

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

FIDELITY AND GUARANTY INSURANCE COMPANY,	:	CIVIL ACTION
	:	
	:	
Plaintiff,	:	
	:	
v.	:	
	:	
	:	
KEYSTONE CONTRACTORS, INC.;	:	
KEYTEL DEVELOPMENT CORPORATION;	:	
TELFORD RENTALS, INC.;	:	
DONALD STAUFFER, Jr.;	:	
CYNTHIA STAUFFER;	:	
ROBERT J. STAUFFER;	:	
AND HEATHER STAUFFER,	:	
	:	
Defendants.	:	NO. 02-CV-1328

Reed, S.J.

August 14, 2002

MEMORANDUM

Presently under the consideration of this Court is the motion of defendants Keystone Contractors Inc., Keytel Development Corporation, Telford Rentals Inc., Donald Stauffer Jr., Cynthia Stauffer, Robert J. Stauffer and Heather Stauffer (collectively, "Keystone") for relief from a default judgment pursuant to Federal Rules of Civil Procedure 55(c) and 60(b)(1) and the response from plaintiff Fidelity & Guaranty Insurance Company ("F&GIC") thereto. Keystone has also moved for a stay of proceedings in aid of execution pending the resolution of the motion to vacate the default judgment. For the reasons that follow, Keystone's motion to vacate the default judgment will be denied, and the accompanying motion to stay the proceedings will be denied as moot.

FACTUAL AND PROCEDURAL BACKGROUND

F&GIC is a surety company that underwrote and issued “Payment Bonds” for three construction projects involving Keystone.¹ The three bonds were issued pursuant to the terms of a General Agreement of Indemnity (“GAI”) executed between F&GIC and Keystone on May 6, 1999. All three Payment Bonds were issued on behalf of Keystone as the principal. F&GIC issued the first Payment Bond in the amount of \$1,097,000 to the Upper Merion School District for construction work on the New Roberts school. The second Payment Bond was issued to the Berks Career and Technology Center in the amount of \$359,000, and a third Payment Bond in the amount of \$925,000 was issued to Bilt-Rite Contractors, Inc. for construction work on the Owen J. Roberts school. Under the express terms of the GAI, Keystone is obligated to indemnify the surety, F&GIC, against all liability and losses relating to the execution of the three Payment Bonds. The GAI further requires Keystone to provide the surety, F&GIC, with collateral equal to the amount of any monetary reserve which F&GIC may establish in anticipation of future claims, losses or other expenses resulting from the execution of the three Payment Bonds.

For reasons unknown to this Court, Keystone became financially unable to meet its payment and performance obligations to other contractors and suppliers with which it worked on these construction projects. Accordingly, on April 3, 2001, F&GIC sent a letter by certified mail apprising Keystone of claims in the amount of \$101,140.21 that had been brought against the New Roberts school and Berks Career and Technology Payment Bonds. Pursuant to the GAI, F&GIC demanded indemnification for these claims and cash or other collateral equal to the

¹ The so-called “Payment Bonds” are actually suretyship bonds, with F&GIC acting as the surety, Keystone as the principal and the respective bond holders as the obligees.

reserve of \$125,000 that it had established under these Payment Bonds. F&GIC sent another letter on January 28, 2002 notifying Keystone that the amount of the reserve had been increased to \$404,875 in light of claims and reasonable expenses that it had incurred against all three of the Payment Bonds; the letter demanded a cash deposit or other collateral within ten days for the amount held in reserve. Keystone has withheld the required indemnification and reserve payments.

F&GIC filed this action against Keystone on March 15, 2002. All of the defendants were duly served with the complaint by March 28, 2002, and their counsel became aware of the service upon them by April 1, 2002. F&GIC sought a default judgment on April 19, 2002 after Keystone failed to file a responsive pleading within the statutorily allotted time frame. See Fed. R. Civ. P. 12(a)(1)(A) (providing that “a defendant shall serve an answer within 20 days after being served with the summons and complaint”). This Court entered a default judgment against Keystone in the amount of \$404,875 on April 25, 2002; no other equitable or compensatory relief was granted in the judgment. F&GIC issued a Writ of Execution and an accompanying Subpoena for a Deposition in Aid of Execution against the defendants on May 13, 2002. On June 10, 2002 a U.S. Marshall personally served the defendants with the Writ and Subpoena scheduling the depositions for June 18, 2002. The defendants filed this motion for relief from the default judgment and for a stay of the accompanying proceedings in aid of enforcement of the judgement on June 19, 2002.

LEGAL STANDARD FOR VACATING A DEFAULT JUDGEMENT

Although setting aside a default judgment pursuant to Federal Rules of Civil Procedure 55(c) and 60(b)(1) is left primarily to the discretion of the District Court, the Court of Appeals

for the Third Circuit has circumscribed that power of decision with repeated admonitions to dispose of cases on the merits whenever practicable.² See e.g., Hritz v. Woma Corp., 732 F.2d 1178, 1181 (3d Cir. 1984); United States v. \$55,518.05 in U.S. Currency, 728 F.2d 192, 194-95 (3d Cir. 1984). In accordance with this directive, doubtful cases must be resolved in favor of the party moving to upset the default judgment. Id. This presumption applies *a fortiori* to matters involving large sums of money. Tozer v. Charles A. Krause Milling Co., 189 F.2d 242, 245 (3d Cir. 1951). The resolution of a motion to vacate a default judgment under Rule 60(b) is subject to a four factor test, the elements of which are: (1) whether lifting the default would prejudice the plaintiff; (2) whether the defendant has a *prima facie* meritorious defense; (3) whether the defaulting defendant's conduct is excusable or culpable; and (4) the effectiveness of alternative sanctions. See Emcasco Ins. Co. v. Sambrick, 834 F.2d 71, 73 (3d Cir. 1987). Of the four factors, a meritorious defense is the *sine qua non* for overturning a default judgment; if the defendant cannot win at trial, there is quite simply no point in setting aside the default judgment. See \$55,518.05 in U.S. Currency, 728 F.2d at 195. The manner in which the District Court balances all of these factors must be based on explicit findings of fact derived from the pleadings. See Emcasco, 834 F.2d at 74. Because the finding of facts tantamount to a meritorious defense is a threshold determination, I will begin the analysis by considering this factor.

² Federal Rule of Civil Procedure 55(c) provides as follows:

(c) Setting Aside Default. For good cause shown the court may set aside an entry of default and, if a judgement by default has been entered, may likewise set it aside in accordance with rule 60(b).

Federal Rule of Civil Procedure 60(b) provides in pertinent part:

(b) Mistakes; Inadvertence; Excusable Neglect; Newly Discovered Evidence; Fraud, Etc. On motion and upon such terms as are just, the court may relieve a party or a party's legal representative from a final judgement, order or proceeding for the following reasons: (1) mistake, inadvertence, surprise or excusable neglect

ANALYSIS ³

For purposes of a motion to vacate a default judgment, a meritorious defense exists when the “allegations of defendant’s answer, if established on trial, would constitute a complete defense to the action.” Tozer, 189 F.2d at 244; \$55,518 in U.S. Currency, 728 F.2d at 195. A meritorious defense cannot be fashioned from “simple denials and conclusionary statements.” Ferrostaal Metals Corp. v. Carle Shipping Corp., No. 93-3041, 1994 WL 2517, at * 3 (E.D. Pa. 1994) (quoting \$55,518 in U.S. Currency, 728 U.S. at 195). Nevertheless, the standard against which a defendant’s answer is measured only requires that the proffered defense not be “facially unmeritorious.” Emcasco, 834 F.2d at 73-74 (quoting Gross v. Stereo Components Systems Inc., 700 F.2d 120,123 (3d Cir. 1983)).

Keystone’s proposed answer is replete with simple denials and conclusionary statements. At various points within their proposed answer, defendants attempt to rely upon Federal Rule of Civil Procedure 8(b) in pleading insufficient knowledge or information to form a belief as to the truth of various averments by plaintiff. However, their attempts to deny sufficient knowledge or information on matters clearly within the scope of their knowledge are so blatantly evasive as to be ineffective as denials. See 5 CHARLES A. WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1262 (1990). For example, Keystone denies sufficient knowledge or information that they executed the GAI, despite their notarized signatures on the document. (Proposed Answer, ¶ 13; GAI at 4-6.) Similarly, Keystone denies sufficient knowledge or information as to its own financial ability to meet its payment and performance obligations on the

³ Parties appear to agree that Pennsylvania law applies in this diversity action. Therefore, this Court will not engage in a conflicts of law analysis.

relevant contracts, claiming such information was solely within the possession of plaintiff. (Proposed Answer, ¶ 18.) The failure of defendants to comply in good faith with the basic federal pleading rules belies the existence of a meritorious defense to the claims asserted.

What few facts Keystone does allege contest the amount of damages awarded, not the underlying issue of liability. Keystone advances three defenses against separate portions of the damages claimed by F&GIC under the Payment Bonds: With respect to the New Roberts school and Berks Career and Technology Center Payment Bonds, Keystone argues that no new claims will be brought against F&GIC because construction has been completed on these projects. Therefore, Keystone asserts, \$10,414.62 of the default judgment under the New Roberts school Payment Bond and \$9,521.92 under the Berks Career and Technology Center Payment Bond are for “claims not made, paid or reported on this project.”⁴ (Affidavit of Donald L. Stauffer, Jr. ¶¶ 21, 23). In the case of the Owen J. Roberts school Payment Bond, Keystone argues that the reserve demanded in the amount of \$291,623.00 is “unnecessary and would be invalid under the general terms of the general agreement of indemnity.” (Proposed Answer, Second Affirmative Defense). Keystone contends it is only obligated to complete \$25,000 worth of the remaining construction work. *Id.* Thus, according to Keystone, it should not be required to provide collateral for a reserve under the Owen J. Roberts school Payment Bond greater than \$25,000. Keystone further asserts that all \$62,164.26 of the “reasonable expenses” claimed under the Owen J. Roberts school Payment Bond “would have been unreasonable, unjustified and made in

⁴ F&GIC demanded Keystone provide collateral against a reserve of \$87,267.00 established under the New Roberts school Payment Bond in response to \$75,212.07 of claims F&GIC already paid. Under the Berks Career and Technology Center Payment Bond, F&GIC established a reserve of \$25,985.00 in response to \$14,093.60 of claims already paid. The amount contested by Keystone represents the difference between the amount of the claims and the reserve under both Payment Bonds.

bad faith [had Keystone paid them].” (Proposed Answer, Fifth Affirmative Defense). Lastly, Keystone believes that it is entitled to a set-off of \$163,000 against its financial obligations F&GIC, the amount which Bilt-Rite Contractors Inc. owes to Keystone for work that it has already completed on the Owen J. Roberts project.

Under general principles of contract interpretation in Pennsylvania, when the words of a contract are clear and unambiguous, the contract is construed as a matter of law from its contents alone. See Mace v. Atl. Ref. & Mrktg. Corp., 785 A.2d 491, 495-96 (Pa. 2001). The GAI provides that Keystone is obligated to indemnify F&GIC, as well as provide collateral equal to the amount of any reserve established under the Payment Bonds. (GAI, ¶¶ 6-7).⁵ Under Pennsylvania law, where the principal expressly “agreed to place the surety company in the funds which it *might require before* the surety company should be required to make payment [on a

⁵ In paragraph 6, the GAI provides in pertinent part:

The UNDERSIGNED will indemnify the SURETY and hold it harmless from and against all liability, losses, costs, damages, attorneys fees, disbursements and expenses of every nature which the surety may sustain or incur by reason of, or relating to having executed or procured the execution of any such bond, or that may be sustained or incurred by reason of making any investigation of any matter, or prosecuting or defending any action in connection with any such bond, or recovering any salvage or enforcing any provision of this agreement.

(GAI, ¶ 6).

In paragraph 7, the GAI provides in pertinent part:

If the SURETY [F&GIC] shall set up a reserve to cover any contingent claim or claims, losses, costs, attorneys fees and/or other expenses in connection with any such bond, the UNDERSIGNED [Keystone], within ten (10) days after transmittal of written demand by the SURETY, shall pay to the SURETY current funds in an amount equal to such reserve, and any subsequent increase thereof, such funds to be held by the SURETY as collateral in addition to the indemnity afforded by this agreement, with the right to use the same or any part thereof, at any time, in payment or compromise of any judgement, claim, liability, loss, damage, attorneys fees and disbursements or other expenses.

(GAI, ¶ 7).

claim] ... [s]uch a contract is legal, and may be the basis of a recovery.” Tennant v. United States Fidelity and Guarantee Co., 17 F.2d 38, 39 (3d Cir. 1927) (emphasis added). The surety is entitled to specific performance under a collateral security agreement like the one included in the GAI. See United States Fid. & Guar. Co. v. Feibus, 15 F. Supp. 2d 579, 588 (M.D. Pa. 1998) (recognizing that collateral security agreements “have routinely been upheld”), aff’d, 185 F.3d 864 (3d Cir. 1999); United Bonding Ins. Co. v. Stein, 273 F. Supp. 929 (E.D. Pa. 1967); American Motorists Ins. Co. v. United Furnace Co., 876 F.2d 293, 301-02 (2d Cir. 1989). Thus, under the express terms of the GAI, F&GIC may establish a reserve to cover any future claim against the Payment Bonds, and may demand that Keystone provide it with funds which F&GIC is to hold as collateral against the reserve. The GAI provides that F&GIC may hold collateral against the amount of any reserve until the termination of *F&GIC’s liability* on the Payment Bonds. Thus, Keystone must pay F&GIC the full amount of the reserve set under the Payment Bonds in accordance with the default judgment. However, the surety may not reap a windfall by retaining collateral security payments which are not used to pay claims from an obligee. See Feibus, 15 F. Supp. 2d at 588. F&GIC has acknowledged its obligation to return whatever remains of Keystone’s collateral security payments if the claims it had envisioned fail to materialize. (Plaintiff’s Response to Defendants’ Motion, at 22; Declaration of Matthew L. Silverstein, ¶ 60).

Keystone also contests the \$62,164.26 of expenses under the Owen J. Roberts school Payment Bond for which F&GIC demands immediate indemnification. Keystone alleges that the expenses were incurred in bad faith because they were “unspecified and unauthorized.” (Defendants’ Memorandum of Law, at 13; Affidavit of Donald L. Stauffer, Jr., ¶ 12).

Specifically, defendants argue that they were not provided copies of invoices. For this reason, defendants could neither monitor fees and costs that F&GIC incurred under the Owen J. Roberts school Payment Bond, nor ascertain whether they were justified. (Affidavit of Donald L. Stauffer, Jr., ¶¶ 12, 15 and 17). The standard for “bad faith” of a surety “implies the conscious doing of a wrong because of dishonest purpose or moral obliquity.” Feibus, 15 F. Supp. 2d at 585 (quoting PolSELLI v. Nationwide Mut. Fire Ins. Co., 23 F.3d 747, 751 (3d Cir. 1994)). Even gross negligence on the part of a surety in paying a claim or incurring expenses does not satisfy this standard. Id. That a surety has made payments without giving the principal notice is not evidence of bad faith. See id. at 587 (citing Transamerica Ins. Co. v. Avenell, 66 F.3d 715, 719 (5th Cir. 1995)). Under the GAI, Keystone agreed that:

[F&GIC] shall be entitled to damages for any and all disbursements made by it in good faith under the belief that it is or was liable for the sums and amounts so disbursed, or that it was necessary or expedient to make such disbursements, whether or not such liability, necessity or expediency existed.

(GAI, ¶ 6). The terms of the GAI allow F&GIC to settle claims and incur expenses regardless of actual liability. Accordingly, F&GIC is under no obligation to secure Keystone’s approval prior to reaching a settlement or incurring an expense under the Payment Bonds. F&GIC’s payments of the alleged “unspecified and unauthorized” expenses were made in accordance with the express provisions of the GAI, and thus are not evidence of bad faith. Therefore, I conclude that Keystone has failed to state a meritorious defense to these expenses under the Owen J. Roberts school Payment Bond.

Finally, Keystone argues that the damages should be reduced by \$163,000, the amount owed by Bilt-Rite Contractors, Inc. to Keystone for work completed on the Owen J. Roberts

project. F&GIC had sent a letter on January 2001 to Bilt-Rite Contractors Inc. demanding payment directly pursuant to their rights under the GAI. Under paragraph 12(a) of the GAI, the parties agreed:

In the event ... (iii) any breach of the terms of this Agreement ... shall occur, the UNDERSIGNED [Keystone] ... hereby assign[s] and set[s] over unto the SURETY [F&GIC] ... their [its] right, title and interest in and to; (a) ... all moneys and properties that may be, and that thereafter may become, payable to the CONTRACTOR on account of ... such contract ..., [Keystone] hereby agreeing that such money ... shall be the sole property of the SURETY [F&GIC] *to be credited by it upon any sum due or to become due under the terms of this agreement.*

(Id. ¶ 12(a)) (emphasis added). Thus, under the terms of the contract, in the event of Bilt-Rite Contractors Inc.’s payment to F&GIC of the money owed to Keystone, such sum would be credited by F&GIC to the total amount awarded against Keystone. Therefore, Keystone’s argument to reduce the amount of damages awarded by \$163,000 is unavailing.

In conclusion, all of Keystone’s ostensible defenses are untenable; Keystone is without a meritorious defense to the claims upon which the default judgment rests.

As this Court has previously recognized, “[b]ecause the existence of a meritorious defense is a threshold consideration, the absence of such is necessarily fatal to the Rule 60(b) motion of the defendant.” NuMed Rehabilitation, Inc., v. TNS Nursing Homes, Inc., 187 F.R.D. 222, 225 (E.D. Pa. 1999) (citations omitted). See also Scherzer v. Quality Health Services, Inc., No. 93-CV-1439, 1993 WL 311303, at *3 (E.D. Pa. 1993) (noting that other factors need not be considered in absence of meritorious defense). Therefore, consideration of the remaining factors would be nugatory and need not be undertaken.⁶

⁶ I note, however, that F&GIC has also sustained its burden on the remaining Emcasco factors. Specifically, plaintiff has shown that Keystone engaged in culpable conduct by recklessly disregarding letters and

CONCLUSION

Based on the foregoing conclusions, the motion of Keystone to vacate the default judgment will be denied in its entirety and all proceedings in aid of execution of the judgment will move forward.

pleadings sent by F&GIC and this Court. See Hritz, 732 F.2d at 1183; Zawadski De Bueno v. Bueno Castro, 822 F.2d 416, 421 (3d Cir. 1987); Wells v. Rockefeller, 728 F.2d 209, 214 (3d Cir. 1984).

Plaintiff has further established that its substantial reliance upon the default judgement rises to the level of prejudice necessary to carry the first element of the Emcasco test. See Feliciano v. Reliant Tooling Co., 691 F.2d 653, 657 (3d Cir. 1982); Choice Hotels Int'l, Inc., v. Pennave Assocs., 192 F.R.D. 171, 174 (E.D. Pa. 2000). And finally, this Court is persuaded that alternative sanctions are likely to further exacerbate and complicate Keystone's financial situation, are thus inappropriate and would needlessly delay its resolution of this claim.

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FIDELITY AND GUARANTY INSURANCE COMPANY,	:	CIVIL ACTION
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Plaintiff,	:	
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KEYSTONE CONTRACTORS, INC.;	:	
KEYTEL DEVELOPMENT CORPORATION;	:	
TELFORD RENTALS, INC.;	:	
DONALD STAUFFER, Jr.;	:	
CYNTHIA STAUFFER;	:	
ROBERT J. STAUFFER;	:	
AND HEATHER STAUFFER,	:	
	:	
Defendants.	:	NO. 02-CV-1328

ORDER

AND NOW, this 14th day of August, 2002, upon consideration of the motion of defendants Keystone Contractors, Inc., Keytel Development Corporation, Telford Rentals Inc., Donald Stauffer Jr., Cynthia Stauffer, Robert J. Stauffer and Heather Stauffer to vacate the default judgment under Federal Rules of Civil Procedure 55(c) and 60(b)(1), and to stay all proceedings in aid of execution of the judgment (Document No. 18), and plaintiff Fidelity and Guaranty Insurance Company's response thereto (Document No. 19), and for the reasons provided in the foregoing memorandum, it is hereby **ORDERED** that the motion of defendants to vacate the judgment is **DENIED** and that the motion of defendants to stay the proceedings in aid of execution is **DENIED AS MOOT** .

LOWELL A. REED, Jr., S.J.

