IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

UNIVERSAL ENTERPRISE GROUP, L.P.; 617 NORTH SALISBURY BOULEVARD, LLC; 176 FLATLANDS ROAD, LLC; 106 CEDAR STREET, LLC; 102 WEST CENTRAL AVENUE, LLC; 326 EAST DOVER STREET, LLC; 101 MAPLE AVENUE, LLC; 241 CYPRESS STREET, LLC; 28768 OCEAN GATEWAY HIGHWAY, LLC; 610 SNOW HILL ROAD, LLC; 5318 SNOW HILL ROAD, LLC; 302 MAPLE AVENUE, LLC; 177 OLD CAMDEN ROAD, LLC; 111 SOUTH WEST STREET, LLC; 1272 SOUTH GOVERNORS AVENUE, LLC; 505 BRIDGEVILLE HIGHWAY, LLC; 323 WEST STEIN HIGHWAY, LLC; 100 SOUTH MAIN STREET, LLC; 1104 SOUTH STATE STREET, LLC; 133 SALISBURY ROAD, LLC; UNIVERSAL DELAWARE, INC.; and DANIEL SINGH a/k/a DAMINDER S. BATRA;	)	
Plaintiffs,	)	
v.	)	C.A. No. 4948-VCL
DUNCAN PETROLEUM CORPORATION and ROBERT M. DUNCAN;	)	
Defendants.	)	

REPORT PURSUANT TO DELAWARE SUPREME COURT RULE 19(c)

Date Submitted: March 19, 2014
Date Decided: April 29, 2014

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LASTER, Vice Chancellor.

On July 1, 2013, the court issued its post-trial decision in this matter. *Universal Enter. Gp., L.P. v. Duncan Petroleum Corp.*, 2013 WL 3353743 (Del. Ch. July 1, 2013) (the "Memorandum Opinion"). The Memorandum Opinion ruled in favor of the nineteen entity plaintiffs on their breach of contract claim and awarded actual damages of $1,497,429. The entity plaintiffs were debtors in a pending bankruptcy proceeding, and the Memorandum Opinion reserved judgment on the defendants' counterclaims against them and related affirmative defenses. The lone individual plaintiff had filed for bankruptcy and been discharged, and the decision similarly reserved judgment on Count IV of the complaint, in which he sought a declaratory judgment, and on the defendants' counterclaims and affirmative defenses against him. The court asked the parties to submit supplemental briefing on the implications of the bankruptcy.

On September 10, 2013, after receiving and considering the supplemental briefing, the court issued its final order and judgment. *Universal Enter. Gp., L.P. v. Duncan Petroleum Corp.*, C.A. No. 4948-VCL (Del. Ch. Sept. 10, 2013) (ORDER) (the "Final Order"). As part of the consideration in the underlying transaction, the nineteen entity plaintiffs had issued notes to the defendants, and a substantial balance of over $7.6 million remained outstanding and unpaid. Under the agreements governing the underlying transaction, the plaintiffs' remedy for any breach was to reduce the amounts due to the defendants on the notes. In the Final Order, the court held that notwithstanding the entities' pending bankruptcy, the doctrine of recoupment permitted the defendants to reduce the plaintiffs' recovery by the amounts due on the notes. Because the amounts

due on the notes exceeded the plaintiffs' recovery, the plaintiffs' judgment was reduced to zero.

The plaintiffs appealed, arguing that the court erred by failing to address in the Final Order whether the defense of unclean hands made recoupment unavailable. By Order dated March 19, 2014, the Supreme Court of Delaware remanded the matter while retaining jurisdiction (the "Remand Order"). The Remand Order instructed this court to address this argument.

As discussed in greater detail below, the Memorandum Opinion found that the plaintiffs had failed to prove grounds for departing from the bargained-for terms of the parties' contractual relationship. The plaintiffs sued for fraud and sought extra-contractual remedies, including rescission and rescissory damages. The Memorandum Opinion ruled against the plaintiffs on those issues and held that the contract governed. The contract specified that the plaintiffs' remedy for the breaches addressed in the Memorandum Opinion was to reduce the amounts due on the notes by the amount of the damages they incurred. Through the defense of recoupment, the Final Order gave effect to this contractual remedy.

Because the Memorandum Opinion had rejected the plaintiffs' claims for extra-contractual remedies and held the parties to their contract, the Final Order did not dilate on whether the plaintiffs could invoke unclean hands as an equitable defense to create a similar extra-contractual outcome. As demonstrated by the Remand Order, the Final Order's failure to discuss explicitly that step in the court's reasoning was an oversight. The Final Order should have explained that the court did not accept the plaintiffs' attempt

to use unclean hands to block recoupment on the notes, because doing so would grant the plaintiffs an extra-contractual remedy (and a windfall) under circumstances where the Memorandum Opinion previously had held that the contract should control. By permitting the defendants to assert recoupment, the Final Order gave effect to the parties' bargained-for agreement.

I. FACTUAL BACKGROUND

The parties' disputes stem from a 2007 transaction in which defendants Robert M. Duncan and Duncan Petroleum Corporation sold nineteen gas station and convenience store properties (the "Properties") to plaintiff Universal Enterprise Group, L.P. and its nineteen affiliated special purpose entities, one per property (collectively, "Universal"). Under the terms of the sale agreement governing the transaction (the "Sale Agreement"), Universal paid total consideration of $16 million. Half was paid in cash, with $500,000 paid at signing and $7.5 million delivered at closing. The remaining $8 million took the form of promissory notes in favor of Duncan to be paid off over time, with each special purpose entity executing a promissory note for its allocated portion of the $8 million balance (collectively, the "Notes"). Plaintiff Daniel Singh a/k/a Daminder S. Batra ("Batra"), the principal behind Universal, personally guaranteed the payments due under the Notes (the "Personal Guarantee").

In the Sale Agreement, "Duncan made certain representations about the condition of the Properties." Mem. Op., at *6. The petroleum business is heavily regulated, and compliance with the applicable environmental laws was an important consideration for

Universal. The representation concerning environmental regulatory compliance provided that, except as disclosed,

> [t]o the best of the Seller's knowledge, the Seller has received no notice as of the Effective Date of the Agreement from [the Delaware Department of Natural Resources and Environmental Control] or [the Maryland Department of the Environment] requiring the Seller to undertake environmental corrective or remedial actions . . . and to the best of the Seller's actual knowledge, the Property is in compliance with all applicable Environmental Laws.

Id. (quoting Sale Agreement at 23 (the "Environmental Compliance Representation")). "The Sale Agreement backstopped Duncan's specific representations by warranting that the sell-side representations were true and not materially misleading." *Id.* at *7.

The Sale Agreement provided for a 60-day due diligence period, and it contemplated that regulatory compliance issues could be identified during due diligence. Section 13 of the Sale Agreement stated that if the applicable environmental laws required "monitoring, well installations, tests, inspections, borings, remediation operations," or other activities (defined as "Corrective Action"), then Duncan would coordinate and pay for the Corrective Action. *Id.* (quoting Sale Agreement at 29).

A. Universal Discovers Environmental Issues But Decides To Proceed.

During due diligence, Universal and its environmental consultants investigated whether and to what extent any of the Properties had an environmental condition, defined as "the presence or likely presence of any hazardous substances or petroleum products on a property under conditions that indicate an existing release, a past release, or a material threat of a release . . . ." Mem. Op., at *8 (quoting JX 8 at 4). Universal identified several potential issues with regulatory compliance, and on October 12, 2007, Universal

told Duncan "that Corrective Action would be needed and that he would have to escrow sufficient funds." *Id.* at *10.

Universal developed cost estimates for the Corrective Action, which Universal knew were based on incomplete information. "Part of what Universal and its advisors had to address was how to proceed in the face of both known unknowns and unknown unknowns." *Id.* at *11. After much internal deliberation, "Universal told Duncan that it would proceed with the transaction only" if certain modifications to the deal were made (the "October Modification"). *Id.* The October Modification contemplated that:

> Duncan would remediate the environmental conditions which existed at seventeen Properties investigated . . . to the point where the Properties received either a "Notice of Compliance" or a "No Further Action" letter from [the Delaware Department of Natural Resources and Environmental Control] or [the Maryland Department of the Environment], whichever was applicable.
>
> Duncan would escrow $1.6 million of the purchase consideration to fund any Corrective Action.
>
> If Duncan did not fully undertake the Corrective Action, then Universal could perform the repairs itself and offset the costs against the Notes.
>
> If Duncan were found to have breached any of the obligations, representations, indemnities, covenants, and agreements in the transaction, Universal would have the right to offset any resulting damages against the Notes.

Id. (internal citations and quotation marks omitted).

In light of the issue raised in the Remand Order, it bears emphasizing that under the October Modification, Universal's remedy if Duncan breached his representations under the Sale Agreement or failed to undertake Corrective Action was to reduce the amounts due to Duncan under the Notes. Universal was not entitled in the first instance

to recover from Duncan cash equal to the costs of Corrective Action or to obtain a damages award against him.

Duncan agreed to Universal's terms. On November 15, 2007, the transaction closed with the October Modification incorporated into the deal.

B. Universal Invokes Its Contractual Remedy.

After closing, in early 2008, Universal's environmental consultants identified additional problems with two of the Properties. On February 28, Universal asserted that Duncan had breached the representations in the Sale Agreement by failing to disclose these problems. In April, after discovering further issues, Universal provided the consultants' reports to Duncan and asserted further breaches of the Sale Agreement. Duncan denied that he had breached the Sale Agreement.

On June 2, 2009, after a prolonged letter writing campaign, Universal "took the position that it would fix the compliance issues and exercise the right of setoff against the Notes." Mem. Op., at *12. In other words, Universal invoked the contractual remedy to which it was entitled under the Sale Agreement. Universal's costs and damages did not exceed the balance due on the Notes, and Universal still owed Duncan substantial amounts on those obligations. At the time of trial, more than $7.6 million remained outstanding and unpaid.

C. Universal Declares Bankruptcy.

On July 23, 2009, Universal filed for bankruptcy. The nineteen special purpose entities were consolidated into the bankruptcy estate, and the bankruptcy estate stopped making payments on the Notes.

On October 5, 2009, the trustee for the bankruptcy estate filed this action. The complaint asserted claims for common law fraud and equitable fraud. To the extent that the fraud claims failed, the complaint asserted a claim for breach of the Sale Agreement. As a remedy, Universal sought rescission of the transactions governed by the Sale Agreement and a return of the amount it expended in connection with the transaction, plus interest. If rescission was impractical, then Universal sought rescissory damages. Alternatively, Universal sought damages equal to the diminution in the value of the properties caused by Duncan's fraud and contract breaches. In addition, Batra sought a declaration reducing his obligations under the Personal Guarantee. The defendants' counterclaimed for the amounts still owed under the Notes.

In 2010 and 2011, the Properties were sold for $8 million. At trial, Universal relied on the sale as evidence of the extent of the Properties' diminution in value and sought damages equal to the difference between the amount it expended in connection with the transaction and the $8 million sale price, plus interest.

In January 2011, Batra filed for personal bankruptcy. Duncan filed claims against Batra under the Personal Guarantee for amounts due under the Notes. Batra later exited bankruptcy with his debts discharged.

D. The Memorandum Opinion

After a four-day trial in December 2012, this court issued the Memorandum Opinion. The Memorandum Opinion rejected Universal's fraud claims and its requests for rescission and rescissory damages because it found that Universal had not reasonably relied upon Duncan's representations regarding compliance. Instead, "Universal treated

Duncan's representations with healthy skepticism." Mem. Op., at *15. Universal "relied on the representations in the sense that they contractually allocated to Duncan the risk that the representations would be incorrect." *Id.* "Universal did not rely on the representations in the sense of being fraudulently induced by them to close the transaction." *Id.* "Universal instead relied on its advisors and the improved terms it extracted from Duncan." *Id.*

The Memorandum Opinion granted judgment in favor of the Universal on the breach of contract claim and held that Universal was entitled to actual damages incurred due to the breaches. The Memorandum Opinion found that Universal had proved actual damages of $1,497,429.

The Memorandum Opinion reserved judgment on Count IV of the complaint and the defendants' counterclaims. In Count IV, Batra sought a declaration reducing his obligations under the Personal Guarantee securing the Notes. In his counterclaims, Duncan sought to recover on the Notes and contended that any damages owed to Universal should offset the unpaid balance of the Notes. The court ordered supplemental briefing on these issues because the parties' submissions had not addressed the implications, if any, of Universal's and Batra's bankruptcies for the court's ability to adjudicate the issues raised or grant the relief requested.

After receiving and considering the supplemental briefing, the court issued the Final Order. The Final Order found that the issue of recoupment had been tried by implied consent and that Duncan could "rely on recoupment as a defense up to the amount of plaintiffs' recovery, which the [Memorandum Opinion] found to be

$1,497,429." Final Order ¶ 4. The effect of this ruling was to prevent Universal from enforcing its judgment against Duncan to obtain cash in the amount of $1,497,429. Instead, those amounts were offset against the balance due under the Notes, as contemplated by the Sale Agreement.

Because the Memorandum Opinion considered and rejected the argument that Universal could obtain extra-contractual remedies based on Duncan's conduct, the Final Order did not revisit Duncan's conduct for purposes of analyzing whether equitable defenses such as unclean hands could defeat recoupment and give rise to a comparable extra-contractual result. That was an oversight. Because the Memorandum Opinion limited the parties' to the terms of their contractual relationship, the Final Order focused instead on the procedural question of whether the recoupment defense had been tried by implied consent and the substantive issue of whether Universal's and Batra's bankruptcies limited the court's ability to use recoupment to hold the parties to the terms of the Sale Agreement.

II. LEGAL ANALYSIS

The Remand Order instructs this court to address why the doctrine of unclean hands did not prevent the defense of recoupment from operating in Duncan's favor. The short answer is that this court believed, for reasons expressed in the Memorandum Opinion, that the parties should be held to the terms of the Sale Agreement and limited to the contractual remedies that it contemplated. The Memorandum Opinion did not credit the plaintiffs' claims of fraud and fraudulent inducement as a means of escaping the contractual framework and securing an extra-contractual result. The plaintiffs relied on

the same bad acts and misconduct by Duncan for their equitable defenses. Consistent with the Memorandum Opinion, the Final Order enforced the parties' contractual framework and, by applying the doctrine of recoupment, held the parties to the contractually specified outcome.

A. The Memorandum Opinion's Rejection Of An Extra-Contractual Result

In ruling that extra-contractual remedies were not appropriate, the Memorandum Opinion recognized that (i) Duncan had made a series of representations and warranties about the prior operations, status, and condition of the Properties and (ii) those representations and warranties were incorrect. This is the aspect of the Memorandum Opinion that the plaintiff-appellants rely on for their defense of unclean hands. But the Memorandum Opinion also found that Universal had anticipated Duncan's misrepresentations through its due diligence and input from environmental consultants. To address the resulting risks, Universal insisted on the October Modification. Most significantly, Universal bargained for and obtained "the right to offset any resulting damages against the Notes" if the defendants "were found to have breached any of the 'obligations, representations, indemnities, covenants, and agreements' in the transaction." Mem. Op., at *11 (citing JX 93 at 2).

Universal did not prevail on its common law fraud claim because it could not prove all the elements of fraud. A fraud claim requires more than an incorrect statement. It requires that a plaintiff prove (i) a false representation, (ii) the defendant's knowledge of or belief in its falsity or the defendant's reckless indifference to its truth, (iii) the defendant's intention to induce action based on the representation, (iv) reasonable

reliance by the plaintiff on the representation, and (v) causally related damages. *Stephenson v. Capano Dev., Inc.*, 462 A.2d 1069, 1074 (Del. 1983). The plaintiffs carried their burden of proof on the first three elements. For the first and second elements, "Universal proved that Duncan knowingly made a series of false representations in the Sale Agreement, including both the Environmental Compliance Representation and the more general representations about compliance with laws, the absence of litigation, and the providing of all material information." Mem. Op., at *13. For the third element, Universal proved that "Duncan made these false representations and failed to provide records or otherwise inform Universal about the condition of the Properties because he wanted to induce Universal to buy." *Id.* at *14. But Universal failed to prove the fourth element, reasonable reliance. Universal relied on its own due diligence and its environmental consultants. Furthermore, through the October Modification, "Universal specifically addressed the risks it faced, including the known risks that Duncan's files were incomplete and that there were additional, as yet unknown, problems at the Properties." *Id.* at *15. As a result, "Universal did not in fact rely on the representations of the Sale Agreement in a manner sufficient to support common law fraud." *Id.*

Because Universal did not rely on the representations in the Sale Agreement and "structured its affairs to manage [the] risk [that certain representations in the Sale Agreement were false]," Universal failed to prove fraud, and the Memorandum Opinion held that "Universal must take solace in the contractual remedies that it obtained." *Id.*

Under the October Modification, Universal's principal contractual remedy was to reduce the amounts due under the Notes by the amount of the damages suffered.

The Memorandum Opinion also considered that an extra-contractual remedy would confer a windfall on the plaintiffs. The plaintiffs sought rescission, but that remedy "requires that all parties to the transaction be restored to the *status quo ante, i.e.,* to the position they occupied before the challenged transaction." *Strassburger v. Earley*, 752 A.2d 557, 578 (Del. Ch. 2000). Because the Properties had been sold to third parties in 2010 and 2011, rescission was not available. This left rescissory damages as the principal alternative, but rescissory damages are the exception, not the rule. *Id.* at 579.

> They are exceptional, because such damages are measured as of a point in time *after* the transaction, whereas compensatory damages are determined at the time *of* the transaction. As a consequence, rescissory damages may be significantly higher than the conventional out-of-pocket damages, because rescissory damages could include post-transaction incremental value elements that would not be captured in an "out-of-pocket" recovery.

Id. The Memorandum Opinion held that an award of rescissory damages would have conferred "an unfair windfall on Universal" and penalized Duncan by awarding "a remedy that ignore[d] the manifold independent causes leading to the rescissory damages calculation proffered by Universal." Mem. Op., at *16.

Rescissory damages also were "not appropriate" because Duncan's breaches "did not go to the heart of the transaction." Mem. Op., at *18; *accord* Donald J. Wolfe, Jr. & Michael A. Pittenger, *Corporate and Commercial Practice in the Delaware Court of Chancery* § 12.04[a], at 12-62 (2012) (explaining that rescission may be appropriate if a breach of a representation or warranty "may be said to go to the root of the agreement

between the parties"). As the Memorandum Opinion explained, "Universal understood that Duncan likely breached the Environmental Compliance Representation, negotiated the October Modification to address this risk, and elected to close." Mem. Op., at *18. Further, the evidence at trial demonstrated that "after closing, Universal did not originally seek to escape the transaction but rather relied on its contractual rights to ameliorate the harm that Duncan's breaches caused." *Id.* at *19. After becoming aware of Duncan's likely and actual breaches, "Universal affirmed the contract." *Id.*

The Memorandum Opinion also cited Universal's conduct as counseling against an extra-contractual remedy.

> By April 29, 2008, the [environmental consultant's reports] were complete. Over the next year and a half, the parties haggled over the alleged breaches. All the while, Universal continued operating the Properties. In July 2009, Universal filed for bankruptcy for reasons unrelated to its operation of the Properties. Only then did Universal seek rescission. By doing so, Universal "tested the waters," sought to make a go of the venture, and then resorted to its request for rescissory damages as a form of business insurance.

Id.

Rather than constructing an extra-contractual remedy, the Memorandum Opinion held that "awarding damages based on the terms of the contract place[d] Universal in the position it bargained for" because "[e]ither Duncan [would] pay for the Corrective Action, or Universal [could] offset the cost of compliance against the Notes." *Id.* at *20. Having "recognized the likely falsity of certain representations in the Sale Agreement," Universal "structured its affairs to manage that risk." *Id.* at *15. Consequently, Universal had to "take solace in the contractual remedies that it obtained." *Id.*

B. The Issues That The Memorandum Opinion Did Not Reach

Because Universal and its affiliates were debtors in a pending bankruptcy proceeding, and because Batra also had declared bankruptcy, the Memorandum Opinion did not reach the question of how to implement the contractual remedy that was called for under the October Modification, namely a reduction in the amounts due to Duncan under the Notes. Duncan had filed claims on the Notes in the Universal bankruptcy and on the Personal Guarantee in Batra's bankruptcy. It was unclear whether this court had jurisdiction to implement the contractually called-for reduction, or whether those issues were exclusively within the jurisdiction of the bankruptcy courts. Count IV of the Complaint sought a declaration modifying the Personal Guarantees from Batra, which raised similar concerns. The Memorandum Opinion directed the parties to provide supplemental briefing addressing these issues.

C. The Implications Of The Memorandum Opinion For The Final Order

After receiving and considering the parties' supplemental submissions, the court issued the Final Order. An unspoken premise of the Final Order was the court's continuing belief in the appropriateness and desirability of a remedy driven by the terms of the parties' contract, as expressed in the Sale Agreement and the October Modification. The Final Order used the doctrine of recoupment to offset the plaintiffs' damages award against the outstanding balance on the Notes, just as the parties' agreement contemplated. This resulted in the plaintiffs recovering nothing in this action, but it reduced on a dollar-for-dollar basis Duncan's claims on the Notes and the Personal Guarantee. By contrast, to have allowed the plaintiffs to recover a judgment for

$1,497,429 in cash through this action would have departed from the bargain that the parties reached in the Sale Agreement and the October Modification. Such a result would have conferred an extra-contractual windfall on the plaintiffs, because instead of receiving a reduction in the amounts due on the Notes pursuant to their agreement, the plaintiffs would have received cash on a non-contractual basis.

In opposing this result, the plaintiffs argued that the doctrine of unclean hands should bar Duncan from invoking principles of recoupment. The doctrine of unclean hands is based on the long-established rule that if a party who seeks relief in a Court of Equity "has violated conscience or good faith or other equitable principles in his conduct, then the doors of the Court of Equity should be shut against him." *Bodley v. Jones*, 59 A.2d 463, 469 (Del. 1947). For the defense of unclean hands to apply, the conduct "must be so 'offensive to the integrity of the court' that the claims should be denied, 'regardless of their merit.'" *In re Wilbert L.*, 2010 WL 3565489, at *5 (Del. Ch. Sept. 1, 2010). Fraud can constitute "offensive conduct" sufficient to invoke the unclean hands doctrine. *See, e.g.*, *Derickson v. Derickson*, 281 A.2d 487, 488 (Del. 1971) (finding unclean hands based on fraudulent conveyance of property to prevent creditors from reaching the property, even though the party had since paid the debts); *Sutter Opportunity Fund 2 LLC v. Cede & Co.*, 838 A.2d 1123, 1131 (Del. Ch. 2003) (finding unclean hands based on plaintiff's intentional violation of the ownership cap in the partnership agreement with full knowledge of its existence, false reporting of their ownership in a series of SEC filings, and refusal to provide information to defendants as required by the partnership agreement).

"In fashioning a remedy for unclean hands, the Court has a wide range of discretion in refusing to aid the 'unclean litigant.'" *Merck & Co., Inc. v. SmithKline Beecham Pharm. Co.*, 1999 WL 669354, at *44 (Del. Ch. Aug. 5, 1999) (quoting *Monsanto Co. v. Rohm & Haas Co.*, 456 F.2d 592, 598 (3d Cir. 1972)), *aff'd*, 746 A.2d 277 (Del. 2000) (TABLE) (affirming judgment), *and aff'd*, 766 A.2d 442 (Del. 2000) (affirming decision). "The application of the doctrine of unclean hands is not 'bound by formula or restrained by any limitation that tends to trammel the free and just exercise of discretion.'" *Id.* (quoting *Keystone Driller Co. v. Gen. Excavator Co.*, 290 U.S. 240, 245-46 (1933)). "Ultimately, the doctrine is about public policy, and the Court has the broad discretion to refuse relief if [a party] can establish that [the other party] does not meet a very basic though inexact standard: 'where the litigant's own acts offend the very sense of equity to which he appeals.'" *Id.* at *45 (quoting *Nakahara v. The NS 1991 Am. Trust*, 718 A.2d 518, 522 (Del. Ch. 1998)).

"If unclean hands is the sole reason for refusing relief and the opposing party has not been harmed by the inequitable conduct, the Court of Chancery ordinarily will not apply the doctrine." Wolfe & Pittenger, *supra*, § 11.07[b], at 11-91 (collecting cases). Delaware courts are hesitant to apply unclean hands in cases involving a breach of contract.

> If every breach of contract automatically evoked the unclean hands doctrine, then any non-breaching party to a breached contract would have the effective ability to act inequitably against the breaching party with impunity . . . . Any future complaint by the breaching party would be barred by the doctrine of unclean hands. This is not a sound rule of law . . . .

SmithKline Beecham, 1999 WL 669354, at *51. "When parties have ordered their affairs voluntarily through a binding contract, Delaware law is strongly inclined to respect their agreement, and will only interfere upon a strong showing that dishonoring the contract is required to vindicate a public policy interest even stronger than freedom of contract." *Libeau v. Fox*, 880 A.2d 1049, 1056 (Del. Ch. 2005), *aff'd in part, rev'd in part*, 892 A.2d 1068 (Del. 2006). Requiring parties to live with "the language of the contracts they negotiate holds even greater force when, as here, the parties are sophisticated entities that bargained at arm's length." *Progressive Int'l Corp. v. E.I. Du Pont de Nemours & Co.*, 2002 WL 1558382, at *7 (Del. Ch. July 9, 2002).

Regrettably, the Final Order did not elaborate on these principles because the court recently had ruled in the Memorandum Opinion that the parties would be limited to their contractual remedy. That bargained-for remedy contemplated addressing the potential falsity of representations in the Sale Agreement through a right to offset any damages or costs for Corrective Action against the amounts due under the Notes. In preparing the Final Order, the court proceeded on the premise that the same conclusion—limiting the parties to their contractual remedy—rendered inappropriate an extra-contractual remedy based on equitable defenses, such as the doctrine of unclean hands. If the Final Order had prevented Duncan from asserting his defense of recoupment, then the plaintiffs would have been placed in a better position than the one they bargained for: They would have recovered damages for breach amounting to $1,497,429, while remaining in default to Duncan for more than $7.6 million owed on the Notes. That result seemed less equitable to the court than holding the parties to their agreement.

As the Memorandum Opinion held, the plaintiffs failed to prove all of the elements of fraud. Duncan's misrepresentations therefore did not rise to the level of fraud, although they did constitute a breach of contract. His misrepresentations were insufficient to support extra-contractual remedies like rescission or rescissory damages. The court believed they were likewise insufficient to support an extra-contractual remedy on the basis of unclean hands.

Applying the doctrine of recoupment, by contrast, fulfilled the parties' bargained-for remedy. Recoupment is an equitable defense that permits a defendant to reduce or eliminate a plaintiff's recoverable damages on the basis that the plaintiff owes an obligation to the defendant arising out of the same transaction or occurrence as the plaintiff's suit. *See TIFD III-X LLC v. Fruehauf Prod. Co., L.L.C.*, 883 A.2d 854, 859 (Del. Ch. 2004); *see also* 80 C.J.S. *Set-off and Counterclaim* § 2 (2013) ("Recoupment is a common-law, equitable doctrine that permits a defendant to assert a defensive claim aimed at reducing the amount of damages recoverable by a plaintiff." (footnote omitted)). This is precisely what the parties' bargained for in the form of a reduction in the amounts due on the Notes. The Final Order therefore held that Duncan was "entitled to rely on recoupment as a defense up to the amount of plaintiffs' recovery, which the [Memorandum Opinion] found to be $1,497,429." Final Order ¶ 4.

Although this reasoning meant that the plaintiffs did not recover a money judgment through this proceeding, that result was not inequitable. A reduction in the amounts due under the Notes was what the plaintiffs sought in the October Modification, and it was precisely what they received.

III. CONCLUSION

As directed by the Remand Order, this report has explained why the Final Order granted recoupment and did not apply the equitable defense of unclean hands to permit Universal to obtain an extra-contractual remedy. To the extent the Supreme Court has other questions regarding the Memorandum Opinion or Final Order, I would be pleased to attempt to answer them.