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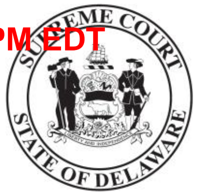

IN THE SUPREME COURT OF THE STATE OF DELAWARE

AVON ROAD PARTNERS, LP, a Delaware limited partnership, ROBERT BERMAN and DENNIS VACCO, Defendants-Below, Appellants, v. CASTLE POINT 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

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NATURE AND STAGE OF THE PROCEEDINGS

On October 16, 2013, defendant Robert Berman, as sole General Partner of defendant Avon Road Partners, LP ("Avon Road"), executed a written consent (the "October Written Consent") in an effort to change the composition of the board of directors of nominal defendant Cinium Financial Services Corporation, a Delaware corporation ("Cinium"). The October Witten Consent purported to: (1) remove Cinium directors James Roberts, Joel Asen, Jeffrey Camp and Michael Michigami from Cinium's Board; (2) remove John Crowe as Cinium's Secretary and General Counsel; (3) elect Dennis Vacco as Secretary and General Counsel of Cinium; and (4) remove Williams, Williams, Rattner & Plunkett, P.C. as General Counsel of Cinium.

In response, Plaintiffs CastlePoint Insurance Company ("CastlePoint"), Tow Sur, LLC ("Tow Sur"), REL-REM Holdings, Inc. ("REL-REM"), Trombone, LLC ("Trombone"), Joel Asen, and James Roberts instituted this action pursuant to Section 225 of the Delaware General Corporation Law (the "DGCL"). Plaintiffs' Section 225 action sought to invalidate the October Written Consent on the grounds that it violated the express language of the June 14, 2012 Securityholders' Agreement among defendants Avon Road, Berman, and Cinium and Plaintiffs CastlePoint, Tow Sur, REL-REM, Trombone, and Asen, and certain non-parties (the "Securityholders' Agreement"). The Securityholders' Agreement

prohibits the removal of directors of Cinium except by a majority of the directors of the Cinium Board, including the Investor Director, in attendance at a duly convened meeting of the Cinium Board (a "Supermajority Vote"). Pursuant to the Securityholders' Agreement the "Investor Director" includes CastlePoint's designee on the Board, which is currently Plaintiff Roberts.

In violation of the Securityholders' Agreement, Berman and the other Defendants never convened a meeting of the Cinium Board. In further violation of the Securityholders' Agreement, no Supermajority Vote of the Cinium Board approved the actions purportedly taken through the October Written Consent.

The October Written Consent represented Berman's second improper attempt within three months to gain control of the Cinium Board by removing directors by written consent in violation of the Securityholders' Agreement. Berman's August 12, 2013 written consent (the "August Written Consent") purported to replace four members of Cinium's Board. However, shortly after Plaintiffs sued in the Court of Chancery pursuant to Section 225 to invalidate the August Written Consent, Defendants revoked the August Written Consent, admitted that it was void and without effect, and confirmed that the composition of the Cinium Board remained unchanged.

Berman's October Written Consent, like his August Written Consent, was in plain violation of the Securityholders' Agreement, and Defendants do not

contend otherwise. Defendants instead argued below that the Securityholders' Agreement violated Section 1506 of the New York Insurance Law when Berman and Cinium entered into it in June 2012. According to Defendants, the Securityholders' Agreement, gave CastlePoint "control" over Upper Hudson National Insurance Company ("UHNIC"), a New York "domestic insurer," when CastlePoint invested $7 million in Cinium, UHNIC's parent company, without the prior approval of the Superintendent of the New York State Department of Financial Services ("DFS"). Despite his claim of invalidity, Berman did not offer to repay the $7 million that Cinium had used for the intervening years.

The parties agreed to present the case to the Court of Chancery for a final decision on the merits through written submissions and without live testimony. (B-58). Counsel for the parties presented their arguments before the Court at a hearing on February 26, 2014.

On March 3, 2014, the Court issued a bench opinion decision ("Opinion" or "Op."; Ex. A to Appellants' Op. Br), and later entered final judgment in favor of Plaintiffs that the October Written Consent was invalid and without effect. The Court's Order dated March 10, 2014 stated that, on October 16, 2013, and through and including the date of the order and judgment: (1) the Cinium Board consisted of, and continued to consist of, James Roberts, Joel Asen, Jeffrey Camp, Michael Michigami, Robert Berman and Dennis Vacco; (2)

Cinium's Secretary and General Counsel was John Crowe; and (3) Williams, Williams Rattner & Plunkett, P.C. was General Counsel of Cinium. (("Order") (Ex. B to Appellants' Op. Br)).

SUMMARY OF ARGUMENT

1. Denied. The Court of Chancery correctly concluded that "the Securityholders' Agreement is enforceable as a matter of Delaware law[,]" and that "Avon [Road]'s written consent purporting to remove Directors Roberts, Asen, Camp and Michigami, as well as certain officers of Cinium, is therefor[e] invalid." (Op. at 15). Defendants have not, and cannot, meet their burden of establishing that the Securityholders' Agreement is void or invalid under Delaware law -- the substantive law that, by express agreement of the parties to it, governs the Securityholders' Agreement. It is undisputed that the Securityholders' Agreement is facially valid under Delaware law and that the October Written Consent therefore violates the express terms of the Securityholders' Agreement. (Appellants' Br. at 17).

On appeal, Defendants set forth a convoluted argument that there has been a "transfer of control from Cinium to CastlePoint without Form A approval, in violation of New York Insurance Law and public policy" (Appellants' Br. at 26), and that the Court of Chancery supposedly failed to evaluate this argument. But the Court evaluated the argument thoroughly and rejected it. The Court determined that Defendants had failed to meet their burden because "it is far from 'clear and certain' that a violation [of New York law] has occurred" (Op. at 11). and that any "potential violation of New York public policy would not in this

instance clearly outweigh th[e] [c]ourt's interest in enforcing an otherwise facially valid contract[.]" (*Id).*. On the contrary, the Court of Chancery noted that the New York Department of Financial Services – the regulatory agency charged with enforcing the Insurance Law – had "determined that performance of the Securityholders Agreement . . . does not violate New York public policy such that this Court should find the agreement unenforceable." (Op. at 9). As a result, the Court's decision should be affirmed.

STATEMENT OF FACTS

A. The Parties.

Plaintiff CastlePoint is a New York insurance company that is wholly owned by Tower Group International Ltd. ("Tower").

Plaintiffs Tow Sur and Trombone are both Connecticut limited liability companies. Each company is a Cinium shareholder and a party to the Securityholders' Agreement. (A-321-403). Plaintiff REL-REM, a Delaware corporation, is also a Cinium shareholder and a party to the Securityholders' Agreement. (A-321-403).

Plaintiff Joel Asen was first elected to the Cinium Board pursuant to Section 5.1 of the Stock Purchase Agreement dated February 7, 2011 entered into by Cinium and Tow Sur ("Stock Purchase Agreement"). (A-444-457). Pursuant to Section 5.2 of the Stock Purchase Agreement, Asen was also elected to serve as the Chairman of the Audit Committee of Cinium's Board. Asen has maintained his positions as a director and Chairman of the Audit Committee since his initial election.

Plaintiff James Roberts is a Senior Vice President of Corporate Underwriting for Tower. Roberts was appointed as a director of the Cinium Board during Cinium's June 20, 2012 Board meeting.

Nominal defendant Cinium is a Delaware corporation and a privately-held company whose subsidiary companies provide specialty insurance, financing and working capital to small business clients.

Defendant Avon Road is a New York limited partnership and beneficially owns an aggregate of 2,048,488 shares of Cinium's voting common stock.

Defendant Robert Berman served as Cinium's CEO, the President, and the Chairman of the Cinium Board and is also Avon Road's General Partner.

Defendant Dennis Vacco is a long-time associate of Berman. Defendant Vacco is a partner at the firm of Lippes Mathias Wexler Friedman LLP ("Lippes") in Buffalo, New York. Lippes, more specifically Vacco, serves as Berman's counsel for personal and business affairs. Vacco serves as a member of the Cinium Board.

B. The Securityholders' Agreement.

Plaintiff Castle Point invested $7 million in Cinium in 2012 pursuant to a Note Purchase Agreement dated May 15, 2012 (the "NPA"). (A-235-268). As part of that transaction, the Securityholders' Agreement (A-321-403) served to "specify the terms of [the parties'] agreement as to certain matters governing their relationship as holders of [Cinium's] securities." (A-323). Among its many provisions, the Securityholders' Agreement gives Tower the right to designate one

of the directors of the Cinium Board. (A-332). James Roberts was appointed as Tower's designee to the Cinium Board. (A-272).

The NPA identifies as Ancillary Agreements the employee agreements between Cinium and each of Robert Berman, CEO, and Jeffrey Camp, CFO, as well as the Securityholders' Agreement, which was to be entered into at the closing of the note purchase transaction. (A-258-259).

Prior to entering into the agreements, the parties contemplated the sale of one of Cinium subsidiaries, UHNIC, directly to Tower, but they chose not to use this approach. (A-10, 109). As a result, CastlePoint did not acquire any voting securities of UHNIC, a domestic insurer, or of Cinium, the parent of UHNIC, but instead acquired Convertible Senior Notes due 2026 (the "Senior Notes") issued by Cinium in exchange for a $7 million investment. (A-235-268). The Senior Notes are convertible to 1,931,103 shares of Cinium voting common stock. (A-417). They have never been converted.

C. The Parties Did Not Agree to Obtain DFS Approval in the Note Purchase Agreement Prior to Closing.

The NPA did not require CastlePoint to obtain DFS approval before investing in Cinium. Instead, it mandated DFS approval only in the case that such approval was deemed to be required. Under the NPA, Cinium and CastlePoint agreed in Section 6(a) to "use their commercially reasonable efforts…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 and obtain as practicable all Governmental Approvals *necessary or advisable* in connection with the transactions contemplated by this Agreement." (A-248-249) (emphasis added). Under the NPA, the parties agreed to the condition that "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…shall have been made or obtained…" (A-250, 251) (emphasis added).

Likewise, the Securityholders' Agreement did not include any additional obligations other than that the parties seek whatever approvals were "needed" from the regulatory bodies. The Securityholders' Agreement did not, however, indicate that any approvals were in fact required. (A-363). Section 14 of the Securityholders Agreement provides that "[t]he parties shall cooperate, consult with each other and use their reasonable best efforts to…(iii) obtain as promptly as practicable, Governmental Authorities' and other third parties' consents needed in connection with this Agreement and the transactions contemplated hereby."

To the extent that approval from Governmental Authorities was required under the NPA, such approval would include compliance with Article 15 of the New York Insurance Law, which sets forth rules for New York insurance

companies and their holding companies. Section 1506, which relates to the acquisition or retention of control of insurers, requires prior approval of the Superintendent of DFS only in instances where a person or entity acquires control of any domestic insurer. *See* § 1506(a) ("No person, other than an authorized insurer, shall acquire control of any domestic insurer, whether by purchase of its securities or otherwise, unless…it receives the superintendent's prior approval."). The filing made in accordance with Section 1506 for an "acquisition of control" is commonly referred to as a "Form A Filing."

Neither the Securityholders' Agreement nor the NPA reference any Form A Filing or suggest that one was required. (*See* A-235-268, A-321-403). Neither CastlePoint nor Cinium itself was of the view that a Form A filing was required when the transaction was entered into by the parties. Indeed, Cinium's corporate counsel, Williams, Williams, Rattner & Plunkett, P.C. ("WWRP"), issued an opinion regarding CastlePoint's investment in Cinium. (A-114-120). That opinion states that, aside from filings specifically provided for in the transaction documents, "no filings with any government or regulatory authority or agency are necessary for the execution, delivery, or performance by [Cinium] of the Transaction Documents." (A-116). Moreover, the completion of a Form A filing before execution of the transaction document was not specifically referenced

in any of the transaction documents or in the opinion of Cinium's counsel. (A-116-117).

D. CastlePoint's In-House Regulatory Counsel Did Not Mislead DFS and Cinium Regarding the Requirement to Obtain Regulatory Approval.

Tower's Vice President and Insurance Regulatory Counsel, Adam Perri, reviewed the transaction documents, conferred with other Tower executives and regulatory in-house counsel and analyzed Article 15 of the New York Insurance Law governing the regulation of holding company systems. (A-136-137, A-142). Based on this analysis as well as his experience, Perri concluded that a Form A filing was not necessary because: (1) the transaction did not trigger the presumption of control; (2) CastlePoint did not have the right to direct Cinium's affairs; and (3) DFS has customarily taken the view that unconverted shares do not indicate control. (A-141-142).

After the NPA was executed, the parties also confirmed their understanding that DFS approval was not required. (A-122-123). Jason Wolfe, an advisor to Cinium, contacted Adam Perri, with a request to call DFS. (A-98-99, A-131, A-133). Perri called DFS Supervising Examiner Joanne Brazenor to provide information regarding CastlePoint's investment in Cinium. (A-144-145). He explained the investment was being made in exchange for a convertible note and that CastlePoint obtained a seat on the board of the holding company, but that there

were no voting rights associated with the investment. (A-144). Brazenor agreed with Perri that the transaction was not a change in control event and that a Form A filing was not necessary. (*See* A-103). Perri emailed Wolfe on May 24, 2012 and informed him of DFS's opinion. (A-103). Wolfe forwarded Perri's email to Berman, and Berman responded: "Good News!" (A-103).

Perri did not mislead Brazenor regarding terms the Securityholders' Agreement on their call. The supermajority provisions are protective measures that allow CastlePoint to protect its investment. They do not provide CastlePoint with the power to direct the management and operations of the company and, thus, do not affect the analysis of control under Section 1506 of the New York Insurance Law. (A-176-178).

Both Tower and CastlePoint include the Cinium investment on their annual reports to DFS. DFS has posed questions regarding other of their investments, but has never made any further inquiries with regards to the Cinium investment. (A-195). Perri is in frequent contact with Brazenor in the ordinary course of business (A-144, A-194), and DFS has demonstrated to Tower that it will make inquiries where it finds that they are necessary (A-195 ("Q. If the DFS has questions about anything disclosed in the filings that Tower or CastlePoint makes, do they raise those questions with you? A. Yes, very often.")). Additionally, Perri neither imposed any restrictions on the ability of Cinium or its advisor to

communicate directly with DFS nor did he prevent Cinium from obtaining its own opinion regarding the necessity of a Form A filing. (A-74, A-193). Cinium never expressed that it did not have the capacity or opportunity to complete its own due diligence or that it completed any diligence and came to a different conclusion.

E. The Parties Become Adverse.

On August 12, 2013, Berman, as Avon Road's General Partner, executed a written consent purporting to replace four members of Cinium's board. (B-1; *see also* A-408, A-414). Contrary to Defendants' opening appeal brief, Defendant Dennis Vacco was among those purportedly removed, in addition to Plaintiffs Asen and Roberts and Jeffrey Camp. (B-1). On August 22, 2013, Plaintiffs filed an action in the Court of Chancery pursuant to Section 225, seeking a declaration that the August Written Consent was invalid under the terms of the Securityholders' Agreement because Defendant Berman never convened a Board meeting and a supermajority of the Cinium Board did not approve the actions purportedly taken through the August Written Consent. (B-2); *see also* A-274, A-407). Rather than oppose Plaintiffs' first Section 225 action, Defendants Berman and Avon Road quickly capitulated, revoked the August Written Consent, and confirmed that the Cinium Board remained unchanged. (A-407-408).

On August 29, 2013, Tower filed a Form A with DFS. (A-167, B-11). In its application, Tower expressed its interest in converting its notes in order to

remove Berman as Cinium's CEO, President and Chairman of the Board. (A-164). Tower gave a presentation to DFS on the same day the application was filed in which it provided details of misconduct by Berman that precipitated Tower's filing. (A-168, A-418-421). Among the general misconduct alleged was tax fraud, self-dealing, and a violation of the insurance law regarding intercompany transfers. (A-170-171, A-409-431). With regards to Cinium management in particular, Tower informed DFS of the August Written Consent, Cinium's negative cash flow, the Cinium Board's concerns regarding the need for significant expense cuts, and Berman's failure to convene a meeting of the board of directors for over a year. (A-414, A-418-419). The exhibits to CastlePoint's Form A filing included the following exhibits: (1) the Securityholders' Agreement; (2) the Note Purchase; (3) the Senior Note; (4) a Pre-Acquisition Organizational Chart of Cinium; (5) a Pre-Acquisition Organizational Chart of CastlePoint; (6) a Post-Closing Organizational Chart of CastlePoint; (7) CastlePoint's Anticipated Shareholdings in Cinium Before and After Conversion; (8) a List of Directors and Executive Officers of CastlePoint; and (9) the Financial Statements of Tower and CastlePoint.

Berman executed a second written consent, notwithstanding the conceded invalidity of the August Written Consent, on October 16, 2013. (B-24); *see also* A-492). The October Written Consent purported to: (1) remove Roberts, Asen, Camp and Michigami from the Cinium Board; (2) remove John Crowe as

Secretary and General Counsel of Cinium; (3) Elect Dennis Vacco as Secretary and General Counsel of Cinium; and (4) remove WWRP as General Counsel of Cinium. (B-24); *see also* A-492).

On October 21, 2013, Plaintiffs filed a Verified Complaint in the Court of Chancery seeking expedited relief pursuant to Section 225 to declare the October Written Consent invalid. (A-493). Until January 31, 2014, Defendants' only affirmative defense in the action was that "[t]he Securityholders' Agreement is void and of no effect as it violates the New York Insurance Law, specifically Section 1506." (B-57).

F. Defendant Berman Asks DFS to Determine that the Validity of the Securityholders' Agreement.

Berman sent DFS a "Request for Determination" seeking a determination regarding the validity of the Securityholders' Agreement on October 9, 2013, prior to executing the October Written Consent, but DFS has yet to respond to his request. (B-126; *see also* A-275).

Previously, Defendants argued that the "issue of whether approval of the Securityholders' Agreement by DFS is required is a matter that should be determined by DFS." (B-38, at ¶ 15). In addition, Defendants argued that "decision by the DFS could be dispositive of this action." (*Id.* at ¶ 18).

Although Defendants have argued that the Securityholders' Agreement is void and unenforceable, they have not brought an action or asserted a claim in a Delaware Court for rescission of the contract. (B-189) (Mr. Lafferty: But their argument had been that this contract is void. . . And my only point is that they have taken that position in their pleadings and their answer and their briefs. But they have never offered to pay back the $7 million. And, you know, to me that -- THE COURT: I find that problematic. I agree.")). Defendant Berman admitted that he is not seeking to rescind the agreements. (B-115-16).

G. DFS Concludes that It Has No Objections to the Securityholders' Agreement.

On February 27, 2014, Perri received a call from DFS requesting that Tower's representatives meet with DFS to discuss the Securityholders' Agreement. (B-221). As a result of that meeting, which took place on February 28, 2014, Tower and DFS reached the following agreement: "CastlePoint has waived certain provisions in the Securityholders' Agreement and agreed to use reasonable efforts to obtain Cinium's consent to amend the Securityholders' Agreement to reflect CastlePoint's waiver of those provisions, and DFS has stated that it has no objection to the Securityholders' Agreement." (*Id*). DFS did not conclude that any of the provisions Plaintiffs relied on to argue that CastlePoint acquired "control" of

Cinium/UHNIC gave CastlePoint "control" and DFS did not ask CastlePoint to waive any of those provisions. (*Id).*

Now that DFS has issued a determination that is not in Defendants' favor, Defendants quickly reversed course arguing that DFS' opinion is meaningless. In a sign of desperation, Appellants made unsupported allegations against Tower and the DFS, a well-respected government agency, stating that "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[.]" (Appellants' Op. Br. at 18). Appellants do not set forth any factual evidence to support this unfounded claim but merely refer to an Article 78 petition that has been filed by them, which in turn is riddled with bizarre and unsupported allegations. (A-496-522).

ARGUMENT

I. THE COURT OF CHANCERY CORRECTLY CONCLUDED THAT THE SECURITYHOLDERS' AGREEMENT IS ENFORCEABLE AND THAT THE OCTOBER WRITTEN CONSENT IS INVALID AND WITHOUT EFFECT.

A. Question Presented.

Did the Court correctly conclude that the Securityholders' Agreement is enforceable and that the October Written Consent is invalid and without effect?

B. Scope of Review.

Legal questions are subject to *de novo* review. *See Brody v. Zaucha*, 697 A.2d 749, 753 (Del. 1997); *Emmons v. Hartford Underwriters Ins. Co.*, 697 A.2d 742, 744 (Del. 1997); *Arnold v. Society for Sav. Bancorp, Inc.*, 650 A.2d 1270, 1276 (Del. 1994). Where *de novo* review is warranted, "[t]he trial court's legal rulings will be affirmed unless there was an error in formulating or applying legal principals." *Brody v. Zaucha*, 697 A.2d 749, 753 (Del. 1997). Additionally, when the record supports the reasons for the Court's judgment, this Court will affirm even if the trial court did not rule on that basis. *See Windom v. William C. Ungerer, W.C.*, 903 A.2d 276, 281 & n.18 (Del. 2006).

C. <u>Merits of the Argument.</u>

The Court of Chancery's ruling should be affirmed because the Court did not commit any error in its application of the law. Taking into account ample evidence identified in the parties' written submissions at the February 26, 2014 hearing (the "Hearing"), the Court of Chancery correctly concluded that "the Securityholders' Agreement is enforceable as a matter of Delaware law[,]" and that "Avon [Road]'s written consent purporting to remove Directors Roberts, Asen, Camp and Michigami, as well as certain officers of Cinium, is therfor[e] invalid." (Op. at 15).

As confirmed in their appellate brief, Defendants conceded that the Securityholders' Agreement is facially valid. Therefore, their only defense to the execution of the October Written Consent was that there had been an alleged violation of the New York Insurance Law that rendered the Securityholders' Agreement void. (Appellants' Br. at 17). It appears that they now argue that the Court erred because it did not determine whether the Securityholders' Agreement resulted in CastlePoint acquiring control over Cinium, for which prior approval by DFS was allegedly required under Section 1506 of the New York Insurance Law. (Appellants' Br. at 16). Defendants make reference to an alleged "violat[ion] [of] New York public policy" as part of their articulation of the question presented on appeal. (*Id).* However, Defendants never fully articulate what public policy

considerations are implicated by an alleged violation of Section 1506 that would render the Securityholders' Agreement invalid. As a result, Defendants have not established that they have any basis for a reversal of the trial court's Decision.

1. The Trial Court's Determination that the Securityholders' Agreement is Valid as A Matter of Delaware Contract Law Is Factually Supported and Legally Correct.

The Securityholders' Agreement is governed by Delaware law. "This Agreement and the rights and obligations of the parties hereunder and the persons subject hereto shall be governed by and construed and interpreted in accordance with the laws of the State of Delaware, without giving effect to conflicts of laws rules that would require the application of the laws of another jurisdiction." (A-365). The Court correctly concluded (and Defendants conceded) that the Securityholders' Agreement is "facially valid." Defendants do not contest this determination.

The Court also concluded that the Securityholders' Agreement was enforceable as a matter of Delaware law. The Court correctly recognized that "Delaware courts are adverse to voiding agreements on public policy grounds unless their illegality is clear and certain[,]" and that such "authority must be exercised with caution, and only in cases that are free from doubt." *Sann v. Renal Care Centers Corp.*, 1995 WL 161458 at *5-7 (Del. Super. Mar. 28 1995).

Defendants do not contest this dispositive legal principle. The Court concluded that Defendants did not meet their burden to establish that there was a "clear and certain" violation of public policy such that the Securityholders' Agreement should be deemed void. In so finding, the Court set forth the following determinations regarding the validity of the Securityholders' Agreement:

- "DFS has . . . determined that performance of the Securityholders' Agreement . . . does not violate New York public policy such that this Court should find the agreement unenforceable." (B-235).
- "DFS has determined that enforcement of the provisions of the Securityholders' Agreement at issue in this litigation does not violate New York public policy." (B236).
- "Moreover, even if DFS had not yet made [its] determination, I would not find the Securityholders' Agreement unenforceable as a matter of Delaware contract law." (*Id.*).
- "I find that the potential violation of New York public policy would not in this instance clearly outweigh this Court's interest in enforcing an otherwise facially valid contract since DFS is in a better position than I am to vindicate New York policy considerations, should it determine that a violation has occurred." (B237).

- "[I]t is far from 'clear and certain' that a violation has occurred." (*Id).*
- "[T]he form of control, if control it is, at issue here, the power to veto certain board actions, is unlikely to implicate public policy considerations at all since it is essentially a power to preserve the status quo, not to direct management of the company in such a way that could harm New York policyholders." (B238).
- "Ultimately, however, I find dispositive the consideration that if DFS determined that New York public policy is implicated, and it appears . . . that it has considered the issue and determined that the agreement does not, in fact, violate New York policy, DFS is itself in a position to remedy any violations. It does not need the assistance of this Court in that endeavor." (B239).
- "Because DFS has already evaluated CastlePoint's need to file a Form A and had the power to protect New York interests if it believed a violation had occurred, I find that the otherwise facially valid Securityholders' Agreement should not be held invalid or unenforceable in this court in order to protect New York public policy interests." (B240-41).

Ultimately, the Court correctly concluded that "the Securityholders' Agreement is enforceable as a matter of Delaware law." (B241).

2. Defendants' Argument that the Securityholders' Agreement is Not Enforceable Because CastlePoint Did Not Seek Prior Approval from DFS Before the Agreement Was Executed Is Without Merit.

Defendants argue that "CastlePoint's failure to obtain DFS' approval of the Securityholders' Agreement violated N.Y. Ins. Law § 1506" and, thus, the Securityholders' Agreement is unenforceable. (Appellants' Br. at 18). However, the trial court concluded that "it is far from 'clear and certain' that a violation has occurred." (Op. at 11). To support their argument on appeal, Defendants do not: (1) reference any new factual developments relevant to this Court's determination regarding whether the trial court's decision should be upheld; (2) rely on any new legal precedent that would affect this Court's decision; or (3) apply the reasoning in the cases previously cited in a manner that is any more persuasive than in its original pre-Hearing briefs. The record remains clear that neither CastlePoint nor its Board designee, Appellee Roberts, acquired "control" or a "controlling influence" over Cinium via the Securityholders' Agreement.

a. Defendants Have Failed to Establish that CastlePoint Obtained Control Over Cinium/UHNIC Under Section 1506(a) of the New York Insurance Law.

Section 1506(a) of the New York Insurance Law states that "[n]o person, other than an authorized insurer, shall acquire control of any domestic

insurer, whether by purchase of its securities or otherwise, unless . . . it receives the superintendent's prior approval." N.Y. Ins. L. § 1506(a). "Control" is defined as "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 . . . or otherwise*; but no person shall be deemed to control another person solely by reason of his being an officer or director of such other person." N.Y. Ins. L. § 1501(a)(2) (emphasis added). Control is presumed "if any person directly or indirectly owns, controls or holds with the power to vote ten percent or more of the voting securities of any other person." *Id.* Therefore, DFS can conclude that a company "controls" another company pursuant to an objective standard (owning 10% or more of the company's voting securities) or a subjective standard ("otherwise" having the power to direct or cause the direction of the management and policies).

It is undisputed that CastlePoint did not obtain ownership of 10% or more of Cinium's "voting securities," the percentage ownership at which control would be presumed under the New York Insurance Law. The Securityholders' Agreement gave CastlePoint no equity in Cinium and no voting securities. Thus, Defendants have not met their burden in establishing that CastlePoint obtained "control" over Cinium/UHNIC.

b. Defendants Have Failed to Establish that CastlePoint Obtained a Controlling Influence Over Cinium/UHNIC Under Section 1501(b) of the New York Insurance Law.

Nor can CastlePoint be deemed to have control over Cinium under the subjective standard. Section 1501(b) of New York Insurance Law states:

> 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.

It is undisputed that CastlePoint has the right to designate only *one* of six directors of Cinium, which on its face suggests that CastlePoint does not maintain a "controlling influence over the management or policies" of Cinium/UHNIC. In addition, the power given to CastlePoint with regards to certain specified Board actions that require a Supermajority Vote, does not result in CastlePoint or Appellee Roberts becoming a "'controlling influence' over Cinium/UHNIC without DFS approval." (Appellants' Br. at 21). Rather, certain Board actions requiring a Supermajority Vote are those that would result in a fundamental change in the nature of Cinium/UHNIC. As Perri testified, the Supermajority Vote

provisions "provide a braking mechanism to prevent the appropriate people who control the company we're investing in from making any changes to its board, to its business plan, to its financial condition, which are normal things you would see in a situation where we're investing in another company." (A-149). In other words, and as the Court of Chancery correctly concluded, the Supermajority Vote provisions only give CastlePoint the power to maintain the status quo, not to direct management of Cinium.

Similar to their pre-hearing briefs, Defendants cite to a number of cases that are either inapposite to the facts and circumstances or have no bearing on this action. First, Defendants cite to cases from non-New York jurisdictions regarding how the regulators in these jurisdictions define "control" of a domestic insurer under a statute which has no bearing on DFS's determination of "control" under Section 1506. *See, e.g. National American Ins. Co. v. CenTra, Inc.*, 151 F.3d 780 (8th Cir. 1998) (the definition of control derived from Nebraska state statute). Second, Defendants cite to cases where veto power constituted control, but the cases either turn on facts that are not analogous to the facts in this action or do not state the propositions Defendants suggest they do. *See, e.g. Bentas v. Haseotes*, 769 A.2d 70 (Del. Ch. 2000) (finding that a single director's power to prevent quorum by not attending board meetings constitutes "negative control" but does not state that negative control is synonymous with affirmative control over

the day-to-day control over the entity); *Hoban v. Dardanella*, 1984 WL 8221 (Del. Ch. June 12, 1984) (does not state anywhere in the opinion that "refusal to give required consent to action is 'negative control'" as Defendants suggest); *Kalisman v. Friedman,* 2013 WL 6456232, at tr. 5-6 (Del. Ch. May 14, 2013) (Transcript) (court found that control can include contractual arrangements granting blocking power but emphasized that "control" by contract or otherwise demonstrable influence over corporate affairs was a fact-specific determination); *Johnston v. Pederson*, 28 A.3d 1079, 1087 (Del. Ch. 2011) (facts not analogous because a majority vote of the holders of Series B preferred stock was "required for the approval of *any matter* that [was] subject to a vote of the Corporation's stockholders, whether or not a class vote is required by law.").

Defendants do not contest the fact that CastlePoint neither has the power to appoint, nor did it appoint, any of Cinium's of UHNIC's officers as a result of entering into the Securityholders' Agreement, and that CastlePoint does not: (1) exercise managerial control over Cinium or UHNIC; (2) exercise administrative control over Cinium or UHNIC; (3) control the hiring or termination of Cinium's or UHNIC's workforce; or (4) lease office space to Cinium or UHNIC. Thus, the argument that CastlePoint and Roberts exercise "control" or a "controlling influence" over Cinium fails. Defendants have failed to meet their

burden in establishing that CastlePoint obtained a "controlling influence" over Cinium/UHNIC.

c. The Securityholders' Agreement Does Not Violate New York Public Policy.

In what appears to be an afterthought at the end of their brief, Defendants argue that CastlePoint's alleged violation of Section 1506 results in a violation of New York public policy. (Appellants' Br. at 24). The failure to seek or obtain DFS approval, according to Defendants, is a violation of a statute designed to protect the public, "thereby offending New York public policy" and rendering the Securityholders' Agreement's "control devices" unenforceable. (Appellants' Br. at 24-25). The trial court's observation that Defendants "have not fully articulated what public policy considerations are implicated by a violation of the control provisions at issue under New York insurance law" (Op. at 13) remains true on appeal. Defendants have not set forth any viable argument to support a finding that CastlePoint has violated New York public policy.

Defendants cite to one New York appellate court case, *Benjamin v. Koeppel*, 650 N.E.2d 829 (N.Y. App. 1995), involving whether a fee agreement was valid under a New York licensing statute. (Appellants' Br. at 24). In *Benjamin*, the court stated that "where [a licensing] 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 noncompliance with its terms would affect the legality of the business." *Benjamin*, 650 N.E.2d at 831. A violation of a licensing statute could result in harm to New York residents who obtain policies from unlicensed insurers because they could later be left without insurance coverage. Section 1506 is not a licensing statute. Thus, this case is inapplicable. In addition, Defendants do not set forth any support, nor can they, for an argument that Section 1506 was enacted for the "protection of public health or morals or the prevention of fraud" or, more importantly, how an alleged violation of Section 1506 would ultimately harm New York residents.

Moreover, the *Benjamin* court did not invalidate the fee agreement at issue, entered into by an attorney not in conformity with a licensing requirement, because, on balance, public policy concerns did not weigh against voiding the fee agreement. Importantly, the court found that "the existence of a legislatively prescribed sanction for noncompliance militates against imposing a civil forfeiture by nullifying bargained-for contractual obligations." *Id.* at 556. The same reasoning holds here. DFS has an enumerated list of penalties that it can impose if it finds that a party is in violation of Section 1506 including the option to: (1) begin an action to rehabilitate or liquidate UHNIC (Section 1510(a)(1); (2) revoke or refuse to renew the authority to do business of an authorized foreign or alien insurer within Cinium's holding company system in New York (Section

1510(a)(2)); (3) request the Attorney General to bring an action to enforce compliance with Section 1506 or for an order directing termination of CastlePoint's control of UHNIC (Section 1510(a)(3)); or (4) fine CastlePoint up to $2,500 (Section 1510(a)(4)). *See* N.Y. Ins. L. § 1510(a)(1)-(4). None of these remedies include the ability to void a private contract between two parties. In addition, there is nothing in the record to suggest that the Securityholders' Agreement will result in harm to the public. In sum, Defendants' argument that a violation of Section 1506 results in a violation of New York public policy is without merit.

Despite Defendants' argument to the contrary, the Court did in fact evaluate whether the Securityholders' Agreement violated public policy under New York law and found that: (1) "it is far from 'clear and certain' that a violation [of New York law] has occurred" (Op. at 15).; (2) "DFS has . . . determined that performance of the Securityholders' Agreement . . . does not violate New York public policy such that this Court should find the agreement unenforceable" (Op. at 15); (3) ". . .the potential violation of New York public policy would not in this instance clearly outweigh this Court's interest in enforcing an otherwise facially valid contract since DFS is in a better position than I am to vindicate New York policy considerations, should it determine that a violation has occurred" (Op. at 11).; and (4) ". . . the form of control, if control it is, at issue here, the power to

veto certain board actions, is unlikely to implicate public policy considerations at all since it is essentially a power to preserve the status quo, not to direct management of the company in such a way that could harm New York policyholders." (Op. at 12). Therefore, even assuming the Court was obligated to evaluate whether there was a violation of public policy under New York law, it did so and found that there was no violation.

CONCLUSION

Defendants have failed to establish that: (1) the trial court committed any error in formulating or applying legal principals or that its decision is not supported by the record; (2) the Securityholders' Agreement violated Section 1506 of the New York Insurance Law; or (3) the Securityholders' Agreement violates New York public policy and is therefore invalid.

WHEREFORE, for the foregoing reasons, Appellees respectfully request that this Court affirm the decision of the Court of Chancery.

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CERTIFICATE OF SERVICE

I, Kevin M. Coen, hereby certify that on the 23rd day of June, 2014, I served a copy of the Appellee's Answering Brief via File and Serve Xpress upon the following counsel of record:

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