Denn v. Anderson

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Court of Appeals Division I

State of Washington

Opinion Information Sheet

Docket Number: 42954-0-I

Title of Case: Edward S. Denn, Appellant

v.

John O Anderson, Respondent

File Date: 02/14/2000

SOURCE OF APPEAL

Appeal from Superior Court of King County

Docket No: 96-2-32737-9

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JUDGES

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IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION I

EDWARD S. DENN, a single person,) No. 42954-0-I

)

Appellant,)

)

v.) UNPUBLISHED OPINION

)

JOHN O. ANDERSON and WENDY)

ANDERSON, Husband and Wife,)

)

Respondents.) FILED

BECKER, J. -- Denn and Anderson were partners in a printing franchise. Anderson agreed to purchase Denn's stock. Anderson insisted that Denn should assign to him the existing lease on the building and when Denn refused to do so, Anderson did not close the purchase. Denn then acquired

Anderson's stock on favorable terms under the buy-sell provision in their partnership agreement. As the sole owner of the building where the business was located, Denn had no duty to assign the existing lease to Anderson. The court erred in finding that Denn breached an implied duty of good faith by insisting on his right to raise the rent, and this error requires reversal of the judgment.

In 1980, Ed Denn acquired a Sir Speedy Printing franchise. He later incorporated the business as Graphics Communications, Inc., and owned it as the sole shareholder. He became interested in sharing ownership of the business with someone who would eventually be able to buy him out. John Anderson, first employed by Graphics when he was a high school student, entered into a shareholder agreement with Denn in 1990 and bought 50 percent of Denn's corporate shares. Anderson did not pay cash; he gave Denn a promissory note for $309,091, and received a larger salary to enable him to make the monthly payments.

Graphics prospered and its gross sales and profits steadily increased. In 1995, Graphics moved its business to a larger building. The partners had intended that the corporation would purchase the building, but the lender, Key Bank, required personal guarantees. Because Anderson did not have enough collateral to satisfy the bank's requirements for a personal guarantee, Denn purchased the building in his own name. Key Bank held a first deed of trust on the property, and took all the business assets as additional collateral, to be released upon completion of certain improvements to the building. Denn leased the space to the corporation at Key Bank's recommended rent.

In 1996, the business relationship between Denn and Anderson deteriorated to the point where they could no longer agree on major business decisions. In October, Anderson offered to sell his stock to Denn for $450,000, or a net of $250,000 plus cancellation of the balance due under the promissory note. Denn refused this offer. Denn then offered to sell his stock to Anderson under Section 11 of their Shareholder Agreement - the buy-sell or 'shotgun' provision. Section 11 provided that either shareholder could submit to the other shareholder a Price Notice specifying a price at which the initiating shareholder would sell all of his stock to the other. If the non-initiating shareholder failed or refused to purchase the initiator's stock within 30 days of the offer, the initiating party then had the right to purchase the other party's stock on the same terms. Denn's Price Notice specified the following terms by which Anderson could obtain Denn's shares: Anderson would pay off the balance on the promissory note he owed to Denn - then approximately $200,000 -- and pay the additional sum of $201,000; and Anderson would procure a release 'from each personal guaranty the seller has made in behalf of the Corporation.' In return, Denn promised to deliver at closing clear title to all of his shares of stock.

Denn, aware that Anderson lacked collateral, did not expect that Anderson would be able to accept the offer. His letter accompanying the Price Notice acknowledged that if Anderson was unable to buy Denn's stock on these terms, Denn would buy Anderson's stock on the same terms. Denn stated that he was prepared to do so.

Anderson, however, did accept Denn's offer. On November 22, after

receiving a financing commitment from the National Bank of Tukwila, Anderson formally notified Denn of his agreement and acceptance of the terms in the Price Notice. He deposited $25,000 forfeitable earnest money, and agreed to pay the balance at closing as well as to provide appropriate documents releasing Denn from his guaranty obligations.

Anderson originally scheduled the closing of his purchase of Denn's stock for November 26. On that date, he wrote to Denn stating that he needed a little more time to take care of all the guarantees. Denn had attached to the Price Notice a list of the firm's 249 trade creditors without identifying the ones to whom he had given a personal guaranty. Anderson said, 'We have already taken care of the big ones, but need the list from Ed to make certain everything else is covered.' Responding the next day, Denn informed Anderson that he could not remember which of the corporation's suppliers had requested his personal guaranty. He suggested that Anderson send a form to each vendor, soliciting a release of Denn or a statement to the effect that no such guarantee was in effect. The closing of Anderson's purchase of Denn's stock was delayed by agreement, and ultimately rescheduled for Monday, December 23, 1996.

Assignment of the lease on Denn's building, a topic Denn did not mention in the Price Notice, then emerged as a major obstacle to closing. The issue arose when Key Bank asked Denn for a copy of the proposed premises lease. On December 12, Denn advised Anderson that if he chose to continue to operate the business in Denn's building, he would have to establish a new lease and pay a higher rent to meet Denn's increased risk inherent in having a non-owner tenant. Anderson responded that he was willing to re-

execute the existing lease on the same terms. On December 16, Denn rejected this offer, and insisted that he was entitled to collect what he considered to be a market rate rent with security provisions. Anderson responded on December 18 that the square foot rate quoted by Denn was exorbitant, and restated his position that it was not necessary to renegotiate a lease. In his letter to Denn, he stated that he had the funds to satisfy all of the financial requirements of the price notice and was prepared to proceed. He added, however, that 'The only thing which precludes going forward at this time is Mr. Denn's insistence that the lease be renegotiated on terms wholly favorable to him as a landlord.'

The transfer of the franchise, another matter not mentioned in the Price Notice, also became an issue. The franchise agreement with Sir Speedy contained provisions barring transfer of the franchise without the franchisor's consent; giving the franchisor a right of first refusal to purchase the business on the same terms offered by the third party; and retaining secondary liability for Denn in the event of a transfer. By December 18, Denn had not received any notice from Sir Speedy consenting to the transfer of the franchise. By letter to Anderson, he expressed his concern that the consent had not been obtained.

Denn's letter of December 18 also emphasized that as a landlord, he was entitled to renegotiate the lease. He expressed his view that it did not appear that Anderson was able to perform. Denn at this time declined to consent to a further extension of the closing date, now less than a week away.

On December 19, Anderson informed Denn that he had been unable to obtain

the required releases from all the vendors. As an alternative, Anderson offered to pay the vendor accounts to zero and close each vendor account. As to the franchise, he said he had spoken to certain individuals at Sir Speedy about transferring the franchise and expected their answer within a day. He said he had been given no reason to anticipate an unfavorable decision. As to the lease, Anderson stated again that he was prepared to re-sign the existing lease in order to satisfy Key Bank's request.

On December 20, Denn wrote back, reiterating his belief that Anderson would not be in a position to close in a timely fashion. Denn again refused to re-sign the lease on its existing terms. He stated that he was willing to waive the requirement for supplier releases on a case by case basis, but refused to accept Anderson's proposal of paying off all the accounts. Denn said he did not believe that procedure would assure that he had no lingering liability as a guarantor for the debts the business would necessarily incur in its on-going operations. Denn also complained that Anderson had waited too long to take care of the releases and the transfer of the franchise, and expressed doubt that Sir Speedy would regard Anderson as financially qualified to become the sole franchisee.

On December 19, the Bank of Tukwila informed Anderson that if he executed a lease on new terms, the bank would view it as a material change. 'If a lease on new terms is executed it will be necessary for us to review the final lease document prior to disbursement of your loans.' Also on December 19, Sir Speedy informed Anderson that it would need as much as ten days more to be able to make a decision about the transfer.

Anderson responded to Denn's December 20 letter on the same day. He took

the position that Denn had implicitly consented to assign the lease on the same terms when he offered to sell his stock. If Denn was refusing to close without a renegotiated lease, Anderson took that as evidence that Denn had no intention of complying with the Price Notice and transferring his stock. Therefore, he wrote, 'Tendering funds would be a useless and vain act.'

Anderson did not appear for closing on the scheduled date. Denn promptly informed Anderson that he would proceed to buy Anderson's stock. He assumed sole ownership of the corporation; terminated Anderson's employment; and shut him out of the premises. Denn also sued Anderson for specific performance. Anderson counterclaimed seeking damages for breach of contract. He alleged that Denn's actions constituted a breach of an implied duty of good faith and fair dealing.

The competing claims went to a bench trial in May, 1997. The court found that Denn had intentionally manipulated his demands as landlord so as to cause Anderson's stock purchase to become 'financially infeasible'; had unreasonably rejected proposed alternatives to obtaining releases of his personal guaranty; and had actively discouraged Sir Speedy from giving its consent to the transfer of the franchise. The court found that Denn had endeavored to contrive a technical default so that he would be able to reverse the terms of the Price Notice. The court concluded that Denn's direct and indirect efforts to frustrate the transaction and hinder Anderson's performance constituted a breach of the implied covenant of good faith and fair dealing in the Shareholder Agreement and Price Notice. The court also concluded that Denn's breach excused Anderson's failure to

close. The court awarded Anderson substantial damages for Denn's conversion of his stock. Denn appeals.

Every contract contains an implied covenant of good faith and fair dealing, including a duty not to interfere with the other party's performance of the contract. State v. Trask, 91 Wn. App. 253, 272-73, 973 P.2d 781 (1998), review denied, 137 Wn.2d 1020 (1999). The implied duty does not, however, impose a 'duty to affirmatively assist in the other party's performance.' Trask, 91 Wn. App. at 273. The implied duty arises only in connection with obligations imposed by the agreement of the parties. Badgett v. Security State Bank, 116 Wn.2d 563, 569, 807 P.2d 356 (1991). Thus, a lease agreement does not give rise to an implied duty of good faith and fair dealing unless there are specific contractual obligations to which the duty can attach. A landlord may arbitrarily refuse to consent to a lease assignment when the lease prohibits assignment without the landlord's consent and imposes no explicit standard of conduct. Johnson v. Yousoofian, 84 Wn. App. 755, 760-62, 930 P.2d 921 (1996), review denied, 132 Wn.2d 1006 (1997).

The central issue here is whether the trial court erred in finding that Denn breached an implied duty of good faith by insisting on his right to refuse to assign the lease to Anderson without renegotiating new terms. The trial court was well aware of the case law stated in Johnson v. Yousoofian, and did not rely on the lease as the source of the duty that Denn breached. Instead, the court found it important that the lease was only one of many documents affecting their legal relationship. The court reasoned that the duty to act in good faith with respect to the lease could

arise from the totality of the circumstances even if it did not arise from the lease. The court remarked that Denn's implied duty to act in good faith under the Shareholder agreement and Price Notice would be illusory 'if he could then put on his landlord hat and do whatever he pleased'. Accordingly, the court entered as a conclusion of law, 'In determining whether the parties proceeded in good faith the Court may consider Mr. Denn's unreasonable demands for a renegotiated lease as part of the totality of circumstances bearing on whether he acted in good faith in connection with the obligations imposed by the Shareholder Agreement and Price Notice."

We hold it was error for the court to regard Denn's insistence on a new lease as a breach of the duty of good faith implied by the Shareholder Agreement and Price Notice. The law does not allow a court to find a duty arising from 'the totality of circumstances.' The law requires a court to point out the specific contractual obligation that gave rise to the supposed duty of good faith. 'As a matter of law, there cannot be a breach of the duty of good faith when a party simply stands on its rights to require performance of a contract according to its terms.' Badgett, 116 Wn.2d at 570.

Denn's obligation as expressed in the Price Notice was to deliver the clear title to his shares at closing. His implied duty of good faith in this transaction required that he not interfere with Anderson's purchase of those shares. But it did not require him to treat Anderson as a favored tenant. The court found that Denn insisted on raising the rent simply because he 'wanted to earn more from the lease', and not because of any

'business necessity.' Nothing express or implied in any of the agreements between the parties precluded Denn from raising the rent solely for his own financial benefit.

Even assuming that the Price Notice and Shareholder Agreement imposed upon Denn a duty not to be unreasonable in his demand for a new lease, the evidence does not support a finding that it was unreasonable for him to obtain a new lease on terms that would secure his interest in a building that he was no longer going to occupy. Anderson, by flatly refusing even to negotiate and insisting instead that he had a right to re-sign the existing lease, overestimated the extent of Denn's obligation to cooperate. If Anderson was not willing to come to terms with Denn about a new lease, he had the choice of moving the business to a new location. If both choices were beyond Anderson's reach financially, then his acceptance of Denn's buy-sell offer was unrealistic.

In summary, Denn agreed to sell his share of the corporation. He did not agree to sacrifice, for Anderson's benefit, his own ability to prosper from his separate investment in the commercial property. Thus, Denn's refusal to assign the lease did not deny Anderson anything that he had bargained for, and cannot be the basis for excusing Anderson's failure to perform.

In its conclusion that Anderson was excused from further performance, the trial court relied not only on the lease problem but also, to a lesser degree, on findings that Denn unreasonably rejected Anderson's proposed alternative method of releasing Denn from his guarantees, and that Denn rather than Anderson was responsible for obtaining Sir Speedy's consent to transfer the franchise. But Anderson's performance may be excused only if

Denn's specific breaches actually caused Anderson's failure to perform.

Barrett v. Weyerhaeuser Co. Severance Pay Plan, 40 Wn. App. 630, 636-38, 700 P.2d 338 (1995).

The nonperformance (breach) of a promise made by A does not necessarily excuse the performance of a different promise made by B.

If A's performance of one promise is not a condition precedent to B's performance of a different promise, A's nonperformance (breach) renders A liable for damages; it does not, however, excuse B's performance of the other promise.

Trask, 91 Wn. App. at 273.

Anderson had agreed to close by tendering over $400,000 and the releases. He did not tender the funds. As for the releases, he did not tender performance. Anderson even failed to satisfy his alternative proposal of closing all the vendor accounts and reopening them in his own name. Anderson has not shown that Denn's obligations to waive the release requirement and to ensure Sir Speedy's acceptance of the new franchisee were conditions precedent. Therefore, it was error to conclude that Denn's breaches of these obligations assuming he did have these obligations, and breached them excused Anderson's obligation to tender his own promised performance. Indeed, the record indicates that the reason Anderson did not have his cash ready at the time of closing was that both Key Bank and National Bank of Tukwila were unwilling to take the necessary steps so long as the dispute about the lease remained unresolved.

Because of the erroneous conclusion that Denn breached an implied duty of

good faith excusing Anderson's performance, the judgment in favor of Anderson must be reversed and his suit dismissed.

What remains is Denn's contention that he is entitled to judgment on his suit for specific performance requiring Anderson to transfer his stock to Denn, and forfeiting the $25,000 earnest money due to his failure to close. For resolution of Denn's claim, the case is remanded to the trial court for further proceedings not inconsistent with this opinion.

Reversed.

WE CONCUR: