In the United States Bankruptcy Court

for the Northern District of Iowa

IOWA IRON WORKS *Debtor(s).*	Bankruptcy No. 94-11378-C Chapter 7
HARRY R. TERPSTRA Trustee *Plaintiff(s)* vs. KOEHRING CRANE CO. *Defendant(s)*	Adversary No. 96-1231-C

ORDER RE DEFENDANT'S MOTION TO SET ASIDE DEFAULT JUDGMENT

The above-captioned matter came on for hearing on October 10, 1997 on a motion by Defendant Koehring Crane Co. to set aside a default judgment. Plaintiff Harry Terpstra, Trustee, was represented by Gregory Epping. Defendant Koehring Crane Co. was represented by William Nicholson. After the presentation of evidence and arguments of counsel, the Court took the matter under advisement. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(A).

STATEMENT OF THE CASE

Koehring filed this motion pursuant to Fed. R. Civ. P. 60(b)(1) incorporated by Fed. R. Bankr. P. 9024. It claims its failure to answer Trustee's adversary complaint is due to mistake, inadvertence, or excusable neglect. This adversary proceeding arises out of a Chapter 7 Bankruptcy case, In re Iowa Iron Works, No. 94-11378KC. Trustee was attempting to settle and collect Debtor's account receivables and, in so doing, contacted Koehring on November 6, 1996 requesting payment. Trustee informed Koehring that an action would be filed if payment was not made within 10 days. On November 11, Koehring faxed a reply stating it believed that it did not owe Debtor or the estate due to warranty claims against Debtor for defective products.

On December 11, 1996, Trustee filed this adversary complaint seeking to recover on the account receivable under 11 U.S.C. §542. A Summons was issued by the Bankruptcy Clerk on December 12, 1997. The Summons referred Koehring to Rule 7012, and also stated that if an answer or motion was not filed in 30 days, judgment by default could enter.

On December 17, Trustee served the Complaint and Summons on CTS Corporation, Koehring's registered agent in Iowa. Neither an Answer nor a motion was forthcoming from Koehring. On March 20, 1997, Trustee filed a motion for default.

Default judgment was entered on March 25, 1997. On the same date, Mr. Jeff Ehrhardt of Koehring faxed information to his corporate counsel regarding receipt of the motion for default. The following day, Trustee's attorney faxed a memo to Koehring's corporate counsel indicating a default judgment had been entered. This memo stated that Trustee anticipated a motion to set aside default and an opening of negotiations.

Initial negotiations apparently took place in late March. There is no record of additional action taken on this case by either party until negotiations were reopened in August, 1997.

Koehring filed this motion to set aside the default on September 22, 1997. It also moved to stay the Petition for Enforcement of Foreign Judgment which Trustee had filed with the Iowa District Court, In and For Bremer County. The parties have agreed that no enforcement or collection efforts would occur pending the Court's ruling on this matter.

CONCLUSIONS OF LAW

"Under Fed. R. Civ. P. 55(c), a judgment of default may be set aside for the reasons listed in Rule 60 (b) (e.g., mistake, inadvertence, excusable neglect)." United States v. Harre, 983 F.2d 128, 130 (8th Cir. 1993). Ruling on a motion to set aside a default judgment is within the sound discretion of the court. Id.at 130. After entry of a default judgment, relief under Fed. R. Civ. P. 60(b)(1) requires a more compelling reason than ordinary lapse of diligence or simple neglect to justify disturbing the default judgment. Jones v. Phipps, 39 F.3d 158, 162 (7th Cir. 1994); Widmer-Baum v. Chandler-Halford, 162 F.R.D. 545, 553 (N.D. Iowa 1995).

In considering a motion to set aside a default judgment, the court must determine whether the evidence permits the conclusion that a party chose to ignore the litigation and whether the defendant has shown good cause to set aside the default. Hall v. T. J. Cinnamon's, Inc., 121 F.3d 434, 435 (8th Cir. 1997). Courts must also balance between the "sanctity of final judgments" and the "court's conscience that justice be done in light of all the facts." Hoover v. Valley West D M, 823 F.2d 227, 230 (8th Cir. 1987).

The movant bears the burden of establishing that the default judgment should be set aside. Nikwei v. Ross Sch. of Aviation, Inc., 822 F.2d 939, 941 (10th Cir. 1982); Fidelity State Bank v. Oles, 130 B.R. 578, 585 (D. Kan. 1991). The movant must meet its burden separately on both the proof of the specific justification of relief under Fed. R. Civ. P. 60(b) and the existence of a meritorious defense. Oles, 130 B.R. at 585-86; see also Gibbs v. Air Canada, 810 F.2d 1529, 1537 (11th Cir. 1987) (requiring that movant demonstrate a good reason for default and existence of a meritorious defense to carry the burden of establishing excusable neglect).

The court in Widmer-Baum enunciated a specific test for relief under Rule 60(b)(1). 162 F.R.D. at 551-52. The defaulting party must first establish that its conduct satisfies one of the excusable criteria of Fed. R. Civ. P. 60(b). If this criteria is met, it must also demonstrate that: (1) the defaulting party's default was not willful; (2) the defending party has a meritorious defense to opposing party's claim; and (3) the opposing party will not be prejudiced by setting aside of the default. Id.

EXCUSABLE NEGLECT

While Rule 60(b)(1) discusses the excusable criteria as "mistake", "inadvertence," and "excusable neglect", the courts addressing this issue have ordinarily decided the case on the basis of whether the

conduct was excusable in a general sense. The proper focus is always upon whether the neglect is excusable. e.g., Pioneer Inv. Services v. Brunswick Assocs., 507 U.S. 380, 113 S. Ct. 1489, 1494-95 (1993); In re Jones Truck Lines, Inc., 63 F.3d 685 (8th Cir. 1995); In re Food Barn Stores, Inc., ___ B.R. ___, 1997 WL 705577, at *2 (B.A.P. 8th Cir. Nov. 14, 1997). In analyzing this issue, courts must examine all relevant circumstances including "the danger of prejudice to the debtor, the length of the delay and its potential impact on judicial proceedings, the reason for the delay, including whether it was within the reasonable control of the movant, and whether the movant acted in good faith." Pioneer Inv., 113 S. Ct. at 1498. The Supreme Court also expressed concern about protecting "the interests of efficient judicial administration." Id. at 1499.

A mere breakdown in communication does not suffice as mistake, inadvertence, or excusable neglect. See Baez v. S.S. Kresge Co., 518 F.2d 349, 350 (5th Cir. 1975) (a complaint received in a timely manner by defendant then lost en route to counsel does not constitute excusable neglect), cert. denied, 425 U.S. 904 (1976). Failure of a party to establish minimum procedural safeguards to be sure action is being taken in response to a summons and a complaint does not constitute excusable neglect. Florida Physician's Ins. Co. v. Ehlers, 8 F.3d 780, 784 (11th Cir. 1993); Gibbs, 810 F.2d at 1537; Widmer-Baum, 162 F.R.D. at 554.

THE WIDMER-BAUM FACTORS

The Widmer-Baum court held that it would "consider all of the factors, but give especial weight to consideration of whether the default here was inadvertent or excusable, or instead was culpable or willful." 162 F.R.D. at 553. A finding of willful failure constitutes sufficient cause to deny the motion to set aside judgment. Id. at 553; see also Harre, 983 F.2d at 130 (requiring a finding of willful violations of court rules, contumacious conduct, or intentional delay to uphold default judgment); In re Kasden, 209 B.R. 236, 238 (B.A.P. 8th Cir. 1997) (following Harre). The movant must demonstrate that its acts were both excusable and neither culpable nor willful before a court need even consider other factors. Waifersong, Ltd. v. Classic Music Vending, 976 F.2d 290, 292-93 (6th Cir. 1992); Action S. A. v. Marc Rich & Co., 951 F.2d 504, 507 (2d Cir. 1991).

WILLFULNESS

In the present context, conduct is willful if nothing occurred to prevent the party from formulating an Answer, and the party demonstrated a pattern of disregard for obligations as a litigant. Jones Truck Lines, 39 F.3d at 164. The willfulness requirement does not necessarily require a conscious choice to thwart procedure. Price v. Seydel, 961 F.2d 1470, 1473 (9th Cir. 1992). A party is culpable when it "has received actual or constructive notice of the filing of the action and has failed to answer." Id.; see also Widmer-Baum, 162 F.R.D. at 554-55 (using both culpability and willfulness in determining good cause and excusable neglect). The Widmer-Baum court found that parties and attorneys are expected to be aware of procedures and deadlines, particularly when specified in the summons. Id. at 555.

MERITORIOUS DEFENSE

The existence of a meritorious defense is a prerequisite to granting relief under Fed. R. Civ. P. 60(b) for mistake, inadvertence, surprise or excusable neglect. The movant must show that a meritorious defense exists as well as establish that facts exist which satisfy the other conditions for relief from default judgment. See Universal Film Exchanges, Inc. v. Lust, 479 F.2d 573, 576 (4th Cir. 1973). Even if these criteria are satisfied, a party must take quick action to rectify the default or the motion

may be denied. Pretzel & Stouffer v. Imperial Adjusters, Inc., 28 F.3d 42, 45 (7th Cir. 1994); see also Ackra Direct Mktg. Corp. v. Fingerhut Corp., 86 F.3d 852, 857 (8th Cir. 1996) (meritorious defense does not prohibit default judgment when conduct of defaulting party is willful).

PREJUDICE AND DELAY

The Widmer-Baum court formulated its analysis of prejudice and delay in terms of whether the defaulting party took "quick action" in response to the default judgment. 162 F.R.D. at 556. "This consideration is required because the cement of finality hardens each and every day beyond the entry of the judgment; the winning party increasingly fashions its expectations and affairs on having and holding the judgment as time passes." Id. (quoting Jones Truck Lines, 39 F.3d at 165). The Widmer-Baum court found that a "remarkably casual response" by the defendant represented a too casual assumption that failings could be undone. 162 F.R.D. at 557. It found an unjustified two-week delay to be too casual and prejudicial. Id.

The parties here began negotiations post-default. Negotiations toward an out-of-court settlement can excuse delay under limited circumstances. Jones Truck Lines, Inc., 63 F.3d at 687-88. The facts in Jones Truck Lines, however, establish that both parties were involved in active ongoing negotiations toward a settlement. Id. at 688. When plaintiff brought to the attention of defendant that no answer had been filed, the defendant promptly filed within one week. Id. In the present case, Trustee's counsel alerted Koehring on March 26 that a default judgment was entered. The motion to set aside, however, was not filed until September 22, a period of almost six months.

Koehring argues that its delay is excusable relying on United States v. Harre, 983 F.2d 128 (8th Cir. 1993). The two cases bear little resemblance. In Harre, the defendant filed his answer twelve days late. Id. at 130. This was over a month prior to entry of the default judgment. Id. at 129 (emphasis added). Because of this, the Harre court prescribed leniency for the "marginal failure to comply with the time requirements." Id. at 130. Those factors do not exist here.

REASONABLE TIME

The justifications required in Fed. R. Civ. P. 60(b)(1) are limited to the time period leading up to the default judgment, and are not used to explain delays in filing post-judgment motions. In re Ellis, 72 F.3d 628, 631 (8th Cir. 1995). A separate standard is provided for judging delay involving the motion to set aside. Id. When excusable neglect is invoked to justify pre-judgment delay, the standard for filing the post-judgment motion to set aside is "within a reasonable time... not more than one year." Fed. R. Civ. P. 60(b).

Consideration of a motion on its merits is not automatic within the one year period. The longer the delay between the defendant's awareness of a default judgment and the motion to set aside, the greater the burden the defendant has to show the delay was reasonable. In re Nick Julian Motors, 148 B.R. 22, 26 (Bankr. N.D. Tex. 1992). Generally, courts will look to the broader issue of whether a defendant took proper and "quick action" in responding to the default. Widmer-Baum, 162 F.R.D. at 556.

ANALYSIS

Koehring provides many reasons why it feels that its conduct constitutes excusable neglect. First, it takes the position that Mr. Jeff Ehrhardt of Koehring concluded that his correspondence to the Trustee

satisfied its obligation to answer the complaint. Mr. Ehrhardt reached this conclusion apparently because he felt that Koehring did not owe any debt to Plaintiff. Koehring asserts that its obligation was satisfied because counter-weights purchased from Debtor were allegedly defective. This appears to be an assertion of a right of recoupment or setoff. As support for this position, Koehring asserts that on November 11, 1996, it faxed the Trustee documents which contained evidence allegedly supporting this defense.

However, it is elementary that the operation of an affirmative defense such as setoff is not automatic. The burden of proof is upon the creditor to plead and prove entitlement to such a setoff. In re Fairfield Plantation, Inc., 147 B.R. 946, 951 (Bankr. E.D. Ark. 1992). In other words, a creditor must take affirmative action to exercise its rights of setoff under 11 U.S.C. §553. In re Gehrke, 158 B.R. 465, 468 (Bankr. N.D. Iowa 1993).

It is difficult to accept that Koehring's personnel actually believed that one fax transmission asserting an alleged affirmative defense actually resolved this entire adversary proceeding. In fact, the timing of the response belies any such belief. Mr. Ehrhardt sent this fax on November 11, 1996 in response to Trustee's letter of November 6, 1996 and not in response to the Notice served on December 17, 1996. If the matter were truly resolved, it is improbable that the Trustee would have continued to send any correspondence. It appears that Mr. Ehrhardt admits, at a minimum, an awareness that he received papers from the Trustee which constituted a notice and complaint.

Koehring asserts that it mistakenly thought the notice and complaint were merely copies of previous correspondence. Koehring's brief states that Mr. Jeff Ehrhardt believed that the materials he received were merely additional copies of what the Trustee had previously sent. While it is true that both sets of documents contained copies of the same six pages of invoices, the complaint contained four additional pages containing the complaint, summons and notice. Any reasonable examination of these documents would have revealed that they were not copies of previous correspondence. Additionally, receipt of these documents from CTS Corporation, the registered agent for Koehring, should have been sufficient to alert Koehring that these were court documents and not ordinary correspondence.

Koehring tenders a third excuse that the individuals who received the notice of the complaint mistakenly failed to forward to legal counsel for a prompt response.

The burden is upon the movant to show good cause for failure to answer. Gibbs, 180 F.2d at 1537. While Koehring has provided numerous reasons why it feels its conduct is excusable, it is ultimately the conclusion of this Court that none constitute excusable neglect or justifiable cause to set aside the default judgment. Koehring's assertion that it felt that it did not owe any debt is most generously categorized as a mistake as to the consequences of the Federal Rules of Civil Procedure. It is well established that unfamiliarity with Bankruptcy Rules and the Federal Rules of Civil Procedure does not constitute excusable neglect. In re Silver Oak Homes, Ltd., 169 B.R. 349, 351 (D. Md. 1994). Koehring's assertion that it mistook the documents for ordinary correspondence establishes neglect but not of the type which the law considers excusable. There is nothing in this record to establish that the service made was improper in any respect. In fact, the previously described facts would lead a reasonable person to no other conclusion than that these were court documents which must be dealt with according to the Rules of Civil Procedure.

Finally, the failure to forward the documents to counsel establishes neglect but not of the type which the law construes as excusable. It was the responsibility of Koehring to take action necessary to protect its rights. Simple failure to do so does not constitute excusable neglect. Even after the default and default judgment were entered, Koehring failed to take action. Koehring was notified by Trustee's

attorney shortly after the entry of the default judgment that it had been entered and Trustee was anticipating a motion to set aside the default. If there was any doubts in the mind of Koehring at that point as to the legal consequences of the previous proceedings, they should certainly have been clarified by this memo. Nevertheless, six months passed until the motion to set aside the default was ultimately filed on September 22, 1997.

Koehring's corporate counsel states that the four-month gap in post-judgment activity was due to counsel's prolonged involvement in costly and unrelated legal matters. This is a clear statement that counsel made a deliberate decision to process other litigation and to take no action in this case. Such conduct does not constitute excusable neglect. Koehring argues that such a conclusion is misplaced in that its correspondence makes clear that it did intend at all times to dispute the amount owed. However, the failure to take appropriate action upon receipt of the legal documents, the failure to file an answer, and the failure to file any type of motion from the date of filing of the adversary petition on December 11, 1996 until September 22, 1997 establish a pattern of conduct in this case which completely negates Koehring's assertion that it desired to contest this case.

The extraordinary length of this delay had a significant impact on the entire case. The aim of a Chapter 7 liquidation is the prompt closure and distribution of debtor's estate. Pioneer Inv., 113 S. Ct. at 1495. Koehring is the only remaining account receivable in this case. Trustee has stated that the Chapter 7 case would have already been closed but for the existence of this dispute. Significant pressure exists to dispose of Chapter 7 bankruptcy cases in an efficient manner. Koehring's failure to file responsive pleadings and become actively involved in this adversary proceeding has not only delayed disposition of this adversary but has also delayed closure of the underlying Chapter 7 case. Based on these factors, the need for finality and closure far outweighs Koehring's equitable position in this case seeking to have the matter tried on the merits.

Finally, Koehring suggests that Trustee should be estopped from resisting the motion to set aside default judgment. This is based upon Koehring's assertion that negotiations occurred which may somehow have lulled Koehring into its present position. "Equitable estoppel prevents a party from denying a state of facts . . . previously asserted to be true if the party to whom the representation was made has acted in reliance on the representation and will be prejudiced by its repudiation." Total Petroleum, Inc. v. Davis, 822 F.2d 734, 737 (8th Cir. 1987).

There is no evidence in this record that the Trustee either agreed to waive rights to enforce the default judgment or requested that Koehring not file any pleadings. In fact, in the first post-judgment communication, Trustee's attorney suggested to Koehring's corporate counsel that a motion to set aside the default judgment was anticipated. This record is devoid of any conduct on the part of the Trustee or Trustee's counsel which could be reasonably construed as misleading. As such, Koehring's theory of estoppel is without merit.

In summary, the Court has weighed all of the relevant circumstances surrounding Koehring's conduct. In so doing, the Court has considered those factors deemed important in Pioneer Investment. It is the conclusion of this Court that this analysis using equitable principles leads ultimately to the conclusion that Koehring has not shown any type of excusable conduct which would justify setting aside the default judgment in light of the length of the delay and the prejudice to Trustee and the estate by delaying closure of this matter. Because of this determination, Koehring's motion to set aside default judgment must be denied.

WHEREFORE, Defendant Koehring Crane Company's Motion to Set Aside Default Judgment is DENIED.

FURTHER, the voluntary stay of Trustee's Petition for Enforcement of Foreign Judgment filed in the Iowa District Court, In and For Bremer County is dissolved and Trustee is authorized to proceed with collection efforts.

SO ORDERED this 21st day of November, 1997.

Paul J. Kilburg
U.S. Bankruptcy Judge