IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

J. MICHAEL STEPP,	:	
	:	
Plaintiff,	:	
	:	
v.	:	C.A. No. 4427-VCL
	:	
HEARTLAND INDUSTRIAL PARTNERS, L.P., a Delaware Limited Partnership,	:	
	:	
	:	
Defendant.	:	

DEFENDANT HEARTLAND INDUSTRIAL PARTNERS, L.P.'S ANSWERING BRIEF IN OPPOSITION TO PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT

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PRELIMINARY STATEMENT

Plaintiff J. Michael Stepp, the former Chief Financial Officer of bankrupt automotive parts supplier Collins & Aikman Corporation ("C&A"), brings suit against Heartland Industrial Partners, L.P. ("Heartland") for advancement and indemnification of legal expenses allegedly incurred in connection with various federal criminal, SEC and civil actions against him arising out of his alleged conduct at C&A.[1] On April 8, 2009, Heartland moved to dismiss Mr. Stepp's complaint in its entirety. On the same day, Mr. Stepp moved for partial summary judgment on his claim for advancement.

Mr. Stepp's motion must be denied. Mr. Stepp concedes that Heartland's limited partnership agreement specifically prohibits Heartland from making advances "without the prior written approval of the General Partner." Mr. Stepp concedes that Heartland's General Partner has not approved advances to him. Therefore, Heartland is prohibited from making advances to Mr. Stepp.

But Mr. Stepp argues that this provision of Heartland's limited partnership agreement should be viewed as a nullity because, for some reason, the General Partner ought to be prohibited from withholding or placing conditions on its approval. Thus, Mr. Stepp argues that the required "prior written approval" is merely a ministerial record-keeping function. That argument has no merit. The plain and unambiguous meaning of the limited partnership agreement (also supported by every applicable canon of Delaware

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[1] Contrary to Mr. Stepp's assertion that "Heartland has not contested (nor could it) that the underlying proceedings give rise to advancement claims" (Pl. Op. Br. at 8), Mr. Stepp sues for advancement of his legal expenses in connection with claims that seek to recover the monies paid to him by C&A as preferential transfers or fraudulent conveyances, which under any standard are not properly the subject of advancement from Heartland.

contract construction) prohibits advances that the General Partner has not approved. The Court should deny Mr. Stepp's motion for partial summary judgment.

STATEMENT OF FACTS

Heartland's motion to dismiss should be granted, and Mr. Stepp's motion for partial summary judgment should be denied, each as a matter of law based on the unambiguous terms of Heartland's limited partnership agreement. But even if the Court were to conclude that the relevant provisions of the limited partnership agreement are ambiguous, Mr. Stepp's motion for partial summary judgment should still be denied because resolution of that ambiguity would require examination of extrinsic evidence. Mr. Stepp has not offered any evidence at all in support of his motion for partial summary judgment other than the Limited Partnership Agreement itself. Accordingly, if the Court finds the relevant provision ambiguous, it should deny the motion pursuant to Court of Chancery Rule 56(f) and permit the case to proceed to discovery of the parties' intent. Should the Court so find, Heartland is entitled to discovery and summary judgment is not appropriate under Court of Chancery Rule 56(f).

ARGUMENT

The Delaware Revised Uniform Limited Partnership Act ("DRULPA") does not give anyone a right to the advancement of legal expenses. As a result, "absent a clearly worded bylaw or contract making advancement mandatory, Delaware law leaves the decision whether to advance expenses to the business judgment" of the entity's governing body. *Bernstein v. TractManager, Inc.*, 953 A.2d 1003, 1008 (Del. Ch. 2007). "Partnership Agreements are contracts to be construed like any other contract," and if a "contract is clear on its face, the court will rely solely on the clear, literal meaning of those words." *Madison Ave. Inv. Partners, LLC v. Am. First Real Estate Inv. Partners, L.P.*, 806 A.2d 165, 172 (Del. Ch. 2002); *Interactivecorp v. Vivendi Universal S.A.*, C.A. No. 20260, 2004 Del. Ch. LEXIS 90, at *30 (Del. Ch. June 30, 2004). Here, the Limited Partnership Agreement is plain as day. In clear and unambiguous language it prohibits Heartland from advancing legal expenses without the written approval of the General Partner. The Limited Partnership Agreement should be enforced according to its terms.

I. THE CONTRACTUAL PROHIBITION AGAINST ADVANCES WITHOUT PRIOR "WRITTEN APPROVAL" OF THE GENERAL PARTNER MUST HAVE MEANING.

As demonstrated in Heartland's opening brief in support of its motion to dismiss, the only reasonable interpretation of section 4.4(b) of the Limited Partnership Agreement is that the term "prior written approval" has meaning. *See* Def. Op. Br. at 8-12.[2] This is true for at least five reasons: (1) contract terms should be given their usual

[2] Heartland hereby incorporates by reference the arguments advanced in its opening brief in support of its motion to dismiss.

and ordinary meaning; (2) requiring advancement without the General Partner's prior written approval would render that contract term meaningless; (3) the Limited Partnership Agreement should be read as a whole, and the indisputably substantive nature of the prohibition in section 4.4(b)*(ii)* defeats any contention that the exclusion in section 4.4(b)*(i)* is merely ministerial; (4) the specific term "[n]o advances shall be made … without the prior written approval of the General Partner" should govern over the general term "shall be advanced"; and (5) interpreting the Limited Partnership Agreement in a manner that gives the General Partner authority to withhold its written approval is consistent with Delaware law's presumption that advancement is within the discretion of an entity's governing body. *See id*. In his opening brief in support of his motion for partial summary judgment ("Pl. Op. Br."), Mr. Stepp ignores these five arguments (which he had seen previously in Heartland's motion to dismiss the parallel *Stockman* case), but puts forth three arguments of his own. *See* Pl. Op. Br. at 8-14.

First, Mr. Stepp argues that section 4.4(b)(i) can be construed to give meaning to all of its terms only by reading "written approval" as a "ministerial" "record-keeping function." Pl. Op. Br. at 10. Mr. Stepp is wrong because (1) his interpretation would not give meaning to the term "prior written approval"; (2) both the "shall be advanced" and "prior written approval" provisions can be harmoniously applied without rendering "prior written approval" meaningless; and (3) his interpretation conflicts with case law analyzing similar provisions and holding that the term "written approval" connotes discretion. *Second*, Mr. Stepp argues that the absence of the word "discretion" in section 4.4 means that the General Partner does not have discretion to withhold its

written approval. As explained below, however, the inclusion of the word "discretion" would be redundant in light of the "written approval" provision and other sections of the Limited Partnership Agreement. *Third*, Mr. Stepp argues that the General Partner lacks discretion to require a different type of undertaking or impose additional requirements on an Indemnitee for advancement, and that the grant of discretion could lead to arbitrary advancement decisions. Mr. Stepp is wrong both because imposing conditions on advancement is part of the authority given to the General Partner to grant or withhold its written approval, and because he has not challenged the General Partner's decision as a breach of the Limited Partnership Agreement, a breach of the covenant of good faith and fair dealing or on any other grounds. As further discussed below, all three arguments fail.

A. Permitting The General Partner To Withhold Or Give Its Approval Is The Only Reasonable Interpretation Of Section 4.4(b) That Gives Meaning And Effect To Both Sentences.

Mr. Stepp's primary argument is that the sentence "[n]o advances shall be made by the Partnership under this section 4.4(b)(i) without the prior written approval of the General Partner" does not actually prohibit the Partnership from making advances but instead merely imposes a ministerial record keeping function on the General Partner. According to Mr. Stepp, his construction is the only one that gives meaning to both that sentence and the prior sentence providing that "[e]xpenses reasonably incurred by an Indemnitee in defense or settlement of any claim that may be subject to a right of indemnification hereunder shall be advanced by the Partnership." Pl. Op. Br. at 10-11. He is wrong for several reasons.

First, Mr. Stepp's interpretation does not, as he contends, give effect to both sentences. *See* Def. Op. Br. at 9-12. If a plaintiff can get a court order directing Heartland to advance legal expenses regardless of whether the General Partner has not given "prior written approval," then obviously the provision explicitly prohibiting advances without the prior written approval of the General Partner would be rendered meaningless. Such interpretations are to be carefully avoided. *See, e.g.*, *In re Cencom Cable Income Partners, L.P. Litig.*, Consol. C.A. No. 14634, 2000 Del. Ch. LEXIS 10, at *24 (Del. Ch. Jan. 27, 2000) ("I find that [such a] reading of this provision would render the limiting language completely superfluous.").

Second, the interpretation advanced by Heartland is the only interpretation that gives effect and meaning to both terms in section 4.4(b). Under Heartland's interpretation, written approval is given its usual and ordinary meaning conferring authority and discretion on the General Partner to grant, withhold or condition its approval for advancement. The prior term "shall be advanced" is subject to the two qualifications that follow in sections 4.4(b)(i-ii). The effect of the combined provision is to protect decisions of the General Partner concerning advancement from challenge by the limited partners. In the absence of the first provision that funds "shall be advanced," the General Partner might be forced to defend claims of breach of fiduciary duty by limited partners challenging arguably self-interested decisions to advance limited partnership funds to its members and officers. The second sentence of section 4.4(b) ensures that the General Partner can refuse or condition advancement to persons to whom advancement would be inappropriate. Thus, the two-part structure of section 4.4(b) – a

right to advancement for the General Partner's employees subject to approval of the General Partner itself – makes perfect sense in the context of a limited partnership and is consistent with the presumption under Delaware law that advancement decisions lie within the discretion of the entity's governing body. *See* 8 *Del. C.* § 145(e); *see also Bernstein*, 953 A.2d at 1008.

Third, case law interpreting the term "written approval" holds that the term connotes discretion. *See, e.g., Resolution Trust Corp. v. Fed. Sav. & Loan Ins. Corp.*, 25 F.3d 1493, 1502 (10th Cir. 1994) (noting that a provision which provides the company may "not make any new loans or investments or increase assets without the prior written approval of the District Director" meant "it was within the Director's discretion").[3] This case law is consistent with the common usage of the term "written approval" as connoting the inherent discretion and authority to grant or withhold approval.

Finally, Mr. Stepp cites no case holding that the term "written approval" is "ministerial" or that this provision or any similar term was intended as merely a "record-keeping" function. Cases that find specified acts to be merely ministerial commonly refer

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[3] *See also Switzer v. Commissioners for Loaning Certain Moneys*, 134 A.D. 487, 490 (N.Y. App. Div. 1909) ("Section 6 of chapter 360 of the Laws of 1898 provides that before the delivery of a deed by the loan commissioners for and on behalf of the People of the State of New York 'every sale ***shall be approved in writing*** by the Comptroller of the State of New York.' Hence, every contract made by the commissioners for the sale of lands must be read as if the clause providing for the delivery of the deed made such delivery expressly contingent upon the written approval of the sale by the Comptroller. ***Such approval is evidently intended to be something more than a formal ministerial act and involves the exercise of judgment and discretion***. The execution of such an approval is a condition precedent to the execution of a deed, for without such approval a deed cannot lawfully be executed. Therefore, until the Comptroller has approved the sale, of which there is no allegation in the complaint, the commissioners cannot be compelled to specifically perform the contract of sale.") (emphasis added).

to provisions that require, for example, the designation of an account or time of day for payment. *See, e.g.*, *Bank of New York Mellon v. Realogy Corp.*, C.A. No. 4200-VCL, 2008 Del. Ch. LEXIS 186, at *28-29 (Del. Ch. Dec. 18, 2008).

B. Inclusion Of The Term "Discretion" In Section 4.4(b) Would Be Redundant.

Mr. Stepp argues that the absence of the term "discretion" in the written approval provision "suggest[s] that the written approval required is ministerial only." Pl. Op. Br. at 11-12. In support of this argument, Mr. Stepp points to section 4.2 of the Limited Partnership Agreement. An examination of section 4.2 demonstrates that it supports the opposite conclusion. Section 4.2, "Powers of the General Partner," provides that "the General Partner … shall have the power … to carry out *any and all the objects and purposes of the Partnership* and *to perform all acts* and enter into and perform all contracts and other undertakings that it may *in its sole discretion* deem necessary or advisable or incidental thereto, *all in accordance with and subject to the other terms of this Agreement*." (Compl. Ex. A. § 4.2). Thus, section 4.2 grants the General Partner sole discretion to carry out any and all of the functions of the Partnership, including responding to advancement requests.

The other provision cited by Mr. Stepp, section 11.12, does not help him. Section 11.12 simply states that "[w]henever in this Agreement a Person is permitted or required to make a decision (i) in its … *'discretion' or under a grant of similar authority*

or latitude,[4] the Person shall be entitled to consider any interests and factors as it desires, including its own interests …." (Compl. Ex. A § 11.12 (emphasis added)) Notably, Mr. Stepp points to no provision where a specific grant of authority under the Limited Partnership Agreement contains the word discretion. Of course, this makes perfect sense in light of Section 4.2, which conveys to the General Partner sole discretion to act in all respects under the Limited Partnership Agreement and demonstrates that inclusion of the word discretion in section 4.4(b) would be redundant. Thus, sections 4.2 and 11.12 do not undermine, but instead reinforce, the conclusion that the General Partner has the authority and discretion to withhold its written approval for advancement.

C. Mr. Stepp Cannot Challenge The General Partner's Decision To Condition Its Written Approval.

Mr. Stepp argues that "it was not the drafter's intention to give the General Partner discretion" to impose additional requirements for advancement because section 4.4(b) makes no "mention of any other criteria beyond being an 'Indemnitee.'" Pl. Op. Br. at 12-14. Mr. Stepp's argument misses the point. The General Partner has the discretion to impose conditions on advancement as part of the authority given to the General Partner to grant or withhold its written approval. Mr. Stepp further argues that such authority could be exercised "arbitrar[ily]" and "invites … an inequitable result." Pl. Op. Br. at 12. Simply put, because the General Partner has the authority and discretion to withhold its written approval, it may do so subject only to a legal challenge on some

[4] Moreover, inclusion of the term "or under a grant of similar authority or latitude" in section 11.2 implies that there is no magic in the incantation of the word "discretion" and the term "written approval" is an equally powerful synonym.

other basis. Plaintiff's argument fails because he has not challenged the General Partner's decision as a violation of the Limited Partnership Agreement, as a breach of the implied covenant of good faith and fair dealing or on any other cognizable legal grounds.[5]

II. THE DOCTRINE OF CONTRA PROFERENTEM DOES NOT APPLY.

Finally, Mr. Stepp argues that, if the Limited Partnership Agreement is ambiguous, he is entitled to judgment in his favor based on the doctrine of *contra proferentem*. *See* Pl. Op. Br. at 12-13. The Court need not reach this argument because there is no ambiguity in the Limited Partnership Agreement. *See, e.g.*, *E.I. du Pont de Nemours & Co. v. Allstate Ins. Co.*, 693 A.2d 1059, 1061 (Del. 1997). As discussed above and in Defendant's opening brief, the plain text of the Limited Partnership Agreement, aided, if necessary, by other canons of contractual construction lead to the inevitable conclusion that Defendant's interpretation is the only correct one. In any event, the doctrine of *contra proferentem* is a tool of last resort used only where the disputed language is "hopelessly ambiguous," *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 398-99 (Del. 1996), and contains language "that *cannot be resolved by resort to extrinsic evidence*." *Twin City Fire Ins. Co. v. Delaware Racing Ass'n*, 840 A.2d 624, 630 (Del. 2003) (emphasis added). Thus, even if there were some uncertainty as to the exact meaning or intention of section 4.4, that would be insufficient to apply *contra*

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[5] Mr. Stepp has not disputed, nor could he, that the conditions imposed by the General Partner are entirely appropriate and reasonable. *See, e.g.*, *Thompson v. The Williams Cos.*, C.A. No. 2716-VCS, 2007 Del. Ch. LEXIS 112, at *7 (Del. Ch. July 31, 2007) ("[T]he board was well within its contractual discretion to require [the employee] to establish his ability to repay the loan and to represent that his conduct as an employee was consistent with an ultimate right of indemnification.").

proferentem and the Court should look first to extrinsic evidence, including evidence of the intent of the drafters, which is the touchstone of contract interpretation. *See Seaford Golf & Country Club v. E.I. du Pont de Nemours & Co.*, 925 A.2d 1255, 1262 (Del. 2007) (finding contract ambiguous and remanding to trial court for further fact finding); *Minnesota Invco of RSA No. 7, Inc. v. Midwest Wireless Holdings LLC*, 903 A.2d 786, 794 (Del. Ch. 2006) ("[I]f the terms are ambiguous, the court may look to extrinsic evidence to determine the intent of the parties.").

Even if the Court should conclude that the disputed provision is "hopelessly ambiguous," Mr. Stepp's heavy reliance on the *contra proferentem* doctrine is misplaced here because Mr. Stepp's entire relationship with Heartland was negotiated between sophisticated parties. Indeed, Mr. Stepp negotiated many aspects of his relationship with these companies and if he believed the advancement provision of the Limited Partnership Agreement was inadequate or ambiguous, he could have readily negotiated a separate indemnification and advancement agreement as is common for executives. *See, e.g., Brady v. i2 Techns., Inc.*, C.A. No. 1543-N, 2005 Del. Ch. LEXIS 194, at *1 (Del. Ch. Dec. 14, 2005) ("i2 presciently entered into an Indemnification Agreement … to induce [the plaintiff] to continue to serve as an officer or director of the Company. Relevant provisions of the [Indemnification] Agreement beyond general indemnification obligations include … the advancement by the Company of reasonable expenses incurred in defending against any action …."). Accordingly, Mr. Stepp may not pile the *contra proferentem* doctrine on top of his *ipse dixit* contention that "prior written approval" is merely ministerial.

To be sure, Mr. Stepp may not have been involved in the drafting of the Limited Partnership Agreement, but he is a sophisticated party with real bargaining power who negotiated his global relationship with both C&A and Heartland, not one of hundreds of limited partners or public unitholders, which sharply distinguishes the three cases he cites. *See* Pl. Op. Br. at 9. All three cases involved suits brought by individuals without bargaining power against publicly traded entities with a large number of limited partners. *See SI Mgmt. L.P. v. Wininger*, 707 A.2d 37, 43 (Del. 1998) (noting "the General Partner solicited and signed on 1,850 investors to the Agreement"); *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, C.A. No. 15754, 2000 Del. Ch. LEXIS 146, at *5 (Del. Ch. Sept. 27, 2000) ("The Partnership's units are publicly traded on the American Stock Exchange ('AMEX')."), *rev'd on other grounds*, 817 A.2d 160 (Del. 2002); *Arvida/JMB Partners, L.P. v. Vanderbilt Income & Growth Assocs.*, C.A. No. 15238, 1997 Del. Ch. LEXIS 79, at *13 (Del. Ch. May 23, 1997) ("The Supreme Court has recently discussed the interpretation of contracts governing publicly sold securities.") (citing *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392 (Del. 1996)). At the very minimum, Heartland would be entitled to discovery into the disputed material facts surrounding the negotiation of Mr. Stepp's relationship with both C&A and Heartland and summary judgment is inappropriate until that discovery is completed. *See* Ct. Ch. R. 56(f).

CONCLUSION

For the foregoing reasons, the Court should deny Mr. Stepp's motion for partial summary judgment.

Respectfully submitted,

/s/ Robert S. Saunders

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