COURT OF CHANCERY
OF THE
STATE OF DELAWARE

JOHN W. NOBLE
VICE CHANCELLOR

417 S. STATE STREET
DOVER, DELAWARE 19901
TELEPHONE: (302) 739-4397
FACSIMILE: (302) 739-6179

November 16, 2004

Leo J. Ramunno, Esquire
1205 N. King Street
Wilmington, DE 19801

Francis J. Trzuskowski, Esquire
Trzuskowski, Kipp & Kelleher, P.A.
1010 Concord Avenue, #101
P.O. Box 429
Wilmington, DE 19899-0429

Re: The Liquor Exchange, Inc. v. Tsaganos
C.A. No. 19312-NC
Date Submitted: September 8, 2004

Dear Counsel:

This case arises out of a dispute between Defendant Nicholas Tsaganos ("Tsaganos"), landlord of the Summit Village Shopping Center ("Shopping Center") near Middletown, Delaware, and Plaintiff The Liquor Exchange, Inc. (the "Tenant"), a tenant in the Shopping Center. The Tenant is seeking specific performance of paragraph 28 of the original Agreement of Lease (the "Lease"), which the Tenant believes operates as a right of first refusal with respect to units that become available during its tenancy in the Shopping Center.

For the reasons set forth below in this post-trial letter opinion, I find for Tsaganos and deny the Tenant all requested relief.

I. BACKGROUND FACTS

The Tenant and Tsaganos signed the Lease for Unit #103 of the Shopping Center on November 30, 1998. Paragraph 28 of the Lease reads:

> Right of First Refusal: In the event other leaseable space becomes available for rent in the Summit Village Shopping Center at any time during the first one year term and any of the four one year option periods, if any, of this Lease, the Tenant shall have the first chance and opportunity to rent the additional leaseable space provided the Landlord and Tenant agree upon all terms of the lease for the additional leaseable space.

The Tenant, owner and operator of a liquor store, sought a right of first refusal as to other available space in the Shopping Center primarily because liquor distributors sell merchandise at a quantity discount; thus, the more merchandise purchased from distributors, the cheaper the merchandise on a unit basis becomes. Obviously, the cheaper the merchandise because, the more profit a store owner can make. Unsure of how the new store would perform, the Tenant wanted the opportunity to acquire additional space if the store was successful in order to have more space to stock additional merchandise, and thereby take advantage of quantity discounts. The unit leased to the Tenant is not large enough for the Tenant to take advantage of many of the quantity discounts that otherwise would be available.

Various units have become available since the Lease commenced; however, the Tenant has never entered into a lease for any other unit in the Shopping Center. The Tenant and Tsaganos disagree as to why an additional lease was never consummated. The Tenant contends that, while a number of units became available during its tenancy, Tsaganos either presented unreasonable lease terms or never presented the available units at all. Although not stated in the Lease, the Tenant believed that it was entitled to a five year lease on additional space because it thought the new lease should match up with the original lease in duration.[1] The Tenant was unwilling to compromise on a lease for less than 5 years. Furthermore, the Tenant, in one instance, objected to purchasing restaurant equipment located in one of the units at a cost of $20,000 as requested by Tsaganos because it only wanted an empty unit. The Tenant did not view Tsaganos as reasonable in asking it to absorb the cost of such equipment.

Tsaganos contends that he did in fact present available space to the Tenant with leases in duration of two years, one year, or on a month-to-month basis. None of these proposed leases, however, contained a right of renewal. Tsaganos was unwilling to extend the duration of any lease offered to the Tenant beyond the initial term because of Tsaganos' desire not to lock up units for a long time in what he believes to be a high growth area with potential for national tenants. According

[1] It should be noted that there is disagreement as to the length of the original lease.

to Tsaganos, no new lease was consummated because the Tenant insisted on a five-year lease. The Tenant, however, balked at such short leases because they were not consistent with the duration of the lease the Tenant already had and, therefore, it made little sense to acquire additional space under a lease that could expire shortly.

The Tenant seeks an order from the Court requiring specific performance of paragraph 28 of the Lease, which would force Tsaganos to provide it with a lease for a larger rental unit.

II. ANALYSIS

A. *Principles of Contract Interpretation*

For any court, the primary goal of contract interpretation is to satisfy the reasonable expectations of the parties at the time they entered into the contract.[2] When a contract is clear on its face, the court should rely solely on the clear, literal meaning of the words contained in the contract.[3] "Where parties have entered into an unambiguous integrated written contract, the contract's construction should be that which would be understood by an objective reasonable third party."[4] When the contract language is clear, the court may not consider parol or extrinsic

[2] *See Bell Atlantic Meridian Systems v. Octel Communications Corp.,* 1995 WL 707916 (Del.Ch.).
[3] *See Myers v. Myers*, 408 A.2d 279, 281 (Del. 1979).
[4] *Demetree v. Commonwealth Trust Co.,* 1996 WL 494910, at *4, (Del. Ch.) (citing *City Investing Co. v. Continental Cas. Co.*, 624 A.2d 1191, 1198 (Del. 1993).

evidence to determine the intent of the parties.[5] Essentially, when parties have agreed, and the contract is clear on its face, the court may look only to the words chosen by the parties to determine the contract's meaning.

Situations arise however, where terms of the contract are not clear on its face, and the court is forced to look outside the contract for meaning. When terms are "fairly susceptible [to] different interpretations", they are considered ambiguous.[6] "Ambiguity may exist if the terms of the contract are inconsistent, or when there is a reasonable difference of opinion as to the meaning of words or phrases."[7] When a court determines that there is ambiguity in the terms of a contract, the court is empowered to look to extrinsic evidence to determine the parties' reasonable intent at the time of the contract.[8] The extrinsic evidence the court may consider includes "overt statements and acts of the parties, the business context [of the contract], prior dealings between the parties, business custom and usage in the industry."[9]

Finally, situations arise when the contract itself is missing terms. While it "is not the proper role of a court to rewrite or supply omitted provisions to a

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[5] *See E.I. du Pont de Nemours & Co. v. Allstate Ins. Co.*, 693 A.2d 1059, 1061 (1997); *Citadel Holding Corp. v. Raven*, 603 A.2d 818, 822 (Del. 1992).
[6] *Comrie v. Enterasys Networks, Inc.*, 837 A.2d 1, 13 (Del. Ch. 2003)(quoting *Eagle Indus., Inc. v. DeVilbiss Health Care, Inc.*, 702 A.2d 1228, 1232 (Del. 1997)).
[7] *Mell v. New Castle County*, 2004 WL 1790140, at *3 (Del. Super.).
[8] *See Comrie*, 837 A.2d 13 (quoting *Eagle Indus., Inc.*, 702 A.2d 1232).
[9] *Comrie*, 837 A.2d 13 (quoting *Supermex Trading Co., Ltd. v. Strategic Solutions Group*, 1998 WL 229530, at * 3 (Del. Ch.)).

written agreement,"[10] "[i]n cases where obligations can be understood from the text of a written agreement but have nevertheless been omitted in the literal sense, a court's inquiry should focus on 'what the parties likely would have done if they had considered the issues involved.'"[11] Where a court cannot determine what the parties would have agreed to had they considered the issues and terms omitted, a court is not permitted to insert its own judgment and terms. However, "in the narrow context governed by principles of good faith and fair dealing, this Court has recognized the occasional necessity of implying such terms in an agreement so as to honor the parties' reasonable expectations."[12] Additionally, "it is a fundamental principle of equity that the remedy of specific performance will only be granted as to an agreement which is clear and definite and as to which there is no need to ask the court to supply essential terms."[13]

B. *The Lease*

Paragraph 28 of the Lease is titled as "Right of First Refusal," but it reads:

> In the event other leaseable space becomes available for rent in the Summit Village Shopping Center at any time during the first one year term and any of the four one year option periods, if any, of this Lease, the Tenant shall have the first chance and opportunity to rent the

[10] *Weston Investments, Inc. v. Domtar Industries, Inc.*, 2002 WL 31011141, at *6 (Del. Super.)(quoting *Cincinnati SMSA Ltd. Partnership v. Cincinnati Bell Cellular Sys.*, 708 A.2d 989, 992 (Del. 1998)).
[11] *Cincinnati SMSA Ltd. Partnership*, 708 A.2d at 992.
[12] *Id.; see Weston Investments, Inc.* 2002 WL 31011141, at *6.
[13] *Baynard v. Jervey*, 1984 WL 21123, a *3 (Del. Ch.); *See M.F. v. F.*, 172 A.2d 274, 276 (Del. Ch. 1961).

> additional leaseable space provided the Landlord and Tenant *agree upon all terms* of the lease for the additional leaseable space.[14]

The Tenant asserts that paragraph 28 should be read as a traditional right of first refusal which would grant it the right to match the terms of any proposed lease for additional space that became available in the Shopping Center. The Tenant further contends that paragraph 28 required Tsaganos not only to act in good faith when dealing with the Tenant, but that it also required Tsaganos to engage in good faith negotiations with the Tenant in order to come to mutually agreeable terms on any lease for new space. At trial, the Tenant argued that Tsaganos failed to act in good faith with respect to lease negotiations because he was unwilling to compromise on various terms (length, renewal) of leases that were presented to the Tenant in connection with available units in the Shopping Center.[15] Additionally, the Tenant argued that many of the terms presented by Tsaganos were unreasonable, and therefore not in good faith. The Tenant also asserted that, in direct violation of its rights under paragraph 28, some available units were never presented to the Tenant.

[14] Emphasis added.

[15] While there was a dispute at trial as to the term of the Lease, the Tenant made clear that it was seeking a five-year lease on any unit because it wanted a lease that would match the original lease as the Tenant understood it. Tsaganos, with respect to any unit offered to the Tenant, only wanted to offer a one year lease, as was his preference with respect to the Shopping Center and its potential for new tenants and general neighborhood growth. The Court does not resolve the actual duration of the Lease because it is not necessary to reach its conclusion.

The Court rejects the Tenant's characterization of paragraph 28 of the Lease as a right of first refusal. Despite the fact that paragraph 28 is titled "Right of First Refusal," the Court finds that paragraph 28 does not in fact entitle the Tenant to a traditional right of first refusal. Instead, paragraph 28 simply entitles the Tenant to what may be referred to as a "right of first negotiation": an agreement to try to come to a future agreement.[16] The Tenant was given the right to negotiate with Tsaganos regarding any open units in the Shopping Center prior to other potential tenants in order to reach terms agreeable to both parties. Tsaganos, under paragraph 28, contracted only to give the Tenant an opportunity to negotiate with him to come to agreeable terms for vacant units. Tsaganos, despite the Tenant's assertion, was not required to alter his desired terms. In fact, as will be discussed below, Tsaganos' only obligation under the Lease was to present and discuss terms to the Tenant in good faith.

C. *Good Faith and Fair Dealing*

Turning to the Tenant's good faith argument, the Court concludes that, while not explicitly contained in the Lease, there exists a covenant of good faith and fair dealing. The covenant springs from fundamental notions of fairness that, in the context of the Lease, Tsaganos would negotiate with the Tenant in good faith with

[16] The "right of first refusal," nevertheless is expressly conditioned upon whether "[Tsaganos] and [the] Tenant *agree upon all terms* of the lease for the additional space." (emphasis added). *See The Liquor Exchange, Inc. v. Tsaganos*, 2004 WL 1254166, at *1 (Del. Ch.).

respect to a larger unit. The covenant of good faith and fair dealing is "designed to protect the spirit of [the] agreement, when, without violating an express term of the agreement, one side uses oppressive or underhanded tactics to deny the other side the fruits of the parties' bargain."[17] When applying the covenant of good faith and fair dealing, the Court will "extrapolate the 'spirit' of the contract from its express terms, and 'determine the terms that the parties would have bargained for to govern the dispute had they foreseen the circumstances under which their dispute arose.'"[18]

However, while an implied covenant of good faith and fair dealing may exist, the covenant "cannot contravene the parties' express agreement and cannot be used to forge a new agreement beyond the scope of the written contract."[19] When applied to the Lease and specifically paragraph 28, the covenant requires only that Tsaganos, in good faith, give the Tenant the opportunity to negotiate for new space and that Tsaganos present and discuss good faith terms at any negotiation. There is no requirement that Tsaganos must alter his good faith terms to reach an agreement with the Tenant.

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[17] *PAMI-LEMB I Inc. v. EMB-NHC, L.L.C.*, 857 A.2d 998, 1016 (Del. Ch. 2004) (quoting *Chamison v. Healthtrust, Inc.*, 735 A.2d 912, 920 (Del. Ch. 1999)). *See ACE & Co. v. Balfour Beatty PLC*, 148 F. Supp. 2d 418, 426 (D. Del. 2001).
[18] *PAMI-LEMB*, 857 A.2d at 1016 (quoting *Chamison*, 735 A.2d at 920-21).
[19] *Chamison*, 735 A.2d at 921.

The Court's analysis with respect to good faith stops at this juncture, because the determination of whether Tsaganos acted in good faith is not necessary to resolve this dispute.[20] Instead, the Court finds that specific performance, the Tenant's requested relief, is inappropriate with respect to the Tenant's right of "first negotiations" because the Court would be forced to supply material terms for the new lease. As noted, the Court is reluctant to supply terms to an agreement and will only do so when it can be determined what the parties agreed to, or would have agreed to. Similarly, the Court will not order specific performance when it would be necessary for the Court to supply essential terms to the agreement.

In this instance, the Court is unable to conclude from the Lease what the parties would have agreed to had they chosen to address the terms of a lease for additional or larger space. It is clear that the parties did not agree to any such terms, but, instead, the language of paragraph 28 indicates that the parties, at best, agreed only to discuss the issue of an additional lease at a later date.[21] Even the

[20] To the extent it may be appropriate, the Court notes that the Tenant has not demonstrated that Tsaganos' clear desire not to rent another unit to the Tenant interfered with his duties under the Lease. While Tsaganos' conduct was hostile and, indeed, at times, inappropriate, the fundamental obstacle to reaching an agreement was caused by the Tenant with its demands for a longer term lease. As long as the Tenant insisted upon something to which it was not entitled – and which Tsaganos was not making available to other tenants (or prospective tenants) – it is difficult to conclude that the failure to reach agreement can be blamed, in an actionable sense, on Tsaganos, especially in light of his reasonable concerns about long-term leases in general.

[21] *See The Liquor Exchange, Inc.*, 2004 WL 1254166, at *2 n.10.

most basic terms with respect to additional space cannot be found in the Lease. There are no terms in the Lease regarding how rent for any additional space would be calculated, or what the duration of a new lease would be. The Tenant asks the Court to assume that the intention was for the additional lease to match the original lease in duration, and therefore the Lease was only ambiguous, and not completely lacking terms relating to a new lease. In addition, the Tenant urges the Court to look at extrinsic evidence to conclude that at least some of the terms of a new lease were agreed to. The Court finds that, in fact, this is not a situation where an agreement was reached but ambiguity remained in the contract with respect to terms; instead, it is a situation where material terms did not exist because no agreement was reached. In short, the extrinsic evidence does not provide a sufficient basis for imposing lease terms.

The Court is unable to grant specific performance in a situation where it would be required to supply the essential terms of the agreement, and surely the rental rate and duration of a lease are essential terms. Because the Lease provides the Court with none of the necessary terms for a lease of an additional unit, and because the evidence does not suggest to the Court that the parties had agreed to but failed to memorialize these terms, the Court is unwilling and unable to supply these terms and therefore must deny the Tenant's application for specific performance.

III. CONCLUSION

For the foregoing reasons, judgment is entered in favor of Tsaganos and against the Tenant. Costs are awarded to Tsaganos.

IT IS SO ORDERED.

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Register in Chancery-NC