –- notice sent to Sandy Mac demanding payment of the entire amount due under the note. Robert Zitin, Sandy Mac's secretary, testified that he had no knowledge of any acceleration besides the acceleration in 2003. Tr. at 130. He further testified that to the best of his knowledge, neither Merton Zitin, the president of Sandy Mac, nor Michael Zitin had received previous notice of acceleration. Tr. at 130-31. Acceleration of the note does not require notice to the defendants as guarantors, but because of their ownership and management of Sandy Mac, the fact that they did not receive notice of acceleration in 1993

weighs strongly in favor of a finding that an acceleration did not occur.[1] See Joint Pretrial Stip. ¶¶ 2, 7 (stating that the defendants were "officers, directors and stockholders" of Sandy Mac and that the note was executed by Merton Zitin on behalf of the company).

The plaintiff's file of the Sandy Mac loan, which was provided to it by the SBA, is similarly devoid of evidence of acceleration. The file is slim, according to Lisa Cavender, a representative of Beal Service Corporation, a loan servicer for the plaintiff. Tr. at 50. The file does, however, include a "Borrower History" which contains a list of debits and credits for the Sandy Mac account but not any indication that the note was accelerated. Tr. at 50, 61.[2]

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[1] In its Memorandum and Order of March 20, 2007, the Court stated that it was unclear what weight to accord the fact that the defendants did not receive notice of acceleration for several reasons, including the uncertainty surrounding who specifically was making payments on the note after the sale of Sandy Mac's assets to S-M Acquisition. See Op. at 8-10. (The asset sale occurred in contravention of the loan agreement, which forbids transfer of Sandy Mac's property without approval by the SBA, which the company did not have. See Pl.'s Ex. 2 at 22.) Because of the defendants' failure to explain the mechanics of the asset sale or their involvement with Sandy Mac, S-M Acquisition, or the note after the transaction, –- in other words, because the defendants have not explained why it should not do so –- the Court treats the lack of notice to the defendants as a fact weighing against a finding that the note was accelerated.

[2] If the file had suggested otherwise, the plaintiff would presumably not have sent its notice of acceleration in 2003, which would have been meaningless if the note had already been accelerated in 1993.

The lack of any record of acceleration is sufficient for the plaintiff to show, by a preponderance of the evidence, that the note was not accelerated. (It is not clear what other evidence the plaintiff could produce besides the lack of notice to the debtor and its owners and the absence of copies of any notice in the files of the lender.) Because the existence of acceleration turns on whether notice was sent to the debtor by the noteholder, the Court draws from the absence of notice the inference that there was no acceleration.

The defendants argue that this inference is unwarranted because the SBA's records indicate that there was an acceleration of the note prior to 2003. The basis for their belief is the increase in the amount of principal due under the note after it was transferred to the SBA. Although the loan had a principal amount of $174,608.90 at the time it was acquired by the SBA, the SBA listed its principal balance as $249,470.92 at the time it was sold to the plaintiff. Pl.'s Exs. 40, 47. The defendants claim that this increase in principal is attributable to acceleration, which would have capitalized the note's interest, unpaid principal, and prepayment fees, forming a new principal balance on which to calculate interest.

Assuming that the SBA did not simply make a mistake in its records, they show that some amount was indeed added to the principal of the loan while it was held by the SBA. The records

do not, however, support the defendants contention that this increase was due to acceleration. As Ms. Cavender noted, acceleration makes the outstanding principal immediately due and payable but does not affect the principal balance of the note. Tr. at 42. The principal amount of the loan changes only if the loan contains a specific provision that allows capitalization. Tr. at 44. The note in this case contains a provision that allows the holder to add to the principal amount costs incurred in enforcing the note or preserving the loan's collateral, but neither the note nor the loan agreement allows the noteholder to add interest and unpaid fees to the principal balance upon acceleration. Tr. at 58-59. Without a clause authorizing augmentation of the principal balance upon acceleration, there is no basis for concluding that acceleration was the cause of the increase in principal.

The testimony of the defendants' only witness, John Villios, District Counsel for the SBA, is consistent with this conclusion. He testified that the new loan number opened by the SBA after it acquired the note represented a note receivable for the amount that it expended to honor its guaranty of the debenture. Tr. at 103-05. He did not, however, testify that the SBA's records suggested that an acceleration had occurred. To the contrary, he testified that acceleration does not increase the amount of a loan's principal. Tr. at 111. He thus attested

to the undisputed fact that the SBA increased the principal amount of the note, but he did not claim that this implied acceleration.

The plaintiff claims, without citation to the record, that Mr. Villios "essentially testified" that the records revealed that the note was "immediately due and payable." Defs.' Br. at 5. Mr. Villios's actual testimony, however, was a general statement that a note receivable is a note that is "currently due." Tr. at 104. This appears to be a claim about the way that notes receivable are accounted for in a company's books. It is not an assertion that the SBA's records reveal that the entire balance of the note in this case was "immediately due and payable."[3]

The defendants' final argument is that the absence of several documents in the SBA's loan file implies that the note was accelerated. They contend that a new amortization schedule, establishing new payment amounts, would be necessary if the loan

[3] Even if Mr. Villios intended to assert that the note was accelerated, the Court would reject such testimony. He had no personal involvement with the note in this case, and no knowledge of the terms of the note, the loan agreement, or the guaranty. Further, the program under which the note was issued was discontinued prior to his arrival at the SBA, and it is the SBA's Washington office, not the local district offices, that initiates SBA loans. Tr. at 92, 96, 106, 108. In any event, testimony about the SBA's records would be, at most, indirect evidence of acceleration because they do not speak to the precise question at issue: whether notice was sent to the debtor demanding immediate payment of the entire sum due under the note.

was in default but not accelerated to ensure that the loan was payed back within the required timeframe. They further point to the lack of any documents relating to the servicing of the loan, which they claim would have been in the SBA's file unless the loan were accelerated.

The Court does not view these absences as evidence of acceleration. The defendants did not elicit testimony on the importance of these gaps in the SBA file, and the Court declines to speculate.[4] The defendants, therefore, have failed to counter the plaintiff's evidence that the SBA did not alter the note's 25-year payment plan when it honored its guaranty of the debenture. Because the defendants' only defense to the plaintiff's claim was conditioned on a prior acceleration of the note, the plaintiff is entitled to judgment in its favor.

The final matter is the amount of the judgment. As the Court stated in its Memorandum of March 20, 2007, the parties agree that if the loan was accelerated for the first time in

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[4] Even if the Court were to speculate, these facts do not seem to support acceleration. First, the lack of a "new" amortization schedule does not appear unusual given that there was no prior amortization schedule. The only amortization tables produced in this case were prepared by the plaintiff. See Pl.'s Exs. 41, 42. Second, it is not clear how the lack of any correspondence with the debtor in the SBA's files supports the defendants' contention that there was an acceleration. There was no testimony taken about what documents would be sent to the debtor, and therefore might be in the debtor's file, if there was no acceleration. In fact, the only piece of correspondence that the evidence establishes must be sent to the debtor is any notice of acceleration, and such notice is not in the Sandy Mac file.

2003, the defendants are liable for $149,936.92 in principal and $134,133.73 in interest, with additional interest of $48.20 for each day after April 1, 2006. By the Court's calculation, there are 502 days (for additional interest of $24,196.40) between April 1, 2006 and the date of this Memorandum, August 15, 2007. The defendants' liability for the unpaid balance of the note is therefore $308,267.05.

An appropriate order follows.

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ORDER

AND NOW, this 15th day of August, 2007, after a bench trial held on July 12, 2007, IT IS HEREBY ORDERED that judgment is entered in favor of the plaintiff and against the defendants in the amount of $308,267.05 for the unpaid balance of the note.

The plaintiff claims that under the guaranty, it is also entitled to recover costs and attorneys' fees. The plaintiff may file a brief on or before August 28, 2007 itemizing such expenses and giving the legal basis for their recovery. The defendants may file an opposition within ten days of the plaintiff's brief.

BY THE COURT:

/s/ Mary A. McLaughlin
Mary A. McLaughlin, J.