EFiled: Jun 02 2014 11:28AM EDT
Filing ID 55526054
Case Number 164,2014

IN THE SUPREME COURT OF THE STATE OF DELAWARE

AVON ROAD PARTNERS, LP, a Delaware limited partnership, ROBERT BERMAN and DENNIS VACCO, Defendants-below/Appellants, v. CASTLEPOINT INSURANCE COMPANY, a New York insurance company, TOW SUR, LLC, a Connecticut limited liability company, REL-REM HOLDINGS, INC., a Delaware corporation, TROMBONE, LLC, a Connecticut limited liability company, JOEL ASEN and JAMES ROBERTS, Plaintiffs-below/Appellees and CINIUM FINANCIAL SERVICES CORPORATION, a Delaware corporation, Nominal Defendant-below.	No. 164, 2014 On appeal from the Court of Chancery in C.A. No. 9021-VCG

APPELLANTS' CORRECTED OPENING BRIEF ON APPEAL

Of counsel:
Joseph Bernstein
Bernstein & Bernstein
1045 Fifth Avenue
New York, NY 10028
(917) 365-3651

Dated: June 2, 2014 (corrected version)

David L. Finger (DE Bar ID #2556)
Finger & Slanina, LLC
One Commerce Center
1201 N. Orange St., 7th floor
Wilmington, DE 19801-1186
(302) 573-2525
Attorney for Appellants Avon Road Partners, LP, Robert Berman and Dennis Vacco

TABLE OF CONTENTS

Exhibits

A - Transcript ruling below dated March 3, 2014

B - Final Order below, dated March 10, 2014

C - unreported decision, *Hoban v. Dardanella*, 1984 WL 8221 (Del. Ch. June 12, 1984)

D - unreported transcript decision, *Kalisman v. Friedman*, 2013 WL 6456232 (Del. Ch. May 14, 2013)

TABLE OF AUTHORITIES

Cases

Other Authorities

NATURE AND STAGE OF THE PROCEEDINGS

On October 21, 2013, Appellees filed suit in the Court of Chancery challenging a written consent executed by Robert Berman as sole General Partner of appellant Avon Road Partners, L.P. ("Avon Road"), dated October 16, 2013 (the "Written Consent"), that, *inter alia*, removed four of six directors from the board of nominal defendant-below Cinium Financial Services Corporation ("Cinium"). The two directors who were not removed by the Written Consent are appellants Robert Berman and Dennis Vacco.

Appellees contended below that the Written Consent violated a Securityholders' Agreement ("SHA") entered into by Cinium and CastlePoint Insurance Company ("CastlePoint") in June 2012. Appellants contended that pursuant to New York Insurance Law §1506(a), the New York Department of Financial Services (the "DFS") had to approve the acquisition of any approval rights or veto powers of CastlePoint and its designated director under the SHA that met the definition of the acquisition of "control" over Cinium under New York Insurance Law Sec. 1501(a)(2).

Subsequent to the filing of the complaint, on November 8, 2013, the Court of Chancery entered a stipulated Status Quo Order that reinstated the composition of the board of directors of Cinium. The parties agreed to a discovery schedule and a

hearing without live testimony. On February 26, 2014 (D.I. 82), the Court conducted a hearing and issued an oral transcript ruling from the bench in favor of appellees on March 3, 2014. (D.I. 87). On March 10, 2014, the Court entered a Final Order voiding the Written Consent. (D.I. 86). Appellants filed a Notice of Appeal on April 7, 2014. This is their opening brief on appeal.

SUMMARY OF ARGUMENT

1. The Court of Chancery erred in failing to determine whether the SHA effected a change of control under Section 1506 of the New York Insurance Law. Without FORM A approval, the SHA was not enforceable to defeat the Written consent and removal of the four Cinium directors and substitution of General Counsel by Avon Road as of October 16, 2013, and any subsequent determination by the DFS in March 2014, had it otherwise been valid, should not have been given retroactive effect by the Court in order to invalidate the Written Consent. The public policy of New York, as set forth by statute, mandated that FORM A approval be obtained by both CastlePoint and James Roberts in order for the Written Consent to be invalidated by the Court. Given a violation of that public policy, the SHA was invalid at the time the consent was filed, and any subsequent approval of a change in control did not act retroactively to validate the SHA at the time of the consent.

STATEMENT OF FACTS

A. THE PARTIES.

Cinium and UHNIC provide surety-related services in connection with construction contracts, including performance bonds, under agreements with customers based on the financial backing and rating of Tower and its affiliates. Cinium and UHNIC and their subsidiaries have several agreements relating to Cinium's and UHNIC's surety businesses with Tower affiliates that were entered into in February 2012 (A-269-271), as follows: a Program Underwriting Agreement (A-277-303), and a Reinsurance Agreement (the "Reinsurance Agreement)." (A-304-322).

B. THE 2012 NOTE PURCHASE TRANSACTION AND SHA.

On May 15, 2012, Cinium and CastlePoint entered into the NPA (A-235-268). Under the NPA, CastlePoint agreed to lend Cinium $7,000,000 in the form of a Convertible Note. There were three "Ancillary Agreements" annexed as exhibits to the NPA that the NPA provided were to be executed after receipt by the parties of approval of the NPA transaction by the DFS. Two of the Ancillary Agreements were the Employment Agreements of Robert Berman as CEO of Cinium and Jeffrey Camp as CFO. The third Ancillary Agreement, which is at issue in this action, is the SHA.

(A-321-403) The SHA was to be signed by all holders of Cinium's voting stock following approval of the transaction by DFS.

The purpose of the SHA was to provide CastlePoint, as the "Investor" under the NPA, the right to designate one director – the "Investor Director," out of a total of six directors mandated by the SHA. (A-332). At closing, CastlePoint designated James Roberts, who is the Sr. Vice President of all Tower affiliates having agreements with Cinium or UHNIC as the Investor Director. Mr. Roberts became a director and fiduciary of Cinium while at the same time remaining a senior officer of Cinium's contract partners at Tower who represented Tower's interests with respect to the Convertible Note, NPA, SHA, PUA, and Reinsurance Agreement. The SHA granted supermajority voting rights to Mr. Roberts as the Investor Director, enabling him to block all significant actions sought to be approved, even by 100% of the shareholders of Cinium or all five of the other directors of Cinium. This veto power gave Mr. Roberts the equivalent of six negative votes in relation to the five other directors with a single vote each, and voting power equivalent to over 50% of the shares of Cinium with respect to a negative vote on material shareholder matters. Mr. Roberts could by his Supermajority Vote at any time override a majority of the votes of the shareholders or board members of Cinium, thereby granting him control over the majority, and hence complete "control" over Cinium.

Actions that require approval of the Investor Director are defined in the SHA as "Supermajority Actions" (A-400-402). Control over Supermajority Actions by the Investor Director are accomplished in the SHA by granting the Investor Director a "Supermajority Vote," defined in the SHA as "a vote by a majority of the Directors in attendance at a duly convened meeting of the Board which vote includes the vote of the Investor Director." *i.e,* the director designated by CastlePoint. (A-331). The SHA has the following control provisions:

1. Under Sec. 2(a)(i), the number of directors of Cinium is fixed at six and can be changed only with the approval of Mr. Roberts (A-332);

2. Under Sec. 2(a)(iii), Mr. Roberts must approve the composition of the board of directors of all Cinium subsidiaries, including UHNIC (A-332);

3. Under Sec. 2(a)(iv), Mr. Roberts must approve the appointment of members of the audit, compensation, governance or other committees of Cinium or UHNIC (A-333);

4. Under Sec. 2(d)(i), without the approval of Mr. Roberts, no shareholder action or board action listed as a Supermajority Action on Schedule A of the SHA can be undertaken (A-333-34);

5. Under Sec. 2(d)(ii), without the approval of Mr. Roberts, no Supermajority Action can be undertaken by Cinium or any subsidiary (A-334); and

6. Under Sec. 2(a)(v), Mr. Roberts cannot be removed as a director, even for cause, without the approval of CastlePoint. (A-333).

Without Mr. Robert's approval, none of the following Supermajority Actions could be undertaken, not by all of the shareholders and not by all five of the other directors of Cinium:

> 1. Amendment of the certificate of incorporation or by-laws of the Company (or any modification, supplement or waiver with respect thereto);
>
> 2. Removal of Directors other than by the party that designated the Director to be removed;
>
> 3. Declaration or payment of any dividend, provided that the following distributions or dividends may be declared by the normal act of the Board of Directors without a Supermajority Vote, [except under defined circumstances];
>
> 4. Issuance or sale of any of the Company's securities, or purchase or redemption by the Company of any securities of the Company, or any change, increase or reduction in the share capital or reserves of the Company or transfer of any securities of the Company except as provided in the Agreement;
>
> 5. Reorganization, reclassification, reconstruction, consolidation or subdivision of the capital of the Company or creation of any different class of securities in the capital of the Company;

6. Assumption or incurrence of any material indebtedness, lien, charge, mortgage, pledge, guarantee or other encumbrance on any asset of the Company, provided that the Company or any of its Subsidiaries may assume or incur indebtedness, lien, charge, mortgage, pledge, guarantee or other encumbrance on an asset of the Company or Subsidiary for purposes of facilitating the working capital program to

customers upon the normal act of the Board of Directors without need for a Supermajority Vote as long as such indebtedness never exceeds five percent of the penal sum placed by the Company at any time.

7. Commencement of any voluntary liquidation, winding up or dissolution of the Company or filing of any petition in bankruptcy;

8. Commencement of an initial public offering;

9. The sale of any Subsidiary, division or line of business of the Company or of all or substantially all of the assets of the Company or such Subsidiary or division, whether by merger, sale of shares, asset transfer, block reinsurance or otherwise;

10. Approval, adoption or modification in any material respect of, or any material departure from, any annual budget, operating budget or business plan of the Company;

11. Appointment or removal (with or without cause) of any senior executive or senior officer of the Company; or

12. Any commitment or agreement to do any of the foregoing.

(A-400-01).

C. THE PARTIES AGREED IN THE NOTE PURCHASE AGREEMENT TO OBTAIN DFS APPROVAL PRIOR TO CLOSING.

In the SHA, the parties agreed to seek approval of the contemplated transaction from the appropriate regulatory bodies (*i.e.*, DFS): "the parties shall cooperate, consult with each other and use their reasonable best efforts to (i) promptly prepare, and file, all applications relating to...obtain[ing] as promptly as practicable, Governmental Authorities' and other third parties' consents needed in connection

with this Agreement and the transactions contemplated hereby." (A-363). The NPA further contemplated that the SHA would be executed at closing, with the closing scheduled to occur on "the fifth Business Day immediately following the first day on which all of the conditions set forth in Sections 8 and 9 are satisfied or waived...." (A-236). One of those conditions was found in Sections 8(h) and 9(d) (which are identical)) that provided for securing all government approvals required as a condition to each party's obligation to close the transaction:

> Other Governmental Approvals. All filings required to be made prior to the Closing Date with, and all consents, approvals, permits and authorizations required to be obtained prior thereto from, Governmental Authorities in connection with the consummation of the transactions contemplated by the Ancillary Agreements by the Investor and the Company shall have been made or obtained, in each case, without the imposition of any Burdensome Condition, and no such filing, consent, approval, permit or authorization shall have been withdrawn or revoked as of the Closing Date.

(A-251).

The NPA further provides in Sec. 6:

> a. The Company and the Investor shall each use their commercially reasonable efforts, and shall cooperate fully with each other to (i) comply as promptly as practicable with all requirements of Governmental Authorities applicable to the transactions contemplated by this Agreement and (ii) to seek to obtain as promptly as practicable all Governmental Approvals necessary or advisable in connection with the transactions contemplated by this Agreement. . . b. Without limiting the generality of the foregoing, as soon as reasonably practicable, but

> not later than 45 days, after the date hereof, the parties shall take all commercially reasonable efforts to make all filings, notifications and requests for approval (including all required exhibits related thereto) with applicable Insurance Regulators related to the transactions contemplated by this Agreement....

(A-248-49).

In accordance with the parties' agreement to seek "Governmental Approvals," Sec. 2(b)(iv) of the NPA provided that "[At the Closing,] each party shall deliver to the other copies (or other evidence) of all valid Governmental Approvals obtained, filed or made by such party or its respective Affiliates in satisfaction of Section 6…" (A-238).

D. CASTLEPOINT'S IN-HOUSE REGULATORY COUNSEL MISLED THE DEPARTMENT OF FINANCIAL SERVICES AND CINIUM THAT THERE WAS NO REQUIREMENT TO OBTAIN REGULATORY APPROVAL.

Prior to closing, concern was raised by Cinium's General Counsel as to whether, due to the presence of the Supermajority Vote in the NPA, the overall transaction would require regulatory approval. (A-22, 93-97). In mid-May 2013, after the NPA was executed, the parties began to focus on seeking approval from DFS. (A-122-123). Elliot Orol, General Counsel for the Tower Group of companies instructed that Adam B. Perri, Vice-President and Insurance Regulatory Counsel of the Tower Group Companies, lead the regulatory approval process. (A-92-99,131, 134-135, 159-160). Tower asked Cinium not to contact DFS, saying that it would handle the regulatory issues itself. (A-272-273).

Mr. Perri made a telephone call to Joanne Brazenor, a supervising examiner with DFS, to discuss the transaction with her and to obtain her opinion as to whether regulatory approval was required. However, all he told Ms. Brazenor was that CastlePoint would be receiving a debt instrument convertible into common stock in the future, along with the right to appoint a director to the board and represented to her that CastlePoint would have "no voting rights." According to Mr. Perri, Ms.

Brazenor responded "thanks for telling me, sounds good, thanks for letting us know." (A-143-146).

Mr. Perri did not advise Ms. Brazenor of the existence of the SHA nor provide Ms. Brazenor a copy of either the NPA or the SHA to her. He did not tell Ms. Brazenor about the existence of the Supermajority Vote in the SHA. (A-145-149). In his deposition, Mr. Perri explained that he "did not think they affected the analysis of whether or not [CastlePoint] had control." (A-176-177). Ms. Brazenor was not given an opportunity to confirm or reject his opinion as Mr. Perri misrepresented to Ms. Brazenor that CastlePoint would not get any voting rights whatsoever in the transaction.

On May 24, 2012, Mr. Perri sent an email stating, "I spoke to Joanne Brazenor, our supervising examiner at the NYID this afternoon. I explained our investment and why it is not a change in control event, and she agreed. So no acquisition of control filing should be required now." (A-92-104). Mr. Crowe, corporate counsel for Cinium, testified that he interpreted Mr. Perri's email to mean that he "had described the parameters of the transaction, the many facts and details of the transaction, to the examiner and she had presumably, I don't know, had said if that is the case, Tower does not need to file FORM A now." (A-34).

Cinium relied on Mr. Perri's representation in deciding to go forward with the transaction. (A-26-27, 30, 32, 33). The transaction closed on June 14, 2012, and the SHA was executed on that date. CastlePoint thereafter designated James E. Roberts as its "Investor Director" without DFS' approval.

E. THE SIDES BECOME ADVERSE.

In August 2013, Tower issued a press release announcing that it was postponing the release of its financial results for the second quarter of 2013 and that that it would have to record a loss of $60-$110 million. Prior to this announcement, Mr. Berman heard rumors about adverse changes in Tower's financial condition. This was bad news, as Cinium had entered into the transaction with CastlePoint based on Tower's FSR, as indicated by Tower's public financial statements. A downgrade of Tower's FSR would prove devastating to Cinium's business. Concerned about the impact of these new revelations on Cinium, Mr. Berman attempted to convene a meeting of the Cinium board of directors. His requests for a meeting went unanswered. (A-38-39). In fact, Mr. Berman could not convene a simple Board meeting without the approval of Mr. Roberts, as Mr. Roberts' presence was required for a quorum. (A-33). Mr. Berman was further frustrated in his effort to get the board members to discuss Tower's problems as three of the four other directors – Messrs.

Asen, Camp and Michigami, aligned themselves with Tower and followed Mr. Roberts lead.

Unable to hold a meeting, and concerned that CastlePoint's board designee would thwart any effort to address the issue out of loyalty to Tower, Mr. Berman delivered a written consent on behalf of Avon Road, majority stockholder of Cinium, on August 12, 2013, removing Messrs. Asen, Camp and Michigami from the board of directors (leaving in place Mr. Roberts, Mr. Vacco and himself) and elected three new directors to the board. Plaintiffs below filed an action pursuant to 8 Del. C. §225. In the early phase of that litigation, Mr. Berman concluded that, notwithstanding the initial concern about Tower's finances, the litigation would do more harm than good in advancing Cinium's financial situation. Accordingly, Avon Road executed a "Revocation" of the Consent and the parties agreed to dismiss the action without prejudice. (Compl., D.I. 1 Ex. F, at 102). Avon Road's counsel wrote to plaintiffs' counsel on August 29, 2013: "As your clients are aware, the Company is facing serious financial circumstances. The current litigation will not further, and may hinder, the Company's ability to overcome those circumstances. We hope that with this Revocation, the Company can move past the present conflict, and that all parties will act reasonably and focus their efforts on cooperatively advancing the Company's

business goals. We accordingly request that your clients voluntarily dismiss the litigation at this time." (*Id.* Ex E, at 99).

The news about Tower's financial condition continued to worsen. On October 7, 2013, Tower announced that it needed to strengthen loss reserves by $365 million in order to make up for covered losses. Tower's financial rating was downgraded. (A-7). With this new revelation, and the risk that Tower's rating would be downgraded (which occurred), making it difficult for Cinium to write policies. At this point, Mr. Berman saw the business of Cinium of UHNIC as falling off a cliff and decided that he had to take control of Cinium as soon as possible. On October 9, 2013, he requested a determination from DFS regarding the validity of the SHA. (A-121).

On October 16, 2013, Mr. Berman, again on behalf of Avon Road, delivered his second written consent, removing all of the members of the current board of directors other than Dennis Vacco and himself. He added Mr. Roberts this time as he was advised by counsel that, pursuant to an Opinion of the General Counsel (A-275), Mr. Roberts could not have been lawfully appointed as a director of Cinium without a FORM A approved by the DFS.

ARGUMENT

I. THE COURT OF CHANCERY ERRED IN FAILING TO DETERMINE WHETHER THE SHA TRANSFERRED TO CASTLEPOINT INSURANCE COMPANY A CONTROLLING INTEREST IN CINIUM FINANCIAL SERVICES CORPORATION IN VIOLATION OF NEW YORK INSURANCE LAW SECTION 1506.

A. QUESTION PRESENTED.

The question presented is whether the Court of Chancery erred in not determining whether appellants' obtaining control of Cinium through the SHA violated New York public policy, as set forth in the New York Insurance Code, which requires a regulated entity such as Cinium to obtain approval of DFS before entering into any agreement which transfers "control" to a third party, without obtaining such approval. This issue was raised in Appellants' opening brief. (D.I. 64 at 20-31).

B. SCOPE OF REVIEW.

Whether a contract violates public policy and is therefore illegal is a question of law subject to *de novo* review. *Law Capital, Inc v. Kettering*, 836 N.W.2d 642, 645 (S.D. 2013); *Country Preferred Ins. Co. v. Whitehead*, 979 N.E.2d 35, 42 (Ill. 2012).

C. MERITS OF THE ARGUMENT.

1. The Court of ChanceryFailed to Rule On The Principal Issue Before the Court: Did The SHA Violate The Acquisition of Control Provisions Under New York Insurance Law Section 1506?

a. Appellants Conceded At Trial That The SHA Was Facially Valid.

Although Appellants took the position in their Answer that the SHA was void as a matter of law, they subsequently conceded at the February 26th hearing that the SHA was facially valid under Delaware law. Appellants, rather, were asking the Court to rule that the SHA was not enforceable under New York law for lack of FORM A approval so that CastlePoint and Mr. Roberts would not be able to exercise control over Cinium prior to obtaining FORM A approval. The only question the Court needed to address was whether the SHA, valid on its face under both Delaware and New York law, transferred incidents of control to CastlePoint and Mr. Roberts and was unenforceable under New York statutory law prior to approval of CastlePoint's and James Roberts' FORM A, which never occurred.

On January 22, 2014, CastlePoint withdrew its FORM A submission at the request of the DFS. Tower subsequently disclosed in a delayed 10-K Annual Report filing with the SEC that its losses in 2013 exceeded $900 million and that, in addition to numerous shareholder securities fraud class action lawsuits pending against Tower,

on January 9, 2014, the SEC informed Tower that it was inquiring about Tower. http://www.sec.gov/Archives/edgar/data/1289592/000119312514180255/d692054d10k.htm. The Court may take judicial notice of SEC filings. *See In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 170 (Del. 2006).

The SEC made the information request of Tower just before the DFS requested CastlePoint to withdraw the FORM A. Clearly, At that point, with heavy losses, class action lawsuits, and an SEC inquiry, Tower could not successfully get through the FORM A process. Notwithstanding the FORM A withdrawal, however, the DFS and CastlePoint's lobbyists conjured a plan under which the DFS would be able to assist CastlePoint to influence the decision of the court below, as described in the Article 78 Petition. (A-461-486). This Court may take judicial notice of the court filing in that action in New York. *See Hamilton Partners, L.P. v. Englard*, 11 A.3d 1180, 1187 (Del. Ch. 2010).

b. The SHA Was Not Enforceable Without Prior Approval of FORM A By The New York Department of Financial Services Prior To The October 16, 2013 Date Of Issuance Of The Written Consent.

CastlePoint's failure to obtain DFS' approval of the SHA violated N.Y. Ins. Law § 1506: "Acquisition or retention of control of insurers," which provides:

> (a) No person, other than an authorized insurer, shall acquire control of any domestic insurer, whether by purchase of its securities or otherwise,

> unless: (1) it gives twenty days written notice to the insurer, or such shorter period of notice as the superintendent permits, of its intention to acquire control, provided that the notice shall include an agreement by the person seeking to acquire control that the person will provide the annual report specified in section one thousand five hundred three of this article for so long as control exists; and (2) it receives the superintendent's prior approval.

N.Y. Ins. Law § 109(a) further provides: "Every violation of any provision of this chapter shall, unless the same constitutes a felony, be a misdemeanor."

There are two types of "control" provisions under the N.Y. holding company statute. The first is found in Sec. 1501(a)(2), which provides a definition of "control." The second is found in subsection (b), which relates to a "controlling influence" that rises to the level of being deemed control. The Supermajority Vote and other control provisions in the SHA provided CastlePoint with "control" within the meaning of N.Y. Ins. Law § 1501(a)(2) and gave CastlePoint's Investor Director a "controlling influence" over Cinium and UHNIC under N.Y. Ins. Law § 1501(b).

Sec. 1501(a)(2) provides:

> "Control", including the terms "controlling", "controlled by" and "under common control with", means the possession direct or indirect of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract (except a commercial contract for goods or non-management services) or otherwise…"

The second type of control provision, Sec. 1501(b), may deem a person to be in control if that person has a "controlling influence" over management and policies of the insurer, i.e., a person with a "controlling influence…[may] be deemed to control the insurer." Sec. 1501(b) provides:

> Notwithstanding the provisions of paragraph two of subsection (a) of this section, the superintendent may determine, after notice and opportunity to be heard, that a person exercises directly or indirectly either alone or pursuant to an agreement with one or more other persons such a controlling influence over the management or policies of an authorized insurer as to make it necessary or appropriate in the public interest or for the protection of the insurer's policyholders or shareholders that the person be deemed to control the insurer."

The relationship between Cinium/UHNIC with Tower, its subsidiaries and Mr. Roberts – the PUA, Reinsurance Agreement, Convertible Note and SHA – is analogous to the facts in the 2005 New York Office of the General Counsel Opinion ("OGC"), where OGC ruled that review of an agreement was required by DFS where a consulting agreement provided that the president of the consulting firm would also be president of the insurer. OGC opined: "It is unclear from the limited facts provided whether the president involved would, among other things, own voting securities or have other influence so that a determination can be made as to whether there is control or not. For these reasons, the agreement in question should be submitted to the Department for review and approval so that the Department can make such a

determination." (A-458-60). Mr. Roberts' multiple roles as Investor Director required that he should have obtained FORM A approval. The failure to do so constituted a misdemeanor under the New York Insurance Law as CastlePoint acquired "control" and Mr. Roberts became a "controlling influence" over Cinium/UHNIC without DFS approval.

The statute does not distinguish between affirmative or negative control. Interpreting a similar Nebraska statute, the 8th Circuit ruled that "control" of a domestic insurer does not require active voting rights. *National American Ins. Co. v. CenTra, Inc.*, 151 F.3d 780, 787 (8th Cir. 1998). Rather, the statute refers to the "power to direct or cause the direction of the management and policies...." As such, the issue is the ability to exert control over management and policies, not whether control is achieved through stock ownership or whether control actually is or will be exercised. *See Johnston v. Pederson*, 28 A.2d 1079, 1091 (Del. Ch. 2011) (recognizing transaction granting certain stockholders veto power over any action submitted to stockholder vote as "control"); *Bentas v. Haseotes*, 769 A.2d 70, 78 (Del. Ch. 2000) (single director's power to prevent a quorum by not attending board meetings amounts to "negative control"); *Hoban v. Dardanella*, 1984 WL 8221 at *2 (Del. Ch. June 12, 1984) (refusal of director to give required consent to action is "negative control").

Under the SHA, Mr. Roberts can thwart the will of the other five board members and 100% of the stockholders. As both Mr. Perri and Mr. Crowe testified, if all other board members wanted to, for example, make a material modification to the budget, and all of the stockholders also wanted that change, Mr. Roberts can stop it. (A-59, 181-182). Moreover, the SHA provided that a board meeting could not be convened without the presence of the Investor Director. "A quorum of the Board will consist of a majority of Directors then in office, at least one of whom shall be an Investor Director…If a quorum is not present within 30 minutes of the time specified for a meeting of the Board, the meeting will be adjourned to a date and time seven Business Days after the original time of the meeting and at the same place as the original meeting by written notice to all Directors." (A-333). *Bentas*, 769 A.2d at 78 (single director's power to prevent a quorum by not attending board meetings amounts to "negative control"). In a transcript ruling, the Court of Chancery has recognized that under Delaware corporate law control can include contractual arrangements granting blocking power:

> In fact, the equity ownership isn't something that contributes to the control. The control comes from the contract rights…. It's actually more problematic, then, for someone to have control without the underlying equity stake than it is for somebody to have control with the underlying equity stake. But to repeat, the underlying equity stake isn't what provides the control. It's the rights that come with it, which are things like the right to defeat transactions proposed by the board, the right to

> appoint or elect directors, et cetera. Again, I don't think there's any point in making a fetish out of the stock ownership.

Kalisman v. Friedman, 2013 WL 6456232, tr. at 5-6 (Del. Ch. May 14, 2013) (italics added).

Absent the SHA, Avon Road, as owner of 60% of the stock of Cinium, would control the election of the directors of Cinium and, consequently, UHNIC. By restricting the rights of the majority stockholder in this manner and obtaining effective veto power, CastlePoint has taken control from Avon Road, and now has the "power to direct or cause the direction of the management and policies of" Cinium.

c. The Failure to Fulfill the Mandatory Statutory Prerequisite Renders the SHA Control Provisions Unenforceable.

It is undisputed that, at the time Avon Road delivered the Written Consent, no FORM A for CastlePoint or James Roberts had been approved by DFS. As such, the Supermajority and other control provisions are unenforceable. In *Beeber v. Walton*, 32 A. 777 (Del. Super. 1887), a state statute provided that "no insurance company or corporation shall be engaged in, prosecute, or transact any insurance business within the limits of this state without having first obtained authority therefor agreeable to the provisions of this act." The statute further provided that every violation of that statute constituted a misdemeanor punishable by fine and imprisonment. *Id*. at 778. The

Superior Court determined that insurance policies had been written in violation of that statute. Id. at 778-79. The Court in *Beeber* indicated that the insurance contract was void, even though there was no indication that the statute stated as such, and even though the statute provided other express remedies. 32 A. at 779 (citing *Cook v. Pierce*, 7 Del. (2 Houst.) 399 (Del. Super. 1862)).

New York's highest court has stated that:

> *Galbreath-Ruffin* (supra, at 363-364, 280 N.Y.S.2d 126, 227 N.E.2d 30, quoting *Silinsky v. Lustig*, 118 Misc. 298, 299, 192 N.Y.S. 837) established one of the key controlling principles in this area: " '[W]here the procuring of a license is merely for the purpose of raising revenue it would seem that acts performed without securing a license would be valid. But where the statute looks beyond the question of revenue and has for its purpose the protection of public health or morals or the prevention of fraud, a non-compliance with its terms would affect the legality of the business'."

Benjamin v. Koeppel, 650 N.E.2d 829, 830-31 (N.Y. App. 1995). Consequently, contracts made in violation of regulatory laws designed to protect the public are not enforceable. Section 1506 is expressly designed to grant the New York Insurance Superintendent the authority to deny approval of any such control devices if necessary "to protect the interests of the people of [New York]," taking into consideration the financial condition and trustworthiness of the party obtaining control, as well as the effect of the transaction on competition. N.Y. Ins. Law 1506(b).

It is no answer to say that DFS subsequently required certain amendments to the SHA which did not include striking the provision restricting removal of directors by written consent. At the time the consent was delivered, there was no DFS approval sought or obtained, and so Appellants had violated their statutory obligations, thereby offending New York public policy. "A bargain that is illegal when formed does not become legal (a) by reason of a change of fact, except where both parties when the bargain was made neither knew nor had reason to know the facts making it illegal, or (b) by reason of a change of law, except where the Legislature manifests an intention to validate the bargain." *Restatement of Contracts* §609 at 1128 (1932) (quoted in *Springer v. Kuhns*, 571 N.W.2d 323, 329 (Neb. App. 1997); *Licznerski v. U.S.*, 180 F.2d 862, 865 (3rd Cir. 1950)). Appellees, having failed to perform their obligations under the law, had no right to receive the benefits of the bargain.

CONCLUSION

The facts and the law establish that the SHA gave CastlePoint "control" and a "controlling influence" over Cinium by allowing its designated director to prevent a quorum of the board from meeting, in addition to express, extensive veto rights over removal of directors, corporate governance, management and policies. The New York Insurance Law requires that any person with any such rights first obtain regulatory approval, which CastlePoint and Mr. Roberts were obligated to obtain. At the time the Written Consent was delivered, CastlePoint and James Roberts had not received FORM A approval, and so the SHA did not prevent Avon Road from validly acting under the Written Consent to remove four members of Cinium's board of directors. As a result of the decision below, and despite Avon Road's majority voting rights, Avon Road has been removed from the ability to control Cinium, and the four directors Avon Road attempted to remove by the Written Consent remain in complete control as CastlePoint has refused to allow Avon Road to remove them. Clearly, this manifests that there has been a transfer of control to CastlePoint without FORM A approval, in violation of New York Insurance Law and public policy.

WHEREFORE, for the foregoing reasons, Appellants respectfully request that this Court reverse the decision of the Court of Chancery.

Respectfully submitted,

/s/ David L. Finger

David L. Finger (DE Bar ID #2556)
Finger & Slanina, LLC
One Commerce Center
1201 N. Orange St., 7th floor
Wilmington, DE 19801-1186
(302) 573-2525
Attorney for Appellants Avon Road Partners, LP, Robert Berman and Dennis Vacco

Of counsel:

Joseph Bernstein
Bernstein & Bernstein
1045 Fifth Avenue
New York, NY 10028
(917) 365-3651

Dated: June 2, 2014 (corrected version)