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Case Number 36,2013

IN THE SUPREME COURT OF THE STATE OF DELAWARE

DAVID F. MILLER III,	)	
	)	
Plaintiff Below, Appellant,	)	No. 36, 2013
	)	
	)	Court below: Court of Chancery of the State of Delaware
v.	)	
	)	
PALLADIUM INDUSTRIES, INC.,	)	
	)	C.A. No. 7475-VCN
	)	
Defendant Below, Appellee.	)	
	)	

APPELLANT DAVID F. MILLER III'S REPLY BRIEF

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ARGUMENT

I. MR. MILLER IS ENTITLED TO MANDATORY ADVANCEMENT PURSUANT TO THE BYLAWS

Palladium's Bylaws[1] specifically mandate indemnification "to the fullest extent which it is empowered to do so" by law when an individual is involved in civil litigation "by reason of the fact that he, ..., is or was a director or officer, of the corporation or is or was serving at the request of the corporation as a director" and requires that this right "***shall*** include the ***right*** to be paid by the corporation the expenses incurred in defending any such proceeding ***in advance*** of its final disposition..." (Op. at 2; A52-53) (emphasis added). The Bylaws' "construction should be that which would be understood by an objective, reasonable third party". *Osborn ex rel. Osborn v. Kemp*, 991 A.2d 1153, 1159 (Del. 2010). The Bylaws should not be interpreted to '"render any provision or term illusory or meaningless.'" *Stockman v. Heartland Indus. Partners, L.P.*, 2009 WL 2096213, at *6 n.24 (Del. Ch. July 14, 2009).

A. THE WORD "SHALL" CREATES MANDATORY ADVANCEMENT RIGHTS

Palladium argues that the Bylaws provide for permissive advancement, focusing on the word "unless." However, it never suggests an interpretation which

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[1] Capitalized terms used herein are defined in Appellant David F. Miller III's Opening Brief. (Transaction ID 51949324). References to Appellant David F. Miller III's Opening Brief are cited to herein as "(OB at _)". References to the Answering Brief of Palladium Industries Inc. are cited to herein as "(AB at _)".

gives meaning to the word "shall", thus, under Palladium's theory, the Bylaws become illusory. In addition, Palladium does little to distinguish the cases cited by Mr. Miller that support the conclusion that the use of the word "shall" creates mandatory advancement rights.[2] (OB at 13-14 citing cases); *see Stockman*, 2009 WL 2096213, at *6 n.26 ("the plain meaning of 'shall be advanced' is that advancement is mandatory.").

Palladium seeks to strictly construe the Bylaws, arguing that a bylaw must be clearly, specifically, or expressly worded to provide the right to advancement. (AB at 8-9). In reaching this conclusion, Palladium relies on a line of cases in which claimants asserted a right to advancement where the controlling documents provided only for indemnification and were silent with respect to advancement. *See Majkowski v. American Imaging Mgmt. Servs., LLC*, 913 A.2d 572, 580 (Del. Ch. 2006) (noting the operative agreements "nowhere mention advancement" and finding the phrase "indemnify and hold harmless" in an indemnification provision does not require advancement); *Bernstein v. TractManager, Inc.*, 953 A.2d 1003, 1008 (Del. Ch. 2007)(finding an LLC manager was not entitled to advancement because the LLC's operating agreement "contained no provision for advancement of expenses"); *Advanced Mining Systems, Inc. v. Fricke*, 623 A.2d 82, 84 (Del. Ch.

[2] Palladium simply asserts that the cases cited by Mr. Miller are not advancement cases. (AB at 15). This, of course, is not a basis to distinguish the cases which are cited for the proposition of contract construction. Moreover, Palladium does not cite a case that stands for the proposition that "shall" does not indicate mandatory.

1992)(framing the question as "whether a mandate to 'indemnify' includes an obligation to advance expenses prior to a determination whether indemnification is permitted or required."). As such, these cases have no application to the Bylaws, which expressly provide for advancement. Additionally, requiring strict construction of advancement provisions would be contrary to the public policy favoring indemnification and advancement. *See Brown v. Liveops, Inc.*, 903 A.2d 324, 327-28 (Del. Ch. 2006); *Sun-Times Media Group, Inc. v. Black*, 954 A.2d 380, 389 (Del. Ch. 2008).

Palladium also claims that *Schoon v. Troy Corp.*, 948 A.2d 1157, 1169 (Del. Ch. 2008), supports its position, rather than Mr. Miller's. It does not. In *Schoon* the court first noted that the word "shall" "establishes a right to mandatory advancement" and then determined that certain limiting provisions in the bylaws did not apply. Here, unlike *Schoon*, Palladium offers no reading of the Bylaws that would equate "shall" with mandatory advancement, subject to specific limitations or conditions. Rather, Palladium's asserted limitation (discussed below) swallows any right to mandatory advancement, and thus, "shall" is meaningless.

B. PALLADIUM'S READING OF THE WORD "UNLESS" EVISERATES THE MANDATORY RIGHT TO ADVANCEMENT

Palladium argues that the "unless" in Section 5 creates an exception to the requirement that expenses "shall be paid...in advance...." (AB 9). Its theory is

that advancement is mandatory, unless the board decides it is not mandatory. As such, the board can ***always*** exercise its business judgment to deny advancement. Indeed, as Palladium admits, there are "[n]o language limits what the board may or may not consider in making this determination." (AB at 10). In contrast, a mandatory right to advancement deprives the board of the right to "evaluate the important credit aspects of a decision" to advance funds." *Advanced Min. Systems, Inc.*, 623 A.2d at 84.

Palladium then tries to support its argument by citing several examples in rules and statutes that use the "shall .....unless" construct and claims that Mr. Miller's interpretation would render all these rules and statutes meaningless. (AB at 10-11). Mr. Miller is not asserting that "unless" cannot create an exception after the mandatory "shall". Rather, the exception must be just that – an exception, not a complete evisceration of the mandatory right, as Palladium would have it.[3] The examples cited by Palladium enforce this point. (AB at 11).

- Section 102(b)(3) preserves rights as part of a statutory change relating to how those rights are created. Thus, that section provides that existing rights shall be enforceable without having to comply with new statutory requirements and will not be terminated unless specific steps are taken to do so. The "unless" clause in this provision does

[3] For example, bylaws can provide for mandatory advancement unless a director is a plaintiff in an action. *See e.g.*, *Baker v. Impact Holding, Inc.*, 2010 WL 2979050 (Del. Ch. July 30, 2010) (granting motion to dismiss and finding there was no advancement right for any type of affirmatively filed action).

not swallow the "shall" provision, but rather applies only to a specific subset of rights' holders.

- Section 110(g) provides that in an emergency, the officers "who are present shall, unless otherwise provided in emergency bylaws, be deemed" directors for the meeting. This default provision will apply unless there is a specific bylaw addressing the issues. Again, the "unless" clause provides a specific criteria of when the "shall" clause does not apply.

- Section 212(b) provides "no such proxy shall be voted or acted upon after 3 years from its date, unless the proxy provides for a longer period...." As such, there is a three year limit except if the proxy expressly states it is valid for a longer period of time. Thus, the "unless" clause provides a specific factual criteria that must be met.

- Section 217(a) provides that "[p]ersons whose stock is pledged shall be entitled to vote, unless ... such person has expressly empowered the pledgee to vote..." Again, the "unless" clause provides specific criteria for when the "shall" clause will not apply. [4]

In contrast to these examples, the Bylaws, according to Palladium, provide that a director has a right to advancement unless the board decides he does not have that right. There is no specific criterion for when the "shall" clause will not apply. Under Palladium's reading, any mandatory advancement granted by "shall" is

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[4] The rules cited by Palladium also provide for specific events or occurrences for the "unless" clause to apply. For example, Del. Sup. Ct. R. 9(b)(ii) "the clerk of the trial court shall transmit the record within 20 days after receipt of the duplicate of the notice of appeal from the Clerk of this Court unless the attorney for another party to the appeal shall timely designate additional transcription...." (specific event is opposing counsel designates additional transcription); Del. Sup. Ct. R. 26(d)(iii) providing in part, "the Superior Court shall make and report its findings of fact within 30 days of the remand, unless some other time is ordered by the Court." (specific event is Court entering an order).

taken by the "unless" clause; with no limitations on the board's exercise of its business judgment.[5]

Palladium also argues that Mr. Miller's interpretation of the Bylaws does not give meaning to the word "unless". However, like in *Stockman*, the word "unless" confirms that the board has the ability to determine that the individual seeking advancement is qualified to receive advancement, sometimes referred to as policing powers. *See* (OB at 21-23); *Stockman*, 2009 WL 2096213. Such a determination is not "ministerial" as Palladium suggests, but an important component of the board's duty with respect to advancement. For example, it is not uncommon for litigation to arise centered around questions of whether an individual is qualified to receive advancement and/or whether a particular proceeding is covered. *See e.g. Sun-Times Media Group, Inc.*, 954 A.2d 380; *Citadel Holding Corp. v. Roven*, 603 A.2d 818 (Del. Ch. 1992). The Palladium board can make such determinations. Additionally, the Palladium board is granted the authority pursuant to Sections 3 and 4 and the "unless" clause in Section 5 to, for example, ensure that the claims for which the director/officer is seeking advancement arose out of his official capacity and determine whether its

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[5] Palladium makes the argument that the board would not "by silence" place limits on how it could exercise its business judgment with respect to advancement. (AB 24). It is not, however, by silence that the policing powers are reserved for the board. When read as a whole, the Bylaws provide for such determinations. (OB at 23 discussing Bylaws Section 3 and Section 4).

obligations under the Bylaws are affected by rights granted pursuant to another agreement. (*See* OB at 22-23). Palladium argues that these powers would be surplusage because the board already has the obligation to determine that the individual is qualified to receive advancement, thus rending the "unless" clause meaningless. (AB 25-26). A reading of Section 5 alone shows that Palladium is wrong.

Section 5 provides that the right to advancement is conditioned upon the receipt of an undertaking by the director to repay such amount if it shall ultimately be determined that he is not entitled to indemnification. The requirement of an undertaking is compelled by 8 *Del. C.* § 145(e). Because this obligation already exists, under Palladium's theory, this provision would be surplusage. Of course, Palladium is not arguing that it is. The rights of the board and the reiteration of the requirement of an undertaking in Section 5 are important because the Bylaws are to be read in light of the reasonable expectation that the text creates for directors and officers relying on the Bylaws. *See Stockman*, 2009 WL 2096213, at *5 n.21. Thus, Section 5 provides the board of Palladium with the policing powers to ensure that the other conditions of mandatory advancement have been satisfied. In other words, an individual "shall" have the right to advancement "unless" the board, in exercising its policing powers, determines that the individual seeking the advancement is not qualified.

The Court of Chancery rejected Mr. Miller's argument in a conclusory fashion stating "there is no way to isolate the 'unless' provision from the advancement grant provision" and that Mr. Miller "has not conjured up a way to give meaning to the 'unless' phrase" (Op. at 10-11). The lower Court's ruling, however, ignores that reading the "unless" phrase as granting policing powers to the Palladium board is consistent with the reasonable expectation that an officer or director of Palladium would have when reading the Bylaws that provide that expenses "shall be paid by the corporation in advance."

Additionally, the structure of the provision in *Stockman* is not so different from the current Bylaws. The lower court focused on the fact that in *Stockman* there were two sentences rather than one sentence contained in Section 5. (Op. at 9-10). But, the *Stockman* court's analysis did not turn on these phrases being in two separate sentences and, in fact, seemed to analyze them as if they were in one sentence.[6] 2009 WL 2096213, at *6 (acknowledging "tension in the Advancement Provision between the requirement that litigation expenses '*shall* be advanced' and the requirement that '[n]o advances *shall* be made'...."). *Id.*

Palladium makes much of Mr. Miller's illustration that if the right to advancement was mandatory until the point in time the board decides to deny the

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[6] While Bylaws Section 1 is "subject to" Section 5, Palladium does not recognize that under any circumstances the "shall" is mandatory. *See infra* at pp. 11-12.

right, a claimant would be entitled to have his/her expenses advanced while the right was mandatory, (*i.e.*, until the board rejected it) and asserts Mr. Miller did not raise this argument below. (AB at 19). Mr. Miller's example, however, was merely the natural outgrowth of the Court of Chancery's ruling and is not a new or separate legal argument.

Palladium also claims the lower court's ruling that "'[t]he only reading of Palladium's advancement provision is that advancement shall be paid (i.e., up to this point, it is mandatory) unless Palladium's board specifically determines not to pay a specific advancement'" meant up to that point "in the analysis of the bylaw, not 'up to this point' in time." (AB at 20). Even if it was meant to be at that point in the analysis, it still suffers from the same fatal flaw. The exception swallows the grant and thus, under Palladium's theory, the right to advancement is never mandatory. This is because the board must decide not to deny advancement, with no limitations on what it can consider in making that determination.

Palladium also claims that Mr. Miller did raise the argument of the board's failure to act would result in an abdication of its duties. To the contrary, Mr. Miller argued at oral argument:

> The right to advancement is an advancement of credit.[7] So, under their view, if the director makes a request for

[7] Palladium cannot credibly contend that the Palladium board can wholly fail to authorize the advancement –the failure of which (under its theory) results in the advancement of credit for possibly millions of dollars – without it being a breach of duty. *See Havens v. Attar*, 1997 WL

> advancement and they say the board does nothing, are they proposing that the board breaches its fiduciary duties and doesn't meet, doesn't consider it and just by inaction doing nothing that, by default, then that right to advancement ripens into a right…?
>
> I doubt that that's what they're saying. What they're saying is that the board still has to meet and consider it and they have to thumbs up or thumbs down. It's still business judgment. So what does the "shall" mean? They can't explain it.

A69-70.

In response, Palladium now argues that under the Bylaws, the "board can consider an advancement request, deem it appropriate, and then affirmatively decide not to deny it, knowing this will result in advancement." (AB at 21). This, however, is no different than an affirmative decision to grant advancement, making the "shall" meaningless.

Palladium also cannot logically answer the question, why, if the directors/officers do not have a mandatory right to advancement, are such different paradigms used to grant the rights of directors/officers to advancement versus employees - whose rights to advancement are permissive as evidenced by use of the word "may". Palladium's response is simply that the officers have no right to advancement until the board acts to grant such a right. Again, this is no different

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695579, at *1 (Del. Ch. Nov. 5, 1997)(indicating a board must determine whether advancement promotes the corporation's interests). As Palladium admits, the board has an obligation to determine if advancement is in the corporation's interest. (AB at 13).

than the board deciding not to deny a director advancement rights. Thus, Palladium's attempt to distinguish the two paradigms fails. Indeed, in both circumstances, advancement is subject to the board's business judgment, with no limitations on what it can consider, and this is only permissive. Any interpretation that supports using different words, in the same contract, to create the same rights goes against the weight of Delaware law. (*See* OB at 18).

C. SECTION 1 BEING SUBJECT TO SECTIONS 2 AND 5 DOES NOT MAKE THE RIGHT TO ADVANCEMENT PERMISSIVE

Palladium argues that the "subject to" phrase in Bylaws Section 1 eliminates any inconsistency between Section 1 and Section 5. (AB at 15-16). Because Section 5 is "superior and more powerful" than Bylaws Section 1, Palladium contends Mr. Miller has no right to mandatory advancement under Section 1, relying on *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 56 A.3d 1072 (Del. Ch. 2012)("*Martin Marietta*") for this proposition. (AB at 16). In *Martin Marietta*, however, the court considered extrinsic evidence after trial to determine whether the definition in paragraph 4 narrowed the definition in paragraph 3 or whether paragraph 4 operated in isolation. In resolving the ambiguity it found to exist, the court ruled that the definition in paragraph 4 was not limited by paragraph 3. This ruling turned on the parties' drafting history and one party's (Martin Marietta) inclusion of the phrase "subject to paragraph (4)" in paragraph 3, which resulted in paragraph 4 being more powerful than paragraph 3, which was

contrary to Martin Marietta's intent when it inserted the phrase. 56 A.3 at 1123, 1128. *Martin Marietta* does not stand for the proposition that just because a paragraph is "subject to" another provision that the first provision is substantively limited by the second, as Palladium suggests. Rather, the "subject to" phrase must be read in the specific context of the agreement. When read in context here, the grant of the right to advancement is subject to the procedures or other policing powers, as provided in Section 2 and 5 of the Bylaws. Section 5 does not eliminate the rights granted in Section 1, as Palladium suggests.

D. LEGISLATIVE HISTORY SUPPORTS MR. MILLER'S READING OF THE PLAIN LANGUAGE OF THE BYLAWS NOT PALLADIUM'S INTERPRETATION

Palladium argues, oddly, that the legislative move away from authorizing advancement based upon an individual determination and forbidding mandatory advancement supports its argument that Mr. Miller is not entitled to advancement. (AB 12; *comparing* 8 *Del. C.* § 145(e)(1983) to 8 *Del. C.* 145(e)(2013). Palladium asserts that if it intended to grant mandatory advancement, it would not have included the language "in the specific case" as appears in Section 5. By inclusion of this phrase, Palladium continues, the board intended to make the right permissive because that was the language used by the legislature prior to the 1986 amendment to preclude mandatory advancement. As explained *supra* at pp. 6-7, Section 5 relates to the policing powers of the board. It is Section 1 that grants the

right to advancement. Palladium does not explain why Palladium included that the right to indemnification "***shall include the right*** to be paid ... in advance of its final disposition" if it intended to make the right only permissive.

The legislature's move toward a "general authorization" model also dovetails with the policy of encouraging qualified persons to become or remain as directors because it assures them "that they may resist lawsuits that they consider meritless, free of the burden of financing (at least initially) their own legal defense." *In re Central Banking Sys., Inc.*, 1993 WL 183692, at *3 (Del. Ch. May 11, 1993) (citation omitted); *see Homestore, Inc. v. Tafeen*, 888 A.2d 204, 218 (Del. 2005); *Havens v. Attar*, 1997 WL 55957, at *13 (Del. Ch. Jan. 30, 1997) (citation omitted). The legislative change also furthered Delaware's policy favoring broad construction of advancement rights. *See Sun-Times Media Group, Inc.*, 954 A.2d at 404 ("the Delaware policy gloss favoring advancement to corporate officials supports resolving [] ambiguity in favor of advancement"); *Brown*, 903 A.2d at 327-28 (citation omitted).

Palladium relies upon *Advanced Mining* in support of this argument. This reliance is entirely misplaced. (AB 13-14); *see Advanced Mining Sys.*, 623 A.2d 82. The bylaw in *Advanced Mining* did not contain a grant of the right to advancement, but only a right to indemnification. *See supra* at p. 2. There, without a specific grant of advancement and because the statute at the time the bylaw was

adopted containing the "in the specific case" language, the court ruled that it would not have been likely that a reasonable person would have assumed that the right to advancement was granted. Here, however, the right was granted.

II. IF THE COURT DETERMINES PALLADIUM'S BYLAWS ARE AMBIGUOUS, IT WAS AN ERROR TO DISMISS THE ACTION

Palladium's main argument – that *contra proferentum* does not apply to the its Bylaws – fails for two reasons: (A) the doctrine applies to corporate organizational documents that must be interpreted consistently; and (B) the doctrine can be applied in instances where a director served on the board at the time of the adoption of the organizational document.

A. THE DOCTRINE OF *CONTRA PROFERENTEM* APPLIES TO ORGANIZATIONAL CORPORATE DOCUMENTS

Palladium argues that "[h]istorically, the doctrine has only been applied to ... insurance policy or . . . documents governing the rights of investors." (AB at 28). Palladium's argument, however, ignores that Delaware courts, including this Court, have repeatedly applied the doctrine of *contra proferentem* to corporate organizational documents. *See, e.g., Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 398-399 (Del. 1996) (construing certificate of designation against corporation); *SI Management L.P. v. Wininger*, 707 A.2d 37, 43 (Del. 1998) (applying doctrine to limited partnership agreement); *Stockman*, 2009 WL 2096213, at *5 (applying the doctrine of *contra proferentum* to advancement provision in partnership agreement and granting summary judgment to former officers/directors because to the extent there is any ambiguity, that ambiguity must

be construed against the company in favor of the officers); *Greco v. Columbia/HCA Healthcare Corp.*, 1999 WL 1261446, at *13 (Del. Ch. Feb. 12, 1999) (construing certificate of incorporation against corporation and in favor of the advancement claimant); *see also, Norton v. K-Sea Transp. Partners L.P.*, 238, 2012, 2013 WL 2316550, at * 3 (Del. Supr. May 28, 2013)(indicating the Court would apply the doctrine of *contra proferentem* to a limited partnership agreement if it determined the contractual language was ambiguous). Moreover, Delaware courts have not hesitated to apply the doctrine of *contra proferentem* when advancement rights are at issue in other agreements. *See Brady v. i2 Technologies Inc.*, 2005 WL 3691286 (Del. Ch. Dec. 14, 2005)(applying doctrine of *contra proferentem* to indemnification agreement where right to advancement was disputed).

The need for the application of the doctrine of *contra proferentum* to organizational documents is apparent. "[I]t is critical that the governing instruments of entities be interpreted consistently and that they be applied in a predictable manner." *Stockman*, 2009 WL 2096213, at *5. As such, courts will construe governing instruments against an entity and in a manner that is consistent with the expectations of officers and directors. *Id.* at *5 n.21 (citing *Kaiser Aluminum Corp.*, 681 A.2d at 398-99).

B. *CONTRA PROFERENTEM* CAN BE APPLIED HERE DESPITE THE FACT THAT MR. MILLER WAS A BOARD MEMBER WHEN THE BYLAWS WERE ADOPTED

Citing not a single case in support of its argument, Palladium claims the doctrine of *contra proferentem* cannot be invoked by Mr. Miller who was an officer and on Palladium's board of directors when the Bylaws were adopted. (AB at 29). Nor does Palladium attempt to distinguish *Stockman* that squarely dealt with this very issue.

In *Stockman*, the court construed an advancement provision in a partnership agreement. The court held "to the extent there is any ambiguity in the Partnership Agreement regarding advancement, that ambiguity must be resolved against [the company]" and in favor of the reasonable expectations of the claimants. 2009 WL 2096213, at **1, 5. The *Stockman* court applied the doctrine of *contra proferentem* to all claimants even though one of them was likely involved in the drafting of the partnership agreement. This is because, like here, the operative document "must be read in all cases in light of the expectations that its text would create for a reasonable officer or director." *Id.* at *5 n.21. As such, applying the Bylaws to Mr. Miller in one way, and in another way to a different director based on subjective intent or involvement in drafting, would create the "bizarre outcome" against which *Stockman* warned. *Id.*

Like in *Stockman,* the Bylaws, and in particular, the advancement provisions, made promises to parties who did not negotiate them. Palladium's Bylaws granted advancement rights not only to then-directors (2002 when the Bylaws were adopted), but to all future Palladium directors as well.

Thus, Palladium's related argument that a factual inquiry must be made prior to the application of the doctrine of *contra proferentem* is legally unsupported. Again, the *Stockman* case addressed this issue. The *Stockman* court did not analyze extrinsic evidence, but determined it could rule on ambiguous contract language without it, stating,

> 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.

2009 WL 2096213, at *5. The *Stockman* court applied the doctrine of *contra proferentem* without any factual analysis (even though one of the directors may have been involved in the drafting of the organizational document) because doing so protects the reasonable expectation of those relying on the document, as opposed to a reading based on extrinsic evidence. *See e.g. Tenneco Automotive Inc. v. El Paso Corp.*, argues that 2004 WL 3217795, at *8 (Del. Ch. Aug. 26, 2004)("If the Court is able, by employing the doctrine of *contra proferentem*, to

determine the intent of the parties to the contract, resort to extrinsic evidence is unnecessary.")

The application of *contra proferentem* when construing the Bylaws results in the conclusion that the Bylaws provide for mandatory advancement. The plain language of the Bylaws – "shall include the right to be paid …in advance of its final disposition" and "Expenses…shall be paid…in advance of such proceeding's final disposition" - creates the expectation of a reasonable director or officer that he or she is entitled to mandatory advancement (A53-54).

CONCLUSION

For the reasons discussed above, the decision of the Court of Chancery should be reversed and the matter remanded.

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Dated: June 10, 2013

CERTIFICATE OF SERVICE

I certify that, on this **10th** day of **June, 2013**, a copy of **APPELLANT DAVID F. MILLER III'S REPLY BRIEF** was caused to be served in the manner indicated.

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