EFiled: Dec 19 2013 12:10PM EST
Filing ID 54733700
Case Number 545,2013

IN THE SUPREME COURT OF THE STATE OF DELAWARE

DEF and GHI, Non-Parties Below, Appellants, v. STATE OF DELAWARE *ex rel.* THE HONORABLE KAREN WELDIN STEWART, CIR-ML, Insurance Commissioner of the State of Delaware Petitioner-Below, Appellee, -and- XYZ, Respondent-Below, Appellee.	)	No. 545, 2013 On appeal from C.A. No. 8601-VCL in the Court of Chancery of the State of Delaware Public Version Filed Dec. 19, 2013

APPELLANTS' OPENING BRIEF

GREENHILL LAW GROUP, LLC

Theodore A. Kittila (DE Bar No. 3963)
1000 N. West Street, Suite 1200
Wilmington, DE 19801
Phone: (302) 414-0510
Fax: (302) 595-9346
Email: ted@greenhilllaw.com

Counsel for Non-Parties Below

Dated: November 25, 2013

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NATURE OF PROCEEDINGS

This case is DEF and GHI's[1] (together, "Appellants") appeal from: (i) a September 10, 2013, Order Amending Seizure and Injunction Order and to Show Cause (the "Amended Seizure Order") (attached hereto as Exhibit A) issued by the Court of Chancery of the State of Delaware (the "Trial Court"); (ii) a September 25, 2013, Order Imposing Sanctions and Directing Discovery (the "Sanctions Order") (attached hereto as Exhibit B) issued by the Trial Court; and (iii) an October 7, 2013, Order denying Appellants motion to modify or for relief from the Trial Court's Order imposing sanctions (the "Rehearing Denial") (attached hereto as Exhibit C).

DEF and GHI appealed the decision of the Trial Court on October 9, 2013. *See* Supr. Ct. Dkt. 1 and 2 (Notice of Appeal). On October 15, 2013, appellees XYZ and the Delaware Insurance Commissioner (the "Commissioner") filed motions to dismiss the appeal for failure to comply with Supreme Court Rule 42. *See id.* at 9 and 10. Following briefing on the motion to dismiss (*see id.* at 17, 18, and 19), this Court ruled that the appeal could proceed pursuant to the collateral order doctrine. *See id.* at 20.

This is DEF and GHI's Opening Brief in support of their appeal.

[1] The proceeding pending before the Trial Court was initially filed under seal, and this Court by way of an October 10, 2013, Order (Supr. Ct. Dkt. 5) permitted the parties to continue the use of pseudonyms in this appeal. In a November 1, 2013, Order (filed after this appeal), the Trial Court determined that the case can proceed without the sealing of filings. Appellants will continue the use of pseudonyms until the Court orders otherwise.

SUMMARY OF ARGUMENT

1. The Trial Court erred as a matter of law where it did not allow for an opportunity to present proper argument with respect to the amendment and modification of a May 30, 2013, Seizure Order and Injunction (the "Seizure Order") (A51) which broadened the Seizure Order to enjoin and restrain the appellant DEF from:

> discussing, disclosing, or communicated with or to Respondent's [XYZ's] employees or any persons or entities that [DEF] knows have business relationships with Respondent regarding (i) any matter or fact relating to the Seizure Order or other matters contained in filings under this docket or (ii) any matter relating to Respondent's business. Those entities having business relationships with Respondent shall include but are not limited to insurance brokers and agents that have placed their clients in Respondent's insurance policies, rating agencies, existing or prospective reinsurance counterparties and Respondent's policy holders.

Amended Seizure Order (Ex. A) at ¶ 2. The Amended Seizure Order has had a direct, significant, and adverse impact on the rights and property of DEF and GHI, and the Trial Court's granting of the Amended Seizure Order without an opportunity to be heard violated Appellants' constitutional rights to due process.

2. The Trial Court erred as a matter of law and fact when it ruled following a September 24, 2013, sanctions hearing that, as a consequence for behavior that it deemed contemptuous, among other things: (1) "[p]ending further order of this Court," DEF would not "directly or indirectly, exercise any control over [GHI]," an entity owned by DEF and not subject to the regulatory powers of

the Commissioner; and (2) DEF would pay all fees and costs related to discovery as to corporate separateness. *See* Sanctions Order (Ex. B). The Trial Court's decision was made *sua sponte* and without an adequate opportunity to present evidence regarding the corporate separateness of XYZ and GHI. The error was compounded when the Trial Court refused to consider additional evidence discovered after the prior hearing.

3. The Trial Court abused its discretion when it denied DEF's motion to amend the Sanctions Order less than one hour after its filing, without any opposition from opposing counsel and without a hearing, despite the fact that DEF presented evidence discovered after the hearing imposing sanctions. *See* Rehearing Denial (Ex. C).

STATEMENT OF FACTS

A. The Commissioner Obtains A Confidential, *Ex Parte* Seizure Order Prior To An Evidentiary Hearing.

DEF, through RB Entertainment Ventures, LLC (a Delaware limited liability company), is the 99 percent owner of XYZ, a Delaware domiciled captive insurance company operating as a risk retention group (A98). On May 30, 2013, following an *ex parte* petition filed by the Commissioner in which the Commissioner alleged concerns that XYZ was insolvent,[2] the Trial Court issued a Confidential Seizure and Injunction Order (the "Seizure Order") pursuant to 18 *Del. C.* §§ 5943 and 5944, granting the Commissioner broad authority to seize control of XYZ (A51). By stipulation of the Commissioner and XYZ, and order of the Trial Court, the Seizure Order dated August 9, 2013, was extended for at least an additional 90 days (A7).

Pursuant to the Seizure Order, on June 18, 2013, the Commissioner took immediate and exclusive possession and control of all the property of XYZ, including all of XYZ's assets, contracts, rights of action, books, records, bank accounts, certificates of deposit, collateral and rights to collateral, securities, and all real or personal property of any nature of XYZ (A54). The Commissioner was able to extend this degree of control after "domesticating" a much broader

[2] *See*, *e.g.*, A52 (stating that Commissioner had "uncovered several areas of high concern regarding [XYZ]'s financial ability"). To date, the Commissioner has not shown that XYZ is insolvent, and in fact, filed a petition for rehabilitation on November 6, 2013 (A41).

Maryland order in an *ex parte* proceeding (A329-30). The effect of the Seizure Order, as domesticated, was to give the Commissioner control of not only the assets of XYZ, but other personal property of, among others, DEF located within the XYZ office (the "Office") (A330).[3]

The purpose of the Seizure Order was to allow the Commissioner to examine XYZ. The Commissioner, however, has had exclusive possession and control for approximately **6 months** (A1-50).

B. The Commissioner Seeks to Push Out DEF.

Shortly after the Commissioner took control over the assets and the Office, the Commissioner began to push for DEF's removal from control. DEF raised his concerns that, without his direct involvement in the ongoing operations of XYZ, XYZ would be unable to operate in the ordinary course and the business that he started more than a decade ago would suffer irreparable harm as a result. DEF's concerns regarding the stability of daily operations, in part, prompted a telephonic hearing with the Trial Court on July 10, 2013 (A62). Ironically, counsel for the Commissioner acknowledged to the Trial Court that DEF was critical to XYZ "because we have a company that is really dominated by one person and, at least as far as the department has been able to determine so far, doesn't really exist apart from [DEF]" (A71 [10:5-8]).

[3] Included among this personal property is private documents of DEF, personal collectables of DEF, as well personal gifts that DEF purchased for his wife.

During the teleconference, Commissioner's counsel admitted that the seizure was not going as smoothly as planned. However, one of the excuses for the fumbling was that the Department of Insurance had little, if any, experience with handling an actual seizure:

> I will confess, first of all, that I am relatively new in this particular position, and there has been no seizure during my time, in Delaware or elsewhere, that I'm aware of, although it may have happened.
>
> I'm not -- in speaking with people who have been at the department a lot longer than I've been their counsel, this is apparently a very unusual proceeding. And there may be many reasons for that.

(A70 [9:12-20]).

At the same hearing, XYZ's counsel advised the Trial Court that XYZ was "contemplating having the Court consider the merits of an interim management team…" (A85 [24:15-16]). The Trial Court responded by stating, among other things, that the "idea of an interim management team" was "screwy" (A88 [27:22-24]). In the Trial Court's view, "the whole point of this type of receivership, the whole point of these type of standstill orders, is to freeze the company in the ordinary course of business pending the outcome of whatever is getting done" (A89 [28:1-4]). In short, "[c]hanging management is completely inconsistent with the status quo. The point of one of these orders is to maintain the status quo by freezing these people in the ordinary course of business" (*id.* [28:10-13]).

The Commissioner's counsel sought to reassure the Trial Court that "the

day-to-day procedures, including [DEF]'s decision on settling claims and on writing checks, you know, would go forward subject to somebody, in effect, looking over his shoulder. And that the Commissioner's intent was that the company operate in the ordinary course" (A91 [30:18-23]).

C. The Commissioner Files a Liquidation Petition.

On July 26, 2013, the Commissioner filed a Verified Petition for Liquidation and Injunction Order (the "Liquidation Petition") seeking to have the Trial Court liquidate XYZ and appoint the Commissioner as receiver (A2). The Liquidation Petition, filed approximately two months after the Commissioner took control of XYZ's operations and assets **did not** contain a single allegation that DEF had interfered with the Commissioner's efforts since those efforts began (A333).[4]

D. DEF, Though the Principal Owner of XYZ, Agrees To Resign from the Board and as an Officer of XYZ, But to Remain an Employee of the Company He Built.

In early August 2013, at the demand of XYZ's counsel, DEF agreed to relinquish his roles as an officer of the company and as a member of the Board of

[4] On or about August 21, 2013, XYZ filed its "Opposition Statement" to the Liquidation Petition (A10). XYZ's Opposition Statement was supported by the Expert Report of Key Coleman of Grant Thornton (the "Expert Report") (A365). While the Expert Report addressed and refuted many of the key issues raised by the Commissioner, particularly important was the fact that it noted the company had been and remained profitable. In particular, the Expert Report noted, "[i]n the years 2011 and 2012, the Company's [XYZ's] net income was $3.4 million and $2.9 million respectively. The Company has continued its profitability showing $1.8 million in net income for the first half of 2013" (A368). The Expert Report's findings appear to have been prescient: while not part of this appeal, but the subject of a later-filed, related appeal (Case No. 621, 2013), the Commissioner has now filed a petition seeking the rehabilitation of XYZ without any mention of insolvency.

Directors in order to deflect some of the Commissioner's attacks and potentially stave off liquidation (A334). DEF understood that in doing so, he would remain an employee (and remain subject to an existing Employment Agreement) and would be able to continue his input into the day-to-day operations of XYZ (A335). XYZ's Board met on August 2, 2013, and passed a resolution stating, among other things, that "it being understood that during the period in which [DEF] is relieved of his title as President and Chief Executive Officer **he shall remain employed without change to his compensation by the Corporation** and shall provide such services to the Corporation as may be requested by the officers of the Corporation or their designees" (A519 [emphasis added]).

During this same time period, counsel for GHI, a separate company operated by DEF that performs insurance-related services (A757-9), began reaching out to the Commissioner's counsel, to work out means to ensure the continuity of GHI's business operations: the primary issue, one that was well known to the Commissioner and XYZ, was and remains the fact that several different entities—entities that were not subject to the Commissioner's regulatory authority—were being operated as separate, stand-alone businesses from the Office (A335). Although some services for the separate businesses were rendered by XYZ employees, the majority of the services provided to these other businesses were provided by DEF himself (*id.*).

Logistically speaking, these separate businesses have information and operational data located on computer servers in the Office—servers that were owned not by XYZ, but by GHI (*id.*). Even the Office itself was leased not to XYZ, but instead leased exclusively to GHI. However, in early August following his resignation from the Board, DEF was abruptly informed by XYZ that he was being barred from the premises and no longer permitted to work at the Office (*id.*).[5]

E. DEF's Efforts to Run His Separate Businesses Are Obstructed.

Barring DEF from the Office created immediate problems both for XYZ and for the other separate businesses that operated independently of XYZ at the same location (A336). As a result of the decision to bar DEF from the Office, on August 21, 2013, GHI's counsel wrote to the Commissioner's counsel seeking clarification on who at the Office would perform important accounting functions on behalf of multiple entities operating from the Office (A528-30). Since DEF was no longer permitted to appear at the Office, these functions needed to be performed by someone, or the entities' operations would be jeopardized (*id.*).

The Commissioner's counsel responded on August 26, 2013 (A532-3). The Commissioner took the position that DEF would not be permitted to enter the

[5] On August 14, 2013, RB Entertainment Ventures, LLC ("RB Entertainment"), a Delaware limited liability company which was wholly-owned by DEF and which in turn owned 99% of XYZ filed a Motion to Intervene in the ongoing proceeding (A97). The Trial Court, following a hearing denied RB Entertainment's motion on August 22, 2013 (A12).

Office to manage other entities operating from the Office because DEF "has resigned all of his responsibilities with respect to the operations of [XYZ] and the Vice Chancellor has made it clear that [DEF] has no operational role and, thus, as far as the Vice Chancellor is concerned, has no right to be on the premises for any purpose, including operating the [DEF] entities" (A532). The Commissioner's counsel offered, however, that "[t]o the extent that there are specific records or materials in hard copy or electronic form that belong to the [DEF] Entities and that either DEF or Ms. Piotrowski require in order to operate the [DEF] Entities and perform any of the activities that you have identified, please identify those records and materials so that we can discuss how to make such records and materials available to DEF" (A533).

GHI responded to the Commissioner's August 26, 2013 letter the same day (A535-7). GHI offered a solution that included permitting DEF to appear at the Office once per week, for half of a day, so that the important business functions identified in prior correspondence could be properly performed (A537). These suggestions were not responded to by the Commissioner.

F. XYZ Terminates DEF's Employment.

Relations between XYZ and DEF soured after DEF stepped down from the Board, and despite the Board's commitment to the contrary, in late August/early September, DEF was purportedly terminated from his employment at XYZ

(A513).[6] On August 28, 2013, XYZ's IT employees informed DEF that they had been instructed to take whatever steps were necessary to prevent DEF from accessing what were actually GHI's servers (and indirectly owned by DEF) (A515 at ¶ 14). In a letter from GHI to XYZ dated August 28, 2013, GHI's counsel raised GHI's concern that DEF needed access to GHI's servers to run the various other businesses (A539). In the letter, counsel for GHI noted that he had just learned that the Commissioner's agents were seeking "administrator" status over the computer servers, which would allow the agents to destroy, alter or otherwise manipulate the data in the servers—servers that did not belong to XYZ but were instead owned by GHI (A54).

On August 29, 2013, XYZ responded to GHI's counsel's letter of August 28, 2013 and specifically the representations regarding GHI's ownership of the computer servers and related devices (A545). XYZ claimed that GHI had "transferred ownership and custody of such servers and information to XYZ as of April 1, 2012," but it provided no support for its statement (*id.*). XYZ also claimed that the servers were subject to the Seizure Order because the Trial Court granted the Commissioner "exclusive possession and control of . . . all right, title and interest in, of or to, all of the property of [XYZ] including, without limitation, all

[6] DEF had an employment agreement that was in effect for over two years at the time of his termination. The employment agreement included among other clauses, a penalty for the early termination of DEF. DEF moved to enforce his rights under Maryland law, yet the Trial Court sanctioned DEF for bringing suit in Maryland to protect his rights.

of [XYZ]'s … books and records" (*id.*). XYZ indicated that "[p]erhaps there is a way to grant [DEF] limited access to these servers only, or to otherwise provide him with an archived copy of the information contained on such servers (at his expense)" (A546). XYZ also relied upon a statement made by the Trial Court at a hearing held on August 22, 2013, wherein the Trial Court indicated that DEF would not be permitted to "take off his [XYZ] baseball cap and put on a different baseball cap so he can come in and do what he couldn't do in his [XYZ] capacity" (*id.*).

On August 29, 2013, GHI's counsel responded to XYZ's letter (A548-51). GHI's counsel provided a specific breakdown of when each server and related peripheral devices were purchased by GHI and how much GHI paid for such servers (A548). GHI's letter also pointed out that these assets have been listed on GHI's balance sheet and personal property returns since the date of purchase (*id.*).

G. XYZ Begins Its Campaign of Filing Motions for Sanctions.

On September 6, 2013, GHI's counsel sent an email to XYZ's counsel, asking if XYZ planned to respond to the specific facts set forth in GHI's counsel's letter of August 29, 2013 (A554). Rather than provide specific facts, XYZ's counsel indicated, "[w]e have not responded because we have not been asked by the client to do so and, frankly, because there is little to really add" (A553). In

fact, XYZ had never provided any of the requested documentation to support its claim that it somehow owned the computer servers.

GHI's counsel responded by indicating that absent such information, "I must conclude that [XYZ] does not have information that would either support [XYZ]'s prior statements or refute the facts set forth in my [August 29, 2013] letter" (A553). Counsel further indicated, "I am used to working out these issues between counsel without the need for court intervention, but [XYZ] apparently has no intention of working with us" (*id.*). Thereafter, XYZ began its campaign of filing expedited motions against DEF in the Trial Court.

1. The Motion to Amend and the Amended Seizure Order.

On September 9, 2013, XYZ responded with its Expedited Motion to Amend Confidential Seizure and Injunction Order (the "Motion to Amend") (A271). In this motion, XYZ wrote that "Respondent's new management team has acted with no objection from the Commissioner to operate the business, and thus has been managing and utilizing the Assets, to conduct day to day operations" (A273 at ¶ 4). XYZ then wrote that DEF had "gained access to Respondent's information technology system" (A274 at ¶ 6). The Motion to Amend also accused DEF of forwarding an email (although the email had the name of someone else at XYZ on the "From" field) to a rating agency regarding the seizure of XYZ by the Commissioner (A275-6 ¶ 12). Finally, the Motion to Amend said that DEF had

sent emails to the employees and brokers of the company venting his concerns about the future of the company after his termination. *See* A274-6 at ¶¶ 7, 9-12. In XYZ's view, "Clearly [DEF] is attempting to drive a wedge between [XYZ's] new management team and [XYZ]'s lower level employees, and he is interfering with [XYZ]'s authorized use of the Assets. [DEF]'s conduct is a clear violation of the Seizure Order and, moreover, an affront to the authority of the Commissioner which derives directly from the Seizure Order" (A275 at ¶ 10).

Counsel for DEF responded the next day, September 10, 2013, with a request to present an opposition within three days in light of the "serious allegations" contained in the Motion to Amend (A307). However, less than two hours later, the Trial Court entered the Amended Seizure Order, enjoining and restraining DEF from:

> discussing, disclosing, or communicated with or to Respondent's [XYZ's] employees or any persons or entities that [DEF] knows have business relationships with Respondent regarding (i) any matter or fact relating to the Seizure Order or other matters contained in filings under this docket or (ii) any matter relating to Respondent's business. Those entities having business relationships with Respondent shall include but are not limited to insurance brokers and agents that have placed their clients in Respondent's insurance policies, rating agencies, existing or prospective reinsurance counterparties and Respondent's policy holders.

Amended Seizure Order (Ex. A) at ¶ 2. The Trial Court further added that the restrictions set forth in this amended order "apply to and govern [DEF], his agents,

attorneys, and all those persons in active concert or participation with him who receive actual notice of this Order by personal service or otherwise." *Id.* at ¶ 3. Additionally, the Trial Court ordered DEF to show cause on or before September 24, 2013, "why by accessing Respondent's information and technology[7] systems he is not in contempt of paragraphs 7 and 9 of the Seizure Order." *Id.* at ¶ 5. [8]

On September 12, 2013, XYZ filed its Expedited Motion for Sanctions (A308), arguing that, DEF had violated the Amended Seizure Order on September 10, 2013, approximately one-hour after the Trial Court entered the Amended Seizure Order (A310-11). XYZ's counsel sought a monetary sanction of $30,000 (A312). The Trial Court, after receiving XYZ's latest expedited motion, ordered the parties to respond and set a show cause hearing date of September 24, 2013 (A326). [9]

[7] XYZ did not own the information and technology systems, and the Trial Court erred by not taking into consideration, the proper ownership of the information and technology systems.

[8] On September 19, 2013, in order to preserve its arguments, DEF and GHI filed a response to XYZ's Motion to Amend, even though the Trial Court had already issued the Amended Seizure Order (A327). XYZ, in a reply filed on September 20, 2013, stated that the Amended Seizure Order had already been granted and that the Amended Seizure Order "does not contain any provision permitting [DEF] or [GHI] to reopen the matter and argue the merits of the Amended [Seizure] Order" (A585 at ¶ 1).

[9] Before the hearing, on September 19, 2013, counsel for DEF filed an opposition to the motion for sanctions (A557). XYZ filed a reply shortly before the hearing (A584).

2. The Sept. 24 Hearing and the Sanctions Order.

At the September 24 hearing, the Trial Court heard XYZ's evidence that DEF had "interfered" with the company (A750-927).[10] In its briefing before the hearing, DEF presented evidence that, among other things: (1) XYZ did not own the servers that DEF was accused of accessing; rather these were owned by GHI (A343-4); (2) DEF did not send the email to the ratings agency disclosing the existence of the seizure order (A345-6);[11] (3) DEF did not listen into the meeting on any phone lines; instead, an employee had recorded the meeting and taken it to DEF (A559-60).[12]

After the hearing, however, the Trial Court ruled from the bench that DEF had violated ¶ 9 of the Seizure Order which the Trial Court noted "forbids people

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[10] The Trial Court appears to have been troubled by DEF not being at the hearing even though three of his lawyers were there:

> THE COURT: I was sort of expecting to see him here today. Why did he decide not to come to testify and rebut some of these issues that have been raised?
>
> MR. WILKS: Well, Your Honor, a couple reasons. One, we did submit his affidavit, which we think squarely addressed and rebutted all the accusations against him. More importantly, Your Honor, it's not his burden. It's the movant's burden to come forward with evidence that shows that they are entitled to the sanction that they seek.

(A752-3 [3:24-4:10]).

[11] In fact, given DEF's ownership interest in XYZ, DEF had no incentive to harm XYZ (A345); furthermore, XYZ admitted that it did not have any proof that DEF had sent the email and that its investigation was ongoing (A827 [78:16-22]).

[12] Additional evidence was discovered after this hearing that certain members of management at XYZ had actually attempted to have a vendor lie under oath that certain computer problems occurring at XYZ were being caused by DEF himself. Counsel attempted to present this evidence at a subsequent hearing following the filing of this appeal, but the Trial Court refused. This is the subject of the related appeal.

from 'interfering with the Commissioner and her authorized agents … in the discharge of their duties hereunder" (A915 [166:6-9]). With respect to DEF's explanations for his behavior, the Trial Court ruled: "[DEF] may be able to stand on some legal niceties, but I think that it would be clear to a 10-year-old that he has, in fact, been trying to interfere with the State and current management. So let me repeat. [DEF] will stand down" (A915-6 [166:22-167:2]). Despite the fact that it had not been part of XYZ's motion for sanctions, the Trial Court ruled *sua sponte* that the Seizure Order would be extended to include seizure of GHI:

> I recognize that in doing this, I am imposing relief on [DEF] and imposing relief on [GHI], a company, it has been represented, with nominally separate ownership. Nevertheless, the record to date indicates -- and were I required to make an actual finding on this based on the evidence to date, I would so find -- that [GHI] and [XYZ] are so interwoven and so mutually dependent, that it is impossible for the State to perform its receivership and supervisory functions if the State is solely limited to dealing with [XYZ].

(A919 [170:14-24]). The Sanctions Order was issued on September 25, 2013, which, among other things: (1) required DEF to deposit $100,000 with the Register in Chancery since the Trial Court, without much evidence, determined he was a person of means, and ruled that such amount would be forfeited if any future contempt occurred, and (2) ruled that "[p]ending further order of this Court," DEF would not "directly or indirectly, exercise any control over [GHI]," an entity DEF owned and not subject to the regulatory powers of the Commissioner. Ex. B.

3. The Motion to Modify the Order and the Denial.

On October 7, DEF and GHI moved pursuant to Chancery Rule 59(e) arguing that the Trial Court's decision had been issued on an inadequate record given the fact that they did not have an adequate opportunity to litigate the corporate separateness issues raised at the hearing, and that they were not put on notice that the injunction regarding GHI was being considered by the Trial Court (A934). Alternatively, DEF and GHI moved pursuant to Chancery Rule 60(b) arguing that manifest injustice would result if the injunction related to GHI were not lifted (A935). Examples were provided to the Trial Court of the harm that would occur (including collateral effects from a lack of corporate separateness in other litigation), and discovery was requested to be expedited to gather the requisite evidence (A932-3).

The Trial Court denied the motion less than one hour after its filing. *See* Ex. C. The Trial Court wrote in the Rehearing Denial, "Having reviewed it, the Court regards the motion as another unfortunate example of the improvident filings from [DEF] that have burdened this case to date."

This appeal was filed shortly thereafter.[13]

[13] Since the filing of this appeal, the Trial Court has issued additional sanctions, which have cascaded from the effect of the Seizure Order, the Amended Seizure Order, and the Sanctions Order. These later sanctions are the subject of a November 8, 2013, appeal to this Court, Case No. 621, 2013. Counsel is currently considering a possible motion for consolidation.

ARGUMENT

I. The Trial Court Erred as a Matter of Law When It Entered the Amended Seizure Order Without Any Proper or Meaningful Opportunity to Respond.

Question Presented

Whether the Trial Court erred as a matter of law and in violation of the protections of due process under the Federal Constitution and the Constitution of the State of Delaware, where it did not allow for a proper opportunity to present any argument before entry of an amendment to the Seizure Order which broadened the scope of the seizure so as to enjoin and restrain the appellant DEF from, among other things, "discussing, disclosing, or communicating" with any person having business relations with XYZ, among other things, "any matter relating to [XYZ's] business," Amended Seizure Order at ¶ 2. *See* A307.

Standard and Scope of Review

The standard and scope of review is *de novo* where the Court is asked to review an alleged constitutional violation. *See* Cooke v. State, 977 A.2d 803, 840, (Del. 2009) ("We review claims of violations of constitutional rights *de novo*."). Additionally, this Court decides mixed questions of law and fact *de novo*. *See* D.L. Wolfe and M.A. Pittenger, *Corporate and Commercial Practice in the Delaware Court of Chancery* § 14.10[c] (Matthew Bender 2013) (quoting *Hunter v. State*, 783 A.2d 558, 561 (Del. 2001) and *Miller v. State*, 4 A.3d 371, 373 (Del. 2010))

("[T]he Court has stated it will review mixed question of fact and law *de novo*, 'to the extent that we examine the trial judge's legal conclusions,' and for clear error, '[t]o the extent the trial judge's decision is based on factual findings.'").

Merits of the Argument

A. The Amendment of the Seizure Order and the Extension of the Seizure over GHI.

This appeal arises in the context of the granting of an *ex parte* Seizure Order by the Trial Court—a Seizure Order that has now been in place for approximately **6 months**. The sweeping effect of the Seizure Order was to permit the Commissioner to "immediately take exclusive possession and control of" and to vest the Commissioner with "all right, title and interest in, of or to, all of the property of [XYZ]" (A54 at ¶ 2). Additionally, the Seizure Order provided a broad injunction prohibiting any person from "interfering with the Commissioner and her authorized agents either in their possession and control of the Assets or in the discharge of their duties hereunder" (A58 at ¶ 9).

The broad grant of power to the Commissioner and her agents under the Seizure Order had a direct and significant impact on the property interests and rights of GHI—which at that time was serving as the managing general agent of XYZ (A758)—and DEF, who through RB Entertainment, owned 99 percent of the equity in XYZ. On September 9, 2013, XYZ filed its expedited Motion to Amend (A271), seeking a further broadening of the Seizure Order. A proposed order was

submitted with the Motion to Amend (A304). Counsel for DEF and GHI responded in less than 24 hours, writing: "We respectfully submit that a fair disposition of the motion requires that our clients have an opportunity to present an opposition. Should the Court afford us that opportunity, we are prepared to make our submission no later than Friday, September 13, 2013" (A307).

Despite this request, the Amended Seizure Order was entered by the Trial Court two hours later. The Amended Seizure Order significantly broadened the Seizure Order, specifically enjoining DEF from:

> discussing, disclosing, or communicating with or to Respondent's [XYZ's] employees or any persons or entities that [DEF] knows have business relationships with Respondent regarding (i) any matter or fact relating to the Seizure Order or other matters contained in filings under this docket or (ii) any matter relating to Respondent's business. Those entities having business relationships with Respondent shall include but are not limited to insurance brokers and agents that have placed their clients in Respondent's insurance policies, rating agencies, existing or prospective reinsurance counterparties and Respondent's policy holders.

Amended Seizure Order (Ex. A) at ¶ 2. It is the entry of this order, without a reasonable opportunity to be heard that DEF and GHI are challenging.

B. The Requirements of Due Process and the *Eldridge* Factors.

This Court held in *Formosa Plastics Corp. v. Wilson*, 504 A.2d 1083, 1089-1090 (Del. 1986):

> Before a party can be deprived of life, liberty, or property, it has the right to notice and a hearing in a meaningful time and a meaningful manner. *Fuentes v. Shevin*, 407 U.S. 67, 80, 92 S. Ct. 1983, 1994, 32

> L. Ed. 2d 556 (1972). The due process requirements of the Fifth and Fourteenth Amendments[14] of the United States Constitution dictate that result as do Art. I, sections 7-9 of the Delaware Constitution.

See also Slawik v. State, 480 A.2d 636, 645 (Del. 1984) ("A rudiment of procedural due process is the right to receive notice and to be heard 'at a meaningful time and in a meaningful manner,' *Armstrong v. Manzo*, 380 U.S. 545, 552, 14 L. Ed. 2d 62, 85 S. Ct. 1187 (1965), prior to the deprivation of a protected interest."); *In re Buckson*, 610 A.2d 203, 218 (Del. 1992) (citing *Slawik*).[15]

In weighing whether a challenged procedure satisfies the requirements of "procedural due process," this Court has looked to, among other precedent, the U.S. Supreme Court's decision in *Matthew v. Eldridge*, 424 U.S. 319 (1976), a case in which the U.S. Supreme Court outlined a three factor analysis whether a procedure satisfied the requirements of the Constitution's Due Process Clause. This Court (albeit in another context) has outlined the so-called "*Eldridge* factors" stating that the Court will examine the following:

> (1) the private interest that will be affected by the official action; (2) the risk that there will be an erroneous deprivation of the interest through the procedures used and the probable value of additional or

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[14] The Due Process Clause in Section 1 of the 14th Amendment to the Federal Constitution provides, "nor shall any State deprive any person of life, liberty, or property, without due process of law." Furthermore, "Delaware constitutional due process is coextensive with federal due process." *Sheehan v. Oblates of St. Francis de Sales*, 15 A.2d 1247, 1259 (Del. 2011).

[15] While *In re Buckson* involves challenges to certain expedited and *sua sponte* decisions issued by the Chancery Court, the Court's decision utilizing the *Eldridge* factors (*see*, discussion, *infra*) is entirely case specific. *C.f. Moore*, 62 A.3d at 1208 (noting "case-by-case" analysis of claim of due process violation).

> substitute procedural safeguards; and (3) the government interest involved, including the added fiscal and administrative burdens that addition or substitute procedure would require.

Moore v. Hall, 62 A.3d 1203, 1209 (Del. 2013). *See also Xcomp, Inc. v. Ropp*, 2002 Del. Ch. LEXIS 170, at *8-13 (Del. Ch. July 17, 2002) (applying *Eldridge* factors). Here, an application of the *Eldridge* factors leads to the conclusion that the Trial Court's amendment of the Seizure Order without an opportunity to be heard does not satisfy due process requirements.

C. Application of the *Eldridge* Factors.

With respect to the first prong, the amendment to the Seizure Order directly and significantly impacted DEF's rights: specifically, ¶ 2 of the Amended Seizure Order enjoined DEF from communicating with anyone having a business relationship with XYZ regarding "any matter or fact relating to the Seizure Order or any matter relating to XYZ's business." Even setting aside the 1st Amendment issues (which are substantial), the scope of this amendment had the effect of shuttering several of DEF and GHI's businesses: XYZ has business/contractual relationships with several of DEF's and GHI's various other business entities.

With respect to the second *Eldridge* factor, "the risk that there will be an erroneous deprivation of the interest through the procedures used and the probable value of additional or substitute procedural safeguards," *Moore*, 62 A.3d at 1209, the risk here is substantial. XYZ claimed that DEF violated the order by sending a

text message to a member of XYZ's board approximately 45 minutes after the Trial Court entered the Amended Seizure Order.[16] Following the filing of yet another XYZ expedited motion, this time seeking sanctions in the amount of $30,000 (*see* A310), DEF was ordered by the Trial Court to show cause in five days why the communication was not a violation of the Amended Seizure Order (A326).

The Amended Seizure Order was entered without a meaningful opportunity to respond and served as one of the bases for XYZ to threaten sanctions. The risk of error is not hypothetical. Here, the deprivation of DEF's right to communicate with persons with whom he had a business relationship not only risked substantially harming DEF, but actually harmed him.

Finally, with respect to the third *Eldridge* factor (*i.e.*, the cost-benefit of added safeguards), with minimal cost, the harm discussed in the preceding paragraph could have been avoided altogether. One of the great values to litigating in Delaware is the ability to have matters expedited and comprehensively addressed. However, where a party continues to file expedited motion after

[16] The text message followed a meeting that the board member, Michael Abram, Esq., had with the employees of the company where Mr. Abram, in an expletive-laced speech told XYZ employees that DEF "isn't here" and that he "ain't coming back" (A360). Mr. Abram told the employees that he knew some of them were talking to DEF and that he was not going to tell them who they "can and cannot talk to" (*id.*). Abram stated, "I know some of you may be talking to [DEF], and if you want to go grab a pen and paper and write down exactly what I say, so when he sues over [this] later, we'll have the words transcribed" (*id.*). Evidence showed that an employee at the meeting recorded Mr. Abram's speech (A565). DEF texted Mr. Abram after hearing the recording advising him that he would see Mr. Abram in court (A322).

expedited motion in a case that is not an expedited track, there is a significant risk of a due process violation.

Unfortunately, because the Amended Seizure Order was so quickly granted, there were no procedural "safety valves" built into the order to protect DEF's due process right. For example, the Amended Seizure Order could have resembled a Temporary Restraining Order—with a procedural safeguard of having a 10-day expiration date (*see* Chancery Rule 65(b)); or, similar to cases where no notice is provided prior to the granting of an order, there could have been a requirement for a "hearing at the earliest possible time." Neither of these procedural checks occurred. In fact, DEF and GHI, in order to preserve their arguments, filed a response to the Motion to Amend on September 19, 2013. XYZ wrote in a reply the following day that the Amended Seizure Order was "decided on September 10, 2013 and does <u>not</u> contain any provision permitting [DEF] or [GHI] to reopen the matter and argue the merits of the Amended [Seizure] Order" (A585).

Based on the foregoing, Appellants' maintain that the Trial Court erred.

II. The Trial Court Erred as a Matter of Law and Fact When It *Sua Sponte* Determined that It Would Extend the Seizure Order Over GHI.

Question Presented

Whether the Trial Court erred as a matter of law, including due process protections under the Federal Constitution and the Constitution of the State of Delaware, where it *sua sponte* determined that it would extend the seizure over GHI, a separate entity, following a September 24 hearing on a motion for sanctions. *See* A931.

Standard and Scope of Review

The standard and scope of review is *de novo* where this Court is asked to review an alleged constitutional violation. *See* Cooke, 977 A.2d at 840. Additionally, this Court decides mixed questions of law and fact *de novo*. *See* D.L. Wolfe and M.A. Pittenger, *Corporate and Commercial Practice in the Delaware Court of Chancery* § 14.10[c] (Matthew Bender 2013) (quoting *Hunter v. State*, 783 A.2d 558, 561 (Del. 2001) and *Miller v. State*, 4 A.3d 371, 373 (Del. 2010)) ("[T]he Court has stated it will review mixed question of fact and law *de novo*, 'to the extent that we examine the trial judge's legal conclusions,' and for clear error, '[t]o the extent the trial judge's decision is based on factual findings.'").

Merits of the Argument

The challenge to the Trial Court's decision to extend the Seizure Order over

GHI following the September 24 sanctions hearing likewise can be analyzed under *Eldridge*. As noted, the Trial Court's focus at the sanctions hearing was whether DEF had "interfered" with the Commissioner or her agents in the course of their duties. The September 10 Amended Seizure Order provided that DEF "should show cause on or before September 24, 2013, why by accessing [XYZ]'s information and technology systems he is not in contempt of paragraphs 7 and 9 of the Seizure Order." *See* Ex. A. The Trial Court then modified this show cause component on September 13, 2013, ordering an in-court hearing on September 24, 2013, on both the show cause component of the Amended Seizure Order and a September 12 expedited motion for sanctions (A325).

A. The *Sua Sponte* Raising of Corporate Separateness.

At the outset of the September 24 sanctions hearing, the Trial Court focused on the corporate separateness of the various DEF-related entities that operated in the Office and GHI's separateness from XYZ. Following questioning by the bench, counsel for DEF noted:

> MR. BROWN: And, really, [DEF]'s concern here is, setting aside the issues that we have discussed, is we know from the mail we've been receiving from [XYZ] and we know from the calls that we've been receiving from the concerned employees, that the work of these companies is not being done. So irrespective --
>
> THE COURT: "the work of these companies is not being done" because your client set up a funky division between the regulated entity and the entity that does all the work. And the funky division may well have had legal and business justifications that he felt were

> sound… But what we've now got is we've got a regulatory proceeding and we've got a regulatory proceeding at a stage where, at least so far, nobody is showing me real separation between these businesses.

(A774 [25:8-20; 26:2-6]). The Trial Court's raising of the issue of corporate separateness was done *sua sponte*. While DEF's pre-hearing submissions argued that XYZ's allegations that DEF was not permitted to access servers located in the Office were baseless because GHI, not XYZ, owned the servers (A343-4), the Trial Court determined that it would pierce the corporate veil, and extend the Seizure Order over GHI until GHI could prove that it was separate from XYZ:

> Finally, there's sufficient evidence of a close interrelationship between [GHI] and [XYZ] that at this point I believe it's necessary to preserve the status quo to extend the seizure order and to enjoin [DEF] from taking any action to interfere with the company through [GHI].
>
> [DEF] requested basically the opposite relief; namely, that he'd be allowed full access to [GHI] and all of its assets so long as the company, [XYZ], continued to have access to its information. I'm denying that request, and I am doing exactly the opposite.

(A919 [170:2-13]). Additionally, the Trial Court imposed sanctions on DEF based on a number of allegations of "interference" where DEF was operating his independent companies (and referred to DEF's arguments as "legal niceties" (A915 [166:22])). The Trial Court's Sanctions Order issued on September 25 made clear that control over GHI was being taken away by the Trial Court: "Pending further order of this Court, [DEF] shall not, directly or indirectly, exercise any control over [GHI]." Ex. B.

B. Application of the *Eldridge* Factors.

GHI is a company that is owned by DEF, not XYZ. Therefore, with respect to the first *Eldridge* factor, the Trial Court's decision—which took control out of GHI's hands and placed it in the control of the Commissioner—had a significant impact.

As to the second *Eldridge* factor, by turning the sanction hearing into a hearing on corporate separateness, the Trial Court proceeded on incomplete record. This is particularly risky where Delaware requires a heightened standard before piercing the corporate veil:

> [P]ersuading a Delaware court to pierce the corporate veil is a **difficult task**. **Absent compelling cause**, a court will not disregard the corporate form or otherwise disturb the legal attributes, such as limited liability, of a corporation. Although the legal test for doing so "cannot be reduced to a single formula that is neither over- nor under-inclusive," our courts have only been persuaded to "pierce the corporate veil" after substantial consideration of the shareholder-owner's disregard of the separate corporate fiction and the degree of injustice impressed on the litigants by recognition of the corporate entity.

Midland Interiors, Inc. v. Burleigh, 2006 Del. Ch. LEXIS 220, at *9-10 (Del. Ch. Dec. 19, 2006) (emphasis added). Because the Trial Court proceeded on an incomplete record, additional evidence could not be discovered and presented at the hearing.

At the sanctions hearing, the only evidence that counsel thought that would be presented was evidence directly related to the DEF's alleged interference.

However, for the first half of the hearing, the Trial Court questioned counsel from the bench about what the distinctions were between the various entities operating from the Office. Given the fact that counsel had no notice that the Trial Court was going to focus on a veil piercing argument, counsel did not have the requisite evidence to address each of the Trial Court's questions. For example, counsel was prepared to address the question of ownership of the servers that DEF was accused of accessing—*i.e.*, presenting the sworn affidavit of DEF on the topic (A568).

But where the questions turned to the number of overlapping employees, the business of each of the entities, who the employees of the various entities were, what the percentages of business between various third-party entities (*see, e.g.*, A753-73), the scope of the hearing changed dramatically. Even if counsel had had advance notice of the scope of the hearing and could have presented additional evidence, it would not have been a complete picture because the evidence presented would have been based solely what DEF and GHI had in advance of the hearing.[17] Undoubtedly, any hearing on whether to pierce the corporate veil would require the full scope of discovery.

[17] Throughout this case, one of the chief concerns of DEF has been its inability to gain access to various documents located in the Office. Without this access, DEF has been hamstrung in his efforts to gather and present evidence supporting his concerns. For example, during the sanctions hearing, XYZ representatives testified that DEF could "terminate the entire computer system." (A887 [138:22-23]). In fact, DEF learned after the hearing, that certain vendors had been asked to perjure themselves by testifying that certain computer problems experienced by the company were caused by DEF. This issue will be addressed in the related appeal, Case No. 621, 2013.

Opposing counsel may argue that the Trial Court actually ruled on the corporate separateness pending the outcome of discovery ordered by the Trial Court and that the Trial Court actually had a means in mind of ameliorating the risks posed to the deprivation of rights. However, the benefit of this procedural safeguard is outweighed by the harm that has already been done to GHI; for example DEF has been made aware that certain GHI bills have not been paid—bills which have a direct impact on DEF's credit worthiness. Additionally, various litigation matters have been left in limbo pending a determination of who could handle what aspect (A930). Finally, DEF has tremendous concerns that the harm that has been caused to XYZ during the Commissioner's and current management's stewardship will occur to GHI.[18]

Further, as the Sanctions Order makes clear, DEF is increasingly penalized by the Trial Court with respect to this issue by being forced to "bear the costs of this discovery, including the attorney's fees of Respondent [XYZ] and Petitioner [the Commissioner]." *See* Ex. B. In other words, DEF is punished by the very procedural safeguard that should be protecting his rights—to defend the companies' corporate separateness, DEF must fund the efforts of all counsel.

Turning to the third *Eldridge* factor, "the government interest involved,

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[18]Specifically, XYZ has had massive computer problems since the seizure, primarily stemming from the hiring of vendors that DEF has alleged were incompetent. The computer problems have been so severe, that on multiple occasions, employees have been sent home, and brokers have been unable to write policies.

including the added fiscal and administrative burdens that addition or substitute procedure would require," while the Trial Court stated that it was making its ruling to support the police powers of the State (A920 [171:1-4] ("I am not about to allow the legal fig leaf of [GHI] to prevent the State from exercising its police powers and supervisory and regulatory authority over a Delaware entity")), the Trial Court placed the value of the State's police powers over the value of allowing an adequate opportunity to gather and present evidence. Undoubtedly, the State has a significant interest in being able to exercise its police powers, but it must be balanced with a right to protect property interests.

Here, the Sanctions Order issued by the Trial Court on September 25 did not provide any time period for the extension of the seizure over GHI to end; rather, the seizure would be in place "[p]ending further order of this Court." Ex. B. The effect of this clause is gives no guidance when the seizure may be lifted. Given the fact that the Commissioner's seizure of XYZ has extended over 6 months, DEF has substantial concerns over the duration of the seizure of GHI. The Trial Court has already denied DEF's request to modify the Sanctions Order and to expedite the corporate separateness discovery—even in the light of newly discovered evidence. This fact further supports DEF's concerns that the extension of the seizure may continue much longer. *See* Ex. C.

Based on all of these factors, Appellants maintain that the Trial Court erred.

III. The Trial Court Abused Its Discretion When It Denied a Motion for Relief from the Sanctions Order Without a Hearing In the Face of New Evidence.

Question Presented

Whether the Trial Court erred when it denied a motion for relief from the Sanctions Order when the motion was denied without a hearing even though new evidence was presented. *See* A929.

Standard and Scope of Review

The standard and scope of review is abuse of discretion where the Court is asked to review a denial of a motion for rehearing or to reopen a judgment. *See Poe v. Poe*, 872 A.2d 960 (Del. 2005).

Merits of the Argument

Finally, DEF and GHI presented new evidence in a motion for modification or relief from the Sanctions Order (A929-37). The motion was filed pursuant to Chancery Rule 59(e), and alternatively, Chancery Rule 60(b). In the motion, DEF and GHI presented new evidence regarding the potential harmful impact of the Sanctions Order's provisions preventing DEF from "exercise[ing] any control over [GHI], either directly or indirectly" (Ex. B). The motion argued that the Sanctions Order had "severe and unintended consequences" especially in the light of XYZ's "recent activities" (A931). The evidence included the fact that XYZ employees, now charged by the Sanctions Order with exercising control over GHI, were

simply not fulfilling those obligations. Specifically, the motion stated that XYZ "cannot, by its own admission, operate [GHI] and has refrained from doing so to the great detriment of the entities at issue" (A930). Examples such as XYZ attorneys withdrawal from matters that were supposed to be handled by GHI, and XYZ's refusal to deposit funds were cited in the motion (*id.*).

However, less than one hour after the filing of the motion, the Trial Court denied the motion—without even a response from the other side. *See* Ex. C (Rehearing Denial). The Trial Court's denial of the motion, even if done without prejudice, denied DEF and GHI their opportunity to be fairly heard. Without this opportunity for a hearing, Appellants did not have an opportunity to present evidence of the harmful effects of the Sanctions Order.

Furthermore, given the fact that the Trial Court stated that the motion was simply "another unfortunate example of the improvident filings from [DEF] that have burdened this case to date," DEF maintains that the Trial Court abused its discretion. Ex. C.

CONCLUSION

For all the reasons stated herein, DEF and GHI respectfully request that this Honorable Court reverses the Amended Seizure Order, the Sanctions Order, and the Rehearing Denial, in accordance with the arguments outlined in this appeal.

Respectfully submitted,

Dated: November 25, 2013

GREENHILL LAW GROUP, LLC

/s/ Theodore A. Kittila

Theodore A. Kittila (DE Bar No. 3963)
1000 N. West Street, Suite 1200
Wilmington, DE 19801
Phone: (302) 414-0510
Fax: (302) 595-9346
Email: ted@greenhilllaw.com

Counsel for DEF and GHI