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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

APPELLANT'S OPENING BRIEF ON APPEAL

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NATURE AND STAGE OF PROCEEDINGS

Appellant / plaintiff-below Finger Lakes Capital Partners LLC ("Finger Lakes") and Appellee / defendant-below Lyrical Opportunities Partners, LP ("Lyrical") formed Appellee / defendant-below Honeoye Lake Acquisition LLC ("HLA") to invest in Revolabs, Inc. ("Revolabs"). They did so by executing a limited liability company operating agreement (the "HLA Agreement," A204-A238), which states that it alone sets forth "all of the understandings and agreements" regarding its subject matter and "supersed[es] all prior agreements." Post-trial Memorandum Opinion ("Op.," Ex. A) 10.

HLA sold its Revolabs investment for $31.3 million, realizing a $23.8 million profit after returning $4.3 million of invested capital with a 6% annual return). HLA refused to distribute to Finger Lakes its 25% profit share ($5.9 million) as the HLA Agreement required (the "Carry"). Finger Lakes then sued HLA and its managing member Lyrical (collectively, "Defendants").

Defendants filed affirmative defenses and counterclaims seeking to enforce two agreements predating the HLA Agreement (the "Prior Agreements"): (i) an oral clawback agreement entered into before July 28, 2005 (the "Clawback Agreement"); and (ii) an April 2004 term sheet (the "Term Sheet"). Defendants alleged that the Clawback Agreement required HLA to distribute to Lyrical an amount (the "Clawback Amount") equal to the losses Lyrical realized on account of its investment in

other Finger Lakes managed companies in which Lyrical invested (each, an "LLC"). Doing so would reduce the distributable profit from the Revolabs proceeds to $10.4 million (and Finger Lakes' Carry to $2.6 million). Lyrical also claimed that the Term Sheet required HLA to distribute 25% of the Carry to Lyrical (further reducing the Carry to $2 million), and then required Finger Lakes to split any management fees it received from Revolabs and other LLCs with Lyrical.

Finger Lakes filed a motion for judgment on the pleadings. The trial court granted it, holding that the HLA Agreement is integrated and unambiguous. The Prior Agreements therefore "cannot modify the HLA [A]greement as to its terms." A425-26. The court withheld judgment to determine if the counterclaims and affirmative defenses could reduce the distribution by way of offset or recoupment. A430-31.

After trial the court reversed course, holding that the Prior Agreements were enforceable notwithstanding the HLA Agreement's later date and integration clause. Moreover, the court required Finger Lakes to make up to Lyrical the entire Clawback Amount from the amount otherwise distributable to it as its profit share from all LLCs, including HLA. Lyrical thus kept the entire $23.8 million Revolabs profit and was also entitled, under the Clawback Agreement, to the first $8.9 million of profit, if any, otherwise distributable to Finger Lakes by the other LLCs. This appeal followed.

SUMMARY OF ARGUMENT

I. The Prior Agreement are unenforceable. The HLA Agreement is clear and unambiguous on its face. When that is so, "neither this Court nor the trial court may consider parol evidence to interpret it or search for the parties' intentions." *Pellaton v. Bank of N.Y.*, 592 A.2d 473, 478 (1991). The Prior Agreements predate the HLA Agreement. A426. Such evidence of "antecedent understanding" cannot be used to vary the HLA Agreement's clear text. *Scott v. Land Lords, Inc.*, 1992 WL 276429, at *3 (Del. Sept. 22, 1992). The court erred when it held that the parties intended the Prior Agreements and the HLA Agreement to be "read together" to determine the distribution of Revolabs proceeds. Op. 39, 46. That is particularly so since the words in Section 9.6 of the HLA Agreement—such as "all," "entire" and "supersedes"—make clear that no examination of extrinsic evidence is required to determine what the parties intended. Even an "unpalatable" result is no basis for a court to vary the "words chosen by sophisticated parties who drafted a complex and comprehensive agreement. More importantly, it is not for [a] judge to substitute his subjective view of what makes sense for the terms accepted by the parties." *Matria Healthcare, Inc. v. Coral SR LLC*, 2007 WL 763303, at *1 (Del. Ch. Mar. 1, 2007).

II. Were the Clawback Agreement not superseded—which it is—then the court erred by misinterpreting it. The court conceded that JX 82 accurately set forth the substance of the oral Clawback Agreement. Op. 20. That document explains:

> [O]n the sale of [Revolabs]… any dollar of gain between $0 and [the Clawback Amount] will go directly to [Lyrical] . . . **prior to any [Carry] being paid to [Finger Lakes]. Once the gain is greater than [the Clawback Amount] the [Carry] will apply at the rates and distributions as specified by the [HLA Agreement].**

The parties agreed that the Clawback Agreement, were it not superseded, requires that: (a) HLA distribute the $13.4 million Clawback Amount to Lyrical *before* distributing any Carry under Section 7.1(c), thus reducing the distributable amount from $23.8 to $10.4 million; (b) Finger Lakes' 25% Carry of $10.4 million would then be $2.6 million; and (c) even if that Carry is further reduced by 25% under the Term Sheet provision requiring a 25/75 "split" of the Carry, Finger Lakes would still be entitled to a distribution of approximately $2 million. *See* A560, A639; A1193-95; A1267; A1257; A1343; A369 ¶ 42(iv).

III. The court also erred by finding that the provision in the Term Sheet requiring a management fee "split" survives the HLA Agreement. The HLA Agreement provides Finger Lakes with rights to engage in any business "without any accountability, liability, or obligation whatsoever to [HLA] or [Lyrical]." A118-19, 220-21 §§ 4.2(p), 4.6. Thus, Finger Lakes is not liable to Lyrical for any fees earned for providing services to Revolabs or any other investment company. Moreover, Finger Lakes' ability to provide management services to Revolabs and earn fees is an outgrowth of HLA's Revolabs investment. It thus concerns the same subject matter as the HLA Agreement. Any Term Sheet provision requiring such a "split"

is superseded.

IV. The court's holding that Lyrical could offset or recoup the amount of otherwise time-barred fee sharing claims is erroneous. Delaware law—10 *Del C.* § 8120—prohibits the use of otherwise time-barred debt to offset a damage claim. Nor could Lyrical satisfy the elements of recoupment, *i.e.*, that the debt involved both (1) the same parties, and (2) the same transaction. Lyrical's fee sharing claim derives from the Term Sheet, whereas Finger Lakes' claim against HLA stems from the HLA Agreement. *TIFD III-X LLC v. Fruehauf Prod. Co.*, 883 A.2d 854, 859 (Del. Ch. 2004).

V. Lastly, the trial court erroneously limited Finger Lakes' indemnification claim under Section 4.4 of the HLA Agreement to legal fees incurred at or prior to the time the court awarded Finger Lakes judgment on the pleadings. It did so on the grounds that any subsequent fees related solely to the parties' "overarching business deal" (Op. 34)—even though those fees were incurred to defeat the Defendants' counterclaims and affirmative defenses and thus relate substantially and directly to Finger Lakes' enforcement of its rights under the HLA Agreement. Accordingly, HLA is required to indemnify Finger Lakes for all of its attorneys' fees.

STATEMENT OF FACTS

A. The HLA Agreement

Finger Lakes and Lyrical entered the HLA Agreement in October 2005.[1] Op. 15. Section 7.1 of the HLA Agreement, captioned "Distribution of Profits and Losses" provides, in pertinent part:

> Distributions of available cash of the Company shall be made to the Members as follows:
>
> (a) Return of Capital: First, one hundred percent (l00%) to the Members. . . until. . . distributions to each Member. . . is equal to. . . [its] Capital Contribution. . . ;
>
> (b) Preferred Return: Second, one hundred percent (100%) to the Members. . . until. . . distributions. . . are sufficient to provide each. . . Member with a rate of return equal to six percent (6%) compounded annually on the Capital Contribution of such Member. . . .
>
> (c) Common Return: Third, to the Members in accordance with the Common Sharing Percentage.

Section 4.2 of the HLA Agreement captioned "Power of the Manager" provides, in pertinent part:

> [T]he Manager shall have the right, power and authority to. . . (p) to do any act which is necessary, desirable, convenient or incidental to the conduct of the business and affairs of the Company.

Section 4.6 of the HLA Agreement, captioned "Right of Competition,"

[1] The parties were represented by counsel in negotiating the first such agreement on which the HLA Agreement is based. *See* Op. 8. At that time, Lyrical was represented by Akin Gump. A20, A90.

provides in pertinent part that:

> [E]ach Member and each Manager, their respective principals and Affiliates, and each such Affiliate's officers, employees, agents and representatives, shall be free to engage in, conduct or participate in any business or activity whatsoever, without any accountability, liability or obligation whatsoever to the Company or to any other Member or Manager.

Section 9.6 of the HLA Agreement, captioned "Entire Agreement," states, in pertinent part:

> This Agreement. . . contain[s] all of the understandings and agreements of whatsoever kind and nature existing between the Members with respect to the subject matter hereof and thereof and supersede[s] all prior agreements and undertakings, whether written or oral, with respect thereto.

No prior agreement of any kind is referred to or carved out from this clause.

B. The Prior Term Sheet Agreement

The parties entered into the Term Sheet in April 2004. A329-31. The Term Sheet provided for a "split" of the "GM Stake," which consists of the "carry" and "management fees," 75% to Finger Lakes' principals, Shalov and Mehta, on the one hand, and 25% to Lyrical on the other. Op. 3. Between 2004 and 2014, Finger Lakes received roughly $6 million from the portfolio companies as fees that it recorded on its books of account as management fees. Op. 43. In exchange, Finger Lakes provided substantial services. For example, Shalov was engaged as Revolabs' head of sales and by another portfolio company, Rethink Autism, as vice president of sales, while Mehta was engaged as Potadam's interim chief executive officer. Op. 23;

A695-96. The term "GM Stake" appears nowhere in the superseding HLA Agreement.

C. The Prior Oral Clawback Agreement

The parties entered into the oral Clawback Agreement some time before July 28, 2005, at which time they "had a meeting of the minds." Op. 15; *see* A160-203. Finger Lakes and Lyrical formed a separate LLC for each portfolio company; as of this time, Finger Lakes and Lyrical had formed three such LLCs. Op. 1, 8.

The Clawback Agreement purported to align Finger Lakes' interests with those of Lyrical by limiting the profit distribution Finger Lakes could receive from any one LLC to the profit distribution that would obtain if all LLCs were taken together in the aggregate, so that losses in some, if any, could offset gains in the others. In April 2008 Finger Lakes sent the following email to Lyrical:

> [Finger Lakes] currently has a Clawback of $6,083,866.00 that it must make up to [Lyrical]. As such, on the sale of any of the three remaining investments, any dollar of gain between $0 and $6,083,866.00 will go directly to [Lyrical] . . . prior to any Carried Interest being paid to [Finger Lakes]. Once the gain is greater than $6,083,886.00, the Carried Interest will apply at the rates and distributions as specified by the various Operating Agreements at the various LLCs.

A281. It is undisputed that this email sets forth the full substance of the Clawback Agreement (A560, A640) and that at the time the Clawback Amount was $6,083,866.00.

D. The Revolabs Sale and HLA's Partial Distribution to Finger Lakes

In February 2014, Lyrical ousted Finger Lakes as Manager. Op. 26. In March 2014, HLA sold its Revolabs interest to a third party for $31 million. Op. 25. HLA distributed $4.2 million to Lyrical and $0.01 to Finger Lakes million constituting a return of invested capital as Section 7.1(a) of the HLA Agreement requires, plus a 6% annual rate of return on that invested capital, as Section 7.1(b) of the HLA Agreement requires. Op. 36. Thereafter, approximately $23.8 million remained for HLA to distribute. *Id*. Lyrical caused HLA to withhold making the profit distribution to Finger Lakes otherwise required by Section 7.1(c) of the HLA Agreement. This litigation followed. Op. 26, 29.

E. Procedural History

On January 28, 2015, the trial court granted Finger Lakes' motion for judgment on the pleadings, holding that the "plain terms of the [] Agreement required Lyrical to distribute the funds "initially" in accordance with the waterfall set forth in that agreement." Op. 29. It held that the HLA Agreement is unambiguous and integrated and not susceptible to modification by the Prior Agreements. A426.

After trial, however, the trial court found that the Prior Agreements were not superseded by the HLA Agreement. Op. 38-40. It held that the HLA Agreement and the Prior Agreements, "read together," "govern the distribution and allocation

of the proceeds from the Revolabs sale," not the later, fully integrated HLA Agreement alone. Op. 38-42, 46.

On November 2, 2015, Finger Lakes moved to reargue the trial court's interpretation of the Clawback Agreement. Even were this prior agreement enforceable (which it was not), the trial court applied it in a manner contrary to the undisputed evidence submitted by all parties by deducting the $13.4 million Clawback Amount from the $5.9 Carry that would have obtained absent enforceable Prior Agreements, leaving a substantial negative balance, rather than deducting the Clawback Amount from the $23.8 million net gain derived from the Revolabs sale and then calculating the Carry from the remaining $10.4 million balance. On November 18, 2015, the court denied that motion (the "Reargument Order," Ex. B).

On January 22, 2016, the court entered the Final Order and Judgment (the "Judgment," Ex. C). The Judgment required HLA to distribute the entire $23.8 million of net gain directly to Lyrical, awarded Lyrical $1,511,636.24 as its share of Finger Lakes' previously-collected management fees, of which $883,893.24 is payable currently and $627,742 is payable only by way of offset or recoupment, and required Finger Lakes to make up the $8,770,764.82 balance of the Clawback Amount out of profits, if any, otherwise distributable to Finger Lakes by the other LLCs.

ARGUMENT

I. THE COURT ERRED IN HOLDING THAT SECTION 7.1(c) OF THE HLA AGREEMENT DOES NOT SUPERSEDE THE CLAWBACK AGREEMENT AND THE PROVISION OF THE TERM SHEET CONCERNING SPLIT OF FINGER LAKES' CARRY

A. Question Presented

Did the court err when it held that the integrated HLA Agreement's distribution section, Section 7.1(c), did not supersede the prior oral Clawback Agreement and the agreement in the prior Term Sheet requiring a "split" of the Carry? A1293.

B. Standard And Scope Of Review

The Court reviews a trial judge's contract interpretations *de novo*, and will overturn findings of fact if they are clearly erroneous. *Nationwide Emerging Managers., LLC v. Northpointe Hldgs., LLC*, 112 A.3d 878, 889 (Del. 2015).

C. Merits Of The Argument

1. The Parol Evidence Rule Bars Consideration of Extrinsic Evidence to Modify The HLA Agreement And The Prior Agreements, If Enforced, Do Operate to Modify the HLA Agreement

"The parol evidence rule bars the admission of evidence extrinsic to an unambiguous, integrated written contract," thus ensuring that no such evidence may be utilized. *Philips v. Wilks, Lukoff & Bracegirdle, LLC*, 2014 WL 4930693, at *4 (Del. Oct. 7, 2014); *see also Galantino v. Baffone*, 46 A.3d 1076, 1081 (Del. 2012) (the parol evidence rule "bars the admission of evidence extrinsic to an unambiguous, integrated written contract for the purpose of varying or contradicting the terms of

that contract"); *ev3, Inc. v Lesh*, 114 A.3d 527, 538 n.32 (Del. 2015) ("An earlier agreement . . . may not contradict a binding later integrated agreement"). The parties did not incorporate the Prior Agreements in the later integrated HLA Agreement or exclude them from the consequences of its integration clause. Accordingly, since the Prior Agreements concern the same subject matter as the integrated HLA Agreement (the Revolabs investment) those terms are superseded. The court previously held that the Prior Agreements "predated the HLA agreement and, therefore, cannot modify the HLA agreement as to its terms." A426. Then the court did just that by enforcing them, and therefore erred.

Enforcement of the Prior Agreements modifies the HLA Agreement's distribution scheme. Section 7.1 of the HLA Agreement requires HLA to distribute the Revolabs sales proceeds by: (a) first distributing to each of Finger Lakes and Lyrical their invested capital with a 6% return, compounded annually (§ 7.1(a) and (b)), leaving $23.8 million still to distribute; and (b) then distributing 75% of the remaining gain to Lyrical ($17.9 million) and 25% of the remaining gain to Finger Lakes ($5.9 million).

The Prior Agreements, as both parties described them if enforceable, when coupled with the Term Sheet "split" of the Carry provision, changes the distribution under Section 7.1 as follows: (a) first Finger Lakes and Lyrical receive back their capital with a 6% return (§ 7.1(a) and (b)), leaving $23.8 million; (b) then Lyrical

receives $13.4 million under the Clawback Agreement, leaving a gain of $10.4 million; (c) of which 75% ($7.8 million) goes to Lyrical, and (d) lastly, HLA distributes the remaining 25% ($2.6 million) under Section 7.1(c), as modified by the Term Sheet "split" provision, 75% to Finger Lakes ($2 million) and 25% to Lyrical ($0.6 million).

The Clawback Agreement as described by the court, when coupled with the Term Sheet "split" of the Carry provision, changes the distribution scheme of Section 7.1 as follows: (a) first Finger Lakes and Lyrical receive back their invested capital with a 6% compounded annual rate of return (§ 7.1(a) and (b)), leaving $23.8 million (though nothing is yet distributed); (b) then 75% of that remainder is "allocated" to Lyrical ($17.9 million) and 25% is "allocated" to Finger Lakes ($5.9 million) (though still nothing is distributed); (c) then Finger Lakes' "allocation" is reduced by 25% due to the Term Sheet "split" provision (to $4.45 million); and (d) then Finger Lakes' "allocation" is reduced again by the Clawback Amount of $13.4 million (reducing it to negative $8.9 million). The result was that the entire $23.8 million of Revolabs Proceeds being distributed to Lyrical (and $0 to Finger Lakes). The negative $8.9 million is payable by Finger Lakes from profits, if any otherwise distributable to it by other LLCs. The operation of the HLA Agreement, contrasted with how the trial court applied it, is illustrated below:

Item	Distribution Under the HLA Agreement	Distribution Under the HLA Agreement as Modified by (1) Clawback Agreement (as Interpreted by the Parties) and (2) the Term Sheet	Distribution Under the HLA Agreement as Modified by (1) the Clawback Agreement (as Misinterpreted by the Court) and (2) the Term Sheet
Gross Proceeds	$31,329,807.81	$31,329,807.81	$31,329,807.81
Less attorney fees	($274,012.25)	($274,012.25)	($274,012.25)
Less Capital/Interest (§7.1(a)-(b))	($7,292,353.00)	($7,292,353.00)	($7,292,353.00)
Gross Distributable Amount Clawback Amount Balance	$23,763,442.56	$23,763,442.56 ($13,362,156.46) $10,401,286.10	$23,763,442.56
Carry Less 25% Pursuant to Term Sheet Balance Clawback Amount Balance	$5,940,860.64	$2,600,321.53 ($650,080.38) $1,950,241.15 $1,950,241.15	$5,940,860.64 ($1,485,215.16) $4,455,645.48 ($13,362,156.46) ($8,906,510.92)
Distribution to Finger Lakes Under §7.1(c))	**$5,940,860.64**	**$1,950,241.15**	**$0.00**
Distribution to Lyrical Under §7.1(c))	**$17,940,860.64**	**$21,813,201.35**	**$23,763,442.56, plus Clawback Credit of $8,906,510.92**

As the chart demonstrates, the earlier Term Sheet provision requiring a "split of the Carry, as well as the earlier Clawback Agreement, however described, if enforced, would modify Section 7.1 of the HLA Agreement and accordingly have been superseded thereby.

2. The Trial Court Engaged In Circular Reasoning To Justify Its Use Of Parol Evidence To Enforce the Prior Agreements Notwithstanding the HLA Agreement's Integration Clause

The HLA Agreement, with its integration clause, is a final and complete

agreement between two sophisticated parties. As such, it constitutes a fully integrated, unambiguous agreement. Had the parties wished to preserve these Prior Agreements, they knew how to do so:

> A matter of particular importance in drafting [an agreement] for a complex business dispute is to ensure that the agreement clearly states whether prior agreements among some or all of the settling parties are intended to survive the settlement. *To the extent any prior agreement or any portion thereof, is intended to survive, language should be incorporated into the integration clause to effectuate that intent*.

ev3, Inc., 114 A.3d at 532 (emphasis added). Lyrical was a sophisticated party with sophisticated counsel. It chose not to insist that the HLA Agreement incorporate terms giving continuing effect to the Prior Agreements. This is fatal to Lyrical's claim, as *Liquidation of* Freestone illustrates. There, the parties first entered an overarching "Custody Agreement," which provided for payment obligations arising under "any other agreement." The court held that this provision did not extend to a later Accident Trust Agreement "because it was executed after the Custody Agreement and contains an integration clause." 2014 WL 7399502, at *9.

Here, the Prior Agreements were entered into in or before July 2005 and in April 2004, respectively, *before* the integrated HLA Agreement.[2] The fact that the

[2] The Opinion suggests that the Clawback Agreement was "expanded" in 2006, in exchange for additional investments from Lyrical, but this is not so. Op. 17-18, 40. Rather, the Clawback Agreement was agreed to in 2005, and later memorialized by Mehta's April 8, 2008 email, as Lyrical has repeatedly acknowledged. *See, e.g.*, A449-450 (stating the Clawback Agreement was agreed to by July 2005 and that the April 8, 2008 email "detailed [the 2005] agreement," and citing

HLA Agreement does not incorporate, or otherwise exclude from the consequences of its integration clause, the Clawback Agreement or the Term Sheet "split" of the Carry provision means both are superseded. This should end the inquiry.

To avoid that outcome, however, the trial court relied solely on parol evidence to conclude that the parties intended the Prior Agreements and the HLA Agreement to be "read together" to "govern the distribution and allocation of the proceeds from the Revolabs sale." Op. 38-42, 46. The court then relied on this same parol evidence to find that its failure to enforce the Prior Agreements would "produce [the] absurd result" that, in turn, supposedly permitted the court to rely on parol evidence in the first place. Op. 29. This circular reasoning was error.

Extrinsic evidence of the parties' conduct, on which the court erroneously relied, cannot vary the HLA Agreement's clear terms. Op. 38-39. Where, as here, the parties have entered an unambiguous integrated agreement, their own behavior cannot render the document ambiguous to justify using parol evidence.

> Consideration of this extrinsic evidence is inappropriate for one reason: it is irrelevant because the Operative Agreements and the Mistras Transactional Documents are not ambiguous with respect to Mrs. Ostroff's claim to the policy proceeds. Disagreement as to facts after the parties have contracted does not prove ambiguity in the documents themselves.

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no "expansion" in the interim); A1249 (stating the Clawback Agreement was "subsequently reaffirmed"—but not expanded—"on multiple occasions when [Finger Lakes] was seeking more money from Lyrical"). The court did not cite any factual support for such "expansion," aside from JX 65, which is a 2006 email from Mehta to Keswin that references the *existing* Clawback Agreement but states nothing about any "expansion" or change to the Clawback Agreement's terms. *See* Op. 18; A240-41.

Ostroff v. Quality Servs. Lab., Inc., 2007 WL 121404, at *12 (Del. Ch. Jan. 5, 2007); *see also Manley v. Assocs. in Obstetrics & Gynecology, P.A.*, 2001 WL 946489, at **4-6 (Del. Super. July 27, 2001). The court was therefore prohibited from using parol evidence to create the very "absurdity" it then used to justify setting aside an unambiguous agreement. *See, e.g.*, *Knight v. Caremark Rx, Inc.*, 2007 WL 143099, at *1 (Del. Ch. Jan. 12, 2007) ("I reject [plaintiff's] attempt to create an ambiguity by introducing parol evidence that supposedly demonstrates that [defendant] had a subjective understanding contrary to their plain language").

3. The Trial Court's Reference To "Scope" Does Not Justify Reliance On Parole Evidence

Having first ruled that the Prior Agreements cannot modify the HLA Agreement when it granted Finger Lakes' motion for judgment on the pleadings (A426), the trial court determined that the Prior Agreements remain enforceable because the "scope" of the integration clause of the HLA Agreement, which is a "special purpose agreement," does not extend to ongoing business relationship between Lyrical and Finger Lakes created by the Prior Agreements, which are "overarching agreements that applied across multiple investments." Op. 38, 41. The HLA Agreement's integration clause, however, includes "all of the understandings and agreements of whatsoever kind and nature" between the parties "with respect to [its] subject matter," which the court found "was the investment in Revolabs." Op. 38; A230 § 9.6. The

terms of the Prior Agreements at issue here fall within the HLA Agreement's integration clause because they concern, among other things, "the distribution and allocation of Revolabs proceeds." Op. 46. Moreover, the court's characterization of the Prior Agreements as "overarching" agreements is not relevant here, because a later integrated agreement supersedes a prior agreement insofar as the two agreements address the same subject matter, whether or not the prior agreement is "overarching" or the later agreement is "special purpose." *See Ostroff*, 2007 WL 121404, at *10; *Minn. Invco of RSA #7, Inc. v. Midwest Wireless Hldgs., LLC*, 903 A.2d 786, 795 (Del. Ch. 2006); *see also Dubuque v. Taylor*, 2007 WL 3106451, at *2 (Del. Super. Oct. 1, 2007).

In *Ostroff*, a company first agreed under a "Split Dollar Agreement" to pay life insurance premiums for an employee "so long as the Employee remains in the active employ of the Company." The company and the employee, among others, later entered a Stock Purchase Agreement with a third party under which the third party acquired control of the company. The Stock Purchase Agreement contained a new employment agreement between the employee and the company, made no provision for the payment of premiums or death benefit on a life insurance policy, and most important, contained an integration clause. The court held that "because the subject matter of both [agreements] did concern employment, the Stock Purchase Agreement . . . superseded [the Split Dollar Agreement]." *Id*. at *10.

In *Minnesota Invco*, the plaintiff argued that a "right of first refusal" in an earlier 1995 agreement survived a later integrated agreement made in 1999. Invco rejected the argument that "the court should narrowly construe 'subject matter' so that the integration clause is strictly limited to the section in the 1999 agreement that discusses the purpose of that agreement." 903 A.2d at 795 n.52. The court held that the prior agreement, if enforced, would alter the outcome contemplated by the later agreement and thus, the later agreement, by its silence, extinguished the earlier agreement's right of first refusal. *Id.* at 795.

The court withheld entering the judgment it had ordered on January 28, 2015 so that the court could determine at trial whether the Defendants' counterclaims could be used to recoup or offset the judgment. A426. Instead, after trial, the court stated it held the trial to determine the "scope" of the Prior Agreements and to determine the "scope" of the HLA Agreement's integration clause. Op. 29, 37-38. The "scope" of the Prior Agreements, however, should not be at issue, because the "scope" of those agreements remains undisputed. *See supra* 3-4, 7-8. Nor should the "scope" of the HLA Agreement's integration clause be at issue, because the scope of the HLA Agreement's integration clause is defined by its subject matter. *See Ostroff*, 2007 WL 121404, at *10. Rather, the issue is whether the later, fully integrated HLA Agreement supersedes the Prior Agreements insofar as they address

the same subject matter. The trial court's holding that the Prior Agreements' "overarching" form, coupled with the HLA Agreement's ostensibly "special purpose" nature, require enforceability of the Prior Agreements, cannot be reconciled with Defendants' admission, *see supra* 4, 12-13, and the trial court's prior determination, Op. 30, that each of the Prior Agreements alter the outcome contemplated by the parties in the HLA Agreement.

4. Even If The Prior Agreements Did Not Modify the HLA Agreement's Terms Directly They Still Should Not Be Enforced Because They Concern The HLA Agreement's Subject Matter and are thus Superseded.

The trial court supported its conclusion by holding that the Clawback Agreement does not modify Section 7.1(c) of the HLA Agreement because the Revolabs proceeds are first distributed to the parties "in their capacity as members" under the HLA Agreement and "then reallocated in accordance with [the parties'] other agreements" apparently in some other capacity. Op. 1.

The court's reference to "distribution" under the HLA Agreement followed by a "reallocation" under the Prior Agreements does not make the parol evidence rule inapplicable. In sum, the trial court's holding resulted in the Prior Agreements modifying, directly, the later, fully integrated HLA Agreement such that (1) the Term Sheet reduced the amount otherwise distributable to Finger Lakes; and (2) the Clawback Agreement reduced the amount otherwise distributable to Finger Lakes further to negative $8.9 million. Indeed, the Judgment ordered HLA to distribute

the *entire* net gain, including the Carry, to Lyrical, bypassing Finger Lakes altogether. Judgment at 2. This left Finger Lakes with nothing to "reallocate" to Lyrical. But even had the court ordered HLA to distribute the entire $5.9 million Carry to Finger Lakes and ordered Finger Lakes to then "reallocate" all or a portion of that amount to Lyrical under the Prior Agreements, that decision should still be reversed because the Prior Agreements address subject matter covered by the later, fully integrated HLA Agreement—the split of the Revolabs Proceeds between Finger Lakes and Lyrical. 11 WILLISTON ON CONTRACTS § 33:1 (4th ed.) (explaining that, "evidence that seeks to prove an agreement or understanding arising out of the parties' words or conduct spoken or engaged in prior to or contemporaneous with the execution of the final, fully integrated written agreement. . . may not be used to vary, supplement, or contradict language appearing in the contract.").

II. EVEN IF THE PRIOR AGREEMENTS ARE NOT SUPERSEDED BY THE HLA AGREEMENT, THE COURT ERRED WHEN IT HELD THAT FINGER LAKES WAS NOT ENTITLED TO ANY CARRY

A. Question Presented

Even if the Prior Agreements are enforceable, did the court err when it determined that Finger Lakes was not entitled to any Carry at all? A1326-28; A1345-53.

B. Standard And Scope Of Review

The Court reviews a trial judge's contract interpretations *de novo*, and will overturn findings of fact if they are clearly erroneous. *See supra* § I.B.

C. Merits Of The Argument

The trial court's holding that Finger Lakes was not entitled to any Carry at all was based on its misinterpretation of the Clawback Agreement. The court's holding was thus erroneous. Under the correct interpretation of the Clawback Agreement, if it is otherwise enforceable, Finger Lakes is entitled to $2.6 million of Carry.

Were it enforceable, the Clawback Agreement only reduces Finger Lakes' distributive share of HLA's profits by 25% of the Clawback Amount—from $5.9 million to $2.6 million—rather than eliminating the Carry entirely. Lyrical conceded this. *See* A506, A510 ("Giving effect to the Clawback will reduce [Finger Lakes'] share of the Revolabs proceeds by 25% of Lyrical's losses on other [Finger Lakes] managed investments"); A1257 (same).

In the Reargument Order, the trial court explained its interpretation of the

Clawback Agreement as being based on a "belief" that "Lyrical did not agree to subsidize 75% of the Clawback Amount and that if Finger Lakes had asked Lyrical specifically to do so, then Lyrical would have rejected that position." Reargument Order at 2. This is error because the court's "belief" has no support in the record. The pleadings, evidence and parties' briefs unequivocally support the *opposite* interpretation. In contrast, the record demonstrates good reason why the Clawback Agreement provided Finger Lakes with participation in the upside if the Finger Lakes/Lyrical investments as a whole produced net gain. *See* A240 ("It would be unrealistic in any PE situation for the Partners of a firm to make up investment losses via their carried interest [or Carry] rather than a clawback (with the idea being if I make up your money back from a loss, we should be able to participate in the upside), as we'd never have any upside going forward (and that's not a situation that makes sense for either of us, given our incentives).").

Thus, Finger Lakes remained incentivized to do its best as manager of the LLCs because its distributive share would not be eliminated, but merely capped at 25% of the net gain obtained from the entire LLC investment portfolio. With HLA/Revolabs, that incentive paid off: through Finger Lakes' efforts, the Revolabs investment resulted in a $27 million gain for the parties. Under the trial court's interpretation, for Finger Lakes to receive *any* Carry, HLA would be required to

realize over four times the Clawback Amount as its profit from the Revolabs investment (or *over $53.6 million*) and over six times that amount to earn a Carry of $5.9 million. Thus, even if the HLA Agreement does not supersede the Clawback Agreement, Finger Lakes still is entitled to receive its Carry in the amount of $2.6 million, or $2 millions, if the Term Sheet "split" provision is enforced.

III. THE COURT ERRED IN HOLDING THAT THE HLA AGREEMENT DID NOT SUPERSEDE THE PROVISION OF THE TERM SHEET CONCERNING SPLIT OF MANAGEMENT FEES

A. Question Presented

Did the court err in holding that the parol evidence rule does not bar evidence of the Term Sheet provision concerning management fee splits, even though it modified the terms of the subsequent fully-integrated HLA Agreement? A1282.

B. Standard And Scope Of Review

The Court reviews a trial court's contract interpretations *de novo*, and will overturn findings of fact if they are clearly erroneous. *See supra* § I.B.

C. Merits Of The Argument

The parol evidence rule "bars the admission of evidence extrinsic to an unambiguous, integrated written contract for the purpose of varying or contradicting the terms of that contract." *Galantino*, 46 A.3d at 1081. The trial court violated that rule by modifying the HLA Agreement to permit enforcement of the Term Sheet "split" of management fees.

The HLA Agreement (and other operating agreements between Finger Lakes and Lyrical) deal with this same subject matter twice.[3] *First*, Section 4.2(p) authorized Finger Lakes, as Manager, to "do any act which is desirable, convenient, or

[3] The two other relevant agreements are those governing the parties' investments in Portadam, Inc. (A298-A327) and Rethink Autism (A243-A279).

incidental to conduct the business and affairs of the Company." This power included providing management services to portfolio companies and, consequently, collecting management fees in exchange. A219. *Second*, Section 4.6 authorized Finger Lakes "to engage in, conduct or participate in any business or activity whatsoever, without any accountability, liability, or obligation whatsoever to the Company or to any other Member." A220. Thus, Finger Lakes can have no liability to Lyrical for fees collected by it for management services provided to Revolabs and other Finger Lakes/Lyrical portfolio companies. Lyrical cannot rewrite the Term Sheet to impose a management fee liability that it surrendered in the HLA Agreement.

Finally, the management agreement between Finger Lakes and Revolabs is a byproduct of the Revolabs investment (just as the management agreement between Finger Lakes and other portfolio companies is a byproduct of the other LLCs' investments in them). As such, the Term Sheet management fee "split" provision constitutes an agreement in respect of the subject matter of the HLA Agreement—*i.e.*, the investment in Revolabs and is accordingly superseded by them (and, again, the same is true with regard to all the portfolio companies, the LLCs' investments in them and the precedence of the agreements governing those LLCs).

IV. THE COURT ERRED IN HOLDING THAT LYRICAL CAN RECOVER ITS TIME-BARRED MANAGEMENT FEE COUNTERCLAIM AS AN OFFSET OR IN RECOUPMENT

A. Question Presented

Did the court err when it held that Lyrical can recover on an otherwise time-barred counterclaim for management fees (if not otherwise superseded by the parties' LLC Agreements) by way of recoupment or offset? A1317-18.

B. Standard And Scope Of Review

The Court reviews the court's interpretation of Delaware law *de novo*. *Gotham P'rs, L.P. v. Hallwood Realty P'rs, L.P.*, 817 A.2d 160, 170 (Del. 2002).

C. Merits of The Argument

Finger Lakes showed at trial that laches limits Lyrical's counterclaim for management fees to the three years preceding this litigation. 10 *Del. C.* § 8106(a); *Durham v. Grapetree, LLC*, 2014 WL 1980335, at *6 (Del. Ch. May 16, 2014) (limiting plaintiff's recovery to expenses incurred three years before litigation). The trial court held that $6,247,472 of Lyrical's management fee claim fell outside this period. However, it held that Lyrical could rely on those amounts "to support its affirmative defenses of recoupment and setoff, to which laches does not apply." *Id.* That ruling was error.

1. Statutory Law Prohibits Setoff Of Time-Barred Debt

The trial court erred by ignoring the controlling statute, 10 *Del. C.* § 8120,

which provides: "This chapter shall apply to any debt alleged by way of *setoff* or counterclaim on the part of a defendant. The time of limitation of such debt shall be computed in like manner as if an action therefor had been commenced at the time when the plaintiff's action commenced." (emphasis added).

Under this statute, when a defendant asserts a debt owed by the plaintiff as a setoff against a debt owed by the defendant, the alleged setoff debt is subject to the statute of limitations in the same manner as if the defendant had commenced a separate action. *See also Greer v. Moore*, 166 A. 403, 404 (Del. Ch. 1933) ("if the claim constituting the item of setoff is subject to the bar of the statute of limitations at law, the complainant may rest securely behind the defense of the statute against its assertion by way of setoff.").

Section 8120 is dispositive here. Lyrical asserted a debt allegedly due to it under the Term Sheet for management fees that Finger Lakes received more than three years before this litigation—and therefore outside the limitations period—as a *setoff* to the distribution contractually due to Finger Lakes from HLA under the HLA Agreement. Lyrical can no more assert such a time-barred claim as a setoff than it could commence an independent separate action on that time-barred debt. The court erred in awarding any such amounts as a setoff to Finger Lakes' distribution due under the HLA Agreement.

2. Recoupment Is Unavailable For A Debt Involving Different Parties and a Different Transaction than Finger Lakes' Claim

The trial court's ruling on recoupment was also erroneous. Recoupment, unlike setoff, permits a defendant to avoid the statute of limitations bar for a prior debt up to the amount sought by plaintiff. However, the defendant must show that: (1) "the recoupment claim arises out of the same transaction or occurrence as the plaintiff's suit"; and (2) "both the primary damages claim and the claim in recoupment must involve the same litigants." *TIFD*, 883 A.2d at 859 (internal punctuation omitted). *See also Universal Enter. Grp., L.P. v. Duncan Petroleum Corp.*, 2014 WL 1760023, at *8 (Del. Ch. Apr. 29, 2014) (discussing availability of recoupment where plaintiff's obligation to the defendant "*aris[es] out of the same* transaction" as plaintiff's action) (emphasis added).

TIFD's reasoning is dispositive here. There, a limited partner had a dispute with the general partner about how to distribute assets upon dissolution of the partnership. The general partner asserted, by way of recoupment, a time-barred derivative claim on behalf of the partnership, alleging that the limited partner had financially injured the partnership more than three years earlier. The court dismissed the recoupment claim on two grounds. *First*, the claim and counterclaim involved different parties. 883 A.2d at 863. *Second*, the "same transaction" requirement was not satisfied because, although both claims arose out of a *single contract*, the deriv-

ative recoupment claim did not arise out of the same transaction as the limited partner's claim. *Id.* at 863-64.

A fortiori, recoupment is unavailable here. Finger Lakes seeks a distribution from (1) *HLA* under (2) the *HLA Agreement*. By contrast, recoupment is asserted by (1) *Lyrical*, not HLA, under (2) the *Term Sheet*, not the HLA Agreement. The claims involve not only different *contracts* but different *transactions*: Lyrical seeks management fees paid to Finger Lakes by portfolio companies, while Finger Lakes seeks its distributive share of HLA's profit from Revolabs. Thus, Lyrical cannot assert recoupment for time-barred management fees.

The court's use of the label "affirmative defense" does not avoid this time bar. Again, *TIFD* is dispositive. The defendant there asserted the recoupment claim *as an affirmative defense*. *TIFD*, 883 A.2d at 863. That label did not prevent dismissal of the time-barred recoupment claim.

Nor do the cases cited in the Opinion hold otherwise. *Atkins v. Hiram*, 1993 WL 287617, at *1 (Del. Ch. July 26, 1993), *see* Op. 45, did not address the issue of setoff or recoupment. It held only that an affirmative defense concerning the alleged invalidity of an election is not time-barred. Thus, it offers no basis to seek an offset for time-barred debt.

Delaware Chemicals v. Reichold Chems, Inc., 121 A.2d 913, 918 (Del. Ch. 1956), *see* Op. 45, is also inapposite. In *Reichold*, plaintiff alleged that the defendant

stole its trade secrets in breach of an agreement. The defendant asserted that the agreement was fraudulently induced. The court held only that, to the extent defendant desired to assert these claims "defensively" as an affirmative defense to enforcement of the contract, it had leave to amend. What *Reichold* did *not* hold is that the plaintiff could seek to recover otherwise time-barred damages as an offset or recoupment. To the contrary: *Reichold* noted that the rule that statute of limitations are "not applicable to defenses" applies "*only in the cases of strict defenses* [*i.e.*, defenses to liability], and in the absence of statute, *does not apply to cases of set-off or counterclaim*." *Id.* at 501-02 (emphasis added; internal quotation marks and citations omitted).

Accordingly, the trial court erred as a matter of law in holding that Lyrical could assert setoff or recoupment of time-barred management fees as an "affirmative defense" to payment due Finger Lakes under the HLA Agreement.[4]

[4] While the court's erroneous ruling did not affect the Judgment below, it has significant impact on this appeal. As shown in Point II, *supra*, under a correct interpretation of the Clawback Agreement, Finger Lakes is entitled to a money judgment, regardless how the court decides the other issues on appeal. If the court deems the Term Sheet enforceable, then Lyrical's management fee claim must be limited to that portion that was timely asserted; as shown here, neither offset nor recoupment is available for the time-barred amount of $627,642.

V. THE COURT ERRED WHEN IT LIMITED FINGER LAKES' FEES TO $137,043 AND DENIED THE BALANCE OF ITS INDEMNIFICATION CLAIM.

A. Question Presented

Did the court err in limiting Finger Lakes' indemnity under the HLA Agreement to $137,043 because Finger Lakes was not entitled to indemnification for its defense against Lyrical's counterclaims because those claims pertained to the "overarching business deal" between Finger Lakes and Lyrical? A1329-30.

B. Standard And Scope Of Review

The Court reviews a trial judge's contract interpretations *de novo*, and will overturn findings of fact if they are clearly erroneous. *See supra* § I.B.

C. Merits Of The Argument

The trial court limited Finger Lakes' claim for indemnity under Section 4.4 of the HLA Agreement to fees incurred prior to its judgment on the pleadings based on its assertion that the counterclaims and affirmative defenses pertain to "the overarching business deal between Finger Lakes and Lyrical," and not to Finger Lakes "status as a member" of HLA. Op. 34. This was error.

Section 4.4(a) of the HLA Agreement entitles HLA's members to indemnity for all costs and expenses, including attorneys' fees, incurred in "any proceeding to which such [member] is made a party or which such [member] otherwise becomes involved in because such [member] is or was a Manager or Member of [HLA]." Op.

34 (quoting A219-20 § 4.4(a)). The Court limited Finger Lakes' claim to attorneys' fees incurred before it granted Finger Lakes' motion for judgment on the pleadings based on the reasoning that, thereafter, the proceedings did not relate to Finger Lakes' status as a member of HLA but rather under the parties' "overarching business deal. . . ." Op. 35.

HLA and Lyrical interposed its counterclaims and affirmative defenses in this action to stop Finger Lakes from receiving the distribution to which it is entitled under the HLA Agreement. The counterclaims and affirmative defenses thus directly relate to Finger Lakes' status as a member of HLA. Finger Lakes disputed the court's determination that the business relationship created by the Prior Agreements constitutes a defense to HLA's obligation to distribute to it the amounts to which it is otherwise entitled under the terms of the HLA Agreement. Accordingly, HLA is required to indemnify Finger Lakes for all legal fees incurred defending against those claims and defenses asserted against it in this case, including the legal fees incurred by it in prosecuting this appeal.

Those counterclaims and affirmative defenses, based on the Clawback Agreement and the Term Sheet, constitute an attempt to defeat Finger Lakes' claim that it is entitled to a $5.94 million distribution from HLA as required by the unambiguous terms of the integrated HLA Agreement. As such, and contrary to the court's reasoning, the counterclaims and affirmative defenses directly pertain to "Finger Lakes'

status as a member of HLA and its effort to compel a distribution in that capacity" under the HLA Agreement. *See* Op. 34. Finger Lakes should therefore receive indemnity for all fees incurred pursuant to Section 4.4 (a) of the HLA Agreement. *See* A219-20.[5]

CONCLUSION

For the reasons set forth above, the court should (1) reverse the court's Judgment and the underlying Opinion and Reargument Order, and (2) award Finger Lakes $5,940,860.64, representing its distributive share under the HLA Agreement, together with attorney's fees and prejudgment interest.

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[5] The trial court also held Finger Lakes was not entitled to indemnity because Shalov and Mehta engaged in "willful misconduct" under Section 4.4(a) of the HLA Agreement by not complying with the Term Sheet and Clawback Agreement. Op. 36. This, too, was error. Finger Lakes' decision to bring suit and "ignore" the prior two agreements on the basis of the HLA Agreement's integration clause—for which it obtained judgment on the pleadings—can hardly be characterized as "willful misconduct" depriving it of indemnification under the HLA Agreement.