IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

DAVID A. STOCKMAN, Plaintiff, v. HEARTLAND INDUSTRIAL PARTNERS, L.P. and HEARTLAND INDUSTRIAL GROUP, L.L.C., Defendants.	)	C.A. No. 4227-VCS
J. MICHAEL STEPP, Plaintiff, v. HEARTLAND INDUSTRIAL PARTNERS, L.P., Defendant.	)	C.A. No. 4427-VCS

MEMORANDUM OPINION

Date Submitted: May 20, 2009
Date Decided: July 14, 2009

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STRINE, Vice Chancellor.

I. Introduction

Two former officers and directors of Collins & Aikman Corporation ("C&A") seek, through separate actions, advancement of legal fees and indemnification from C&A's majority investor, Heartland Industrial Partners, L.P. ("Heartland") for their expenses arising from a variety of civil and criminal proceedings brought against them in connection with their roles at C&A.

David A. Stockman and J. Michael Stepp brought these suits after Heartland refused their requests for advancement related to ongoing legal proceedings, and for indemnification related to a dismissed criminal action, arguing that both advancement and indemnification to them are mandatory under Heartland's "Partnership Agreement." Heartland, for its part, argues that Stockman and Stepp's advancement and indemnification rights under the Partnership Agreement are more limited. Specifically, Heartland contends that advancement is not mandatory where, as here, its General Partner has refused to provide written approval. Likewise, Heartland argues that indemnification is not mandatory because Stockman and Stepp must first plead and then prove that the conduct giving rise to the underlying dismissed criminal action met three requirements set forth in the Partnership Agreement. Specifically, Heartland asserts that it is Stockman and Stepp's burden to plead and ultimately demonstrate that they i) did not breach their duties to the partnership; ii) did not knowingly violate applicable law; and iii) did not act with scienter.

In this opinion, I find in favor of Stockman and Stepp on both their advancement and indemnification claims, and accordingly grant their motions for partial summary

judgment regarding the advancement claims and deny Heartland's motion to dismiss the indemnification claims.

I find in favor of Stockman and Stepp because the plain language of the Partnership Agreement does not unambiguously support Heartland's reading of that document. In the case of the advancement claims, I conclude that there is only one reasonable reading of the Partnership Agreement, which is that Heartland's General Partner did not have discretion to withhold its written approval and defeat Stockman and Stepp's contractual right to mandatory advancement. Moreover, to the extent there is any ambiguity in the Partnership Agreement regarding advancement, that ambiguity must be resolved against Heartland.[1] Likewise, the Partnership Agreement does not clearly require an indemnitee to plead and demonstrate good faith, lawfulness, and a lack of scienter where, as occurred in this case, the indemnitee was successful in the underlying proceeding. Rather, if such a de novo inquiry is required at all by the Partnership Agreement — a reading that is hardly compelled by the odd language of the Agreement — Heartland bears the burden of proof, and Stockman and Stepp's pleading of success in the dismissed criminal action in their complaints satisfies any burden they have at this stage. In future proceedings, the parties can, if they do not settle the case, more specifically address this issue, recognizing that, absent a clear contractual requirement to

[1] *See SI Mgmt. L.P. v. Wininger*, 707 A.2d 37, 42-44 (Del. 1998) (holding that ambiguities in a limited partnership agreement should be construed against the general partner unless all participants engaged in individualized negotiations); *Harrah's Entm't, Inc. v. JCC Holding Co.*, 802 A.2d 294, 309-10 (Del. Ch. 2002) (same); *see also Penn Mut. Life Ins. Co. v. Oglesby*, 695 A.2d 1146, 1150 (Del. 1997) (noting that it is incumbent on an issuer of securities to make the terms of its operative documents clear to a reasonable investor).

prove good faith, lawfulness, and a lack of scienter in this circumstance, principles of both contract interpretation and of our state's public policy regarding indemnification will dictate an outcome in favor of Stockman and Stepp.[2]

II. Factual Background

I draw these undisputed facts from the well-pled allegations in both Stockman's First Amended and Supplemental Verified Complaint and Stepp's Verified Complaint (the "Stockman Complaint" and "Stepp Complaint," respectively) — which, except as noted, are the same in all material respects — and the documents incorporated in or attached to them.[3]

A. The Parties

Plaintiff David A. Stockman is a co-founder of Heartland and the Managing Member of both its General Partner and Investment Manager.[4] Plaintiff J. Michael Stepp is a Senior Managing Director of Heartland. Both served as officers and directors of

[2] *See Stifel Fin. Corp. v. Cochran*, 809 A.2d 555, 561 (Del. 2002) (recognizing Delaware's strong public policy interest in promoting indemnification in order to, among other benefits, encourage capable people to serve as directors); *DeLucca v. KKAT Mgmt., L.L.C.*, 2006 WL 224058, at *7 (Del. Ch. Jan. 23, 2006) (holding that, where reasonable, indemnification contracts should be read in favor of indemnification in light of Delaware's pro-indemnification policies); *Delphi Easter Partners Ltd. P'ship v. Spectacular Partners, Inc.*, 1993 WL 328079, at *2 (Del. Ch. Aug. 6, 1993) (holding that courts should construe limited partnership agreements "so as to achieve where possible the beneficial purposes that indemnification can afford").

[3] Ct. Ch. R. 10(c); *Vanderbilt Income & Growth Assoc's v. Arvida/JMB Managers, Inc.*, 691 A.2d 609, 613 (Del. 1996). This includes the Partnership Agreement, which was attached to the Stepp Complaint and incorporated by reference in the Stockman Complaint.

[4] Beginning in June 2005, Stockman entered an agreement delegating these duties to an executive committee pending the investigations against him, and so, assumably, did not take part in the General Partner's decision to deny the advancement and indemnification requests at issue here. *See* Stockman Compl. ¶ 6.

C&A, which was one of Heartland's portfolio companies, at the direction of Heartland.[5] Stockman joined the C&A Board of Directors in 2001, became its Chairman in 2002, became CEO in 2003, and remained as Chairman and CEO until 2005. Stepp was Vice President and CFO of C&A from 2002 until 2004, and also served as the Vice Chairman of the C&A Board.

C&A designed, engineered, and manufactured automobile interior components. Heartland is a private equity fund. In 2001, Heartland acquired a 60% stake in C&A, and continued to acquire C&A shares in the following years. In March 2005, C&A publicly disclosed and corrected "certain historical accounting errors" that had been revealed in an internal management review.[6] Two months later, C&A filed for bankruptcy protection and was liquidated in 2007.

B. The Proceedings

C&A's announcement of its accounting and financial problems was followed by a multitude of legal actions naming Stockman and Stepp, among other C&A officers and directors, as defendants. Currently, about half a dozen civil actions remain pending against Stockman and Stepp in Michigan, New York, and Delaware. The one criminal action brought against Stockman and Stepp (the "Criminal Proceeding"), however, was dismissed through a *nolle prosequi* order on January 9, 2009. The Criminal Proceeding was filed by the federal government in the District Court for the Southern District of New York and was dismissed by that court at the request of the Acting U.S. Attorney, who

[5] Stockman Compl. ¶ 7; Stepp Compl. ¶ 8.
[6] Stockman Compl. ¶ 8.

concluded, "[a]fter a renewed assessment of the evidence," that further prosecution of Stockman and Stepp "would not be in the interests of justice."[7] The *nolle prosequi* order constitutes a dismissal without prejudice. The U.S. Attorney may bring the same charges against Stockman and Stepp within the applicable statute of limitations, which varies in this case between five and ten years depending on the charge, but would be required to do so through a new indictment.[8]

C. Heartland's Partnership Agreement

Stockman and Stepp's claims are governed by Heartland's Partnership Agreement, which provides for indemnification of and advancement to, among others, officers and directors of its portfolio companies. There is no dispute that Stockman and Stepp are "Indemnitees" as that term is defined in the Partnership Agreement.

The Partnership Agreement contains a broad indemnification provision (the "Indemnification Provision"):

> *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 . . . of any nature whatsoever, known or unknown, liquidated or unliquidated, that are

[7] Stepp Compl. Ex. B ¶ 3. A *nolle prosequi* order is "[a] legal notice that a lawsuit or prosecution has been abandoned." BLACK'S LAW DICTIONARY 1074 (8th ed. 2004). "It is a judicial determination in favor of [the] accused and against his conviction, but it is not an acquittal, nor is it equivalent to a pardon." *Id.* (quoting 22A C.J.S. *Criminal Law* § 419, at 1 (1989)).

[8] The doctrine of *nolle prosequi*, involving dismissal at the request of the prosecutor, has been codified in Rule 48 of the Federal Rules of Criminal Procedure. "A dismissal properly taken under Rule 48(a) is without prejudice, and, within the period of the statute of limitations, a second indictment or information may be brought on the same charge." 3B CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE & PROCEDURE § 811 (3d ed.) (citations omitted); *see also Woods v. Clay*, 2005 WL 43239, at *15 n.6 (N.D. Ill. Jan. 10, 2005) ("[A] *nolle prosequi* order terminates the charge and requires the institution of a new and separate proceeding to prosecute the defendant." (quotations omitted)).

> 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 . . . *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 . . . .*[9]

The Partnership Agreement also grants Heartland's Indemnitees generous advancement rights under certain conditions (the "Advancement Provision"):

> *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 be 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.[10]

Thus, advancement of expenses to Heartland Indemnitees is mandatory under the Partnership Agreement, subject to the requirement of prior written approval from the General Partner, and except in situations where Heartland itself, through a majority of its owners, sues an Indemnitee, which is not the case here.

[9] Partnership Agreement § 4.4(a) (emphasis added).
[10] Partnership Agreement § 4.4(b) (emphasis added).

D. Heartland's Refusal To Provide Advancement Or Indemnification

After the various actions against them were initiated, Stockman and Stepp submitted advancement claims to C&A's insurance carriers for their ongoing legal expenses, which were apparently paid until C&A's insurance policies were exhausted. Stockman and Stepp next turned to Heartland's insurance carriers for advancement, but by the autumn of 2008, Heartland's insurance plans were also exhausted.

When Stockman and Stepp then turned to Heartland directly to provide the funds, Heartland refused to advance legal expenses to Stockman or Stepp unless they agreed to additional conditions not set forth in the Partnership Agreement. Stockman alleges that Heartland required him to accept a cap on the total amount of legal fees for which he could receive advancement.[11] Similarly, but less restrictively, in a letter attached to the Stepp Complaint, Heartland requested that Stepp provide monthly litigation budgets as a condition of receiving advancements.[12] Both Stockman and Stepp plead that Heartland also asked them to submit written certifications that they were entitled to advancement, including statements that they at all times acted in accordance with the requirements for indemnification listed in the Indemnification Provision, and to put up adequate security in case repayment is ultimately required.

Heartland took the position that the Partnership Agreement granted it the discretion to impose these additional conditions through the requirement in the Advancement Provision that the Heartland's General Partner give prior written approval

[11] Stockman Compl. ¶ 19.
[12] Stepp Compl. Ex. F at 2.

before any funds are distributed. Stockman and Stepp dispute that Heartland has this discretion. Accordingly, Heartland has so far denied Stockman and Stepp's advancement requests.

Heartland has been similarly unwilling to open its purse strings to indemnify Stockman and Stepp with regard to the Criminal Proceeding, which was dismissed at the request of the Acting U.S. Attorney in January 2009. Heartland informed Stockman and Stepp that their indemnification requests, made after the Criminal Proceeding was dismissed, were premature. Heartland contended that if a court in one of the still-pending civil proceedings found that Stockman and Stepp's conduct involved a state of mind inconsistent with the requirements set forth in the Indemnification Provision, then Stockman and Stepp would not be entitled to indemnification with regard to the Criminal Proceeding. As a result, Heartland argued, it could not make a determination about Stockman and Stepp's eligibility for indemnification until all legal proceedings against them were resolved.

After Heartland rejected their advancement and indemnification requests, Stockman and Stepp both filed suit in this court seeking indemnification for the Criminal Proceeding and advancement of legal expenses for the pending proceedings, which in turn led to a flurry of motions and cross motions seeking claim-dispositive orders. Heartland has moved to dismiss both the Stockman and Stepp Complaints in their entirety for failure to state a claim. Stockman and Stepp responded by each filing motions for partial summary judgment regarding their advancement claims. The result is that the advancement claims in this action are subject both to motions for summary

judgment from Stockman and Stepp and to Heartland's motions to dismiss. The indemnification claims, on the other hand, are subject only to Heartland's motions to dismiss.

III. Legal Analysis

A. Applicable Standards

Two standards of review are applicable to the pending motions. First, Stockman and Stepp's motions for summary judgment regarding the advancement claims are governed by Court of Chancery Rule 56, under which parties are entitled to summary judgment if they demonstrate "that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law."[13] Second, Heartland's motions to dismiss both the advancement and indemnification claims are governed by the Rule 12(b)(6) standard providing for dismissal where a plaintiff to fails to "plead enough facts to plausibly suggest that the plaintiff will ultimately be entitled to the relief she seeks."[14]

These two standards largely converge where, like here, a dispute turns on issues of contract interpretation. In both cases, a moving party is generally only entitled to a claim-dispositive order on its motion — either for summary judgment or dismissal — where the contract is unambiguous.[15] A contract is unambiguous if its terms are

[13] Ct. Ch. R. 56(c); *see also United Rentals, Inc. v. RAM Holdings, Inc.*, 937 A.2d 810, 829-30 (Del. Ch. 2007).
[14] *Desimone v. Barrows*, 924 A.2d 908, 929 (Del. Ch. 2007).
[15] *See VLIW Tech., LLC v. Hewlett-Packard Co.*, 840 A.2d 606, 615 (Del. 2003); *United Rentals*, 937 A.2d at 830.

"reasonably or fairly susceptible" to only one meaning.[16] So, as a general rule, a party is only entitled to a dispositive order short of trial where its interpretation of a contract is the only reasonable one.

But, where the contract in dispute is an entity's organizing document, like the Partnership Agreement, a dispositive order following motion practice may be appropriate even where the contract is ambiguous. When an agreement like the Partnership Agreement makes promises to parties who did not participate in negotiating the agreement, Delaware courts apply the general principle of *contra proferentum*, which holds that ambiguous terms should be construed against their drafter.[17] The *contra proferentum* approach protects the reasonable expectations of people who join a partnership or other entity after it was formed and must rely on the face of the operating agreement to understand their rights and obligations when making the decision to join.[18]

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[16] *Rhone-Poulenc Basic Chems. Co. v. Am. Motorists Ins. Co.*, 616 A.2d 1192, 1196 (Del. 1992); *see also United Rentals*, 937 A.2d at 830.

[17] *See, e.g.*, *SI Mgmt. L.P. v. Wininger*, 707 A.2d 37, 43 (Del. 1998) ("[A]mbiguous terms in the Agreement should be construed against the General Partner as the entity solely responsible for the articulation of those terms."); *Penn Mut. Life Ins. Co. v. Oglesby*, 695 A.2d 1146, 1149-50 (Del. 1997) ("[I]t is the obligation of the issuer of securities to make the terms of the operative document understandable to a reasonable investor whose rights are affected by the document."). Delaware courts have applied this principal in a variety of procedural contexts. *See, e.g.*, *Werner v. Miller Tech. Mgmt., L.P.*, 831 A.2d 318, 333 (Del. Ch. 2003) (denying motion to dismiss); *In re Nantucket Island Assocs. Ltd. P'ship Unitholders Litig.*, 810 A.2d 351, 361 (Del. Ch. 2002) (granting plaintiffs' motion for summary judgment); *Harrah's Entm't, Inc. v. JCC Holding Co.*, 802 A.2d 294, 309-10 (Del. Ch. 2002) (applying principle by analogy in corporate charter context in post-trial opinion).

[18] *See Oglesby*, 695 A.2d at 1150; *Harrah's*, 802 A.2d at 309-10 ("[W]hen a court is asked to construe a limited partnership agreement drafted solely by the corporate general partner, it will resolve all ambiguities against the general partner as drafter and in favor of the reasonable expectations of the public investors.").

As a practical matter, it is critical that the governing instruments of entities be interpreted consistently and that they be applied in a predictable manner. To introduce the consideration of parol evidence when issues regarding subjects like indemnification come up would create unpredictable results, reduce the incentives for clear drafting, and undermine the ability of investors, officers, and other relevant constituencies to rely on the written text of governing instruments in deciding whether to invest in, work for, or supply debt capital to entities.[19]

Thus, where an entity's governing instruments are involved, the onus is on the drafter to be clear. As discussed by our Supreme Court, in the context of discussing both insurance contracts and operative entity documents:

> [T]he insurer or the issuer, as the case may be, is the entity in control of the process of articulating the terms. The other party, whether it be the ordinary insured or the investor, usually has very little say about those terms except to take them or leave them or to select from limited options offered by the insurer or issuer. Therefore, it is incumbent upon the dominant party to make terms clear. Convoluted or confusing terms are the problem of the insurer or issuer — not the insured or investor. [20]

The same concerns are equally applicable to the directors, officers, and employees of limited partnerships who, like limited partners, typically must base their decision to serve on the terms of the limited partnership agreement as written. That is, in the case of an entity with ongoing operations, key constituents, including directors, officers, and employees, look to the governing instrument's words, and not some obscure archive of

[19] *See Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 398-99 (Del. 1996).
[20] *Oglesby*, 695 A.2d at 1149-50.

parol evidence.[21] As a result, any ambiguities in Heartland's Partnership Agreement should be resolved in favor of the reasonable expectations of Heartland's Indemnitees regarding their indemnification and advancement rights.

With these standards in mind, I turn to the parties' specific contentions regarding the Partnership Agreement.

B. The Advancement Claims

At the center of the parties' dispute over advancement is the question of how to read the requirement that "[n]o advances shall be made by the Partnership . . . without the prior written approval of the General Partner."[22] Heartland argues that the plain meaning of the prior written approval requirement is that the General Partner has discretion to deny that approval, otherwise there would be no point in requiring prior approval.

In contrast, Stockman and Stepp argue that the language providing that "[e]xpenses reasonably incurred by an Indemnitee . . . *shall* be advanced by the

[21] Notably, and in contrast to Stepp, Stockman does not argue that *contra proferentum* is applicable to his claims, likely because, as a co-founder of Heartland, Stockman was probably involved in drafting the Partnership Agreement. I nevertheless apply *contra proferentum* to both Stockman and Stepp's claims. Doing otherwise risks the bizarre outcome of concluding that the same language of the Partnership Agreement means different things as applied to two persons who are both Indemnitees within the meaning of the Indemnification and Advancement Provisions. Because the Partnership Agreement makes promises to officers and directors who did not participate in its drafting, the Partnership Agreement must be read in all cases in light of the expectations that its text would create for a reasonable officer or director. *See Kaiser*, 681 A.2d at 398-99 (holding that, when faced with ambiguous provisions in preferred stock certificates, "the Court must construe the document to adhere to the reasonable expectations of the investors who purchased the security and thereby subjected themselves to the terms of the contract" in order to, in part, avoid the drawbacks of disuniform readings of contract provisions that apply to many people).

[22] Partnership Agreement § 4.4(b).

Partnership"[23] makes advancement mandatory, and the written approval requirement serves the more ministerial, but still important, purpose of ensuring that the requirements set forth in the Advancement Provision — that the expenses be reasonably incurred and the indemnitee provide an undertaking to repay non-indemnifiable expenses — have been met before the money is turned over.

In my view, Stockman and Stepp's interpretation of the Partnership Agreement is the only reasonable one. A basic principle of contract interpretation is that the court reads an agreement as a whole to give effect to each term and to harmonize seemingly conflicting terms.[24] There is, admittedly, some tension in the Advancement Provision between the requirement that litigation expenses "*shall* be advanced" and the requirement that "[n]o advances *shall* be made by the Partnership . . . without the prior written approval of the General Partner."[25] But, Heartland's interpretation of the Partnership Agreement strains the plain meaning of the relevant language when it is read in its full context, as it must be. In contrast, Stockman and Stepp's interpretation of the Partnership

[23] Partnership Agreement § 4.4(b) (emphasis added).
[24] *See, e.g.*, *Council of the Dorset Condo. Apartments v. Gordon*, 801 A.2d 1, 7 (Del. 2002) ("A court must interpret contractual provisions in a way that gives effect to every term of the instrument, and that, if possible, reconciles all of the provisions of the instrument when read as a whole."); *Julian v. E. States Constr. Serv.*, 2008 WL 2673300, at *7 (Del. Ch. July 8, 2008) ("[W]hen interpreting a contractual provision, a court attempts to reconcile all of the agreement's provisions when read as a whole, giving effect to each and every term."); *Delta & Pine Land Co. v. Monsanto Co.*, 2006 WL 1510417, at *4 (Del. Ch. May 24, 2006) ("[C]ontracts must be interpreted in a manner that does not render any provision illusory or meaningless.") (quotations omitted); *In re Cencom Cable Income Partners, L.P. Litig.*, 2000 WL 640676, at *5 (Del. Ch. May 5, 2000) ("In order to discern the intent of the parties, the contract should be read in its entirety and interpreted to reconcile all of the provisions of the agreement.").
[25] Partnership Agreement § 4.4(b) (emphasis added).

Agreement is reasonable and supports a finding that Stockman and Stepp are entitled to judgment as a matter of law.

1. Heartland's Reading Of The Partnership Agreement Is Unreasonable

Heartland argues that the use of "shall be advanced" in the first part of Advancement Provision is meant to protect Heartland from potential duty of loyalty claims by limited partners for authorizing advancements to Heartland officers and directors, and, on the flip side, the requirement of written approval in the second part of the Advancement Provision is meant to protect Heartland from having to give advances where "advancement would be inappropriate."[26] Stated differently, Heartland argues that the Advancement Provision serves to shield Heartland's advancement decisions from any form of challenge by eliminating discretion at the front door to bar limited partner claims — expenses "shall be advanced" — but then reintroducing discretion through the back door to also bar Indemnitee claims — "no advances shall be made . . . without prior written approval."

But this argument does not convince me for a number of reasons. For starters, the plain meaning of "shall be advanced" is that advancement is mandatory. To give the General Partner unfettered discretion to deny an advancement request would, in essence, convert the Advancement Provision to a permissive rather than a mandatory term, in contravention of its plain language.

And, the Advancement Provision does not serve the liability-insulating purpose that Heartland claims it does because the Advancement Provision does not eliminate suits

[26] Heartland Ans. Br. to Stepp Mot. for Partial Summ. J. at 7.

from limited partners. As written, any discretion granted to the General Partner through the written approval requirement must necessarily be exercised in accordance with the General Partner's fiduciary duties.[27] Taken as a whole, the Partnership Agreement embodies a clear and specific approach to allocating discretion to the General Partner: numerous provisions throughout the Agreement delegate decisions expressly to the "discretion," "sole discretion," or "sole and absolute discretion" of the General Partner.[28] And, the Partnership Agreement states that, when the General Partner's decision is subject to one of those standards, it "shall be entitled to consider any interests and factors as it desires, including its own interests," therefore limiting the ability of plaintiffs to sue the General Partner.[29] The import of these provisions is that the Partnership Agreement's drafters thought about when the General Partner should have discretion and explicitly

[27] Under the Partnership Agreement, the General Partner is liable to Heartland and its limited partners for conduct that was not in or opposed to the best interests of Heartland, that the General Partner had reason to believe was unlawful, or that was the result of fraud, bad faith, willful misconduct, gross negligence, a violation of applicable securities laws, or a breach of the Partnership Agreement. Partnership Agreement § 4.3(a).

[28] *See, e.g.*, Partnership Agreement § 2.7 (General Partner may change fiscal year end date "in its sole discretion"); § 2.9(d)(ii) ("General Partner may obtain such additional capital as determined by the General Partner in its sole discretion"); § 2.9(e)(ii) (same); § 3.2 (opinion of counsel "may be waived by General Partner in its sole discretion"); § 3.3(a) ("General Partner may, in its sole discretion, admit additional Limited Partners"); § 3.3(g) ("General Partner in its sole discretion may adjust the percentage interests" in response to adding limited partners); § 3.4(b)(i) ("Distributions prior to the termination of the Partnership may only take the form of cash or Marketable Securities, in the General Partner's discretion . . . ."); § 3.4(b)(ii) ("General Partner may, in its sole discretion, offer each Partner a choice to receive an in kind distribution of Marketable Securities"); § 4.2(a) ("[General Partner] shall be authorized and empowered on behalf of and in the name of the Partnership to carry out any and all of 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 . . . ."); § 4.2(b) ("General Partner is authorized and empowered . . . [to] make in its sole discretion, an and all elections for federal, state, local and non-United States tax matters."); § 4.10 ("General Partner in its discretion may terminate or change the composition of the membership of the Advisory Board at any time").

[29] Partnership Agreement § 11.2(b).

stated in the Agreement when the General Partner has discretion. It would be very poor drafting indeed for Heartland to leave out a contractually important, liability-limiting term like "sole and absolute discretion," or at least "discretion," where Heartland intended to immunize the General Partner from a claim regarding advancement.

Indeed, in its provisions regarding the rights of limited partners to transfer their interests, the Partnership Agreement creates the same situation of required written approval that can be denied in the General Partner's discretion that Heartland claims the Advancement Provision creates, but does so by explicit reference to a standard of discretion: "A Limited Partner shall not sell, assign, pledge or otherwise transfer its Interest in whole or in part to any Person . . . *without the prior written consent of the General Partner, which consent may be given or withheld in the sole and absolute discretion of the General Partner* . . . ."[30] Heartland has offered no explanation for why two provisions that purport to achieve the same purpose would be drafted so differently in the same agreement. In other words, Heartland says that the Advancement Provision should be read as stating that Heartland may not grant an advancement request without the prior written approval of the General Partner, which approval may be given or withheld in the sole discretion of the General Partner. But Heartland does not explain why this clear formulation was not used if this was the intent. It would have been easy to write the Advancement Provision to accomplish the end Heartland wanted using the Partnership Agreement's provision on transfers of interest as a model; all the Advancement Provision had to say is that the General Partner's approval of an

[30] Partnership Agreement § 8.2(a) (emphasis added).

advancement request "may be given or withheld in the sole and absolute discretion of the General Partner." Instead of that type of clearly non-binding formulation, the drafters of the Partnership Agreement used plainly mandatory language to describe an Indemnitee's right to receive advancement.

Thus, given the availability of drafting tools that clearly stated the discretion of the General Partner and the Partnership Agreement's consistent use of them, it is unreasonable to read the Advancement Provision, which lacks any phrase involving the word "discretion," as somehow obliquely conferring discretion to the General Partner.[31]

2. Stockman And Stepp Are Entitled To Judgment As A Matter Of Law

In contrast to Heartland's flawed interpretation, Stockman and Stepp's interpretation of the Advancement Provision — that the prior written approval requirement gives the General Partner a means of policing the express preconditions to an

[31] In this regard, Heartland's ambitious argument that § 4.2(a) of the Partnership Agreement grants the General Partner discretion to deny advancement claims is unpersuasive. Under § 4.2(a), the General Partner is authorized "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" to carrying out the business of the Partnership. Partnership Agreement § 4.2(a) (emphasis added). Heartland argues that this provision grants the General Partner discretion in *all* of its actions! But, if § 4.2(a) is a blanket conferral of discretion, then the numerous uses of "sole discretion" or its variants throughout the Partnership Agreement are superfluous. As a result, this interpretation is at odds with the requirement that this court attempt to give meaning to every term in an agreement. *See NAMA Holdings, LLC v. World Market Ctr. Venture, LLC*, 948 A.2d 411, 419 (Del. Ch. 2007) ("Contractual interpretation operates under the assumption that the parties never include superfluous verbiage in their agreement, and that each word should be given meaning and effect by the court."); *Majkowski v. Am. Imaging Mgmt. Servs., LLC*, 913 A.2d 572, 588 (Del. Ch. 2006) (stating that, as a general matter, courts "attempt to interpret each word or phrase in a contract to have an independent meaning so as to avoid rendering contractual language mere surplusage"); *W. Willow-Bay Court, LLC v. Robino-Bay Court Plaza, LLC*, 2007 WL 3317551, at *11 (Del. Ch. Nov. 2, 2007) ("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.").

Indemnitee's receipt of advancement contained in the Advancement Provision — is reasonable and gives meaning to all of the terms in that Provision. Although advancement may be required, it would place Heartland in a precarious situation if it had to turn over its cash on receipt of any request for advancement, without some means of ensuring that the requirements clearly set forth in the Advancement Provision — that the expenses are reasonably incurred and the Indemnitee provide an undertaking to repay non-indemnifiable expenses — are met. Relatedly, judges on this court are familiar with situations where entities have taken the position that they need not advance funds because a particular proceeding or claim does not implicate the indemnitee's official capacity,[32] or that an entity's advancement obligation is triggered only after another entity's coverage is exhausted.[33] The approval role of the General Partner under the Advancement Provision allows it to examine requests for advancement to address issues like these. This review function is important, even if it leaves the General Partner with no blanket discretion to deny a proper advancement request.

In this regard, I am unpersuaded by Heartland's argument that any reading of the prior written approval requirement in a limited or non-discretionary way is precluded by the nature of the last part of the Advancement Provision, which categorically bars advancement where the underlying proceeding was brought by a majority of the limited partners. Heartland's assertion is that this second restriction on advancement is plainly

[32] *See, e.g., Sassano v. CIBC World Mkts. Corp.*, 948 A.2d 453, 470 (Del. Ch. 2008); *Zaman v. Amedeo Holdings, Inc.*, 2008 WL 2168397, at *25 (Del. Ch. May 23, 2008); *Tafeen v. Homestore, Inc.*, 2004 WL 556733, at *4-5 (Del. Ch. Mar. 22, 2004), *aff'd*, 888 A.2d 204 (Del. 2005); *Reddy v. Elec. Data Sys. Corp.*, 2002 WL 1358761, at *5-6 (Del. Ch. June 18, 2002).
[33] *See, e.g., DeLucca v. KKAT Mgmt., L.L.C.*, 2006 WL 224058, at *15 (Del. Ch. Jan. 23, 2006).

meant to be substantive, and so a harmonious reading of the Advancement Provision requires that the first restriction on advancement, the prior written approval requirement, be read equally substantively. But, as just discussed, the prior written approval requirement need not be read as conferring broad discretion to have substance. The approval requirement bars advancement in all cases where the request does not meet the express conditions of the Advancement Provision as policed by the General Partner, making the prior written approval requirement as categorical a restriction, albeit a narrow one, as the bar on advancement in suits brought by the majority of limited partners.

In sum, reading the written approval requirement as one of limited discretion does not read any language out of the Partnership Agreement and provides the only reasonable way to harmonize all of the terms of the Advancement Provision, making the Advancement Provision unambiguous.[34]

Moreover, to the extent there is any ambiguity in the Advancement Provision, that ambiguity must be resolved against Heartland in favor of the reasonable expectations the terms of the Provision engender in those they affect. Delaware courts resolve ambiguities in governing instruments in order to provide uniform, predictable interpretations of the documents that officers, investors, and other constituencies who provide benefits to the entity rely on in making their decisions about whether to participate in the entity's

[34] In reaching the conclusion that the Advancement Provision confers limited discretion on the General Partner, I make no finding about whether Heartland's request that Stepp provide litigation budgets was a legitimate exercise of the General Partner's discretion. In my view, there is a colorable argument that a non-binding litigation budget requested merely as a guide for Heartland to budget its own expected costs may be a reasonable condition to the General Partner's written approval, but I do not dilate on this question as neither side's briefs focused on this minor issue.

activities.[35] This principle of interpretation protects the participants' reasonable expectations, which in turn benefits the entity by encouraging participants to provide their capital, be it human or financial, at a lower cost than they would if they faced greater uncertainty.[36] Here, the language of the Advancement Provision creates a reasonable expectation on the part of Indemnitees that the written approval of the General Partner will be forthcoming in any instance where an advancement request met the express criteria of the Advancement Provision. Accordingly, to the extent there is any ambiguity about the General Partner's obligation to provide written approval in these circumstances, that ambiguity must be construed in favor of Stockman and Stepp, who indisputedly met the Advancement Provision's express requirements.

For all of these reasons, I conclude that Stockman and Stepp are entitled to summary judgment in their favor on the advancement claims.[37]

C. The Indemnification Claims

Section § 17-108 of the DRULPA gives limited partnerships wider freedom of contract to craft their own indemnification scheme for a partnership's indemnitees than is available to corporations under § 145 of the DGCL, which creates mandatory indemnification rights for corporate indemnitees in some circumstances and also bars

[35] *See SI Mgmt.*, 707 A.2d at 43; *Oglesby*, 695 A.2d at 1149-50; *Kaiser*, 681 A.2d at 398-99.
[36] *See Kaiser*, 681 A.2d at 398 ("[T]he creation of enduring uncertainties as to the meaning of boilerplate provisions [in debenture indentures] would . . . vastly increase the risks and, therefore, the costs of borrowing with no offsetting benefits either in the capital market or in the administration of justice." (quoting *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.*, 691 F.2d 1039, 1048 (2d Cir. 1982))).
[37] Because I grant Stockman and Stepp summary judgment, I necessarily deny Heartland's motions to dismiss with respect to the advancement claims, which raise the same issues.

indemnification in others.[38] Here, the drafters of the Partnership Agreement used their contractual freedom to craft an approach to indemnification that employs language drawn from § 145, but in a selective way that creates some room for confusion. In a nutshell, the Indemnification Provision adopts § 145's standard for good faith and lawful conduct, but is silent about the effect of a disposition of the underlying proceeding in favor of the Indemnitee, which is a key consideration when determining whether a corporate official is entitled to indemnification under § 145.

This inelegant drafting has given rise to a dispute between the parties over whether Stockman and Stepp must plead, and ultimately prove, that they acted in accordance with the three requirements for indemnifiable conduct listed in the Indemnification Provision in order to be entitled to indemnification with regard to the Criminal Proceeding, even though that Proceeding was dismissed in their favor. Typically, analysis of the indemnification rights of participants in a limited partnership begins with the language of the relevant partnership agreement. But here, all of the parties have made express appeals to the language and policies of § 145 — which appears to have served as a model to the Partnership Agreement's drafters — in their arguments about how the Indemnification Provision should be interpreted. As such, it is useful to first take a brief look at that statutory scheme created by § 145 and how it would operate in this case before turning to Heartland's Partnership Agreement.

[38] *See* 6 *Del. C.* § 17-108 ("Subject to such standards and restrictions, if any, as are set forth in its partnership agreement, a limited partnership may, and shall have the power to, indemnify and hold harmless any partner or other person from and against any and all claims and demands whatsoever.").

1. Indemnification Under § 145

Section 145 states, in relevant part:

> (a) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation) by reason of the fact that the person is or was a director, officer, employee or agent of the corporation . . . *if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe the person's conduct was unlawful*. . . .
>
> (b) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that the person is or was a director, officer, employee or agent of the corporation . . . *if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation* . . . .
>
> (c) *To the extent that a present or former director or officer of a corporation has been successful on the merits or otherwise* in defense of any action, suit or proceeding referred to in subsections (a) and (b) of this section, or in defense of any claim, issue or matter therein, such person *shall be* indemnified against expenses (including attorneys' fees) actually and reasonably incurred by such person in connection therewith.[39]

As discussed by our Supreme Court:

> 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. Beyond that, its larger purpose is to encourage capable men to serve as corporate directors, secure in the knowledge that expenses incurred by them in upholding their honesty and integrity as directors will be borne by the corporation they serve.[40]

[39] 8 *Del. C.* § 145 (emphasis added).
[40] *Stifel Fin. Corp. v. Cochran*, 809 A.2d 555, 561 (Del. 2002) (quotations omitted).

Section 145 meets these policy goals in two ways. First, subsections (a) and (b) authorize corporations to indemnify their officers, directors, and other agents in proceedings brought against them "by reason of the fact" of the indemnitee's position as long as the indemnitee "acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation" and, in proceedings within the scope of §145(a), "with respect to any criminal action or proceeding, had no reasonable cause to believe the person's conduct was unlawful."[41] Thus, under §§ 145(a) and (b), corporations can shield their indemnitees from the risk that they will incur personal liability in the course of their good faith efforts to serve the corporation. But, the corporation's power to do so is limited where there is a risk that indemnification will encourage officers to break the law or breach their duty of loyalty to the corporation. As explained by members of the committee that drafted § 145:

> It was also apparent that revision was appropriate with respect to the limitations which must necessarily be placed on the power to indemnify in order to prevent the statute from undermining the substantive provisions of the criminal law and corporation law. If indemnification in criminal proceedings were to be included within the scope of the statute, the full deterrent effect of the anti-trust law, for example, could be maintained only where the party involved had no reasonable cause to believe his conduct was unlawful. . . . The need for a similar provision to protect the corporation law's requirement of loyalty to the corporation was equally apparent . . . .[42]

In other words, the purpose of the limits on indemnifiable conduct in §§ 145(a) and (b) is in part to ensure that corporate officials do not evade the consequences of their own

[41] 8 *Del. C.* §§ 145(a), (b).
[42] S. Samuel Arsht & Walter K. Stapleton, *Delaware's New General Corporation Law: Substantive Changes*, 23 BUS. LAW. 75, 78 (1967).

misconduct in such a way that they are rewarded for or encouraged to violate applicable laws and to breach their fiduciary duties to the corporation.

But, where there is no punishment to avoid — i.e., there has been no conviction, no fine, and no settlement payment — the corporation may not inquire into the good faith and lawfulness of its indemnitees. Rather, the second integral part of the § 145 scheme is that corporate indemnitees have an absolute right to mandatory indemnification where they are "successful on the merits or otherwise" in the underlying proceeding.[43] In other words, § 145(c) assures corporate indemnitees that their reasonable legal expenses will be paid any time they are "successful" in a proceeding. An indemnitee in a criminal proceeding is successful any time she avoids conviction: "[s]uccess is vindication . . . any result other than conviction must be considered success."[44] Accordingly, if § 145 were applicable to Stockman and Stepp's claims, they would be considered successful in the Criminal Proceeding because it was dismissed, and Stockman and Stepp would be entitled to mandatory advancement.[45]

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[43] *See* 8 *Del. C.* § 145(c); *see also FGC Holdings Ltd. v. Teltronics, Inc.*, 2007 WL 241384, at *9 (Del. Ch. Jan. 22, 2007) ("[S]ubsection (c) grants an absolute right of indemnification to the movant, provided that he has been successful on the merits or otherwise."); *Perconti v. Thornton Oil Corp.*, 2002 WL 982419, at *3 (Del. Ch. May 3, 2002) ("Under 8 *Del. C.* § 145(c), an officer or director who meets the requirements of the statutory provision has an absolute right to indemnification.").

[44] *Merritt-Chapman & Scott Corp. v. Wolfson*, 321 A.2d 138, 141 (Del. Super. 1974); *see also Waltuch v. Conticommodity Servs., Inc.*, 88 F.3d 87, 96 (2d Cir. 1996) ("'[S]uccess' under § 145(c), does not mean moral exoneration. Escape from an adverse judgment or other detriment, for whatever reason, is determinative."); *Zaman*, 2008 WL 2168397, at *22 ("The success on the 'merits or otherwise' standard is one that grants indemnification to corporate officials even when they have not been adjudged innocent in some ethical or moral sense.").

[45] *See Perconti*, 2002 WL 982419, at *3. In *Perconti*, the U.S. Attorney had dismissed charges against a corporate officer after a mistrial. This court then held that the officer was entitled to

Admittedly, some believe that there remains a question in our law as to whether a corporate indemnitee is successful when an action is dismissed without prejudice and could theoretically be revived, as is the case here.[46] But, two recent decisions of this court support awarding indemnification after a dismissal without prejudice on the basis that indemnification decisions should be made on a case-by-case basis, especially where the governing bylaw or organizational document provides broad, mandatory indemnification rights.[47] To do otherwise would be the same as requiring indemnitees to wait for all proceedings against them arising from the same set of operative facts to be concluded before receiving indemnification for any of them, which this court has held to be improper in similar circumstances.

In *Levy v. Hayes Lemmerz International, Inc.*,[48] this court held that plaintiffs did not have to await the outcome of an SEC investigation into alleged accounting irregularities in order to receive indemnification for a settled class action suit arising from the same conduct.[49] The *Levy* court took particular note of the bylaw's promise to

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indemnification under § 145(c): "Dismissal of the charges against Perconti by the government, for whatever reason, constituted 'success.'" *Id.*

[46] *See* 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS ("BALOTTI & FINKELSTEIN") § 4.12[B] at 4-63 n.391 (2009) (noting that the law is unclear in this area and that "[t]he Court of Chancery has not clearly stated what 'otherwise' means.").

[47] *See Zaman v. Amedeo Holdings, Inc.*, 2008 WL 2168397 (Del. Ch. May 23, 2008); *Levy v. Hayes Lemmerz Int'l, Inc.*, 2006 WL 985361 (Del. Ch. Apr. 5, 2006).

[48] 2006 WL 985361 (Del. Ch. Apr. 5, 2006).

[49] Heartland argues that this court's decision in *Levy* is distinguishable because it applied § 145, but the Indemnification Provision is not identical to § 145 because, as discussed, it does not contain the language found in § 145(c). This argument is unpersuasive. For starters, Heartland does not indicate how the existence or non-existence of a § 145(c) alters the *Levy* analysis. Even where § 145(c) would not be applicable because the indemnitee was not successful in the underlying action, I read *Levy* as indicating that a party need not wait until all actions against it

provide indemnification for an action "whether civil, criminal, administrative, or investigative,"[50] which is similar to the Indemnification Provision's promise to provide indemnification for "any and all claims . . . of any nature whatsoever," and concluded that this language evinced an intent to treat indemnification requests on a case-by-case basis because "a party may be indemnified for a civil action, and may also seek indemnification for a later criminal action, if it arises."[51]

Moreover, as the *Levy* court noted:

> To read this language to mean that in any case where multiple causes of action could be raised the indemnified party must wait for all relevant statutes of limitations to run, or for all other possible causes of action to be disposed of, is to eviscerate the important right of indemnification on which Delaware corporations rely to secure qualified people to serve on their boards.[52]

Similar concerns animated this court's holding in *Zaman v. Amedeo Holdings, Inc.*,[53] where the court concluded that indemnitees were entitled to indemnification on federal claims that were dismissed without prejudice for lack of subject matter jurisdiction, and that the indemnitees did not have to wait until the dismissed claims were resolved in state court.[54]

I adhere to the *Levy* and *Zaman* approach here and conclude that, under § 145(c), the dismissal of the Criminal Proceeding would be considered a success. Otherwise,

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are settled before seeking indemnification on the basis that it acted in good faith and without reason to believe its conduct was unlawful.

[50] *Levy*, 2006 WL 985361, at *10.

[51] *Id.*

[52] *Id.*

[53] 2008 WL 2168397 (Del. Ch. May 23, 2008).

[54] *Id.* at *22 ("Here, the Derbyshires were successful in having the Federal Action entirely dismissed. The fact that the dismissal of a lot of the counts was without prejudice does not mean that the Derbyshires were not successful.").

requiring Stockman and Stepp to wait for all of the relevant statutes of limitation to run, one of which is ten years in this case, would work the very evisceration of important indemnification rights that *Levy's* well-reasoned analysis counsels against.[55]

With this understanding of how the corporate statutory scheme would operate in this case, I turn to the governing terms of the Partnership Agreement.

2. Indemnification Under The Partnership Agreement

The Indemnification Provision begins with an expansive grant of mandatory indemnification rights: "*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 . . . *of any nature whatsoever*, known or unknown, liquidated or unliquidated . . . ."[56] The "to the full extent permitted by law" language is common in both corporate bylaws and in alternative entity operating agreements,[57] and is "an expression of the intent for the promise of indemnity to reach as far as public policy will allow."[58]

[55] For the same reasons, I reject Heartland's argument that Stockman and Stepp cannot receive indemnification for the Criminal Proceeding until all the pending civil proceedings involving the same underlying conduct are resolved. *See also Green v. Westcap Corp. of Del.*, 492 A.2d 260, 265 (Del. Super. 1985) ("Under § 145 indemnification must be considered as each criminal or civil proceeding arises or is concluded.").
[56] Partnership Agreement § 4.4(a) (emphasis added).
[57] *See, e.g.*, *Donohue v. Corning*, 949 A.2d 574, 576 (Del. Ch. 2008) (LLC agreement); *Brown v. LiveOps, Inc.*, 903 A.2d 324, 328 (Del. Ch. 2006) (corporate bylaw); *Underbrink v. Warrior Energy Servs. Corp.*, 2008 WL 2262316, at *7 (Del. Ch. May 30, 2008) (corporate bylaw); *FGC Holdings*, 2007 WL 241384, at *8 (corporate bylaw); *Morgan v. Grace*, 2003 WL 22461916, at *2 (Del. Ch. Oct. 29, 2003) (LLC agreement).
[58] *DeLucca*, 2006 WL 224058, at *10; *see also Brown*, 903 A.2d at 328; *Underbrink* 2008 WL 2262316, at *7.

The Partnership Agreement's broad grant of indemnification, however, is subject to certain qualifications:

> [A]n 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 . . . .[59]

These requirements are similar to the language in §§ 145(a) and (b) requiring that an indemnitee act "in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe the person's conduct was unlawful."[60] But, puzzlingly, and unlike § 145, the drafters of the Indemnification Provision joined the list of requirements with "or" rather than "and," an issue I address in more detail below.

Moreover, the Indemnification Provision is silent with respect to the rights of Indemnitees who are successful in proceedings brought against them, meaning the Indemnification Provision does not address the issue covered by § 145(c). The appropriate interpretation of this silence — i.e., whether the Partnership Agreement's silence should be read as implicitly adopting a success standard akin to § 145(c) or not — is important because, as discussed above, such a success standard would mandate indemnification in this case.

[59] Partnership Agreement § 4.4(a)(i) (emphasis added).
[60] 8 *Del. C.* § 145(a).

3. The Partnership Agreement Does Not Require Stockman And Stepp To Plead That Their Conduct Was Consistent With The Indemnification Provision's Requirements

Heartland argues that even though Stockman and Stepp were successful in the Criminal Proceeding, they still must plead and ultimately demonstrate that they acted in accordance with the requirements set forth in the Indemnification Provision because the omission of a success standard in that Provision should be read as an intentional choice by the drafters to require an affirmative showing of proper conduct in all cases. Moreover, Heartland argues that an Indemnitee must comply with all three of the requirements listed in the Indemnification Provision because the "or" joining those three requirements should be read as an "and."

For their part, Stockman and Stepp argue that they were not required to plead anything about their conduct because the mandatory nature of the Indemnification Provision shifts the burden to Heartland to demonstrate that Stockman and Stepp's conduct was at odds with that Provision. This is a persuasive argument. Although a plaintiff generally bears the burden of pleading all elements of her claim, in the case of a mandatory indemnification provision, the burden rests on the party from whom indemnification is sought to prove that indemnification is not required.[61] By imposing a mandatory indemnification obligation on itself in the Partnership Agreement, Heartland undertook to pay all indemnification requests unless Heartland could

[61] *VonFeldt v. Stifel Fin. Corp.*, 1999 WL 413393, at *3 (Del. Ch. June 11, 1999) ("By using the phrase 'shall indemnify,' the bylaw not only mandates indemnification; it also effectively places the burden on [the corporation] to demonstrate that the indemnification mandated is not required.").

demonstrate that indemnification was not required.[62] As a result, Stockman and Stepp are not required to make allegations about their conduct in order to state a claim for indemnification. And, even if such allegations were required, Stockman and Stepp have pled that the Criminal Proceeding against them was dismissed without an adverse finding. Given that plaintiff-friendly inferences must be made, and that it is reasonable to believe that the federal government would not dismiss an indictment lightly, the pled facts support the reasonable inference that the government could not prove that Stockman and Stepp engaged in any criminal wrongdoing, an inference that supports a claim for indemnification.

This determination that the Stockman and Stepp Complaints sufficiently allege indemnification claims that can move forward could end the analysis for present purposes because it provides a sufficient basis to deny the motions to dismiss. I dilate on this topic a bit longer, however, because denying the motions to dismiss simply passes a key legal question down the line — namely, does the Indemnification Provision of the Heartland Partnership Agreement require an Indemnitee to endure a plenary trial on the conduct underlying a favorably dismissed case as the price of indemnification? That is, must the Indemnitee endure the equivalent of the very proceeding she has already won to get her costs indemnified? The parties have to some, but not full, extent joined issue on these questions. For the sake of efficiency, and so that the parties can contemplate how to

[62] *See id.* ("To overcome this self-imposed, mandatory obligation on [the corporation's] part, [the corporation] must demonstrate to this Court why it should not be required to indemnify [its director]. . . . This interpretation, however, does not discharge the good faith requirement; it only shifts the burden on this issue to the corporation.").

approach the remainder of this case, I now consider, in a necessarily preliminary way, how the court might approach these questions.

The reason these questions arise is because Heartland argues that the Indemnification Provision requires that an Indemnitee's conduct have complied with all three of the listed requirements, specifically: i) the conduct was in or not opposed to the best interests of Heartland; ii) the Indemnitee had no reasonable cause to believe the conduct was unlawful in the case of criminal actions; and iii) the conduct did not constitute fraud, bad faith, willful misconduct, gross negligence, a violation of applicable securities laws, or a material breach of the Partnership Agreement or an associated advisory agreement. Thus, Heartland contends that there must be a judicial proceeding to determine whether Stockman and Stepp met that standard. That is, even though Stockman and Stepp had the Criminal Proceeding against them dropped, Heartland asserts that it can force them to litigate over the substance of the conduct underlying the dismissed indictments before receiving indemnification. This requires not only an ultimate conclusion about scienter and motive, but, critically, an inquiry into exactly *what conduct* was at issue in the dismissed Criminal Proceeding.

To support its argument that the Indemnification Provision requires compliance with all three of the listed standards, not just one, Heartland contends that the "or" in the Indemnification Provision should be read as "and." In so doing, Heartland relies heavily on the language and policies of § 145:

> The language and context of the provision make clear that, although joined by the term "or," all three requirements must be met. As indicated in a case relied upon by Mr. Stepp, good faith and acting in the best interests of the

> partnership are indispensable requirements for indemnification. *Cf. Vonfeldt v. Stifel Fin. Corp.*, C.A. No. 15688, 1999 WL 413393, at *2 (Del. Ch. June 11, 1999) ("It should now be clear that, as far as § 145 is concerned, Delaware corporations lack the power to indemnify a party who did not act in good faith or in the best interests of the corporation."). This policy underlying indemnification from Delaware corporations, on which Mr. Stepp seeks to rely, serves to reinforce the conclusion that the Limited Partnership Agreement requires compliance with all three requirements.[63]

Reading the Indemnification Provision in the way Heartland contends helps avoid an arguably unreasonable result. Although the normal approach to interpretation is to treat "and" as conjunctive and "or" as disjunctive, the opposite approach has been applied where the normal approach would lead to an absurd result or one contrary to the drafter's overall intent.[64] Here, employing "or" in the disjunctive sense could lead to rather odd results.

And, although Heartland has not provided any briefing on how the "or" came to be included in the Indemnification Provision, I note that language identical to the Indemnification Provision's standard of conduct appears in the Partnership Agreement's provision limiting the liability of the General Partner to Heartland and its limited partners (the "Exculpatory Provision"). But, in the Exculpatory Provision the "or" makes more sense given the surrounding text:

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[63] Heartland's Rep. Br. in Support of Mot. to Dismiss Stepp Compl. at 12 (footnotes omitted); *see also* Heartland's Rep. Br. in Support of Mot. to Dismiss Stockman Compl. at 16-17 (containing an identical passage except referring to Stockman rather than Stepp).

[64] *See In re Application of Emmet S. Hickman Co.*, 108 A.2d 667, 671 (Del. 1954) ("It is well settled that the disjunctive 'or' in a statute or ordinance may be read as 'and' if to do so will conform to the legislative intent. This rule of construction has resulted from the common and careless use of the words in legislation."); *Concord Steel, Inc. v. Wilmington Steel Processing Co.*, 2008 WL 902406, at *7 n.57 (Del. Ch. Apr. 3, 2008) ("In the analogous statutory interpretation context, courts occasionally have construed 'and' to mean the disjunctive 'or' to avoid an incoherent reading of a statute.").

> [No Indemnitee] shall be liable to the Partnership or to any limited Partner for (i) any act or omission taken or suffered by the Indemnitees in connection with this Agreement or the matters contemplated herein, unless such act or omission (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 . . . .[65]

It would be strange for the Partnership Agreement's drafters to have intended to have different standards of conduct for indemnification and liability insulation given the identical nature of the language used. The more plausible explanation for the "or" in the Indemnification Provision is that it was the result of careless "pasting" of text. The carelessness of the drafting is also suggested by the inclusion in the Exculpation Provision of the phrase from § 145 dealing with criminal cases. This is odd, as criminal cases do not involve civil liability, but rather responsibility to society. This inclusion was either a blunderbuss or a use of § 145's language as a very crude way of crafting an exculpatory provision somewhat in the mold of § 102(b)(7).[66]

For these reasons, it is possible that Heartland could prevail on the merits of its contention that the "or" in the Indemnification Provision should be read conjunctively, meaning that, where the standard of conduct in the Indemnification Provision is applicable, Indemnitees must demonstrate that they did not breach their duties to the partnership, did not knowingly violate applicable law, and did not act with scienter. It is important to recognize, however, that such a conclusion would necessarily rely on a

[65] Partnership Agreement § 4.3(a) (emphasis added).
[66] 8 *Del. C.* § 102(b)(7). In § 102(b)(7), the DGCL permits exculpation of duty of care violations involving breaches of positive law, but only if it was not a "a knowing violation of law." *Id.*

number of the interpretive tools that this court uses to make sense of governing instruments that on their face appear to generate absurd results, including turning to background statutory schemes and public policies.[67]

This point is important because Heartland asks the court to ignore these same considerations when they work against Heartland with regard to interpreting the Indemnification Provision's silence on a success standard. On that issue, Heartland argues that the terms of the Indemnification Provision, and the lack of an explicit success standard, must be read as a careful choice made by the Partnership Agreement's drafters to force even successful Indemnitees to demonstrate their compliance with their legal and fiduciary duties, even though such a reading leads to an inefficient result at odds with Delaware's public policies for indemnification.

Heartland cannot, however, have it both ways. For starters, any contention that the terms of the Indemnification Provision's standard of conduct were thoughtfully selected and carefully reviewed is belied by the fact that those very terms contain a misplaced "or" that Heartland has strenuously argued must be corrected by reference to § 145 and its underlying policies. That is, Heartland's argument is particularly problematic in light of the way Heartland has asked the court to draw on § 145 to resolve the "or" problem. Heartland has argued, in essence, that the standard of conduct in the Indemnification Provision should be read the same as the analogous language in

[67] *See Cantor Fitzgerald, L.P. v. Cantor*, 2000 WL 307370, at *21 (Del. Ch. Mar. 13, 2000) (discussing the rule that, if a partnership agreement is silent or ambiguous, the Court may "begin to look for guidance from the statutory default rules, traditional notions of fiduciary duties, or other extrinsic evidence" (quoting *Sonet v. Timber Co., L.P.*, 722 A.2d 319, 324 (Del. Ch. 1998))).

§§ 145(a) and (b). But, the meaning of the analogous §§ 145(a) and (b) language is informed by the existence of § 145(c).

The language of §§ 145(a) and (b) applies comfortably only to cases where there has been a finding that the party seeking indemnification has violated some legal or equitable duty to someone, the party has made an admission of culpability, or the party has settled a case by making a payment.[68] In the first two of these situations, there is a strong basis to believe the indemnitee acted against the interests of the corporation or society, and therefore providing indemnification would dampen the incentives of corporate officials to comply with their legal and fiduciary duties, a result at odds with public policy. Moreover, in these situations, there will be a judicial record developed in a plenary proceeding regarding the underlying conduct which can serve as a basis for evaluating whether the indemnitee met the §§ 145(a) and (b) standard for good faith and law compliance.

In the case of settlements, there has been precious little application of the §§ 145(a) and (b) standard because indemnitees typically work with the corporation, its lawyers, and insurers in resolving cases. I am not aware of, and no party has cited, a proceeding in this court examining whether the conduct of a potential entity indemnitee who settled a case met the good faith test of §§ 145(a) and (b). After all, parties seek to

[68] Where one of these circumstances is not present, the corporate indemnitee was, assumably, successful in the underlying proceeding, triggering the mandatory advancement right of § 145(c), which does not require that the indemnitee meet the §§ 145(a) and (b) standard. *See FGC Holdings*, 2007 WL 241384, at *9 (the indemnification right granted by § 145(c) is "absolute"); *Green*, 492 A.2d at 265 (situations within the scope § 145(c) are not subject to the state of mind requirements of §§ 145(a) and (b)).

settle cases in order to obtain peace and end further costs, not to kick the litigation can down the road.

Given this dearth of cases involving settlements, it is equally unsurprising that the §§ 145(a) and (b) standard is ill-suited for application to matters concluded by a dismissal in favor of an indemnitee. And, in a case like this one, where the underlying proceeding was dismissed in the defendants' favor with no finding of guilt, no admission of guilt, or even an agreement to pay for peace, § 145 (c) shields corporate indemnitees from any inquiry into their conduct.[69]

Given these realities, the requirements of §§ 145 (a) and (b) seem best read as public policy limits designed to prevent corporations from indemnifying corporate officials in only the most incentive-distorting circumstances: when the officials have been convicted or otherwise incurred liability as a result of culpable conduct *and* that liability was the result of conduct that involved a certain level of scienter. Nothing cited by Heartland suggests that these requirements — which are baked into the Indemnification Provision — were designed to require an indemnitee who faced civil or criminal liability claims and had those claims dismissed to then put on, or even defend, a merits case about the purity of their state of mind regarding the conduct alleged in the dismissed claims. Indeed, turning an indemnification case into a hypothetical trial on the

[69] *See* 1 RODMAN WARD, JR. ET AL., FOLK ON THE DELAWARE GENERAL CORPORATION LAW §145.4 (4th ed. 2004) (noting that the purpose of the "or otherwise" language in § 145(c) is to avoid forcing indemnitees to incur the expense of litigating on the merits where a preliminary defense is sufficient to dispose of the underlying case); *see also Green*, 492 A.2d at 265 (reviewing the legislative history and determining that the drafters of § 145 specifically intended that situations within the scope § 145(c) would not be subject to the state of mind requirements of §§ 145(a) and (b)); 1 BALOTTI & FINKELSTEIN § 4.12[B], at 4-63 n.388 ("The good faith requirement does not apply to a director or officer who is 'successful' under Section 145(c).").

merits of a dismissed case is a bizarre notion to propose and would be counterproductive to Delaware's policy goal of assuring indemnitees "that their reasonable expenses will be borne by the corporation they have served if they are vindicated."[70]

From Heartland's financial perspective, the economic inefficiency of such a proceeding would be rather large. To be specific, one can assume that the costs Stockman and Stepp incurred to get the indictment against them dismissed were far less than would have been involved in defending against its charges at trial. If Heartland demands a plenary hearing on the conduct that Stockman and Stepp engaged in — in which Heartland must prove that Stockman and Stepp violated their legal or equitable duties with a state mind inconsistent with the Indemnification Provision's coverage — Heartland will have to expend huge resources presenting its case. Meanwhile, it may well have to advance funds to Stockman and Stepp to defend themselves in such a hearing, a defense that would likely far exceed what they seek in indemnification now. And, in any event, if Heartland loses, it will have to bear its own costs and indemnify Stockman and Stepp.

The awkward terms of the Indemnification Provision do not unambiguously require such an inefficient approach. Rather, these terms are perhaps better read as a crude way of requiring that an Indemnitee have acted with an innocent state of mind only in a situation where the Indemnitee seeks indemnification for a civil or criminal liability or fine, or somehow tries to stick Heartland with the costs of a settlement payment without its consent. In that circumstance, where there is a solid basis for concluding that

[70] *Cochran*, 809 A.2d at 561 (quotations omitted).

the Indemnitee committed a breach of fiduciary or legal duty, or Heartland is being asked to foot the bill for a settlement, the Indemnitee may only recover if the Indemnitee is found to have acted with the requisite level of subjective innocence. But in a situation where the outcome of the underlying proceeding is favorable to the Indemnitee and provides no rational basis to infer that a breach of duty occurred, the Indemnitee is not required to litigate over the substance of her conduct and her state of mind.

Reading the Indemnification Provision in this way does not contravene, as Heartland argues, the policy of the DRULPA to "give maximum effect to the principle of freedom of contract."[71] The drafters of the Partnership Agreement could have exercised their freedom of contract to eschew the Delaware statutory approach to corporate indemnification and create an indemnification scheme that does not grant mandatory indemnification to successful Indemnitees. But, they did not do so clearly in this case. Instead, the Indemnification Provision provides mandatory indemnification "to the fullest extent permitted by law." Delaware law plainly allows an entity to indemnify an officer or director who avoids conviction in a criminal proceeding, regardless of whether there is an affirmative finding that she was not culpable. Thus, as an initial matter, the Indemnification Provision grants Stockman and Stepp a very broad right to mandatory indemnification. And, the limiting language of the Indemnification Provision does not clearly eliminate this right as to the dismissed Criminal Proceeding. Rather, the Indemnification Provision simply adopts statutory language from § 145 that ensures that

[71] 6 *Del. C.* § 17-1101(c).

no convicted indemnitee will receive indemnification unless she acted in good faith and had no reason to believe her conduct was unlawful.

In other words, the Indemnification Provision can be reasonably read as implicitly incorporating the notion that indemnification is available to a prevailing Indemnitee, and that the conditions relating to the Indemnitee's state of mind are meant to police the availability of indemnification only where the Indemnitee has suffered an adverse judgment, admitted to a breach of duty, or settled a case for money. Admittedly, this conclusion rests on what explicit terms of the Indemnification Provision imply rather than state. And, Heartland is accurate in saying that the Partnership Agreement does not incorporate language from § 145(c), and restricts itself only to a garbled recitation of the words of §§ 145(a) and (b). But, the omission of an explicit success criteria from the Indemnification Provision does not, in my view, clearly require a successful Indemnitee in a criminal proceeding to face a de novo inquiry into whether "the Indemnitee had no reasonable cause to believe his conduct was unlawful."[72] That language, in itself, clearly implies there is a preexisting basis for believing that the Indemnitee committed an unlawful act, and triggers an inquiry into whether the Indemnitee had reason to know that her conduct was unlawful. Similarly, the language requiring that the Indemnitee act "in or not opposed to the best interests of the Partnership" and that the Indemnitee's conduct "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

[72] Partnership Agreement § 4.4(a)(i)(B).

Agreement"[73] presupposes that Heartland is being asked to indemnify culpable conduct that raises the question of whether the Indemnitee acted with scienter. But, when the criminal charges against an Indemnitee are dismissed without any finding of liability, the contract argument for examining what the Indemnitee did and whether the Indemnitee acted with an innocent state of mind is arguably irrelevant as there is no underlying violation to examine.

And, to the extent there is reasonable doubt about whether the Indemnification Provision grants mandatory indemnification to successful Indemnitees, important principles of contract interpretation support a reading in favor of providing indemnification. First, such an interpretation is consistent with the general principles for approaching indemnification provisions in limited partnership agreements set forth by then-Chancellor Allen in *Delphi Easter Partners*[74]:

> 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. 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.[75]

Here, that means that any ambiguity regarding whether Heartland owes indemnification rights should be resolved against it, and in favor of the Indemnitees seeking

[73] Partnership Agreement § 4.4(a)(i) (emphasis added).
[74] *Delphi Easter Partners Ltd. P'ship v. Spectacular Partners, Inc.*, 1993 WL 328079 (Del. Ch. Aug. 6, 1993).
[75] *Id.* at *2; *see also DeLucca*, 2006 WL 224058, at *7 ("Delaware has a strong public policy in favor of assuring key corporate personnel that the corporation will bear the risks resulting from performance of their duties on the grounds that such a policy best encourages responsible persons to occupy positions of business trust, so Delaware courts have read indemnification contracts to provide coverage when that is reasonable." (citing *Perconti*, 2002 WL 982419, at *3; *VonFeldt*, 714 A.2d at 84)).

indemnification. That result is consistent with analogous precedent in corporate cases.[76] Similarly, the doctrine of *contra proferentum* is applicable in this context and would dictate that the lack of clarity in the Indemnification Provision be read against Heartland and in favor of indemnification for Stockman and Stepp.

In sum, if it is reasonable to read the Indemnification Provision as granting Indemnitees like Stockman and Stepp a right to mandatory indemnification for actions that are concluded in their favor, the principles of contract interpretation governing limited partnership agreements would require that I read the Indemnification Provision in that way.

For all these reasons, it may be that there is little left to litigate regarding Stockman and Stepp's indemnification claims. But, because no party has sought summary judgment on the indemnification claims, my ruling is necessarily limited to making a determination about the motions to dismiss. The parties should reflect on how to proceed, and if Heartland persists in contending that an evidentiary hearing on the nature and lawfulness of Stockman and Stepp's conduct is required, it must as an initial matter file an answer that pleads facts supporting a rational inference that the conduct of Stockman and Stepp at issue in the Criminal Proceeding breached a legal duty and that Stockman and Stepp acted with a state of mind inconsistent with their right to indemnification.

[76] *See Cochran*, 809 A.2d at 561 ("This Court has emphasized that the indemnification statute should be broadly interpreted to further the goals it was enacted to achieve."); *VonFeldt*, 714 A.2d at 84. ("We eschew narrow construction of the [indemnification] statute where an overliteral reading would disserve [Delaware's public policy regarding indemnification].").

For now, I simply deny Heartland's motions to dismiss the Stockman and Stepp Complaints.

IV. Conclusion

For the foregoing reasons, Stockman and Stepp's motions for summary judgment are granted, and Heartland shall advance Stockman and Stepp their unpaid legal expenses in accordance with the terms of the Advancement Provision as discussed in this opinion. Furthermore, Heartland's motions to dismiss are denied in their entirety. IT IS SO ORDERED.