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

BEDROCK STONE AND STUFF, INC., HOWARD YOUNG and DEBRA YOUNG, His Wife, Plaintiffs	)	Civil Action No. 04-CV-02101
vs.	)	
MANUFACTURERS AND TRADERS TRUST COMPANY, Defendant	)	

* * *

APPEARANCES:
RICHARD H. WIX, ESQUIRE
On behalf of Plaintiffs

DAVID E. TURNER, ESQUIRE
On behalf of Defendant

* * *

O P I N I O N

JAMES KNOLL GARDNER,
United States District Judge

This matter is before the court on the Motion for Summary Judgment of Defendant Manufacturers and Traders Trust Company filed January 27, 2005. Plaintiffs' Answer to Defendant's Motion for Summary Judgment was filed February 16, 2005. For the reasons expressed below, we deny defendant's motion for summary judgment.

Specifically, we conclude that defendant owed plaintiff a duty of good faith and fair dealing which duty plaintiff contends was breached. Furthermore, we conclude that there are

genuine issues of material fact whether defendant breached its duty of good faith and fair dealing and whether the bank exercised the discretion authorized by the terms of the contract in an unreasonable way.

JURISDICTION AND VENUE

This action is before the court on diversity jurisdiction. Plaintiff Bedrock Stone & Stuff, Inc. is a Pennsylvania corporation and plaintiffs Howard and Debra Young are residents of the Commonwealth of Pennsylvania. Defendant Manufacturers and Traders Trust Company is a New York corporation. The amount in controversy is in excess of $75,000. See 28 U.S.C. § 1332. Venue is proper because plaintiff alleges that the facts and circumstances giving rise to the cause of action occurred in Berks County, Pennsylvania. 28 U.S.C. §§ 118, 1391.

PROCEDURAL HISTORY

On December 3, 2003 plaintiffs Howard Young, Debra Young and Bedrock Stone & Stuff, Inc. ("Bedrock") commenced this action by filing a one-count Complaint in the United States District Court for the Middle District of Pennsylvania. In their Complaint, plaintiffs contend that defendant Manufacturers and Traders Trust Company, commonly referred to as M & T Bank, owed them a duty of good faith and fair dealing, which they contend

defendant breached.

On February 23, 2004 the Answer of Defendant Manufacturers and Traders Trust Company with Affirmative Defenses was filed. On February 11, 2004, prior to filing its answer to plaintiffs' Complaint, defendant filed a motion for change of venue to have this action transferred to the United States District Court for the Eastern District of Pennsylvania. By Memorandum and Order dated May 13, 2004, United States District Judge Yvette Kane transferred venue of this action from the Middle District of Pennsylvania to this court.

On May 14, 2004 a certified copy of the record from the Middle District was received by the Clerk of Court for the Eastern District of Pennsylvania and the case was assigned to the undersigned. On September 28, 2004 a Rule 16 Status Conference was conducted by the undersigned at which time we set certain deadlines including deadlines for the completion of discovery, filing of dispositive motions and a trial date.

FACTS

Based upon the pleadings, record papers, depositions, exhibits, the concise statement of facts submitted by defendant and the counter-statement of facts submitted by plaintiffs, the pertinent facts are as follows.

Plaintiff Bedrock Stone and Stuff, Inc. was incorporated by plaintiff Howard Young. Mr. Young was the

President and sole shareholder of Bedrock; and his wife, plaintiff Debra Young, was the company's Secretary. Bedrock was in the business of the manufacture and sale of soil and mulch for landscaping.

In September 1998 Pennsylvania National Bank and Trust Company, which subsequently became Keystone Financial Bank, N.A. ("Keystone") extended financing to Bedrock. On September 24, 1998, in conjunction with the financing, Bedrock executed and delivered a promissory note, in the original principal amount of $138,000 to Keystone to finance the purchase of a Morbark Model 1000 Tub Grinder plus additional equipment attachments. Mr. and Mrs. Young guaranteed repayment of the September 24, 1998 Note.

In March 2000 plaintiffs approached Jeffrey O'Neill, a loan officer of Keystone, concerning a possible refinance of the existing debt and sought a new line of credit. By letter dated March 24, 2000 Mr. O'Neill informed plaintiffs that Keystone would provide plaintiffs with a term loan in the amount of $580,000 as well as a $75,000 line of credit.

Security for the $580,000 loan would consist of the personal sureties of Howard and Debra Young, a perfected first lien security interest in all of Bedrock's account receivables, inventory, machinery, general intangibles and various tractor titles and equipment, and a second mortgage on the Youngs' residence. Security for the $75,000 line of credit would consist

of the personal sureties of the Youngs and a blanket security interest in all of the present and future business assets of Bedrock.

On March 24, 2000 Mr. and Mrs. Young executed an acceptance of the terms contained in the March 24, 2000 letter. On April 6, 2000 Bedrock executed and delivered to Keystone two separate promissory notes. The first note was a term loan note in the original principal amount of $580,000 and the second note was the $75,000 line of credit. As required, both Howard and Debra Young guaranteed repayment of the two notes.

In July 2000 Keystone extended an additional $30,000 in financing for the purchase of a mulching machine. In conjunction therewith, Bedrock delivered a promissory note in the amount of $30,000 that was also personally guaranteed by the Youngs.

In October 2000 defendant M & T Bank acquired Keystone by merger, thereby acquiring the commercial loan obligation of Bedrock. In addition, in October 2000 plaintiffs requested a $50,000 increase in the line of credit. This request was denied. The parties dispute the reasons for the denial. Plaintiffs assert that Mr. O'Neill advised them that they needed to purchase property in order for the bank to consider any additional financing. Defendant asserts that the increase of the credit line was denied because of the deficit net worth of Bedrock, marginal collateral and the personal leverage and weak credit

scores of Howard and Debra Young.

On November 6, 2000 Bedrock was permitted to skip its principal payment of $5019.07 because of a short-term cash flow problem. Bedrock was still required to make its interest payment of $4501.72.

From 1998 to 2000 Bedrock's operating income and gross profit increased. However, beginning in 2001, Bedrock's operating income and gross profit began to decrease. Plaintiffs contend that the decrease in Bedrock's income was because of a six-month drought, the purchase of real estate for the Bedrock business and the cost of obtaining permits for the property from the Pennsylvania Department of Environmental Protection.

In September or October 2002 Mr. O'Neill, and his immediate supervisor James Donovan, decided to refer Bedrock's loan obligations to the Special Assets Division of defendant because of Bedrock's cash flow problems, the financial deterioration of the company and continued overdrafts of Bedrock's checking account. In early December 2002 oversight of Bedrock's loan obligations was assigned to Joseph E. Warner, III, Vice President and Loan Workout Specialist for defendant.

On December 6, 2002 Mr. Warner, Mr. O'Neill, Mr. Young, Lisa Thompson, Esquire, counsel for plaintiffs, and Richard Althouse, Business Manager for Bedrock, met at the Bedrock work site. This was an introductory meeting in which Mr. Warner was

introduced as the new account officer. The condition, future outlook and future needs of Bedrock were discussed at this time.

Prior to the Bedrock account being assigned to Mr. Warner, Mr. O'Neill would approve the payment of overdrafts. The parties disagree if some or all overdrafts were approved by Mr. O'Neill. After Mr. Warner took over the account, defendant continued to honor some, but not all overdrafts. Plaintiffs contend that Mr. Warner agreed to pay all critical checks. It is unclear what defendant contends that it actually agreed to pay.

In early December 2002 plaintiffs approached other lenders concerning possible financing. Plaintiffs sought an amount in excess of $30,000 from these banks, and plaintiffs were hoping to refinance the entire loan package. In addition, plaintiffs approached some of its customers about obtaining short-term loans. The extent of help these customers were willing to provide to Bedrock is in dispute.

In a letter dated December 19, 2002 defendant agreed to extend to plaintiffs an additional $30,000 in financing for Bedrock's working capital needs if Bedrock could meet five specific conditions. As outlined in the December 19, 2002 letter, the conditions were as follows:

> 1. The Bank will require a direct assignment of all permits, licenses, and approvals for the current operation of the business.
>
> 2. The Bank will require that all past due interest be paid at the time of loan closing.

> The current amount due is $8,469.24. This amount is subject to change as the December loan payments become due and payable.
>
> 3. The Bank will require a mortgage on the business property, subject only to the purchase money mortgage already in place.
>
> 4. The Bank will require the unlimited guaranties of Howard and Debra Young.
>
> 5. The Bank will require that all indebtedness be cross-defaulted and cross-collateralized.

Exhibit P to the Motion for Summary Judgment of Defendant, Manufacturers and Traders Trust Company.

The December 19, 2002 letter set forth other conditions and agreements. Defendant agreed to accommodate plaintiffs' seasonal business by providing a principal repayment moratorium during the winter months, with an accelerated principal repayment schedule during Bedrock's peak season. Furthermore, defendant requested that plaintiffs provide a list of its most crucial accounts payable and agreed "[u]pon receipt and review of this information, the Bank may approve additional overdrafts on your corporate checking account until the $30,000 can be advanced."

On December 19, 2002 plaintiffs agreed to the terms and conditions and executed an acknowledgment and acceptance of those terms. Thereafter, Lisa Thompson, Esquire, counsel for plaintiffs, contacted Mr. Warner to see if defendant would be willing to increase the amount of the loan. Mr. Warner informed her that defendant would be unwilling to provide more than

$30,000 in financing.

In addition, Attorney Thompson held discussions with Kurt Althouse, Esquire, counsel for defendant. The exact substance of these discussions is disputed, but the parties agree that it did involve a request for financing in excess of the $30,000 figure and possible post-bankruptcy financing.

On January 7, 2003 defendant formally withdrew its offer to provide the $30,000 in financing to plaintiffs. Moreover, defendant advised plaintiff that it would no longer honor any overdrafts from the corporate checking account. Finally, by separate letter of that same date, Mr. Althouse indicated that a post-bankruptcy extension of credit would be considered.

The parties dispute the course of negotiations after January 2003. Defendant contends that it required plaintiffs to provide certain information regarding the future projections for Bedrock and details concerning plaintiffs' representations regarding possible investment in the business by some of Bedrock's customers.

Plaintiffs contend that they were willing and able, and in fact did provide defendant with the information it sought. Furthermore, plaintiffs contend that on February 13, 2003 Mr. Warner verbally indicated that defendant was going to commit to lending additional money to Bedrock and also refinancing all of

Bedrock's outstanding loans. Plaintiffs further contend Mr. Warner requested additional information that was communicated to him on February 14, 2003 and that plaintiffs began contacting all of the unsecured creditors to begin a plan to avoid bankruptcy.

In a letter dated February 21, 2003 defendant advised plaintiff that it was unwilling to agree to refinance plaintiffs' indebtedness. Defendant further declined to extend the $30,000 for working capital needs and demanded that plaintiff repay the overdrawn balance of the corporate checking account in the amount of $14,954.12.

On March 5, 2003 defendant filed Confession of Judgment Complaints in order to collect the amounts owed by plaintiffs. Defendant confessed judgment on all of Bedrock's outstanding commercial obligations.

On April 22, 2003 Bedrock filed a petition under Chapter 11 of the United States Bankruptcy Code. On April 28, 2003 Howard and Debra Young filed a voluntary petition under Chapter 13 of the Bankruptcy Code. On May 12, 2003 defendant filed a motion for relief from the automatic stay provisions of the Bankruptcy Code. By Order dated July 31, 2003 of the United States Bankruptcy Court for the Eastern District of Pennsylvania Judge Thomas M. Twardowski granted defendant relief from the automatic stay in Bedrock's Chapter 11 case. Judge Twardowski permitted defendant to liquidate its secured assets and to use

the proceeds derived therefrom to reduce Bedrock's indebtedness to defendant. Defendant was also permitted to file for any deficiency that remained.

Finally, in relation to the liquidation of assets, defendant contends that after receiving Judge Twardowski's Order, it contacted Bedrock's account creditors in order to collect the accounts receivable of Bedrock. Specifically, defendant asserts that Attorney Kurt Althouse, Mr. Warner and Richard Althouse had discussions as to the best means to collect the accounts receivable. Defendant asserts that as a result of these discussions, it was decided that Mr. Warner would send a letter to the account debtors directing that payments should be made directly to defendant.

Plaintiffs assert that prior to the issuance of Judge Twardowski's July 31, 2003 Order, defendant issued the letter to all of its customers demanding that all payments be sent to the bank, and if not, the bank may initiate legal proceedings against the customer. Furthermore, plaintiffs contend that Richard Althouse never agreed with Attorney Althouse and Mr. Warner about sending the letter.

STANDARD OF REVIEW

In considering a motion for summary judgment, the court must determine whether "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the

affidavits, if any, show that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c); Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986); Federal Home Loan Mortgage Corporation v. Scottsdale Insurance Company, 316 F.3d 431, 433 (3d Cir. 2003). Only facts that may affect the outcome of a case are “material”. Moreover, all reasonable inferences from the record are drawn in favor of the non-movant. Anderson, supra.

Although the movant has the initial burden of demonstrating the absence of genuine issues of material fact, the non-movant must then establish the existence of each element on which it bears the burden of proof. See Watson v. Eastman Kodak Company, 235 F.3d 851, 857-858 (3d Cir. 2000). Plaintiffs cannot avert summary judgment with speculation or by resting on the allegations in their pleadings, but rather must present competent evidence from which a jury could reasonably find in their favor. Ridgewood Board of Education v. N.E. for M.E., 172 F.3d 238, 252 (3d Cir. 1999); Woods v. Bentsen, 889 F. Supp. 179, 184 (E.D. Pa. 1995).

CONTENTIONS OF THE PARTIES

Defendant's Contentions

Initially, defendant contends that in Pennsylvania a duty of good faith and fair dealing arises only in a limited number of circumstances. Defendant relies on the line of cases emanating from the decision of the Superior Court of Pennsylvania in Creeger Brick and Building Supply, Inc. v. Mid-State Bank and Trust Company, 385 Pa. Super. 30, 560 A.2d 151 (1988).

Specifically, defendant asserts that a duty of good faith is limited to situations where there is a special relationship between the parties such as a confidential or fiduciary relationship. A confidential relationship exists where one party has reposed a special confidence in another party to the extent that the parties do not deal with one another on equal terms. A business relationship may be the basis of a confidential relationship if one party surrenders substantial control over some portion of its affairs to the other. Commonwealth of Pennsylvania, Department of Transporation v. E-Z Parks, Inc., 153 Pa. Commw. 258, 620 A.2d 712 (1993).

The duty of good faith has been found between franchisors and franchisees as well as between an insurer and insured. However, a duty of good faith will not be recognized where its application would modify or defeat the legal rights of a creditor. Creeger Brick, supra. Moreover, a plaintiff cannot

invoke a duty of good faith if plaintiff is able to seek recourse for the same rights in an independent cause of action. See Fremont v. E.I. DuPont deNemours & Company, 988 F. Supp. 870 (E.D. Pa. 1977).

Finally, defendant asserts that even if we conclude that it owed a duty of good faith and fair dealing to plaintiffs, summary judgment is appropriate because there are no genuine issues of material fact in dispute because defendant contends it did at all times act in good faith toward plaintiffs.

Plaintiffs' Contentions

Plaintiffs contend that in Corestates Bank, N.A. v. Cutillo, 723 A.2d 1053 (Pa. Super. 1999), the Superior Court of Pennsylvania established an exception to the general rule articulated in Creeger Bank and held that while a lending institution does not generally owe a duty of good faith to a creditor, where there is a long standing relationship between the parties, the bank owes the creditor a duty of good faith and fair dealing.

In this case, plaintiffs assert that the parties had a 5-6 year relationship, that plaintiffs had exclusively dealt with defendant and its predecessor lending institutions exclusively since the inception of Bedrock and that this is sufficient time and dealing to fall within the Corestates Bank exception to the rule in Creeger Brick. Hence, plaintiffs assert that they have

established that they have a viable cause of action for breach of a duty of good faith and fair dealing.

Plaintiffs further contend that there are genuine issues of material fact which prevent a grant of summary judgment in favor of defendant.

For the following reasons, we agree with plaintiffs in part and disagree with defendants in whole. Specifically, for different reasons, we conclude that plaintiffs have a cause of action for a breach of the duty of good faith and fair dealing and that there are genuine issues of material fact that preclude granting defendant's motion for summary judgment.

DISCUSSION

As a United States District Court exercising diversity jurisdiction, we are obliged to apply the substantive law of the Commonwealth of Pennsylvania. See Erie Railroad Co. v. Tompkins, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938).

If the Supreme Court of Pennsylvania has not addressed a precise issue, a prediction must be made taking into consideration "relevant state precedents, analogous decisions, considered dicta, scholarly works, and any other reliable data tending convincingly to show how the highest court in the state would decide the issue at hand." Nationwide Mutual Insurance Company v. Buffetta, 230 F.3d 634, 637 (3d. Cir. 2000) (citation omitted). "The opinions of intermediate state courts

are 'not to be disregarded by a federal court unless it is convinced by other persuasive data that the highest court in the state would decide otherwise.'" 230 F.3d at 637 (citing West v. American Telephone and Telegraph Co., 311 U.S. 223, 61 S.Ct. 179, 85 L.Ed. 139 (1940)).

For the reasons expressed below, we conclude that the Supreme Court of Pennsylvania would recognize a duty of good faith and fair dealing in this matter.

The recent decisions of the Court of Common Pleas of Philadelphia County in Philadelphia Plaza-Phase II v. Bank of America National Trust and Savings Association, 2002 Phila. Ct. Com. Pl. LEXIS 14 (June 21, 2002, Herron, J.) and Academy Industries, Inc. v. PNC Bank, N.A., 2002 Phila. Ct. Com. Pl. LEXIS 94 (May 20, 2002) (Sheppard, Jr., J.) noted the ambiguity and conflict on the state of the law relating to the issue of when a duty of good faith and fair dealing arises between a lender and creditor.

On one hand, state and federal courts, have repeatedly stated that every contract in Pennsylvania imposes on each party a duty of good faith and fair dealing in the performance and enforcement of the contract. Donahue v. Federal Express Corporation, 753 A.2d 238 (Pa. Super. 2000); Liazis v. Kosta, Inc., 421 Pa. Super. 502, 618 A.2d 450 (1992); Creeger Brick, supra; see Fraser v. Nationwide Mutual Insurance Company,

135 F. Supp. 2d 623 (E.D. Pa. 2001). Furthermore, the Supreme Court of Pennsylvania has specifically adopted Section 205 of the Restatement (Second) of Contracts. Bethlehem Steel Corporation v. Litton Industries, Inc., 507 Pa. 88, 125, 488 A.2d 581, 600 (1985).

Section 205 of the Restatement (Second) of Contracts provides: "Every contract imposes on each party a duty of good faith and fair dealing in its performance and enforcement." In addition, there is a similar requirement on contracts for the sale of goods within the scope of the Uniform Commercial Code. See 13 Pa.C.S.A. § 1203.

On the other hand, a number of courts have concluded that a covenant of good faith and fair dealing is not present in every contractual relationship. Agrecycle, Inc. v. City of Pittsburgh, 783 A.2d 863 (Pa. Commw. 2001); E-Z Parks, supra; see Benevento v. Life USA Holding, Inc., 61 F. Supp. 2d 407 (E.D. Pa. 1999).

Many of the courts which have limited the application of the duty of good faith and fair dealing have done so based upon their reading of the decision of the Superior Court in Creeger Brick. Judge Herron in Philadelphia Plaza and Judge Sheppard in Academy Industries, posit that such a reading is in error and that the limited holding of Creeger Brick does not support the conclusion that the covenant of good faith is

inherent in some contracts, but not others. We agree and adopt their reasoning.

We find the analysis of Judges Herron and Sheppard more persuasive than the litany of decisions that have attempted to follow Creeger Brick. Furthermore, we predict that if given the opportunity, the Supreme Court of Pennsylvania would rule consistently with its prior precedent and hold that a duty of good faith and fair dealing is inherent in every contract.

We find it inconsistent and unworkable to state that there is such a duty in every contract, but then to attempt to limit the application of the implied covenant in certain instances but not others. The covenant is either implied in every contract or it is not. There cannot be any other reasonable interpretation of the adoption by the Supreme Court of Pennsylvania of Section 205 of the Restatement than to apply it equally to every contract. To do otherwise would strain the use and meaning of the word "every" to mean something other than "all".

However, our prediction should not be misinterpreted to imply that a duty of good faith and fair dealing should override the express terms of a contract. Philadelphia Plaza, 2002 Phila. Ct. Com. Pl. LEXIS 14, at *15. "Where a duty of good faith arises, it arises under the law of contracts, not under the law of torts." D'Ambrosio v. Pennsylvania National Mutual

Casualty Insurance Company, 494 Pa. 501, 431 A.2d 966 (1981). "The question of what constitutes a breach of the covenant will depend greatly upon the scenario presented and will vary from situation to situation." Academy Industries, 2002 Phila. Ct. Com. Pl. 94 at *27.

The covenant of good faith may be breached when a party unreasonably exercises discretion authorized in a contract. See Burke v. Daughters of the Most Holy Redeemer, Inc., 344 Pa. 579, 581, 26 A.2d 460, 461 (1942). This is the situation here. The parties dispute many of the facts surrounding an agreement to refinance the existing debt, the circumstances regarding the payment of overdrafts and the information that was or could have been provided by plaintiffs regarding the financial condition of the business.

Plaintiffs contend that the actions of defendant, while arguably permissible under the terms of the contract, were not performed in a reasonable way. Specifically, in viewing the facts of this matter, in the light most favorable to plaintiffs as the non-moving party as we are required to do under the standard of review, we conclude that there is a genuine issue of material fact regarding the reasonableness of defendant's actions in this matter.

A jury will need to decide the credibility of a number of witnesses to determine whether in light of all the

circumstances, defendants actions in what it characterizes as simply enforcing its rights under the various contracts, were reasonable actions.

Accordingly, because we conclude that the Supreme Court of Pennsylvania, if presented with the issue, would determine that every contract in Pennsylvania carries with it an implied duty of good faith and fair dealing and because we conclude that there are genuine issues of material fact at issue in this matter, we conclude that summary judgment in favor of defendants is not appropriate.

CONCLUSION

For all the forgoing reasons, we deny the Motion for Summary Judgment of Defendant, Manufacturers and Traders Trust Company.

IN THE UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF PENNSYLVANIA

BEDROCK STONE AND STUFF, INC.,	)	
HOWARD YOUNG and	)	Civil Action
DEBRA YOUNG, His Wife,	)	No. 04-CV-02101
	)	
Plaintiffs	)	
	)	
vs.	)	
	)	
MANUFACTURERS AND TRADERS	)	
TRUST COMPANY,	)	
	)	
Defendant	)	

O R D E R

NOW, this 25th day of May, 2005, upon consideration of the Motion for Summary Judgment of Defendant Manufacturers and Traders Trust Company filed January 27, 2005; upon consideration of Plaintiffs' Answer to Defendant's Motion for Summary Judgment was filed February 16, 2005; upon consideration of the briefs of the parties; and for the reasons expressed in the accompanying Opinion,

IT IS ORDERED that defendant's motion for summary judgment is denied.

BY THE COURT:

/s/ JAMES KNOLL GARDNER

James Knoll Gardner

United States District Judge