IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

ASB ALLEGIANCE REAL ESTATE FUND, EBREF HOLDING COMPANY, LLC, and DWIGHT LOFTS HOLDINGS, LLC,	)	
Plaintiffs and Counterclaim-Defendants,	)	
v.	)	C.A. No. 5843-VCL
SCION BRECKENRIDGE MANAGING MEMBER, LLC, SCION 2040 MANAGING MEMBER, LLC, and SCION DWIGHT MANAGING MEMBER, LLC,	)	
Defendants and Counterclaim-Plaintiffs.	)	

MEMORANDUM OPINION

Date Submitted: April 27, 2012
Date Decided: May 16, 2012

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LASTER, Vice Chancellor.

Entities affiliated with ASB Capital Management, LLC sued to reform the capital-event waterfall provisions in a series of agreements governing real estate joint ventures managed by affiliates of The Scion Group, LLC. The erroneously drafted provisions called for Scion to receive incentive compensation known as a "promote" even if the joint ventures lost money. Scion seeks to enforce the agreements as written, and its affiliates advance counterclaims for breach of fiduciary duty, breach of the implied covenant of good faith and fair dealing, and breach of contract. In this post-trial opinion, I find that the plaintiffs have proved their entitlement to reformation by clear and convincing evidence and enter judgment in their favor on the defendants' counterclaims.

I. FACTUAL BACKGROUND

The case was tried on March 12-15, 2012. My factual findings rest on a record that included more than 300 documentary exhibits and twenty-five deposition transcripts. Nine fact witnesses and two experts testified live at trial.

Each of the ASB witnesses testified candidly and credibly. Despite obvious personal and professional embarrassment, each witness detailed his or her role in contributing to the scrivener's error in the capital-event waterfall provision. Each described how the standard transactional technique of duplicating the prior deal precedent then focusing only on terms that needed changing caused the perpetuation of the error in subsequent joint venture agreements. The ASB witnesses and their expert explained cogently how the resulting provision departed from settled real estate practice and produced an economically irrational result.

The Scion witnesses' testimony was at best self-serving. Robert and Eric Bronstein, who co-founded and remain the principals of Scion, were not credible witnesses. Rob,[1] the majority owner of Scion, was the Bronstein brother who took responsibility for negotiating Scion's business deals. In contemporaneous, pre-litigation emails, Rob demonstrated a willingness to say whatever he thought would close the deal on the terms he wanted, irrespective of any correlation with historical fact. Although more restrained at trial, his testimony had a similar feel.

Eric, an attorney who owns a minority stake in Scion, serves as the firm's Executive Vice President and General Counsel. He and ASB's lawyers at DLA Piper LLP worked to memorialize the deal terms that Rob and ASB negotiated. Eric advanced two contradictory accounts at trial. In one version, he negotiated changes to the capital-event waterfall provision as the authorized representative of Scion and obtained the disproportionately pro-Scion change, fully aware of its implications. In the other version, he lacked sophistication in real estate matters, innocently asked about the capital-event waterfall provision, and naively believed that DLA Piper accurately scrivened the deal. It is one thing to plead claims in the alternative; it is quite another to testify in the alternative about your own role, knowledge, and intentions.

Scion's expert witness fared worse. He could not offer any plausible justification for the mistakenly drafted capital-event waterfall provision. He later admitted that he

[1] For clarity, I refer to the brothers Bronstein by their first names. I use "Rob" for Robert Bronstein to distinguish him from Robert Bellinger of ASB and because the parties used that shortened form in their contemporaneous communications.

was "simply looking back in hindsight and speculating and trying to come up with some argument that supports some consideration that would justify" the provision as written. Tr. 767-68.

A. Scion And ASB Form A Business Relationship.

Rob and Eric co-founded Scion in 1999. Rob previously worked as a vice-president for a Chicago-based real estate services and consulting firm, where he consulted for a number of major corporate and institutional real estate investors. Eric was a partner at Jaffe Raitt Heuer & Weiss, a Detroit law firm with over 100 lawyers. Eric focused on commercial real estate transactions, including the formation of a $100 million real estate joint venture and multiple real estate financings. Eric later served as senior group counsel for Johnson Controls, the world's largest automotive interior supplier, where he supervised $5 billion a year in business transactions.

Scion specializes in the student housing industry. Converting a building that leases unfurnished apartments without utilities to furnished, utilities-included student housing is potentially lucrative. This is because unlike traditional rental properties, student housing is leased by the bed. "[I]f three people live together, they're on their own separate contract, even though they share a living room and kitchen." Tr. 328 (Rob). Student housing also provides relatively reliable cash flows. Between 2002 and 2006, Scion served as the sponsor or developer on fifteen student housing real estate joint ventures in which Scion made equity investments totaling $12.2 million.

In 2006, former ASB managing director Keyvan Arjomand cold-called Rob Bronstein. ASB is a registered investment adviser that serves as an investment manager

for approximately 150 pension funds. As part of its diversification strategy, ASB maintains a real estate investment portfolio. At the time of trial, ASB managed seventy-five real estate investments, sixty-seven of which were joint ventures. It was Arjomand's role to find attractive real estate investment opportunities. Arjomand was particularly interested in student housing, which he believed offered attractive risk-adjusted returns, and he contacted Rob after learning that Scion was soliciting investors for a student housing project.

Between January 2007 and January 2008, ASB-advised pension funds entered into five joint ventures for the ownership, operation, and development of student housing with special purpose entities wholly owned by Scion. Each ASB/Scion venture is a Delaware limited liability company: University Crossing Apartments, LLC; Millennium Bloomington Apartments, LLC; Breckenridge Apartments, LLC; 2040 Lofts, LLC; and Dwight Lofts, LLC.

For each deal, Rob negotiated the economic terms for Scion. Arjomand served as Scion's primary contact at ASB and negotiated with Rob. ASB President Robert Bellinger actively oversaw the negotiations and personally approved each venture. The joint ventures were subject to further approval by ASB's Real Estate Investment Advisory Committee (the "Investment Committee"). When evaluating a given investment, the Investment Committee did not review actual transaction documents, but instead considered the investments based on an internally drafted Investment Committee memorandum summarizing the deal terms.

Rob left the "wordsmithing" of the agreements to Eric. Tr. 257 (Rob). ASB relied

on DLA Piper, a large, international law firm. Barbara Trachtenberg, a partner experienced in real estate joint ventures, headed the DLA Piper team. Trachtenberg was heavily involved in the initial joint venture agreement for the University Crossing deal. After that, she ceded much of the drafting responsibility on later deals to Cara Nelson, an associate who "had been working on [real estate joint venture] deals for a couple of months and was just starting to get introduced" to their terms. Tr. 186 (Nelson).

B. The Core Joint Venture Terms

Real estate joint ventures follow a recurring pattern with the same basic players: a promoter, who provides the bulk of the capital, and a sponsor, who typically finds the deal and manages the property. In each of the five ASB/Scion joint ventures, ASB served as the promoter, provided at least 99% of the capital, and retained at least 99% of the equity. Scion served as the sponsor and invested no more than 1% of the capital. As sponsor, Scion earned a management fee for overseeing the day-to-day operations of the properties, as well as a leasing fee and an acquisition fee. Scion primarily earned fees through incentive compensation that took the form of a promoted interest, or "promote."

A promote pays a sponsor an agreed-upon portion of the cash flows generated by operations or by a capital event such as a sale or refinancing of the joint venture property. The promote is triggered once the project clears a specified hurdle known as the "preferred return." Once the preferred return has been reached, the promote grants the sponsor a share of profits disproportionately greater than that sponsor's ownership stake. The promote thus incentivizes the sponsor to achieve higher levels of profitability.

Real estate professionals commonly discuss promotes using industry shorthand, in which the economics are described as "an X over a Y." In this formulation, the X refers to the disproportionate share of profits that the sponsor will receive. The Y refers to the preferred return on capital that the investment must achieve to trigger the promote. For example, the phrase "20% over an 8%" means the sponsor would receive 20% of incremental profits after the project generated an 8% preferred return.

C. The Initial ASB/Scion Joint Ventures

During the discussions leading up to the first joint venture, Arjomand and Rob Bronstein negotiated Scion's compensation using the industry shorthand for promotes. By email dated October 2, 2006, Arjomand proposed a "20% above an 8% preferred return." JX 7. Rob replied the following day that he was "probably okay with the promote structure." *Id.* Neither side questioned the meaning of the industry shorthand or sought to clarify whether Scion would get its greater share of profits if ASB did not receive back its capital. Bellinger explained at trial that the 8% preferred return was designed to motivate Scion to achieve above-average profitability: "In most of these investments, the target return on cost at stabilization was around 6-1/2 to 7 percent. . . . So the notion was that if [Scion] hit that 8 percent, everyone is doing well. We're exceeding the expectations." Tr. 21. The notion was not for Scion to do well following a capital event even if ASB suffered a significant loss.

The University Crossing LLC Agreement incorporated the promote and preferred return as proposed by Arjomand and agreed to by Rob. The relevant portion of the

capital-event waterfall provision, which the parties labeled the Sale Proceeds Waterfall, called for distributions to be made in the following order:

> (ii) *Second*, among the Members in proportion to the Unrecovered 8% Preferred Return Amounts of the Members at such time, until such time as each Member's Unrecovered 8% Preferred Return Amount has been reduced to zero;
>
> (iii) *Third*, among the Members in proportion to the Invested Capital of the Members at such time, until such time as each Member's Invested Capital has been reduced to zero;
>
> (iv) *Fourth*, (x) the Remaining Percentage to the Members in proportion to each Member's respective Percentage Interests at such time, and (y) the Promote Percentage to Venture Partner.

JX 20, § 4.2. I have omitted the first tier because the parties agree it is not relevant to their dispute. The University Crossing LLC Agreement defined the Promote Percentage and the Remaining Percentage as 20% and 80%, respectively. *Id.* § 1.1.

In simplified terms, the Sale Proceeds Waterfall calls for distributions in proportion to the members' respective percentage equity investments, approximately 99% for ASB and 1% for Scion, until each member receives an 8% preferred return on that investment. Distributions then continue at a ratio of 99:1 until each member receives back the capital it invested in the venture. Only after invested capital is returned does Scion receive a promote payment equal to 20% of excess profits, with the members continuing to receive the remaining 80% pursuant to their 99:1 equity-ownership ratio.

The parties' second venture, Millennium Bloomington Apartments, LLC, followed closely on the heels of the University Crossing deal. In the University Crossing deal, ASB paid Scion an acquisition fee of $150,000 and a property management fee equal to

5% of gross revenue. Rob asked for higher acquisition and management fees on the Millennium deal, but ASB refused. The compensation for the Millennium deal mirrored the University Crossing terms.

D. The Parties Agree On A Two-Tier Promote For Scion.

Although ASB rejected his request for greater fees on the Millennium deal, Rob continued to seek greater compensation for Scion. Increasing the promote percentage provided an alternative means to that end. One way for a sponsor like Scion to make increasing the promote percentage attractive to an equity investor is to create a second tier of promote that will be triggered after the project achieves a higher preferred return. In this structure, the project only pays out the larger promote if the equity investor also makes more money.

In March 2007, Rob suggested a two-tier promote on a joint venture opportunity called Case Western Triangle Apartments. In his Case Western proposal, Rob suggested that Scion receive "20% of returns above an 8% preferred return—and 30% of returns above 12%." JX 28. Neither Rob nor Arjomand asked about the industry shorthand or whether Scion could earn its promote if ASB did not receive back its capital. Quite obviously, the second level of promote contemplated an additional level of incentive compensation *on a profitable deal*. It meant that "if the project generated returns so great as to give ASB a return of 12 percent on its capital, [Scion would] receive an even greater disproportionate share of the returns above a 12 percent second hurdle . . . ." Tr. 239 (Rob).

During the same period, Arjomand encouraged Rob to focus on the promote as a way to achieve potentially greater compensation. By email dated March 20, 2007, Arjomand told Rob that Arjomand's boss, Bellinger, "wants to try to structure deals with lower fees but appropriate incentive comp so that partners are less incented by fees to do deals, and more by the upside they can earn in their promote and through ongoing good management at the properties . . . ." JX 29. Rob responded that "[w]e respect [Bellinger's] point that he doesn't want deals too front-loaded, and of course, if we didn't believe in the deals and our ability to make money on the promotes, we wouldn't be even considering them in the first place. Therefore, we don't mind trading one for the other." JX 30. In a March 30, 2007 memorandum, Rob proposed a two-tier promote for future deals similar to the aborted Case Western proposal: "Once [an] 8% return has been achieved, Scion will receive 25% of the proceeds (75% to [ASB]) until [ASB] realizes a 12.0% cumulative annual return, above which Scion will receive 50% of proceeds (50% to [ASB])." JX 32.

Arjomand and Rob continued to negotiate the two-tier promote before finally agreeing on terms. By email dated May 9, 2007, under the subject heading "ASB/Scion General Deal Parameters Going Forward," Arjomand set forth "a summary of what I believe both sides have agreed to." JX 35. The email stated: "**Promote** – On an unlevered deal, 20% over an 8%, and 35% over a 12%. On a levered deal, 20% over a 9%, and 35% over a 15%." *Id.* Rob replied by email the following day: "Yes, I agree with all this. Thanks." *Id.* Arjomand forwarded the email agreement to the entire deal

team on May 22, adding "[b]elow are the basic economics of our deal format with Scion on a go forward basis . . . ." JX 41 (the "May 2007 Terms").

E. The Breckenridge Joint Venture

After agreeing on the May 2007 Terms, Scion and ASB worked on the Breckenridge joint venture. DLA Piper prepared the initial draft of the Breckenridge LLC Agreement by starting with the Millennium LLC Agreement as a template, then making deal-specific adjustments.

Nelson circulated the first draft on June 14, 2007. The draft did not reflect the May 2007 Terms. Although DLA Piper revised both the operational cash flow waterfall and Sale Proceeds Waterfall to add the second tier of preferred return, each waterfall continued to provide for only one level of promote. Eric emailed back the same day:

> I may not have read it correctly, but I think the distribution paragraphs (both operational proceeds and liquidation proceeds) seem to be missing language applying the "Promote Percentage" split after the first-tier preferred return has been achieved but before the second-tier has been reached. As I read it now, it looks like it measures the first-tier preferred return . . . and then goes straight to the second-tier preferred return before invoking the "promote" split.

JX 37. Contrary to one version of Eric's testimony, in which he claimed to have negotiated the change in the promote, Eric did not offer this comment to alter the economic terms for the Sale Proceeds Waterfall. He rather sought to memorialize accurately the two-tier promote agreed upon by Rob and Arjomand.

In response to Eric's comment, Nelson revised the waterfall provisions. When she circulated the next draft of the Breckenridge LLC Agreement on June 15, 2007, the

missing first-tier promote appeared after the first preferred return but *before* the return of capital in the Sale Proceeds Waterfall. Placing the promote in this position meant that Scion would begin to earn its promote immediately after the preferred return, before ASB and Scion received back their capital. Therefore on a money-losing deal, after the initial 8% preferred return, Scion effectively would receive 20% of every dollar that ASB originally invested.

Despite the dramatic economic consequences of placing the promote in this position, no one commented on the change. Eric reviewed the Sale Proceeds Waterfall in detail following Nelson's June 15 email. He noted that the first-tier promote now appeared before the return of capital, and he understood the favorable implications of the error for Scion. Tr. 462, 472 (Eric). Eric admitted that Scion did not provide any consideration for the placement of the first-tier promote before the return of capital, Tr. 462-63, but he claimed implausibly as part of his negotiation story that it was normal for opposing counsel to give away a significant deal point for nothing. Tr. 467. Given the allocation of responsibility at Scion between Rob and Eric, it is not credible that Eric was negotiating a change in the Sale Proceeds Waterfall. Eric did not play that role, and Rob testified that he did not instruct Eric to seek to elevate the promote before the return of capital. Tr. 259. Rob claimed not to recall being aware of the placement of the first-tier promote before 2010. Tr. 264.

Trachtenberg, the lead DLA Piper attorney, cannot recall whether or not she read the June 14 and June 15 drafts of the Breckenridge LLC Agreement before they were circulated. She admitted that if she read the June 14 draft, she "didn't focus on what the

language was there, because it's just wrong. It's a terrible translation of the [May 2007 Terms]." Tr. 140. Nelson conceded that at the time of the Breckenridge deal, she lacked the experience necessary to understand the terms of the promote. She only learned of the mistake in the Sale Proceeds Waterfall when Trachtenberg explained it to her in fall 2010.

As outside legal counsel, DLA Piper did not have authority to make substantive changes to the economic agreement between the business principals. As Nelson explained, "lawyers don't negotiate the basic economics of a deal. That's just not something that lawyers do. . . . [The basic economic deal terms] are discussed between business people at the business level in every deal." Tr. 196. And placing the first-tier promote before the return of capital was not just a change in the basic economics; it was a radical departure that promised Scion promote compensation even if ASB lost 80-85% of its invested capital. Tr. 459 (Eric).

Eric responded by email on June 19. He attached a draft that changed wording in the Sale Proceeds Waterfall from "each Member," which referred to Scion and ASB, to "the Fund," which refers to ASB alone. JX 45. Eric explained in the June 19 email that he made the change because "Scion would achieve its own 'Second Preferred Return' (12-15%) before the time that the Fund does. But Scion achieving the Second threshold doesn't matter; rather the test for the next split level (65/35) is whether the Fund achieves the higher preferred return." *Id.* Eric's change addressed his concern that Scion, by virtue of the 20% promote payment being disproportionate to its invested capital, would achieve its second preferred return before ASB and that payment of the first-tier promote

to Scion might stop until ASB caught up and received its second preferred return. Eric's June 19 email did not address or reference that the draft placed the promote before the return of capital. Nelson signed off on Eric's change later that evening. Except for the June 19 alteration, ASB and Scion executed the Breckenridge LLC Agreement with the Sale Proceeds Waterfall as circulated by Nelson on June 15.

The executed version of the Breckenridge Sale Proceeds Waterfall reads as follows:

> (ii) *Second,* among the Members in proportion to the Unrecovered First Preferred Return Amounts of the Members at such time, until such time as each Member's Unrecovered First Preferred Return Amount has been reduced to zero;
>
> (iii) *Third,* (x) the Remaining Percentage [80%] to the Members in proportion to each Member's respective Percentage Interest at such time, and (y) the Promote Percentage [20%] to Venture Partner [Scion] until such time as the Fund's Unrecovered Second Preferred Return Amount has been reduced to zero; and
>
> (iv) *Fourth,* among the Members in proportion to the Invested Capital of the Members at such time, until such time as each Member's Invested Capital has been reduced to zero;
>
> (v) *Fifth,* (x) the Remaining Percentage [65%] to the Members in proportion to their respective Percentage Interest at such time, and (y) the Promote Percentage [35%] to Venture Partner.

JX 76, § 4.2. Because the parties erroneously placed Paragraph Third before Paragraph Fourth, the first-tier promote falls before the return of the members' invested capital. This mistake also puts the "and" in a linguistically odd place. If Paragraph Third and Paragraph Fourth were reversed and renumbered, the waterfall would reflect the May 2007 Terms and, conveniently, the "and" would fall into place.

The ASB Investment Committee approved the Breckenridge deal based on an internal memorandum summarizing the deal terms. The memorandum summarized the Sale Proceeds Waterfall as it should have been drafted, with the return of invested capital coming before the first-tier promote.

Bellinger testified that he reviewed parts of the Breckenridge LLC Agreement before approving it, but admitted that he did not read the agreement carefully. Bellinger also admitted that he overlooked the placement of the first-tier promote in the Sale Proceeds Waterfall. He noted that "once someone points out the mistake, it's very obvious that it's wrong." Tr. 42-43.

In the fall of 2007, the parties amended and restated the Breckenridge LLC Agreement to incorporate provisions related to the assumption of certain mortgage financings. The amendment did not relate to the waterfalls or the promote, and the parties did not discuss them.

F. The 2040 Lofts Joint Venture

The next joint venture was 2040 Lofts, LLC. Trachtenberg was on vacation, and Nelson took the lead on drafting the agreement. She electronically copied the Breckenridge LLC Agreement, then made deal-specific changes. The only changes to the Sale Proceeds Waterfall were to replace the word "First" with "8%" in two places and the word "Second" with "12%" in one place. JX 49, § 4.2. Nelson made these changes because 2040 Lofts was an unlevered deal, and the May 2007 Terms called for lower hurdles on an unlevered deal. Neither ASB nor Scion reviewed the Sale Proceeds Waterfall in any meaningful respect. Everyone assumed that the Breckenridge LLC

Agreement reflected the deal terms and that everything should stay the same unless the principals negotiated a change.

As with the Breckenridge deal, the ASB Investment Committee approved the 2040 Lofts LLC Agreement based on a memorandum that described return of capital as preceding the first-tier promote in the Sale Proceeds Waterfall. In the actual 2040 Lofts LLC Agreement, the return of capital came after the first-tier promote, as in the Breckenridge LLC Agreement.

Neither Bellinger nor Trachtenberg read the 2040 Lofts LLC Agreement carefully before approving the deal. Bellinger relied on Trachtenberg. Trachtenberg relied on Nelson. Nelson thought the Breckinridge LLC Agreement accurately reflected the agreed-upon ASB/Scion deal structure and believed she had duplicated it for 2040 Lofts, subject to minor, deal-specific alterations like the unlevered hurdle rates.

In May 2009, the Allegiance Fund, the entity that was the ASB member in the 2040 Lofts deal, transferred its membership interest down to EBREF Holding Company, LLC, a wholly owned subsidiary. The transfer allowed ASB to use its interest in 2040 Lofts as collateral for a line of credit. In documenting the transfer and the admission of EBREF as the new member of 2040 Lofts, ASB and Scion did not focus on or discuss the placement of the first-tier promote ahead of the return of invested capital. At the time, ASB did not know there was anything there to discuss.

G. The Dwight Lofts Joint Venture

The fifth and final joint venture was Dwight Lofts, LLC. Nelson again electronically copied the Breckenridge LLC Agreement, then made deal-specific

changes. The only edits to the Sale Proceeds Waterfall consisted of replacing "Fund" with "Fund Member." JX 79, § 4.2. The first-tier promote remained incorrectly placed before the return of invested capital.

Neither ASB nor Scion reviewed the Sale Proceeds Waterfall in any meaningful respect. Neither Bellinger nor Trachtenberg read the Dwight Lofts LLC Agreement carefully before approving the deal. Once again, everyone assumed that the Breckenridge LLC Agreement reflected the agreed-upon deal structure, that the Dwight Lofts LLC Agreement duplicated the Breckenridge LLC Agreement, and that everything stayed the same except for minor deal-specific modifications.

Effective March 3, 2008, ASB and Scion amended the Dwight Lofts LLC Agreement (the "Dwight Amendment") to modify a put provision. Paragraph 4 of the Dwight Amendment states: "Except as set forth herein, the terms and provisions of the [Dwight Lofts LLC Agreement] are hereby ratified and confirmed and shall remain in full force and effect." JX 97. Nothing in the Dwight Amendment changed the Sale Proceeds Waterfall. Before executing the amendment, Scion and ASB did not have any discussions about the Sale Proceeds Waterfall, the placement of the first-tier promote, or the economic implications of its location. At the time, ASB and DLA Piper did not know about the error. Only Scion did.

H. The Automatic Lofts Deal

After the 2040 Lofts joint venture but before the Dwight Lofts joint venture, Scion and ASB entered into a sixth deal for a project known as Automatic Lofts. For tax reasons, Scion could not participate as either an equity holder or a lender, so Automatic

Lofts was not structured as a traditional joint venture. Instead, Scion participated as property manager and loan servicer, and the parties agreed to structure Scion's compensation in these roles to "mimic" Scion's joint venture compensation under the May 2007 Terms, including the two-tier promote. *See* JX 69 (email from Eric to deal team asking whether "Scion's 'upside' compensation (mimicking our usual economics) [is] being written in a side agreement . . . ?").

Because of the need for a new set of documentation, Trachtenberg was heavily involved for DLA Piper. She recommended re-casting Scion's two-tier promote as an "Incentive Fee" paid pursuant to an Incentive Management Agreement. By email dated August 28, 2007, Arjomand explained to Rob that the "[i]ncentive management fee . . . is meant to mimic the Scion/ASB promote structure. In this case, … 20% over a 9% preferred return and 35% over a 15% preferred return . . . ." JX 62. Rob responded that the approach was "probably fine," but argued that the deal should use the lower, unlevered preferred return hurdles of 8% and 12%. *Id.*

To mimic the preferred return concept, the Incentive Management Agreement employed an internal rate of return ("IRR") formulation. The Incentive Management Agreement provides that cash flows "from the operation and/or disposition" of Automatic Lofts would be first distributed "in an amount sufficient to yield ST-Park [an ASB affiliate] a eight percent (8%) Internal Rate of Return." JX 74, § 4(a). After ST-Park achieved an 8% IRR, proceeds would be distributed "(i) twenty percent (20%) to [Scion] and eighty percent (80%) to ST-Park, until ST-Park has achieved an aggregate twelve percent (12%) Internal Rate of Return; (ii) then, thirty-five percent (35%) to [Scion] and

sixty-five percent (65%) to ST-Park." JX 74. Under an IRR formulation, Scion necessarily earns a promote only *after* the return of invested capital.

When reviewing the Automatic Lofts agreement, Eric silently accepted the placement of the return of capital *before* the first-tier promote. If Eric truly believed that Scion and ASB had a deal in which Scion received the promote *pari passu* with ASB's return of capital, he would have objected to the change. When asked about the subject at trial, the Bronstein brothers feigned naivety. Eric claimed that he "had not encountered the [term 'internal rate of return'] prior to that evening." Tr. 495. Rob testified that he thought IRR was a "Microsoft Excel formula." Tr. 278. Neither assertion is credible. I find that the Bronstein brothers accepted the IRR formulation in the Automatic Lofts deal because they knew it was right and that the different Sale Proceeds Waterfalls in the Breckenridge and 2040 Lofts LLC Agreements were wrong.

I. ASB Learns About The Mistake.

On June 12, 2010, Scion exercised a put right in the 2040 Lofts LLC Agreement. At that point, ASB had contributed $47.3 million in capital to the venture and Scion had contributed $479,000. The parties agreed that the venture was underwater and had a fair market value of $35.5 million. On August 30, 2010, Eric informed ASB that the purchase price for the put was $1.83 million. This figure included a promote of $1,556,356.92. If correct, then Scion would receive a gain of 282%; ASB would be left with an investment valued at $32.96 million, representing a loss of $14.41 million or roughly 30%. Without the promote, Scion's buyout price would have been only $347,792.46, in which case Scion would suffer a proportionate loss.

By the time Scion exercised the put, Arjomand had left ASB. James Darcey, who was in charge of the Scion relationship, responded to Eric's purchase-price calculation less than half-an-hour after receiving it: "I'm confused. Does your calculation suggest that Venture Partner (Scion) is due $1.8 million? It seems odd to me that an investment into which we together invested over $47 million and which is now valued at $35.5 million would generate a promote." JX 167. Eric invoked the Sale Proceeds Waterfall: "[W]e prepared our calculation to follow the LLC Agreement precisely, so I believe it is correct." *Id.*

After receiving Eric's response, Darcey emailed Rob to ask if the business deal for 2040 Lofts was different than for University Crossing. Rob responded:

> [T]his was the business deal we negotiated through Keyvan Arjomand in 2007. It was different than the [University Crossing] and Millennium structure, for several reasons—we brought to ASB an off-market deal, our acquisition fee was reduced, we left our proceeds in but still had to pay capital gains tax, our management fee was lowered, etc. Therefore our deal was structured with more back-end compensation.

Id. As Rob was forced to admit at trial, virtually every statement in this email was false. Scion's acquisition fee was not reduced relative to the University Crossing or Millennium deals. Scion did not leave any proceeds in the Breckenridge deal and did not pay any capital gains taxes. And Scion's management fee was not lower than the University Crossing and Millennium deals.

After the email exchanges with Rob and Eric, Darcey and Bellinger examined the Sale Proceeds Waterfall and identified the scrivener's error. Bellinger called DLA Piper and "had a very, very tough conversation." Tr. 44. Bellinger was "incredibly upset that

this had happened because it was clear what the document said, and that it was just wrong." Tr. 44-45. ASB subsequently put DLA Piper on notice of a malpractice claim.

On July 22, 2010, Scion exercised its put right under the Dwight Lofts LLC Agreement. ASB contributed approximately $78.5 million in capital to Dwight Lofts; Scion contributed approximately $790,000. Scion calculated the price for the put rate as $3.38 million. This figure included a promote of approximately $2.6 million. If correct, then Scion would receive a gain of 328%. ASB believes that Scion is due only $1.26 million.

J. The Dwight Lofts Summer Leasing Dispute

By late 2009, ASB had grown dissatisfied with Scion's property management capabilities. Effective March 15, 2010, ASB removed Scion as Dwight Lofts' property manager.

During the period leading up to Scion's removal, ASB and Columbia College of Chicago were negotiating a master lease for Dwight Lofts. ASB and Scion agreed that a master lease was highly desirable. Rob noted that revenue from the proposed ten-month master lease would equal twelve months of revenue generated from non-master lease tenants. After months of difficult negotiations, ASB and Columbia College consummated a master lease in April 2010.

As noted, Scion exercised its put right under the Dwight Lofts LLC Agreement in July 2010. Between December 2009, when ASB gave Scion notice that it would be terminated, and July 22, 2010, when Scion exercised the put right, Rob sent a series of

emails to ASB about ways that Dwight Lofts could increase its summer revenue. It is clear that Rob sent these emails in anticipation of a dispute over the value of the put right.

Two types of summer leasing exist at Dwight Lofts: generic summer leasing and extended summer leasing. Under a generic summer lease, a tenant leases a bed in Dwight Lofts from June 1 until July 31, the period of time not covered by the Columbia College master lease. Under an extended summer lease, a tenant leases a bed in Dwight Lofts for a period that overlaps the Columbia College master lease, either beginning in May or extending into August.

In his emails, Rob advocated strenuously that ASB should re-open discussions with Columbia College and seek permission for extended summer leases, and in May 2010 he provided a detailed memorandum identifying measures that ASB and its new property manager, Campus Advantage, could take to maximize summer revenue. Rob wrote follow-up emails on May 21 and 25 offering to speak personally with Columbia College about the possibility of extended summer leasing. ASB declined, believing it would be unwise to approach Columbia about extended summer leasing after recently executing the master lease. Darcey told Rob that "[w]e are focus[ing] on building a strong, professional and long-term relationship with Columbia and believe a proactive effort at this time to renegotiate their lease start date for some or all of their beds will complicate their transition into the property and cause un-necessary and counter-productive stress." JX 153.

Without telling ASB, Rob contacted Mark Kelly, the Columbia College Vice President of Student Affairs. Rob claims that Kelly said Columbia College would be

pleased to make extended summer leasing arrangements with Dwight Lofts. During his deposition, Kelly could not recall making any such statement and said he "would dispute" Rob's recollection. Kelly Dep. at 35.

On July 22, 2010, Scion exercised its put right under the Dwight Lofts LLC Agreement. Scion valued the joint venture at $96.63 million, a figure that assumed a 75% summer occupancy rate generating an additional $525,000 of revenue in both June and July. JX 140. ASB disputed Scion's valuation, arguing that there was no historical basis for Scion's summer revenue estimates.

Because the parties could not agree on a valuation for the joint venture, Section 6.4.5 of the Dwight Amendment called for the parties to appoint jointly one independent appraiser. Scion and ASB engaged Craig Schumacher of CB Richard Ellis. Scion submitted projections to Schumacher that assumed a 90% occupancy rate in June and July. ASB's projections were based on historical summer leasing rates and assumed a 25% occupancy rate. Using projections that fell in between, Schumacher valued Dwight Lofts at $97.5 million, more than Scion's figure.

Both ASB and Scion rejected Schumacher's appraisal. Under the Dwight Lofts LLC Agreement, the next step was a three-appraiser process in which each side selected its own appraiser and those two appraisers selected a third appraiser. All three appraisers prepared appraisals, and the average of the two closest appraisals would be used as the property's fair market value. ASB selected Nancy Myers of Integra Realty Resources. Scion selected Chris Myers (no relation) of Argianas & Associates, Inc. Chris Myers and Nancy Myers selected Appraisal Resource Counselors ("ARC") to conduct the third

appraisal. The Integra appraisal assumed a stabilized summer occupancy rate of 20%, projected $278,678 in stabilized summer revenue, and valued Dwight Lofts at $90.0 million. The Argianas appraisal assumed a stabilized summer occupancy rate of 35%, projected $431,760 in stabilized summer revenue, and valued Dwight Lofts at $90.7 million. The ARC appraisal is not in the record. The Integra and Argianas appraisals were the closest, and averaging those two produced a fair market value of $90.35 million for Dwight Lofts, less than Schumacher's figure.

At some point after summer 2010, Campus Advantage approached Columbia College about extended summer leasing and reached an oral agreement to permit it. Scion contends that an informal oral agreement was reached in September 2010 and that ASB withheld this information from the appraisers. ASB contends that the informal agreement was not reached until March 2011.

Jacqueline Pingel, general manager of Dwight Lofts for Campus Advantage, backed up ASB's position. Pingel explained that although she discussed generic summer leading with a Columbia College representative in August and September 2010, she first discussed extended summer leasing with Columbia College in January 2011 and only reached an informal oral agreement in March 2011.

II. LEGAL ANALYSIS

ASB seeks an order reforming the Sale Proceeds Waterfalls. Scion seeks to enforce the agreements as written and has counterclaimed for damages. Both sides invoke contractual fee-shifting provisions to recover their legal fees and costs.

A. Equitable Reformation

The Court of Chancery has the power "to reform a contract in order to express the 'real agreement' of the parties involved." *Cerberus Int'l, Ltd. v. Apollo Mgmt., L.P.*, 794 A.2d 1141, 1151 (Del. 2002) (quoting *Colvocoresses v. W.S. Wasserman Co.*, 28 A.2d 588, 589 (Del. Ch. 1942)).

> There are two doctrines that allow reformation. The first is the doctrine of mutual mistake. In such a case, the plaintiff must show that both parties were mistaken as to a material portion of the written agreement. The second is the doctrine of unilateral mistake. The party asserting this doctrine must show that it was mistaken and that the other party knew of the mistake but remained silent.

Id. at 1151 (footnote omitted). "Regardless of which doctrine is used, the plaintiff must show by clear and convincing evidence that the parties came to a specific prior understanding that differed materially from the written agreement." *Id.* at 1151-52. "The clear and convincing evidentiary standard is 'an intermediate evidentiary standard, higher than mere preponderance, but lower than proof beyond a reasonable doubt.'" *Id.* at 1151 (quoting *In re Tavel,* 661 A.2d 1061, 1070 n.5 (Del. 1995)). ASB has met its burden of proof.

1. The Specific Prior Contractual Understanding

Reformation requires the existence of a specific prior contractual understanding that conflicts with the terms of the written agreement. The prior understanding "provides a comparative standard that tells the Court of Chancery 'exactly what terms to insert in the contract rather than being put in the position of creating a contract for the parties.'" *Id.* at 1152 (quoting *Collins v. Burke,* 418 A.2d 999, 1002 (Del. 1980)). The prior

understanding "need not constitute a complete contract in and of itself." *Id.* (finding prior specific understanding based on handwritten note "This looks fine" on proposed term sheet); *see also* Restatement (Second) of Contracts § 155 cmt. a (1981) ("The prior agreement need not, however, be complete and certain enough to be a contract."). Reformation is available even when "'the antecedent expressions . . . [were] no more than a part of the contract that is in the preliminary process of [being made].'" *Cerberus*, 794 A.2d at 1152 n.40 (alterations in original) (quoting Arthur Linton Corbin et al., *Corbin on Contracts* § 614 (2001)).

The May 2007 Terms constitute a specific prior contractual understanding that provides the necessary foundation for reformation. Using industry terms of art, Arjomand proposed terms to Rob: "On an unlevered deal, 20% over an 8%, and 35% over a 12%. On a levered deal, 20% over a 9%, and 35% over a 15%." JX 35. Rob responded: "Yes, I agree with all this." *Id.* Arjomand forwarded the terms to the deal team in an email entitled "ASB / Scion General Deal Parameters Going Forward," noting that it contained "the basic economics of our deal format with Scion on a go forward basis . . . ." JX 41.

The evidence at trial established that a "promoted interest" or "promote" is a term of art that inherently contemplates the return of invested capital when used in the context of a capital event. ASB's expert explained that a promote refers to a share of the profits or upside from a project. In the capital event context, profit or upside is necessarily calculated by subtracting the cost of the investment from the proceeds of the capital event. Invested capital is one such cost. Accordingly, the return of invested capital

precedes the promote in a capital-event waterfall provision. Scion's expert admitted that in twenty-five years of real estate experience, he had never heard of a deal in the real estate industry in which a promote was paid before the return of capital in a capital-event waterfall provision.

In agreeing to terms, the parties operated based on the established industry meaning of a "promote." They reflected this understanding in the two most heavily negotiated agreements: the University Crossing LLC Agreement and the Automatic Lofts Agreement. University Crossing was the first ASB/Scion joint venture. Trachtenberg personally drafted the agreement and placed the return of capital before the promote in the Sale Proceeds Waterfall. The Automatic Lofts deal was the only investment not structured as a joint venture. ASB and Scion employed teams of people to ensure that the economic structure "mimick[ed]" Scion's usual "upside compensation." JX 69 (internal quotation marks omitted). Trachtenberg played a major role in the drafting process. Here too, the promote appears after the return of capital in the capital-event waterfall provision.

I credit the ASB witnesses' testimony about the meaning of a promote and the terms of their agreement with Scion. Their testimony and the economic structure they contemplated make sense as a coherent whole. By contrast, I reject the Scion witnesses' testimony as self-serving and internally contradictory. The economic structure the Scion witnesses described does not make sense in the context of the parties' negotiations or the transactions as a whole.

Based on the trial record, I am convinced that the May 2007 Terms constitute a specific prior understanding that the return of capital was to come before the payment of promote compensation in the Sale Proceeds Waterfall. ASB proved the existence of this specific prior understanding by clear and convincing evidence.

2. Mistaken Belief

ASB proved at trial that it entered into the Breckenridge, 2040 Lofts, and Dwight Lofts LLC Agreements (together, the "Disputed Agreements") in the mistaken belief that the Sale Proceeds Waterfalls reflected the May 2007 Terms. The contemporaneous documentary evidence includes the internal ASB Investment Committee memoranda, which explain the Sale Proceeds Waterfalls in terms consistent with the May 2007 Terms. Consistent with its mistaken understanding, ASB reacted with confusion and disbelief to Scion's put calculation. Darcey described it as "inconceivable that [Arjomand] would agree to pay a promote on a deal that lost principal." JX 167. Bellinger promptly had "a very, very tough conversation" with DLA Piper and put the firm on notice of a malpractice claim. Tr. 44. Bellinger and Trachtenberg testified credibly to their belief about how the Sale Proceeds Waterfalls should have read, and Bellinger testified credibly that he was "incredibly upset that this had happened because it was clear what the document said, and that it was just wrong." Tr. 44-45.

3. Knowing Silence

ASB proved at trial that Scion knew that terms of the Sale Proceeds Waterfalls as written did not reflect the May 2007 Terms but intentionally remained silent. At trial, Eric tried to walk a fine line. He admitted that he identified the placement of the first-tier

promote before the return of capital in the June 15 draft of the Breckenridge LLC Agreement and recognized the favorable implications of the placement for Scion. He further admitted that he remained silent. He therefore tried to construct accounts in which he did not intentionally remain silent. In one account, he negotiated the change and thought DLA Piper gave it away. In a conflicting account, he naively believed that DLA Piper properly drafted the provision.

Eric is a sophisticated real estate attorney with significant real estate joint venture experience. I am convinced that he intentionally remained silent in an effort to capture an undeserved benefit for Scion. I reject Eric's contrary accounts as not credible. Having evaluated Eric's demeanor, I am convinced that Eric recognized the scrivener's error and tried to take advantage of the mistake.

"Delaware law states the knowledge of an agent acquired while acting within the scope of his or her authority is imputed to the principal." *Albert v. Alex. Brown Mgmt. Servs., Inc.*, 2005 WL 2130607, at *11 (Del. Ch. Aug. 26, 2005). "[I]t is the general rule that knowledge of an officer or director of a corporation will be imputed to the corporation." *Teachers' Ret. Sys. of La. v. Aidinoff*, 900 A.2d 654, 671 n.23 (Del. Ch. 2006). This basic principle of agency law applies with equal force to LLCs. Eric acted on behalf of the Scion LLC members in his capacity as Scion's Executive Vice President and General Counsel. Eric's knowing silence and intent are imputed to them.

B. Scion's Affirmative Defenses

Scion raises three affirmative defenses in an effort to avoid reformation: (i) Bellinger failed to read the agreements; (ii) ASB ratified the agreements; and (iii) ASB

has unclean hands. I reject each defense.

1. Failure To Read

Bellinger testified that he read portions of each Disputed Agreement, but that he does not recall how much he read. Scion attacked Bellinger's testimony by pointing to (i) the absence of any email or other communication conveying the document and (ii) differences between the signature pages and the agreements, such as different document stamps, that suggested the use of a form signature page. To rehabilitate Bellinger, ASB introduced a copy of a June 19, 2007, email from Nelson to ASB employees Ashley Earnest and Larry Braithwaite attaching a draft of the Breckenridge LLC Agreement and instructing them to provide it to Bellinger. ASB had withheld the June 19 email as privileged and did not log it. I therefore will exclude the email from the record and decline to consider it. I will not go further and grant Scion an adverse inference contrary to Bellinger's testimony.

Having considered Bellinger's testimony and the overall context of the negotiations, I believe that Bellinger read the University Crossing agreement in its entirety and was familiar with its terms. After that, I believe Bellinger relied on Trachtenberg and Arjomand to advise him about any changes, brief him on new terms, and provide him with any portions that he needed to read. Delaware law does not require that a senior decision-maker like Bellinger read every agreement *in haec verba*.[2] I find

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[2] *See In re Walt Disney Co. Deriv. Litig.*, 907 A.2d 693, 749 n.424 (Del. Ch. 2005), ("[A] board of directors need not read '*in haec verba* every contract or legal document that it approves, but if it is to successfully absolve itself from charges of

that Bellinger adequately and properly oversaw the negotiation process and was informed about the terms of the joint venture agreements as negotiated by the parties.

Even assuming Bellinger did not read the agreements before approving them, that would not bar equitable reformation. "Reformation is not precluded by the mere fact that the party who seeks it failed to exercise reasonable care in reading the writing . . . ." Restatement (Second) of Contracts § 155 cmt. a.[3] Although declining to rule on the issue specifically, the Delaware Supreme Court in *Cerberus* indicated support for the Restatement (Second) approach and noted that "[a]ny mistake claim by definition

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[violations of the duty of care], there must be some credible evidence that the directors knew what they were doing, and ensured that their purported action was given effect.'" (second alteration in original) (quoting *Smith v. Van Gorkom*, 488 A.2d 858, 883 n.25 (Del. 1985), *overruled on other grounds by Gantler v. Stephens*, 965 A.2d 695 (Del. 2009))), *aff'd*, 906 A.2d 27 (Del. 2006).

[3] This is the majority rule. *See, e.g.*, *Albany City Sav. Inst. v. Burdick*, 87 N.Y. 40, 46-47 (1881) ("It has certainly never been announced as the law in this State that the mere omission to read or know the contents of a written instrument should bar any relief by way of a reformation of the instrument on account of mistake or fraud."); *Pioneer Res., LLC v. D.R. Johnson Lumber Co.*, 68 P.3d 233, 251 (Or. Ct. App. 2003) ("[A] party's failure to read a document, by itself, will generally not constitute gross negligence sufficient to bar reformation."); *Wash. Mut. Sav. Bank v. Hedreen*, 886 P.2d 1121, 1127 (Wash. 1994) (en banc) (affirming grant of reformation despite bank's failure to carefully read lease). The minority rule bars reformation where a party fails to read the agreement. *See, e.g.*, *Monroe Guar. Ins. Co. v. Langreck*, 816 N.E.2d 485, 490 (Ind. Ct. App. 2004) ("Equity should not intervene and courts should not grant reformation if the party seeking reformation failed to read the instrument or, if it was read, failed to give heed to its plain terms."); *Pierides v. GEICO Ins. Co.*, 2010 WL 1526377, at *4 (N.J. Super. Ct. App. Div. Apr. 19, 2010) ("Reformation will not be granted based upon a mistake resulting from the complaining party's own negligence." (internal quotation marks omitted)).

involves a party who has not read, or thought about, the provisions in a contract carefully enough." *Cerberus*, 794 A.2d at 1154 (citing Restatement (Second) of Contracts Sections 155 and 157, but "tak[ing] no position on whether, under certain circumstances, a party's misconduct could bar a reformation claim").

Finding little support in reformation jurisprudence, Scion cites avoidance cases for the proposition that "'failure to read a contract in the absence of fraud is an unavailing excuse or defense and cannot justify an avoidance, modification or nullification of the contract or any provision thereof.'" *Graham v. State Farm Mut. Auto. Ins. Co.*, 1989 WL 12233, at *2 (Del. Super. Jan. 26, 1989) (quoting *Standard Venetian Blind Co. v. Am. Empire Ins.*, 469 A.2d 563 (Pa. 1984)), *aff'd*, 565 A.2d 908 (Del. 1989); *see also Hicks v. Soroka*, 188 A.2d 133, 140-41 (Del. Super. 1963) ("'If one voluntarily shuts his eyes when to open them is to see, such a one is guilty of an act of folly (in dealing at arm's length with another) to his own injury; and the affairs of men could not go on if courts were being called upon to rip up transactions of that sort.'" (quoting *Judd v. Walker*, 114 S.W. 979, 980 (Mo. 1908))). In citing these authorities, Scion overlooks a fundamental difference between the remedies of avoidance and reformation. Unlike avoidance, "[a]n agreement subject to reformation is not voidable, and cannot be disaffirmed." *In re Schick*, 232 B.R. 589, 599 n.11 (Bankr. S.D.N.Y. 1999). The remedy of equitable reformation does not void an agreement but rather corrects an error by conforming the as-written document to the agreed-upon understanding.

Section 157 of the Restatement (Second) further explains the rationale for the different rules:

> Generally, one who assents to a writing is presumed to know its contents and cannot escape being bound by its terms merely by contending that he did not read them; his assent is deemed to cover unknown as well as known terms. The exceptional rule stated in the present Section with regard to reformation has no application to the common case in which the term in question was not the subject of prior negotiations. It only affects cases that come within the scope of § 155 [When Mistake Of Both Parties As To Written Expression Justifies Reformation], under which there must have been an agreement that preceded the writing. In such a case, a party's negligence in failing to read the writing does not preclude reformation if the writing does not correctly express the prior agreement.

Restatement (Second) of Contracts § 157 cmt. b. Although the Restatement (Second) discusses these principles under the heading of mutual mistake, they apply equally to a unilateral mistake coupled with knowing silence.

Consequently, assuming Bellinger failed to read the Disputed Agreements, it would not foreclose ASB's claim for equitable reformation. ASB still could prove by clear and convincing evidence, as it has, that the contracts failed to match the parties' specific prior understanding.

2. Ratification

Ratification requires "[k]nowledge, actual or imputed, of all material facts" and "may be implied from conduct, as well as expressed by words." *Frank v. Wilson & Co., Inc.*, 32 A.2d 277, 283 (Del. 1943). In discussing ratification's sister doctrine of acquiescence, this Court explained that

> [w]hen a man with full knowledge, or at least with sufficient notice or means of knowledge of his rights, and of all the material circumstances of the case, freely and advisedly does anything which amounts to the recognition of a transaction, or

> acts in a manner inconsistent with its repudiation, . . . there is acquiescence, and the transaction, although originally impeachable, becomes unimpeachable in equity.

Papaioanu v. Comm'rs of Rehoboth, 186 A.2d 745, 749-50 (Del. Ch. 1962) (internal quotation marks omitted).

For purposes of reformation, however, stricter rules apply. Rather than imputed or constructive knowledge, ratification of a contract subject to reformation requires actual knowledge of the error.[4] The higher standard recognizes that a party otherwise entitled to equitable reformation based on mistake nearly always could have discovered the erroneous provision. The mistaken party unwittingly believes, however, that the provision is accurate. That is the point of the mistake. Accordingly, ratification does not preclude reformation unless the ratifying party actually knew of the error.

Scion identifies nine separate occasions in its post-trial brief when the plaintiffs ostensibly affirmed their intent to be bound by the Disputed Agreements despite having

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[4] *Fitzgerald v. Cantor*, 1998 WL 781188, at *2 (Del. Ch. Oct. 28, 1998) (granting motion to amend pleadings to add reformation claim on grounds that "[t]he context of the particularized reformation claims suggests no information from which one could infer the circumstances that allegedly constituted mutual mistake, fraud or unilateral mistake with [the plaintiff's] knowing silence were different by the time of ratification or reaffirmation"); *see also Elliott v. Sackett*, 108 U.S. 132, 142 (1883) (granting equitable reformation of warranty deed in favor of buyer despite buyer having made two payments under unreformed contract); *Knight v. Elec. Household Utils. Corp.*, 30 A.2d 585, 587 (N.J. Ch. 1943) ("After a party *becomes aware* of a mistake in a written contract, if he acquiesces in the contract as written, he loses his right to reformation." (emphasis added)), *aff'd*, 36 A.2d 201 (N.J. 1944); *Merriam v. Nat'l Life & Accident Ins. Co.*, 86 S.W.2d 566, 569 (Tenn. 1935) ("It is the general rule that reformation will be denied on the ground of ratification only when there is full knowledge of the facts by the party against whom ratification is invoked; and, to make ratification effective, the party must have ratified the instrument as it was, and not as he thought it was.").

constructive or imputed knowledge of the scrivener's error in the Sale Proceeds Waterfalls. These occasions include the execution of the 2040 Lofts and Dwight Lofts LLC Agreements and the drafting and execution of the Dwight Amendment, which "ratified and confirmed" the Dwight Lofts LLC Agreement. In each case, ASB's ostensibly ratifying act occurred before August 30, 2010, when ASB first acquired actual knowledge of the scrivener's error. Accordingly, Scion has not carried its burden to demonstrate that ASB ratified the error in the Sale Proceeds Waterfalls of the Disputed Agreements.[5]

3. Unclean Hands

"The question raised by a plea of unclean hands is whether the plaintiff's conduct is so offensive to the integrity of the court that his claims should be denied, regardless of their merit." *Gallagher v. Holcomb & Salter*, 1991 WL 158969, at *4 (Del. Ch. Aug. 16, 1991) (Allen, C.), *aff'd sub nom. New Castle Ins., Ltd. v. Gallagher*, 692 A.2d 414 (Del. 1997). "The Court invokes the doctrine when faced with a litigant whose acts threaten to tarnish the Court's good name." *Nakahara v. NS 1991 Am. Trust*, 718 A.2d 518, 522

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[5] In post-trial briefing, Scion asserted for the first time that ASB's transfer in May 2009 of its membership interest in 2040 Lofts from the Allegiance Fund to EBREF constituted a novation. Scion now argues that EBREF must establish *its own* prior understanding with Scion in order to obtain reformation. EBREF is a wholly owned subsidiary of the Allegiance Fund. Neither the Allegiance Fund nor EBREF has any employees; ASB acts for both entities. To the extent EBREF needed its own prior understanding, that understanding was the same as ASB's. ASB executed the agreement on behalf of EBREF unaware of the scrivener's error in the Sale Proceeds Waterfall. The reformation analysis therefore applies with equal force to EBREF and the 2040 Lofts LLC Agreement post-transfer.

(Del. Ch. 1998) (applying the doctrine in indemnification and advancement dispute after determining plaintiffs "acted in bad faith, underhandedly, in a manner deserving condemnation, wrongfully, without permission, and surreptitiously with an aim at subverting the judicial process" (alteration, footnotes, and internal quotation marks omitted)). "The Court of Chancery has broad discretion in determining whether to apply the doctrine of unclean hands." *SmithKline Beecham Pharm. Co. v. Merck & Co., Inc.*, 766 A.2d 442, 448 (Del. 2000). "The equitable doctrine of unclean hands is not strictly a defense to which a litigant is legally entitled." *Gallagher*, 1991 WL 158969, at *4.

Scion argues that in a September 20, 2010 letter, Bellinger told Scion that ASB would pay $347,909.52, representing the undisputed portion of Scion's interest in 2040 Lofts, if Scion agreed to correct the Disputed Agreements. When Scion refused, ASB did not pay the undisputed amount until May 18, 2011. Scion claims the eight-month delay constitutes unclean hands sufficient to bar ASB's reformation claim.

Perhaps ASB should have paid the undisputed amount to Scion earlier than it did. The delay, however, "was not so material as to deprive plaintiff[s]" of the requested relief. *Id.* at *1. Moreover, ASB cured its misconduct when it paid Scion the undisputed amount plus statutory prejudgment interest. *See Gen. Elec. Co. v. Klein*, 129 A.2d 250, 252 (Del. Ch. 1956) (Seitz, C.) ("The repentant sinner, especially where he has been duly punished, is not unwelcome in equity."). On the facts of this case, an eight-month delay of payment followed by full payment plus statutory prejudgment interest does not threaten to tarnish this Court's good name such that reformation of the Disputed Agreements should be denied.

C. The Dwight Lofts Counterclaims

ASB removed Scion as Managing Member of Dwight Lofts effective March 15, 2010. Scion contends that after its removal, ASB breached its fiduciary duties by suppressing Dwight Lofts' summer revenue and failing to inform the appraisers of an oral agreement with Columbia College that allowed extended summer leasing. Scion asserts that, for the same reasons, ASB breached the implied covenant of good faith and fair dealing. Neither argument has merit.

1. Breach of Fiduciary Duty

Under the Dwight Lofts LLC Agreement, the Managing Member owes fiduciary duties to the company and its members. Section 5.1.1(i) of the Agreement states:

> The Managing Member shall exercise the power and authority granted to it under this Agreement and shall perform its duties as Managing Member under this Agreement in good faith, in a manner Managing Member reasonably believes to be in the best interests of the Company and with such care as a prudent real estate professional in a like position would use under similar circumstances. The Managing Member acknowledges and agrees with the Company and the other Members that it is undertaking fiduciary duties and responsibilities to the Company and each of its Members identical to those a general partner undertakes in a limited partnership to its limited partners under the statutes and case law of the State of Delaware applicable to a limited partnership form of business organization. The Managing Member shall not, by intentional act or intentional failure to act, commit gross negligence, willful misconduct, a material breach of fiduciary duty, fraud, misapplication of funds, theft, misappropriations of a Company asset or intentional misrepresentation.

JX 82, § 5.1.1(i). Under Section 5.2, a member will not be held liable for damages arising out of acts or omissions (i) "in good faith on behalf of the Company or the

Members," (ii) "reasonably believed . . . to be within the scope of the authority granted to such Member by this Agreement," and (iii) "reasonably believed . . . to be in the best interests of the Company or the Members." *Id.* § 5.2. Section 5.2 does not eliminate liability if acts or omissions are "the consequence of fraud, gross negligence, or willful misconduct . . . ." *Id.*

I assume for purposes of analysis that ASB became the *de facto* Managing Member after removing Scion from that position effective March 15, 2010, and that ASB took on fiduciary duties in that capacity. Regardless, ASB did not act willfully, recklessly, or with gross negligence to suppress Dwight Lofts' summer revenue.

Dwight Lofts and Columbia College entered into the master lease in April 2010. At the time, summer leasing for 2010 did not rank high on anyone's priority list. Rob agreed that it was more important to focus on getting the master lease. Only later did Rob argue that ASB should revisit the lease and seek a concession on extended summer leasing. ASB declined to re-trade the master lease, believing that such a request would "complicate [Columbia's] transition into the property and cause un-necessary and counter-productive stress." JX 153. I credit ASB's explanation and good faith.

Scion also contends that ASB and Columbia College agreed orally in September 2010 to allow extended summer leasing, but hid that information from the appraisers to depress Dwight Lofts' value. Pingel testified that Campus Advantage only reached an informal oral agreement on extended summer leasing in March 2011. Tr. 1163-65. I credit her testimony, which is supported by contemporaneous documents. *See* JX 219

(email dated March 11, 2011 in which Columbia representative notes that "Columbia would be okay" with informal extended summer leasing plan).

The evidence at trial demonstrated that ASB (i) acted reasonably and in good faith to maximize Dwight Lofts' summer revenue within the constraints of the master lease with Columbia College and (ii) participated in the appraisal process in good faith and with candor. Accordingly, ASB did not breach any fiduciary duties that I assume for purposes of this claim it owed to Scion as *de facto* Managing Member.

2. The Implied Covenant Of Good Faith And Fair Dealing

Scion reframes its breach of fiduciary duty count as a breach of the implied covenant of good faith and fair dealing. For reasons similar to those set forth above, ASB did not breach the implied covenant. "The implied covenant of good faith and fair dealing inheres in every contract and 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." *Kuroda v. SPJS Hldgs., L.L.C.*, 971 A.2d 872, 888 (Del. Ch. 2009) (internal quotation marks omitted). "Wielding the implied covenant is a 'cautious enterprise.'" *Lonergan v. EPE Hldgs., LLC*, 5 A.3d 1008, 1018 (Del. Ch. 2010) (quoting *Nemec v. Shrader,* 991 A.2d 1120, 1125 (Del. 2010)). The doctrine should not be used to "rewrite the contract" that a party now regards as "a bad deal." *Nemec*, 991 A.2d at 1126.

As set forth above, ASB did not suppress the value of Dwight Lofts. ASB and Scion agreed to forego potential summer revenue in favor of securing the master lease. ASB participated in good faith in the contractual appraisal process and submitted

reasonable estimates of summer revenue based on historical occupancy rates. Scion's projections were higher and more speculative. With input from both Scion and ASB, the appraisers used their own summer occupancy projections that fell between the ASB and Scion estimates. ASB did not hide an oral agreement about summer leasing from the appraisers. At the time of the appraisals, there was no such agreement. ASB did not engage in any other arbitrary or unreasonable conduct that prevented Scion from receiving the fruits of its equity interest in Dwight Lofts. Accordingly, ASB did not breach the implied covenant of good faith and fair dealing.

D. Scion's Breach Of Contract Counterclaims

Scion's three remaining counterclaims seek to enforce the Sale Proceeds Waterfalls as they appear in the Disputed Agreements. Because I grant reformation, Scion's request for relief runs counter to the terms of the agreements. Judgment is entered against Scion on these counterclaims.

E. ASB Is Entitled To Costs And Expenses

Having prevailed in this litigation, ASB is entitled to recover its costs and expenses under the contractual fee-shifting provisions in the Disputed Agreements. The provisions state:

> In the event that any of the parties to this Agreement undertakes any action to enforce the provisions of this Agreement against any other party, the non-prevailing party shall reimburse the prevailing party for all reasonable costs and expenses incurred in connection with such enforcement, including reasonable attorneys' fees . . . .

See, e.g., JX 82, § 9.9. Scion argues that even if ASB prevails, it is not entitled to fees because an action for reformation is not an "action to enforce the provisions of the Agreement." Scion further argues that ASB did not "incur" costs or expenses because DLA Piper has not been billing ASB for its fees.

Scion's technical arguments do not prevent enforcement of the contractual fee-shifting provisions. The term "Agreement" in Section 9.9 refers to the parties' actual agreement. It does not mean the erroneous agreement that contained a scrivener's error. ASB proved in this action that the Disputed Agreements incorrectly memorialized the parties' actual agreement. Scion breached the parties' actual agreement by attempting to enforce versions that it knew were incorrect. Through this lawsuit, ASB enforced the parties' actual agreement and became entitled to fees under Section 9.9.

The purpose of the contractual fee-shifting provision is to allocate the burden of contract enforcement between the breaching party and the non-breaching party. Arrangements that the non-breaching party may have made internally or with third parties to minimize or lay off its own burdens do not affect the breaching party's liability. If, for example, ASB had obtained litigation insurance such that its fees and expenses were covered by an insurer, that fact would not eliminate Scion's obligation under the fee-shifting provision. Either ASB or the insurer by subrogation could enforce the fee-shifting provision. Here, the non-breaching side of the case caption litigated the dispute at significant cost, albeit a cost that DLA Piper and ASB have allocated between themselves. The contractual fee-shifting provision obligates the breaching side of the caption to bear that cost, regardless of the allocation between DLA Piper and ASB.

III. CONCLUSION

ASB has demonstrated by clear and convincing evidence that (i) the May 2007 Terms constituted a specific prior understanding that promote compensation would be paid only after the return of capital in a capital event, (ii) the ASB Members executed the Disputed Agreements under the mistaken belief that the Sale Proceeds Waterfalls reflected the May 2007 Terms, and (iii) the Scion Members knew that the waterfalls did not reflect the May 2007 Terms but intentionally remained silent. ASB is therefore entitled to reformation of the Sale Proceeds Waterfalls in the Disputed Agreements.

The relevant portion of the Sale Proceeds Waterfall in the Breckenridge LLC Agreement is hereby reformed to read:

> (ii) *Second*, among the Members in proportion to the Unrecovered First Preferred Return Amounts of the Members at such time, until such time as each Member's Unrecovered First Preferred Return Amount has been reduced to zero;
>
> (iii) *Third*, among the Members in proportion to the Invested Capital of the Members at such time, until such time as each Member's Invested Capital has been reduced to zero;
>
> (iv) *Fourth*, (x) the Remaining Percentage to the Members in proportion to each Member's respective Percentage Interest at such time, and (y) the Promote Percentage to Venture Partner until such time as the Fund's Unrecovered Second Preferred Return Amount has been reduced to zero; and
>
> (v) *Fifth*, (x) the Remaining Percentage to the Members in proportion to their respective Percentage Interest at such time, and (y) the Promote Percentage to Venture Partner.

The Sale Proceeds Waterfalls in the 2040 Lofts and Dwight Lofts LLC Agreements are reformed in parallel fashion to reflect the return of capital before payment of the promote.

Judgment is entered in favor of ASB on Scion's counterclaims. ASB is entitled to recover the fees and expenses its side incurred in the action. ASB would be entitled to costs in any event as the prevailing party.

Within ten days, the parties shall submit an order implementing these rulings. The order shall provide conforming language for the 2040 Lofts and Dwight Lofts LLC Agreements. If possible, the parties shall specify a dollar amount of fees and costs to which ASB is entitled. Any dispute over the amount should be presented promptly for the Court to resolve.