**IN THE SUPERIOR COURT OF THE STATE OF DELAWARE**

**IN AND FOR NEW CASTLE COUNTY**

| | | |
|---|---|---|
| **DAYSTAR CONSTRUCTION MANAGEMENT, INC.,** A Delaware corporation, | ) | |
| v. | ) | C.A. No. 04C-05-175-JRS |
| **BRADFORD MITCHELL,** | ) | |
| v. | ) | |
| **CRYSTAL CONCRETE, INC., POLAR MECHANICAL, INC., SUN DOG CABINETRY, INC., ECLIPSE ERECTORS, INC., FLASH ELECTRIC, INC., WEATHER MANAGEMENT, INC., WEATHER SERVICES, INC., DAVID SILLS, IV** and **DENISE SILLS**. | ) | |

Date Submitted: April 26, 2006
Date Decided: July 12, 2006

Decision After Non-Jury Trial.
Verdict for Plaintiff.

Stephen W. Spence, Esquire, PHILLIPS, GOLDMAN & SPENCE, Dewey Beach, Delaware. Attorney for the Plaintiff.

James S. Green, Esquire and Kevin A. Guerke, Esquire, SEITZ, VAN OGTROP & GREEN, P.A., Wilmington, Delaware. Attorneys for the Defendant.

Donald L. Logan, Esquire, TIGHE, COTTRELL & LOGAN, P.A., Wilmington, Delaware. Attorney for the Third Party Defendants.

SLIGHTS, J.

## I.

A long-term business relationship gone sour has caused former friends and business partners to pursue each other in litigation. This case represents a piece of the broader dispute between these parties. The former partners are David N. Sills, IV, sole owner of plaintiff, Daystar Construction Management, Inc. ("DCM"), and defendant, third-party plaintiff, Bradford Mitchell. The subject of this portion of the parties' dispute involves DCM's effort to enforce its rights against Mr. Mitchell under a loan guaranty it has received by assignment from Wilmington Savings Fund Society ("WSFS").

The matter was tried to the Court in a two day bench trial. Thereafter, the Court received post-trial briefing and oral argument. This opinion represents the Court's findings of fact, conclusions of law and verdict.

## II.

Mr. Sills and Mr. Mitchell began their business partnership in 1993 or 1994.[1] They formed several companies together and, through these entities, performed various services related to the construction industry.[2] Mr. Sills maintained either a

---

[1]D.I. 29 at 50 ("D.I. " shall refer to the applicable docket item.)

[2]D.I. 29 at 50-55; 126-138. The various companies formed by Sills and Mitchell shall hereafter be referred to as the "sub companies," a term used by the parties at trial and in post-trial briefing.

50% or 51% ownership interest in each of the sub companies.[3] Mr. Mitchell owned the remaining shares of each sub company, although he was not asked to make any initial capital investment in any of these entities at the time of formation.[4] The parties appear to agree that Mr. Sills controlled most if not all aspects of the finances and operations of the sub companies.[5]

On October 30, 2001, several of the entities owned by Mr. Sills and Mr. Mitchell, including the sub companies, entered into business loan agreements with WSFS for loans totaling $6,040,000.[6] Both Mr. Sills and Mr. Mitchell, along with Mr. Sills' wife and two entities owned and controlled by Mr. Sills, signed identical personal guaranties for the WSFS loans.[7] The loan agreements that were the subject of these guaranties were not introduced as exhibits at trial and are not otherwise before the Court.

By all accounts, the sub companies did not perform well financially.[8] Consequently, many of the entities frequently would reach the limit of their lines of

---

[3] *Id.* at 48; DX 1, Ex. A (refers to companies owned by the parties).

[4] D.I. 29 at 99-100.

[5] D.I. 29 at 53.

[6] D.I. 29 at 13, 51-52, 90; D.I. 27, Facts Admitted Without Formal Proof, ¶ 1.

[7] D.I. 27, § 2, ¶ 2; DX 6, DX 1-3, Ex. H-J.

[8] D.I. 29 at 54.

credit with WSFS.[9] When this occurred, either Mr. Sills personally or the construction company he owned, Daystar Sills Construction Company ("Daystar Sills"), would infuse cash into the entities that were struggling so that they could meet their expenses and service their debt.[10] Thus, notwithstanding their financial difficulties, all of the various sub companies stayed current on their loan obligations with WSFS throughout the parties' relationship.[11]

The parties offered different reasons as to why the various entities were structured as they were. It appears quite clear from the evidence, however, that Mr. Sills in particular reaped most of the benefits from the symbiotic relationship that existed between Daystar Sills and the various sub companies, all subchapter S corporations, and all formed to serve as sub contractors for Daystar Sills and other entities. Daystar Sills, no doubt, assisted the struggling sub companies in meeting their obligations under the loan agreements at significant expense.[12] But Daystar Sills

---

[9]*Id.* at 54.

[10]*Id.* at 54, 115.

[11]D.I. 30 at 70-71; PX5. The sub company loans were paid through Daystar Sills. D.I. 29 at 131 (The sub companies' losses and loans were consolidated into Daystar while Mr. Sills continued to use his personal money to pay Daystar's debt); *Id.* at 122-24 (The sub companies owed money on the principle of the debt alone, not the interest); *Id.* at 58 (Sills testifies that he contributed a considerable amount towards payment of the sub companies' expenses and debt service); *Id.* at 63 (Sills testifies that the sub companies whose loans were not acquired by DCM, have continued to make payments only with substantial personal funding).

[12]D.I. 30 at 9.

received a benefit in return. Indeed, it appears that one goal of the tax structure arranged by the parties was to allow Daystar Sills to book the consolidated losses of the various sub companies.[13] A company owned by Mr. Mitchell, Doors & Drywall ("Doors & Drywall"), however, was not able to avail itself of the sub company losses in its tax planning because, unlike Daystar Sills, Doors & Drywall was not organized as a sub chapter S corporation.[14]

At some point in 2003, Mr. Sills asked Mr. Mitchell to contribute additional capital to their struggling sub companies.[15] Although the parties disagree regarding Mr. Mitchell's reasoning or justification, it is clear that Mr. Mitchell declined to contribute anything further to the sub companies.[16] In late August or early September, 2003, Mr. Mitchell and Mr. Sills terminated their business relationship. This was effected when the Sills-controlled sub companies and Daystar Sills stopped doing business with Mr. Mitchell's Doors & Drywall, and Mr. Mitchell was evicted

---

[13] *Id.* at 6-7.

[14] D.I. 29 at 129. Doors & Drywall was part of the symbiotic relationship that was established by Messrs. Sills and Mitchell that included Daystar Sills (for Sills), Doors & Drywall (for Mitchell) and the sub companies (purportedly for both Sills and Mitchell). Each referred business to the others and, in some instances, shared resources and personnel. Mr. Mitchell also received a salary and/or management fee from some or all of the sub companies. D.I. 30 at 50-51. It also appears from testimony of the Daystar Sills controller that Mr. Mitchell was aware of Daystar Sills' use of the sub company losses for tax planning and agreed to the arrangement. D.I. 29 at 129-30.

[15] D.I. 29 at 55, 95-96.

[16] *Id.*

from premises owned by Daystar Sills.[17]

After the parties' business relationship dissolved, WSFS approached Mr. Sills and asked him to find a way to reduce the debt owed to WSFS by Daystar Sills and the sub companies.[18] Mr. Sills agreed. With proceeds from a refinancing of his vacation home, Mr. Sills, through DCM, purchased seven loans from WSFS, at par, for $725,991.25 (the "Assigned Loans").[19] In exchange, DCM received an absolute assignment of all rights to the Assigned Loans, as memorialized in an "Absolute Assignment of Certain Notes and Rights" dated March 31, 2004.[20]

Mr. Sills also acquired all rights to enforce Mr. Mitchell's personal guarantee to WSFS.[21] Mr. Mitchell's "Guaranty" provides, in pertinent part, as follows:

> 1. Definitions
> Capitalized terms used herein have the same meaning ascribed to them in the "Business Loan Agreements" (hereinafter defined) unless otherwise defined herein.
>
> 1.2 "Business Loan Agreements" means those certain Business Loan Agreements between Secured Party and the Borrowers related to and executed in connection with those certain credit facilities or loans

---

[17] *Id.* at 56-57.

[18] *Id.* at 59.

[19] *See* PX 1; D.I. 29 at 15-17, 47-48; D.I. 30 at 68-74.

[20] PX 1.

[21] *Id.*; D.I. 30 at 68-72; D.I. 29 at 92-93; *Id.* at 59-60.

of up to $6,040,000.00, together with all extensions, modifications, amendments and renewals thereof.

2. Guaranteed Obligations

In consideration of any extension of credit . . . . by Secured Party to Borrower, . . . . Guarantor hereby guarantees (a) the full and prompt payment to Secured Party when due, whether by acceleration or otherwise, all indebtedness and (b) the prompt, punctual and full performance of all of the Borrower's obligations under the Business Loan Agreements.

5. Performance upon Default.

Upon the occurrence of Event of Default [undefined in the Guaranty] under any of the Business Loan Agreements, Guarantor hereby agrees to perform and pay the Guaranteed Obligations . . . . (c) without demand for payment or proof of such demand; [and] (d) without requiring Secured Party to resort first to Borrower or to any other guarantee or any collateral which the Secured Party may hold . . . .

8. Waiver of Defenses

This Guaranty is absolute and unconditional and shall not be affected by any act or thing whatsoever, except as herein provided. Accordingly, Guarantor unconditionally and irrevocably waives all defenses which, under principles of guarantee or suretyship law, may otherwise operate to impair or diminish the liability of Guarantor hereunder.

11. Joint and Several Obligations

The liability and obligations of Guarantor shall be joint and several with any other person who signs this Guaranty and with all other guarantors of the performance of the Guaranteed Obligations.

12. Termination

This Guaranty shall remain in full force and effect as to Guarantor until all Indebtedness outstanding, or contracted or committed for (whether or not outstanding) shall be finally and irrevocably paid in full.

> 14. Interest in the Indebtedness
> The rights and benefits of Secured Party hereunder shall, if Secured Party so directs, inure to any party acquiring any interest in the Indebtedness or any part thereof. Secured Party specifically has the right to assign this Guaranty.[22]

On April 30, 2004, DCM, through counsel, sent a letter to Mr. Mitchell in which DCM demanded that Mr. Mitchell pay 49% of the amount paid for the Assigned Loans pursuant to Mr. Mitchell's personal guaranty.[23] According to DCM, the borrowers were no longer able to make payment on the loans and, therefore, Mr. Mitchell was personally obligated to make good on his personal guaranty in accordance with his 49% ownership interest in the various borrowing entities. Mr. Mitchell denied any personal responsibility for the Assigned Loans, and DCM initiated this suit.

## III.

DCM alleges that it received a valid assignment of the Assigned Loans from WSFS. According to DCM, since the borrowers have now defaulted on the Assigned Loans, DCM, as the "replacement lender," may enforce the personal guaranties it has received by assignment from WSFS in connection with the Assigned Loans, including the one from Mr. Mitchell. DCM claims that it is entitled to receive from

---

[22]PX 6.

[23]PX 2.

Mr. Mitchell the entire amount paid to WSFS for the Assigned Loans, but it has agreed to demand only an amount commensurate with Mr. Mitchell's ownership interest in the borrowers that are subject to the Assigned Loans.[24]

Mr. Mitchell counters that DCM's claim suffers from a failure of proof. Specifically, he argues that DCM has failed to establish that the borrowers have defaulted on the Assigned Loans such that his personal guaranty would be triggered. In addition, he argues that his personal guaranty has been extinguished by virtue of the fact that DCM has "paid off" the Assigned Loans. Finally, he argues that the Court should decline to enforce his personal guaranty because DCM has violated the covenant of good faith and fair dealing that was inherent in Mr. Mitchell's guaranty to WSFS by establishing an elaborate scheme to cause the borrowers to stop paying on the Assigned Loans so that Mr. Sills could pursue Mr. Mitchell personally on the debt. In the event the Court rejects these defenses, Mr. Mitchell seeks contribution from the debtors and other guarantors (all third party defendants hereto) and asks the Court to apportion damages.

In reply, DCM argues that Mr. Mitchell has mischaracterized the state of the Assigned Loans. While it may be true that the loans were current as of April 30,

---

[24]DCM acknowledges that it has only sought to enforce its rights under Mr. Mitchell's guarantee and has not pursued any of the other co-guarantors.

2004, the date of DCM's demand, the borrowers have not paid a nickle on the loans since then and this failure constitutes an "event of default" under Mr. Mitchell's personal guaranty. In addition, DCM takes issue with Mr. Mitchell's characterization of the loan assignment transaction. Specifically, according to DCM, it did not "pay off" the Assigned Loans, but rather it acquired them from WSFS at par pursuant to a valid assignment. Mr. Mitchell's personal guaranty, therefore, has not been extinguished. Finally, DCM disputes that it has acted in bad faith and contends that it is simply enforcing its rights under clear and unambiguous contracts entered into by Mr. Mitchell at arms-length.

**IV.**

At the heart of this dispute is a fundamental difference in the way the parties view their prior business relationship and the manner in which the WSFS loans fit within that relationship. For his part, Mr. Sills portrays Mr. Mitchell as an active participant in and beneficiary of the symbiotic relationship that existed between and among Daystar Sills, Doors & Drywall and the various sub companies that he owned with Mr. Mitchell. Mr. Mitchell's drywall company (Doors & Drywall) received business and financial assistance from Daystar Sills, and Mr. Mitchell himself received wage and benefit compensation from the sub companies. The tax structure of the various entities enured to the benefit of both Mr. Sills and Mr. Mitchell.

Mr. Mitchell views the relationship differently. From his perspective, Mr. Sills and Daystar Sills reaped most of the benefit of the relationship between Daystar Sills and the sub companies, and the relationship between Mr. Sills and Mr. Mitchell. According to Mr. Mitchell, the sub companies "were established to serve Sills' and Daystar [Sills'] tax planning needs" to the tune of "millions of dollars in tax shelters . . . ."[25] When their relationship soured, Mr. Sills simply decided to stop paying on the Assigned Loans so that he could attempt to extract funds from Mr. Mitchell pursuant to Mr. Mitchell's guaranty. Under these circumstances, Mr. Mitchell contends that he personally owes nothing towards the Assigned Loans, nor should he be required to pay anything towards them since he received virtually no benefit from them.

After reviewing the trial record and the parties' post-trial submissions, it is clear to the Court that the parties' vastly different perspectives and/or portrayals of their business relationship have animated the factual and legal positions they have taken in this litigation. Accordingly, as part of the fact-finding process, the Court has endeavored to understand "the big picture" as it considers the particular claims and defenses that have been raised here. Where relevant, the Court's findings in this regard will be referenced in the analysis. As will be discussed below, however, much

[25]D.I. 35 at 9.

of this dispute revolves around contractual documents that were negotiated by sophisticated businessmen and an institutional lender at arm-length. Thus, to the extent these documents are clear and unambiguous, and their terms are dispositive of a claim or defense, the Court will follow the letter of the contract without regard to parol evidence or extrinsic considerations.

### A. The Burden of Proof

The Court begins with the fundamental observation that plaintiff bears the burden of proving its breach of contract claim by a preponderance of the evidence.[26] In this regard, the Court must be mindful that if the evidence presented by the parties during trial is inconsistent, and the opposing weight of the evidence is evenly balanced, then "the party seeking to present a preponderance of the evidence has failed to meet its burden."[27] When balancing the evidence, the Court has applied "the customary Delaware standard to the trial testimony:"

> I must judge the believability of each witness and determine the weight to be given to all trial testimony. I considered each witness's means of knowledge; strength of memory and opportunity for observation; the reasonableness or unreasonableness of the testimony; the motives actuating the witness; the fact, if it was a fact, the testimony was contradicted; any bias, prejudice or interest, manner or demeanor upon

---

[26]The Court will address the burden of proof with respect to Mr. Mitchell's affirmative defense below.

[27]*Eskridge v. Voshell*, 593 A.2d 589 (Del. 1991), (citing *Guthridge v. Pen-Mod, Inc.*, 239 A.2d 709, 713 (Del. 1967)).

> the witness stand; and all other facts and circumstances shown by the evidence which affect the believability of the testimony. After finding some testimony conflicting by reason of inconsistencies, I have reconciled the testimony, as reasonably as possible, so as to make one harmonious story of it all. To the extent I could not do this, I gave credit to that portion of testimony which, in my judgment, was most worthy of credit and disregarded any portion of the testimony which, in my judgment, was unworthy of credit.[28]

**B. DCM Acquired The Assigned Loans From WSFS**

Mr. Mitchell has argued that his guarantee obligations were extinguished because DCM "paid off" the Assigned Loans. In other words, according to Mr. Mitchell, there are no longer any loans for him to guarantee. After reviewing the evidence, the Court is satisfied that DCM purchased the Assigned Loans from WSFS; there was no "pay off" which would extinguish Mr. Mitchell's obligations under his personal guarantee. In this regard, it should be noted that DCM was not a borrower on any loan from WSFS, nor did it purport to be acting on behalf of a borrower when it negotiated with WSFS. DCM was formed by Mr. Sills for the sole purpose of acquiring the Assigned Loans from WSFS and then securing payment of the loan obligations from either the borrowers or the guarantors. Mr. Mitchell has offered no factual basis in the record nor any legal authority that would justify a characterization of the transaction as anything other than what it purported to be: an acquisition of

---

[28] *Dionisi v. DeCampli*, 1995WL 398536, at * 1 (Del. Ch. June 28, 1995).

loans (debt instruments) at par value.

Moreover, Mr. Mitchell's personal guarantee states that it "shall remain in full force and effect as to Guarantor (Mitchell) until **all** Indebtedness outstanding ... shall be finally and irrevocably paid in full."[29] It is clear that the "Indebtedness," as defined in Mr. Mitchell's personal guarantee, includes not only the Assigned Loans, but also all of the other loans secured on behalf of the various sub companies that were not purchased by and assigned to DCM and remain outstanding to WSFS. Thus, even if one might characterize DCM's transaction with WSFS as a payoff of the Assigned Loans, the transaction still would not terminate Mr. Mitchell's personal guarantee because "all Indebtedness outstanding" has not been "paid in full."

### C. Plaintiffs Have Established An "Event of Default"

In his post-trial brief, Mr. Mitchell argued that DCM cannot establish an "event of default" on the Assigned Loans to which his personal guarantee attached because it failed to present any evidence regarding the terms of the underlying loans. DCM acknowledges that it did not put the loan agreements into evidence at trial but argues that the Court can "take notice" of the fact that a failure to pay the loans constitutes an event of default. The parties do not dispute that the borrowers stopped paying on the Assigned Loans prior to DCM's demand that Mr. Mitchell make good on his

[29]PX 7 at ¶12 (emphasis supplied).

personal guarantee. At oral argument after trial, Mr. Mitchell's counsel conceded (appropriately) that nonpayment of the Assigned Loans would be an event of default.[30] The Court so finds and, accordingly, Mr. Mitchell's argument in this regard is rejected. The Court is satisfied that DCM has established an event of default.

### D. The Covenant of Good Faith and Fair Dealing

Mr. Mitchell's showcase defense is that DCM should be barred from recovery because it has acted in bad faith. Specifically, he alleges that Mr. Sills, through DCM, caused the borrowers that he controlled to default on their loan obligations so that Mr. Sills, through DCM, could pursue Mr. Mitchell under his personal guarantee. He has couched this defense as an allegation of "bad faith." In essence, Mr. Mitchell contends that DCM has violated the covenant of good faith and fair dealing ("the covenant") that is implied in his personal guarantee by causing an event of default on the underlying loan agreements.[31] This defense raises several predicate legal issues:

---

[30]D.I. 42 at 53-56.

[31]The Court notes that Mr. Mitchell himself has characterized his "bad faith" argument as a violation of the covenant. D.I. 35 at 8-9; D.I. 27. The Court also notes that Mr. Mitchell has neither pled nor attempted to prove that his defenses are based on any fiduciary duty or other special relationship that Mr. Sills might owe towards or have with him. *Id.* Mr. Mitchell has not made any claims or arguments under the Uniform Commercial Code. *Id.* Nor has he sought to invoke any theories of "lender liability," either by statute or otherwise. *Id.* He raised fraud in his amended answer but alleged no facts to support the defense. He then apparently abandoned the defense in the pretrial stipulation, in his presentation at trial, and in post-trial briefing. *Id.* Accordingly, the Court will consider his asserted defense of "bad faith" only in the context in which he has argued it here, i.e., as a claim that Mr. Sills and/or DCM have breached the covenant.

(1) is the covenant available as a defense to a breach of contract claim;[32] (2) if so, is it an affirmative defense for which Mr. Mitchell would carry the burden of proof; (3) what must Mr. Mitchell prove in order to be relieved of his contractual obligations under his personal guarantee; and (4) if the covenant is available as a defense to Mr. Mitchell as a matter of law, is his personal guarantee sufficiently ambiguous on the issue of his repayment obligation to allow the Court to imply the covenant to relieve him of that obligation. The Court will address these issues *seriatim.*

### 1. The Covenant As a Defense

The Court has not located any Delaware authority that directly addresses the question of whether the covenant can be raised as a defense in a breach of contract action.[33] In Delaware, the covenant generally is raised by plaintiffs as one of several claims of breach, or as a cross or counter claim asserted by the defendant.[34] Nevertheless, there does appear to be authority elsewhere that would support the use

---

[32]Mr. Mitchell has not raised the covenant as a counterclaim.

[33]The Court acknowledges that "bad faith" frequently is raised as a defense in both tort and contract actions. As stated, Mr. Mitchell has refined his allegation of bad faith by focusing on an alleged violation of the covenant. It is in this limited context that the Court notes an apparent lack of authority.

[34] *See e.g. O'Tool v. Genmar Holdings, Inc.,* 387 F.3d 1188 (10th Cir. 2004); *Dunlap v. State Farm Fire & Cas. Co.,* 878 A.2d 434 (Del. 2005); *DuPont v. Pressman,* 679 A.2d 436 (Del. 1996); *In re: Fitzgerald v. Cantor*, 1998 WL 842316 (Del. Ch. Nov. 10, 1998); *Ariba, Inc. v. Elec. Data Sys. Corp.,* 2003 WL 943249 (Del. Super. Ct. Mar. 7, 2003) (all cases illustrating use of the covenant of good faith and fair dealing either as a counter-claim or a direct claim for relief).

of the covenant as a defense to a breach of contract claim. For instance, Massachusetts allows the covenant to be raised as a defense in order "to guarantee that the parties remain faithful to the intended and agreed upon expectations of the parties."[35]

Although Delaware courts have not addressed the question in the civil context, our Supreme Court recently made it clear that a criminal defendant may seek to rescind a plea agreement on the ground that the State violated the covenant in the negotiation or implementation of the deal.[36] Specifically, the Court held:

> "[W]e make explicit what was always implicit: in Delaware, a covenant of good faith and fair dealing applies to plea bargains as well as to any agreement between a criminal defendant and the State. 'Stated in its most general terms, the implied covenant requires a party in a contractual relationship to refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits of the bargain.'"[37]

Other jurisdictions have taken a similar approach to rescind otherwise

---

[35] *See Citizens Bank of Mass. v. Bus. Prod. Online, Inc.*, 2006 WL 541038, *3 (Mass. Super Ct.. Feb. 14, 2006) (quoting *Uno Rest. v. Boston Kenmore Realty*, 805 N.E.2d 957 (Mass. 2004)).

[36] *Cole v. State*, 2005 WL 2805562, at *5 (Del. Oct. 19, 2005).

[37] *Id.* (quoting *Dunlap*, 878 A.2d at 442).

enforceable plea agreements.[38] From these cases, the Court has drawn the conclusion that the covenant can be raised as a defense to a breach of contract claim in the civil context. The covenant, as an implied term, applies to all parties to a contract. It only makes sense, therefore, that all parties to a contract may rely upon the covenant in litigation, whether they are plaintiffs or defendants.

### 2. As Raised Here, The Covenant Is An Affirmative Defense

The burden of proving a breach of the covenant is generally placed upon the party asserting the violation.[39] A party wishing to avail itself of the covenant must make an *affirmative* showing of "oppressive or underhanded tactics" that have thwarted the spirit of the agreement.[40] Although the Court has found no Delaware decision directly on point, the Court is satisfied that a plaintiff in a breach of contract claim need not establish, as a *prima facie* element of its claim, that it has complied with the covenant. Rather, to the extent the fact finder is to consider the plaintiff's

---

[38] *State v. Lutes*, 120 P.3d 299, 303 (Idaho 2005) ("Where . . .a defendant argues that his guilty plea was not voluntary as a consequence of the state breaching an implied term of the contract, we necessarily examine whether that implied term can be reasonably inferred from the express language of the contract." This examination was used to see if the defense's argument of a breach of implied contractual terms in a plea bargain is valid. While defendant's argument failed, the court's reasoning invoked methods consistent with applying the covenant.).

[39] *See Gregg v. NYLCare Health Plans, Inc.*, 2000 WL 336553, at *4 (D. Or. Mar. 30, 2000)(explaining that a plaintiff must make some showing based on the terms of the contract that indicate a violation of good faith and fair dealing has occurred).

[40] *In re Cendant Corp. Sec.*, 2006 WL 1342808, at *4 (3d Cir. May 17, 2006).

non-compliance with the covenant as a basis to defeat the plaintiff's breach of contract claim, it is up to the defendant to raise the issue and then affirmatively prove the plaintiff's material breach, either in the context of a cross claim or, at least, an affirmative defense.

Mr. Mitchell's amended answer did not assert the covenant as an affirmative defense.[41] He did, however, raise fraud but did not state a factual basis for this defense.[42] The first instance where Mr. Mitchell appears to raise the issue of "bad faith" is in his response brief in opposition to DCM's motion for summary judgment.[43] He then reiterated his claim of bad faith in the pretrial stipulation and, as stated, this was his primary defense at trial without objection.[44]

The pretrial stipulation may supersede the initial and responsive pleadings and provide adequate notice of a claim or defense under certain circumstances.[45] The Court is satisfied that Mr. Mitchell has provided adequate notice of his bad faith/covenant defense in the pretrial stipulation and that it should be considered on

---

[41]D.I. 8.

[42]*Id.* at ¶18.

[43]D.I. 17.

[44]D.I. 27, at §3, ¶3 (Mitchell's issues of fact to be litigated).

[45]*See Alexander v. Cahill,* 829 A.2d 117, 129-130 (Del. 2003).

the merits.[46]

### 3. Only A Material Breach Will Excuse Performance

Having concluded that the covenant *may* be raised as an affirmative defense to a breach of contract claim, the Court next considers in what manner the covenant will operate to relieve a defendant of his obligations under a contract. Generally, a party may only be excused from performance of a contract when the other party has materially breached the contract. "It is a basic tenet of contract law that a party is excused from performance under a contract if the other party is in material breach thereof."[47] "The converse of this principal is that a slight breach by one party, while giving rise to an action for damages, will not necessarily terminate the obligations of the injured party to perform under the contract."[48] As the Court of Chancery explained in *BioLife:*

> Non-performance by an injured party under such a circumstance operates as a breach of contract. The question whether the breach is of sufficient importance to justify non-performance by the non-breaching party is one of degree and is determined by weighing the consequences in the light of

---

[46]The Court notes that DCM has not raised the issue of whether Mr. Mitchell has properly preserved a bad faith/covenant defense. Nevertheless, having concluded that the covenant may be raised as an affirmative defense, the Court felt obliged to determine whether Mr. Mitchell had properly done so in this case.

[47] *Word v. Johnson*, 2005 WL 2899684, at *4 (Del. Ch. Oct. 28, 2005).

[48]*BioLife Solutions, Inc. v. Endocare, Inc.*, 838 A.2d 268, 278 (Del. Ch. 2003) (citations and internal quotations omitted).

> the actual custom of men in the performance of contracts similar to the one that is involved in the specific case."[49]

According to the Restatement of Contracts, when determining whether a breach (i.e. "a failure to render or to offer performance") is material, the following circumstances are significant:

> (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
>
> (b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;
>
> (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
>
> (d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;
>
> (e) *the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.*[50]

"Adherence to the standards stated in Subsection (e) is not conclusive, [however], since other circumstances may cause a failure to be material in spite of such adherence. Nor is non-adherence conclusive, and other circumstances may cause a

---

[49] *Id.* (citations and internal quotations omitted). *See also DeMarie v. Neff*, 2005 WL 89403, at *4 (Del. Ch. Jan. 12, 2005) ("[A]lthough a material breach excuses performance of a contract, a nonmaterial-or *de minimis*-breach will not allow the non-breaching party to avoid its obligations under the contract.").

[50] Restatement (Second) of Contracts § 241 (1981) (emphasis supplied).

failure not to be material in spite of such non-adherence."[51] Therefore, the fact that a party has breached the covenant (i.e. non-adherence to subsection (e)) may or may not be considered "material" depending upon the circumstances of the case.[52] The inquiry is fact-intensive. For now, it suffices to say that to be excused from his contractual obligation to satisfy his person guarantee of the Assigned Loans, Mr. Mitchell must establish that DCM has committed a material breach of the covenant. As explained below, his proof at trial fell short of this mark.

---

[51] *Id.* cmt. f.

[52] *See e.g. Carvel Corp. v. Diversified Mgmt. Group, Inc.,* 930 F.2d 228, 230-31 (2d Cir. 1981) (noting that "every contract contains an implied covenant of good faith and fair dealing" and that plaintiff was "under a duty to perform the contract in good faith and ... a failure to do so *could* be considered a material breach.") (emphasis supplied). Other jurisdictions also recognize that a breach of the covenant can amount to a material breach. *See RW Power Partners, L.P. v. Va. Elec. and Power Co.*, 899 F. Supp. 1490, 1498 (E.D. Va. 1995) ( Under Virginia law, the "breach of the duty of good faith and fair dealing requires more than mere inattention to good business practice" in order to be considered a material breach.); *Rand-Whitney Containerboard Ltd. P'ship v. Town of Montville*, 2005 WL 2042066, at * 3 (D. Conn. Aug. 23, 2005) (Holding that to establish that a breach of the covenant is material requires the non-breaching party to "identify undisputed facts about which conduct constituted plaintiff's bad faith."); *Ssangyong Inc. v. Innovation Group, Inc.*, 2000 WL 1339206, at * 9 (S.D. Iowa July 27, 2000)(Holding that the plaintiff's delays in issuing letters of credit to the defendant were commercially unreasonable and "[w]hen viewed as a whole, these delays, coupled with [plaintiff's] failure to respond to [defendant's] inquiries, amount to a *material* breach of the implied covenant of good faith and fair dealing.") (emphasis supplied); *Connaghan v. Maxus Exploration Co.,* 1992 WL 535618, at * 10 (D. Wyo. Feb. 4, 1992) ("This Court now holds that the realigned plaintiffs are precluded from recovering for that breach by their own prior material breach of the implied covenant of good faith and fair dealing (in unreasonably withholding consent to the settlement.")).

### 4. The Covenant Is Not Implicated By These Facts

Good faith and fair dealing is required in the performance of all contracts.[53] The covenant is the means by which courts will enforce this obligation when the parties themselves have not specifically addressed the issue in their oral or written contract.[54] The definition of good faith and fair dealing is fluid and depends upon the facts and circumstances of a given case and the specific terms of the parties' agreement. In general, good faith captures the notion that neither party to a contract will subvert the other party's right to receive the intended benefit of the bargain.[55] Similarly, the covenant directs the parties not to facilitate an "evasion of the spirit of the bargain."[56] The Uniform Commercial Code, in the context of sales contracts, codifies the covenant by requiring "honesty in fact in the conduct or transaction concerned … and the observance of reasonable commercial standards of fair dealing in the trade."[57] Yet

---

[53] *Pressman,* 679 A.2d at 443.

[54] *Dunlap*, 878 A.2d at 440–1.

[55] SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 38:15, 437 (2000).

[56] RESTATEMENT (SECOND) OF CONTRACTS § 205D (1981).

[57] *Pressman*, 679 A.2d at 443.

another description of good faith offered by courts is simply the absence of bad faith.[58] At the end of the day, despite the many characterizations of the term, and the general guidance that can be drawn from these descriptions, good faith must be determined from the context of the contractual relationship of the parties and the circumstances surrounding the alleged breach.[59]

A party generally breaches the covenant by frustrating the overarching purpose of the contract.[60] The first step in applying the covenant, therefore, is to examine the contract to determine if the alleged breach is clearly addressed within the terms of the

---

[58] *See* Emily Houh, *The Doctrine of Good Faith in Contract Law: A (Nearly) Empty Vessel?*, 2005 UTAH L. REV. 1, 5-6 (2005) (explaining that defining good faith as a corollary to bad faith is the primary principle of the so-called "Excluder" analysis. This method of understanding the covenant seeks not to define wholly what constitutes good faith, but instead to leave its application open to various contexts while excluding "certain heterogeneous forms of bad faith.")(citations omitted). This theory is the one adopted by the Restatement. *See* RESTATEMENT (SECOND) OF CONTRACTS § 205D (1981). It also is the theory that appears to have been endorsed by our Supreme Court. *See e.g. Dunlap*, 878 A.2d at 441 ("good faith has no set meaning, serving only to exclude a wide range of heterogeneous forms of bad faith.")(citations omitted).

[59] *See* Werner Ebke, *Good Faith and Fair Dealing in Commercial Lending Transactions: From Covenant to Duty and Beyond*, 49 OHIO ST. L.J. 1237, 1238 (1989) (explaining that the "covenant" of good faith and fair dealing is merely the application of the "duty" of good faith and fair dealing to a contract and must be considered in the context of the particular relationship at issue).

[60] *See Dunlap*, 878 A.2d at 442.

agreement.[61] Regardless of what the parties may allege in litigation, if the terms of the contract are facially clear, the parties must be held to those terms. It would violate the basic principles of contract construction to allow any other result.[62]

Surety and guarantee contracts, like all others, are subject to good faith and fair dealing.[63] The context in which the covenant might apply in these situations, however, is exceptionally rare. Delaware courts frequently hold that a lack of good faith defense is unavailable in cases involving a demand for payment because the ability to demand is an agreed upon term explicit in the contract.[64] For instance, when a contract expressly states a loan is payable on demand, the court cannot dilute these explicit

---

[61] *See Frontier Oil Corp.* v. *Holly Corp.*, 2005 WL 1039027, at *28 (Del. Ch. Apr. 29, 2005) (quoting *Cincinnati SMSA Ltd. P'ship v. Cincinnati Bell Cellular Sys. Co.*, 708 A.2d 989, 992 (Del. 1998)) ("[T]he implied covenant may only be invoked where it is 'clear from what was expressly agreed upon that the parties who negotiated the express terms of the contract would have agreed to proscribe the act later complained of.'").

[62] *See Dunlap*, 878 A.2d at 441 (quoting *Tymshare, Inc., v. Covell*, 727 F.2d 1145, 1152 (D.C. Cir. 1984)) (stating the doctrine requires the "honoring [of] the reasonable expectations created by the autonomous expression of the contracting parties.").

[63] *See Int'l Fid. Ins.. Corp. v. Delmarva Sys. Corp.*, 2001 WL 541469 (Del. Super. Ct. May 9, 2001) (allowing surety claims to use the covenant of good faith and fair dealing when suing for damages).

[64] *First Fed. Sav. Bank v. CPM Energy Sys.*, 1993 WL 138986, at *2 (Del. Super. Ct. Apr. 22, 1993)("[Delaware] courts have consistently held that the lack of good faith defense is unavailable in a suit to collect on a demand note. Generally, the rationale is that the execution of a demand note constitutes an agreement between the borrower and the lender that the note may be called for payment at any time, and without cause.").

terms.[65] A lack of good faith defense in a surety context requires a showing of fraud, deception, or conduct otherwise lacking good faith in the decision to call the loan.[66]

While fraud and deception are easily definable within standard Delaware law, it is not clear what needs to be shown to find a party "otherwise lacking good faith."[67] It is, however, clear that if the contractual conditions preceding the ability to demand payment are met, the motivations for the demand are irrelevant.[68] The fact that the exercise of a good-faith business decision might incidentally harm the other party to the contract is of little moment in the breach analysis.[69]

From this perhaps overly exhaustive survey of the legal standards relating to and

---

[65] *See id.* at *3 (explaining that the loan explicitly stated it was payable on demand and that Defendant failed to provide evidence to back his defense).

[66] *See id.*

[67] *See id.* at *3 (Discussing the claim of bad faith the court first notes the explicit terms of the contract do not provide for any conditions or restrictions before it further explains that the individual representing the instrument holder was "honest and forthright in his dealings with defendant").

[68] *See Gilbert v. El Paso Co.*, 490 A.2d 1050, 1055 (Del. Ch. 1984) (stating that when the conditions for calling a loan are made explicit, absent fraud, the motivations for calling the loan are irrelevant); *State St. Bank & Trust Co. v. Inversiones Errauriz Limitada*, 374 F.3d 158 (2d Cir. 2004) (same).

[69] *See M/A-Com Security Corp. v. Galesi*, 904 F.2d 134, 136 (2d Cir. 1990) (quoting *Van Valkenburgh, Nooger & Neville, Inc. v. Hayden Publishing Co.*, 281 N.E.2d 142, 145 (N.Y. 1972)) ("[T]he implied covenant does not extend so far as to undermine a party's 'general right to act on its own interest in a way that may incidentally lessen' the other party's anticipated fruits from the contract.").

practical applications of the covenant, several principles emerge that direct the Court's analysis here. First, the Court must look to the operative agreement to determine if there is room to imply the covenant in the midst of the parties' express agreements and understandings. Second, the Court must take note of the nature of the contract at issue to determine how (or even if) the covenant fits under the circumstances. Third, the Court must look specifically at DCM's conduct to determine if it rises to the level of a material breach of the covenant such that Mr. Mitchell may be relieved of his personal guarantee of the sub companies' debt.

It is important first to note that Mr. Mitchell has neither alleged nor proven that DCM has breached the express terms of his personal guarantee or any of the other operative agreements in connection with DCM's purchase of the loans from WSFS. Implicit in this concession is a recognition that DCM has complied with the letter of the operative agreements and has pursued a course authorized by their terms. By all accounts, the loans held by WSFS were freely assignable in the discretion of WSFS.[70] Mr. Mitchell's personal guarantee to WSFS likewise was freely assignable.[71] The holder of the assigned guarantee, DCM, was authorized to seek from Mr. Mitchell the

---

[70] *See* PX 1; D.I. 29 at 16; D.I. 30 at 71-72.

[71] *See* PX 6 at ¶14.

entire amount of the "Guaranteed Obligations" without first resorting to the borrowers or any other guarantor.[72] Mr. Mitchell acknowledged that the guarantee was "absolute and unconditional" and that he "unconditionally and irrevocable waiv[ed] all defenses which, under principles of guarantee or suretyship law, may otherwise operate to impair or diminish [Mr. Mitchell's liability under the guarantee]."[73]

An event of default occurred when the borrowers stopped paying on the Assigned Loans because they were no longer financially able to do so. DCM, as the Secured Party under the guarantee, was expressly permitted to seek repayment of the entire amount of the Assigned Loans from Mr. Mitchell or any of the other co-guarantors.[74] Under these circumstances, DCM's motivation for seeking to recover the entire amount from Mr. Mitchell - - a bargained-for right of the Secured Party to which Mr. Mitchell expressly agreed - - is simply not relevant.[75]

In addition to concluding that the covenant defense doesn't fit within settled

---

[72] *Id.* at ¶5.

[73] *Id.* at ¶8.

[74] *Id.* at ¶5.

[75] *See Gilbert*, 490 A.2d at 1055 ("Where, as here, the conditions are expressed, the motivations of the invoking party is, in the absence of fraud, of little relevance."); *Cincinnati SMSA Ltd.*, 708 A.2d at 993 ("The unambiguous terms of the Agreement ultimately defeat the plaintiff's case [based on the covenant]."); *Dunlap*, 878 A.2d at 441 ("one generally cannot base a claim for breach of the implied covenant on conduct authorized by the terms of the agreement.")(citations and internal quotations omitted).

parameters established in the legion of cases addressing its limited use, the Court also notes that the defense as raised here suffers from a factual disconnect that is difficult to reconcile. Clearly, Mr. Sills, through Daystar Sills and personally, was largely responsible for keeping the sub companies afloat as they struggled to make ends meet. Mr. Mitchell contends that Mr. Sills' commitment to the sub companies is explained by the substantial benefit he and his company derived from the floundering sub businesses in the form of significant tax advantages. Yet, even under these circumstances, Mr. Mitchell was willing to execute a personal guarantee for extensive loan obligations undertaken by the sub companies - - a personal guarantee that allowed the lender to choose from whom to collect in the event of a default.

Mr. Mitchell's willingness to expose his personal assets evidences a commitment to the financial well being of the sub companies and an understanding that all interested parties - - the lender and the co-guarantors (including his business partner) - - expected that he would contribute financially, if need be, should the sub companies struggle financially. When WSFS approached Mr. Sills to reduce the amount of the combined loan portfolio after consistently poor performance from the sub companies, a fact unrebutted in the record, it should have come as no surprise to Mr. Mitchell that Mr. Sills would look to him to assist in the effort, particularly given the amounts Daystar Sills and Mr. Sills personally had already contributed. When Mr. Mitchell declined to

help, Mr. Sills pursued a course laid out by the clear and unambiguous loan documents to which Mr. Mitchell was party. Bad faith, in any form, is hard to find under these circumstances. A "material breach" of the covenant - - Mr. Mitchell's ticket to excused performance under his guarantee - - is far from present in these facts.

**E. Mr. Mitchell's Contribution Claim**

Mr. Mitchell has brought third party claims for contribution against each of the co-guarantors of the Assigned Loans. These third-party defendants have alleged that Mr. Mitchell's contribution claim is not ripe because he has not discharged his obligation to DCM, i.e., he has not paid more than his proportionate share of the joint obligation to DCM which, according to the third party defendants, is the entire amount demanded by DCM in its complaint.[76] Mr. Mitchell answers by arguing that Delaware Superior Court Civil Rule 14 and settled Delaware practice permit him to prosecute his contribution claim now since his claim for contribution is contingent upon the success of DCM's claim against him.[77] Both parties, technically, are correct.

It is the law of Delaware that, for purposes of calculating the statute of limitations, a claim for contribution or indemnification accrues at the time the party

---

[76]*See* D.I.14, citing *Brooks v. Savitch*, 576 A.2d 1239, 1235 (Del. Super. Ct. 1989).

[77]*See* D.I. 15, citing *McMichael v. Delaware Motor Coach Co.*, 107 A.2d 895, 896 (Del Super. Ct. 1954).

seeking contribution or indemnification "suffers loss or damage through payment of a claim after judgment or settlement."[78] It is also the law of Delaware, however, that if contribution or indemnification claims are brought as derivative cross or third-party claims, i.e., the claimant's right to indemnification or contribution is contingent upon the success of the plaintiff's direct claim against him, then the court may adjudicate all claims together in the interest of judicial economy.[79] This is the posture of Mr. Mitchell's third party claims here. Accordingly, the third party defendant's motion to dismiss Mr. Mitchell's claims for contribution is DENIED.

The parties did not actively litigate the contribution claims at trial for reasons not entirely clear to the Court.[80] Perhaps the parties were awaiting a definitive word on the motion to dismiss.[81] In any event, in the pre and post trial submissions, the Court has received several different views of Mr. Mitchell's liability for the Assigned Loans. DCM and the third part defendants have suggested that he is liable for the full amount of the Assigned Loans in accordance with his joint and several liability per his personal

---

[78]*Chesapeake Utility Corp. v. Chesapeake & Potomac Tel. Co. Of Md.*, 401 A.2d 101, 102 (Del. Super. Ct. 1979).

[79]*See McMichael,* 107 A.2d at 896.

[80]This judge's first exposure to this case was on the morning of trial because the assigned judge was involved in another trial.

[81]The motion was denied before trial with leave to renew it at trial. *See* D.I. 20.

guarantee.[82] DCM has demanded that Mr. Mitchell pay "only" 49% of the par value of the Assigned Loans in accordance with his ownership interest in the sub company/borrowers.[83] Alternatively, DCM seeks 20% of the amount paid for the loans in accordance with Mr. Mitchell's *pro rata* share of the debt as among the five co-guarantors.[84]

Completely lacking in the parties' various views of Mr. Mitchell's ultimate liability is any guidance as to a methodology for allocation. The Court specifically requested such guidance during the post-trial oral argument. In response, Mr. Mitchell submitted a letter memorandum in which he simply reiterated that he was entitled to contribution as a matter of law.[85] He offered no case law or practical advise as to how allocation should be accomplished by the Court. For their parts, DCM and the third-party defendants did not address the issue of contribution in their post-trial submissions and certainly did not address allocation methodologies. Absent this guidance, the Court cannot enter a definitive final judgment in this case. Thus, as much as the Court is loathe to drag this controversy out further, it appears that it must do so in order to

---

[82] *See* D.I. 14 at ¶10; D.I.36 at 5.

[83] *See* D.I.36 at 5.

[84] *See id.* at n. 1.

[85] *See* D.I. 41.

reach an informed result.[86]

## V.

Based on the foregoing, the Court will enter judgment in favor of DCM on its breach of contract claim in connection with Mr. Mitchell's personal guarantee. DCM has demanded that Mr. Mitchell pay 49% of the par value paid for the Assigned Loans, which amounts to $356, 543.01 plus interest. DCM may well be entitled to this amount or more from Mr. Mitchell under the "joint and several" provisions of Mr. Mitchell's guarantee.[87] Mr. Mitchell has sought contribution from his co-guarantors and the Court intends to adjudicate that claim in accordance with Mr. Mitchell's properly filed third party complaint. In order to avoid piecemeal judgments, however, the Court will defer its ruling on the amount of damages to award DCM until after it receives further submissions from the parties regarding the appropriate means by which to calculate damages under the circumstances (including interest calculations) and the appropriate means by which to allocate responsibility for the Assigned Loans among the co-guarantors.

---

[86]The delay thus far is by no means of the parties' making. The Court has been delayed in its completion of this unanticipated task by intervening complex and acute matters on both the civil, toxic tort and criminal dockets. Once again, the Court expresses its sincere apologies for the delay.

[87]Nothing herein shall be read to suggest that DCM may not have a right to collect the entirety of its damages from Mr. Mitchell. That issue will be decided definitively along with the Court's decision on the third-party contribution claims.

DCM and third party defendants shall file letter memoranda, ***with supporting case law and/or other authorities,*** addressing these issues (not to exceed 8 pages double spaced each) within 14 days. Mr. Mitchell shall file a combined response, ***with supporting case law and/or other authorities,*** (not exceed 10 pages double spaced) within 14 days thereafter. The Court will then issue a final order of judgment setting forth the amount of damages awarded to DCM (with interest), and the allocation percentages as among the co-guarantors.

**IT IS SO ORDERED.**

**/s/ Joseph R. Slights, III**
Judge Joseph R. Slights, III

Original to Prothonotary.