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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

DAVID A. STOCKMAN, Plaintiff, v. HEARTLAND INDUSTRIAL PARTNERS, L.P., a Delaware limited partnership and HEARTLAND INDUSTRIAL GROUP, L.L.C., a Delaware limited liability company, Defendants.	)	C.A. No. 4227-VCL

PLAINTIFF'S BRIEF IN SUPPORT OF CROSS MOTION FOR PARTIAL SUMMARY JUDGMENT AND IN OPPOSITION TO DEFENDANTS' MOTION TO DISMISS

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NATURE AND STAGE OF PROCEEDINGS

Plaintiff David A. Stockman commenced this action by filing a verified complaint (the "Original Complaint") on December 16, 2008 against Heartland Industrial Partners, L.P. ("HIP"). In the Original Complaint, Mr. Stockman sought an order compelling HIP to advance to Mr. Stockman certain fees and expenses according to the terms of the Amended and Restated Limited Partnership Agreement of HIP (the "Partnership Agreement") and an award of "fees on fees" for his fees in bringing this action. (D.I. 1.)

On January 8, 2009, HIP filed a motion to dismiss the Original Complaint and brief in support thereof, arguing that Mr. Stockman was not entitled to advancement pursuant to the terms of the Partnership Agreement. (D.I. 8.) On January 9, 2009, the Acting United States Attorney for the Southern District of New York, the prosecutor in one of the actions for which Mr. Stockman sought advancement in the Original Complaint, filed a *nolle prosequi* with the district court, recommending dismissal of all charges against Mr. Stockman and three of his co-defendants. The *nolle prosequi* stated that "after a renewed assessment of the evidence . . . further prosecution of David A. Stockman . . . would not be in the interests of justice." *Nolle Prosequi*, *U.S. v. Stockman et al.*, 07 Cr. 220 (BSJ) (Jan. 9, 2009). The court entered an order dismissing all charges.

After Mr. Stockman's demand for indemnification for the fees and expenses incurred in successfully defending the criminal indictment was rejected by HIP, Mr. Stockman on February 3, 2009 filed his First Amended and Supplemental Verified Complaint (the "Amended Complaint" or "Am. Compl.") against HIP and a new defendant, Heartland Industrial Group,

LLC ("HIG"), adding to the Original Complaint a claim for indemnification for fees and expenses incurred in successfully defending the now dismissed criminal proceeding.[1/] (D.I. 12.)

On March 2, 2009, defendants HIP and HIG (collectively, "Defendants") filed a motion to dismiss the Amended Complaint (the "Motion to Dismiss"). On March 6, 2009, the parties filed with the Court a stipulation setting a briefing schedule for the Motion to Dismiss (the "Briefing Schedule"). (D.I. 20, 21.) Pursuant to the Briefing Schedule, on March 13, 2009, Defendants filed their opening brief in support of the Motion to Dismiss (the "Opening Brief" or "Op. Br."). (D.I. 24.) On April 14, 2009, Mr. Stockman filed a cross-motion for partial summary judgment on his advancement claim. This is Plaintiff's brief in support of Plaintiff's Cross-Motion for Partial Summary Judgment and in opposition to Defendants' Motion to Dismiss.

1/ Based on Defendant's assertion that the claim against HIG must be arbitrated, Mr. Stockman withdraws without prejudice his claim against HIG, which he brought under Section 3.4 of the Amended and Restated Limited Liability Agreement of Heartland Industrial Group, L.L.C. Mr. Stockman continues to pursue his claims against HIP under the separate Partnership Agreement.

STATEMENT OF FACTS

A. The Parties and Relevant Non-Parties

Plaintiff David A. Stockman is a former Member of Congress and served as the director of the Office of Management and Budget from 1981 to 1985. (Am. Compl. ¶ 4.)

Defendant HIP is a private equity fund formed in 2000 by, among others, Mr. Stockman, to make equity investments on behalf of HIP's limited partners. (*Id.* ¶ 5.) HIP maintained a portfolio of investments in several companies. (*Id.*) Mr. Stockman is the Managing Member of HIP's General Partner, Heartland Industrial Associates, L.L.C. ("HIA") and the Managing Member of HIP's Investment Manager, defendant HIG. (*Id.*) HIG is governed by a limited liability company agreement (the "LLC Agreement").

In June 2005, at the outset of government investigations relating to one of HIP's portfolio companies, Collins & Aikman Corporation ("C&A"), Mr. Stockman entered into a Delegation Agreement under which he temporarily delegated his duties (i) as Managing Member of HIA to an Executive Committee consisting of two Members of HIA, Daniel P. Tredwell and Timothy D. Leuliette, and (ii) as Managing Member of HIG to Mr. Tredwell. (*Id.* ¶ 6.) During the pendency of those investigations and ensuing government actions, Mr. Stockman periodically renewed those delegations of authority. Under those delegations and pursuant to the terms of the Delegation Agreement, the Executive Committee has full authority and responsibility to execute the powers and duties of the Managing Member of HIA, including the powers and duties of HIA in its role as General Partner of defendant HIP. (*Id.*)

C&A, one of HIP's portfolio companies, designed, engineered, and manufactured automotive interior components for sale to automobile manufacturers. In 2001, HIP acquired approximately 60% of the outstanding shares of C&A. (*Id.* ¶ 7.) On behalf of HIP and at the request of HIA as General Partner of HIP, Mr. Stockman became a member of the board of

directors of C&A (the "Board") in February 2001, Chairman of the Board in August 2002, and Chief Executive Officer of C&A in August 2003. (*Id.*) Mr. Stockman continued serving as Chairman of C&A until May 2005. During this time period, HIP continued to acquire shares of C&A, and Mr. Stockman himself purchased $1.5 million of C&A stock in the second half of 2004. (*Id.*)

B. C&A's Bankruptcy Filing Spawned Multiple Proceedings

During the period Mr. Stockman served on the Board and as CEO, the automotive industry faced increasing pressure, particularly companies like C&A which supplied component parts to automobile manufacturers. (*Id.* ¶ 8.) In March 2005, a C&A internal management review identified certain historical accounting errors to be corrected which were disclosed to the public. (*Id.*) In May 2005, C&A filed for bankruptcy protection. (*Id.*)

Disclosure of C&A's accounting errors and its subsequent bankruptcy filing spawned both government investigations and a number of civil and criminal actions in which Mr. Stockman was named as a defendant in his capacity as, or because of his service as, a director and/or officer of C&A, including: *United States v. Stockman, et al.*, 07-Cr-220 (BSJ) (S.D.N.Y.) (the "Criminal Proceeding"); *SEC v. Collins & Aikman Corp., et al.*, 1:07-CV-02419 (SAS) (S.D.N.Y.); *K.J. Egleston v. Heartland Industrial Partners, L.P., et al.*, Case NO. 2:06-cv-13555 (including consolidated cases) (E.D. Mich.); *MainStay High Yield Corporate Bond Fund* v. *Heartland Industrial Partners, L.P., et al.*, 07-cv-10542 (E.D. Mich.); *Collins & Aikman Corp., et al.* v. *Stockman, et al*., 07-cv-265 (SLR) (D. Del.); *Aurelius Capital Master, Ltd., et al.* v. *Stockman, et al.*, No. 08-1601483 (N.Y. Sup. Ct.); *In re Collins & Aikman Corp., et al.*, Case No. 05-55927 (SWR) (E.D. Mich. Bankruptcy) (including several adversary proceedings) (collectively, other than the Criminal Proceeding, the "Other Proceedings").

Apart from the cases pending in U.S. Bankruptcy Court, the Criminal Proceeding and the Other Proceedings (together, the "Proceedings") all involve alleged conduct by Mr. Stockman in the capacity of his service as a director and/or officer of C&A on behalf of HIP. The bankruptcy actions involve an attempt to recover from Mr. Stockman preferential payments allegedly paid by C&A to Heartland before the bankruptcy, which allegedly were then paid to Mr. Stockman by Heartland in his capacity as a member of Heartland.

Mr. Stockman incurred fees and expenses in defense of the Proceedings. From the inception of the Proceedings, Mr. Stockman sought reimbursement of these fees and expenses under C&A's directors and officers insurance coverage.[2/] Because insurance limits were exhausted by demands from numerous insureds in the many pending proceedings, the insurance coverage only partially reimbursed Mr. Stockman's fees and expenses to date, and based on policy language, coverage was denied totally for fees and expenses in connection with the proceedings in U.S. bankruptcy court. In addition, Mr. Stockman's attorneys were advised by the insurance carriers that as of the date of the Amended Complaint, the amount of bills submitted to the insurance carriers for reimbursement exceeds the limits applicable to the remaining extant policies, leaving them unable to reimburse a portion of his already-incurred expenses. In short, Mr. Stockman incurred fees and expenses to date that will remain unreimbursed by any available insurance policies and he continues to incur fees and expenses in defense of the pending actions.

2/ Section 4.4(d) of the Partnership Agreement requires persons to first seek recovery under available indemnity or insurance policies prior to seeking indemnification from the Partnership.

C. The Relevant Contractual Provisions

Section 4.4 of the Partnership Agreement provides for indemnification of and advancement to an "Indemnitee." Defendants do not dispute that Mr. Stockman qualifies as an Indemnitee under Section 4.3(a) of the Partnership Agreement. (Op. Br. at 5, n.5.)

Indemnitees are entitled to indemnification pursuant to Section 4.4(a) of the Partnership Agreement:

> 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 than 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.

(Partnership Agreement § 4.4(a).)

Pursuant to Section 4.4(b) of the Partnership Agreement, Indemnitees are entitled to advancement of fees and expenses incurred in defending claims that may be subject to indemnification:

> Expenses 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 prior to the final disposition thereof 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 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.

(Partnership Agreement § 4.4(b).)

D. Mr. Stockman's Request For Advancement Is Denied

In a letter dated July 16, 2008 (the "July 16 Letter"), counsel for Mr. Stockman informed counsel for HIP that Mr. Stockman expected the insurance coverage available under the C&A policies to be exhausted before the end of August and to advise HIP that once the insurance proceeds are exhausted, Mr. Stockman intended to seek advancement of his costs and expenses incurred in defending the Proceedings under Section 4.4(b) of the Partnership Agreement. (Am. Compl. ¶ 14.) In the July 16 Letter, counsel for Mr. Stockman also asked HIP to provide proposed language for the undertaking required by Section 4.4(b). (*Id.*)

On August 11, 2008, after counsel for HIP failed to respond to the July 16 Letter, counsel for Mr. Stockman sent an e-mail (the "August 11 E-mail") informing counsel for HIP that Mr.

Stockman was advised by C&A's insurance carrier that requests for reimbursement of defense costs in July from all sources would exhaust all of the remaining C&A directors and officers insurance. (*Id.* ¶ 15.) In the August 11 E-mail, counsel for Mr. Stockman asked that HIP inform Mr. Stockman of its position on his request for advancement. (*Id.*)

By letter dated August 26, 2008 (the "August 26 Letter"), counsel for HIP responded to the July 16 Letter and the August 11 E-Mail. (*Id.* ¶ 16.) In the August 26 Letter, counsel for HIP informed counsel for Mr. Stockman that insurance coverage for Mr. Stockman was still available under policies issued to HIP, so any request for advancement was premature at that time. (*Id.*) He advised Mr. Stockman to seek reimbursement of his defense fees and costs from the HIP insurance carrier and provided contact information. (*Id.*) In addition, counsel for HIP indicated that HIP believed the language requiring written approval of the General Partner for any advancement gave the General Partner discretion to advance fees and expenses incurred by Indemnitees. (*Id.*)

Mr. Stockman proceeded as requested by HIP by submitting requests for reimbursement that exceeded the available limits of the C&A directors and officers insurance policy to the HIP insurance carrier. (*Id.* ¶ 17.) As the fees submitted to the HIP insurance carrier mounted, counsel for Mr. Stockman asked the HIP insurance carrier for information regarding funds remaining under that policy before the insurance limits were exceeded. (*Id.*) Mr. Stockman's counsel was informed that the amount remaining available under the HIP insurance policy for reimbursement of all insureds was less than the fees and costs already submitted to the carrier for reimbursement by Mr. Stockman alone. (*Id.*)

By letter dated October 29, 2008 (the "October 29 Letter"), counsel for Mr. Stockman advised counsel for HIP that requests for reimbursement of defenses costs submitted to HIP's

insurance carrier would exhaust the amount remaining under that policy, and that the only remaining avenue for advancement of Mr. Stockman's fees and costs of defense therefore was HIP. (*Id.* ¶ 18.) Accordingly, in the October 29 Letter counsel for Mr. Stockman made a formal demand for advancement pursuant to Section 4.4(b) and submitted an unsigned form of undertaking to repay any amounts advanced if it is ultimately determined that Mr. Stockman is not entitled to indemnification, asking that HIP approve or edit the proposed undertaking. (*Id.*)

By letter dated November 21, 2008 (the "Rejection Letter"), HIP rejected Mr. Stockman's demand for advancement. (*Id.* ¶ 19.) In the Rejection Letter, HIP took the position that notwithstanding the language of Section 4.4(b) providing that "[e]xpenses reasonably incurred by an Indemnitee . . . *shall be advanced* by the Partnership," that section gave the General Partner complete discretion whether to make any advancement, and, if so, on any terms and conditions he so chose. (*Id.*) Accordingly, HIP, which heretofore has not had to shoulder *any* of the burden of the legal fees and expenses incurred by its affiliates named in the Proceedings, took the position that it would not advance any sums to Mr. Stockman unless he agreed to several conditions or limitations not contained in Section 4.4(b), namely: (i) that he accept a cap on total legal fees entitled to advancement; (ii) that he provide adequate security to assure repayment if it is ultimately determined that he is not entitled to indemnification; and (iii) that he provide a written certification that he (a) is entitled to advancement, (b) has not transferred any assets by gift other than in the ordinary course, and (c) has acted consistently with Section 4.4(a)(i) of the Partnership Agreement. (*Id.*) In addition, HIP vaguely questioned statements in the draft form of undertaking sent with the October 29 Letter without specifying those objections or suggesting an alternative form of undertaking, and took the position that Mr.

Stockman was not entitled to any advancement for defense of the preference action against him in U.S. Bankruptcy Court seeking the return of funds allegedly paid to him by Heartland. (*Id.*)

In light of the unspecified objections counsel for HIP raised to his previously proposed form of undertaking, on December 5, 2008 Mr. Stockman delivered to counsel for HIP a signed undertaking tracking the exact language specified in Section 4.4(b). (*Id.* ¶ 21.) Having received no response to the December 5, 2008 undertaking, on December 16, 2008, Mr. Stockman commenced this proceeding to enforce his right to advancement by filing the Original Complaint. (*Id.* ¶ 22.)

E. Mr. Stockman's Request For Indemnification Is Denied

On January 9, 2009, the Acting United States Attorney for the Southern District of New York filed a *nolle prosequi* as to the indictment against Mr. Stockman and others. (*Id.* ¶ 23.) In the *nolle prosequi*, the Acting U.S. Attorney stated that after a renewed assessment of the evidence, "further prosecution of David Stockman … would not be in the interests of justice." (*Id.*) The filing and acceptance by the court of a *nolle prosequi* is the functional equivalent of a dismissal with prejudice of all charges brought against Mr. Stockman in the Criminal Proceeding. (*Id.*)

By letter dated January 15, 2009, Mr. Stockman requested pursuant to Section 4.4(a) of the Partnership Agreement and Section 3.4 of the LLC Agreement that HIP and HIG indemnify him for the fees and expenses incurred in defending the Criminal Proceeding. (*Id.* ¶ 24.) By letter dated January 21, 2009, HIP and HIG rejected Mr. Stockman's claim for indemnification, arguing that the *nolle prosequi* did not convert Mr. Stockman's requests for advancement of expenses for the Criminal Proceeding into a claim for indemnification, and that the claim for indemnification of those expenses was premature. HIP and HIG stated that notwithstanding the fact that Mr. Stockman was successful on the merits in the Criminal Proceeding, he may not be

entitled to indemnification if, in the Other Proceedings, Mr. Stockman's conduct is found not to have satisfied the standard of conduct required for indemnification set forth in the Partnership Agreement and the LLC Agreement. (*Id.*)

ARGUMENT

I. MR. STOCKMAN IS ENTITLED TO SUMMARY JUDGMENT ORDERING ADVANCEMENT PURSUANT TO THE TERMS OF THE PARTNERSHIP AGREEMENT

Mr. Stockman is entitled to summary judgment on his claim for advancement from HIP. No genuine issue of material fact is in dispute, and Mr. Stockman is entitled to judgment as a matter of law. *See Sun-Times Media Group, Inc. v. Black*, 954 A.2d 380, 389 (Del. Ch. 2008) (internal citation and quotation marks omitted). The parties agree that construction of the Partnership Agreement governs Mr. Stockman's advancement claim.

Delaware courts have found summary judgment to be a particularly "efficient and appropriate method" of deciding advancement disputes "as the relevant question turns on the application of the terms of the corporate instruments setting forth the purported right to advancement and the pleadings in the proceedings for which advancement is sought." *Weinstock v. Lazard Debt Recovery GP, LLC*, 2003 WL 21843254 at *2 (Del. Ch.). "And although advancement provisions in corporate instruments often are of less than ideal clarity, rarely is resort to parol evidence appropriate or even helpful..." *DeLucca v. KKAT Mgmt., L.L.C.*, 2006 WL 224058, at *6 (Del. Ch.).

A. The Only Reasonable Interpretation of the Advancement Provision Is Mandatory Advancement, Subject to Ministerial "Written Approval" of Specific Payments by the General Partner

In interpreting partnership agreements, Delaware courts apply the "canon[s] of contract construction." *Citadel Holding Corp. v. Roven*, 603 A.2d 818, 822 (Del. 1992); *see Weinstock*, 2003 WL 21843254, at *5. The starting point for construing contracts is the language of the agreement, from which the intent of the parties must be ascertained. *See Schoon v. Troy Corp.*, 948 A.2d 1157, 1167 (Del. Ch. 2008) (citing *Citadel*). "When the language of a contract is plain

and unambiguous, the intent of the parties expressed in that language is binding." *See Sun-Times Media Group*, 954 A.2d at 389 (citing *Citadel*).

The first sentence of Section 4.4(b) provides for mandatory advancement to Indemnitees for claims that may be subject to a right of indemnification under the Partnership Agreement:

> Expenses 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 prior to the final disposition thereof 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 indemnified hereunder.

(Emphasis added.) Defendants do not dispute that Mr. Stockman qualifies as an Indemnitee (Op. Br. at 5, n.5), nor have they argued that the Proceedings do not meet the requirement that they "may be subject to a right of indemnification." Use of the word "shall" in this sentence evidences mandatory advancement. *See Homestore v. Tafeen*, 888 A.2d 204, 212-13 (Del. 2005) (bylaws stating that "The Corporation *shall* pay all expenses … in advance" provided mandatory right to advancement); *Citadel*, 603 A.2d at 823 ("The Agreement … renders the corporations' duty mandatory in providing that expenses *shall* be paid in advance."); *Schoon*, 948 A.2d at 1169 ("[t]his court must first note that the word 'shall' in section 9 establishes a right to mandatory advancement"); *Brown v. LiveOps, Inc.*, 903 A.2d 324, 328 (Del. Ch. 2006) (finding that "plain terms of the indemnification agreement and the company's bylaws [*i.e.*, "[Defendant] shall advance all expenses"] provide for mandatory advancement ....").

This first sentence also specifies precisely the single precondition an Indemnitee must satisfy to be entitled to mandatory advancement: providing the required repayment undertaking. There is no dispute that Mr. Stockman provided HIP with such an undertaking here.

The second sentence of Section 4.4(b) states: "No advances shall be made by the Partnership under this Section 4.4(b) (i) without the prior written approval of the General Partner

…." Defendants argue this "prior written approval" provision negates the first sentence by conferring on the General Partner unfettered discretion as to whether to advance funds.

Defendants' reading of Section 4.4(b) cannot be reconciled with the mandatory advancement provision and contravenes the basic principle of contract construction that provisions should not be interpreted in a way that renders any terms illusory or meaningless. *See O'Brien v. Progressive Northern Ins. Co.*, 785 A.2d 281, 287 (Del. 2001) ("[c]ontracts are to be interpreted in a way that does not render any provisions 'illusory or meaningless'"); *Council of Dorset Condominium Apts. v. Gordon*, 801 A.2d 1, 6 (Del. 2002) (internal citation omitted) (to the extent possible, a "court must interpret contractual provisions in a way that gives effect to every term of the instrument, and that … reconciles all of the provisions of the instrument when read as a whole"); *W. Willow-Bay Court, LLC v. Robino-Bay Court Plaza, LLC*, 2007 WL 3317551, at *11 (Del.Ch.) ("Delaware courts do prefer to interpret contracts to give effect to each term rather than to construe them in a way that renders some terms repetitive or mere surplusage."). Under Defendants' reading, the language of Section 4.4(b) providing mandatory advancement is negated by the "written approval" provision that Defendants contend confers unfettered discretion on the General Partner. But the word "shall" in the first sentence evidences the partnership's intent to provide *enhanced* protection to Indemnitees, subject only to provision of the required undertaking to repay. *See Citadel*, 603 A.2d at 823 ("use of the word 'shall' therefore simply reflects the parties' intention to provide [Plaintiff] with expanded protection"). The "written approval" language cannot reasonably be interpreted to mean precisely the opposite – that the requirement for written approval of advancement requests gives the General Partner total discretion (i) over whether to make advances, and (ii) to specify terms for advancement beyond those explicitly set forth in the first sentence.

The only reasonable interpretation of this section that gives effect and meaning to all of its provisions is that the "written approval" provision confers on the General Partner a ministerial function of reviewing and approving in writing specific requests for advancement submitted pursuant to the first sentence. This is not an insubstantial function. It requires the General Partner to monitor the reasonableness of fee requests, specifying a control mechanism for the proper disposition of partnership funds. It also assures that the General Partner maintains appropriate books and records regarding advancement expenses. This reading of the second sentence to specify a review and control function for each specific advancement request is consistent with the first sentence of Section 4.4(b), which limits mandatory advancement to "[e]xpenses reasonably incurred." Likewise, the Partnership Agreement limits advancement to expenses incurred "in defense or settlement of any claim that may be subject to a right of indemnification hereunder." Mandating that the General Partner review the specific advancement requests helps ensure these requirements are satisfied. Provision for such a protocol, however, does *not* give the General Partner unfettered discretion over whether or not to advance expenses that were "reasonably incurred" in defense of claims that may be subject to indemnification

Notably, nowhere in Section 4.4(b) does the word "discretion" appear. If the partnership intended to confer on the General Partner discretionary power to approve, reject, or otherwise condition advancement requests, it would have stated so explicitly, as it did elsewhere in the agreement. For example, with respect to elections for tax matters, the agreement expressly states that the General Partner is authorized to make such elections "in its sole discretion." (Partnership Agreement § 4.2(b)(vii).) Also, the Partnership Agreement defines the scope of the interests and factors that may be considered when a "Person" is permitted to make a decision in

its "sole discretion," "sole and absolute discretion," or "discretion." (Partnership Agreement § 11.12(b).) If the partnership intended to give the General Partner discretion over whether to approve advancement requests, it would have used one of these terms in Section 4.4(b) to reflect that intent.

Finally, Defendants' interpretation of the "written approval" language of the advancement provision cannot stand because it would lead to absurd and capricious results. *See Citadel*, 603 A.2d at 823-24 (interpreting disputed advancement provision in a manner that "advances the intent of the parties without producing an absurd result"). If the General Partner had absolute discretion on advancement requests, as Defendants contend, it could deny advancement for one Indemnitee, but grant advancement to another similarly situated Indemnitee. Alternatively, the General Partner could choose to deny all requests for advancement, an outcome entirely inconsistent with the mandatory advancement provision. Provision for such arbitrary results, which Defendants' interpretation by definition would allow, cannot be the intention of the Partnership Agreement. The only reasonable interpretation is the one proposed above, which is to read the "written approval" language as conferring on the General Partner the important function of approving in writing specific advancement requests by an Indemnitee to assure they involve "expenses reasonably incurred" for a claim "that may be subject to a right of indemnification" under the Partnership Agreement.

B. Defendants Cannot Impose New Conditions on Providing Advancement to Indemnitees

In its written response to Mr. Stockman's request for advancement, Defendant took the position that it would not provide any advancement to Mr. Stockman unless he agreed to several conditions not contained in Section 4.4(b), including a cap on reimbursable expenses and that he provide adequate security to assure repayment if it is ultimately determined that he is not entitled

to advancement. Defendants cannot impose these, or any other, arbitrary conditions on Mr. Stockman's advancement. If the partnership had intended to subject the advancement right in Section 4.4(b) to certain conditions, those limitations would have been specified in the Partnership Agreement. *See Reddy v. Elec. Data Sys. Corp.*, 2002 WL 1358761, at *4 (Del. Ch.) ("If it chose, [defendant] could have conditioned former employees' advancement rights on an undertaking, proof of an ability to repay, or even the posting of a secured bond. But it did not do so."); *Homestore*, 888 A.2d at 212 ("corporations may specify by bylaw or contract the terms and conditions upon which present and former corporate officials may receive advancement, *e.g.*, proof of an ability to repay or the posting of a secured bond.") As the Court of Chancery warned, Defendants cannot now amend their mandatory advancement provisions to include new conditions:

> "Time and again, this court, and recently our Supreme Court in *Tafeen*, has pointed out that sage businesspersons who wish to avoid situations like this must exercise the contractual freedom afforded to them under Delaware law to delimit the circumstances in which they are obliged to advance funds to, or ultimately indemnify, employees and other officials. There is no requirement that advancement provisions be written broadly or in a mandatory fashion. But when an advancement provision is, by its plain terms, expansively written and mandatory, it will be enforced as written."

DeLucca, 2006 WL 224058 at *13.

C. Mr. Stockman Is Entitled to "Fees on Fees" as a Matter of Law

As the Supreme Court held, "indemnification for expenses incurred in successfully prosecuting an indemnification suit are permissible under Section 145(a), and therefore 'authorized by law.'" *Stifel Fin. Corp. v. Cochran*, 809 A.2d 555, 561 (Del. 2002). This entitlement to "fees on fees" likewise applies to advancement actions. *See Barrett v. Am. Country Holdings, Inc.*, 951 A.2d 735, 746-47 (Del. Ch. 2008) ("In accord with the Supreme Court jurisprudence mandating 'fees on fees' in advancement actions, Kingsway must pay all the

fees and expenses of the [plaintiffs'] counsel.") (citing *Stifel*); *Weinstock*, 2003 WL 21843254 at *7 (granting fees on fees to plaintiffs for prosecuting advancement action); *DeLucca*, 2006 WL 224058 at *15-16 (awarding plaintiff fees on fees incurred in bringing action to enforce advancement provision); *Underbrink v. Warrior Energy Servs. Corp.*, 2008 WL 2262316, at *17-18 (Del. Ch.) ("The same policy considerations justifying allowance of fees on fees for indemnification equally support an award of fees for the successful prosecution of advancement claims as well."). Defendants could have included language in the Partnership Agreement excluding payment of "fees on fees," but did not do so. *See DeLucca*, 2006 WL 224058 at *15 ("The only way out of the *Stifel* 'fees on fees' award was for the [defendants] 'to tailor their indemnification to exclude "fees on fees," if that [was] a desirable goal.'"). Accordingly, if the Court enters partial summary judgment in Mr. Stockman's favor on his claim for advancement, Mr. Stockman is entitled as a matter of law to payment of the fees he has incurred (as well as future fees) in connection with bringing this action.

II. MR. STOCKMAN ADEQUATELY PLEADED HIS CLAIM FOR INDEMNIFICATION OF EXPENSES INCURRED IN THE CRIMINAL PROCEEDING

Defendants' motion to dismiss Mr. Stockman's indemnification claims should be denied because Defendants fail to show with reasonable certainty that Mr. Stockman cannot prevail on any set of facts reasonably inferable from the well-pleaded allegations of his complaint. *See Winner Acceptance Corp. v. Return on Capital Corp.*, 2008 WL 5352063, at * 6 (Del. Ch.). Where, as here, the claims primarily concern the interpretation of written agreements, the "court will only grant the motion to dismiss in favor of the defendants if those written agreements may only be reasonably read in the manner advanced by [Defendants]." *Levy v. Hayes Lemmerz International, Inc.*, 2006 WL 4762857, at *5 (Del. Ch.). Defendants fail to meet that burden.

Defendants argue that Mr. Stockman's indemnification claim against HIP must be dismissed because he (i) "failed to allege that his conduct met the standards for indemnification required by the governing agreements"; (ii) the Partnership Agreement "does not mandate indemnification merely upon success in any particular proceeding" and instead confers unfettered discretion on the General Partner; and (iii) any adjudication of Mr. Stockman's indemnification claim for the Criminal Proceeding would be "premature" because "numerous other active proceedings are pending." (Op. Br. at 13-15.)

None of these arguments has merit. Mr. Stockman adequately pleaded he is entitled to indemnification under a reasonable reading of the terms of the Partnership Agreement, and Mr. Stockman's claim for indemnification is timely under applicable Delaware law. Accordingly, Defendants' motion to dismiss Mr. Stockman's claim for indemnification should be denied.

A. Mr. Stockman Pleaded He Is Entitled to Indemnification under a Reasonable Interpretation of the Partnership Agreement

Under a reasonable reading of the Partnership Agreement, Mr. Stockman, as an Indemnitee, is entitled to indemnification for the Criminal Proceeding.[3/] As Defendant HIP conceded in its January 8, 2009 brief in support of its Motion to Dismiss the Original Complaint, the Partnership Agreement "contains a broad indemnification provision limited only by standard prerequisites …. " (D.I. 8 at 9.)

Mr. Stockman's right to mandatory indemnification is set forth in Section 4.4(a) of the Partnership Agreement, which provides in part that he is indemnified "to the fullest extent permitted by law" for "any and all claims" … "of any nature whatsoever." Section 4.4(a) continues by stating that "an Indemnitee *shall be entitled* to indemnification hereunder only to

[3/] Defendants do not dispute that Mr. Stockman is an Indemnitee under the terms of the Partnership Agreement, and they have not argued that the Criminal Proceeding is not a covered action.

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." (Partnership Agreement § 4.4(a) (emphasis added).)

Use of the word "shall" in the Partnership Agreement evidences an intent to provide for mandatory indemnification and enhanced protection to Indemnitees. *See infra* at 13. The Partnership Agreement is silent on which party must show that the conduct at issue satisfies one of the three enumerated criteria in the proviso. Defendants' position—that Mr. Stockman must plead not only that he is entitled to indemnification but also that his conduct satisfied these criteria—finds no support under Delaware law, and certainly is not the only reasonable reading of the Partnership Agreement.

VonFeldt v. Stifel Financial Corporation, 1999 WL 413393, at *1 (Del. Ch.), analyzed an indemnification claim made pursuant to an indemnification bylaw that provided far more expansive coverage than DGCL § 145(a), the corporate statute addressing permissive indemnification. The court rejected the corporation's argument that the Indemnitee bore the burden of demonstrating that his conduct was undertaken in good faith in order to be entitled to indemnification. *Id*. at *3. "By using the phrase 'shall indemnify,' the bylaw not only mandates indemnification; it also effectively places the burden on [the entity] to demonstrate that the indemnification mandated is not required." *Id.*

The same reading is appropriate here. The Partnership Agreement's invocation of the word "shall" creates a "self-imposed, mandatory obligation" to indemnify Mr. Stockman. *See id*.

at *10. HIP must provide Mr. Stockman with the indemnification to which he is entitled by contract unless it can "demonstrate to this Court why it should not be required" to do so. *See id.*; *see also Levy v. Hayes Lemmerz International, Inc.*, 2006 WL 985361, at *12 (Del. Ch.) (the corporation, *not* the indemnitee, has the "responsibility to make a decision" regarding whether the indemnitee satisfied the "acted in good faith" proviso in the corporation's bylaw providing mandatory indemnification).

Moreover, any ambiguity should be resolved in favor of indemnification. The Delaware Revised Uniform Limited Partnership Act ("DRULPA") "defers completely to the contracting parties to create and delimit rights and obligations with respect to indemnification and advancement of expenses." *Delphi Easter Partners Limited Partnership v. Spectacular Partners, Inc.*, 1993 WL 328079, at *2 (Del. Ch.). In "construing contractual language under DRULPA conferring rights of indemnification, courts should interpret language so as to achieve where possible the beneficial purposes that indemnification can afford." *Id.* "Those benefits include the allocation of certain risks at the outset of a contractual relation in order to make the contractual structure feasible or more attractive to participants." *Id.*

Mr. Stockman adequately pleaded he is entitled to indemnification for the Criminal Proceeding under a reasonable reading of the Partnership Agreement. Defendants' motion to dismiss his claim for indemnification therefore should be denied.

B. Mr. Stockman's Pleading of a Successful Defense of the Criminal Proceeding Plainly Satisfies the Requirements of Section 4.4(a)

Even if, as HIP argues, Mr. Stockman had an affirmative obligation to plead compliance with the provisos to Section 4.4(a), he plainly did so. HIP contends that that Mr. Stockman must affirmatively plead compliance with all three criteria set forth in Section 4.4(a). *See* Op. Br. at 14 (arguing that Mr. Stockman must plead that "his conduct complied with *these requirements*"

(emphasis added)). That ignores the plain language of the Partnership Agreement, which, by subjecting the criteria to the disjunctive "or," requires that an Indemnitee's conduct satisfy *one*, not all, of the specified criteria. If HIP intended to require its Indemnitees to comply with provisos (A), (B), *and* (C), it would have done so by selecting the word "and" instead of "or."

Delaware courts routinely reject attempts by entities to rewrite contracts in order to avoid indemnification and advancement obligations. *See DeLucca*, 2006 WL 224058, at *2 ("[I]t is not the job of a court to relieve sophisticated parties of the burdens of contracts they wish they had drafted differently but in fact did not. Rather it is the court's job to enforce the clear terms of the contracts."); *Tafeen v. Homestore, Inc.*, 2004 WL 556733 at *1 (Del. Ch.) (corporation must abide by its bylaws, even where they may be "drafted with holes large enough to drive a truck through"). In other words, this is "yet another case in which defendants...seek to escape the consequences of their own contractual freedom." *DeLucca*, 2006 WL 224058, at *2.

Here, because only the Criminal Proceeding is at issue in the indemnification claim, only criterion (B) applies ("in the case of a criminal action or proceeding, the Indemnitee had no reasonable cause to believe his conduct was unlawful"). Mr. Stockman pleaded the filing and acceptance by the court of a *nolle prosequi* in which the federal prosecutors acknowledged that "a renewed assessment of the evidence" called for dismissal of Mr. Stockman's criminal prosecution. Having pleaded facts showing the prosecutors concluded the evidence did not justify the continuation of Mr. Stockman's prosecution "in the interests of justice," surely Mr. Stockman satisfied a requirement to plead that he "had no reasonable cause to believe his conduct was unlawful."

C. Mr. Stockman's Interpretation of Section 4.4(a) Is Consistent With Delaware Public Policy

HIP makes much of the fact that DRULPA defers to the language of the applicable agreements without setting forth the same types of mandatory indemnification as in the General Corporation Law of the State of Delaware (the "DGCL"). (Op. Br. 13). To be sure, as noted above, the language of the agreement is critical. But that language must also be read and applied in the context of the Delaware law of advancement and indemnification and its underlying policies. The Partnership Agreement mandates indemnification "[t]o the fullest extent permitted by law" and Mr. Stockman was successful on the merits in the Criminal Proceeding. The standard of conduct in Section 4.4(a) does not expressly address the circumstance of an undisputed and unequivocal successful defense on the merits. In that context, the public policies underlying the Delaware law of indemnification support indemnification as a matter of law.

Delaware law of advancement and indemnification is strongly grounded in public policy considerations that favor advancement and indemnification and seek to assure a workable, functional framework to address those claims fairly and efficiently. Those public policy considerations often dictate results not reflected in the precise language of the applicable provisions. For example, it is well-settled under Delaware law that while the right to advancement and indemnification are "correlative" rights, they are still discrete and independent rights, and a corporation may not avoid its advancement obligations by arguing that the person seeking advancement will not ultimately be entitled indemnification. *See Kaung v. Cole Nat. Corp.*, 884 A.2d 500, 509-510 (Del. 2005); *Citadel*, 603 A.2d at 822. But nowhere does the DGCL state that advancement and indemnification are distinct rights, such that the right to advancement is not dependent upon the right to indemnification. Rather, that rule of law was articulated by the Delaware courts based on a strong public policy favoring the protection of

officers and directors from debilitating costs arising out of the performance of their corporate duties. Likewise, the "fees on fees" doctrine reflects a similar reliance on public policy where the statute is silent. In 2002, the Supreme Court overturned contrary Chancery Court rulings denying "fees on fees" because "without an award of attorneys' fees for the indemnification suit itself, indemnification would be incomplete." *Stifel*, 809 A.2d at 561 (Del. 2002). Although this public policy-driven presumption could be overcome by clear provisions in corporate bylaws to the contrary, absent such a clear statement the "fees on fees" mandate is presumed. *Id.* This doctrine was later extended to claims for advancement. *Fasciana v. Elec. Data Sys. Corp.*, 829 A.2d 178 (Del. Ch. 2003) (awarding fees for fees in connection with advancement claim where bylaw provided for advancement to the fullest extent permitted by law).

Similar public policy principles should apply here to mandate indemnification for a successful defense in the absence of express contract provisions stating otherwise. Although the Limited Liability Company Act (the "LLC Act") and DRULPA do not track the DGCL provisions regarding advancement and indemnification, Delaware courts consistently apply DGCL corporate principles to claims for advancement or indemnification under the provisions of limited liability company and partnership agreements. *See Majkowski v. American Imaging Management Services, LLC*, 913 A.2d 572, 586-87 (Del. Ch. 2006) (language providing LLC would "hold harmless" did not provide for advancement rights); *Morgan v. Grace*, 2003 WL 22461916, at *2 (Del .Ch.) (rejecting defense that plaintiffs were not entitled to advancement because they may not ultimately be entitled to indemnification as blurring the distinct purposes of advancement and indemnification); *Senior Tour Players207 Management Co., LLC v. Golftown 207 Holding Co., LLC*, 853 A.2d 124, 131 (Del. Ch. 2004) (citation omitted) (awarding fees for fees to plaintiffs successful on advancement claim). Despite the fact that in these cases

the limited liability company or limited partnership agreements lacked provisions stating that advancement and indemnification should be treated separately as distinct rights, or that successful plaintiffs in an advancement case are entitled to "fees for fees," and both the LLC Act and DRULPA are silent on the issue, the Delaware courts still applied the underlying public policies to these agreements to provide a fair and workable result for the persons seeking to enforce these rights.

Accordingly, HIP cannot avoid its indemnification obligation simply by repeating the mantra that its indemnification obligations are only those specifically set forth in the Partnership Agreement. The Partnership Agreement provides Mr. Stockman with indemnification "to the fullest extent permitted by law," but does not address the indemnification consequences of a successful defense of a covered action. In the face of such silence, the Delaware law of indemnification looks to the public policy of the State—including a strong public policy in favor of advancement and indemnification to protect innocent covered persons from debilitating costs of defense—to yield the most sensible and fair result. *Cf. Stifel*, 809 A.2d at 561 ("The invariant policy of Delaware legislation on indemnification is to 'promote the desirable end that corporate officials will resist what they consider unjustified suits and claims, secure in the knowledge that their reasonable expenses will be borne by the corporation they have served if they are vindicated.'").

In contrast, HIP's interpretation yields an unworkable result inconsistent with the overall goals of indemnification. It would require Mr. Stockman to litigate the same common nucleus of operative facts multiple times. Mr. Stockman would be forced to fund one defense of his conduct and then another affirmative case to obtain indemnification. Multiple litigation over the same facts not only could lead to inconsistent judgments, it would also not further the clear

policy underlying indemnification that a covered person be secure in the knowledge that the costs of a successful defense will be reimbursed. Because Mr. Stockman was successful on the merits in the Criminal Proceeding, indemnification should now be mandatory.[4/]

D. Mr. Stockman's Claim for Indemnification Is Timely

HIP also argues that Mr. Stockman's claim for indemnification for the Criminal Proceeding should be dismissed on the basis that it is premature "because numerous other active proceedings are pending against Mr. Stockman, calling into question precisely the same conduct that led to the criminal indictment." (Op. Br. at 15.) This contention is refuted by settled Delaware law.

In *Levy v. Hayes Lemmerz International, Inc.*, 2006 WL 985361, *3, the plaintiffs sought indemnification for amounts paid in settlement of a class action. The company refused, arguing that it could not determine whether they acted in good faith and in the best interests of the company until the U.S. Securities and Exchange Commission completed its investigation into the same underlying conduct. *Id*. at *5. The court rejected this argument as "contrary to the plain language of the indemnification agreements, as well as to well established Delaware law." *Id*. at *10. The relevant bylaw promised indemnification "for any action." *Id*. "This standard

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[4/] This is especially true here, where the standard of conduct HIP argues Mr. Stockman must meet was borrowed in significant part from portions of the DGCL that do not apply to a person seeking indemnification based on the successful defense of the action. *See Perconti v. Thornton Oil Corp.*, 2002 WL 982419, at *3 (Del. Ch.) (director who was successful on the merits is "entitled to indemnification regardless of whether or not he acted in good faith or in what he perceived to be the best interests of the corporation"); Wolfe & Pittenger, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY, § 8.02[a][2] (2007) ("section 145(c) does not incorporate the good faith standards of Section 145(a) and (b)); *cf. Zaman v. Amedeo Holdings, Inc.*, 2008 WL 2168397, at * 16 (Del. Ch.) ("Having promised to indemnify persons they ask to serve as agents of other corporations to the fullest extent permitted by Delaware law, the defendants are bound if a person is sued in an indemnifiable capacity and is successful"). Indemnification "to the fullest extent permitted by law" should include the right to indemnification after success on the merits without having to meet any standard of conduct unless it is expressly stated otherwise.

indemnification language, by enumerating the various kinds of actions for which an indemnified party might seek remedy, clearly implies that indemnification is to be treated on a case-by-case basis: a party may be indemnified for a civil action, and may also seek indemnification for a later criminal action, if it arises." *Id*. The plaintiffs were therefore entitled to indemnification upon the payment of the class action settlement. *Id*.

Here, Section 4.4(a) states that the "Partnership agrees to indemnify ... from and against *any and all claims* ... of any nature whatsoever." As in *Levy*, the language of the agreement plainly provides for indemnification on a case-by-case basis, and Mr. Stockman need not wait until all of the pending proceedings are litigated to finality in order to be eligible for indemnification.

CONCLUSION

For all of the foregoing reasons, plaintiff David A. Stockman respectfully requests that the Court enter judgment in favor of Mr. Stockman on his Cross Motion for Partial Summary Judgment and deny Defendants' Motion to Dismiss.

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CERTIFICATE OF SERVICE

I, Peter B. Ladig, Esquire, hereby certify that on April 14, 2009, the foregoing Plaintiff's Brief in Support of Cross Motion for Partial Summary Judgment and in Opposition to Defendants' Motion to Dismiss was served electronically on counsel listed below:

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