



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. :

**OPENING BRIEF IN SUPPORT OF
DEFENDANT HEARTLAND INDUSTRIAL PARTNERS, L.P.'S
MOTION TO DISMISS THE VERIFIED COMPLAINT**

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DATED: April 8, 2009

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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. Both Mr. Stepp's claim for advancement and his claim for indemnification must be dismissed.

Mr. Stepp's claim for advancement must be dismissed because Heartland's limited partnership agreement specifically prohibits advancement of legal expenses "without the prior written approval of the General Partner." It is undisputed that the General Partner has not approved advancement of legal expenses to Mr. Stepp. As a matter of law, therefore, Mr. Stepp is not entitled to advancement of legal expenses from Heartland.

Mr. Stepp's claim for indemnification must also be dismissed because Mr. Stepp has alleged only one of three necessary elements for indemnification under its governing agreement. Heartland's limited partnership agreement conditions indemnification on the nature of the underlying conduct, not on the outcome of any particular proceeding. Thus, neither the limited partnership agreement nor anything in the Delaware Revised Uniform Limited Partnership Act entitles Mr. Stepp to indemnification merely because federal authorities decided not to prosecute their indictment. Instead, Mr. Stepp would be entitled to indemnification only if his conduct met the standards set forth in the governing limited partnership agreement, which he has

not alleged. In any event, any determination of whether Mr. Stepp's conduct meets those standards is premature because the same conduct underlying the action for which he seeks indemnification underlies a civil SEC action and various civil suits. As a matter of law, therefore, Mr. Stepp's claim for indemnification is legally insufficient and premature.

Accordingly, the Court should dismiss Mr. Stepp's complaint in its entirety.

STATEMENT OF FACTS¹

A. The Parties.

Plaintiff J. Michael Stepp was a Senior Managing Director of Heartland. (Compl. ¶ 2) Stepp was C&A's Chief Financial Officer and Vice President from January 2002 until October 2004 and was also Vice Chairman of C&A's Board of Directors. (*Id.*)

Heartland is a Delaware limited partnership formed in 2000 whose assets included an equity investment in C&A.² (Compl. ¶ 3)

B. The Pending Proceedings.

Mr. Stepp has been named as a defendant in civil and criminal actions (the "Proceedings") because of his conduct in his capacity as an officer of C&A.³ (Compl. ¶ 4) Mr. Stepp has incurred legal fees and expenses in defending these Proceedings. (Compl. ¶ 6) C&A's and Heartland's directors and officers insurance policies have been exhausted. (*Id.*) On November 5, 2005, Mr. Stepp sent a letter to Heartland of possible claims against Mr. Stepp. (Compl. ¶ 11) On August 5, 2008, Mr. Stepp's counsel contacted counsel for Heartland seeking advancement of expenses. (Compl. ¶ 12) In

¹ The facts are taken from the allegations in the Verified Complaint, filed on March 17, 2009 (the "Complaint") and are assumed true only for the purposes of this Motion to Dismiss.

² Unless otherwise noted, capitalized terms have the same meaning as in the Complaint and the Limited Partnership Agreement.

³ These actions are alleged to include: *In re Collins and Aikman Corp. Securities Litigation*, 03-cv-71173 (E.D. Mich.); *Egleston v. Collins & Aikman Corp., et al.*, 06-cv-13555 (E.D. Mich.); *Mainstay High Yield Corporate Bond Fund v. Heartland Industrial Partners, L.P., et al.*, 07-cv-10542 (E.D. Mich.); *United States v. Stockman, et al.*, 07-cr-220 (S.D.N.Y.); *SEC v. Collins & Aikman Corp., et al.*, 07-cv-2419 (S.D.N.Y.); *Collins & Aikman Corp., et al. v. Stepp*, 07-5695 (E.D. Mich. Bankr.); *Collins & Aikman Corp., et al. v. Stockman, et al.*, 07-cv-265 (D. Del.); and *Aurelius Capital Master, Ltd., et al. v. Stockman, et al.*, No. 081601483 (N.Y. Sup. Ct.). (Compl. ¶ 4)

several letters between the parties, Heartland asked Mr. Stepp if he would provide: (1) a budget of month-to-month expected legal expenses; (2) a written certification by Mr. Stepp that he met all three requirements for indemnification under the Limited Partnership Agreement; and (3) adequate security to support his undertaking. (Compl. ¶ 13, Ex. F) Mr. Stepp refused to agree to any of these reasonable terms and conditions. (Ex. G)

On January 9, 2009, the United States Attorney for the Southern District of New York filed a *nolle prosequi* as to the indictment against Mr. Stepp in the Criminal Proceeding. (Compl. ¶¶ 5, 16, Ex. B) On January 22, 2009 and March 10, 2009, Mr. Stepp's counsel purported to "put Heartland on notice of its indemnification obligation for defense costs associated with the successful defense of the Criminal Proceeding." (Compl. ¶ 17)

C. Heartland's Limited Partnership Agreement.

Heartland is governed by an Amended and Restated Limited Partnership Agreement of Heartland Industrial Partners, L.P. dated as of May 10, 2000 (the "Limited Partnership Agreement"). (Compl. ¶¶ 1, 9, Ex. A) The Limited Partnership Agreement is governed by Delaware law. (Ex. A, § 11.8) Advancement of legal expenses is governed by section 4.4(b) of the Limited Partnership Agreement, which provides:

Expenses reasonably incurred by an Indemnitee⁴ in defense or settlement of any claim that may be subject to a right of indemnification hereunder shall be advanced by the Partnership prior to the final disposition thereof

⁴ Mr. Stepp asserts that he qualifies as an "Indemnitee" under Section 4.3(a) of the Limited Partnership Agreement. (Compl. ¶¶ 8, 26) For purposes of this Motion to Dismiss, Heartland does not dispute this assertion.

upon receipt of an undertaking by or on behalf of the Indemnitee to repay such amount to the extent that it shall be determined ultimately that such indemnitee is not entitled to [sic] indemnified hereunder. ***No advances shall be made by the Partnership under this Section 4.4(b) (i) without the prior written approval of the General Partner*** or (ii) in connection with an action brought against an Indemnitee by a Majority in Interest of the Limited Partners.

(Compl. ¶¶ 1, 9; Ex. A, § 4.4(b)) (emphasis added)

Mr. Stepp concedes by his silence that the General Partner has not given written approval for advances to him.

Indemnification of legal expenses is governed by section 4.4(a) of the Limited Partnership Agreement, which provides:

To the fullest extent permitted by law, the Partnership agrees to indemnify and save harmless each of the Indemnitees from and against any and all claims, liabilities damages, losses, costs and expenses (including amounts paid in satisfaction of judgments, in compromises and settlements, as fines and penalties and legal or other costs and reasonable expenses of investigating or defending against any claim or alleged claim) of any nature whatsoever, known or unknown, liquidated or unliquidated, that are incurred by any Indemnitee and or to which such Indemnitee may be subject by reason of its activities on behalf of the Partnership or in furtherance of the interest of the Partnership or otherwise arising out of or in connection with the affairs of the Partnership, its Portfolio Companies or any Alternative Vehicle, including acting as a director of a Portfolio Company or the performance by such Indemnitee of any of the General Partner's responsibilities hereunder or the Investment Manager's responsibilities under the Advisory Agreement or otherwise in connection with the matters contemplated herein or therein; ***provided, that: (i) an Indemnitee shall be entitled to indemnification hereunder only to the extent that such Indemnitee's conduct (A) was in or was not opposed to the best interests of the Partnership, (B) in the case of a criminal action or proceeding, the Indemnitee had no reasonable cause to believe his conduct was unlawful, or (C) did not constitute fraud, bad faith, willful misconduct, gross negligence, a violation of applicable securities laws or any material breach of the Agreement or the Advisory Agreement (which has not been cured within 30 days after due notice), and except that nothing herein shall constitute a waiver or limitation of any rights which a Partner or the Partnership may have under applicable securities laws***

or other laws and which may not be waived; and (ii) the Partnership's obligations hereunder shall not apply with respect to (x) economic losses or tax obligations incurred by any Indemnitee as a result of such Indemnitee's ownership of an interest in the Partnership or in Portfolio Company or (y) expenses of the Partnership that an Indemnitee has agreed to bear; and provided, further, that any amount payable by the Partnership to, or on behalf of, an Indemnitee pursuant to this Section 4.4 as a result of any settlement of a claim against such Indemnitee in an amount in excess of \$1 million, shall be subject to prior approval of the LP Advisory Committee.

(Compl. ¶¶ 1, 10; Ex. A, § 4.4(a) (emphasis added))

Mr. Stepp does not allege that his conduct at C&A qualifies for indemnification under the standards described in the Limited Partnership Agreement, only that he "had no reasonable cause to believe his conduct was unlawful". (Compl. ¶¶ 10, 29)

ARGUMENT

I. AS A MATTER OF LAW, THE LIMITED PARTNERSHIP AGREEMENT FORECLOSES MR. STEPP'S CLAIM FOR ADVANCEMENT.

The Delaware Revised Uniform Limited Partnership Act ("DRULPA") does not provide a right to the advancement of legal expenses. To be sure, a right to advancement may be provided by contract, but "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).⁵ Accordingly, a claim for advancement should be dismissed absent a clearly worded contract making advancement mandatory. *Majkowski v. Am. Imaging Mgmt. Servs., LLC*, 913 A.2d 572, 593 (Del. Ch. 2006).

Here, Mr. Stepp claims that section 4.4(b) of the Limited Partnership Agreement entitles him to mandatory advancement, based exclusively on the first sentence of section 4.4(b) (which provides generally that Expenses "*shall be advanced*" to Indemnitees). (Compl. ¶ 14) In advancing this contention, Mr. Stepp ignores entirely the second sentence of section 4.4(b), which expressly qualifies the first sentence.

Indeed, the second sentence unequivocally states that "[n]o advances shall be made by

⁵ See also *Havens v. Attar*, C.A. No. 15134, 1997 Del. Ch. LEXIS 147, at *1-2 (Del. Ch. Nov. 5, 1997) (noting that the Court of Chancery has "held that absent a specifically worded by-law providing for mandatory advancement, 8 *Del. C.* § 145(e) 'leaves to the business judgment of the board the task of determining whether ... advancement of expenses would on balance be likely to promote the corporation's interests'"); *Advanced Mining Sys., Inc. v. Fricke*, 623 A.2d 82, 84 (Del. Ch. 1992) (denying motion to compel advancement of legal expenses, noting that a mandatory advancement bylaw should "expressly ... state its intention to mandate the advancement by the corporation").

the Partnership under this section 4.4(b)" in two specific circumstances. The first circumstance is "without the prior written approval of the General Partner" (Ex. A, § 4.4(b)) (The second circumstance, not applicable here, is "in connection with an action brought against an Indemnitee by a Majority in Interest of the Limited Partners." (*Id.*)) Mr. Stepp's Complaint concedes by silence, as it must, that the General Partner has not approved his request for advancement. Thus, the plain language of section 4.4(b) forecloses Mr. Stepp's advancement claim because his complaint does not allege that he has obtained "the prior written approval of the General Partner" and the Limited Partnership Agreement therefore explicitly requires that "[n]o advances shall be made" (*Id.*)

Despite this unequivocal contractual prohibition on advancement absent the General Partner's advance approval, Mr. Stepp appears to contend that this plain language does not mean what it says. Without explanation, he alleges *ipse dixit* that "the plain language of the [Limited] Partnership Agreement [] makes advancement mandatory." (Compl. ¶ 23) Of course, this allegation is merely a legal conclusion and need not be accepted as true at the pleading stage. *Grobow v. Perot*, 539 A.2d 180, 187 (Del. 1988). In any event, Mr. Stepp's contention is demonstrably wrong for several reasons.

To begin with, Delaware courts give clear words their usual and ordinary meaning, without resort to extrinsic evidence. *Continental Ins. Co. v. Rutledge & Co.*, 750 A.2d 1219, 1236 (Del. Ch. 2000). Indeed, this Court has repeatedly held that language of a limited partnership agreement must be read "literal[ly]" and "precisely." *In*

re Nantucket Island Assocs. Ltd. P'ship Unitholders Litig., 810 A.2d 351, 361 (Del. Ch. 2002); *In re Mesa Ltd. P'ship Preferred Unitholders Litig.*, Consol. C.A. No. 12243, 1991 Del. Ch. LEXIS 214, at *13 (Del. Ch. Dec. 10, 1991); *Boesky v. CX Partners, L.P.*, C.A. Nos. 9739, 9744, 9748, 1988 Del. Ch. LEXIS 60, at *27 (Del. Ch. Apr. 28, 1988); *see also Interactivecorp v. Vivendi Universal S.A.*, C.A. No. 20260, 2004 Del. Ch. LEXIS 90, at *30 (Del. Ch. June 30, 2004) ("If the contract is clear on its face, the court will rely solely on the clear, literal meaning of those words.") (citation omitted). On its face, section 4.4(b)(i) in no uncertain terms prohibits advances without the prior written approval of the General Partner. That should be the end of the matter.

Although there is no need to reach them, other recognized principles of Delaware contract construction buttress the plain language of section 4.4(b)(i). *First*, as with all Delaware contracts,⁶ a limited partnership agreement should not be construed in a way that would render terms meaningless. *See United States Cellular Inv. Co. v. Bell Atl. Mobile Sys., Inc.*, C.A. No. 12984, 1994 Del. Ch. LEXIS 37, at *5-6 (Del. Ch. Mar. 11, 1994) (holding that an interpretation that renders a section of the partnership agreement meaningless "is not preferred and cannot prevail as a matter of law on a motion to dismiss"), *aff'd*, 677 A.2d 497 (Del. 1996). Here, section 4.4(b)(i) provides that "no advances shall be made ... without the prior written approval of the General Partner." (Ex. A, § 4.4(b)(i)) If the General Partner did not have the right to withhold its approval

⁶ *Sonitrol Holding Co. v. Marceau Investissements*, 607 A.2d 1177, 1183 (Del. 1992) ("Under general principles of contract law, a contract should be interpreted in such a way as to not render any of its provisions illusory or meaningless.") (citation omitted).

of advances, then section 4.4(b)(i) would be meaningless. *See 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, as with all Delaware contracts,⁷ a limited partnership agreement should be read as a whole. *Hillman v. Hillman*, 910 A.2d 262, 270 (Del. Ch. 2006). Here, other provisions of the Limited Partnership Agreement reinforce the plain meaning of section 4.4(b)(i). Indeed, the substantive nature of the limitation established by the second qualification – section 4.4(b)(ii) – confirms that the written approval by the General Partner mandated by section 4.4(b)(i) also was intended to create a substantive limitation on any advancement created by section 4.4(b). Under section 4.4(b)(ii), no advances shall be made in connection with an action brought against an Indemnitee by a majority in interest of the limited partners. Because section 4.4(b)(ii) plainly creates an entire class of cases in which advancement is prohibited, it cannot be disputed (and the Amended Complaint provides no basis to dispute) that any advancement right created by the first sentence of section 4.4(b) is qualified by the second sentence. *See In re Cencom*, 2000 Del. Ch. LEXIS 10, at *23 (denying advancement under limited partnership agreement, which provided that expenses "shall" be advanced "provided that" the "action

⁷ "[P]roper interpretation of a provision often requires the court to read the contract as a whole and derive the meaning of particular clauses from the context of other terms." *In re TD Banknorth S'holders Litig.*, 938 A.2d 654, 665 n.28 (Del. Ch. 2007) (citation omitted).

is initiated by a third party who is not a Limited Partner" where claims were initiated by limited partners).

Third, as with all Delaware contracts,⁸ specific terms in a limited partnership agreement control over general ones. *Katell v. Morgan Stanley Group, Inc.*, C.A. No. 12343, 1993 Del. Ch. LEXIS 92, at *11-12 (Del. Ch. June 8, 1993). Here, the first sentence of section 4.4(b) provides generally for advancement to Indemnitees, but the second sentence creates two specific exceptions. Those specific exceptions expressly apply to advances "under this Section 4.4(b)." (Ex. A, § 4.4(b)) Accordingly, the specific exceptions in the second sentence plainly limit the general right established by the first sentence.

Finally, 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. Acting together, the two sentences make clear that the General Partner will be entitled to control advancement decisions in its discretion without challenge either from limited partners or from employees. Thus, the first sentence of section 4.4(b) protects the General Partner from claims by limited partners who object to the use of limited partnership funds to make advances, and the second sentence of section

⁸ See *DCV Holdings, Inc. v. ConAgra, Inc.*, 889 A.2d 954, 961 (Del. 2005) ("Specific language in a contract controls over general language, and where specific and general provisions conflict, the specific provision ordinarily qualifies the meaning of the general one.").

4.4(b) ensures that the General Partner can reject advancement demands by persons to whom advancement would be inappropriate.

II. MR. STEPP IS NOT ENTITLED TO INDEMNIFICATION.

A. Mr. Stepp Has Not Alleged That His Conduct Met The Standards Required By The Limited Partnership Agreement.

Mr. Stepp's Amended Complaint against Heartland for indemnification must also be dismissed because he has failed to allege that his conduct met the requirements for indemnification required by the governing agreement.

As a limited partnership, Heartland is governed by the DRULPA. The indemnification provision of the DRULPA, Section 17-108, "defers completely to the contracting parties to delimit rights and obligations with respect to indemnification" *Delphi Easter Partners L.P. v. Spectacular Partners, Inc.*, C.A. No. 12409, 1993 Del. Ch. LEXIS 159, at *4 (Del. Ch. Aug. 6, 1993); 6 *Del. C.* § 17-108 (stating that indemnification under the Act is discretionary, but "[s]ubject to such standards and restrictions ... set forth in [the] partnership agreement ..."). Thus, unlike the Delaware General Corporation Law, the DRULPA does not mandate indemnification upon "success on the merits or otherwise" in an "action, suit or proceeding." *Compare* 8 *Del. C.* § 145 with 6 *Del. C.* § 17-108. *Cf. Bernstein v. TractManager, Inc.*, 953 A.2d 1003, 1009-10 (Del. Ch. 2007) ("Limited liability companies and corporations differ in important ways, most pertinently in regard to indemnification: mandating it in the case of corporate directors and officers who successfully defend themselves, but leaving the

indemnification of managers or officers of limited liability companies to private contract.").⁹

The Limited Partnership Agreement does not mandate indemnification merely upon success in any particular proceeding. Rather, an Indemnitee's entitlement to indemnification turns on the nature of the underlying conduct from which the proceeding arose, not the outcome of the proceeding. Because the governing indemnification provisions are conduct-based and not outcome-based, Heartland must indemnify Mr. Stepp only if his conduct satisfied the contractual standard – which the Amended Complaint conspicuously fails to aver.

Here, section 4.4(a) of the Limited Partnership Agreement permits indemnification "only to the extent that such Indemnitee's conduct (A) was in or was not opposed to the best interests of the Partnership, (B) in the case of a criminal action or proceeding, the Indemnitee had no reasonable cause to believe his conduct was unlawful, or (C) did not constitute fraud, bad faith, willful misconduct, gross negligence, a violation of applicable securities laws or any material breach of the Agreement or the Advisory Agreement...." (Ex. A, § 4.4(a)) Mr. Stepp refused to sign a certification that his conduct complied with these three requirements. (Ex. F, Ex. G)

Apparently, Mr. Stepp takes the position that he must meet only one of the three requirements to be entitled to indemnification because he has not alleged that his

⁹ The Limited Liability Corporation Act contains a similar indemnification provision as the DRULPA. *See, e.g., Senior Tour Players 207 Mgmt. Co. LLC v. Golftown 207 Holding Co. LLC*, 853 A.2d 124, 127 n.5 (Del. Ch. 2004) (noting that limited liability companies and
(cont'd)

conduct was in or not opposed to the best interests of the Partnership or did not constitute fraud, bad faith, willful misconduct, gross negligence, a violation of securities laws or material breach of the Limited Partnership Agreement. Instead, he alleges only that he "had no reasonable cause to believe that his conduct was unlawful." (Compl. ¶ 29) In context, the only reasonable interpretation of the provision is that all three requirements must be met.

Indeed, under Mr. Stepp's flawed interpretation, he could be found to have committed civil securities fraud and found to have acted in a way opposed to the best interests of the Partnership, yet, he would still be entitled to indemnification based on his representation that he had no reasonable cause to believe his conduct was unlawful. This is not a reasonable reading of the provision. Mr. Stepp's fundamental failure of pleading requires dismissal of the Amended Complaint.

B. Any Adjudication Of Mr. Stepp's Indemnification Claim Would Be Premature.

In all events, any attempt to determine whether Mr. Stepp is entitled to reimbursement of expenses incurred in connection with the Criminal Proceeding would be premature because numerous other active proceedings are pending against Mr. Stepp, calling into question precisely the same conduct that led to the criminal indictment. Under the Limited Partnership Agreement, Mr. Stepp will be entitled to indemnification only if he proves that his conduct met the specific standards established in the Limited

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limited partnerships "are governed by a statute that gives the contracting parties broad authority in setting their indemnification provisions").

Partnership Agreement. But that conduct is still the subject of numerous civil suits and an active SEC civil action. It would be premature and duplicative to attempt to determine here whether Mr. Stepp acted in bad faith, with gross negligence or committed securities fraud when those very same questions are being actively litigated in other courts. *See, e.g., SEC v. Collins & Aikman Corp., et al.*, 1:07-CV-02419 (S.D.N.Y.) (alleging that Mr. Stepp's conduct at Collins & Aikman violated the Securities Act and the Exchange Act) (attached hereto as Exhibit A).

CONCLUSION

For the foregoing reasons, the Court should dismiss Mr. Stepp's Complaint.

Respectfully submitted,

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DATED: April 8, 2009