IN THE SUPREME COURT OF THE STATE OF DELAWARE

LEAF INVENERGY COMPANY, a Cayman Islands exempt limited liability company, Plaintiff Below-Appellant/ Cross-Appellee, v. INVENERGY RENEWABLES LLC, a Delaware limited liability company, Defendant Below-Appellee/ Cross-Appellant.	No. 308,2018 Court Below: Court of Chancery of the State of Delaware, C.A. No. 11830-VCL PUBLIC VERSION filed November 20, 2018

REPLY BRIEF ON CROSS-APPEAL OF DEFENDANT BELOW-APPELLEE/CROSS APPELLANT INVENERGY RENEWABLES LLC

MORRIS, NICHOLS, ARSHT & TUNNELL LLP
Kenneth J. Nachbar (#2067)
Kevin M. Coen (#4775)
Zi-Xiang Shen (#6072)
Coleen W. Hill (#6287)
1201 N. Market Street
P.O. Box 1347
Wilmington, DE 19899-1347
(302) 658-9200
Attorneys for Defendant Below-Appellee/Cross Appellant Invenergy Renewables LLC

November 5, 2018

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

Cases

PRELIMINARY STATEMENT

In its answering brief on appeal (and opening brief on cross-appeal) Invenergy argued the trial court erred in failing to set aside Leaf's put-call appraisal as being "unworthy of respect because it does not, as a result of contractual wrongdoing, represent the genuine impartial judgment on value that the contract contemplates." AB at 59,[1] citing *Senior Hous. Capital, LLC v. SHP Senior Hous. Fund, LLC*, 2013 WL 1955012, at *26 (Del. Ch. May 13, 2013). Invenergy argued the trial court erred by treating Leaf's appraisal as "independent" when the facts indicate it was dramatically increased as a result of (i) Leaf's instruction that XMS's appraiser use a definition of fair market value as the "highest amount that could be achieved . . . on an M&A sale" (*id*. at 9, 59, citing Op. 93 (quoting A993); B561), and (ii) Leaf's pressuring XMS within days of its original $45.7-56.7 million appraisal to slash the original discount rate of 15% for the speculative development pipeline valuation to 10% and then 9%. *Id*. at 61-62. The facts, which cannot be disputed, show that through its admitted "cajoling" and

[1] Invenergy's Answering Brief on Appeal and Opening Brief on Cross-Appeal is cited herein as "AB." Leaf's Reply Brief on Appeal and Answering Brief on Cross-Appeal is cited herein as "RB."

"bird-dogging," Leaf caused XMS to raise the valuation of the pipeline from a low of $300 million to $900 million (the "top of the range").

Leaf begins its argument defending its communications with its appraiser, XMS, by asserting a technical argument that Invenergy did not identify a contractual provision prohibiting such interference with the independent appraiser. Leaf argues that Invenergy failed to sufficiently identify any "gap" that would justify breach of the implied covenant of good faith and fair dealing. RB at 33-34. Leaf did not make this argument in the trial court[1], and for good reason: *Senior Housing* squarely holds that where, as here, a contract requires valuation issues to be resolved by third-party appraisers, the implied covenant of good faith and fair dealing prohibits the parties from "tak[ing] action to taint the appraisal process" by, for example, "pressur[ing]" an appraiser to raise or lower its valuation. 2013 WL 1955012, at *26, *2.

Leaf next claims its instruction to its appraiser to use a definition of fair market value as "the high end of its valuation range" was reasonable. RB at 35. Leaf acknowledges the trial court so held based on an earlier version of the

[1] Leaf's failure to raise this argument in the trial court constitutes a waiver under Supreme Court Rule 8.

LLC Agreement, which defined fair market value as the "highest price" that could be obtained in a sale transaction. Op. at 93 (quoting B1532). Significantly, this language was *deleted* from the final LLC Agreement that was in place at the time of the put and governed the parties' rights. A545; Op. at 94. Thus, the "highest price" standard that Leaf instructed its appraiser to use conflicts with the definition in the operative LLC Agreement, as well as with the standard typically applied under Delaware case law.

Leaf also attempts to distinguish *Senior Housing* on the grounds that the factual record shows that XMS was not improperly influenced by Leaf's admitted "cajoling" and "bird-dogging." RB at 36-37. It is undisputed, however, that this "cajoling" and "bird-dogging" resulted in a dramatic increase in XMS' valuation in the space of a few days, from a midpoint of $51.2 million to a final valuation of $73.1 million. As shown herein, contrary to Leaf's assertions, there was ***no*** credible explanation for this change. The XMS representative, James Nygaard, testified in wholly conclusory terms that the changes were "justif[ied]" and were not the result of Leaf's "pressure[]" (B919; B921), but the actual factual record demonstrates the opposite. XMS was not able to offer ***any*** coherent explanation for its sudden and last-minute decision to slash the discount rate on its

development pipeline from 15% to 9%, which resulted in the dramatic valuation increase here in issue. As Leaf admits, the critical factor driving the result in *Senior Housing* was that "the appraiser who made the change could not identify any specific reason for it." RB at 38 (quoting *Senior Housing*, 2013 WL 1955012, at *39). As shown herein, that is the ***exact*** situation here, as Nygaard offered no credible explanation for his last-minute changes to his discount rate.

Finally, Leaf asserts that Invenergy also communicated with its appraiser and seeks refuge in the trial court's statement that the interactions between each principal and its appraiser "did not differ in kind." RB at 32 (quoting Op. 90). This is no answer – even if Invenergy had interfered with its appraiser, Leaf's own wrongdoing would not be excused. But in all events, there was no equivalency: as shown herein, Invenergy's discussion with its appraiser involved issues of ***fact,*** not the judgmental determinations influencing value, and those interactions in total resulted in Invenergy's appraiser increasing its valuation of Leaf's interest.

ARGUMENT

I. THE COURT ALLOWED AN ERRONEOUS DEFINITION OF FAIR MARKET VALUE

Leaf concedes it instructed XMS to use the "highest" end of its valuation range. A974 (Alemu); A993 (Alemu). Leaf seeks to justify this instruction by construing the definition of Fair Market Value ("FMV") in the LLC Agreement as requiring the "highest amount that could be achieved . . . on an M&A sale." B561 (Alemu); RB at 35; *see also* A974. XMS followed this instruction. B909-910 (Nygaard); RB at 38-39.

This standard is contrary to the definition of fair market value applied by Delaware courts. As the Delaware Supreme Court's recent decision in *DFC Global Corp. v. Muirfield Value Partners, L.P.*, 172 A.3d 346, 370 (Del. 2017), held:

> fair value is just that, "fair." It does not mean the highest price that a company might have sold for had Warren Buffet negotiated for it on his best day and the Lenape who sold Manhattan on their worst.

Numerous Delaware decisions define Fair Market Value as the "price which would be agreed upon by a willing seller and a willing buyer, under ordinary circumstances, neither party being under any compulsion to buy or sell." *Young v. Red Clay Consolidated School Dist.*, 2017 WL 2271390, at *3 (Del. Ch. May 24,

2017); *Improved Parcel of Land Known as No. 400 Maryland Ave. v State Highway Dep't.*, 201 A.2d 453, 454 (Del. 1964).[2]

The trial court nonetheless accepted Leaf's contrary definition of Fair Market Value as reasonable. Remarkably, it reached its conclusion that Leaf's instruction was not unreasonable by relying on the definition of "Fair Market Value" set forth in an earlier, superseded version of the LLC Agreement (the Second Amended LLC Agreement, (Op. at 93, n. 365) which defined FMV as the **"highest price** per unit of equity interest which the Company could obtain from a willing buyer . . . for the Company's Company Interests . . . . " B1532 (emphasis added). The trial court's reliance on the Second LLC Agreement language was legally improper for two reasons.

First, as the trial court recognized, the "highest price" language was "dropped" from the final governing LLC Agreement (the Third Amended LLC Agreement). Op. at 94; A545. That agreement defines FMV as "the amount that could be obtained from an arm's length willing buyer . . . ." Op. 94 (quoting

---

[2] The use of the word "could" rather than "would" makes no difference – it is the same. Could means "can" – it does not imply the highest price. If the parties meant "highest price" they would have said so, as they did in the prior LLC agreement.

A545). There is nothing ambiguous about the operative Third Amended LLC Agreement that required or permitted reference to the abandoned definition in the Second LLC Agreement. The operative agreement is clear, and it does not mandate use of the "highest" value. Under the parol evidence rule, the Second LLC Agreement cannot be used to interpret the definition of Fair Market Value in the Third LLC Agreement absent an ambiguity establishing that Leaf's interpretation is reasonable under Delaware law – and there is none here. *RTN Investors LLC v. RETN LLC*, 2011 WL 862268, at *13 (Del. Super. Feb. 10, 2011); *see also Yencer Builders Inc. v. Fabi*, 2010 WL 8250829, at * 1 (Del. Super. Oct. 1, 2010) ("[T]he general rule is that Courts interpreting an integrated contact should not consider prior or contemporaneous communications that are not within the four corners of the document.").

Second, to the extent the Second LLC Agreement is relevant at all, it is evidence that the Third Amended Agreement should not be read to include the "highest price" standard. *Cohen v. Formula Plus Inc.*, 750 F. Supp. 2d 495, 504-05 (D. Del. 2010) (where an earlier version of a contract contained an arbitration clause and the next, controlling, one did not, the integration clause unambiguously required the later contract to control and the arbitration clause had no effect).

Because the parties abandoned the use of the "highest price a purchaser could pay" criteria – which in all events is contrary to the plain language of the agreement and the definition typically applied under Delaware law – the Court erred by deferring to XMS' use of this "highest value" approach to appraise Leaf's interest.

II. LEAF'S INFLATION OF XMS'S APPRAISAL WAS NOT "JUSTIFIED"

Leaf also defends its inflation of the XMS appraisal by contending the trial court properly found *Senior Housing* does not apply because the court correctly found that XMS' last-minute slashing of the discount rate applied to Invenergy's development pipeline was "justif[ied]" and the result of "independent judgment", distinguishing this case from *Senior Housing*. RB at 37, 39. As shown below, the trial court cited no evidence to support this conclusion, other than conclusory and self-serving denials of wrongdoing by XMS' principal, Nygaard. Significantly, as shown below, Nygaard, was not able to offer any justification for his last-minute change in discount rates, and the present case is therefore indistinguishable from *Senior Housing.*

In *Senior Housing*, CalPERS' principal, Pottle, exerted pressure on Cushman and Wakefield to lower its discount rate to achieve CalPERS' preferred valuation. As then-Chancellor Strine described it: "after Pottle spoke with Dennis, Cushman and Wakefield increased the discount rate to 13%" (from 11.5%), wiping out over $18 million in value. *Senior Housing*, 2013 WL 1955012, at *18. And he noted, "the reasoning that [C&W] used to support the 13% figure was identical to that [which] it used to support the 11.5%." *Id.* Chancellor Strine held that because the defendant could not provide "any specific reason" for such changes, the changes should be disregarded. *Id.* at *39. The facts here – which are undisputed – bear a remarkable similarity to the facts in *Senior Housing*:

1. On April 20, 2016, days before the deadline for valuing Leaf's interest, XMS valued Leaf's interest at $45.7 – $56.7 million, with the Invenergy development pipeline valued between [redacted] B999, B1004; B246. XMS believed its appraisal was final. B425.

2. On April 21, 2016, Nygaard, the XMS partner managing the appraisal, had a call with Leaf to inform Leaf of XMS's appraised value. Yonatan Alemu, Leaf's principal, told Nygaard the value was too low and gave him the reasons why it should be higher. A992.

3. Gordon Dean, Leaf's advisor, then immediately called Nygaard and told him the value was too low; he stated there was a "complete disconnect" between the cash flow projections and the market and expressed his "hope . . . you can at least get to the higher end of this pathetic range." B1071-1072; A1054 (Dean).

4. By the end of the next day (April 22), XMS increased its valuation to a range of $57.8 – $71.1 million. B282. It did so principally by decreasing the discount rate for the pipeline from 15% to 10%, thereby increasing its value from [redacted]. Patrick O'Hara (of XMS) wrote in his notes: "what is going to move the value is the pipeline, so we have flexibility here." B391.

5. Then, a few days later, after another call from Leaf, XMS again lowered the discount rate on the pipeline to 9% and then used the upper limit of [redacted] as the pipeline value. B411-12.

6. Throughout this period, Leaf and its advisor Dean "cajoled" XMS to appraise Invenergy at the top end of what Dean described as its "pathetic" range. A1050 (Lerdal); A1054 (Dean).

7. Mark Lerdal, Leaf's Executive Chairman, admitted XMS increased its appraisal as a result of Leaf's "cajoling" and "bird-dogging" XMS, all of which generated a "thanks" from Lerdal to Alemu and Dean with a note: "Hopefully you helped them get to the top of their range and a firm number." B419. At trial, Lerdal conceded that "but for Leaf's cajoling and bird-dogging, XMS would [not] have gotten above the top of its prior range [$56.7M]." A1050.

Leaf offers essentially three responses to this obvious interference in the work of the allegedly "independent" appraiser. *First*, it claims that the development pipeline was "only" 28% of the total value, as if that would justify the interference. RB at 37. Second, it asserts that the adjustments were "justif[ied]", and that the trial court's crediting of Nygaard's statements that he was not improperly influenced by Leaf is entitled to deference. RB at 39-41. Finally, Leaf asserts that Invenergy engaged in similar conduct with its appraiser, Navigant, and any of Leaf's interfering with XMS is therefore not actionable. RB at 37-38. None of these assertions has merit.

As to the development pipeline constituting "only" 28% of the XMS valuation, XMS manipulated the pipeline discount rate for the same reason that Willie Sutton robbed banks: that's where the money was. As Nygaard admitted,

XMS considered other changes in its valuation model that could increase the value of Invenergy, but found that they did not "move the needle." B930 (Nygaard) (because other changes "did not move the needle a lot", "there was much more focus on the pipeline"). The place where XMS could significantly increase value was in the development pipeline, and that is therefore where it focused its value-increasing efforts. The fact that those assets represented 28% of the total valuation cannot excuse Leaf's manipulation.

Leaf makes much of the trial court's statement that "both appraisers ultimately exercised independent judgment to reach supportable valuation opinions." Op. at 90, n. 353, quoted at RB at 6, 32, 37, 40. The record does not support the trial court's conclusion. The citations to Alemu and Lerdal (representatives of Leaf) are misplaced – they simply were not in any position to know whether XMS was or was not influenced by Leaf's "cajoling." And, the trial court's citations to Nygaard's testimony are instructive – they consist of statements that Leaf did not demand a specific number; a conclusory statement that Leaf did not "pressure" XMS to get to the top of its range; a conclusory statement by Nygaard that he did not feel "cajoled"; and self-serving responses to leading questions by Leaf's lawyer that Leaf did not do anything improper to influence

XMS and did not specifically tell XMS to use a specific number or that its appraisal should be high.[3]

Significantly, while Nygaard claimed XMS' increases were justified, neither he, Lerdal nor Dean offered any reasons or facts to support the dramatic and almost immediate increase in the pipeline value, which drove XMS' increased valuation – increasing the value from a low of [redacted] value in XMS' final appraisal. Leaf attempts to distinguish *Senior Housing* on the grounds that there was evidence there "that the breaching party 'improperly persuaded' its appraiser to make a 'last-second move' in the discount rate where there was 'no plausible basis' for the change and, critically, 'the appraiser who made the change could not identify any specific reason for it.'" RB at 38 (quoting *Senior Housing*, 2013 WL 1955012, at *39). While Leaf asserts: "There are no such facts here" (*id.*), the record is plainly to the contrary.

As in *Senior Housing*, the relevant change was to a discount rate, and was made at the last minute. There was clearly evidence that the change was the result of the admitted communications from Leaf and its representative, Gordon

[3] The trial court's citations in footnote 353 of its opinion are to Nygaard Dep. at 110, 115, 119 and 180-82. These citations, summarized in the text above, are Appendix pages B920-922, B937-38.

Dean, excoriating XMS for its low valuation. Yet, Leaf seeks to assert that the changes were "justif[ied]," and therefore the Court should credit Nygaard's wholly conclusory assertions that the changes were not the result of pressure or interference by Leaf.

Nygaard's testimony, however, undermines this assertion. Nygaard was asked specifically about the development pipeline discount rate, and testified only that "the rate needed to be above all of the other rates in our model to reflect the speculative nature of the development." B903 (Nygaard). Of course, XMS' original discount rate of 15% was above the general 7-1/2% discount rate XMS used, so Nygaard's testimony does nothing to explain XMS' subsequent slashing of the discount rate from 15% to 9% after Leaf complained that XMS' valuation was too low.

When Nygaard was asked specifically how he determined the adjustment to the general discount rate that led him to use his ultimate 9% development pipeline discount rate, he stated it was the result of "market judgment" and "general experience" of XMS "collectively as a firm." B904 (Nygaard). When asked to explain the decrease in his original pipeline discount rate of 15% to his ultimate rate of 9%, he was completely unable to do so. B924,

et seq. Nygaard admitted that there was no "quantitative analysis" that justified the decrease from the original 15% discount rate to the subsequent 9% discount rate. B928. Indeed, Nygaard testified that "there was no analysis of discount rates" but instead "[t]he numbers that were put in here were very speculative and actually didn't have as much – rigor is the wrong word because, again, were dealing with – these are very high level numbers. They're – they're – they're theoretical. This is nothing close to reality. I just want to be clear about that. Nothing here will mimic the actual development that's undertaken." B925. Nygaard admitted that there was also no "qualitative analysis" of the factors that underlie the change from a 15% long-term development pipeline discount rate to the 9% rate ultimately used. B924.[3] Thus, he offered no explanation at all of why he changed the discount rate from 15% to 9%, and gave no explanation of why he ultimately chose 9% rather than 18%, 12%, 4% or any other rate, beyond "market judgment." Moreover, he admitted that the changes he made to increase the value of Invenergy were "speculative":

---

[3] Nygaard subsequently contradicted himself, stating that there was a qualitative analysis performed to support XMS' discount rate. B928. But his sole explanation of that "qualitative analysis" is that "we wanted to make sure that we were reflecting appropriate value for a buyer who was going to ascribe a high value to the pipeline." *Id*.

> Q: Ultimately, the change between April 21st and the final report relied on a speculative analysis?
>
> A: Correct.

B928 (Nygaard).[4]

Accordingly, the trial court erred in crediting Nygaard's conclusory denials of wrongdoing or improper influence by Leaf. Indeed, the facts here are functionally identical to those in *Senior Housing.* The party obtaining a contractually-mandated appraisal did not like the initial results and therefore prevailed upon the appraiser to manipulate its discount rate to achieve an appraisal more to the litigant's liking. In both cases, the last-minute change in the discount rate significantly altered the valuation and was completely unexplained by any factor other than the litigant's desire to have an appraisal more to its liking. In these circumstances, Nygaard's conclusory assertions that he was not influenced by Leaf cannot be credited, and the trial court's reliance on them (Op. at 90, n. 353) was error.[5]

---

[4] In view of this testimony, Leaf's claim that "Invenergy resorts to *misrepresenting* Nygaard's testimony to suggest he viewed the changes to the value of the pipeline as speculative" (RB at 39) is simply wrong.

[5] The assertions of Leaf representatives, Alemu and Lerdal, that XMS was independent, which are also relied on by the trial court (Op. at 90, n. 353), are similarly entitled to no weight. Beyond being obviously self-serving,

The undisputed facts prove Leaf pressured XMS in the final stages of its work to make unsupported changes in its appraisal, just as in *Senior Housing*.

Finally, Leaf seeks to defend its obvious interference with XMS' appraisal by claiming the trial court held the interactions between Leaf and XMS differed "in degree" but not "in kind" from those between Invenergy and Navigant, its appraiser. RB 32 (citing Op. at 90).

First, as pointed out in Invenergy's answering brief and not addressed by Leaf, such interference by Invenergy, even if it occurred, would provide no justification for interference by Leaf with the work of its appraiser, XMS. *See* AB at 63.[6] If Leaf thought that Invenergy committed wrongdoing, it could have, and should have, raised the issue and sought appropriate relief. Simply put, improper

---

(. . . continued)

conclusory denials, neither Alemu nor Lerdal was in a position to know why XMS made the changes that it did, and their denials that the changes were not the result of Leaf's pressure are therefore entitled to no weight.

[6] Leaf's Answer to Invenergy's Counterclaim (B1542-48, ¶¶24-42) never questioned the validity of the Navigant appraisal or process. *See ThoughtWorks Inc. v. SV Investment Partners*, LLC, 902 A.2d 745, 754 (Del. Ch. 2006) (refusing to address a claim of violation of the implied duty of good faith and fair dealing regarding an alleged interference with the right to obtain a line of credit because it "was not asserted in [plaintiff's] complaint or in any submission prior to trial, but rather was made for the first time in its post-trial brief").

conduct cannot be excused by an assertion that another party engaged in similar conduct.

But in any event, the facts show no equivalency between the actions of Invenergy with Navigant and those of Leaf with XMS. Leaf asserts that Shashank Sane of Invenergy reviewed drafts of the Navigant appraisals. RB at 41. But Sane testified (and his testimony was uncontradicted) that he provided comments on factual inaccuracies in the analysis, such as misallocation of the development expense between the operating business and the development business, incorrect calculation of income and tax rates and a couple of mathematical errors. A1185. As Thomas Houlihan of Navigant explained, the comments by Invenergy were part of the normal process of information flow, and the net result was **to increase** the valuation. B867, B872. Leaf cites changes in the Navigant appraisal values between April 21 and April 26 (RB at 37-38, citing A1180-81) – but in this period Navigant increased the appraised value of the Leaf interest by hundreds of millions of dollars. The April 21 appraisal had a mid-point of $1.35 billion value with the pipeline valued at [redacted] and a discounted cash flow of $[redacted] After Sane pointed out the development expense was incorrectly attributed to the pipeline, later that day the appraisal was changed to

$1.63 billion with a pipeline value of $[redacted] and a discounted cash flow of $[redacted]. *Compare* AR14, *with* AR21. Next, the valuation was changed to $1.92 billion, but then reduced to $1.66 billion, and ultimately to $1.583 billion. These changes reflected, for example, application of the proper tax rate and removal of the TerraForm put option (originally valued at $124 million).[8] *Compare* AR27, *with* B1569, and B1576; *see* B866, 868-69 (Houlihan). Significantly, even though Invenergy as buyer would favor a low appraisal, this value was $200 **million higher** than the mid-point of Navigant's initial appraisal prepared on April 21. AR14. Thus, there is no basis to assert that Invenergy's interactions with Navigant "did not differ in kind" from Leaf's interactions with XMS.

---

[7] Leaf claims the final Navigant appraisal of the pipeline made little sense. RB at 38 n.7. But Moelis the independent appraiser, valued it on the low side at [redacted]. B467.

[8] As Invenergy explained in its Post Trial Answering Brief, Sun Edison, the put counter-party filed bankruptcy on April 21, 2016, just before the appraisal issued. B1342-43, n. 14.

CONCLUSION

For the foregoing reasons, Invenergy respectfully requests the Appraisal issue be remanded to the Court of Chancery for a determination of the Fair Market Value to be used to establish the price at which Invenergy will purchase Leaf's interests in Invenergy pursuant to the Put-Call, with an instruction that the XMS appraisal be disregarded.

MORRIS, NICHOLS, ARSHT & TUNNELL LLP

/s/ Kenneth J. Nachbar
Kenneth J. Nachbar (#2067)
Kevin M. Coen (#4775)
Zi-Xiang Shen (#6072)
Coleen W. Hill (#6287)
1201 N. Market Street
P.O. Box 1347
Wilmington, DE 19899-1347
(302) 658-9200
Attorneys for Defendant Below-Appellee/Cross Appellant Invenergy Renewables LLC

OF COUNSEL:

Bruce S. Sperling
Harvey J. Barnett
Eamon P. Kelly
SPERLING & SLATER, P.C.
55 West Monroe Street, Suite 3200
Chicago, IL 60603
(312) 641-3200

November 5, 2018

CERTIFICATE OF SERVICE

I hereby certify that on November 20, 2018, the foregoing was caused to be served upon the following counsel of record via File & ServeXpress:

Bradley D. Sorrels
Shannon E. German
Andrew D. Berni
WILSON SONSINI GOODRICH & ROSATI
222 Delaware Avenue, Suite 800
Wilmington, DE 19801

/s/ Coleen W. Hill
Coleen W. Hill (#6287)