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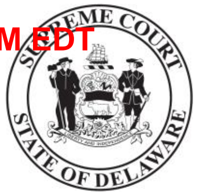

IN THE SUPREME COURT OF THE STATE OF DELAWARE

FINGER LAKES CAPITAL PARTNERS, LLC, Plaintiff and Counterclaim Defendant Below, Appellant, v. HONEOYE LAKE ACQUISITION, LLC, and LYRICAL OPPORTUNITY PARTNERS, L.P., Defendants and Counterclaim Plaintiffs Below, Appellees.	No. 42, 2016 On appeal from the Court of Chancery of the State of Delaware, C.A. No. 9742-VCL

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NATURE OF PROCEEDINGS

This is a contract dispute. Finger Lakes Capital Partners, LLC ("FLCP") appeals from an adverse judgment for money damages entered against it by Vice Chancellor J. Travis Laster after a trial and extensive post-trial briefing. The court made detailed factual findings in its 47-page opinion (the "Opinion") after considering dozens of exhibits and the testimony of four live witnesses, including FLCP's principals Gregory Shalov and V. Zubin Mehta, and Lyrical Opportunity Partners, L.P. (together with its affiliates "Lyrical")'s principal Jeffrey Keswin and his CFO Ted Gage. The purpose of the trial was for the court to assess how two agreements between the parties, called the Term Sheet and the Clawback Agreement, interacted with the operating agreement of Honeoye Lake Acquisition LLC ("HLA") (the "Revolabs Agreement"), and which party owed how much money to whom. The Opinion concluded that on a net basis HLA owed FLCP a little under $140,000 for indemnification of legal fees while FLCP owed Lyrical almost $900,000 (before interest). FLCP's position throughout the litigation, which it continues on appeal, is that it wishes to take advantage of the one contract out of the three (the Revolabs Agreement) that is financially advantageous to it while repudiating its obligations under the other two contracts.

SUMMARY OF ARGUMENT

I. As to FLCP's Points I and III, the record below indisputably supports the Vice Chancellor's detailed factual findings that the Term Sheet and the Clawback Agreement "extended to all of the equity investments" in the parties' "overarching business relationship." Opinion at 35, 38, 41. Despite their contrary sworn testimony after litigation arose (*see id.* at 11), Mehta and Shalov's own consistent course of conduct treated both agreements as valid and binding long after they claimed they had been "superseded". The standard integration clause in the operating agreements of all five of the individual portfolio companies' special purpose vehicles, including the Revolabs Agreement, did not supersede the two "Cross-Investment" agreements because they did not cover the same "subject matter."

II. As to FLCP's Point II, the documentary and testimonial evidence, and specific language of both agreements, support the application of the agreements' specific provisions in the decision below. The Vice Chancellor applied the parties' undisputed understanding of the Revolabs Agreement's distribution waterfall (Opinion at 32); then, through email exchanges and [the parties'] course of dealing," determined how "Shalov, Mehta, and Keswin objectively manifested their agreement on the Clawback Agreement and subsequent modifications…" (*id.*

at 14-15, 17-18, 39-40), and thus correctly determined how the interplay of the agreements affected the net amounts due among the parties.

III. As to FLCP's Point IV, while the Vice Chancellor held that the portion of Lyrical's share of the management fees that had been past due more than three years prior to the litigation could not be used to support an affirmative recovery, he correctly held (Opinion at 44) that that portion could be used defensively to reduce any future, albeit unlikely, recovery by FLCP.

IV. As to FLCP's Point V, the ruling (Opinion at 34-36) that HLA's indemnification obligations would not extend to its failed attempt to disavow its obligations under both the Clawback Agreement and Term Sheet is similarly supported by the record below which, in addition to the absence of any contractual support for FLCP's indemnification request, includes the Court's substantial finding that Mehta and Shalov engaged in "willful misconduct."

STATEMENT OF FACTS

The Opinion contains 28 pages of detailed factual findings, virtually none of which are criticized by FLCP as to their truth, only their legal relevance.

Lyrical Agrees to Invest in Opportunities Identified and Managed by FLCP; Lyrical Suffers Huge Losses On Those Investments; A Dispute Arises About Allocation of the Proceeds from the Sale of Revolabs. FLCP was founded by Mehta and Shalov in 2003. They wished to start an asset management business, but lacked access to a substantial source of capital. In early 2004, they were introduced to Lyrical's principal Jeffrey Keswin. Lyrical and its affiliates have approximately $4 billion in assets under management. Opinion at 2. FLCP and Lyrical reached an overall agreement pursuant to which Lyrical provided almost 100% of the capital necessary for FLCP to manage investments in five portfolio companies, known as Performance, Tiber, Portadam, Revolabs, and Rethink.

Over the next decade, it gradually became clear that Mehta and Shalov had not done well either in choosing portfolio companies or at managing those investments. Performance failed first, wiping out Lyrical's investment—over $6 million. Opinion at 17, 41. Tiber also failed, wiping out Lyrical's approximate $3.3 million equity investment and an additional approximate $3 million in direct and indirect debt investments. *Id.* at 18, 24, 41. Portadam likewise ended up

insolvent, wiping out Lyrical's approximate $4 million equity investment. *Id.* at 24-25, 41. As explained further below, their need for additional capital led to their agreement that Lyrical would recoup those losses from any profits on other investments before FLCP would receive any profits (the "Clawback Agreement"). *Id.* at 14-15.

The only successful investment thus far (Rethink has yet to yield a profit but is not thus far insolvent) was Revolabs. Opinion at 25. A 2014 sale of Revolabs yielded approximately $31 million in proceeds for HLA, the limited liability company through which Lyrical's FLCP-managed investment in Revolabs was held. *Id.* at 36. (Similar special entity LLC's were set up, with almost identical operating agreements, including the same standard-form integration clause on which FLCP relies, for the other four portfolio investments. *Id.* at 7-11.) The Revolabs investment had been made almost a decade earlier, using $4.6 million in capital from Lyrical as compared to $100,000 from FLCP. *Id.* at 15.

FLCP, however, had not gone uncompensated during the decade before the Revolabs sale occurred. FLCP used its control of Revolabs to pay itself almost $4.2 million (almost as much as Lyrical invested in the company) in management fees from Revolabs, as well as taking over $1.4 million in fees from Portadam before its insolvency and almost $500,000 from Rethink, for total management fees of over $6 million. Opinion at 43, 46. Lyrical was entitled pursuant to the

Term Sheet to a 25% share of those fees. Because of FLCP's chronic cash flow difficulties, Lyrical did not receive its share of those fees, and was kept unawares as to the amount of fees, which dramatically increased in the later years of the relationship.[1] *Id.* at 22-24, 43. After Lyrical learned in early 2014 that the fees being taken by FLCP were substantially more than it had understood, it lost any remaining trust in Shalov and Mehta and exercised its contractual right to replace FLCP as manager of HLA and take control of HLA (as well as the LLCs managing the other investments). *Id.* at 25-26.[2]

Shortly before the Revolabs sale closed, Mehta sent Lyrical (B97-B105); Opinion 28-29) a proposed "waterfall" for allocation of the proceeds to be received by HLA. Contrary to their subsequent sworn testimony (A1002) in this case claiming $6 million, Mehta allocated less than $3.8 million of the approximate $31 million total to FLCP, because his analysis (B98-B104) gave partial effect to the Clawback Agreement and to the Term Sheet—the same agreements FLCP now

[1] The Vice Chancellor found (Opinion at 45) that Lyrical's willingness to acquiesce in delay in receiving payment (in hopes of settling up once there was more cash to do so), did not waive its right to this share. FLCP does not challenge that ruling on appeal.

[2] Shalov and Mehta became concerned that they would not control the disposition of the proceeds received from the anticipated Revolabs sale because Lyrical, rather than FLCP, would control HLA's bank account, and in a discussion they inadvertently recorded, they began to formulate an illegal self-help plan to set up a separate account they could convince the buyers of Revolabs to wire the proceeds into—a plan they quickly abandoned after they realized this could expose them to criminal prosecution for "bank fraud," and recalled a previous time they had previously "got[ten] in trouble" (i.e. gotten sued) after making legally-binding promises without considering the possibility "it would ever come back to bite us." B6.

claims are irrelevant and unenforceable. After Lyrical showed them its own analysis indicating that the amounts due under the Clawback Agreement and Term Sheet were larger than Mehta had conceded and might reduce FLCP's net recovery to zero, FLCP threatened litigation and eventually commenced it. Opinion at 29.

The Vice Chancellor's decision has not left FLCP impoverished or given Lyrical a windfall. FLCP received over $6 million in management fees from the portfolio companies, which as the Vice Chancellor noted (Opinion at 43), represented well over half the equity Lyrical invested in the three companies successful enough to generate that fee income. FLCP is entitled to retain over 85% of that amount and received substantial additional revenue from the Revolabs sale.[3] FLCP always understood that its upside from managing Lyrical's investments was to be almost entirely performance-based, and acknowledged as early as 2006 (*id.* at 18) that, given the terms of the agreements it had struck, it could well end up with nothing even if the total portfolio of Lyrical's investments it managed was significantly profitable in the aggregate. *See also id.* at 7 (noting

[3] Lyrical was not awarded its full 25% share of those fees because a significant portion was held to be outside the statute of limitations, thus permitting FLCP to retain more than the 75% it was contractually entitled to. Additionally, FLCP received from HLA repayment of its $100,000 initial investment in Revolabs plus $66,000 of "preferred return." Opinion at 42. It also received over a million dollars in "carried interest" from other investment vehicles it managed that shared in the Revolabs sales proceeds. A1320; A1242. Interpreting the Term Sheet against Lyrical, the Vice Chancellor held (Opinion at 5) that Lyrical was not entitled to share in that carry.

the "price [for FLCP of the provisions of the Term Sheet] was high, but it represented the cost of access to the funds Shalov and Mehta needed to launch their own asset management firm. After all, the hardest part of managing money may well be finding the money to manage.").

The Term Sheet. The Term Sheet was signed in April 2004. Opinion at 3. After disputing earlier that it was ever binding, FLCP finally conceded at trial (*id.* at 11-13) that it had originally been binding. The Vice Chancellor found that the agreement was ambiguous and thus considered (*id.* at 4) parol evidence to construe it. The Court determined that the Term Sheet addressed "the on-going business relationship between Lyrical and [FLCP] that would span multiple investments." *Id*. Under the Term Sheet, Lyrical was to receive a 25% ownership interest in FLCP and a right of first refusal for any potential transaction for which FLCP sought to raise capital. *Id*. The Term Sheet also provided a "sliding scale" formula for Lyrical to share in the "GM [General Manager] Stake": (a) whatever carried interest FLCP would be entitled to receive if the deal proved profitable; and (b) whatever management fees FLCP received as a result of the deal. *Id*. For deals requiring less than $5 million of capital where Lyrical committed to all of the capital needed (which included all those relevant here) Lyrical's percentage of the GM Stake was to be 25%, a finding FLCP does not dispute. *Id.* at 5-7.

In April 2004, the month the Term Sheet was signed, the parties also signed the operating agreements for the LLCs through which the Performance and Tiber investments were made, each of which contained the same standard integration clause as the Revolabs Agreement. Opinion at 8-11. Thus, on FLCP's current litigation theory (see also trial testimony at A968-69, A977-79, the Term Sheet was superseded only a few days later—with Lyrical having given up all of the valuable economic rights it had bargained while receiving nothing in return. *Id.* at 11. Such a result would be, as the Vice Chancellor noted (Opinion at 39), "absurd."

Despite Mehta and Shalov's sworn testimony to the contrary, FLCP's after-the-fact contention that the integration clause of the Revolabs Agreement "superseded" the Term Sheet and rendered its provisions unenforceable was inconsistent with a series of statements and actions by FLCP stretching over a decade. FLCP referred to various terms of the Term Sheet (Opinion at 11-13) as binding in multiple communications from late 2004 forward (both before and after the execution of the Revolabs Agreement). It also did so with third parties, agreeing to confirm (*id.* at 13-14, n.3) Lyrical's 25% ownership stake to its auditors, and referencing Lyrical's sliding-scale percentage interests in the GM Stake in representations it made in 2008 in an insurance application. In 2014, shortly before this litigation, FLCP's first-cut proposal for the allocation of the

Revolabs proceeds explicitly acknowledged Lyrical's entitlement to 25% of the carried interest that the Revolabs Agreement initially assigned to FLCP. B97-B104.

The Clawback Agreement. The Performance investment became troubled very quickly after it was made in the spring of 2004. Opinion at 14. By early 2005, Mehta and Shalov decided they needed more capital to try to salvage it, and, to induce Lyrical to put up more capital (as loans), they promised a "clawback,"—if the principal amount of the loan was lost, Mehta wrote, they would make it up to Lyrical from the monies "we made from any of our other investments." *Id.* The loan documentation further pledged that such a clawback agreement "will be put in place." *Id.* at 15.

Again and again, both before and after the Revolabs investment was made, Mehta and Shalov reaffirmed and expanded (Opinion at 15, 18-19) the Clawback Agreement when they were asking Lyrical for more money, and received more money from Lyrical on the basis of those very representations. Thus, on July 25, 2005, while seeking yet another $300,000, Mehta wrote "we have already agreed to the following:…(2) A full clawback on all of our deals, and (3) In the event there is upside in [Performance], neither [Shalov] or I will get any of our carry for this deal." *Id.* at 15 (quoting A160). Again, in November 2006, when seeking almost $2 million more, Mehta and Shalov agreed that in addition to any loss on

equity investments, the Clawback would apply to more than $3.6 million in loans to Performance, and as Mehta then recognized, the investments in the portfolio companies as a whole could be "up 30% and we still end up with nothing." Opinion at 18 (quoting A241).

The last time FLCP sought money (for the Rethink investment, in April 2008, Opinion at 19-20), Performance had already collapsed, and all of Lyrical's capital in that investment had been lost. Before funding Rethink, Lyrical asked for (*id.* at 19) a schedule confirming the exact dollar amounts of the existing investments subject to the Clawback Agreement. FLCP did so (and subsequently supplemented it when Lyrical at first found it unacceptable, and then subsequently pointed out it had omitted one such investment, *id.* at 20). On the basis of that schedule and the email accompanying it in which Mehta reaffirmed the Clawback Agreement in detail, Lyrical provided almost $2 million to FLCP to invest in Rethink. *Id.* at 25.

Although Mehta's email acknowledges the Clawback, and his trial testimony was that he and Shalov intended to "live up" to the content of that email (A801), the April 2008 email (A240-A241) does not dictate the Clawback formula FLCP espouses. In fact, FLCP instead relies on an earlier email, from almost two years before. *See* App. Br. at 23. This earlier email is not an agreement between the parties, but simply Mehta's self-serving justification for the losses FLCP has

suffered while making a plea for more funds and an undertaking to make up their losses even if that means "we still end up with nothing."

The representation in 2008 made by FLCP in order to obtain millions in new capital was made almost three years after the execution of the Revolabs Agreement. Indeed, FLCP now claims (App. Br. at 8) that it was that very 2008 e-mail that sets forth the "full substance" of the Clawback Agreement—the same agreement it contends had been superseded at least three years prior. FLCP's selective quotation of that e-mail, avoids the key introductory section which uses the present tense to recommit FLCP to that agreement (Opinion at 19, emphasis added): "Per the attached schedule, [FLCP and its principals] *are agreeing* that [FLCP's] entire investment portfolio is subject to a clawback." Finally, as with the Term Sheet, FLCP's proposed allocation of the proceeds of the Revolabs sale shortly before litigation commenced acknowledged the validity and impact of the Clawback Agreement, accordingly increasing the amount to be received by Lyrical and decreasing the amount to be received by FLCP.[4] B98-B104.

FLCP's Bad Faith Conduct in Connection with This Litigation.

The Court below correctly found (Opinion at 35-36) that Mehta and Shalov had engaged in "willful misconduct" in connection with seeking more than their

[4] The proposed allocation contained in B98-B104 recognized the relevance and binding nature of both the Term Sheet and the Clawback Agreement, but the parties' disagreement on how to apply the provisions of those agreements led to this litigation.

entitlement of the HLA distribution proceeds, and specifically disavowing the Term Sheet and Clawback Agreement as "superseded" or to which they only "gratuitously" agreed when both had been so essential to the business of FLCP. (A810, A938; Opinion at 35-36). Those findings were also amply supported by the record. As the court found, among other things, Mehta and Shalov argued the Revolabs Agreement "superseded" the Term Sheet in its entirety and "willfully refused to comply with their terms" "[d]espite not believing that at the time" and, in fact "never" believing it (Opinion at 11-13, 36, 38); claiming to have agreed to an extension of the Clawback Agreement "gratuitously" when in fact "[e]ach time they agreed to expand the Clawback Agreement it was in connection with a request for money" (*id.* at 40); and making "pretextual" re-characterizations of management fees to "dodge" their obligations under the Term Sheet (*id*. at 43-44; *see also* 21-24).

Procedural History of the Litigation. FLCP repeatedly suggests (App. Br. at 2, 9-10) that the Vice Chancellor reversed course between the earlier hearing (the "1/28/15 Hearing") at which he orally granted FLCP's motion for partial judgment on the pleadings (construing the Revolabs Agreement in isolation) and trial (when he considered the effect of the other two agreements on the amounts due among the parties). He did no such thing. To the contrary, he explicitly

refused at the 1/28/15 Hearing to enter a Rule 54(b) partial judgment in FLCP's favor based on the Revolabs Agreement because (A430):

> I do think that there are viable claims here as to the [Term Sheet] and the clawback agreement. I think it makes sense that any claims that the defendants would have on those agreements would be potentially setoffs against amounts that they could owe or, under the more equitable term, potentially recoupments. I think there is some legitimate concern that if these amounts [claimed by FLCP] were paid out, they could be distributed and [FLCP] would essentially be left as a shell entity.

Thus, the Vice Chancellor ruled that any enforceable judgment as to who owed how much to whom needed to await adjudication of all claims under all three relevant agreements. That is exactly the approach he then took at trial and in his post-trial rulings.[5]

Separately, the Vice Chancellor stated at the 1/28/15 Hearing that (A427) "it's undisputed that" any reserve to be maintained for future indemnification obligations for legal fees "only would relate to the claims against HLA and Lyrical in its capacity as manager and that it would not extend to the counterclaims for the breach of the [Term Sheet] or the clawback agreement." FLCP's subsequent

[5] It is rather *FLCP* which reversed course, arguing at trial that the Revolabs Agreement was ambiguous, incorrectly drafted, and/or otherwise failed to accurately reflect the proper "waterfall" allocation of proceeds, because its language did not give them as much money as they thought they were entitled to receive. FLCP convinced the Vice Chancellor that the Revolabs Agreement probably did not reflect the likely actual agreement of the parties, although the court held that judicial estoppel (*not* the integration clause or the rule against parol evidence) prevented FLCP from switching positions and seeking equitable reformation of the agreement. Opinion at 32-33. (FLCP has not challenged on appeal the rejection of its reformation claim.)

position that it has a right to be indemnified by HLA for *its* legal fees defending against the counterclaims is thus contrary to the position it took at that hearing (where it claimed that HLA had no need to hold money in reserve because of future indemnification obligations).

ARGUMENT

I. THE CLAWBACK AGREEMENT AND TERM SHEET WERE NOT BARRED BY THE REVOLABS AGREEMENT'S INTEGRATION CLAUSE

Question Presented. Did the Vice Chancellor correctly find that the "subject matter" of the Term Sheet and Clawback Agreement was not the same "subject matter" of the Revolabs Agreement, such that the integration clause of the Revolabs Agreement did not affect the validity of the other two agreements?

Standard of Review. Lyrical and HLA agree with FLCP's statement except that de novo review only applies to contract language in the context of an unambiguous and fully integrated written agreement. "To the extent the trial court's interpretation of [an agreement] rests on findings concerning extrinsic evidence, however, this Court must accept those findings unless they are unsupported by the record and are not the product of an orderly and logical deductive process." *Schock v. Nash*, 732 A.2d 217, 224 (Del. 1999).

Merits of the Argument. FLCP's core argument is that the integration clause of the Revolabs Agreement relieved it from its obligations under the Term Sheet and Clawback Agreement, and consequently all of the Vice Chancellor's detailed factual findings are irrelevant "parol evidence." This contention is admitted by FLCP itself (App. Br. at 3) to be "unpalatable," and would lead to

results the Vice Chancellor characterized (Opinion at 39) as “absurd.” Unsurprisingly, it is supported neither by the facts nor the law.

As the Vice Chancellor correctly held, while the Court cannot use extrinsic evidence “for the purpose of varying or contradicting the terms” of an unambiguous, written contract, it may be admitted for any number of other purposes, including “to prove a collateral or separate agreement.” Opinion at 31 (quoting *Galantino v. Baffone*, 46 A.3d 1076, 1081 (Del. 2012) and *Scott-Douglass Corp. v. Greyhound Corp*., 304 A.2d 309, 315 (Del. Super. Ct. 1973)). Here, the Vice Chancellor did not use parol evidence to override the unambiguous terms of the Revolabs Agreement, but to determine the terms, scope, and effect of the Term Sheet and the Clawback Agreement, which all parties agreed had never been memorialized in single, integrated writings.[6]

It is undisputed that the Revolabs Agreement’s integration clause only purports to supersede prior inconsistent agreements “with respect to the subject matter hereof.” The effect of a contract’s integration clause is a fact-intensive question that depends on context. *Brady v. i2 Technologies Inc.,* 2005 WL 5756601 (Del. Ch. Dec. 14, 2005) (integration clause of later agreement on

[6] FLCP’s claim (App. Br at 19) that the “scope” of the Term Sheet and Clawback Agreement “remains undisputed” is strange, given how vigorously FLCP disputed at trial the scope of those agreements, sometimes with success. *See* Opinion at 5 (resolving dispute about ambiguous language in Term Sheet in FLCP’s favor).

indemnification of ex-CEO did not override validity of earlier agreement entitling him to advancement of legal expenses, because advancement and indemnification were different "subject matters" and because the earlier agreement was one "the parties might naturally make separately").[7] Thus, the Vice Chancellor's key factual findings (Opinion at 38) were that the "subject matters" of the Clawback Agreement and Term Sheet were different than the "subject matter" of the Revolabs Agreement, making the integration clause inapplicable to them. These findings are correct (and certainly not clear error).

The Vice Chancellor held (Opinion at 38) that the provisions in the Term Sheet dealing with the percentage splits of the "GM Stake" were part of the "overarching business deal," and thus operated on a separate level from the calculation of carried interest in the Revolabs Agreement (and the parallel agreements for the other LLC's). The provisions of the Term Sheet necessarily assume a separate agreement calculating FLCP's carried interest for each deal; the Term Sheet provides the formula for a separate payout to Lyrical. Thus, it is the Revolabs Agreement that determines, with respect to carried interest, what the GM

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[7] *See also Green Isle Partners, Ltd. v. Ritz-Carlton Hotel Co*., 2000 WL 1788655 (Del. Ch. Nov. 29, 2000) (when contract with integration clause lacked forum selection agreement and was only contract between parties dealing with right to inspect books and records, forum selection clause in different contract dealing with different subject matter was not applicable to inspection demand); *United States v. Stein*, 452 F. Supp. 2d 230, 265 (S.D.N.Y. 2006), vacated on other grounds, 486 F.3d 753 (2d Cir. 2007).

Stake will be and the Term Sheet that provides who then shares, and in what proportion, in that GM Stake at a subsequent stage of the process and at a different level of the parties' overall business relationship. Indeed, the Term Sheet provided (Opinion at 5) that the balance of the GM Stake not due to the Lyrical (here, 75%) would go not to FLCP as an entity but to its principals Mehta and Shalov, confirming that Lyrical was participating in the economics of FLCP the same way they were.

FLCP argues that, because the Revolabs Agreement controls the initial calculation of FLCP's carried interest, it preempts any separate agreement entitling Lyrical to share in FLCP's revenues. But it makes no sense that the Revolabs Agreement preempts the right of Lyrical, as owner of a 25% stake in FLCP, to receive its 25% share in whatever net profits FLCP might distribute to its owners just because the ultimate source of those profits might be carried interest from the Revolabs sale. The Term Sheet supplemented Lyrical's right to 25% of FLCP's net profits with a separate right to share in certain of FLCP's revenue streams on a gross rather than net basis.[8] The Vice Chancellor's factual finding that those splits were intended to occur as part of the overarching relationship rather than at an

[8] Because the consideration for FLCP's willingness to give Lyrical a percentage interest in both net profits and certain gross revenues was Lyrical's willingness to be FLCP's backer and "seed investor," it makes perfect sense for the percentage splits in the GP Stake to vary as they do, i.e. Lyrical's split is highest when Lyrical has committed to provide all of the capital for a particular deal, and smaller when Lyrical only commits to lesser percentages of the capital.

investment-specific level makes perfect business sense and thus cannot be "clearly erroneous." The same is true for the management fees, where the revenue stream in which Lyrical is entitled to share came from multiple investments, not just Revolabs. It would make no sense that the integration clause of the Revolabs Agreement controlled the "subject matter" of FLCP's revenue stream consisting of management fees from Portadam or Rethink.

Likewise, the Vice Chancellor's factual finding (Opinion at 41) that the Clawback Agreement was not superseded because as an "overarching agreement[] that applied across investments" (i.e., it was not known in advance which investments might be losses and which might generate positive returns from which Lyrical could be made whole for those losses) it had a different "subject matter" than the deal-specific Revolabs Agreement also makes perfect business sense, and thus cannot be clear error.[9]

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[9] Finally, none of the case law cited by FLCP supports its position that the Vice Chancellor committed reversible error here. They simply confirm that each case turns on its particular facts. *See, e.g., Ostroff v. Quality Servs. Lab., Inc.*, 2007 WL 121404 (Del. Ch. Jan 5, 2007) (when integration clause in contract buying out retiring employee's stake in business recited it superseded all former agreements except for those carved out on an attached schedule, prior agreement regarding life insurance that had presumed such employee's continuing employment and was not listed on schedule as carved out was superseded); *Minn. Invco of RSA #7, Inc. v. Midwest Wireless Hldgs., LLC*, 903 A.2d 786 (Del. Ch. 2006) (subsequent agreement restructuring parties' business relationship not only had broad integration clause but express provision stating it would govern in event of any conflict with provisions of specific earlier agreement on which plaintiffs sought to rely). *Dubuque v. Taylor*, 2007 WL 3106451 (Del. Super. Ct. Oct. 1, 2007) is irrelevant here. It involved a situation where a seller who had breached a warranty by failing to transfer a valuable asset to the buyers of a business was barred by the integration clause from contending he had orally alerted the buyers to the issue.

II. THE COURT CORRECTLY CALCULATED THE AMOUNTS DUE UNDER THE CLAWBACK AGREEMENT, BUT IN THE ALTERNATIVE THIS COURT SHOULD GIVE LYRICAL FULL CREDIT FOR THE LOST PRINCIPAL OF ALL ITS DEBT INVESTMENTS

Question Presented.

Was the Vice Chancellor's interpretation of the application of the Clawback Agreement sufficiently supported by the record? In the alternative, did the Vice Chancellor err in excluding Lyrical's lost capital on certain direct and indirect debt investments in Tiber from the operation of the Clawback Agreement?

Standard of Review. The standard of review is the same given supra at 16.

Merits of the Argument. The Vice Chancellor found that the total amount due to Lyrical under the Clawback Agreement was $13,362,156.46. Opinion at 41. FLCP has abandoned on appeal the arguments it made below that, even if the Clawback Agreement were enforceable, the amounts due under it were substantially less. FLCP only objects now to the formula employed to apply that amount.

The Opinion accurately sets forth and applies (at page 36) the three-step "waterfall" formula of the Revolabs Agreement (A226, A208-09) for determining the respective shares of Lyrical and FLCP, and then applies (*id*. at 42) the Clawback amount against the amount of carried interest due to FLCP under that waterfall. FLCP claims that the Vice Chancellor should instead have deducted the

amount due under the Clawback part way through the Revolabs Agreement's waterfall, i.e. after taking steps (a) and (b) (dealing with return of capital and preferred return on that capital) but before step (c) (calculating FLCP's share of carried interest). In other words, FLCP wants (since it cannot evade the Clawback Agreement in its entirety) the Clawback amount deducted from the approximate $23.8 million remaining after steps (a) and (b), rather than from the approximate $6 million "Manager Share" that results from the application of step (c) of the Revolabs Agreement's formula for the allocation of funds. This approach is more advantageous for FLCP, because, as the Vice Chancellor noted in denying its motion for rehearing (App. Br. Exh. B at 2-3), that formula would cost FLCP only 25 cents for each dollar received by Lyrical under the Clawback Agreement, meaning Lyrical would be subsidizing 75% of its own recovery.[10]

But the record supports the result reached, and FLCP has not shown reversible error in the court's calculation. FLCP repeatedly reaffirmed and expanded the Clawback Agreement, but, despite promises to do so (Opinion at 19), never embodied it in a single integrated document. Thus, the Vice Chancellor

[10] In its unsuccessful motion for reargument below, FLCP told the Vice Chancellor that adopting its "take it off the top" approach would only yield a recovery of $438,875.64. FLCP now seeks approximately $2.6 million by apparently ignoring the effect of the Vice Chancellor's rulings enforcing the Term Sheet. The arithmetic in its motion for reconsideration gave full effect to all of the Vice Chancellor's rulings on the Term Sheet, changing only the formula for applying the amounts found due under the Clawback Agreement from after step (c) of the Revolabs Agreement's formula to between steps (b) and (c). A1344.

considered a string of references to the Clawback Agreement in e-mails and other documents over several years, plus oral testimony as to its business purpose and intent. He declined to rely on any single writing as the complete embodiment of the Clawback Agreement. In so doing, he not only rejected FLCP's favored formula, but eliminated substantial debt investments that Lyrical contends are subject to the Clawback Agreement.[11] His resulting interpretation of the agreement is thus reviewed under the deferential standard of *Schock*, 732 A.2d at 224.

Here FLCP's arguments are premised on two separate emails. In the relevant section of its argument (App. Br. at 23), FLCP cites a self-serving email sent by Mehta (A240), containing Mehta's opinion as to the business rationale for the Clawback Agreement. The Vice Chancellor was not required to give *any* weight to this document, because there was contrary evidence from which he reasonably could draw different conclusions as to the business purpose of the Clawback Agreement and the commercial reasonableness of the methodology he adopted. For example, Lyrical's principal Jeff Keswin testified, regarding the overall goal of the agreement, that "they wouldn't get paid a carry until we got all of our capital back" (A551) and "earlier I mentioned the clawback agreement that

[11] Lyrical acknowledges that its calculation of potential damages at trial used the same methodology FLCP now advocates. The Vice Chancellor was certainly free to give such weight to the parts of the record (including Lyrical's proposed damages calculation) as he deemed appropriate. FLCP does not claim that the Vice Chancellor lacked jurisdiction to adopt a methodology more favorable to Lyrical than Lyrical's damages analysis, only that the Vice Chancellor's decision to do so lacked support in the record.

we would make back all of our losses from [FLCP] first" (B148).[12] Moreover, in the earlier emails that established and expanded the Clawback Agreement, FLCP promised Lyrical (supra at 10-11) that its losses would be repaid from the monies "we made from any of our other investments," and that it understood the portfolio of the various investments it had made with Lyrical's capital could be "up 30% and we still end up with nothing."

FLCP now contends (App. Br. at 8) that it "is undisputed that" the key April 2008 email (Opinion at 19-20, quoting A281) "sets forth the full substance of the Clawback Agreement." That was certainly not its position during discovery or at trial. The text of that email also fails to support FLCP's current position. That email provides that all "gain" will go to Lyrical prior to "any Carried Interest being paid" to FLCP until the full amount due under the Clawback Agreement has been received by Lyrical. Nothing about this language says that the Clawback Agreement will be applied before "Carried Interest" is even calculated, and this language is perfectly consistent with the Vice Chancellor's ruling that FLCP's share of Carried Interest must first be calculated (step (c) of the waterfall set forth in the Revolabs Agreement) and then used to satisfy the Clawback Agreement's

[12] Separately, the Court noted the existence (Opinion at 41; App. Br. Ex. B at 2) of a separate, more limited, clawback provision in the document governing the Debt Fund, indicating that any early profits taken from that entity by its manager FLCP could (if the entity subsequently proved unprofitable overall) be clawed back for the investors benefit. B67. This shows that in another context in which the parties dealt with each other, the economic impact of a clawback fell 100% on FLCP, rather than the 25-cents-on-the-dollar impact it is arguing for here.

obligations until (once those obligations have been satisfied) any excess may then be receivable by FLCP, thus becoming part of the GM Stake subject to the Term Sheet's provisions.

However, if FLCP's belated decision to rely exclusively on the 2008 email (A281) is accepted, the aspects of the email favorable to Lyrical that the Vice Chancellor thought not dispositive on issues where he ruled against Lyrical should be recognized as well.

The Vice Chancellor determined that the total amount due to Lyrical under the Clawback Agreement was $13,362,156.46. However, read literally, A281 states that this figure should have been $16,337,156.44, a $2,975,000 difference. Given the Vice-Chancellor's formulation (in which the lower amount was sufficient to reduce FLCP's net recovery to zero), this ruling did not affect the amount of Lyrical's judgment and thus Lyrical had no reason to cross-appeal. However, should this Court accept FLCP's claim that the Vice Chancellor committed reversible error with respect to the methodology for applying the Clawback Agreement, this issue would then become material, changing (if the larger amount is used) a revised judgment in favor of FLCP against Lyrical (and HLA) of $438,875.64 to one of $118,936.86 against FLCP in Lyrical's favor.[13]

[13] See A1358-59, B161-162 (showing calculation of this amount). Because this result would be less than the judgment the Vice Chancellor awarded to Lyrical, Lyrical may request it without having cross-appealed. *Haley v. Town of Dewey Beach*, 672 A.2d 55, 59 (Del. 1996) ("An

The $2,975,000 difference consisted of capital Lyrical directly and indirectly invested in the FLCP-managed portfolio company Tiber in the form of debt in addition to the approximate $3.3 million lost equity the Vice Chancellor did (Opinion at 41) include.[14] While the Vice Chancellor included as damages, the approximate $3.3 million lost by Lyrical on its equity investment in Tiber (*id.*), the Vice Chancellor also found that, although the Clawback Agreement explicitly included losses on debt investments in Performance (*id*. at 20, 41) (both direct loans and indirect loans via the Debt Fund), the Clawback Agreement did not extend to the debt investments in Tiber.

In the April 2008 email, Mehta expressly represented that (Opinion at 19, quoting A281): "Per the attached schedule, [FLCP and Shalov and Mehta, individually] are agreeing that FLCP's entire investment portfolio is subject to a clawback." The "attached schedule" included the indirect Tiber debt investments made via the Debt Fund. A282.[15] It omitted the $500,000 in direct subordinated

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appellee who does not file a cross-appeal . . . may defend the judgment with any argument that is supported by the record, even if it questions the trial court's reasoning" as long as it does not seek to "enlarg[e] the appellees' own rights or lessen[] the rights of an adversary").

[14] $500,000 was subordinated loans directly to Tiber. The rest was indirectly invested ($250,000 in equity and $2,225,000 in a loan) through an entity known as Finger Lake Debt Partners (the "Debt Fund") The Debt Fund then loaned the money to Tiber. Tiber which became insolvent long ago, defaulted on its obligations to the Debt Fund, thereby rendering the Debt Fund insolvent.

[15] Only the lost principal amount of the loan made to the Debt Fund (now smaller than it was in 2008) is covered by the Clawback Agreement. FLCP did not guarantee the loss of past-due interest. Lyrical has separately obtained a judgment against the Debt Fund in New York state court for several million dollars of interest in addition to the lost principal of that loan, but believes that judgment will be largely uncollectible. That said, Lyrical does not seek to collect a

loans, but when Lyrical sent Mehta an email raising the issue, he promised the same day to "wrap them into the schedule" and subsequently did so. Opinion at 20. Thus, if A281 (as supplemented by Mehta's agreement) sets forth the "full substance" of the Clawback Agreement, the only fair reading is that the "entire investment portfolio" to which it applies is the "attached schedule" referenced in the same sentence, which included the items giving rise to the additional $2,950,000 in losses.

Accordingly, if this Court were to agree with FLCP's contention that the Vice Chancellor's failure to credit its methodology of applying the amounts due under the Clawback Agreement was clear error, it should likewise find the failure to credit the April 2008 email (A281)'s inclusion of the Tiber debt investments in the "entire investment portfolio" subject to the Clawback Agreement as clear error, and alter the judgment in Lyrical's favor from $883,893.25 (before prejudgment interest) to $118,936.86 in Lyrical's favor, as per the calculation set forth in the record below.

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double recovery for the same loss of principal on the Debt Fund loan and will be willing to make an appropriate undertaking to that effect.

III. SHOULD THE COURT REACH THE ISSUE, OTHERWISE TIME-BARRED MANAGEMENT FEES MAY BE USED FOR SET-OFF OR RECOUPMENT

Question Presented. Did the Vice Chancellor properly find that the portion of Lyrical's claim for management fees that would have been time-barred if brought as a direct claim could be used defensively to reduce any judgment in FLCP's favor?

Standard of Review. The standard of review is the same given supra at 16.

Merits of the Argument. The Vice Chancellor ruled that $627,472.25 of Lyrical's 25% share of management fees (pursuant to the Term Sheet) could not be recovered as a judgment against FLCP because it related to amounts received by FLCP more than three years before litigation was commenced, and thus Lyrical could rely on that amount "only as an offset or for purposes of recoupment." Opinion at 46. While admitting (App. Br. at 31, n.4) that Lyrical did not receive any credit for this amount in the judgment the Vice Chancellor entered, FLCP argues that this ruling could become relevant if this Court agrees with its other arguments to the extent that it would be entitled to a judgment against HLA and Lyrical and that in such a circumstance Lyrical would not be entitled to a credit. To the extent the Court does decide to reach this issue, it should reject FLCP's claim.

While FLCP presents this issue (App. Br. at 27) as a pure question of law, it then premises its argument on a factual assertion which is seriously misleading. That assertion (*id*. at 30) is that recoupment (which it concedes is not subject to the statute of limitations) is unavailable because of lack of mutuality of parties: the management fee claim is asserted by Lyrical against FLCP whereas FLCP's claim under the Revolabs Agreement is allegedly asserted against HLA rather than Lyrical. But there is no dispute that FLCP sued *both* HLA and Lyrical under the Revolabs Agreement and obtained judgment on the pleadings against *both* of them. A429-430; B153, B157-B158. By contrast, FLCP's indemnification claim for legal fees was only recoverable against HLA, not Lyrical, and the Vice Chancellor did not permit any recoupment or set off by Lyrical against the amount of that award, showing that he understood the distinction.[16]

FLCP's attack on the Vice Chancellor's reliance (Opinion at 10) on *Delaware Chemicals, Inc. v. Reichhold Chemicals, Inc*., 121 A.2d 913 (Del. Ch. 1956) is misplaced. Indeed, *Reichhold* disposes of FLCP's reliance on 10 *Del. C.*

[16] As to the "same transaction" requirement (applicable to recoupment but not setoff), the management fees and the carried interest claimed by FLCP against which they are being recouped are simply the different facets of the same "GM Stake" that Lyrical has the same 25% interest in pursuant to the Term Sheet. Moreover, Lyrical had deferred seeking payment of past-due amounts related to management fees (rather than trying to collect at a time when FLCP claimed to be strapped for cash) until there was actually a transaction that could be a potential source of cash from which FLCP could make good on the arrears. In *TIFD III-X LLC v. Fruehauf Prod. Co*., 883 A.2d 854, 859 (Del. Ch. 2004), the claim asserted as "recoupment" was not a personal claim belonging to the party seeking to assert it but was asserted derivatively on behalf of another entity, claiming a prior breach lowered the value of that entity.

Section 8120, which is its only real argument that setoff cannot be used as an affirmative defense.[17] FLCP claims (App. Br. at 31), incorrectly, that *Reichold* did not permit a party "to recover otherwise time-barred damages." The counterclaims at issue in *Reichold* explicitly "sought damages" and the decision expressly held that despite the statute-of-limitations bar on any affirmative recovery they could be reasserted "defensively." 121 A.2d at 917-918. This holding would make no sense unless Chancellor Seitz contemplated that the defendant there would to be able to do exactly what the Vice Chancellor held that Lyrical could do here, make "defensive" use of otherwise time-barred damages to reduce dollar-for-dollar the amount of any recovery by FLCP. Whether denominated as recoupment, offset, or defense, any modification of the Vice Chancellor's decision that could lead to a net recovery by FLCP should thus be reduced dollar-for-dollar by the $627,472.25 in management fee claims that Lyrical could not use as the basis for a money judgment in its favor against FLCP.

[17] The numbering of statutory sections has changed since 1956, but old section 8119, 121 A.2d at 918, is the same or substantially the same in wording as current section 8120.

IV. FLCP IS NOT ENTITLED TO ANY ADDITIONAL ATTORNEYS' FEES FROM HLA

Question Presented. Did the Vice Chancellor properly decline to grant FLCP a larger amount of attorneys' fees pursuant to its indemnification rights against HLA?

Standard of Review. The standard of review is the same given supra at 16.

Merits of the Argument. FLCP claims that the Vice Chancellor erred by failing to award it more than approximately $137,000 in fees pursuant to its indemnification rights against HLA. It does not take issue with the Vice Chancellor's factual finding that the additional amount it seeks, exceeding $200,000, for alleged pre-litigation investigation and negotiation was "unreasonable and excessive for the nature of the work claimed," Opinion at 35, much less claim that this finding is "clearly erroneous." Nor was the Vice Chancellor's refusal to grant FLCP further indemnification for its (unspecified but presumably considerable) fees unsuccessfully defending the counterclaims clearly erroneous.

As noted above at 14, the Vice Chancellor ruled at the 1/28/15 Hearing, at FLCP's urging, that HLA did not need to set aside any money for future legal expenses that might be incurred in connection with Lyrical's counterclaims enforcing the Clawback Agreement and Term Sheet, because a "reasonable reserve is approximately zero." A429. That meant zero dollars to indemnify Lyrical, and

necessarily also zero dollars to indemnify FLCP as the party defending those counterclaims. FLCP did not quarrel with that analysis (because any reserve large enough to cover such future legal fees would substantially reduce the amount of the partial judgment it was seeking) and submitted a proposed form of judgment (B158) implementing it. FLCP has no claim for indemnification from Lyrical, only from HLA itself, so its encouragement of the Vice Chancellor's order directing HLA to maintain no funds in reserve for any future indemnification for anyone is thus inconsistent with its current attempt to demand such indemnification. It is thus estopped from making such a claim. *Motorola Inc. v. Amkor Tech, Inc*. 958 A.2d 852, 859 (Del. 2008).

Even if not estopped, FLCP does not demonstrate clear error in the Vice Chancellor's factual finding that FLCP's obligations under the Clawback Agreement and Term Sheet, and thus its involvement in the counterclaims, did not arise from its status as a member of HLA. FLCP owed money to Lyrical under the Clawback Agreement because it had lost over $13 million in Lyrical's capital (Opinion at 41) via the doomed investments in Performance, Tiber, and Portadam. It incurred those losses (and thus created its obligations under the Clawback Agreement) in its capacity as manager of the separate entities (not HLA) that were the vehicles for those separate investments, not in its capacity as a member (or former manager) of HLA. Thus, it incurred those losses and payment obligations

in its capacity as a party to the Clawback Agreement that involved the overall business relationship between Lyrical and FLCP and thus operated at a higher level of generality than any individual investment. Indeed, the last time FLCP reaffirmed and clarified the Clawback Agreement in 2008 was not in its capacity as manager or member of HLA, but in the context of inducing Lyrical to invest capital in Rethink.

In the alternative, the Vice Chancellor obviously was correct in his factual finding (Opinion at 36) that FLCP's principals had engaged in "willful misconduct" barring any further indemnification. They spent the entire litigation refusing in bad faith to acknowledge the existence and validity of the Cross-Investment Agreements they had repeatedly reaffirmed as recently as a few months before litigation commenced, as set forth in the Opinion and summarized supra at 12-13, all of which made resolution of the dispute unnecessarily burdensome for the court as well as for Lyrical and HLA.

CONCLUSION

For the foregoing reasons, the decisions and judgment of the Vice Chancellor should be affirmed in their entirety.

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