



subcontract, Borden required K&H to procure performance and payout bonds naming Borden as the obligee to secure K&H's obligations under the subcontract. On March 29, 1999, K&H as principal and Mountbatten as surety co-executed a Subcontractor Performance Bond and a Subcontractor Labor and Material Payment Bond, each in the sum of \$464,800, naming Borden as obligee. As a condition of co-executing the bonds, Mountbatten required K&H and defendants to sign a General Indemnity Agreement. The GIA provides in relevant part:

The liability of the Indemnitors shall extend to and include the amount of all payments, together with interest thereon from the date of such payments, made by Surety in good faith under Surety's belief that (1) Surety was or might be liable therefor or (2) the payments were necessary or advisable to protect any of Surety's rights or to avoid or lessen Surety's liability or alleged liability. The vouchers or other evidence of such payments sworn to by a duly authorized representative of Surety shall be prima facie evidence of the fact and extent of the liability of the Indemnitors to Surety.

(GIA at ¶7.)<sup>1</sup>

K&H's relationship with Borden was tumultuous and progress on the FLETC allegedly was hampered by Borden's failure to coordinate work scheduled by the various subcontractors. Defendants contend that Borden refused to pay K&H \$116,332.10 for work performed. Consequently, K&H was unable to pay one of its suppliers, City Electrical Supply Company ("CESCO").

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<sup>1</sup> Defendants also cite to paragraph 5 of the GIA as a relevant provision:

The Indemnitors hereby jointly and severally covenant, promise, and agree to exonerate, indemnify and save harmless Surety . . . from and against any and all liability, loss, cost, damage and expense of whatsoever kind or nature . . . which surety may in good faith sustain, incur, be put to or to which it may be exposed (1) by reason of having executed any Bond . . . (2) by reason of the failure of the Principal or any of the other Indemnitors to perform or comply with the promises, covenants or conditions of this Agreement or (3) in enforcing any of the promises, covenants or conditions of this Agreement.

Defendants assert that in August of 1999, Mountbatten learned of the problems between Borden and K&H and requested that its affiliate, HMS Dreadnought, Inc.<sup>2</sup> oversee K&H's continued performance on the job. Mountbatten further demanded that K&H assign its rights to receive any payment from Borden to Dreadnought and that K&H permit Dreadnought to control payments to K&H's labor and material suppliers. K&H agreed to this arrangement, believing that Dreadnought's involvement would expedite the payment process from Borden. Although K&H continued to work under the new arrangement, it never received further payment from Borden or Dreadnought. Defendants contend that, eventually, at Mountbatten's direction and without further explanation Dreadnought ordered K&H to stop work on the FLETC Project.

On January 12, 2000, CESCO filed a Miller Act complaint against Borden and K&H in the United States District Court for the District of Georgia, claiming that K&H had failed to pay CESCO \$16,536.37 for electrical supplies. Borden filed a cross-claim against K&H, asserting that K&H was liable to Borden for approximately \$150,000 as a result of alleged failures on the FLETC project. Borden also joined Mountbatten as an additional defendant. Defendants assert that Mountbatten defaulted by not answering the Borden's claim and subsequently negotiated a settlement (without K&H being a party to the negotiations) of Borden's claim against it despite the availability of meritorious defenses. Thereafter, K&H filed for bankruptcy and the Georgia action was stayed.

On October 2, 2002, Mountbatten obtained a confessed judgment ex parte in the Court of Common Pleas for Montgomery County for breach of the GIA between Mountbatten and the

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<sup>2</sup> Defendants assert that Dreadnought and Mountbatten Surety Company are owned by the same parent company, Mountbatten, Inc. (Def.'s Mem. at 6 n.6.)

individual defendants. Thereafter, defendants removed to this Court on grounds of diversity.

### DISCUSSION

A diversity action, such as the present case, involving only state claims is governed by federal procedure and state substantive law. See Erie Railroad Co. v. Tompkins, 304 U.S. 64 (1938). Therefore, a motion to strike or open a confessed judgment is considered pursuant to Federal Rule of Civil Procedure 60(b).<sup>3</sup> See F.D.I.C. v. Deglau, 207 F.3d 153, 161 (3d Cir. 2000). With respect to the substantive claims, however, the motion is considered pursuant to Pennsylvania law. “Federal diversity jurisdiction provides an alternative forum for the adjudication of state- created rights, but does it does not carry with it generation of rules of substantive law.” Gasperini v. Center for Humanities, Inc., 518 U.S. 415, 416 (1996). State law, including the substantive aspects of the Pennsylvania Rules of Civil Procedure, thus governs what types of defenses may be asserted against a confessed judgment, the legal merits of those defenses, and the standard a defendant must meet in support of its defenses to prevail on its motion. Antipas v. 2102, Inc., No. CIV. A. 98-1145, 1998 WL 306537, at \*2 (E.D. Pa. June 9, 1998) (O’Neill, J.); see also Deglau, 207 F.3d at 157 (“Pennsylvania law should govern the substantive aspect of Rule 60(b) motions to open or strike.”).

Defendants claim that the judgment should be struck because 1) Mountbatten incurred its losses through its own bad faith; 2) Mountbatten failed to document the losses it incurred in its

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<sup>3</sup> The applicable portions of Federal Rule of Civil Procedure 60(b) provide the following: On motion and upon such terms as are just, the court may relieve a party or a party’s legal representative from a final judgment, order, or proceeding for the following reasons: . . . (4) the judgment is void; . . . or (6) any other reason justifying relief from the operation of the judgment.

complaint; and 3) the confession of judgment language is overbroad and ambiguous. These arguments do not justify striking the judgment. The Supreme Court of Pennsylvania has delineated the circumstances under which a confession of judgment may be struck:

A petition to strike a judgment may be granted only for a fatal defect or irregularity appearing on the face of the record. In considering the merits of a petition to strike, the court will be limited to a review of only the record as filed by the party in whose favor the warrant is given, i.e., the complaint and the documents which contain confession of judgment clauses. Matters dehors the record filed by the party in whose favor the warrant is given will not be considered. If the record is self-sustaining, the judgment will not be stricken. However, if the truth of the factual averments contained in such record are disputed, then the remedy is by a proceeding to open the judgment and not to strike. An order of the court striking a judgment annuls the original judgment and the parties are left as if no judgment had been entered.

Resolution Trust Corp. v. Copley Qu-Wayne Associates, 683 A.2d 269, 273 (Pa. 1996).

Defendants' argument that Mountbatten acted in bad faith does not stem from "a fatal defect or irregularity appearing on the face of the record." Defendants contend that plaintiffs acted in bad faith by settling Borden's claim without consulting with K&H or asserting available affirmative defenses.<sup>4</sup> This allegation, however, involves factual disputes that are not definitively ascertainable by reference to the GIA.

Defendants next contend that the confessed judgment is defective because plaintiffs did not submit documentation of their losses with their complaint.<sup>5</sup> Defendants cite, Roche v.

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<sup>4</sup> Defendants also argue that the judgment should be struck because plaintiffs failed to plead in the complaint that the amount for which they seek indemnification was incurred in good faith, a condition precedent to indemnification. Defendants do not cite any authority requiring such an allegation.

<sup>5</sup> Defendants also contend that plaintiffs' itemization of their damages in the complaint was insufficient and therefore fatal to the confession of judgment. Defendants cite Pennsylvania Rule of Civil Procedure 2952(a)(7), which provides that the complaint must contain "an itemized computation of the amount then due, based on matters outside the instrument if necessary, which

Rankin, 176 A.2d 668 (Pa. 1962), in which the Supreme Court of Pennsylvania stated that “a judgment by confession must be self-sustaining and cannot be entered into where matters outside of the record need be considered to support it.” Id. at 670. The Roche Court reasoned, “If matters outside of the instrument itself necessarily had to be considered in order to determine the amount of the money due, then of course, the prothonotary would lack the legal power to enter the judgment under the Act of 1806.” Id. at 671.

Roche is inapplicable to the present case because, here, plaintiffs did not proceed under Rule 2951(a) but filed a complaint in confession of judgment pursuant to Pennsylvania Rule of Civil Procedure 2951(b), which requires that an attorney file a complaint. The confession of judgment in Roche was filed pursuant to the Act of February 24, 1806, 12 P.S. § 739. Roche, 176 A.2d at 670. Although section 739 has been repealed, it was analogous to the procedure employed under Rule 2951(a), which allows for the filing of documents with the prothonotary without the filing of a complaint. See 42 Pa. Cons. Stat. Ann. R. 2951 explanatory cmt. - 1979 (“Subdivision (a) was originally restricted to judgments authorized by the Act of 1806.”). The Roche Court explained:

There are two methods by which a warrant to attorney to confess judgment may be utilized in order to accomplish its purpose. One is through the medium of the Act of 1806. In avoiding the necessity of having an attorney appear for the obligor in cases where the amount due appears on the face of the instrument the purpose of that act was to exempt the obligor from the payment of an attorney's fees . . . . The second method is that of defendant himself, or an authorized attorney on his behalf, confessing the judgment; this practice was in use from the earliest times and long before the passage of the Act of 1806.

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may include interest and attorneys' fees authorized by the instrument.” In their complaint, plaintiffs alleged a principal loss of \$153,312.00 plus \$1,000.00 in attorney's fees. This calculation appears to conform to the language of the Rule and defendants do not cite to any authority that would require a more detailed itemization.

Id., at 670 (citations omitted).

The latter method described by Roche is analogous to the method employed in the present case under Rule 2951(b), in which an attorney is authorized to confess judgment against the defendants where “the amount due is not stated in the instrument and cannot be ascertained by calculation from information which it itself furnishes . . . .” R. S. Noonan, Inc. v. Hoff, 38 A.2d 53, 54 (Pa. 1944); see also Pa. R. Civ. P. 2951(c)(4)(providing that action must be brought under subdivision (b) if computation of amount due requires consideration of matters outside instrument). In Noonan, the Supreme Court of Pennsylvania determined that when an attorney confesses judgment on behalf of a defendant the prothonotary may enter judgment without proof of the amount of money due:

What the attorneys were authorized to do was to cause a judgment to be entered against defendant and if they instructed the prothonotary to do this in a ministerial capacity they were, in effect, confessing a judgment, and the prothonotary was acting, not independently by virtue of his office and in pursuance of the duty imposed upon him by the Act of 1806, but on behalf of attorneys for defendant authorized to do what defendant could have done himself, namely, cause or procure a judgment to be entered against him; certainly, if he himself had instructed the prothonotary to enter this judgment he would be confessing judgment against himself, and that is just what the attorneys did who appeared for him under the authority given by him for that purpose. It was therefore not necessary that any of the requirements of the Act of 1806 should have been observed. Plaintiff's affidavit set forth the amount paid on account and the balance alleged to be due; if the amount was overstated or the claim for interest or collection fe[e]s was unjustified defendant's remedy was by a rule to open the judgment, not to strike it off.

Id. at 55.

Finally, defendants argue that the judgment should be struck because the instrument is ambiguous as to “the amounts and types of ‘liability, loss, cost damage and expense’ for which confession of judgment may be obtained.” (Def.’s Mem. at 12, quoting GIA at ¶ 5.) They contend

that such an open-ended indemnity agreement is Draconian in nature and holds the potential for abuse. They argue that under Pennsylvania law any ambiguity in the warrant of attorney authorizing confession of judgment must be resolved against the party in whose favor the warrant is given. See Manor Bldg. Corp. v. Manor Complex Associates, Ltd., 645 A.2d 843, 846 (Pa Super. Ct. 1994); 11 Standard Pennsylvania Practice § 67:4, at 127-28 (1996). The ambiguous language that defendants cite, however, appears in paragraph 5 of the GIA and not in the warrant of attorney, which appears in paragraph 24 of the GIA. The warrant of attorney explicitly empowers the attorney of record only to confess judgment to sums due under the GIA. (GIA at ¶ 24.)

Alternatively, defendants assert that the judgment should be opened. The Supreme Court of Pennsylvania has explained the circumstance under which a court may open a confessed judgment:

A petition to open a confessed judgment is governed by Pa.R.C.P. 2959. A party is entitled to have a judgment entered by confession opened if evidence is produced which in a jury trial would require the issues to be submitted to the jury. Pa.R.C.P. 2959(e) . . . When determining a petition to open a judgment, matters dehors the record filed by the party in whose favor the warrant is given, i.e., testimony, depositions, admissions, and other evidence, may be considered by the court . . . An order of the court opening a judgment does not impair the lien of the judgment or any execution issued on it. Pa.R.C.P. 2959 com.; 12 Standard Pennsylvania Practice § 71:215 (1983).

Resolution Trust Corp. v. Copley Qu-Wayne Associates, 683 A.2d 269, 273 (Pa. 1996) (citations omitted). Although Pennsylvania courts formerly required a defendant to present “clear and convincing” evidence to open a judgment, this is no longer the case since the implementation of Rule 2959(e). “[N]ow that requirement has been substantially liberalized to require only clear, direct, and precise and ‘believable’ evidence.” Suburban Mechanical Contractors, Inc. v. Leo,

502 A.2d 230, 232 (Pa. 1985).

In the present case, defendants assert that they have produced evidence of a meritorious defense that requires submission to a jury. Specifically, defendants allege that plaintiffs acted in bad faith in violation of the GIA's "good faith" requirement: 1) by failing to answer Borden's complaint; 2) by having Dreadnought, Mountbatten's subsidiary, assume control of the work/payment schedule, and ultimately order K&H to cease work; and 3) by settling with Borden when there was no liability of the surety.

Bad faith is one of the few exceptions to the enforcement of an indemnitor's liability for a surety's disbursements and expenses. International Fidelity Ins. Co. v. United Const., Inc., Civ. A. No. 91-2361, 1992 WL 46878, at \*2 (E.D. Pa. March 4, 1992) (Waldman, J.). Pennsylvania contract law recognizes a claim for bad faith. See Somers v. Somers, 613 A.2d 1211, 1213 (Pa. Super. 1992); Baker v. Lafayette College, 504 A.2d 247, 255 (1986), aff'd, 516 Pa. 291, 532 A.2d 399 (1987). The Superior Court of Pennsylvania has generally defined bad faith as an "evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance." Somers, 613 A.2d at 1213, citing Restatement (Second) of Contracts, § 205(d).

In the context of surety agreements, federal courts have determined that "[b]ad faith is not simply bad judgment or negligence, but rather it implies the conscious doing of a wrong because of dishonest purpose or moral obliquity." U.S. Fidelity & Guar. Co. v. Feibus, 15 F. Supp. 2d 579, 585 (M.D. Pa. 1998) (Caputo, J.), citing Polselli v. Nationwide Mut. Fire Ins. Co., 23 F.3d 747, 751 (3d Cir.1994); see also Fidelity and Guaranty Ins. Co. v. Keystone Contractors, Inc.,

No. CIV. A. 02-CV-1328, 2002 WL 1870476, at \*4 (E.D. Pa. Aug. 14, 2002) (Reed, J.). The Court of Appeals has recognized that bad faith exists when a surety pays a claim for which it does not reasonably believe itself liable. See Fallon Elec. Co., Inc. v. Cincinnati Ins. Co., 121 F.3d 125, 129 (3d Cir. 1997) (“A showing that [surety] did not actually believe it was liable for the fees . . . would be tantamount to a showing of bad faith or fraud.”).<sup>6</sup> However, “what an indemnitor must demonstrate to escape liability . . . depends upon the precise language used in the agreement.” Id. Here, paragraph 7 of GIA provides that defendants are responsible only for a settlement in which Mountbatten maintained a good faith belief that it, as the surety, was or might be liable.<sup>7</sup>

The liability of the Indemnitors shall extend to and include the amount of all payments, together with interest thereon from the date of such payments, made by Surety in good faith under Surety’s belief that (1) Surety was or might be liable therefor or (2) the payments were necessary or advisable to protect any of Surety’s rights or to avoid or lessen Surety’s liability or alleged liability.

In the present case, defendants have produced evidence that plaintiff may have breached the GIA by acting in bad faith. William T. Jenkins states in his affidavit that K&H asserted several defenses to Borden’s cross-claim against K&H and Mountbatten, including Borden’s

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<sup>6</sup> I recognize that, because paragraph 7 of the GIA contains a prima facie evidence clause, defendants will bear the burden of proving Mountbatten’s bad faith: “The vouchers or other evidence of such payments sworn to by a duly authorized representative of Surety shall be prima facie evidence of the fact and extent of the liability of the Indemnitors to Surety.” See Fallon, 121 F.3d at 129 (“We conclude that the Pennsylvania courts would hold that a ‘prima facie evidence’ clause in an indemnity agreement shifts to the indemnitor the burden of proving that the costs incurred were not recoverable.”)

<sup>7</sup> The parties’ briefs do not specifically address the latter issue of whether Mountbatten held a good faith belief that “the payments were necessary or advisable to protect any of [its] rights or to avoid or lessen [its] liability or alleged liability.”

initial default, and therefore K&H and Mountbatten were not liable under the subcontractor's agreement. (Jenkins Aff., at ¶14.) The affidavit also states that Mountbatten failed to file a timely answer to this cross-claim, thereby allowing Borden to secure a default judgment against Mountbatten.(Id., at ¶28.)<sup>8</sup> Moreover, Jenkins states in his affidavit that K&H complied with all of its obligations under the subcontractor's agreement with Borden until Mountbatten, through its affiliate Dreadnought, ordered K&H to stop work on the FLETC Project. (Id., at ¶¶ 13, 20.)A permissible inference from these statements is that Mountbatten short-circuited the litigation between Borden and K&H without allowing K&H the opportunity to demonstrate its lack of liability.<sup>9</sup> Similarly, Mountbatten's failure to file a timely response to Borden's cross-claim,

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<sup>8</sup> Mountbatten contends, without citation, that under the GIA defendants had the obligation to defend Mountbatten against all claims. (Mem. Opp. Def.'s Mot. to Open or Strike J., at 13.) However, after reviewing the GIA, I have been unable to locate an explicit provision requiring defendants to defend Mountbatten against suit. At best, it appears the GIA allowed Mountbatten to retain its own counsel and required defendants to indemnify it for all legal costs incurred:

The Indemnitors hereby jointly and severally covenant, promise, and agree to exonerate, indemnify and save harmless Surety . . . from and against any and all liability, loss, cost, damage and expense of whatsoever kind or nature (including, but not limited to, interest, court costs and counsel, attorneys, consulting, accounting and other professional and trade fees, whether incurred on a flat fee per claim, percentage, time and material, hourly or other basis, including the cost of in-house professionals . . . . Surety shall at all times have the right but not the obligation to retain counsel of its choice to defend itself from any claim, lien, levy, liability, suit or judgment bought against Surety on any Bond or against any job funds . . . .

(GIA, at ¶5.)

<sup>9</sup> I note that paragraph 8 of the GIA provides Mountbatten the right to settle any claims: "Surety shall have the right to adjust, settle or compromise any claim, demand, or judgment upon any of the Bonds procured or executed by it and Surety's decision thereon shall be final and binding upon the Indemnitors." However, the authority to settle a suit does not resolve the question whether Mountbatten actually believed that it was or might be liable.

absent a contractual provision requiring K&H to defend Mountbatten, may suggest a willful disregard of possible liability. An additional inference that a jury could draw is that by ordering K&H to stop work on the FLETC project Mountbatten had determined that Borden had breached the subcontract, and that the breach justified K&H's failure to further perform.

On the record now existing, a jury could find that Mountbatten did not have a good faith belief that it was liable to Borden under the subcontract. Therefore, I conclude that the judgment should be opened.

An appropriate Order follows.

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

THE MOUNTBATTEN SURETY  
COMPANY, INC.

v.

WILLIAM H. JENKINS, et al.

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CIVIL ACTION  
NO. 02-CV-8421

**ORDER**

AND NOW, this        day of March, 2003 after consideration of defendants' motions and plaintiff's responses thereto, defendants' motion to strike the confession of judgment is DENIED. Defendants' motion to open the confession of judgment is GRANTED and the judgment is OPENED. All further proceedings with respect to the judgment, including but not limited to execution, are STAYED pending final resolution of this matter.

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THOMAS N. O'NEILL, JR., J.