IN THE SUPREME COURT OF THE STATE OF DELAWARE

SCION BRECKENRIDGE MANAGING MEMBER, LLC, SCION 2040 MANAGING MEMBER, LLC and SCION DWIGHT MANAGING MEMBER, LLC,	
Defendants Below/Appellants,	No. 437,2012
v.	
ASB ALLEGIANCE REAL ESTATE FUND, EBREF HOLDING COMPANY, LLC and DWIGHT LOFTS HOLDINGS, LLC,	Case Below: On Appeal from Court of Chancery of the State of Delaware, C.A. No. 5843-VCL
Plaintiffs Below/Appellees.	

APPELLANTS' CORRECTED OPENING BRIEF

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TABLE OF CONTENTS

TABLE OF CITATIONS

Page(s)

CASES

OTHER AUTHORITIES

NATURE OF PROCEEDINGS

This is an appeal from the Court of Chancery's post-trial grant of Appellees' claim for reformation of three disputed limited liability company agreements. Appellees, institutional investment funds (the "Funds") managed by professionals at ASB Capital Management ("ASB"), sought equitable reformation of the liquidation provisions of three joint venture agreements with Appellants, affiliates of student-housing operator The Scion Group LLC (collectively, the "Scion Members"). DLA Piper US LLP ("DLA"), part of the world's largest law firm, represented the Funds and ASB in drafting and negotiating the limited liability company agreements governing the ventures. The Court of Chancery granted the exceptional remedy of reformation to the sophisticated Funds despite the fact that ASB's executives did not read the agreements (and were otherwise negligent) before signing them, expressly ratified the provisions at least once and had inexperienced counsel at DLA handling the drafting.

Recognizing but then ignoring ASB's and DLA's negligence, the Chancery Court granted equitable reformation to the Funds based on its finding of a unilateral mistake with "knowing silence" on the part of the Scion Members. Then, disregarding that the Funds had incurred no expense in the litigation because DLA represented them without charge, the Chancery Court awarded the Funds over $3.2 million in attorneys' fees under language in the agreements providing for the non-prevailing party to "reimburse the prevailing party for all reasonable costs and expenses incurred."

The Chancery Court issued its post-trial Memorandum Opinion ("Mem. Op.") on May 16, 2012 and issued an Opinion ("Op.") on the amount of the fee award on July 9, 2012. On August 6, 2012, the Scion Members timely filed a Notice of Appeal to this Court challenging those opinions. This is the Scion Members' Opening Brief.

SUMMARY OF ARGUMENT

1. The Chancery Court erred when it failed to recognize that negligence, particularly the failure to read a contract, operates as a complete bar to a claim for equitable reformation. In this case, the Funds entered into three real estate joint venture agreements without reading them, without taking basic steps to ensure the agreements contained their desired terms and without having competent counsel to handle the drafting. Where, as here, a party acts negligently in entering into an agreement, the negligence should bar any claim for equitable relief; equity must not countenance negligence. This is particularly true when the alleged mistake is unilateral and, therefore, entirely preventable with the exercise of even minimal care.

2. The Chancery Court erred in awarding equitable reformation based on its findings of unilateral mistake by the Fund's agent ASB and knowing silence on the part of the Scion Members. Delaware law recognizes reformation for unilateral mistake only in "exceptional cases," which would require a finding of concealment, trickery or another heightened duty to speak by the silent party. No such allegation or finding was made here.

3. The Chancery Court erred in not holding one of the Appellees, Dwight Lofts Holdings, LLC ("DLH") to the clear and unambiguous terms of its ratification of one of the disputed LLC agreements. Because DLH had no impediment to discovering the purported mistake before expressly ratifying the disputed agreement, it should be held to its terms. A party expressly ratifying a contract should be held to have constructive knowledge of its terms.

4. The Chancery Court erred in awarding fees to the Funds, despite the fact that they had not incurred any fees and had not sought to enforce the LLC agreements in accordance with their written terms. Having put their lawyers at DLA on notice of a claim for malpractice due to the purported mistake in the LLC agreements, neither the Funds nor ASB paid, and neither had an obligation to pay, fees or expenses associated with this litigation. Having not incurred any cost, the Funds had no right to reimbursement under the express language of the agreements.

STATEMENT OF FACTS

A. The Parties

The Scion Members are subsidiaries of The Scion Group LLC ("Scion"). Founded by brothers Robert and Eric Bronstein in 1999, Scion focuses exclusively on college student housing, including ownership, management and consulting. (Mem. Op. p. 3). The Scion Members involved in this case were minority managing members of the limited liability companies at issue. (Mem. Op. p. 5).

ASB and its president, Robert Bellinger,[1] are professional money managers and fiduciaries to the investors in the Funds. (Mem. Op. pp. 3-4). In 2007 and 2008, on behalf of the Funds, ASB invested approximately $140 million in the three student-housing joint ventures at issue here. (A67-68). DLA represented ASB and the Funds in negotiating and drafting the agreements governing each venture. (Mem. Op. pp. 4-5).

B. General Venture Background, Negotiation History, And Origin Of The Purported Mistake

Affiliates of Scion and ASB formed five joint ventures over a period of fourteen months, all involving investment in real estate primarily used as student housing. The first two ventures, which are not the subject of dispute, had agreements providing for one level of "promote" compensation to the Scion Member. (Mem. Op. pp. 6-8). In the simplest terms, the ventures paid disproportionate compensation to the Scion Member in a sale or refinancing once the ASB-advised fund received both

[1] ASB is "[o]ne of the leading real estate investment management firms in the United States [with] $3.2 billion in 76 institutional-quality core property assets located in 26 markets." http://www.asbcm.com/ (visited Sept. 18, 2012). Mr. Bellinger is "[r]esponsible for all functions of ASB's Real Estate Division. Robert has over 20 years of real estate investment experience, and has completed over $8 billion in real estate capital transactions during his career . . . . Robert received a BA with honors from Haverford College and an MBA from the Wharton School." http://www.asbrealestate.com/web/page/596/sectionid/561/pagelevel/2/interior.aspx (visited Jan. 16, 2012).

a specified return on its capital (a "preferred return") and a return of its invested capital. (Mem. Op. p. 7). After the second venture, Scion and ASB agreed that any future ventures would limit the Scion Member's up-front compensation and, in return, include two levels of promote compensation upon a sale or refinancing. (*See* A199-200 at pp. 318-19; *see also* Mem. Op. pp. 8-10).

Three joint ventures followed using the new compensation scheme: Breckenridge Apartments, 2040 Lofts and Dwight Lofts. These are the subject of this suit and appeal. At issue is the language of the "Sale Proceeds Waterfall" provision (Section 4.2) in each of the three LLC agreements. (Mem. Op. p. 13). The two-tiered promote structure in these agreements was created first during the negotiation of the Breckenridge venture. (Mem. Op. pp. 10-13). It provides that in sale, refinancing or member buyout, proceeds are distributed sequentially until exhausted, as follows:

(ii) *Second*, in proportion to the parties' investments until the "first preferred return" is satisfied;

(iii) *Third*, to both parties but split according to the "first promote" (*i.e.*, an extra 20% share to the promoter) until the Fund's second preferred-return threshold is achieved;

(iv) *Fourth*, the proportional return of invested capital; and

(v) *Fifth*, split according to the "second promote" (*i.e.*, an extra 35% share to the promoter). (Mem. Op. p. 13).

As written, the agreements pay the first promote (iii) before returning invested capital (iv). The Funds claim the order of these two tiers was mistakenly reversed and must be reformed.

The parties created this structure through their typical process. Keyvan Arjomand (an ASB employee and its lead, non-lawyer negotiator with Scion), Cara Nelson (a junior DLA attorney and ASB's primary attorney negotiating with Scion) and Barbara Trachtenberg (a senior DLA lawyer and the lead attorney or "partner-in-charge" on the ASB/Scion ventures), and Robert and Eric Bronstein of Scion exchanged e-mails with drafts, black-lines and comments. (*See, e.g.*, A565; *see also* Mem. Op. pp. 10-13). Ms. Nelson of DLA circulated the first draft of the Breckenridge agreement with a single-tier promote reminiscent of the earlier joint ventures. (*See* A565, A586). In response, Eric Bronstein requested that a missing "promote percentage" be inserted in the waterfall "<u>after the first-tier preferred return has been achieved but before the second-tier has been reached</u>." (A629 (emphasis added); *see also* Mem. Op. p. 10). Ms. Nelson then circulated a new black-line draft to the group, "reflecting [Scion's] comments" and placing the first promote ahead of the return of invested capital. (A632).

Four days later, Eric Bronstein directed the group's attention back to the first-promote language of Section 4.2(iii) (containing the purported mistake) and asked to refine it further. (*See* A255 at pp. 540-41; *see also* A837 and Mem. Op. p. 12). DLA on behalf of ASB agreed to Mr. Bronstein's additional changes. (*See* A776; Mem. Op. p. 13).

The parties then used the Breckenridge agreement as the template for their next two ventures—2040 Lofts and Dwight Lofts—each with the same two-tiered promote structure. (*See* A1257 at ¶53; Mem. Op. pp. 14-15). Although slight wording changes were made through the same e-mail exchange process (*see, e.g.*, A565), the result was that all three agreements contained the same substantive waterfall provisions. (*See, e.g.*, A916, A1055).

Because DLH is comprised of "separate account" clients of ASB and is independent of the ASB Allegiance Real Estate Fund which invested in the other ventures (*see* A66 at ¶4 and A68-69 at ¶17), the Dwight Lofts agreement was also reviewed by another law firm representing the DLH investors. (*See* A1160 at ¶14). On January 30, 2008, in response to an e-mail from Eric Bronstein seeking confirmation that the language of the agreement did not create a fiduciary conflict for Scion (*see* A1103), Mr. Arjomand wrote by e-mail: "We are confirming that ASB accepts the language of the LLC Agreement for Dwight as shown in Cara's [Nelson] most recent draft . . . ." (*See* A1106).

C. DLH Expressly Ratified The Dwight Agreement In An Amendment

Following execution of the Dwight Lofts agreement, the parties negotiated additional provisions regarding the venture, memorialized in a First Amendment to the Dwight Lofts agreement on March 3, 2008. (A1139-43 (the "First Amendment") and Mem. Op. p. 16). The First Amendment referred to, but did not change, the language of the Sale Proceeds Waterfall. (*See* A258-59 at pp. 554-56; A1107-38; Mem. Op. p. 16). It also included the following language: "Except as set forth herein, the terms and provisions of the [Dwight Lofts] Operating Agreement are hereby ratified and confirmed and shall remain in full force and effect." (A1142 at ¶4 (emphasis added); Mem. Op. p. 16).

D. ASB's Discovery Of The Purported Mistake, And The Resulting Dispute

After ASB forced the Scion Members out of managing the ventures in early 2010, the Scion Members exercised their buyout rights. (A170 at p. 289; A200 at p. 322). Once Scion 2040 Managing Member LLC ("Scion 2040") calculated its buyout price for 2040 Lofts in August 2010, ASB read the 2040 Lofts agreement for the first time, questioned how the agreement came to read as it did, and then went silent. (Mem. Op. pp. 19-20). However, everyone associated with ASB testified that the purported mistake was "obvious." (A108 at pp. 42-43; *see also* A134 at p. 147).

After first claiming that the one-level promote structure of the earlier ASB/Scion ventures represented a mis-transcribed prior agreement of the parties (*see* A1145-46), when the Funds sought to have the Chancery Court reform the unambiguous language of the disputed agreements, they alleged that a May 9, 2007 e-mail among Mr. Arjomand and Robert and Eric Bronstein contained a specific prior agreement between the parties. The entire reference in that e-mail to a two-tiered economic structure for then-unidentified future ventures is: "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%." (Mem. Op. p. 9). Because this language specified nothing about return of capital, the Funds argued that the word "promote" carries an implicit "industry standard" meaning that return of capital must always come before any promote.[2] Both Mr. Arjomand and Mr. Bellinger testified that the May 2007 e-mail was not an agreement between ASB and Scion (or their affiliates) regarding the order of return of capital *vis-à-vis* the payment of promote. (*See* A1377 at pp. 107-09; A116). The Chancery Court nonetheless found the parties were invoking "industry terms of art" that provided "the necessary foundation for reformation." (Mem. Op. p. 25).

In some liquidation scenarios, the challenged ordering of the "waterfall" would have no economic effect at all. (A418 at p. 983). At the time this dispute arose, based on appraised market values of the three ventures, the approximate principal amounts in dispute, were: Breckenridge Apartments, $500,000; 2040 Lofts, $1.5 million; and Dwight Lofts, $2.1 million. (A78 at ¶ 77; A79 at ¶ 83; A80 at ¶¶ 85-86).[3]

E. ASB's And DLA's Negligence In Negotiating And Executing the Agreements

Robert Bellinger signed at least one version of all three agreements that the Funds sought to reform. He admitted in three affidavits, however, that he: (1) did not read the "waterfall" sections (at a minimum) of the agreements prior to their execution; and (2) if he had read them, he would have "immediately seen" what he now says is a mistake and would not have agreed to proceed on those terms. (A1330-34; A1335-39; A1340-44

[2] But only in a sale or refinancing event. The Funds admit that all five ASB/Scion ventures were designed to pay promote compensation from cash flows irrespective of return of capital.

[3] Scion Dwight Managing Member LLC ("Scion Dwight") brought counterclaims against DLH for breach of fiduciary duty and breach of the implied covenant of good faith and fair dealing, alleging that DLH had suppressed the appraised value of the Dwight Lofts venture in connection with the buyout of Scion Dwight. At a higher market value for the Dwight Lofts venture, the challenged waterfall order would have lesser monetary significance or none at all. The Chancery Court denied those counterclaims, which are not the subject of this appeal. (Mem. Op. pp. 38-39).

at ¶ 14). Ms. Trachtenberg also signed multiple affidavits containing nearly identical admissions. (*See* A1345-47; A1348-50 at ¶ 10).

As the Chancery Court observed, ASB and DLA were far from vigilant in their negotiation and execution of the agreements:

> 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 Breckenridge 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. (Mem. Op. p. 15).

Later in its opinion, the Chancery Court specifically found that Mr. Bellinger read only the original University Crossing[4] agreement and did not read any of the subsequent agreements despite ASB negotiating new economic terms for the later deals:

> 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 he needed to read. (Mem. Op. p. 29).

The Chancery Court's fact-findings and the record that supports them make ASB's carelessness patent. Indeed, the record contains nothing showing that Mr. Bellinger even received—let alone reviewed—<u>any</u> versions of the agreements he signed. (*Id.*). Nor did Mr. Bellinger believe ASB had a duty to read these documents before signing them. (A1468 at pp. 238-40). The same is true of John Skram, the ASB executive who signed the original Breckenridge agreement and the First

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[4] "University Crossing" was the first Scion/ASB venture, not at issue here, which contained a one-level promote structure.

Amendment to the Dwight Lofts agreement. (A1487 at p. 47; A1488-89 at pp. 51-53).

ASB's negligence was not limited to its failure to read the contracts; the record actually reveals a complete breakdown of policies and procedures on the part of ASB and DLA, the adherence to any one of which could have prevented the claimed mistake. First, ASB did not create letters of intent or term sheets for any of the disputed ventures, although doing so is standard industry practice. (*See* A335 at p. 748).

Second, according to Mr. Bellinger, ASB has "to be clear with DLA what the business terms are, and they take it from there." (A108 at p. 44). To do that, ASB's policies require it to provide DLA with a copy of its internal Real Estate Investment Advisory Committee ("REIAC") memoranda, detailing ASB's understanding of the waterfall distribution economics. (*See* A124 at p. 108). The REIAC memos for the disputed ventures were not shared with DLA or Scion. (A140 at p. 169; A220 at p. 399).

Third, DLA inexplicably designated Ms. Nelson, a junior attorney who lacked even a basic understanding of the economics of joint-venture transactions, to handle the negotiation and finalization of the agreements:

> Q. And you've testified that in 2006 and 2007, you had very little experience in real estate joint ventures; right?
> A. That's correct.
> Q. In fact, so little experience that you had little if any understanding of the economics of real estate joint ventures?
> A. At that point, that's correct.
> Q. In fact, you lacked an understanding of many of the economic terms of the ASB/Scion transactions in particular, didn't you?
> A. I did.
> Q. For example, at the time you didn't have a specific understanding of what a promote was or how promotes are structured or earned, did you?

A. I did not have a specific understanding. (A148 at pp. 203-4; Mem. Op. p. 12).

Despite this lack of experience, Ms. Nelson was the front-person from DLA for negotiations regarding all aspects of the agreements in question. (A128 at p. 124; A139 at pp. 166-67). Ms. Trachtenberg, the partner at DLA in charge of supervising Ms. Nelson (A139 at p. 166), testified she either did not review the Breckenridge agreement in which the disputed language arose or did not focus on it. (A134 at p. 148; *see also* Mem. Op. pp. 11-12). Yet Ms. Trachtenberg observed that Ms. Nelson's first draft for the Breckenridge agreement (an $18 million investment) "is a pretty embarrassing draft." (A132 at p. 140). When the parties were negotiating the next agreement, the $48 million 2040 Lofts venture, Ms. Trachtenberg was out of the office on vacation and did not review any drafts or any of Ms. Nelson's work. (A135 at p. 150). Thus Ms. Trachtenberg left an attorney she knew was inexperienced to negotiate critical legal documents for a major transaction without supervision. (A139 at pp. 166-67). Ms. Trachtenberg apparently took the same approach with the $75 million Dwight Lofts agreement, either not reviewing it when it was being negotiated or not focusing on it when she had the opportunity to review it.

Fourth, Ms. Nelson testified that when it came time to execute the agreements, <u>it was her practice to send ASB only signature pages</u>. (A152 at p. 218). In other words, Mr. Bellinger and others at ASB signed execution pages for the agreements (and their amendments) without ever seeing those documents. The Chancery Court's conclusion that ASB did not read the agreements is thus inescapable.

F. The Chancery Court's Award Of Expenses To The Funds

Each of the agreements has a narrowly-drawn clause providing for the payment of litigation expenses only under certain circumstances:

> In the event that any of the parties to this Agreement undertakes <u>any action to enforce the provisions of this Agreement</u> against any other party, the non-prevailing party shall reimburse the prevailing party for all reasonable costs

> and expenses <u>incurred in connection with such enforcement</u>, including reasonable attorneys' fees[.] (*See, e.g.*, A1037-1102, Section 9.9) (emphasis added)).

The record is clear that ASB did not incur any costs or expenses in this case. Mr. Bellinger testified that ASB was not paying the cost of the lawsuit and that "DLA is paying for their legal fees." (A109; *see also* A1472 at pp. 253-55).

Although the Funds admit they have not paid and are not responsible for paying any expenses to DLA in connection with the litigation, the Chancery Court awarded them over $3.2 million for costs and fees. In doing so, the Chancery Court, without citation to any authority, concluded that despite the language of the agreements, it was irrelevant whether the Funds themselves "incurred" any costs. (Mem. Op. p. 40). Instead, the Chancery Court reasoned that DLA, a law firm that was party neither to the joint venture agreements nor to this suit, was on ASB's "side," and ordered the Scion Members to pay DLA's hourly rack rates less the 10% discount typically given to ASB in other matters. (Op. p. 19).

ARGUMENT

I. ASB'S AND DLA'S NEGLIGENCE BARS THE FUNDS' CLAIM FOR EQUITABLE REFORMATION AS A MATTER OF LAW.

A. Question Presented

Does the negligence of the Funds' agents ASB and DLA—including the failure to read—bar the Funds' claim for equitable reformation? (This issue was preserved in the Scion Members' post-trial briefs as well as in their motion for summary judgment) (A1521-26; A1580-82).

B. Standard and Scope of Review

The scope of this Court's review extends to a review of the trial court's conclusions of law and findings of fact. *Solis v. Tea*, 468 A.2d 1276, 1279 (Del. 1983). This Court will review questions of law *de novo*. *Town of Cheswold v. Vann*, 9 A.3d 467, 471 (Del. 2010).

C. Merits of Argument

The Chancery Court committed reversible error by finding that both ASB and DLA acted negligently but then holding that their negligence did not bar the Funds' claim for reformation. When this Court last addressed equitable reformation, it took "no position on whether, under certain circumstances, a party's misconduct could bar a reformation claim." *Cerberus Int'l, Ltd. v. Apollo Mgmt., L.P.*, 794 A.2d 1141, 1145-46, 1154 n.47 (Del. 2002). This case presents the circumstances for this Court to clarify that failure to read an agreement before signing it, all the more so when combined with other negligence, bars a claim for equitable reformation.

Unlike many of the cases relied upon by the Chancery Court, this is not a case where a party seeking reformation did not read the provisions of an agreement "carefully enough." *Cerberus*, 794 A.2d at 1154. Instead, the Chancery Court's factual findings demonstrate a level of negligence far greater than a person who fails to do something "carefully enough." Here, the president of a highly sophisticated registered investment advisor (Mem. Op. pp. 3-4) failed outright to review agreements before he signed them; indeed, he did not even receive copies, having received only signature pages for execution, for which the document identification stamps reflected non-final versions or no version. (Mem. Op. p. 29; A122-23).[5] ASB also failed on behalf of the Funds to follow its own policies to ensure the Funds' counsel at DLA understood the "core business terms." (A108 at p. 44; A124 at p. 108). The Funds' abdication of these basic responsibilities was compounded by similar negligence on the part of its legal team at DLA, which relied primarily on a junior associate with little to no experience in the economics of real estate joint venture agreements. (A128 at p. 124; A144 at p. 186). It has never been the purpose of equitable reformation to relieve a party from the consequences of the type of negligence present in this case. Likewise, it has never been the purpose of equitable reformation to correct errors caused by the carelessness and inattention of a party's counsel.[6]

Although the Chancery Court first observed 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," (Mem. Op. p. 30), it nonetheless concluded for purposes of its decision that "Bellinger did not read the agreements before approving them." (*Id.*).[7]

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[5] "A signer's duty to read and understand that which it signed is not 'diminished merely because [the signer] was provided with only a signature page.'" *Vulcan Power Co. v. Munson*, 89 A.D.3d 494, 495 (N.Y. App. Div. 2011).

[6] *See Zaccaria v. Papcsy*, 1998 WL 469505, at *4 (Conn. Super. Ct. Aug. 4, 1998).

[7] "I believe that Bellinger read the University Crossing agreement . . . . 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 he needed to read." (Mem. Op. p. 29). After the University Crossing agreement there is no evidence (and there was no finding by the Chancery Court) that Bellinger was provided with any portions of any agreement, other than signature pages, to read or review.

Brushing aside these facts, the Chancery Court relied on the truism that any claim for mistake "involves a party who has not read, or thought about, the provisions in a contract *carefully enough*." (Mem. Op. pp. 30-31 (emphasis added)) (citing *Cerberus*, 794 A.2d at 1154). On that basis the Chancery Court assumed that this Court would follow a Restatement approach that "[r]eformation is not precluded by the mere fact that the party who seeks it failed to exercise reasonable care in reading the writing." (Mem. Op. p. 30) (citing Restatement (Second) of Contracts § 155 cmt. a). But the Chancery Court found that Bellinger did not read the agreements at all, not that he failed to read them "carefully enough"; therefore, it was legal error to apply such a standard in this case. Stated another way, even if the Chancery Court were correct that this Court would follow the Restatement approach, the Funds' claim for reformation should still be barred due to pervasive negligence in entering into them, including the failure to read the agreements (or at least their core operative provisions).

The Chancery Court's error was compounded when it found that failure to read (and other forms of negligence) would indeed operate as a bar to equitable relief, but only in cases of avoidance. (*See* Mem. Op. p. 31). Citing to the Restatement (Second) of Contracts §157, the court drew a distinction between avoidance cases and reformation cases. (*See* Mem. Op. pp. 31-32). There is little merit to this distinction under Delaware law, the Restatement[8] or the law of sister states. Accordingly, there was no basis for the Chancery Court to find that the negligence would have

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[8] Section 157 contains two express exceptions to its stated rule that failure to read will not bar a reformation claim: (1) where there is extreme misconduct; and (2) where the failure to read amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing. *See Turner v. Terry*, 799 So.2d 25, 36 (Miss. 2001) (citing the standard from § 157 and barring reformation, in part, because party in arms-length transaction violated duty to read what it signed); *cf. McClain v. McDonald's Rests. of Del., Inc.*, 2011 WL 2803108, at *6 n.27 (Del. Super. Ct. July 5, 2011) (citing illustration 2 to § 157 to support its decision to deny the plaintiff the right to amend to correct a mistake in its complaint because, among other things, a simple check would have revealed his mistake).

operated as a bar only if the Funds sought to avoid, rather than modify, the agreements.

In *Pellaton v. Bank of New York*, 592 A.2d 473, 477 (Del. 1991), this Court held that failure to read a contract is a bar to equitable relief, although the plaintiff sought avoidance rather than reformation. The plaintiff had failed to read loan documents and related personal guaranties prior to signing them, which unbeknownst to him contained warrants to confess judgment in the event of default and waiver of service of process. *Id.* at 475. The Court explained that the failure to read has legal consequences:

> It will not do for a man to enter into a contract, and, when called upon to respond to its obligations, to say that he did not read it when he signed it, or did not know what it contained. If this were permitted, contracts would not be worth the paper on which they are written. But such is not the law. A [party] must stand by the words of his contract; and, if he will not read what he signs, he alone is responsible for his omission.

Id. at 477 (quoting *Upton, Assignee v. Tribilcock*, 91 U.S. 45, 50 (1875)); *see also Patel v. Dimple, Inc.*, 2007 WL 2353155, at *11 n.22 (Del. Ch. Aug. 16, 2007) (quoting *Pellaton*).

Applying this rule to all forms of equitable relief, in *Graham v. State Farm Mutual Automobile Insurance Co.*, 1989 WL 12233 (Del. Super. Ct. Jan. 26, 1989); *aff'd on appeal*, 565 A.2d 908 (Del. 1989), the Delaware Superior Court held unequivocally that "'failure to read a contract in the absence of fraud is an unavailing excuse or defense and cannot justify an avoidance, <u>modification</u> or nullification <u>of the contract or any provision thereof</u>.'" 1989 WL 12233, at *2 (emphasis added) (quoting *Standard Venetian Blind Co. v. Am. Empire Ins.*, 469 A.2d 563, 566 (Pa. 1984)). Converted to their equitable names, "avoidance, modification or nullification" become "estoppel, reformation or rescission."[9]

In a recent case on remand from this Court directing it to consider equitable reformation, the Chancery Court in *W. Willow-Bay Court, LLC v. Robino-Bay Court Plaza, LLC*, 2009 WL 3247992 (Del. Ch. Oct. 6, 2009), explained: "'[t]he failure to read a contract provides no defense against enforcement of its provisions where the mistake sought to be avoided is unilateral and could have been deterred by the simple, prudent act of reading the contract.'" *Id.* at *4 n.19 (quoting 27 Williston on Contracts § 70.113 (4th ed. 2009), *aff'd*, 985 A.2d 391 (Del. 2009) (TABLE).[10] That is precisely the situation here. The supposed error was so obvious to ASB that it recognized it immediately upon receiving Scion 2040's request for payment and reading the contract provision for the first time. (Mem. Op. pp. 19-20). This case falls well outside the jurisprudence that may excuse a party for not reading "carefully enough" and calls for this Court to clarify that failure to read an agreement and other forms of negligence will bar a claim for reformation of that agreement.[11]

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[9] *See also* Black's Law Dictionary 1394 (9th ed. 2009) (defining reformation, in relevant part, as "[a]n equitable remedy by which a court will modify a written agreement"); *Solar Turbines, Inc. v. United States*, 26 Cl. Ct. 1249, 1270 (1992) ("Reformation of the contract . . . asks the court to modify the express contract terms").

[10] Chancery Court precedents hold that the failure to read a contract is gross negligence that bars relief in equity. *See, e.g.*, *Sharpless-Hendler Ice Cream Co. v. Davis*, 155 A. 247, 248 (Del. Ch. 1931) ("'If one can read his contract, his failure to do so is such gross negligence that it will estop him from denying it [or] . . . avoiding it on the ground that he was ignorant of its contents.'").

[11] *See also Bryant v. Way*, 2012 WL 1415529, at *13 (Del. Super. Ct. Apr. 17, 2012) (seeking rescission for unilateral mistake) ("The alleged error fundamentally alters . . . and directly impacts an adamantly negotiated provision . . . Plaintiff must be held to some diligence standard to ensure the agreement reflected his intended bargain.").

The Chancery Court also improperly buttressed its legal determination by incorrectly finding its holding was consistent with the "majority rule." In holding that negligence and/or failure to read were not a bar to the Funds' equitable reformation claims, the Chancery Court posited that the majority rule in other jurisdictions is that "'[r]eformation is not precluded by the mere fact that the party who seeks it failed to exercise reasonable care in reading the writing . . . .'" (Mem. Op. p. 30 at n.3 (and cases cited therein)). But the opposite is true; the majority of jurisdictions hold that the negligence of the plaintiff, in one form or another, is (or can be) a bar to equitable reformation. *See, e.g.*, *Thomas v. Trans World Airlines, Inc.*, 457 F.2d 1053, 1056 (3d Cir. 1973) ("Mere failure to read an instrument, thus giving rise to plaintiff's unilateral mistake, is insufficient to obtain relief."); *Holly Stores, Inc. v. Judie*, 179 F.2d 730, 735 (7th Cir. 1950) (finding plaintiff "had no standing in a court of equity to obtain reformation" where "any mistake on its part was the result of its own inexcusable negligence"); *General Refractories Co. v. First State Ins. Co.*, 2012 WL 262646, at *6 (E.D. Pa. Jan. 30, 2012) ("'It falls stale upon the ear to be told that a formal contract was not read . . . or was signed in haste. Such things are no ground for reforming [a contract.]'"); *RS & P/WC Fields L.P. v. Bosp Invs.*, 829 F. Supp. 928, 969 (N.D. Ill. 1993) ("[F]ailure to read the terms of a negotiated contract does not rise to the level of mutual mistake necessary for contract reformation."); *Poly Trucking, Inc. v. Concentra Health Servs., Inc.*, 93 P.3d 561, 563 (Colo. App. 2004) (denying reformation "where a party's unilateral mistake is the result not of fraud, but of its own failure to use due diligence in reading the contract before signing it"); *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."); *Hall Ponderosa, LLC v. Petrohawk Props., L.P.*, 90 So.3d 512, 521 (La. Ct. App. 2012) ("[N]egligence in failing to read the lease . . . preclude[s] [plaintiff] from seeking reformation of the lease due to error."); *Nichols v. Shelard Nat'l Bank*, 294 N.W.2d 730, 734 (Minn. 1980) ("[H]ad plaintiffs read the documents before they signed them, their mistake as to the contents would have been discovered before they suffered any harm. Were this court to allow reformation, it . . . would reward plaintiffs for their negligence."); *Pierides v. GEICO Ins. Co.*, 2010 WL 1526377, at *9 (N.J. Super. Ct. App. Div. Apr. 19, 2010) ("[R]eformation will not be granted based upon a mistake resulting from 'the complaining party's own negligence . . . ."); *Meadlock v. Am. Family Life Assur. Co. of Columbus*, 2012 WL 2891079, at *5 (N.C. Ct. App. July 17, 2012) ("[W]here no trick or device had prevented a person from reading the paper which he has signed . . . , his failure to read when he had the opportunity to do so will bar his right to reformation.");[12] *LPN Trust v. Farrar Outdoor Adver., Inc.*, 552 N.W.2d 796, 799-800 (S.D. 1996) (denying reformation based on failure to read because "equity will not relieve a person from his erroneous acts or omissions resulting from his own negligence"); *Grieve v. Grieve*, 89 P. 569, 571 (Wyo. 1907) ("The mistake, if any, was one which the most ordinary care would have guarded against. Under such circumstances a court of equity will not [grant reformation.]").

While courts, including those from the states cited above, have struggled with balancing the desire to relieve parties of consequences stemming from "mistakes" on the one hand and the desire to discourage negligence and the opportunity for perjury on the other, the better and more reasoned rule—and the one supported by the weight of authority—is that negligence will bar a claim in equity to void, modify or rescind an agreement. This just rule serves the dual purpose of discouraging fraud and encouraging parties to exercise reasonable diligence by simply reading their contracts. Such an approach is also supported by the fundamental principle of courts in equity to administer relief only to the vigilant.

The Chancery Court ignored Delaware precedent and misapplied the law to its factual findings in ruling the Funds' claim was not barred by its own negligence. Accordingly, this Court should reverse and find that the Funds' negligence operates as a complete bar to their claim for reformation.

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[12] *See also Isley v. Brown*, 117 S.E.2d 821, 823-24 (N.C. 1961); *Newbern v. Newbern*, 100 S.E. 77, 78 (N.C. 1919).

II. SILENCE ALONE DOES NOT JUSTIFY REFORMATION

A. Question Presented

Assuming the Scion Members knew about a mistake, does the law impose a duty to disclose it, absent exceptional circumstances? (This issue was preserved in the Scion Members' post-trial brief) (A1561-62; A1577-80).

B. Standard and Scope of Review

The scope of this Court's review extends to a review of the trial court's conclusions of law and findings of fact. *Solis v. Tea*, 468 A.2d 1276, 1279 (Del. 1983). This Court will review questions of law *de novo*. *Town of Cheswold v. Vann*, 9 A.3d 467, 471 (Del. 2010).

C. Merits of Argument

The Chancery Court granted equitable reformation based on its finding of unilateral mistake by the Funds with knowing silence on the part of the Scion Members. (Mem. Op. pp. 27-28). But simply proving a unilateral mistake by one party with knowing silence by another is insufficient to support the extraordinary remedy of equitable reformation.

Delaware courts have long placed strict limits on the availability of reformation in cases of unilateral mistake. In *In re Appraisal of ENSTAR Corp.*, 604 A.2d 404, 413 (Del. 1992), this Court stated unequivocally that, "[a] unilateral mistake <u>cannot</u> be a basis for reforming a contract. The equitable remedy of reformation is only available to correct a mutual mistake in order to conform an agreement to the original intent of the parties." (emphasis added) (internal citations omitted). Although later decisions have taken a more nuanced approach, Delaware courts have held repeatedly that reformation based on unilateral mistake with knowing silence is available only in <u>exceptional</u> cases. *Travelers Cas. & Sur. Co. v. Sequa Corp.*, 2012 WL 1931322, at *5, n.24 (Del. Ch. May 29, 2012) ("'Reformation is appropriate only when the contract does not represent the parties' intent because of fraud, mutual mistake or, in <u>exceptional</u> cases, a unilateral mistake coupled with the other parties' knowing silence'.") (emphasis added).[13] Indeed, reformation in such circumstances is apparently so exceptional that there are no reported Delaware cases (other than the Chancery Court's decision here) granting equitable reformation based on a unilateral mistake.

Because Delaware courts have apparently never granted equitable reformation based on a unilateral mistake, no Delaware court has articulated what type of conduct would meet the exceptional case standard. This much, however, is clear: exceptional circumstances require more than "knowing silence" standing alone. Under Delaware law, even where a party knows it alone possesses facts material to a transaction, absent a fiduciary relationship between parties, no duty to speak exists. *See Airborne Health, Inc. v. Squid Soap, LP*, 2010 WL 2836391, at *9 (Del. Ch. July 20, 2010).[14] Stated another way, sophisticated parties engaged in arms-length contract negotiations have no fiduciary relationship and thus no disclosure obligation to one another. *See id.*; *see also Maclary v. Reznor*, 1870 WL 1646, at *11-12 (Del. Ch. Sept. Term

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[13] The "exceptional cases" standard first appeared in *AOC Ltd. Partnership v. Horsham Corp.*, 1992 WL 136474, at *7 (Del. Ch. June 17, 1992) (citing to *Collins v. Burke*, 418 A.2d 999, 1002 (Del. 1980)). Along with the *Travelers* court above, the following courts have since followed suit: *Chase Manhattan Bank v. Iridium Africa Corp.*, 307 F. Supp. 2d 608, 614 (D. Del. 2004); *Brinckerhoff v. Enbridge Energy Co.*, 2012 WL 1931242, at *3 (Del. Ch. May 25, 2012); *Great-West Investors LP v. Thomas H. Lee Partners, L.P.*, 2011 WL 284992, at *11 (Del. Ch. Jan. 14, 2011); *In re Loral Space & Communications Inc.*, 2008 WL 4293781, at *33, n.161 (Del. Ch. Sept. 19, 2008); *MetCap Securities LLC v. Pearl Senior Care, Inc.*, 2007 WL 1498989, at *8, n.65 (Del. Ch. May 16, 2007); *Interactive Corp. v. Vivendi Universal, S.A.*, 2004 WL 1572932, at *15, n.73 (Del. Ch. July 6, 2004); *R.E.D. v. D.K.D.*, 2000 WL 33201266, at *2 (Del. Fam. Ct. Nov. 8, 2000); *Emmert v. Prade*, 711 A.2d 1217, 1219 (Del. Ch. Nov. 5, 1997); *James River-Pennington Inc. v. CRSS Capital, Inc.*, 1995 WL 106554, at *7 (Del. Ch. Mar. 6, 1995).

[14] *See also WP Devon Assocs., L.P. v. Hartstrings, LLC*, 2012 WL 3060513, at *4 (Del. Super. Ct. July 26, 2012) ("[A]bsent a fiduciary relationship, there is no duty to speak[.]"), *appeal refused*, --- A.3d ---, 2012 WL 4005671 (Del. Sept. 12, 2012) (TABLE).

1870). Moreover, a "moral" duty of disclosure has never been sufficient to support equitable reformation based on unilateral mistake. As Justice Story observed:

> [I]t is essential, . . . not only that an advantage should be taken; but it must arise from some obligation in the party, to make the discovery; not an obligation in point of morals, but of legal duty. In such a case the Court will not correct the contract, merely because a man of nice morals and honor would not have entered into it. It must fall within some definition of fraud or surprise. For the rules of law must be so drawn, as not to affect the general transactions of mankind[.] . . . Equity, as a practical system, though it will not aid immorality, does not affect to enforce mere moral duties. But its policy is to administer relief to the vigilant, and to put all parties on the exercise of a searching diligence. Where confidence is reposed, or the party is intentionally misled, relief may be granted; but in such a case, there is the ingredient of what the law deems a fraud.

1 Sto. Eq. Jur. §220 (emphasis added). Recognizing that generally there is no legal or moral duty to speak, other Delaware courts have held that "fraudulent procurement"—*e.g.*, some trick or artifice—must be coupled with knowing silence to support a claim of equitable reformation based on unilateral mistake. *Westfield Ins. Co. v. Chip Slaughter Auto Wholesale, Inc.*, 717 F.Supp.2d 433, 443-44 (D. Del. 2010) (citing *Waggoner v. Laster*, 581 A.2d 1127, 1135 (Del. 1990) and *Douglas v. Thrasher*, 489 A.2d 422, 426 (Del. 1985)).[15]

The concept that reformation for unilateral mistake requires more than just silence by one party is not unique to Delaware. Of the jurisdictions that allow reformation based on unilateral mistake, many require a finding of concealment, fraud, or some other type of inequitable

[15] *See also Cerberus*, 794 A.2d at 1156 ("[A]n agreement will only be set aside when there is no serious doubt that one party has unfairly procured its execution[.]") (Steele, J., concurring in part, dissenting in part) (emphasis added).

conduct as an additional component. *See, e.g.*, *Smith v. Travelers Cas. Co. of Conn.*, 2011 WL 1114257, at *4 (D.S.C. Mar. 28, 2011) ("A court will not reform an insurance contract on the ground of unilateral mistake absent clear and convincing evidence the mistake was induced by the fraud, deceit, misrepresentation, concealment or imposition in any form . . . without negligence on the part of the party claiming the right, or where the mistake is accompanied by very strong and extraordinary circumstances showing imbecility or something which would make it a great wrong to enforce the agreement.'") (citation omitted); *Am. Home Assur. Co. v. Merck & Co. Inc.*, 329 F.Supp.2d 436, 444 (S.D.N.Y. 2004) (explaining that under New York law, reformation may be granted for a unilateral mistake only when "coupled with fraudulent concealment by the knowing party"); *Klemp v. Hergott Grp., Inc.*, 641 N.E.2d 957, 965 (Ill. App. Ct. 1994) ("In actions . . . for reformation based on the existence of a unilateral mistake coupled with fraud, we have looked to . . . whether the defendant, knowing that the instrument finally prepared does not accurately reflect that agreement, has concealed the defect from the plaintiff at the time of execution."); *Alea London Ltd. v. Bono-Soltysiak Enters.*, 186 S.W.3d 403, 416 (Mo. Ct. App. 2006) ("'The law permits reformation of instruments . . . when the error has arisen by the unilateral mistake of one party and that mistake is accompanied by clear and convincing evidence of some sort of fraud, deception or other bad faith activities by the other party that prevented or hindered the mistaken party in the timely discovery of the mistake.'") (quoting 27 Williston on Contracts, § 70:104, at p. 520 (4th ed.); *Jelsma v. Acceptance Ins. Co.*, 446 N.W.2d 725, 727 (Neb. 1989) ("Reformation may be ordered where there has been . . . a unilateral mistake caused by the fraud or inequitable conduct of the other party."); *Poly Trucking*, 93 P.3d at 563-64 (explaining that absent a duty to speak, one cannot be liable for the fraudulent concealment or nondisclosure necessary to support a claim of reformation based on unilateral mistake); *Oliver v. Flow Int'l Corp.*, 155 P.3d 140, 145 (Wash. Ct. App. 2007) ("A party to a contract is entitled to reformation of the contract based on one party's unilateral mistake only if the other party engaged in inequitable conduct. A party acts inequitably if it knowingly conceals a material fact from the other party and has a duty to disclose that knowledge to the other party.").

In this case, there was no allegation or finding that the Scion Members' conduct amounted to fraud, trickery or artifice to prevent ASB from discovering what it not only claims was an obvious mistake, but one it admits it would have immediately recognized if only it had read any of the contracts.[16] There is nothing in the record to support a finding that this is an "exceptional" unilateral mistake case, and no such finding was made; thus, the Chancery Court's grant of reformation was in error.

[16] "Not volunteering when not asked is not active concealment." *Squid Soap*, 2010 WL 2836391, at *9.

III. DLH'S INDEPENDENT ACT OF EXPRESS RATIFICATION PRECLUDES ITS CLAIM FOR EQUITABLE REFORMATION.

A. Question Presented

Does DLH's independent act of express, written ratification preclude its claim for equitable reformation of the Dwight Lofts agreement? (This issue was preserved in the Scion Members' post-trial brief) (A1582-86).

B. Standard and Scope of Review

The scope of this Court's review extends to a review of the trial court's conclusions of law and findings of fact. *Solis v. Tea*, 468 A.2d 1276, 1279 (Del. 1983). This Court will review questions of law *de novo*. *Town of Cheswold v. Vann*, 9 A.3d 467, 471 (Del. 2010).

C. Merits of Argument

It was undisputed below that, weeks after the Dwight Lofts agreement was signed, its parties entered into an amendment providing that "the terms and provisions of the [Dwight Lofts] Operating Agreement are hereby ratified and confirmed and shall remain in full force and effect." (A1142 at ¶4). The Chancery Court found this statement of ratification would not bind DLH to the written terms of the Dwight Lofts agreement because the amendment was entered into before ASB first acquired "actual knowledge" of the contents of the agreement being amended. (Mem. Op. pp. 33-34). As a result, the Chancery Court concluded that DLH was permitted to continue to rely on the prior mistake of ASB and the other Funds, despite its subsequent acts and its ongoing ability to discover the error.

As recognized by the Chancery Court, however, one can ratify a transaction based upon constructive knowledge. (*See* Mem. Op. pp. 32-33 (citing *Frank v. Wilson & Co.*, 32 A.2d 277, 283 (Del. Ch. 1943))). Discussing the related doctrine of acquiescence, the Chancery Court quoted *Papaioanu v. Comm'r of Rehoboth*, 186 A.2d 745, 749-50 (Del. Ch. 1962) for the proposition that when one has sufficient "'means of knowledge of his rights'" and does anything to recognize the transaction, "'the transaction, although originally impeachable, becomes unimpeachable in equity.'" (Mem. Op. p. 33). Nonetheless, the Chancery Court ruled that "[f]or purposes of reformation . . . stricter rules apply[;] [r]ather than imputed or constructive knowledge, ratification of a contract subject to reformation requires actual knowledge of the error." (*Id.*). This "stricter rule" was a new direction in the law unsupported by Delaware precedent.

In so ruling, the Chancery Court cited four cases—one from Delaware and three from other jurisdictions.[17] Of the four, none involved an express, written ratification (much less one drafted by the party who ratified) and none involved a party that failed to read the agreement it voluntarily ratified.

The lone Delaware case, *Fitzgerald v. Cantor*, 1998 WL 781188 (Del. Ch. Oct. 28, 1998), in which the court stated, "[r]atification or reaffirmation based upon a continuing fraud or misapprehension about the facts will not be sanctioned in equity"[18] (*id.* at *2), is unavailing. *Fitzgerald* does not consider whether one could lose the right to reformation through an express act of ratification based upon constructive knowledge. The case is also factually distinguishable from the present situation. In *Fitzgerald*, the court was deciding whether to allow an amendment to a complaint to add claims for reformation. (*See id.* at *1). Under the very liberal rules permitting amendments to pleadings, the court allowed the amendment. (*See id.* at *2). Further, it is not clear from the opinion whether the party opposing reformation was claiming that the alleged ratifying act was express (*e.g.*, a signed writing ratifying a

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[17] The three non-Delaware cases are: *Elliott v. Sackett*, 108 U.S. 132 (1883) (implied ratification claim based upon the plaintiff having made two mortgage payments); *Merriam v. Nat'l Life & Accident Ins. Co.*, 86 S.W.2d 566 (Tenn. 1935) (implied ratification claim based upon plaintiff accepting and retaining insurance policy); *Knight v. Elec. Household Utils. Corp.*, 30 A.2d 585 (N.J. Ch. 1943) (election or implied ratification claim based upon the plaintiff's inconsistent positions attempting to enforce actual written contract), *aff'd*, 36 A.2d 201 (N.J. 1944).

[18] Other than the Chancery Court in the instant case, no Delaware (or other) court has ever cited to *Fitzgerald* for this proposition.

previous contract) or implied. Finally, the plaintiff in *Fitzgerald* alleged it had read but had misinterpreted the challenged provision; the opinion did not address failure to read and, unlike the facts here, there was no admission that the mistake would have been immediately apparent to the party seeking reformation if it had looked at the document it was ratifying. *Fitzgerald* therefore has little in common with the present case.

The Chancery Court, citing Restatement (Second) of Contracts § 380, also recently held that one could waive a reformation claim based upon what one "should have known" at the time an amendment was executed. *Great-West Investors*, 2011 WL 284992, at *12 n.72. There is no logical distinction between waiver and ratification in this context, and no basis to impose a "stricter" rule requiring actual knowledge for express ratification of a contract of which reformation is sought while constructive knowledge is sufficient for waiver. The rule is and should be that in all cases, and no matter the underlying theory, one can ratify a prior act or contract based on what one should have known. *See, e.g.*, *Frank v. Wilson & Co.*, 32 A.2d 277, 283 (Del. 1943).

A party who signs an agreement is presumed to know its contents, including documents specifically incorporated by reference. *See McAnulla Elec. Constr., Inc. v. Radius Techs., LLC*, 2010 WL 3792129, at *4 (Del. Super. Ct. Sept. 24, 2010). DLH argued that it did not know what it was ratifying—not because it was confused or duped, but simply because it failed to look. Other courts have long recognized that a party who ratifies a contract without reading it should be held to the terms of that contract. *See O'Reilly v. Reading Trust Co.*, 105 A. 542, 544-45 (Pa. 1918) (plaintiff ratified the contact it sought to have reformed when it executed a modification to the contract without reading the contract or the modification). DLH cannot avoid its express and voluntary ratification of the Dwight Lofts agreement by closing its eyes to the ratified contract. In light of this ratification, the Chancery Court erroneously applied the law in reforming the Dwight Lofts agreement.

IV. THE CHANCERY COURT ERRED WHEN AWARDING OVER $3.2 MILLION IN FEES AND COSTS THAT THE FUNDS DID NOT INCUR.

A. Question Presented

Did the Court of Chancery err in awarding the Funds attorneys' fees and expenses where the Funds incurred none and have no obligation to pay any fees or expenses? (This issue was preserved in the Scion Members' post-trial briefs) (A1590-93).

B. Standard and Scope of Review

The scope of this Court's review extends to a review of the trial court's conclusions of law and findings of fact. *Solis v. Tea*, 468 A.2d 1276, 1279 (Del. 1983). This Court will review questions of law *de novo*. *Town of Cheswold v. Vann*, 9 A.3d 467, 471 (Del. 2010).

C. Merits of Argument

The Chancery Court disregarded well-settled precepts of contract interpretation and awarded the Funds' "side" over $3.2 million in costs and attorneys' fees ostensibly pursuant to a fee-shifting clause in the agreements. (Mem. Op. p. 40). Such an award contradicts the plain language of the parties' agreements (which reimburse parties only for fees and expenses actually incurred) and serves to reward DLA for its own negligence in this case.

Delaware law is clear that "[c]ontractual interpretation operates under the assumption that the parties never include superfluous verbiage in their agreement, and that each word should be given meaning and effect by the court." *NAMA Hldgs., LLC v. World Mkt. Ctr. Venture, LLC*, 948 A.2d 411, 419 (Del. Ch. 2007), *aff'd*, 945 A.2d 594 (Del. 2008) (TABLE). The attorneys' fee clause in each agreement reads:

> In the event that any of the parties to this Agreement undertakes <u>any action to enforce the provisions of this Agreement</u> against any other party, the non-prevailing party shall <u>reimburse the prevailing party</u> for all reasonable costs and expenses <u>incurred in connection with such</u>

> enforcement, including reasonable attorneys' fees[.] (*See, e.g.*, A1037-1102, Section 9.9) (emphasis added)).

The Chancery Court disregarded both that the Funds had "incurred" no such costs and expenses to be "reimbursed" and that the Funds' claim was not an "action to enforce the provisions of this Agreement."

The Chancery Court erred in awarding fees to the Funds' "side" because the prevailing parties—the Funds themselves—did not incur any fees. By express contractual language, a non-prevailing party is only responsible to "reimburse the prevailing party for all reasonable costs and expenses incurred . . . , including reasonable attorneys' fees[.]" (*See, e.g.*, A1079 at Section 9.9). In order to incur a charge or expense, one "must *at some point* be legally liable to pay that charge" or expense, even if liability is later extinguished. *Metz v. U.S. Life Ins. Co.*, 662 F.3d 600, 602 (2d Cir. 2011); *cf. O'Brien v. IAC/Interactive Corp.*, 2010 WL 3385798, at *7 (Del. Ch. 2010) ("I find that [plaintiff] actually incurred the full $1,203,812 because he was obliged to pay that amount[.]"), *aff'd*, 26 A.3d 174 (Del. 2011). By definition, one cannot incur a charge or expense for which he was never liable. *See Metz*, 662 F.3d at 602.

In a recent and factually analogous case, a law firm agreed to provide *pro bono* legal services to its client under an express reservation of rights to seek fees from third parties. The client's contract giving rise to a claim for attorneys' fees provided that the client was only entitled to recover such fees actually incurred. As a result of this language, the court in *Deitz v. University of Denver*, 2011 WL 2559829 (D. Colo. June 28, 2011), declined to award fees, stating:

> Johnson did not "incur" any costs or expenses. Johnson argues that "incur" does not mean the same as "pay" and the mere fact that counsel did not bill does not mean that Johnson did not incur those fees. Black's Law Dictionary defines "incur" as "To suffer or bring on oneself (a liability or expense)." Black's Law Dictionary (9th ed. 2009). Johnson owes no debt and has no liability for any fees. Under the plain and ordinary meaning of the words presented, Johnson did not *personally* incur any costs or

expenses, and, hence, did not trigger recovery under the attorneys' fees provision. *Id.* at *4-5.

The acknowledged reality here is that neither the Funds nor ASB were under any legal obligation to pay DLA anything (neither fees nor expenses, contingent or otherwise) because DLA agreed to represent the Funds at its own cost as recognition of its admitted negligence. (A109 at p. 46). Despite this fact, the Chancery Court, again without citation to authority, held it was irrelevant whether the Funds themselves had actually incurred any fees because the purpose of the provision was "to allocate the burden of contract enforcement between the breaching party and the non-breaching party." (Mem. Op. p. 40). In other words, the Chancery Court ignored the terms "incurred" and "reimburse" under the guise of discerning the parties' intent, which it was not permitted to do under Delaware law.[19]

To the extent intent is relevant, the obvious intent of the provision was to make whole a party to the contract who is successful in an action seeking enforcement. The Funds are whole. But in the Chancery Court's apparent zeal to punish the Scion Members for what it perceived as their greed in defending the agreements as written, the court ignored this fact and the contractual language to reach a peculiar result. Under the Chancery Court's ruling, DLA (a non-party) would profit from its own negligence by collecting from a non-client hypothetical fees that the contracting parties never incurred, in connection with the firm's successful avoidance of its own liability (all the while keeping the fees it earned from doing the work for ASB that led to the litigation). Alternately, because the Chancery Court awarded the would-be fees and costs to the Funds (as these were the actual parties to the case), the Funds could potentially keep the money and not pay DLA, thus providing the Funds with windfall

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[19] To reach this result, the Chancery Court likened the relationship between the Funds and DLA to one between an insured and its insurer that has a contractual right of subrogation. That analogy, however, misses the mark. An insurer obtains a right of subrogation through contract—*i.e.*, the insured has a contractual and thus legal obligation to pay the insurer pursuant to those contractual subrogation rights. Here, the Funds labored under no such legal obligation; they simply received free representation.

profits unrelated to any amount incurred. Certainly, neither such result was within the Scion Members' intent when they entered into the agreements.

The Chancery Court also erred by disregarding the "action to enforce" language of the attorney-fee provision. Of the total fee award of $3,267,355, $2,592,290 was assessed jointly and severally against all three Scion Members with respect to the Fund Members' equitable reformation claims. As other courts have recognized, an equitable reformation claim is not an action to enforce the contract. *See, e.g.*, *Natarajan v. Horn*, 402 So.2d 596, 597 (Fla. Dist. Ct. App. 1981) (declining to award contractual attorneys' fees because the "action was not brought to enforce the contract or any provision thereof, but rather to rescind or reform the contract. Thus th[e] action [was] completely outside the terms of the contract"). Without citation to authority, the Chancery Court concluded that the term "Agreement" in the fee provision referred to the parties' "actual" agreement and not the written document containing what the court called a scrivener's error. (Mem. Op. p. 40). The holding ignores the word "this" immediately preceding "Agreement" in the contractual provision. "[T]his Agreement" can only mean the actual written agreement. By contrast, "the agreement of the parties" could conceivably mean something beyond the actual written contract.

Moreover, there was no allegation that the Scion Members committed any breach so that the agreements would need to be "enforced" against them. Instead, the Scion Members sought to defend the agreements against the Funds' equitable request to change them due to ASB's and DLA's own negligence. Because the Funds' equitable reformation action was not an action to enforce the provisions of the agreements, the Chancery Court's fee award was inappropriate. *Cf. Warner v. Sirstins*, 838 P.2d 666, 671 (Utah Ct. App. 1992) (party should not receive fee award where it seeks reformation of a mistake it created); *Crockett v. Green*, 1870 WL 1647, at *7 (Del. Ch. Sept. Term 1870) (disallowing costs to the defendant because "he is brought here in consequence of his own blunder in drawing the memorandum, I think it is equitable that he pay, at least, his own costs").

The Chancery Court awarded an additional $675,065 in fees and costs against Scion Dwight based on DLH's defense of claims brought by

Scion Dwight for breach of fiduciary duty and breach of the implied covenant of good faith and fair dealing pertaining to the Dwight Lofts venture, which claims the Chancery Court denied based on its finding that Scion Dwight had not met its burden of proof. (Mem. Op. pp. 38-39). Applying the attorney-fee provision "in an all-or-nothing manner" (Op. p. 3) the Chancery Court found that in these claims Scion Dwight had sought to enforce provisions of the Dwight Lofts agreement and thus, "[a]s the 'non-prevailing party,' Scion [Dwight] must 'reimburse the prevailing par[ty]' for its fees and costs." (Op. p. 4). But the Chancery Court disregarded that the attorney-fee provision provides only for reimbursement of costs and expenses "incurred in connection with such enforcement" that is, a successful "action to enforce the provisions of this Agreement." (A1079 at Section 9.9). Even if DLH had actually incurred any costs in its defense of these claims, the contractual provision, strictly construed, provides reimbursement only for successful enforcement of the agreement, not the defense of claims. Thus, this portion of the Chancery Court's award was also in error.

CONCLUSION

For the foregoing reasons, this Court should reverse the Chancery Court's grant of reformation and award of attorneys' fees.

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Dated: October 3, 2012

CERTIFICATE OF SERVICE

IT IS HEREBY CERTIFIED that on October 3, 2012, a copy of the foregoing Appellants' Corrected Opening Brief was served on the attorneys below in the manner indicated:

BY E-SERVICE:

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