IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

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| RESERVES DEVELOPMENT LLC and THE RESERVES DEVELOPMENT CORPORATION, | ) | |
| Plaintiffs, | ) | |
| v. | ) | Civil Action No. 2502-VCP |
| SEVERN SAVINGS BANK, FSB, ALAN J. HYATT and BELLA VIA, LLC, | ) | |
| Defendants. | ) | |

**MEMORANDUM OPINION**

Submitted: April 30, 2007
Decided: November 9, 2007

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**PARSONS, Vice Chancellor.**

This action involves the unsuccessful efforts of two companies I will refer to as Reserves and Bella Via to develop a residential resort and spa community in Sussex County, Delaware. The development project has been beset with a myriad of problems and both sides accuse the other and various third parties of causing them. Citing the numerous problems, Reserves sued Bella Via in the Superior Court in and for Sussex County in December 2005, seeking damages for various breaches of contract and other alleged wrongs. Bella Via counterclaimed for breaches of fiduciary duties by Reserves stemming from a joint venture agreement with Bella Via and other acts and omissions in connection with Reserves' unilateral handling of the contractual arrangements. That case is proceeding. What brings the parties to the Court of Chancery are Reserves' claims for equitable relief based on its assertion that, although the parties were to share the cost of developing the infrastructure for the contemplated residential community, Reserves now has paid over $2.5 million toward that effort and Bella Via has not reimbursed Reserves for any of Bella Via's share of those costs. Reserves, therefore, seeks to have this Court order Bella Via's lender, Severn Bank, to release sufficient funds from a construction trust established for the benefit of Bella Via and Severn Bank to pay Bella Via's share of the costs incurred to date.

Reserves stakes its claims for equitable relief on theories of unjust enrichment, equitable estoppel, equitable subrogation, and third-party beneficiary law. Reserves also seeks specific performance of an alleged agreement to have it secure a performance bond, the removal of a principal of Severn Bank as the trustee of the construction trust, and reimbursement for its attorneys' fees and costs in prosecuting this action. Defendants

Bella Via and Severn Bank vigorously deny that Reserves has demonstrated sufficient grounds for any of the relief it seeks. They also urge this Court to deny Reserves' request for equitable relief because it acted with unclean hands.

Based on the evidence presented at trial and the post-trial briefing and arguments, I conclude that Reserves has demonstrated that some of the actions it took in mid-2005 were with at least the implicit authorization of Bella Via and Severn Bank and, therefore, provide a predicate for equitable relief under both unjust enrichment and equitable estoppel grounds. As to certain of those actions, Reserves has established a right to reimbursement from the construction trust for Bella Via's share of the payments Reserves made for those items on behalf of the joint venture. That right to reimbursement supports a decree directing the construction trust trustee to make a payment to Reserves on behalf of Bella Via in the amount of $316,941.87 to be applied toward Bella Via's share of the infrastructure costs. In all other respects, Reserves failed to prove an entitlement to the relief it has requested, including reimbursement of the additional funds it seeks.

To the extent these rulings address Reserves' claims for reimbursement of funds, they relate solely to whether Bella Via and its lender must make a payment immediately to defray part of Bella Via's portion of the costs Reserves has incurred to date on the development project. The ultimate determination of how much, if anything, Reserves or Bella Via owes to the other based on the work performed on this troubled project and other grievances presumably will be determined in the Superior Court action.

## I. FACTS

These are the facts as I find them after trial.

### A. The Parties

Plaintiff Reserves Development LLC ("Reserves LLC") is a Delaware limited liability company.[1] Plaintiff The Reserves Development Corporation ("Reserves Development") is a Delaware corporation.[2] Reserves LLC and Reserves Development collectively are referred to as "Reserves." Abraham Paul Korotki owns both Reserves LLC and Reserves Development.[3] While Korotki previously dabbled in the real estate market, the Reserves development project was only his second venture into planned community development, and his first in Delaware.[4]

Reserves is the developer of a residential community approved for 185 homes located in Sussex County, Delaware, known as The Reserves Resort, Spa and Country Club ("The Reserves").[5] On or about March 24, 2004, Reserves entered into an Agreement of Purchase and Sale (the "Purchase and Sale Agreement" or "PSA") for the sale to Crystal Properties, LLC ("Crystal") of unimproved land located in Phase II of The Reserves, containing 30 unimproved residential lots. These 30 lots plus the Phase II lots retained by Reserves constitute the Project.[6]

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1 Pretrial Stip. ("PT Stip.") ¶ II.1.

2 *Id.* ¶ II.2.

3 Trial Transcript ("T. Tr.") at 8 (Korotki). Where the identity of the witness testifying is not clear from the text, it is indicated parenthetically.

4 *Id.* at 9 (Korotki).

5 PT Stip. ¶ II.7.

6 *Id.* ¶ II.8.

Before the closing of the PSA in October 2004, Crystal assigned its rights and obligations under the PSA to Defendant Bella Via, LLC ("Bella Via"), a Delaware limited liability company.[7] Bella Via's three members, William Esham, II, Eyal Elboim, and Yitshak Rafaeli, created Bella Via in September 2004 to acquire the 30 lots in The Reserves.[8]

Defendant Severn Savings Bank, FSB ("Severn") entered into a contract to make a loan to Bella Via in connection with the PSA (the "Loan"). Severn also recorded a mortgage on the 30 lots acquired by Bella Via to secure the Loan.[9]

Defendant Alan J. Hyatt is the President of and largest shareholder in Severn. Hyatt is also the trustee under a Construction Trust Agreement ("CTA") between Bella Via and Hyatt that provides for the disbursement of certain funds under the Loan to Bella Via to pay for Bella Via's share of the cost of constructing the infrastructure for the Project. Reserves' Complaint names Hyatt as a defendant solely in his capacity as trustee of the Construction Trust.[10]

Reserves previously filed and is prosecuting an action for damages against Bella Via in the Superior Court in Sussex County. This is the post-trial opinion on Reserves' separate claims for equitable relief in the Court of Chancery.

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7 *Id.* ¶ II.9.

8 T. Tr. at 417-19 (Esham).

9 PT Stip. ¶ II.3.

10 *Id.* ¶ II.4.

### B. Purchase and Sale Agreement

The PSA provided for both: (1) the sale of 30 out of 67 lots contained within the Project to Bella Via; and (2) site development of the Project under the direction of Bella Via.[11] Under the PSA, Bella Via paid Reserves $2,250,000 as the Purchase Price for the 30 lots.[12] The PSA also assigned to Bella Via the burden of arranging for the site development work, outlined who bore the relative costs of the infrastructure, and stressed the importance of timely performance.

Specifically, the PSA provides that the Purchaser (Bella Via) bears the primary responsibility of constructing or hiring a third party to construct the infrastructure for the Project.[13] The PSA states that:

> Purchaser is acquiring the Real Property in order to construct homes thereon for sale to the general public. To accomplish this purpose, Purchaser will have to obtain and pay for the installation of roads, street lights, utilities, drainage systems, landscaping and other site improvements for all of Phase II (excluding clubhouse and recreational facilities, hereinafter called "Infrastructure") in order to meet the requirements of the recorded plats and obtain the inspection, approval and acceptance of governmental authorities having jurisdiction.[14]

Further, the PSA states that Reserves sold "unimproved land in bulk" to Bella Via and that Reserves "will not be constructing infrastructure" for the Project.[15] Rather, Bella

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11 Reserves Tr. Ex. ("PX") 2, the Purchase and Sale Agreement.

12 *Id.* § 3.

13 PX 2 § 4B(1).

14 *Id.* § 3(c).

15 *Id.* § 4B(1).

Via bears the obligation to "construct and/or pay for the cost of constructing the Infrastructure for the Real Property" and ensure that it complies with applicable laws, codes, regulations and agreements.[16] In addition to requiring Bella Via to pay the $2,250,000 Purchase Price to Reserves, the PSA calls for Bella Via to deposit $1,500,000 into an escrow account (the "Escrow Account"), from which Reserves' share of the cost of the infrastructure would be paid.[17] Thus, at the closing on the PSA, Bella Via paid $3.75 million plus the settlement charges relating to the Loan with Severn and other miscellaneous charges.[18]

The PSA further requires Reserves and Bella Via to share the cost of infrastructure development in proportion to their relative ownership interests. Under the original lot ratio, Bella Via owned 30 of the 67 lots then comprising the Project, or 44.78%. Conversely, Reserves' share was 37 of the 67 lots, or 55.22%. Sussex County, however, later redefined the Project construction site to include 71 lots. When the lot ratios are recalculated to reflect this change, Bella Via's share drops to 42.25% and Reserves' share rises to 57.75%.

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16 *Id.*

17 *Id.* §§ 3(c) and 4B(5)(ii).

18 PX 4, Bella Via's Settlement Statement with Severn.

The PSA also contains a "Time of the Essence" clause which provides: "Time is of the essence in the performance of each of the duties and obligations of the parties hereunder and the satisfaction of each of the conditions precedent set forth herein."[19]

Settlement of the PSA took place on October 6, 2004. At that time, the parties established two separate vehicles to ensure the availability of sufficient funds to pay Bella Via's and Reserves' respective shares of the infrastructure cost. These two vehicles, the Construction Trust and the Escrow Account, figure importantly in this dispute.

### C. The Construction Trust Agreement

With the Loan from Severn, Bella Via acquired legal title to 30 lots in the Project on October 6, 2004.[20] On the same date and consistent with the Loan, Bella Via and Hyatt entered into the Construction Trust Agreement.[21] Under the terms of the CTA, Bella Via deposited $1,450,000 into a Construction Trust (the "Trust"), so that Hyatt, as Trustee, could disburse the funds for Bella Via to pay its portion of the cost of constructing the infrastructure for the Project.[22] The Trust holds the $1,450,000 subject to the terms of the CTA. Following an inspection by an inspector Hyatt appoints, the CTA requires Hyatt to pay to Bella Via "the installments due in accordance with [each]

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19 *Id.* § 10(k).

20 PT Stip. ¶ II.10.

21 PX 6, the Construction Trust Agreement.

22 PT Stip. ¶ II.10; PX 6.

fully completed and approved Application and Certification for Payment (AIA [American Institute of Architects] Document G702 and G703)."[23]

### D. The Escrow Agreement

On October 6, 2004, Bella Via, as purchaser, and Reserves, as seller, also entered into the Escrow Agreement.[24] In accordance with Section 3(c) of the PSA, Bella Via and Reserves agreed to escrow $1,500,000 of Bella Via's funds to ensure payment of Reserves' share of the Project's infrastructure development costs.[25] The Escrow Agreement provided that Bella Via's counsel, Lynn R. O'Donnell, as Escrow Agent, would establish an interest-bearing escrow account with a bank or other institutional lender to hold the escrowed funds.[26] The Escrow Agreement further stated that O'Donnell would serve as the signatory for the Escrow Account and no disbursements from the account would be made on Reserves' behalf in the absence of written approvals by Bella Via, Reserves, and Severn.[27] The Escrow Agreement also provided that disbursements from the Escrow Account would be made directly to the contractor performing the site development of the Project.[28]

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23 PX 6 ¶ 9.

24 *See* PX 7, the Escrow Agreement (noting that Reserves LLC was the seller and that Reserves Development was the title-holder of the 30 lots before they were sold).

25 *Id.* ¶ 1.

26 *Id.* ¶ 2.

27 *Id.* ¶ 4.

28 *Id.* ¶ 5.

I infer from the evidence that O'Donnell set up the Escrow Account at or about the time of the closing. Despite the explicit requirements in the Escrow Agreement, however, the Escrow Account was not established or operated strictly in accordance with those requirements. For example, contrary to the terms of the Escrow Agreement, Korotki is a signatory on the account.[29] Since the establishment of the Escrow Account, Korotki made disbursements and signed checks from it totaling more than $1.5 million, virtually all of which were spent on the Project.[30] Additionally, although Severn and Bella Via knew that Korotki was signing checks from the Escrow Account to pay invoices on the Project, Korotki made those disbursements without obtaining Bella Via's or Severn's approval.[31]

### E. Actions Reserves Took to Develop the Infrastructure

Before reviewing what actually happened in this matter, it is useful to describe what the parties' agreements contemplated would happen as of early October 2004, when the PSA closed. Under the PSA, Bella Via, arguably with the cooperation of Reserves, bore the responsibility for obtaining a site contractor and securing a bond. The PSA contemplated that once Bella Via made arrangements for a site contractor, Bella Via

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29 T. Tr. at 232 (Korotki). The record does not indicate how Korotki became a signatory on the Escrow Account. I infer from the evidence that he was named as a signatory from the outset.

30 *Id.* at 232-40 (Korotki). Korotki admits that some funds were spent on work outside the Project. *Id.* at 234.

31 *See id.* at 240-41 (Korotki). Berl, Bella Via's counsel, acknowledged that, while the checks went back to the individual signatory, Korotki, both Korotki and O'Donnell received Escrow Account statements. *Id.* at 238.

would begin incurring costs regarding the infrastructure for the Project. As the infrastructure construction progressed, Bella Via would submit invoices for 57.75% of the expenses to the Escrow Account. Assuming she had the approval of Bella Via, Severn, and Reserves, the Escrow Agent would disburse escrowed funds sufficient to pay Reserves' portion of the expenses directly to the contractor. In addition, under the CTA, Bella Via periodically would submit invoices to the Construction Trust for 42.25% of the infrastructure expenses incurred during the period covered.[32] Assuming he received a favorable inspection, the Trustee would authorize payment to Bella Via of its portion of the expenses for remittance to the contractor.

**1. Locating site contractors**

In actuality, however, events played out differently. First, Bella Via did not enter into a contract with a site contractor. In late 2004 and early 2005, the real estate market was "blazing" hot, contractors were busy, and bids were scarce.[33] In October or November of 2004, Korotki, Esham, and Walter Maizel (a representative of Obrecht-Phoenix ("O-P"), a construction management firm retained by Reserves) met to discuss

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[32] *See* PX 6 ¶ 9 (providing that the Trustee would pay Bella Via installments due in accordance with fully completed and approved Applications and Certificates for Payment).

[33] T. Tr. at 42-43 (Korotki).

locating a site contractor.[34] During the meeting, Esham, on behalf of Bella Via, accepted the lead role in jumpstarting the construction.[35]

After this meeting Bella Via obtained a bid from Knorr Contracting, Inc. ("Knorr").[36] The Knorr bid, which totaled $4,155,325, covered only the Project.[37] Separately and independently, Reserves also sought bids with the assistance of O-P. Specifically, Reserves and O-P obtained a bid from Fresh Cut Custom Design Landscaping, Inc. ("Fresh Cut").[38] The original Fresh Cut bid, which totaled approximately $6.5 million, covered both the land in the Project and land in another phase of The Reserves owned solely by Reserves.[39] Although the original Fresh Cut bid listed both Reserves and Bella Via as owners, Bella Via objected to its comprehensive nature and sought two separate contracts, one for the Project and one for the land owned solely by Reserves.[40] Reserves agreed and entered into two contracts with Fresh Cut, one for approximately $3,000,000, which covered the Project, and the other for

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34 *Id.* at 42 (Korotki).

35 *Id.* at 43-44 (Korotki); PX 45, Aug. 18, 2005 Letter from Bella Via's counsel Richard E. Berl, Jr. to Reserves' counsel Richard P. Beck, at 1.

36 T. Tr. at 291 (Maizel), 424 (Esham).

37 PX 51, Knorr's Proposal.

38 T. Tr. at 177, 290-91 (Maizel). Maizel solicited a bid from Fresh Cut, after Korotki provided him with Fresh Cut's name. *Id.*

39 *Id.* at 201-02 (Korotki).

40 *Id.* at 203 (Korotki).

approximately $3,500,000, which applied to the other land.[41] Reserves, however, did not make Bella Via a party to either of the Fresh Cut contracts.

### 2. Posting a bond

As previously mentioned, Sussex County required the posting of security to obtain permits necessary to construct the Project's infrastructure.[42] Between October 2004 and May 2005 Bella Via was unable to secure a construction bond.[43] Esham, on behalf of Bella Via, made several attempts to obtain a bond.[44] Bella Via blames its failure to do so not only on its lack of experience, but also on Reserves' unwillingness to cooperate, specifically Reserves' refusal to submit necessary financial information.[45] Nothing in the PSA, however, required Reserves or Korotki to provide such information. Regardless, Reserves responded to the delay in obtaining the requisite security by posting nearly $2,500,000 ($1,701,428 and $514,805, both on June 7, 2005) in cash to obtain letters of credit from Wilmington Trust Company ("Wilmington Trust").[46]

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41 *Id.* at 203-04 (Korotki); PX 8, AIA Agreement between Reserves Development and Fresh Cut for $3,015,000; PX 9, AIA Agreement between Reserves Development and Fresh Cut for $3,548,000.

42 PX 11, email chain between Esham and Beck.

43 T. Tr. at 279 (Maizel).

44 *Id.* at 443-46 (Esham).

45 *Id.* at 443, 445 (Esham), 313 (Wood), 212-13 (Korotki) (testifying that in addition to Bella Via's lots and financial information, Korotki also would have had to produce personal financial and unencumbered building lots information to Wood).

46 PX 10, Letters of Credit Nos. 1-1731 & 1-1732; T. Tr. at 47 (Korotki).

Reserves posted the cash based on written assurance from Bella Via that Bella Via would pay its pro rata share of the cash needed.[47] Specifically, on June 3, 2005 Beck, representing Reserves, sent an email to Esham outlining Reserves' concern regarding Bella Via's continued delay in obtaining a letter of credit.[48] Stressing the importance of time, Beck made several proposals, chiefly that Reserves would provide cash collateral so that Wilmington Trust would issue a letter of credit for up to $2,500,000 the next week.[49] Beck also indicated that Reserves would replace the cash collateral with real estate, but noted that approval of the substitution would take a few weeks. Over the next several days the parties exchanged emails regarding schedules and minor details. On June 7, 2005, Esham sent an email to Beck, declaring, "We [Bella Via] are prepared to perform in the same manner as Abe [Korotki] in reference to the Letter of Credit with Wilmington Trust."[50] Further, Esham offered to wire Bella Via's funds to satisfy its pro rata share of the Letter of Credit (including the letter of credit fee, lender fees, permit fees, construction management fees, and any other pro-ratable fees), expressing appreciation for Korotki's willingness to put up all the monies, while stating that such an offer was not needed. Beck responded on June 8, 2005, that Korotki had obtained the letters of credit on June 7.[51]

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47 PX 11.

48 *Id.*

49 T. Tr. at 53, 215 (Korotki).

50 PX 11.

51 *Id.*

In an email, five weeks later, on July 14, 2005, Esham referenced a request Bella Via received from Reserves for Bella Via's 42.25% contribution to the costs of the permit fees and letters of credit.[52] Esham questioned Bella Via's 42.25% pro rata share, stating that he recalled its share being closer to 36% because the Fresh Cut contract included some items that were exclusively Reserves responsibility. Beck sent a reply email the same day, in which he emphasized the distinction between shared and exclusive costs, noting that per the contract Reserves alone would pay for exclusive costs, such as the clubhouse and tennis courts. Beck further stated that under the PSA shared costs were calculated on a lot ratio basis, citing Bella Via's original 30 to 67 lot ratio and its current 30 to 71 ratio. Beck concluded his email by reiterating the request for Bella Via's pro rata contribution, stressing the importance of time. The following day, July 15, 2005, Esham responded that Reserves and Bella Via had a "significant misunderstanding" and that "No monies will move until this issue is resolved."[53]

### 3. Expenses incurred

Beginning with the expenses related to the bond, Reserves has paid for all of the infrastructure construction expenses, totaling over $2,500,000, and Bella Via has contributed nothing. On June 8, 2005, Reserves sent to Bella Via a request for reimbursement in the amount of $71,466.83, reflecting 42.25% of the total bonding costs

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52 PX 20, email chain between Esham and Beck.

53 *Id.*

and fees, which were paid by Reserves.[54] On July 13, 2005, the Construction Trust made a disbursement to Bella Via in the amount of $71,466.83, but Bella Via did not use those funds to reimburse Reserves.[55] Instead, Bella Via returned the money to Severn. Wood, the loan officer at Severn handling the Loan for the Project, understood that Bella Via returned the money because it had a dispute or discrepancy with Reserves.[56]

Reserves paid the initial start up fees required by Fresh Cut (a $250,000 deposit) and O-P (a $10,000 deposit), and submitted an application for payment to Bella Via for its share of those amounts. Bella Via in turn applied to the Trust for $109,850, 42.25% of the total deposits paid. On July 26, 2005, Bella Via received a disbursement from the Trust in that amount. Rather than paying those funds to Reserves, however, Bella Via again returned the money to Severn.[57]

During the same general time period, Korotki, on behalf of Reserves, wrote checks from the Escrow Account to pay the expenses Reserves had incurred in connection with

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54 PT Stip. ¶ II.12; PX 32. In a document attached to its opening brief entitled, "Calculation of Payments Owed to Reserves by Bella Via," Reserves seeks a slightly different amount based on its expenses for the letter of credit or bond fees. Pls.' Post-Tr. Op. Br. ("POB") Ex. A. Specifically, the exhibit indicates that Bella Via's share of those expenses is $71,471.90, plus $9,429.22 for a renewal fee, totaling $80,901.12. *Id.* First, because 42.25% of $169,152.26, the total bonding cost, equals $71,466.83, I assume the $71,471.90 is a calculation error. Second, because the invoices in the record do not reference the renewal fee, I infer that Reserves incurred that expense sometime after October 6, 2005. Therefore for the reasons explained in Part III.B, *infra*, I have not awarded any relief based on the renewal fee.

55 PT Stip. ¶ II.13.

56 T. Tr. at 342-46.

57 PT Stip. ¶ II.14.

the Project. Although neither Korotki nor Reserves obtained formal approval from Bella Via or Severn to make these payments, I find that Bella Via and Severn had at least constructive knowledge of the payments.[58]

The infrastructure construction work began on or about July 1, 2005. Fresh Cut submitted an Application and Certificate for Payment ("Application") No. 2 to the construction manager O-P on or about July 30, 2005. Application No. 2 sought $161,331.25 for the following work: sitework layout, clear and grub, erosion control, and earthwork.[59] I find that Reserves paid that amount from the Escrow Account and submitted Application No. 2 to Bella Via, which conveyed it to the Construction Trust. The Trustee had the work covered by Application No. 2 inspected and approved by James Devage, Severn's inspector.[60] Neither Hyatt nor Bella Via, however, made any disbursement from the Trust to Reserves in response to Application No. 2.

In similar fashion, Reserves purported to pay Applications Nos. 3 through 10, all of which were inspected and approved.[61] Under Application No. 3 covering the period ending August 31, 2005, Reserves paid Fresh Cut $104,144.90 for sitework layout, storm

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58 The record suggests, for example, that Bella Via's counsel O'Donnell received regular statements from the Escrow Account.

59 PX 24, Application No. 2.

60 PT Stip. ¶ II.15; T. Tr. at 314, 350-51, 354 (Wood).

61 *See* PT Stip. ¶ II.15 (noting that "Applications one through ten for the construction of the Project have been inspected"). All of those Applications passed inspection. T. Tr. at 515 (Esham) (confirming that Esham was aware of that fact); PX 28, email chain between Wood and Esham.

drainage, and earthwork.[62] In Application No. 4, covering September 2005 and the same type of work as the previous applications, Fresh Cut billed $236,386.22. For that Application and Applications Nos. 5 to 10, covering the months from October 2005 through March 2006, Reserves again sought reimbursement from Bella Via and Bella Via, in turn, submitted those Applications to the Trust.[63] By the end of that period, Reserves claims to have paid over $2.5 million for the infrastructure work on the Project. In addition to the Fresh Cut work covered by the Applications, this amount includes the invoices of the construction manager O-P for the same period, totaling $150,211.46.[64] No reimbursement to Reserves has been made by Bella Via or Severn for any of these expenses. The total amount Reserves seeks to recover from the Trust in this action based on these payments is $1,085,267.19.

### F. Land Swap Contract

Reserves claims that over time it began to look for ways to pay Fresh Cut with assets other than cash to ameliorate the burden imposed on Reserves by Bella Via's

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62 PX 24, Application No. 3.

63 *See* PX 32, a document prepared by Wood, the responsible loan officer at Severn, summarizing the invoices submitted by Esham of Bella Via between July 2005 and March 2006. T. Tr. at 308.

64 POB Ex. A. In March 2006, Reserves also paid an invoice from One Source Associates in the amount of $78,030.00 for light poles and light fixtures. PX 34; POB Ex. A. In addition, Reserves paid $128,311.38 in connection with a mulch fire on the Project land and seeks reimbursement from Bella Via through the Trust of $54,215.41, Bella Via's 42.25% share. POB Ex. A. Finally, Reserves paid $5,000 to Satterfield & Ryan, Inc. for street lighting and pond aeration, fountain and pond water supply wells, and power supply. PX 34; POB Ex. A.

refusal to pay its share of the infrastructure costs.[65] On December 30, 2005, Reserves, without notice to either Bella Via or Severn, entered into an Assignment of Rights to Conveyance by Deed ("Assignment") with Christopher Wayne Glenn, President and sole shareholder of Fresh Cut.[66] The Assignment referenced a Land Sales Contract, dated October 6, 2005 (the first of several land swap agreements), whereby Reserves LLC agreed to transfer and assign to Glenn two lots located in the Project to fulfill Reserves' obligations to Fresh Cut for construction of the infrastructure. The Assignment satisfied Reserves' obligations under the Land Sales Contract.[67] The Assignment further provided that Reserves could satisfy future invoices for site work completed by Fresh Cut by transferring to Glenn one or more of Reserves' lots, at the rate of one lot per $250,000 invoiced amount.

The parties attached to the Assignment as an exhibit an Assumption and Release of Obligations ("Assumption and Release"), signed by Glenn, both individually and as President of Fresh Cut. Under the Assumption and Release, Glenn assumed sole responsibility for the debts owed by Reserves to Fresh Cut and purported to release any claims Fresh Cut might have against Reserves.[68] By April 2006, Reserves had

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65 POB at 10-11.

66 PX 38, Assignment.

67 *Id.*

68 PX 38, Assumption and Release.

transferred eight lots to Glenn, in connection with approximately $2 million in invoices from Fresh Cut.[69]

## II. PROCEDURAL HISTORY

In November 2005, Reserves filed suit against Crystal and Bella Via in the Superior Court in Sussex County (the "Superior Court Action"), seeking: a total of $1,597,087.91 in actual and consequential damages for breach of contract; a declaratory judgment as to the parties' pro rata responsibilities regarding future infrastructure improvement costs; actual, consequential, and punitive damages in connection with Defendants' false representations; and an award of attorneys' fees and costs to Reserves as the prevailing party in accordance with the provisions of the PSA.[70] In the Superior Court Action, Reserves moved for partial summary judgment on the contractual relationship between the parties. Judge Stokes denied Reserves' motion based on the interrelated nature of the facts underlying the various claims and the existence of numerous disputed issues of material fact.[71]

In addition to the Superior Court Action, Reserves filed this action on October 27, 2006, to obtain equitable relief to funds in the Construction Trust held by Defendants Severn and Hyatt. The purpose of the Trust is to pay construction costs and fees

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69 Bella Via Trial Ex. ("BVX") 15 at 2, Proof of Claim filed by Reserves in United States Bankruptcy Court for the District of Delaware in a proceeding involving Fresh Cut (noting that Reserves transferred eight lots to Glenn, representing $2 million).

70 C.A. No. 05C-11-011-RFS.

71 *Reserves Dev. LLC v. Crystal Props., LLC*, 2007 WL 185474, at *4 (Del. Super. Jan. 24, 2007).

attributable to Defendant Bella Via. The Superior Court Action originally was scheduled for trial before this matter, but scheduling issues delayed the Superior Court trial. At the pretrial conference in this action on February 8, 2007, less than a week before trial, Defendants formally requested a stay pending resolution of the Superior Court Action. Reserves opposed that request. I denied the application to stay as untimely, among other reasons, but emphasized that the focus of the trial in Chancery would be on equitable issues.[72] Trial took place from February 14 to 16, 2007.

## III. ANALYSIS

### A. Does Reserves Have a Claim for Relief?

Reserves filed claims for equitable relief based on its allegation that Bella Via improperly has refused to pay its share of the cost of developing the infrastructure for the Project. Reserves, therefore, seeks to have this Court order Bella Via and its lender, Severn, to release sufficient funds from the Trust they control to pay Bella Via's share of the costs incurred to date. Reserves bases its claims on an alleged oral modification of the PSA and on theories of unjust enrichment, equitable estoppel, equitable subrogation, and third-party beneficiary law. Reserves also seeks the removal of Hyatt, a principal of Severn, as trustee of the Trust, and reimbursement for its attorneys' fees and costs in prosecuting this action.[73]

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[72] Pretrial Conf. Tr. at 14-15.

[73] Reserves also had requested specific performance of an alleged agreement to have it secure a performance bond, but effectively abandoned that request at trial. *See* T. Tr. at 33-36; PT Stip. at 5. Additionally, in order to prevail on a specific performance claim, a plaintiff must prove the existence and terms of an

### 1. The PSA was not modified

Reserves argues that the parties actions modified the PSA to make Reserves the party responsible for selecting and getting payments to the Project's site contractors.[74] Reserves asserts that lack of a formal modification is immaterial because a new written agreement is not required to modify an earlier agreement. When Bella Via failed to secure a bond or a contractor, Reserves contends that "the parties agreed to change their deal with Reserves taking over the lead role from Bella Via."[75] Reserves contends that the parties' course of performance further evidences their agreement to this modification. Specifically, Reserves argues that, based on Bella Via's promises to contribute its share, Reserves posted cash to obtain letters of credit for the construction bond, paid for and obtained building permits, paid for the inspection fees, and hired and paid Fresh Cut and O-P. Additionally, during this period of time, Bella Via knew about the nature of Reserves' performance and did not object.[76]

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enforceable contract by clear and convincing evidence. *Williams v. White Oak Builders, Inc.*, 2006 WL 1668348, at *4 (Del. Ch. June 6, 2006) (citing Donald J. Wolfe, Jr. & Michael A. Pittenger, CORPORATE & COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY § 12-3, at 12-40). Because I previously held that the parties did not orally modify the PSA with respect to the bond procurement obligations, Reserves has not met this prerequisite for specific performance.

74 POB at 34.

75 Pls.' Post-Tr. Reply Br. ("PRB") at 21.

76 POB at 34-35.

Generally, the terms of a written contract may be modified by subsequent oral agreement, without a formal abrogation of the written agreement.[77] The oral contract, however, must be of such "specificity and directness" that there is no doubt regarding the parties' intention to change the formally solemnized written contract.[78] Therefore, under this high evidentiary burden, Delaware law recognizes oral modifications of written agreements only when plaintiffs present specific and direct evidence such that there is no doubt regarding the parties' intention.[79]

Reserves' argument that the parties agreed to substitute Reserves for Bella Via as the party responsible for arranging construction of the infrastructure of the Project provides the predicate for its further argument that the parties intended to substitute Reserves for Bella Via as an intended beneficiary of the Construction Trust Agreement. Similarly, Reserves invokes the purported modification of the PSA to excuse certain irregularities in the manner in which it unilaterally disbursed funds from the Escrow Account in terms of the procedure prescribed in the Escrow Agreement.

The record supporting an actual oral modification of the PSA, however, is sketchy. First, regarding the bond, between the closing on October 6, 2004 and May 2005 Bella Via failed to secure a construction bond. Esham, on behalf of Bella Via, made several attempts to obtain a bond, but for various reasons did not succeed. Concerned about the

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77 *Reeder v. Sanford School, Inc.*, 397 A.2d 139, 141 (Del. 1979); *Pepsi-Cola Bottling Co. of Asbury Park v. Pepsico, Inc.*, 297 A.2d 28, 33 (Del. 1972).

78 *Reeder*, 397 A.2d at 141.

79 *Continental Ins. Co. v. Rutledge & Co.*, 750 A.2d 1219, 1230 (Del. Ch. 2000).

delay in obtaining a bond, on June 7, 2005, Reserves posted nearly $2,500,000 in cash to secure two letters of credit. In connection with Reserves' action, its counsel Beck exchanged approximately a dozen emails with Esham between Friday, June 3, and Wednesday, June 8, 2005.

On June 3, Beck wrote that Reserves and Korotki would provide cash collateral to obtain a letter of credit from Wilmington Trust for up to $2,500,000 and later arrange to have it replaced with real estate collateral and Korotki's personal signature. Beck proposed that, in exchange for those actions, Bella Via would bear all costs incurred by Reserves in getting the letter of credit issued and replacing the collateral, as well as any lost interest Reserves suffered and Bella Via's share of the permitting costs paid by Reserves. Further, Beck proposed that Bella Via and its principals would provide personal guarantees and indemnities for its share of the letter of credit, secured by mortgages against Bella Via's lots in The Reserves. In concluding his June 3 email, Beck stated: "Please confirm the willingness of your company and its principals to cooperate on this basis in our effort to solve the problem and avoid loss and damage resulting from further delays in getting the site work done."[80]

On Monday, June 6, Esham responded to Beck that: "One of the options I wanted to discuss with Wilmington Trust is our group putting up our pro-rata share of the cash – that way we continue in the deal on a pro-rata basis as envisioned – your help in allowing

[80] PX 11.

me to pursue that avenue would be appreciated."[81] In a later email the same day, Esham wrote: "When available please provide wiring instructions as to where our monies need be sent. As we discussed it is best to proceed with each party meeting its required obligations."[82]

After further emails regarding logistics, Esham wrote to Beck on June 7 as follows:

> I know you are traveling today but I just want to reiterate our position. We are prepared to perform in the same manner as Abe [Korotki] in reference to the Letter of Credit with Wilmington Trust. As I indicated yesterday, if wiring instructions are provided, our monies will be wired to meet our obligation in order for the Letter of Credit to be issued. I appreciate the offer of Abe to put up monies on our behalf – but it is not needed. We will pay our pro-rated share of: – the monies needed [to] be deposited for the letter of credit – the letter of credit fee – the lender fees – the permit fees – construction management fees [and] – any other pro-ratable fees[.] We are ready to perform now – please provide the necessary information.[83]

On June 8, Beck responded that Korotki had obtained the letters of credit on June 7 and delivered them to Maizel so the permits could be pulled. Beck further stated that, Korotki "is now dealing directly with Eyal [Elboim, another principal of Bella Via] to follow through on all the stuff you and I have been exchanging emails and faxes about."[84] Esham replied the same day that he would meet with Elboim and follow up

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81 *Id.*

82 *Id.*

83 *Id.*

84 *Id.*

with Beck. The parties' later communications shed little, if any, additional light on the specific terms of any agreement they might have reached to modify the PSA as it relates to the construction bond. This incomplete record is not sufficiently "specific and direct" to support a conclusion that the parties orally modified an existing written contract, namely, the PSA. As discussed *infra*, however, it does provide an adequate basis, when considered in the context of the parties' subsequent conduct, to support a claim for equitable estoppel.

Second, regarding the site contractor, in October or November 2004, at a meeting between Korotki, Esham, and Maizel of O-P, Esham agreed to assume the lead role in locating a site contractor. This comported with the terms of the PSA. Bella Via later participated in obtaining a bid from Knorr. Reserves apparently took the lead in getting bids from Fresh Cut. Yet, Bella Via continued to have a role in that process, providing the impetus, for example, for translating the original Fresh Cut bid into two separate contracts. Moreover, the record is vague as to why Bella Via was not made a party to the Fresh Cut contract that covered the Project. As with the posting of security, the evidence fails to indicate directly and specifically the intended terms of the purported oral modification of the PSA to change the party responsible for effectuating construction of the infrastructure. Because the record supporting an oral modification is muddled, it is not sufficiently specific and direct to rule out doubt regarding the parties' intentions. Thus, I reject Reserves' contention that they and Bella Via orally amended the PSA.

### 2. Unjust enrichment

Because the parties never agreed to specific terms modifying the PSA, Reserves' claims for relief must rest on a quasi-contract remedy. One such theory Reserves advances is unjust enrichment. Reserves claims unjust enrichment as to both Bella Via and Severn. The Court addresses those claims separately below.

#### a. Unjust enrichment of Bella Via

Reserves contends that any construction of the Project's infrastructure made the 30 lots owned by Bella Via more buildable and saleable, thereby increasing the value of the lots and enriching Bella Via. Reserves points to Severn's appraisal of the lots at over $8,000,000 for purposes of making the construction loan to Bella Via, as reflecting the extent to which the infrastructure benefits Bella Via. Reserves argues that Bella Via's enrichment was unjust because Reserves bore all the costs of the site improvements without any contribution from Bella Via.

Bella Via challenges Reserves' unjust enrichment claims on several grounds. They argue that unjust enrichment is not available to Reserves because the PSA governs the rights and obligations between Bella Via and Reserves. Further, Bella Via contends that because Reserves sought money damages stemming from the PSA, Reserves has an adequate remedy at law. Additionally, Bella Via asserts that under the totality of the circumstances, Reserves is not entitled to any equitable remedy in this case. Specifically, Bella Via challenges the existence of the requisite enrichment of one party and impoverishment of another, questions the amount and quality of any work completed, and advances an unclean hands defense.

Unjust enrichment is defined as "the unjust retention of a benefit to the loss of another, or the retention of money or property of another against the fundamental principles of justice or equity and good conscience."[85] In determining whether to award a remedy based on unjust enrichment, courts look to the following elements: (1) an enrichment, (2) an impoverishment, (3) a relation between the enrichment and impoverishment, (4) the absence of justification, and (5) the absence of a remedy provided by law.[86] Further, in finding that a party is entitled to unjust enrichment as an equitable remedy, courts engage in a threshold inquiry to determine whether a contract already governs the parties' relationship.[87] If there is a contract between the complaining party and the party alleged to have been enriched unjustly that governs the matter in dispute, then the contract remains "the measure of [the] plaintiff's right."[88] I begin with this preliminary issue.

Here, although the unmodified PSA is a contract between Reserves and Bella Via, it does not govern the matter in dispute. Rather, the PSA governs the sale of land from Reserves to Bella Via, subject to Bella Via's agreement, among other things, to take the

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85 *Schock v. Nash*, 732 A.2d 217, 232 (Del. 1999).

86 *Cantor Fitzgerald, L.P. v. Cantor*, 1998 Del. Ch. LEXIS 97, at *6 (June 16, 1998).

87 *MetCap Secs. LLC v. Pearl Senior Care, Inc.*, 2007 WL 1498989, at *19 (Del. Ch. May 16, 2007).

88 *Id.*; *see also Bakerman v. Sidney Frank Imp. Co.*, 2006 Del. Ch. LEXIS 180, at *18 (Oct. 16, 2006) ("When the complaint alleges an express, enforceable contract that controls the parties' relationship, however, a claim for unjust enrichment will be dismissed."); *Albert v. Alex Brown Mgmt. Servs., Inc.*, 2005 Del. Ch. LEXIS 133, at *11 (Aug. 26, 2005) (dismissing an unjust enrichment claim "when the existence of a contractual relationship [was] not controverted").

primary responsibility for construction of the infrastructure of the Project. In fact, that is not what happened. Nevertheless, as discussed above, I find that the parties did not modify the PSA or reach agreement on specific terms and conditions under which Reserves would assume the lead role with respect to obtaining a bond, securing a site contractor, and monitoring the work on the infrastructure construction.[89] Reserves also is not a party to the CTA; therefore, the CTA is not a contract between Reserves and Bella Via. In sum, there is no contract between Reserves and Bella Via that precludes unjust enrichment in the present circumstances.

Next, addressing the five elements of unjust enrichment, the infrastructure construction proceeded under Reserves' direction and consequently the value of Bella Via's lots increased more than it would have otherwise. Reserves paid all of the infrastructure expenses, despite owning only 41 of the 71 lots. I find that a direct relationship exists between Bella Via's enrichment, the increased value of its lots, and Reserves' impoverishment through the payment of infrastructure expenses in cash or land transfers. Thus, the first three elements of unjust enrichment are satisfied.

Reserves also has demonstrated the fourth element, the absence of justification. On July 15, 2005, Bella Via stated that it would prevent the payment of any monies to Reserves or its contractors until the parties resolved a dispute regarding Bella Via's pro

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[89] At the same time, in mid-2005, Reserves role changed importantly in terms of what was contemplated in the PSA and the way the Project proceeded. The Court does not have the benefit, however, of a prior contractual agreement between Reserves and Bella Via on the ramifications of that change on the parties' respective rights and obligations.

rata share of the expenses, namely whether Bella Via's share was 36% or 42.25%. Even if I accept Bella Via's position, the most that position could justify is the withholding of the disputed 6.25% pending ultimate resolution of that dispute. Bella Via has not presented any reasonable excuse for its failure to pay even 36% of the infrastructure expenses, as they were incurred. Further, I do not find persuasive Bella Via's claim that it should pay only 36% of the disputed costs. While a dispute regarding Bella Via's pro rata share might be legitimate in another context, the argument relies on Reserves seeking reimbursement from Bella Via or the Construction Trust for expenses exclusive to Reserves. Because the record does not indicate any instance in which Reserves sought such a reimbursement, Bella Via's position lacks merit. Hence, the fourth element is satisfied.

The fifth and final element of a claim for unjust enrichment is the absence of a remedy provided by law. This element turns on the adequacy of the legal remedy as a practical matter. Reserves remedy at law would be limited to a money judgment against Bella Via. That remedy is problematic in terms of collectability and timing. Regarding collectability, Reserves showed legitimate reasons to question Bella Via's financial status and ability to pay a future money judgment.[90] Regarding the timing of a remedy, allowing Bella Via or its lender to retain all the money earmarked to pay Bella Via's

[90] For example, Severn has declared that Bella Via is in default of its Loan. T. Tr. at 412-13 (Hyatt); BVX 10. Further, due to Bella Via's inability to post a bond or pay permit fees, both Fresh Cut and O-P looked to Reserves for financial payments because Reserves was in a better financial position than Bella Via. T. Tr. at 522-23 (Korotki).

share of the infrastructure costs during the prosecution of this and the related Superior Court Action would allocate all of the risk to Reserves. In the unique circumstances of this case, I consider that inequitable. Therefore, the fifth and final element is satisfied.

Thus, I conclude that, absent an equitable remedy, Bella Via would be unjustly enriched by maintaining the status quo.

**b. Unjust enrichment of Severn**

Reserves advances a similar unjust enrichment claim against Severn based on its contention that the infrastructure construction increased the value of the 30 lots owned by Bella Via. According to Reserves, the expenses it incurred in constructing the infrastructure financially benefited Severn because Severn holds the mortgages to those lots.[91] Further, Reserves argues that Severn's refusal to disburse the trust funds intended to pay Bella Via's part of the infrastructure costs increased the value of Severn's security interest, again unjustly enriching Severn. Finally, Reserves asserts that by allowing the disbursed trust funds returned by Bella Via to be diverted to pay interest to Severn and reduce the amount of its outstanding loan to Bella Via, Severn doubled its unjust enrichment.[92]

Severn responds that the parties' actions have harmed it, not unjustly enriched it or enriched it at all.[93] Severn avers that it earns compensation through the payment of interest on its loans and that the dispute with Reserves has precluded Severn from earning

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91 POB at 17-19.

92 *Id.* at 18.

93 Severn's Answering Br. ("Severn Br.") at 21.

such compensation. In addition to loss of interest, Severn also claims to have suffered harm in terms of legal costs, travel, and time.

In determining whether Severn has been unjustly enriched, I first address the threshold inquiry of whether a contract exists between Reserves and Severn. Severn is not a party to the PSA, and neither Severn nor Reserves is a party to the CTA. Therefore, neither of those agreements reflects a contractual relationship between Reserves and Severn. So, there is no contract between Reserves and Severn that precludes unjust enrichment.

Turning to the elements of unjust enrichment, I note that as work on the infrastructure proceeded, the value of Severn's collateral, the 30 lots, increased and its risk in the Project decreased. Further, Reserves alone bore the infrastructure construction expenses, when the underlying documents of which Severn was fully aware envisioned Bella Via sharing in those expenses. In these circumstances, I find a direct relationship between Severn's enrichment and the impoverishment of Reserves through its payment of all the infrastructure expenses. Consequently, the first three elements of unjust enrichment are satisfied.

As to the fourth element, the absence of justification, Severn relies on the mantra that it only does what Bella Via says and that it could not disburse funds while a dispute exists between Reserves and Bella Via. Hyatt, however, in his positions as Trustee of the Construction Trust and Severn's owner and President, had the work covered by each of the Applications for payment contemporaneously inspected and approved. Severn also knew the nature of the dispute at that time revolved around whether Bella Via's pro rata

share of the expenses was 42.25% or 36%.[94] Having previously rejected Bella Via's justification for withholding the disputed funds on that basis, I find Severn's indirect invocation of it equally unpersuasive.

Finally, regarding the availability of an adequate remedy at law, there is no mechanism for Reserves to reach the funds in the Construction Trust through a legal remedy other than, perhaps, its argument of acquiescence. Yet, that argument is inextricably tied to the same facts as the equitable remedies Reserves seeks in this action. Therefore, the fifth and final element is also satisfied.

Thus, similar to Bella Via, absent an equitable remedy, Severn would be unjustly enriched by maintaining the status quo.

### 3. Equitable estoppel

Reserves asserts that Bella Via's and Severn's conduct equitably estops them from denying their responsibility to pay Reserves the reimbursement it seeks. Specifically, Reserves alleges that those Defendants voiced assurances that they would reimburse Reserves for Bella Via's share of the infrastructure expenses Reserves incurred to get the delayed site work construction started, including posting the bond required by Sussex County, obtaining necessary building permits, entering into contracts with Fresh Cut and

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[94] More recently, Bella Via has complained about shoddy workmanship and other deficiencies in the work performed by Fresh Cut and others. Those issues are not before me and presumably will be addressed in the Superior Court Action. The ultimate resolution of those issues may result in a judgment for or against Reserves. The circumstances existing when Reserves incurred, and sought reimbursement for, at least the earlier expenses in issue here support the conclusion that, in equity, Severn and Bella Via had no basis to refuse to reimburse them.

O-P, and paying the deposits to Fresh Cut and O-P.[95] Reserves argues that, in reliance upon Severn's and Bella Via's assurances of reimbursement, it paid (1) over $2 million in cash for letters of credit and (2) over $500,000 for building permits and initial contractor deposits, and (3) commenced paying invoices from Fresh Cut and O-P as the construction progressed. According to Reserves, Severn and Bella Via later reneged.

Bella Via responds that, similar to Reserves' unjust enrichment argument, equitable estoppel does not apply because the relationship between the parties is governed by a contract.[96] Additionally, Bella Via argues that Reserves cannot recover under an equitable estoppel theory because Bella Via promptly advised Reserves that "no funds would move." Bella Via contends that it began conveying that message to Reserves as early as May 2005, when Esham asked Maizel about Reserves' exclusive costs, understanding that the exclusive costs would affect the bond obligations. Bella Via denies making any unequivocal promise to Reserves, but contends that even assuming a promise was made, Reserves payments to Fresh Cut and O-P were a result of contractual obligations, not reasonable reliance. Further, Bella Via blames any injury suffered by Reserves on Reserves' adoption of an ill-advised payment scheme, not reliance. For its part, Severn simply adopts Bella Via's arguments.

Equitable estoppel arises when a party by his conduct intentionally or unintentionally leads another, in reliance upon that conduct, to change position to his

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95 POB at 24.

96 BV Br. at 17.

detriment. To establish equitable estoppel, the party claiming estoppel must demonstrate that: (1) they lacked knowledge or the means of obtaining knowledge of the truth of the facts in question; (2) they reasonably relied on the conduct of the party against whom estoppel is claimed; and (3) they suffered a prejudicial change of position as a result of their reliance.[97]

After the PSA closed on October 6, 2004, months passed as Bella Via failed to secure a bond. Responding to this inaction, Reserves sought to assume Bella Via's responsibility and obtained two letters of credit on June 7, 2005. Before Reserves took that action, its counsel Richard Beck exchanged a number of emails with Bella Via's Esham concerning the parties' obligations regarding the bond. On Monday, June 6, Esham asked Beck to provide instructions regarding where Bella Via could wire funds to meet its obligations. On June 7, after several emails concerning logistics, Esham wrote to Beck as follows:

> We [Bella Via] are prepared to perform in the same manner as Abe [Korotki] in reference to the Letter of Credit with Wilmington Trust. . . . We will pay our pro-rated share of: – the monies needed [to] be deposited for the letter of credit – the letter of credit fee – the lender fees – the permit fees – construction management fees [and] – any other pro-ratable fees[.] We are ready to perform now – please provide the necessary information.[98]

On June 8, Beck responded that Korotki had obtained the letters of credit on June 7 and was now dealing with Eyal Elboim, another principal of Bella Via, regarding the issues

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97 *Nevins v. Bryan*, 885 A.2d 233, 249 (Del. Ch. 2005).

98 PX 11.

Beck and Esham had discussed. The same day, Esham replied that he would meet with Elboim and follow up with Beck.

On June 30, 2005, Reserves entered into a contract with Fresh Cut, a site contractor, for construction of the Project's infrastructure. Before signing the Fresh Cut contract, Reserves sought assurances from both Bella Via and Severn that as the infrastructure construction proceeded, Severn would release funds from the Construction Trust to Bella Via to reimburse Reserves for Bella Via's pro rata share of the expenses. Further, before committing to the Fresh Cut or O-P contracts, Korotki confirmed with Wood at Severn that each time a portion of the work passed inspection, the required payment would be made to reimburse Reserves for its expenditure.[99] Reserves proceeded on that basis.[100]

Ultimately, Reserves executed the Fresh Cut and O-P contracts and paid the initial bonding costs and fees. On June 8, 2005, Reserves submitted a bill to Severn for $71,466.83, reflecting 42.25% of the bonding costs and fees it had incurred.[101] On July 13, 2005, the Construction Trust disbursed $71,466.83 to Bella Via, but Bella Via did not use those funds to reimburse Reserves. Instead, Bella Via returned the money to

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99 T. Tr. at 70 (Korotki). Later, Wood memorialized this modification to the payment arrangement for the Trust (also referred to as the "Loan in Progress" or "LIP") in a document he signed on July 11, 2005, that refers to the agreed upon percentages. For example, according to the LIP, Bella Via's agreed share of the $3,015,000 Fresh Cut contract is $1,273,927.95, or roughly 42.25%. PX 15.

100 T. Tr. at 101, 157 (Korotki).

101 PT Stip. ¶ II.12.

Severn, stating that it had a dispute with Reserves over what Bella Via owed. Since then neither Bella Via nor the Trust has reimbursed Reserves for those costs.[102] Reserves also paid the initial start up fees required by Fresh Cut (a $250,000 deposit) and O-P (a $10,000 deposit), and submitted an application to Bella Via for its share of those amounts ($109,850). On July 26, 2005, Bella Via received a disbursement in that amount from the Trust, but again simply returned the money to Severn, rather than paying Reserves.[103]

During the same period, Korotki, on behalf of Reserves, wrote checks from the Escrow Account to pay the expenses Reserves had incurred in connection with the Project's infrastructure construction. The infrastructure work began on or about July 1, 2005. On or about July 30, 2005, Fresh Cut submitted Application No. 2 seeking $161,331.25 for its initial construction work. After paying that amount from the Escrow Account, Reserves submitted Application No. 2 to Bella Via, which conveyed the application to the Construction Trust. The Trustee had the work inspected and approved, but neither Hyatt nor Bella Via authorized any disbursement from the Trust to Reserves in response to Application No. 2.

In similar fashion, Reserves paid the amounts due under Applications Nos. 3 through 10, all of which passed inspection, to either Fresh Cut or its President and sole shareholder, Glenn, in cash or with lots. Under Application No. 3 for the period August 2005, Reserves paid Fresh Cut $104,144.90. Following a similar procedure, Reserves

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102 *Id.* ¶ II.13.

103 *Id.* ¶ II.14.

paid Glenn for Applications Nos. 4 through 10, covering the months from September 2005 through March 2006, by assigning lots to him. By the end of the period, Reserves paid over $2.5 million in cash and alleged land value for the infrastructure work of the Project.[104]

While Reserves was paying for the bonding and infrastructure construction expenses, it remained in communication with Bella Via regarding Bella Via's contribution. On July 14, 2005, Esham, in an email to Beck, questioned Bella Via's 42.25% pro rata share, claiming that it should be closer to 36%. The next day, July 15, Esham suggested that Reserves and Bella Via had a "significant misunderstanding" and that "No monies will move until this issue is resolved."[105]

Turning to the standard for equitable estoppel, before the July 15 email, Reserves clearly satisfies all three elements. First, Reserves lacked knowledge or the means of obtaining knowledge of the truth of the facts in question, *i.e.*, Bella Via's intent to withhold reimbursement of any funds. Second, before July 15, Reserves reasonably relied on the conduct of Bella Via and Severn as meaning that Bella Via would pay its share of the infrastructure expenses on a pro rata basis. Further, although the parties did not modify the PSA, in mid-2005 Reserves did assume a different and more responsible role in the parties' relationship and the conduct of Bella Via and Severn suggested they acquiesced in that change. Third, Reserves suffered a prejudicial change of position as a

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104 This total includes the invoices of both Fresh Cut and O-P.

105 PX 20.

result of their reliance. As noted, by July 15, Reserves already had paid hundreds of thousands of dollars for letters of credit and infrastructure construction-related expenses, for which Bella Via shared responsibility.

The reasonableness of Reserves' reliance after the July 15, 2005 "No monies will move" email from Esham is more complicated. Bella Via argued that approximately $400,000 of the $3,015,000 in cost covered by the Fresh Cut contract for the Project involved costs that were exclusively the responsibility of Reserves, because they did not directly relate to the 71 lots in the Project. In his responsive emails, Beck made clear that none of the Fresh Cut charges for work related to the portions of the contract for which Reserves was exclusively responsible would be charged to Bella Via. Beck also explained that the bond and letter of credit costs related only to work on roads and sewer included in the shared costs of the Project. Esham never controverted those explanations. Instead, he repeatedly sought to engage Reserves in discussions about Bella Via's $400,000 rough estimate of the cost for the work exclusively the responsibility of Reserves. The Applications for Payment after July 15, 2005, generally related to infrastructure work indisputably related to the shared aspects of the Project, as to which Bella Via's argument for a lower percentage is even more strained than it is regarding the cost of the bond and letters of credit.

Based on the facts as I have found them, I consider Bella Via's argument for a lower percentage of approximately 36% for its share of the expenses covered by Application Nos. 2 and later to border on frivolous. Bella Via and its lender Severn essentially remained silent for months after July 15, 2005, while Reserves continued to

incur substantial costs for the infrastructure on the Project. Indeed, Severn's representative continued to have the work for which Reserve had paid inspected. In these circumstances, I find that Reserves has shown reasonable reliance. After receiving Esham's July 15 email, however, Korotki should have been more careful to make sure Bella Via and Severn were informed of what Korotki and Reserves were doing. Thus, for example, I find that by the time Korotki started making payments to Glenn, instead of Fresh Cut, and using lots instead of cash, without informing Bella Via or Severn, the reasonableness of Reserves' purported reliance on Bella Via's conduct became questionable.

Bella Via's and Severn's conduct equitably estops them from denying their responsibility to pay Reserves for some but not all of the reimbursement Reserves seeks. Before July 15, Reserves has a strong claim for relief under equitable estoppel. Reserves also has demonstrated a right to equitable estoppel for the period from July 15 to October 2005, when Reserves entered into the first land swap contract. After the land swaps began in or around October 2005, however, I conclude that Reserves is not entitled to relief under equitable estoppel.

**4. Equitable subrogation**

Reserves also bases its claims for equitable relief on equitable subrogation. Reserves asserts that when it paid Bella Via's share of the Fresh Cut and O-P contracts, it satisfied obligations that Bella Via "owed" to Fresh Cut and O-P and also met Severn's

obligations to Bella Via under the CTA.[106] Moreover, Reserves argues that when it posted over $2 million in cash for letters of credit required by Sussex County, it facilitated the commencement of the infrastructure construction and ameliorated the injury Reserves, Bella Via, and Severn suffered from the construction delay. By advancing these funds, Reserves again asserts that it essentially performed Severn's obligation to Bella Via under the CTA. According to Reserves, as an equitable subrogee, it is entitled to all rights and remedies available to Fresh Cut and O-P against Bella Via and all rights and remedies available to Bella Via against Severn.[107]

Bella Via contends that Reserves fails to meet the requirements of an equitable subrogation claim.[108] Bella Via asserts that Reserves did not make payments to protect its own interests, but rather acted as a volunteer. Bella Via also contends that Reserves has not paid the entire debt because the Project is incomplete. Further, according to Bella Via, subrogation would not be just or equitable under the circumstances due to Reserves' alleged bad acts. Finally, Bella Via argues that Reserves was never intended to be a surety, which is the context in which subrogation most frequently applies.

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106 POB at 28-29.

107 *Id.* at 30-33.

108 BV Br. at 19-22.

Subrogation rights arise in certain circumstances to prevent the unjust enrichment of a party whose obligation is fully performed by another.[109] It enables one who has discharged the debt of another to succeed to the rights of the satisfied creditor, provided that:

> (1) payment must have been made by the subrogee to protect his or her own interest; (2) the subrogee must not have acted as a volunteer; (3) the debt paid must have been one for which the subrogee was not primarily liable; (4) the entire debt must have been paid; and (5) subrogation must not work any injustice to the rights of others.[110]

Under the principle of subrogation, "a surety who pays the debt of another is entitled to all of the rights of the person he paid to enforce his right to be reimbursed."[111]

Here, Reserves claims a right to equitable subrogation in regards to both the claims Fresh Cut and O-P supposedly could assert against Bella Via and the claims Bella Via could assert against Severn. Based on the above quoted legal standard, however, Reserves fails the third element. Bella Via is not a party to Reserves' contracts with Wilmington Trust (for the letters of credit), O-P (the construction manager), or Fresh Cut (the site contractor). Therefore, Reserves, and not Bella Via or Severn, was the party primarily liable for the debts it paid. Because Reserves bore primary responsibility for

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109 *Oldham v. Taylor*, 2003 Del. Ch. LEXIS 85, at *15-16 (July 31, 2003) (quoting *E. States Petroleum Co. v. Universal Oil Prods. Co.*, 44 A.2d 11, 15 (Del. Ch. 1945)).

110 73 AM. JUR. 2D *Subrogation* § 5 (2007).

111 *Travelers Cas. & Sur. Co. of Am. v. Colonial Sch. Dist.*, 2001 Del. Ch. LEXIS 31, at *15-16 (Mar. 16, 2001) (quoting *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 137 (1962)).

the debts paid to Wilmington Trust, O-P, and Fresh Cut, those creditors had no apparent rights against Bella Via or Severn.[112] Thus, Reserves fails the third prong of the legal standard and has no claim for relief under equitable subrogation.

### 5. Third-party beneficiary law

Reserves, in its claim for equitable relief under third-party beneficiary law, asserts that the parties conduct modified the PSA to make Reserves the party responsible for selecting and paying the Project's site contractors. Reserves also contends that the modification of the PSA "necessarily modified" the CTA.[113] Further, Reserves argues that by their acquiescence, Bella Via and Severn ratified and confirmed Reserves as an intended third-party beneficiary of the Construction Trust.

Bella Via denies Reserves' claim to third-party beneficiary status because it was not a party to, or an intended beneficiary of, the CTA. Similarly, Severn argues that the parties to the CTA never intended Reserves to be a third-party beneficiary. To the contrary, Severn contends that the contracting parties, Bella Via, Hyatt, and Severn, intentionally excluded Reserves from the CTA. Further, Severn notes that Reserves was not involved in negotiating the CTA and that Korotki did not even read the CTA before the initiation of this litigation. Consequently, Severn questions the reasonableness of any alleged reliance by Reserves on the CTA.

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112 As to the Applications for payment from Fresh Cut after the land swaps began in or around October 2005, Reserves' subrogation claim is even more problematic, because Reserves paid Glenn, and not Fresh Cut directly, for those invoices.

113 POB at 35.

As a preliminary matter, I reject Reserves' claim that the parties modified the PSA for the same reasons stated earlier.[114] Because Reserves based its argument that the parties modified the CTA on the premise that the PSA had been modified and on the same conduct they contend modified the PSA, I reject that argument, as well. Thus, the only remaining issue is whether the circumstances of this case are such that they elevate Reserves, as a matter of equity, to the status of an intended third-party beneficiary.

On the issue of intended third-party beneficiaries, nonparties to a contract generally do not have any rights under it.[115] Nonetheless, a third party may recover on a contract made for its benefit provided that the contracting parties intended to confer a benefit on that entity.[116] Under this exception, intended—but not incidental—third-party beneficiaries may have enforceable legal rights under a contract.[117] In Delaware,

> not only is it necessary that performance of the contract confer a benefit upon third parties that was intended, but the conferring of a *beneficial* effect on such third party—whether it be a creditor of the promissee or an object of his or her generosity—should be a material part of the contract's purpose.[118]

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114 *See* Part III.A.1, *supra*.

115 *See, e.g.*, *Comrie v. Enterasys Networks, Inc.*, 2004 WL 293337, at *2 (Del. Ch. Feb. 17, 2004) (stating general rule that strangers to a contract ordinarily acquire no rights under it).

116 *Delmar News, Inc. v. Jacobs Oil Co.*, 584 A.2d 531, 533 (Del. Super. 1990).

117 *MetCap Secs. LLC v. Pearl Senior Care, Inc.*, 2007 WL 1498989, at *29-30 (Del. Ch. May 16, 2007).

118 *Insituform of N. Am., Inc. v. Chandler*, 534 A.2d 257, 270 (Del. Ch. 1987).

In other words, demonstrating that a party is a third-party beneficiary requires proof of three elements: (1) an intent between the contracting parties to benefit a third party through the contract; (2) an intent that the benefit serve as a gift or in satisfaction of a preexisting obligation to the third party; and (3) a showing that benefiting the third party was a material aspect to the parties agreeing to contract.[119]

Here, neither Bella Via nor Severn acknowledge Reserves as a third-party beneficiary. Reserves was not a party to the CTA or even mentioned in it. Reserves has no role in drafting the CTA, which occurred before the infrastructure development began, before Reserves secured the bond with Wilmington Trust, and before Reserves hired Fresh Cut. Therefore, Reserves is not an intended third-party beneficiary under the CTA and cannot rely on that theory to establish enforceable rights under the Construction Trust.

### B. Does Any Impediment Block Equitable Relief?

Defendants Bella Via and Severn contend that Reserves is barred from obtaining any equitable relief because it acted with unclean hands. Under the unclean hands doctrine, a court of equity may close its doors to an applicant seeking equitable relief where the applicant has acted in violation of a fundamental concept of equity in connection with the matter in controversy.[120] Courts applying this doctrine therefore consider whether the litigant's own acts offend the very sense of equity to which he

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119 *Madison Realty Co. v. AG ISA, LLC*, 2001 Del. Ch. LEXIS 37, at *15 (Apr. 1, 2001).

120 *Bodley v. Jones*, 59 A.2d 463, 469 (Del. 1947).

appeals.[121] Traditionally, application of the unclean hands doctrine rests within the Court of Chancery's sound discretion, unbound by restrictive formulas.[122]

Defendants focus their allegations of unclean hands on two particular categories of actions of Reserves: Korotki's actions regarding the Escrow Account and Reserves' land swap agreements with Glenn. Korotki's actions regarding the Escrow Account cause the Court some concern. Contrary to the Escrow Agreement, Korotki, who apparently should not have been, but was a signatory on the Escrow Account, withdrew funds from that Account without the approval of Severn or Bella Via or Bella Via's counsel. Further, Korotki improperly spent a limited amount of those funds in the range of $30,000 on expenses unrelated to the Project that were exclusively Reserves responsibility.[123] In the context of the issues before me, the latter conduct by Korotki is not sufficiently material, on its own, to warrant application of the unclean hands doctrine. Korotki's unilateral disbursement of funds from the Escrow Account, however, is inconsistent with the fundamental concepts of equity that Reserves invokes to justify the relief it seeks against Bella Via and Severn in this action. Thus, that conduct by Reserves

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121 *In re Silver Leaf, L.L.C.*, 2005 WL 2045641, at *12 (Del. Ch. Aug. 18, 2005).

122 *SmithKline Beecham Pharms. Co. v. Merck & Co.*, 766 A.2d 442, 448-49 (Del. 2000).

123 T. Tr. at 234-35 (Korotki) (admitting that some funds were spent on work outside the Project, specifically excess funds paid O-P for work on the next Phase of The Reserves). BVX 6, O-P Invoices from November 2005 to March 2006 (indicating expenditures for work on "Phase II," which is outside the scope of the Project and totals approximately $30,000).

tends to support a finding of unclean hands, but is not sufficiently serious on its own to bar Reserves' claims for relief.

Defendants also complain about Reserves entry into a series of agreements whereby it "paid" for work performed by Fresh Cut by deeding lots to Glenn, a third party, without the knowledge or consent of either Bella Via or Severn. As previously mentioned, Glenn is the President and sole shareholder of Fresh Cut. Nevertheless, Glenn is a separate and distinct legal person from Fresh Cut, and payments to Glenn in his individual capacity do not constitute payments to Fresh Cut. In the Assumption and Release Glenn entered into with Reserves, he purports to provide a release on behalf of Fresh Cut. The Fresh Cut release provisions of that contract may or may not be enforceable.[124] I express no opinion on that point. In any event, Reserves decided to transfer lots to Glenn, rather than Fresh Cut, in purported satisfaction of debts owed to Fresh Cut in connection with the infrastructure construction. From the point of view of Bella Via and Severn, those transfers reasonably can be viewed as different from a direct payment by Reserves to Fresh Cut. At a minimum, the way in which Reserves chose to proceed creates a greater risk of disputes over whether Fresh Cut's invoices have been paid. In my opinion, subjecting Bella Via or Severn to such increased risk without any prior notice or consultation offends the same sense of equity to which Reserves appeals for relief.

[124] The record indicates that Fresh Cut is now in bankruptcy.

Taken together, Reserves failure to adhere strictly to the requirements of the Escrow Agreement and its unilateral and undisclosed payments of the later Fresh Cut invoices by means of land transfers, rather than cash, to a principal of Fresh Cut, instead of the company directly, supports the application of the doctrine of unclean hands. As referenced in the Assignment of Rights to Conveyance by Deed, the first of the land swap agreements occurred on October 6, 2005. I therefore hold that Reserves is not entitled to equitable relief in this proceeding as to any amounts it paid on or after October 6, 2005. In addition, I decline on grounds of unclean hands to afford Reserves any relief for transfers of land to Glenn that it made in "payment" of Fresh Cut invoices, whether or not they related to work performed after October 6, 2005.

### C. What if Any Equitable Remedy is Appropriate?

#### 1. Application for reimbursement of expenses

Reserves claims equitable relief based on its allegation that, although Reserves and Bella Via were to share the cost of developing the infrastructure for the Project, Reserves now has paid over $2.5 million toward that effort and Bella Via has not reimbursed Reserves for any of Bella Via's share of those costs. As previously discussed, Reserves has shown that it is entitled to equitable relief under the theories of unjust enrichment and equitable estoppel.[125] Reserves recovery, however, will be limited by the Court's finding

[125] In reaching this conclusion, I am addressing only the question of the relative distribution of risk among Reserves, Bella Via, and Severn, while their numerous disputes regarding the various actions taken to develop the Project are presented in other forums. The merits of those disputes are not before me, and I express no opinion regarding them.

that it acted, in part, with unclean hands. As mentioned above, Reserves is entitled to equitable relief for seven payments, which occurred in June (2), August (2), and September (3) of 2005, before the first land swap agreement. Reserves has not demonstrated a right to equitable relief, however, as to any other payments it made, whether in cash or by land transfer, related to the Project.

Therefore, with reference to the spreadsheet entitled, "Calculation of Payments Owed to Reserves by Bella Via," attached to Plaintiffs' Post-Trial Opening Brief, this Court grants Reserves' request for reimbursement of Bella Via's pro rata share of the letter of credit/bond fees, the Fresh Cut deposit, the O-P deposit, O-P Application Nos. 1 through 4, and Fresh Cut Application Nos. 2 and 3.[126] Using 42.25% as reflecting Bella Via's pro rata share, Hyatt shall pay to Reserves on behalf of Bella Via: (1) $71,466.83 for the letter of credit/bond fees, (2) 109,857.80 for the Fresh Cut and O-P deposits, (3)

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[126] Although Fresh Cut Application No. 4 for $236,386.22 relates to work performed in September 2005, there is no evidence that Reserves paid that amount in cash, as opposed to using a land transfer to Glenn. Based on the record, I infer that Reserves did use a land transfer to satisfy Application No. 4, and therefore will not afford Reserves equitable relief as to that Application.

I deny Reserves' request for Bella Via's pro rata share of the mulch fire because the record does not show that the mulch fire is chargeable to the 71 lot Project. Therefore, there is no basis for any reimbursement of that expense from Bella Via or Severn. Further, I infer from the record that the mulch fire occurred after October 6, 2005. T. Tr. at 239 (Korotki); POB at 11 (stating that the mulch fire "occurred after Fresh Cut and Obrecht-Phoenix had left the Project).

The Court also declines to grant Reserves' request for Bella Via's pro rata share of the One Source or Satterfield & Ryan contracts because Reserves entered into both contracts after October 6, 2005.

$68,167.29 for Fresh Cut Application No. 2, (4) $9,492.79 for O-P Application Nos. 1 and 2, (5) $44,004.34 for Fresh Cut Application No. 3, (6) $7,569.46 for O-P Application No. 3, and (7) $6,383.36 for O-P Application No. 4. These amounts total $316,941.87.

**2. Removal of Hyatt as Trustee**

Reserves also seeks the removal of Hyatt as the Trustee of the Construction Trust in favor of a new and unbiased Trustee.[127] Reserves accuses Hyatt of colluding with Bella Via to avoid paying Reserves. According to Reserves, a disinterested, independent Trustee would have interpled the Construction Trust monies in this case. Further, Reserves suggests that Hyatt is interested and lacks independence because he is the principal shareholder, President, and manager of Severn and a principal partner of the law firm Hyatt & Peters, which represents Severn in this matter.

Hyatt defends his actions as Trustee as being consistent with black letter law in preserving the Trust property that is the subject of dispute in the Superior Court. Citing the Restatement, Hyatt contends that a trustee is under a duty to the beneficiary to administer the trust solely in the interest of the beneficiary and that the trustee should use reasonable care and skill to preserve the trust property.[128] Hyatt asserts that the CTA required him to disburse funds only to Bella Via. Hyatt halted the funding after Bella Via returned the funds and notified Severn of the dispute with Reserves. Although Reserves wrote to Hyatt demanding that Severn release funds only to Reserves, Hyatt contends that

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127 PT Stip. ¶ V.A.5.

128 Restatement (Second) of Trusts § 176 (1959).

he took the prudent action to freeze the trust funds until the Superior Court resolved the dispute.

Ancillary to its jurisdiction to see that trusts are properly administered, the Court of Chancery has the power to remove a trustee.[129] The removal of a trustee lies within the sound discretion of this Court.[130] Here, the record does not show any wrongdoing by Hyatt that would justify his removal as Trustee of the Construction Trust. Consequently, Reserves' request to remove Hyatt as the Trustee is denied.

### 3. Application for attorneys' fees

Reserves requests that Severn and Bella Via pay its legal fees.[131] Reserves argues that even if Bella Via seriously believed that the Fresh Cut contract included $400,000 of work for which Reserves bore exclusive responsibility, there is no excuse for its failure to remit at least 36% of the invoices for work that had been both inspected and approved. Reserves further asserts that Severn and Hyatt acted in bad faith when they had the infrastructure work inspected and approved, but ultimately followed their defaulted borrower's instructions not to make disbursements to Reserves. As a result, the Construction Trust effectively was used to pay Bella Via's interest obligations and reduce its outstanding debt to Severn.

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129 *Gans v. MDR Liquidating Corp.*, 1991 WL 114514, at *3 (Del. Ch. June 25, 1991).

130 *Rosenbloom v. Esso V.I., Inc.*, 766 A.2d 451, 459 (Del. 2003).

131 PT Stip. ¶ V.A.3.

As an equitable exception to the American rule, this Court may grant attorneys' fees if it finds that a party brought litigation in bad faith or acted in bad faith during the course of the litigation.[132] The Court, however, does not lightly award attorneys' fees under this exception, and has limited its application to situations in which a party acted vexatiously, wantonly, or for oppressive reasons.[133] The conduct of the Defendants in this action does not rise to such a level. Therefore, I deny Reserves' request for attorneys' fees.

## IV. CONCLUSION

For the reasons stated, I hold that Reserves is entitled to equitable relief in the amount of $316,941.87. Defendants Severn and Hyatt shall pay that amount from the Construction Trust directly to Reserves on behalf of Bella Via to be applied toward Bella Via's share of the infrastructure costs claimed by Reserves. In all other respects, including without limitation Reserves' requests to remove Hyatt as the Trustee of the Construction Trust and for its attorneys' fees and costs, Reserves' claims for relief in this action are dismissed with prejudice.

**IT IS SO ORDERED.**

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132 *Mainiero v. Tanter*, 2003 WL 21003260, at *2 (Del. Ch. Apr. 25, 2003).

133 *See Slawik v. State*, 480 A.2d 636, 639 (Del. 1984); *Nagy v. Bistricer*, 770 A.2d 43, 64 (Del. Ch. 2000).