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IN THE SUPREME COURT OF THE STATE OF DELAWARE

UNIVERSAL ENTERPRISE GROUP, L.P., 617 NORTH SALISBURY BOULEVARD, LLC, 176 FLATLANDS ROAD, LLC, 106 CEDAR STREET, LLC, 102 WEST CENTRAL AVENUE, LLC, 326 EAST DOVER STREET, LLC, 101 MAPLE AVENUE, LLC, 241 CYPRESS STREET, LLC, 28768 OCEAN GATEWAY HIGHWAY, LLC, 610 SNOW HILL ROAD, LLC, 5318 SNOW HILL ROAD, LLC, 302 MAPLE AVENUE, LLC, 177 OLD CAMDEN ROAD, LLC, 111 SOUTH WEST STREET, LLC, 1272 SOUTH GOVERNORS AVE, LLC, 505 BRIDGEVILLE HIGHWAY, LLC, 323 WEST STEIN HIGHWAY, LLC, 100 S. MAIN STREET, LLC, 1104 SOUTH STATE STREET, LLC, 133 SALISBURY ROAD, LLC, UNIVERSAL DELAWARE, INC., and DANIEL SINGH a/k/a/ DAMINDER S. BATRA, Plaintiffs Below/ Appellants, v. DUNCAN PETROLEUM CORPORATION and ROBERT M. DUNCAN, Defendants Below/Appellees.	No. 540,2013 Court Below – Court of Chancery of the State of Delaware C.A. No. 4948-VCL

SUPPLEMENTAL MEMORANDUM OF APPELLEES
DUNCAN PETROLEUM CORPORATION AND ROBERT M. DUNCAN

POTTER ANDERSON & CORROON LLP

Daniel F. Wolcott, Jr. (ID No. 284)
Ryan M. Murphy (ID No. 5517)
Janine L. Hochberg (ID No. 5188)
1313 North Market Street—6th Floor
Wilmington, Delaware 19801
(302) 984-6000

Attorneys for Defendants Below/Appellees Duncan Petroleum Corporation and Robert M. Duncan

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INTRODUCTION

In its Report Pursuant to Delaware Supreme Court Rule 19(c) issued on April 29, 2014 ("the Report"), the Court of Chancery explained that its final order and judgment applying recoupment to offset Universal's breach-of-contract damages in this matter was based upon the "unspoken premise" that the doctrine of unclean hands was factually inapplicable and that the parties should be limited to their contractual remedies.[1] (SA0073-76.) Universal's supplemental brief on appeal[2] argues that the trial court failed to consider post-closing negotiations between the parties in evaluating Universal's unclean hands argument and that its "refusal to apply unclean hands is . . . facially inconsistent with its own stated goal of *holding the parties to their agreement.*" (Universal's Supp. Br. 2 (emphasis in original).)

No such inconsistency exists. To the contrary, after considering all of the relevant facts, the trial court provided a cohesive and consistent rationale for its judgment, which appropriately effectuated the parties' contractual arrangements. For the reasons set forth herein, that rationale supports the affirmance of the trial court's final order and judgment.

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1 Unless otherwise noted, terms shall be used as previously defined in Appellee's Answering Brief on Appeal.

2 Universal's Supplemental Brief on Appeal, filed on May 19, 2014, shall be cited hereafter as "Universal's Supp. Br."

ARGUMENT

I. THE TRIAL COURT DID NOT ABUSE ITS DISCRETION IN ORDERING RECOUPMENT TO OFFSET THE UNIVERSAL JUDGMENT.[3]

A. Standard Of Review

Duncan agrees with Universal that the trial court's Report is subject to review under an abuse of discretion standard, as it reflects "[d]eterminations of fact and application of those facts to the correct legal standards." *Lingo v. Lingo*, 3 A.3d 241, 243-44 (Del. 2010).

B. The Trial Court Properly Concluded That The Facts Did Not Merit Application Of The Unclean Hands Doctrine.

In its supplemental brief, Universal relies solely upon its post-closing exchanges with Duncan to argue that the trial court erred in refusing to apply the doctrine of unclean hands. Specifically, Universal has narrowed its unclean hands allegations to focus on a May 6, 2008 letter in which Duncan, responding to a letter from Universal's environmental counsel, disputed that he had breached the Sale Agreement (AR004-5). Universal contends that the trial court "failed to give ***any*** weight to the fact that when Universal confronted Duncan . . . [he] expressly

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[3] Duncan limits this supplemental memorandum to the issues raised by the trial court's Report and Universal's supplemental brief, and submits that the trial court's Report offers sound bases for affirming the trial court's judgment. In so limiting its brief, however, Duncan does not intend to waive any of the alternative arguments for affirmance set forth in its Answering Brief.

refused to allow Universal to exercise its contractual remedy and setoff any expenses." (Universal's Supp. Br. 2 (emphasis in original).)

Universal's position misperceives both the trial court's decisions and the underlying events. The trial court's Report and its earlier Memorandum Opinion explicitly acknowledged that the parties engaged in a "prolonged letter writing campaign" after closing, during which "Duncan denied that he had breached the Sale Agreement" and "the parties haggled over the alleged breaches." (Report 6, SA0065; Mem. Op. 40-41, A001102-03; *see also* Mem. Op. 25, A001087.) Thus, the trial court did not fail to weigh Duncan's post-closing communications with Universal; it simply did not find them to be an adequate basis to apply the unclean hands doctrine as Universal urges. This outcome was correct for several reasons.

As an initial matter, Duncan's statements during the post-closing negotiations did not and could not have precluded Universal from exercising its contractual rights. Universal's right to offset under the Notes was unilateral and did not require or otherwise depend upon Duncan's consent.[4] Universal remained

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[4] The offset provisions of the Notes provided as follows: "Notwithstanding any other provision of this Note, Borrower shall have a right of set-off against, or deduction from, any and all amounts due or which may become due under the Note arising from or relating to Lender's breach of Lender's obligations, representations, indemnities, covenants and agreements, under that certain agreement of sale dated July 31, 2007 between Lender, as Seller, and Universal Enterprise Group, L.P., or its nominee, as Buyer (the 'Agreement') and any and all related agreements thereto (whether sounding in tort, contract, or otherwise)." (*See, e.g.*, A000258.)

free throughout the parties' post-closing exchanges to undertake the compliance efforts and offset those expenses against the amounts it owed Duncan on the Notes, subject only to the possibility that Duncan might take legal action if he wished to pursue a dispute regarding the propriety or amount of the offset. Universal recognized this fact throughout the protracted letter-writing campaign. In fact, in June 2009—over a year *after* it received Duncan's May 2008 letter—Universal asserted that it would exercise its offset rights to fund compliance work. (A1087, Mem. Op. 25.) There is no evidence that Universal's failure to carry through on its expressed intention related in any way to Duncan's earlier statements during the negotiations—rather, the following month (July 2009) saw the bankruptcy filing of Universal's affiliate Universal Marketing and the start of Universal's ongoing default on the Notes, neither of which related to the purchase of the Properties.

At the most, the post-closing exchange that Universal cites as purported evidence of "unclean hands" reflects nothing more than another *contractual* dispute between the parties. Neither the existence of that dispute nor Duncan's conduct during it amount to unclean hands. Duncan's May 2008 letter was directed to counsel for Universal and cited several reasoned bases for Duncan's belief that he had not breached the Sale Agreement (including that the environmental evaluations Universal had presented to him were undertaken several months post-closing and that Universal was not to his knowledge operating the

stations with a full-time service department). (AR004-5.) While the trial court ultimately determined that Duncan did breach the representations of the Sale Agreement and that Universal possessed valid offset rights under the Notes, Universal has not provided any authority (nor has Duncan been able to locate any) to support that the assertion of an unsuccessful legal position during pre-litigation negotiations between sophisticated parties constitutes unclean hands.

Furthermore, even if Duncan's statements during the post-closing negotiations were sufficient to have breached Universal's offset rights, they would not suffice to undermine the trial court's conclusion that unclean hands was inapplicable to this case. As the Report held, Delaware law does not support applying unclean hands in a manner that would routinely bring contractual breaches not involving fraud or other egregious circumstances, such as were at issue in this case, within the purview of the doctrine. (Report 16-17, SA0075-76.) Conflating ordinary contractual breaches with the type of conduct against which the doctrine of unclean hands is directed risks devaluing parties' freedom of contract and providing "any non-breaching party to a breached contract . . . the effective ability to act inequitably against the breaching party with impunity." (*Id.* (quoting *Merck & Co., Inc. v. SmithKline Beecham Pharm. Co.*, 1999 WL 669354, at *51 (Del. Ch. Aug. 5, 1999), *aff'd sub nom. SmithKline Beecham Pharm. Co. v. Merck & Co., Inc.*, 746 A.2d 277 (Del. 2000), *and aff'd,* 766 A.2d 442 (Del.

2000)).) As discussed immediately below, the trial court properly recognized that granting Universal's request for an affirmative judgment on its damages claim notwithstanding Duncan's recoupment defense would have realized those risks.

C. The Trial Court's Decisions Consistently Held Both Parties To Their Bargained-For Exchange.

Universal misconstrues the trial court's Report in arguing that it was facially inconsistent and "held only Universal, not Duncan, to the [parties' contractual] agreement." (Universal's Supp. Br. 2.) The Report recognized that, like its failed claims for rescission or rescissory damages, Universal's request for entry of a monetary judgment on its damages claim is an effort to obtain an extra-contractual windfall by rewriting the historical facts of the case.

In its Report, the trial court held that the same considerations which militated against allowing Universal extra-contractual *remedies* (including rescission and rescissory damages) also precluded Universal from invoking unclean hands to block Duncan's recoupment defense. (SA0061-62.) The trial court's Report recounted several factual findings that supported its decision to deny Universal any such "extra-contractual outcome":

- As discussed at length in the trial court's Memorandum Opinion, Universal specifically addressed "both known unknowns and unknown unknowns" it identified in the transaction through the exercise of its due diligence rights by negotiating modifications to the deal, which included Duncan's provision of a $1.6 million escrow to fund Corrective Actions and the bolstering of Universal's right to

offset any damages for breach against amounts owed on the Notes. (Report 5, SA0064.)

- As part of these negotiated modifications, "Universal's remedy if Duncan breached his representation under the Sale Agreement or failed to undertake Corrective Action was to reduce the amounts due to Duncan under the Notes. Universal was not entitled in the first instance to recover from Duncan cash equal to the costs of Corrective Action or to obtain a damages award against him." (*Id.*)

- Duncan's contractual breaches did not go to the "heart of the transaction," as evidenced by Universal's decisions to proceed to closing despite its awareness of probable breaches and to affirm the contract after closing. (Report 12-13, SA0071-72 (quoting Mem. Op. 40, A1102).)

- Universal's own conduct weighed against allowing it any extra-contractual recovery in that it "'tested the waters,' sought to make a go of the venture, and then resorted to its request for rescissory damages as a form of business insurance" after it had to file for bankruptcy for reasons entirely unrelated to its operation of the Properties. (Report 13, SA0072 (quoting Mem. Op. 41, A001103).)

Notably, Universal's supplemental brief does not challenge the trial court's findings on any of these points. Instead, Universal now contends that the monetary judgment it seeks is contractual in nature because it would entail "return of the payments [Universal] was always contractually entitled to withhold from Duncan." (Universal's Supp. Br. 4.)

Universal's position is premised on faulty logic. Although Universal would have been "contractually entitled" to withhold payments owed on the Notes to the extent of its compliance expenses had it elected to do so, *as a factual matter, it chose not to pursue that course of action.* As explained above, that choice rested

solely with Universal; Duncan's statements did not and could not have affected its unilateral offset rights under the Notes. Just as Universal was not entitled to shift the risk of its own unsuccessful business decisions to Duncan via rescission or rescissory damages, it should not be permitted to rely upon unclean hands to undo regrettable strategic choices it made for reasons unrelated to his conduct. Nothing in the parties' negotiated agreement contemplated that Duncan would be required to reimburse payments received on the Notes or otherwise provide funds out-of-pocket to cover compliance work—indeed, such an arrangement is not an "offset" at all. (*See* SA0064 ("Universal was not entitled in the first instance to recover from Duncan cash equal to the costs of Corrective Action or to obtain a damages award against him.").) Despite Universal's protestations, therefore, the relief it seeks is inherently extra-contractual.

Universal's argument is further flawed in that it evades the concerns identified by the trial court that awarding it a monetary judgment would amount to an unfair windfall. Universal has never disputed that it ceased payments on the Notes in 2009 and that the amount outstanding on the Notes (in excess of $7.6 million in principal) dwarfs its proven damages in this case ($1,497,429). Universal's current proposal that Duncan be ordered to return the $1,178,454 in payments it allegedly made before defaulting would, in the trial court's words, "confer[] an extra-contractual windfall" by substituting "a reduction in the amounts

due on the Notes pursuant to [the parties'] agreement" with "cash [received] on a non-contractual basis." (SA0074.) Moreover, but for Universal's pending bankruptcy—a circumstance for which Duncan does not bear responsibility—any cash Universal received in this manner would be owed back to Duncan as an outstanding payment on the Notes, which have been in default for nearly five years.[5] (*See* Report 17, SA0076 ("If the Final Order had prevented Duncan from asserting his defense of recoupment, then the plaintiffs would have been placed in a better position than the one they bargained for: They would have recovered damages for breach amounting to $1,497,429, while remaining in default to Duncan for more than $7.6 million on the Notes.").) The trial court's conclusion that awarding this windfall to Universal "seemed less equitable . . . than holding the parties to their agreement" is entirely consistent with Delaware case law holding that unclean hands should not be used to permit a litigant to obtain such an unconscionable advantage, regardless of its adversary's conduct. *See Saltar v. Wilson*, 1978 WL 176028, at *1 (Del. Ch. July 19, 1978) (holding that a party will not be denied a remedy, even if it has unclean hands, "if to do so would permit an unconscionable gain to the other party"). Universal's arguments offer no meaningful basis for reversing that decision.

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[5] The trial court's final order and judgment implicitly found that it possessed authority to order recoupment notwithstanding the bankruptcies affecting Universal and Batra. The trial court's decision was consistent with authorities presented by Duncan in the supplemental briefing requested by the trial court (*see* SA1773-77) and Universal has not challenged this aspect of the trial court's judgment on appeal.

CONCLUSION

For the reasons set forth herein and in their Answering Brief, Appellees Robert M. Duncan and Duncan Petroleum Corporation respectfully request that the judgment of the Court of Chancery be affirmed in its entirety.

POTTER ANDERSON & CORROON LLP

By: _____

Daniel F. Wolcott, Jr. (ID No. 284)
Ryan M. Murphy (ID No. 5517)
Janine L. Hochberg (ID No. 5188)
1313 North Market Street—6th Floor
Wilmington, Delaware 19801
(302) 984-6000

Attorneys for Defendants Below/Appellees Duncan Petroleum Corporation and Robert M. Duncan

Date: June 11, 2014

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