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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

ROBERT D. KEYSER, JR., FRANK SALVATORE, and SCOTT SCHALK, Plaintiffs, v. TOM CURTIS, THOMAS HANDS, DONALD SHEK, and ALBERT POLIAK, Defendants, and ARK FINANCIAL SERVICES, INC., a Delaware corporation, Nominal Defendant.	)	C.A. No. 7109-VCN **PUBLIC VERSION** **FILED MARCH 13, 2012**

DEFENDANTS' PRETRIAL BRIEF

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INTRODUCTION

This action arises under 8 *Del. C.* § 225. Plaintiffs Robert D. Keyser, Jr., Frank Salvatore and Scott Schalk seek a declaration that they replaced Defendants Tom Curtis, Thomas Hands and Donald Shek as directors of Ark Financial Services, Inc. ("Ark" or "the Company"). The effectiveness of Plaintiffs' December 13, 2011 written consent ("Written Consent") depends upon the invalidation of 25,000 shares of Series B Preferred Stock issued to Defendant Albert Poliak more than a year ago on December 1, 2010 and Keyser's attempted termination of a settlement agreement between Keyser and Ark whereby Keyser agreed to return seven million shares of Ark Common stock to Ark for the price determined by an independent valuation firm. As set forth herein, the Written Consent is ineffective and Keyser breached the settlement agreement by failing to return his stock to Ark.

The Series B Preferred Stock was issued in response to Keyser's first hostile takeover attempt of Ark in November and December 2010. Plaintiff Scott Schalk also participated in that attempt, but Plaintiff Frank Salvatore and non-party Douglas Kaiser refused to join those efforts. In 2010, Keyser attempted to take over Ark with a minority of its creditors, who had previously pushed for Keyser to withdraw from Ark's management in 2009 (which he did). Those creditors decided that they could exploit Ark's limited resources for their own benefit and to the detriment of Ark, its other creditors, other stockholders and employees, with Keyser's assistance. Poliak, as the sole director of Ark, consulted with counsel and authorized the issuance of 25,000 shares of

Series B Preferred Stock with 1,000 votes per share to himself in order to protect Ark from the threat posed by Keyser.

Poliak successfully defended the Company. Since issuance of the Series B Preferred Stock on December 1, 2010, Poliak used his control of Ark to raise millions in offerings of Series A Preferred Stock to new and existing investors and to reduce Ark's substantial debts. Poliak's control of Ark through the Series B Preferred Stock was disclosed in the offering materials for the Series A Preferred Offering. Of the millions raised in the Series A Preferred Offering, $2.2 million went to an entity half owned by Keyser and Keyser received approximately $500,000 of that $2.2 million. Like Keyser, Salvatore and Schalk benefitted from Poliak's control of the Company. Rather than owning stock in a company with a shareholders' deficit of $6.55 million (the deficit at year end 2010), they own stock in a company with a shareholders' deficit of $400,000 (the deficit at year end 2011). While Poliak controlled Ark and expended considerable time and effort running the company, Plaintiffs stood on the sidelines. Plaintiffs made no move to invalidate the Series B Preferred Stock until more than a year after its issuance.

As part of the settlement agreement arising from his failed 2010 takeover attempt, Keyser was supposed to sell his seven million shares of Ark Common stock for the price determined by an independent valuation firm. When Keyser learned that the valuation was likely to be $0, he purported to terminate the agreement and never transferred his shares to Ark. Instead, he again sought to take over Ark. Salvatore and Kaiser teamed up with Keyser because Poliak would not cave into their demands and purchase their stock at an unreasonably high price. Plaintiffs cannot stand by for a year and then challenge

the very control that has benefitted them. Thus, as described herein and as will be shown at trial, the Written Consent is ineffective.

NATURE AND STAGE OF PROCEEDINGS

On December 13, 2011, Plaintiffs Robert D. Keyser, Jr., Frank Salvatore and Scott Schalk filed the Verified Complaint, alleging they held a majority of Ark's outstanding common stock and replaced Defendants Tom Curtis, Thomas Hands and Donald Shek as directors. (Lexis ID 41379551.) The Court entered a status quo order agreed upon by the parties on December 21, 2011. (Lexis ID 41517705.) On December 30, 2011, Defendants answered the Verified Complaint. (Lexis ID 41640868.) The parties engaged in document and deposition discovery through January and February. Trial is scheduled for March 14th and March 15th. (Lexis 41816518.) This is Defendants' pretrial brief.

STATEMENT OF FACTS

A. Poliak And Keyser Found Ark And Dawson James

In 2002, Albert Poliak ("Poliak") and Robert D. Keyser, Jr. ("Keyser") decided to start their own securities firm. Both men were experienced brokers and had already worked together at other brokerage firms. Poliak and Keyser formed Dawson James Securities, Inc. ("Dawson James") as their operating entity. Because a brokerage firm is required to have certain levels of net capital under federal law, Poliak and Keyser also formed a separate holding company to both own Dawson James and to serve as the vehicle to borrow the funds needed to capitalize their new companies. That holding company is Ark, a Delaware corporation.

Poliak and Keyser focused on different areas in the firm. Keyser was the Chief Executive Officer ("CEO") and Secretary of Ark and Dawson James. From inception until December 2009, Poliak and Keyser were the only directors of Ark. Keyser supervised the investment banking efforts of capital raising for public and private companies. Dawson James would act as the underwriter or placement agent when such entities sold their stock in private or public placements of securities. Poliak acted as President of Dawson James and supervised the brokerage operations.

Dawson James successfully expanded to multiple offices in Florida, Maryland, New York, New Jersey and California with over 75 employees. This growth was financed with borrowed funds. In 2002, Ark borrowed $125,000 from Lyonshare Venture Capital ("Lyonshare") and $175,000 from Vestal Venture Capital ("Vestal").

Allan R. Lyons controlled both of these entities. In 2004 through 2006, Ark sold $2 million convertible debentures to outside investors. In 2005, Ark borrowed an additional $500,000 from Vestal. In 2007, Ark borrowed $2 million from HSK Funding, Inc. ("HSK"). Kenneth A. Steel, Jr. and Burton Koffman were principals of HSK and had financial dealings with some of Lyons's entities, including Vestal.

B. Ark Struggles And Keyser Leaves

From inception, Ark and Dawson James borrowed money in order to fund their operations. Ark was eventually unable to pay all of its debt in accordance with the terms of that debt. The Great Recession of 2008 further hurt Ark and Dawson James. The investment banking business dried up and brokerage commission revenues declined. For the years ended December 31, 2008 and 2009, Ark lost $1.8 million and $2 million and shareholders' net worth was ($4,165,000) and ($6,147,000) respectively. As Dawson James' business evaporated, it could no longer pass through funds to its parent Ark. Ark was insolvent.

By early 2009, Ark was forced to pay whatever was demanded to obtain continued support from Lyons, Steel and Koffman. Thus, in February 2009, Ark borrowed $300,000 from Lyons, Steel and Koffman (the "$300,000 Note"). The $300,000 Note included a $60,000 "Origination Fee" and the option to acquire 24% of Ark's common stock "for a purchase price of $1.00." (the "24% Option"). The interest rate on the $300,000 Note was 24% per annum.

In addition to the terms of the $300,000 Note, Lyons and Steel insisted that Ark hire an outside consultant, at Ark's expense, to evaluate Ark and its management and to

decide how to reduce expenses if necessary. Lyons and Steel, as well as the management and employees of Dawson James, were already aware that Keyser was an absentee CEO, working only a few days a week and spending summers in Missouri. As the financial condition of Ark and Dawson James continued to deteriorate, Lyons and Steel expressed their displeasure with Keyser's performance. The consultant concluded that Keyser should step down as CEO in order to reduce expenses and improve leadership. The consultant also recommended and the creditors agreed that Poliak would operate Dawson James and Ark. Keyser informally stepped down as CEO in mid-2009. In December 2009, Keyser formally left when he resigned as an officer and director of Ark and as an officer and director of Dawson James. That left Poliak as the sole director of Ark and CEO of Ark and Dawson James.

To save Ark and Dawson James, Poliak began to negotiate with all of the creditors, including Dawson James' landlord and others. For those creditors holding Ark notes, Poliak's basic plan was to convince them to convert their Ark notes into new preferred stock. Those negotiations were protracted as the creditors watched Poliak slowly improve Dawson James' operating results when the financial markets re-bounded in late 2009 and 2010. The primary creditors holding out from converting debt to preferred stock were those led by Lyons and Steel. They wanted a better deal than the other Ark creditors, but Poliak declined to prefer them over the other debtholders. Plaintiffs Frank Salvatore and Scott Schalk as well as non-party Douglas Kaiser participated in these negotiations. Salvatore and Kaiser were brokers and executive officers of Dawson James as well as significant stockholders of Ark.

C. Keyser, Lyons And Steel Mount A Hostile Takeover Of Ark To Benefit Themselves

Not making headway with their demands on Poliak, Lyons and Steel changed tactics. They turned to Keyser. Their basic plan was to "sell" their Ark notes to a new entity controlled by Keyser, Auxol Capital LLC ("Auxol"), and to transfer the 24% Option to Keyser. As Auxol literally had no capital of its own, the plan was for Auxol to pay the creditors by collecting on the Ark notes. The creditors would then make Ark pay what they wanted by putting Keyser in control of Ark. This would be done by having Keyser exercise the 24% Option, then have Keyser (with the help of his brother, John Keyser, an Ark stockholder and Dawson James broker, Scott Schalk and a former Dawson James employee) vote that 24% with the others' pre-existing Ark shares to throw out Poliak and install Keyser and his colleague, R. Douglas Armstrong as the board of Ark.

This plan was then reduced to an "Agreement For Purchase And Sale Of Certain Assets" (the "Agreement"). The Agreement required "Keyser and Armstrong, while in majority control of the Ark board of directors [to] support and will not alter the distribution to Vestal, on behalf of Holders [defined as Vestal, Lyonshare and HSK] 100% of all proceeds for any Accrued Financial Value."[1] Further, the Agreement mandated additional, substantial payments to the Lyons, Steel and Koffman "after Auxol gains majority control of the Ark board of directors."

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[1] The "Accrued Financial Value" basically meant all the value of underwriting warrants Ark held, the payment of which would have been a bonus to Vestal beyond what it was entitled to under its Ark notes.

On November 29, 2010, Keyser announced to Ark that he held the 24% Option and was exercising it for 8,604,521 shares ("Option Shares"). This turn of events alarmed Poliak and his advisors, including his Chief Financial Officer, Donald Shek ("Shek"). They understood that Lyons and Steel would not have aligned themselves with Keyser, except to obtain an advantage vis-à-vis the other creditors and stockholders that they could not obtain from Poliak. After all, those same creditors had forced out Keyser previously and knew that many Ark and Dawson James employees had no confidence in Keyser and did not want to work for him. They further knew that Keyser had used corporate assets for personal and unnecessarily expensive expenditures.

Accordingly, Poliak consulted with the large Chicago law firm of Locke Lord Bissell & Liddell LLP ("Locke Lord") on November 30, 2010. Locke Lord had previously advised Ark on financial compliance matters. Locke Lord attorneys advised Poliak that as Ark's sole director he had a fiduciary duty to all of Ark's creditors because Ark was insolvent. The Locke Lord attorneys then prepared corporate documents for Poliak to sign that authorized Ark's board of directors to issue super-voting preferred stock. On December 1, 2010, acting on Locke Lord's advice, Poliak approved the issuance of 25,000 shares of Series B Preferred Stock to himself in exchange for $250. Each share of Series B Preferred Stock had 1,000 votes so Poliak secured voting control over Ark.

Poliak had acted just in time. Later in December, 2010, Keyser executed a stockholder consent purporting to vote 15,604,521 Ark shares held by Keyser (the 24% Option shares included) along with Ark stock held by Keyser's brother John, Schalk and

another Ark stockholder ("2010 Written Consent"). The 2010 Written Consent purported to remove Poliak from the board and replace him with Keyser and Armstrong. A flurry of attorney letters then went back and forth between the Poliak and Keyser camps, arguing over the validity of the issuance of the Series B Preferred Stock. While Ark eventually recognized the assignment of the 24% Option shares by Steel, Lyons and Koffman to Keyser, it did not recognize the 2010 Written Consent and Poliak remained in control of Ark.

D. Keyser Accepts And Benefits From Issuance Of The Series B Preferred Stock

By mid-December 2010, the parties began negotiating a resolution of the disputes over the issuance of the Series B Preferred Stock and the demands of Lyons, Steel and Koffman. On January 5, 2011, Ark and Auxol (on behalf of Keyser, his colleague Armstrong and the creditors) executed a Confidentiality and Standstill Agreement ("Standstill Agreement"). The Standstill Agreement contemplated a "Notes Buy-Out Offer" of the promissory notes originally issued to Lyons, Steel and Koffman ("Former Noteholders"). A draft proposal soon followed.

Keyser and the Former Noteholders also reached a side "Memo of Understanding" between themselves. That Memo provided for a payment to the Former Noteholders of $1,785,000, if Keyser reached a deal with Ark. By the end of January, 2011, Ark and Auxol did reach a Confidential Agreement In Principle that contemplated Auxol receiving $2,200,000 by April, 2011 ("Confidential Agreement"). The Confidential Agreement also contemplated the acquisition by Ark of "all equity interests in Ark owned by Robert Keyser," prior to his acquisition of the Option Shares.

In entering into the various preliminary agreements, the parties all understood that Ark then did not have the funds needed to buy the Lyons, Steel and Koffman creditors' notes or Keyser's Ark stock. The funding plan for Ark's $2.2 million purchase of the promissory notes, 24% Option Shares and some Dawson James securities held by Auxol was to have Ark issue Series A Preferred Stock in a private placement to third party investors. Poliak and his colleagues at Ark began the process of securing the new investors required. They also negotiated with existing noteholders to convert their notes into Series A Preferred Stock or to buy back their notes at a discount to the actual amounts owed.

The private placement of the Series A Preferred Stock required the use of a Subscription Agreement and Offering Memorandum to meet Securities and Exchange Commission rules. From its earliest draft, that Subscription Agreement advised the potential investors that Ark would fail if it could not raise new funding. The Subscription Agreement also expressly noted "the existence of Series B Preferred Stock which provides super voting control to Albert J. Poliak" and that "Albert J. Poliak has voting control of our outstanding capital stock pursuant to his Series B Preferred Stock and such voting control will exist indefinitely into the future."

The contents of the Subscription Agreement were circulated to Keyser, Schalk and others by early April 2011. Schalk received a copy of Subscription Agreement for the Conversion of Promissory Notes from a client who wanted to know whether to convert his debt into Series A Preferred Stock on March 28, 2011. Keyser received his copy after his attorney advised Ark was required to give Keyser "all relevant material

information about ark [sic] – which clearly would include, among other things, the financing documents being used by ark [sic] to raise new funding at this time." Keyser's current employer, Richard Rappaport, emailed a copy of the Series A Preferred Offering Subscription Agreement to him on April 7, 2011. Salvatore and Kaiser were also aware of the Series A Preferred Offering (as well as the Series B Preferred Stock) by this time based upon conversations they had with Poliak.

Ark did not meet the anticipated April 1, 2011 deadline to close with the creditors and Keyser. As Ark's attorney explained in an April 1, 2011 email: "[t]he major remaining issue is the sale of the Keyser interest in Ark. Many of the investors want to know that the issues related to Mr. Keyser's interest in Ark and its affiliates . . .h ave been resolved prior to funding their investment." On April 15, 2011, Keyser's attorney advised Ark that based on the 2010 Written Consent Keyser would "promptly . . . commence an action in the Delaware Court of Chancery under Section 225 of the DGCL" to have the Series B Preferred Stock invalidated and to remove Poliak as the Ark director. Ark's attorney responded on April 19, 2011 that litigation "would likely dissuade new investors from investing "and" would likely make an agreement to satisfy the Notes impossible." Further negotiations followed.

Two agreements were then reached. First, the parties agreed to extend the closing date on a previously-executed Stock And Note Purchase Agreement ("Notes Agreement") that governed the purchase of the promissory notes and the Option Shares held by Auxol. The Notes Agreement also provided:

> 6.3 Release of Buyer. After the Closing Date, Seller, its officers, directors, affiliates, partners, employees, agents, attorneys, accountants, successors and assigns, hereby forever discharge and release Buyer, its parents, subsidiaries, affiliates and its present and former officers, directors, agents, employees, attorneys, accountants, successors and assigns, from any and all claims, rights and causes of action of any kind or nature, known or unknown, suspected or unsuspected, fixed or contingent which Seller, its successors or assigns ever had, now has, or may have in the future against Buyer, arising prior to the date hereof, except for claims, rights and causes of action arising from Buyer's obligations under this Agreement.
>
> 6.4 Original Shares. For avoidance of doubt, so long as Keyser retains ownership of some or all of the Original Shares, he is not releasing any rights or claims he has as the owner of such Original Shares.

Second, Keyser, Ark and Poliak later signed a Settlement Agreement ("Settlement Agreement") that dealt with Keyser's "rights or claims . . . as the owner of" his Ark stock. The Settlement Agreement provided that Keyser would sell his Ark stock to Ark at a to-be-negotiated purchase price or if the price negotiations failed, then "the Sale Price shall be submitted to an independent third party valuation firm to value the Shares and determine the Sale Price" "as of April 30, 2011."

On or about May 1, 2011, Ark closed on the Series A Preferred Offering with its investors and raised $3 million. Ark then paid the Auxol $2.2 million of which approximately $500,000 went directly to Keyser as his compensation under his Memo of Understanding with Lyons, Steel and Koffman. Keyser made no more noises about filing legal action to challenge the Series B Preferred Stock

E. Keyser Breaches The Settlement Agreement

Following the May 1, 2011 settlement under the Notes Agreement, Ark and Keyser were not able to negotiate a price for his Ark stock. Thus, pursuant to the

Settlement Agreement, they agreed to retain the firm of Skoda Minotti to value Keyser's stock. Ark supplied voluminous materials to Skoda Minotti, with copies to Keyser as well, and arranged for Keyser to contact Skoda Minotti directly. On August 29, 2011, Keyser asked for additional information concerning "underwriter warrants and any other equity related compensation received in 2010 through the valuation period." These warrants permitted Dawson James to purchase securities at a fixed price for a limited period of time of some of the companies it had served as an underwriter or placement agent when those companies had sold their securities to third parties. The value of the warrants would depend on the exercise price of the underlying stock.

Skoda Minotti reviewed the materials on the underwriter warrants and then requested a teleconference with Keyser and Ark's representatives. Skoda Minotti cautioned that "[b]ased on our analysis to date, the warrants would need to have significant value in order for the common stock to have value." For even by 2011, Ark had debts it could not pay off with the assets available to it. During a telephone call with Keyser on October 6, 2011, Skoda Minotti pointed out that unless the value of the warrants exceeded $3 million, Keyser's seven million remaining shares of Ark Common stock likely had little to no value.

On October 11, 2011 Keyser's counsel notified Ark that he was rescinding the Settlement Agreement. For the first time, Keyser claimed that Ark had not "employed commercially reasonable efforts or cooperated with Keyser . . . so that the valuation could be completed within the timeframe identified in the" Settlement Agreement. Notwithstanding Keyser's attempt to prevent Skoda Minotti from completing its report,

Skoda Minotti issued a 44 page report, with additional exhibits. Skoda Minotti found "the concluded value of the Company's common equity of zero as of April 30, 2011 . . . ." To date, Keyser has refused to tender his Ark stock to Ark. Ark intended to distribute Keyser's shares to new and existing stockholders of Ark.

F. Ark Shareholders Elect New Directors And Ark Sells More Series A Preferred Stock

In order to comply with certain sanctions imposed by the Financial Industry Regulatory Authority, Poliak had to step down as an officer and director of Ark and Dawson James. Poliak nominated Defendant Curtis, Hands and Shek to serve on the Ark board of directors. On November 1, 2011, Curtis, Hands and Shek were elected to the Ark board. Plaintiffs Salvatore and Schalk cast their shares in favor of Curtis, Hands and Shek, while objecting for the first time to the Series B Preferred Stock. Keyser purported to abstain his shares from Shek, but to vote his shares in favor of Curtis and Hands.

At the end of November 2011, Ark was able to sell an additional $1 million in Series A Preferred Stock. Once again, the Subscription Agreement for that stock disclosed that Poliak controlled Ark through his ownership of the Series B Preferred Stock.

G. Keyser Tries To Mount Another Hostile Takeover Of Ark

After Keyser tried to terminate his Settlement Agreement with Ark, he next began recruiting two Ark stockholders to join with him (and his brother) to take over Ark. As was the case in his 2010 takeover attempt, Keyser already had support from Schalk, a former Dawson James broker. This time, Keyser also obtained the cooperation of

Salvatore and Kaiser. Previously in 2010, Salvatore and Kaiser had declined to support Keyser's takeover attempt. In late 2011, they changed their minds when Ark would not purchase their Ark shares at the price they demanded.

Salvatore and Kaiser are long-time close friends. They had worked as executive officers at Dawson James for a number of years, but left in 2010 when Ark was in severe financial trouble. After they left Dawson James, they kept in touch with Poliak because they each had 3,948,000 shares of Ark Common stock and continued to receive certain benefits such as health insurance and broker registration fees from Ark. They wanted Ark to buy back their stock at an unreasonably high price, but Poliak refused because such a purchase was not in the best interest of Ark or its stakeholders. As Poliak told them, many times, Ark's financial condition did not permit it to buy back stock at the prices they wanted.

Salvatore and Kaiser (as well as Schalk) were well-aware Keyser's 2010 takeover attempt had not succeeded and that Poliak remained in control of Ark. Poliak told Salvatore and Kaiser about the issuance of the Series B Preferred Stock and kept them informed about Ark's plans to issue Series A Preferred Stock to raise cash and to convert debt to stock. Both Salvatore and Kaiser told Poliak they supported Ark's plans to issue Series A Preferred Stock. Unless Ark could do so, the survival of Ark would continue to be in jeopardy, their Ark stock would remain valueless and Ark could not buy their Ark stock at the price they wanted. Only after Ark sold the Series A Preferred Stock and they became dissatisfied with the price offered by Poliak, Salvatore and Kaiser decided to team up with Keyser in order to obtain a buyout price that would satisfy them, regardless

of the impact on Ark. They then signed a voting trust agreement with Keyser, agreeing to support his takeover of Ark.

On December 13, 2011, Plaintiffs Keyser, Salvatore and Schalk, along with non-parties Kaiser and John Keyser, executed the Written Consent, which provided for the removal of all members of the Board of Directors of Ark and the election of Plaintiffs.

ARGUMENT

I. THE SERIES B PREFERRED STOCK IS VALID

As the sole director of Ark, Poliak had the power and authority to approve the creation and issuance of the Series B Preferred Stock. Under Section 151 of the Delaware General Corporation Law ("DGCL"), every corporation may:

> issue 1 or more classes of stock or 1 or more series of stock within any class thereof, any or all of which classes may be of stock with par value or stock without par value and which classes or series may have such voting powers, full or limited, or no voting powers, and such designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions thereof, as shall be stated and expressed in the certificate of incorporation or of any amendment thereto, or in the resolution or resolutions providing for the issue of such stock adopted by the board of directors pursuant to authority expressly vested in it by the provisions of its certificate of incorporation.

The certificate of incorporation must "set forth a statement of the designations and the powers, preferences and rights, and the qualifications, limitations or restrictions thereof, which are permitted by § 151 of this title in respect of any class or classes of stock or any series of any class of stock of the corporation and the fixing of which by the certificate of incorporation is desired, and an express grant of such authority as it may then be desired to grant to the board of directors to fix by resolution or resolutions any thereof that may be desired but which shall not be fixed by the certificate of incorporation." 8 *Del. C.* § 102(a)(4).

Article IV(A) of the Company's Certificate of Incorporation authorized the issuance of Common and Preferred Stock. The Certificate of Incorporation further provided that "[t]he Board of Directors of the Corporation (the "Board") is expressly

authorized to provide for the issue of all shares of the Preferred Stock in one or more series...and to determine...such voting powers...as shall be stated and expressed in the resolution or resolutions adopted by the Board providing for the issue of such shares...and as may be permitted by the General Corporation Law of the Corporation Law of the State of Delaware." (*Id.*) Thus, Poliak had the necessary authority to approve creation and issuance of the Series B Preferred Stock.

Mr. Poliak's issuance of 25,000 shares of Series B Preferred Stock to himself for $250 does not render those shares void. At trial, Defendants will show that Poliak issued the Series B Preferred Stock to himself in order to defend Ark from a hostile takeover by the Former Noteholders and a former director who were not acting in the best interests of Ark or all of its creditors, stockholders and employees. The Former Noteholders and Keyser sought to extract value from Ark for themselves, regardless of the negative consequences to Ark, other creditors, other stockholders or Ark employees. By thwarting Keyser's hostile takeover in 2010, Mr. Poliak was able to restructure and reduce Ark's debt, attract new investors and improve Ark's finances so as to benefit all creditors, stockholders and employees. Regardless of the standard of review applied (*Blasius*, *Unocal*, entire fairness and/or business judgment), Defendants will show that Poliak did not breach his fiduciary duties in issuing the Series B Preferred Stock and therefore the Series B Preferred Stock is valid. Thus, Plaintiffs do not possess a majority of Ark's outstanding voting power and their 2011 Written Consent is ineffective.

II. A MAJORITY OF DISINTERESTED SHARES RATIFIED THE SERIES B PREFERRED STOCK

Even if the Series B Preferred Stock was not properly issued to Mr. Poliak, this issuance was at most voidable, not void,[2] and was subsequently ratified by a majority of disinterested Ark shares. Ratification precludes a party from accepting the benefits of a transaction and then attacking that transaction. *Genger v. TR Investors, LLC*, 26 A.3d 180, 195 (Del. 2011); *Frank v. Wilson & Co.*, Inc., 32 A.2d 277, 283 (Del. 1943); *Cianci v. JEM Enter., Inc.*, 2000 WL 1234647, at *12 (Del. Ch. Aug. 22, 2000); *Dannley v. Murray*, 1980 WL 268061, at *5 (Del. Ch. July 3, 1980). Ratification can be express or implied by a party's conduct. *Genger*, 26 A.3d at 195; *Frank*, 32 A.2d at 282; *Dannley*, 1980 WL 268061, at *4.

Through his counsel, Keyser objected to the Series B Preferred Stock issuance on December 10, 2010. Keyser plainly had knowledge of the Series B Preferred Stock more than a year before he filed this action. During this year, Poliak used his control of Ark as a result of the Series B Preferred Stock to cause Ark to enter into significant transactions such as the Notes Agreement, the Series A Preferred Offering and the Settlement Agreement. Keyser benefitted from these transactions. As a result of the Notes

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[2] As previously discussed, Poliak did not exceed his authority or violate Ark's charter in approving issuance of the Series B Preferred Stock. He paid cash for that stock in an insolvent company whose stock was actually worthless at the time. Therefore, this issuance did not constitute waste (assuming waste cannot be ratified, which Chancellor Strine has questioned in decisions like *Harbor Finance Partners v. Huizenga*, 751 A.2d 879, 895-902 (Del. Ch. 1999), fraud or an ultra vires act and is not void. *Michelson v. Duncan*, 407 A.2d 211, 218-19 (Del. 1979). Approval of an interested transaction by an informed, non-coerced majority of disinterested stockholders (such as Keyser) invokes the business judgment rule. *In re PNB Holding Co. S'holders Litig.*, 2006 WL 2403999, at *14 (Del. Ch. Aug. 18, 2006).

Agreement and Series A Preferred Offering, for example, Ark paid Auxol approximately $2.2 million and Keyser in turn received approximately $500,000. Keyser never claimed that Poliak lacked the authority to cause Ark to enter into the Notes Agreement, issuance of the Series A Preferred Stock or Settlement Agreement. Keyser did not object to Poliak signing the Notes Agreement on behalf of Ark or the representation in that agreement that Ark had the power and authority to enter into the contemplated transactions. If the Series B Preferred Stock was invalid *ab initio* as Keyser now claims, then Poliak did not control Ark and could not have caused Ark to enter into the Notes Agreement or Series A Preferred Offering. Keyser knew all of this because when his lawyer on threatened suit over the issuance of the Series B Preferred Stock on April 15, 2011, Ark's lawyer responded that there would be no closing of the Series A Preferred Offering if Keyser maintained his threats. By accepting the benefits of Poliak's control of Ark, Keyser and Auxol impliedly ratified the Series B Preferred Stock.[3] Keyser's seven million Common shares and Auxol's 8,604,521 Option shares represented a majority of Ark's outstanding shares in the spring of 2011 and thus holders of a majority of disinterested shares ratified the Series B Preferred Stock issuance.

As our Supreme Court recently held:

> Implied ratification occurs '[w]here the conduct of a complainant, subsequent to the transaction objected to, is such as reasonably to warrant

[3] Salvatore and Schalk, as well as non-parties who signed the Written Consent (John Keyser and Kaiser), also benefitted from Poliak's control of Ark. If Keyser and the creditors had taken over Ark and looted it for their own benefit, Salvatore, Schalk, John Keyser and Kaiser would have suffered as Ark stockholders. The Ark stock of Salvatore, Schalk, John Keyser and Kaiser is worth more as a result of Poliak's control of Ark because that control led to the Series A Preferred Offering and reduction of Ark's debt.

> the conclusion that he has accepted or adopted it, [and] his ratification is implied through his acquiescence.' Ratification of an unauthorized act may be found from conduct 'which can be rationally explained *only* if there were an election to treat a supposedly unauthorized act as in fact authorized.' Ratification may also be found where a party 'receives and retains the benefit of [that transaction] without objection, [ ] thereby ratify[ing] the unauthorized act and estop[ping] itself from repudiating it . . . .'

Genger, 26 A.3d at 195 (citations omitted). The only explanation for Keyser's (1) signing the Notes Agreement with its broad release of "any and all claims . . .", (2) signing the Settlement Agreement to sell his remaining Ark stock, (3) taking $2.2 million from Ark and (4) not suing over the Series B Preferred stock is that Keyser ratified or acquiesced in the issuance of that stock. As he then held a majority of the Ark stock held by all stockholders other than Poliak, the issuance of the Series B Preferred stock was ratified.

III. PLAINTIFFS ARE OTHERWISE BARRED FROM CHALLENGING THE VALIDITY OF THE SERIES B PREFERRED STOCK

The doctrines of laches, acquiescence, waiver, estoppel and unclean hands also bar Plaintiffs from challenging the validity of the Series B Preferred Stock. Laches bars a claim where: (1) the plaintiff knew or should have known of its rights or claims; (2) the plaintiff unreasonably delayed in asserting its rights or claims; and (3) the defendant was injured by the delay. *Nevins v. Bryan*, 885 A.2d 233, 246-47 (Del. Ch. 2005); *President and Fellows of Harvard College v. Glancy*, 2003 WL 21026784, at *17 (Del. Ch. Mar. 21, 2003); *Stengel v. Rotman*, 2001 WL 221512, at *6 (Del. Ch. Feb. 26, 2001). Plaintiffs have known of Poliak's control of Ark after Keyser's hostile takeover attempt

in 2010 for many months. Yet they failed to bring this litigation until more than a year after the Series B Preferred Stock was issued. Since issuance of the Series B Preferred Stock, Ark, thanks to the efforts of the Individual Defendants, raised approximately $4 million through the two Series A Preferred Offerings and restructured and reduced much of its debt. Plaintiffs' delay has injured Defendants because they expended considerable efforts trying save Ark from bankruptcy and pursued the Series A Stock Offering with a belief that they could fulfill their investors' expectations in their management of Ark. Ark also incurred the expense of the Skoda Minotti valuation pursuant to the Settlement Agreement. Third parties, investors and Ark noteholders who participated in the Series A Stock Offering and were informed that Poliak controlled Ark through super voting stock, could be injured if control of Ark changes suddenly. Accordingly, laches bars Plaintiffs' challenge to the Series B Preferred Stock.

"Acquiescence occurs when a party 'has knowledge of an improper act by another, yet stands by without objection and allows the other party to act in a manner inconsistent with the claimant's property rights.'" *TR Investors, LLC v. Genger*, 2010 WL 2901704, at *15 (Del. Ch. July 23, 2010) (quoting *Brandywine Dev. Group, L.L.C v. Alpha Trust*, 2003 WL 241727, at *4 (Del. Ch. Jan. 30, 2003), *aff'd*, 26 A.3d 180 (Del. 2011)). *See also Bay Newfoundland Co. v. Wilson & Co.*, 37 A.2d 59, 63-64 (Del. 1944); *Dweck v. Nasser*,2012 WL 161590, at *21 (Del. Ch. Jan. 18, 2012); *Nevins*, 885 A.2d at 247. Poliak's control of Ark following issuance of the Series B Preferred Stock is inconsistent with Keyser's claim that the Series B Preferred Stock is invalid. Similarly, Schalk and Salvatore stood by while Poliak ran Ark until November 2011. Thus,

Plaintiffs have acquiesced in the issuance of the Series B Preferred Stock and Poliak's control of Ark.

A "[w]aiver is the voluntary and intentional relinquishment of a known right." *Realty Growth Investors v. Council of Unit Owners*, 453 A.2d 450, 456 (Del. 1982). Keyser has known of the Series B Preferred Stock since December 10, 2010 and entered into transactions with Ark resulting from Poliak's control of Ark. Salvatore and Schalk have known of Poliak's control of Ark for many months, but did not oppose such control until late 2011. Accordingly, Plaintiffs have waived their right to challenge the Series B Preferred issuance.

To invoke the doctrine of equitable estoppel, a party must show that they: (1) lacked knowledge or means of discovering the truth; (2) reasonably relied on the conduct of the party against whom they are asserting estoppel; (3) suffered prejudicial change in position as a result of their reliance. *Nevins*, 885 A.2d at 249. *See also Danvir Corp. v. Wahl*, 1987 WL 16507, at *5 (Del. Ch. Sept. 8, 1987). Following consummation of the Notes Agreement and execution of the Settlement Agreement, Defendants lacked knowledge that Keyser intended to challenge the Series B Preferred Stock. Defendants also lacked knowledge that Salvatore and Schalk intended to object to the Series B Preferred Stock after Poliak acquired control of Ark. Had Poliak known Keyser intended to challenge Poliak's control of Ark after consummation of the Notes Agreement he would not have caused Ark to enter into that agreement. Ark and Poliak reasonably relied on Keyser's conduct in consummating the Notes Agreement and the Series A Preferred Offering. Ark and Poliak similarly relied on Salvatore and Schalk's lack of

objection to the Series A Preferred Offering and Poliak's control of Ark in 2011. Accordingly, Defendants have suffered a prejudicial change as a result of Plaintiffs' conduct.

It is well-settled that "[h]e who comes into equity must come with clean hands." *In re Silver Leaf, L.L.C.*, 2005 WL 2045641, at * 11 (Del .Ch. Aug. 18, 2005) (citing *Bodley v. Jones*, 59 A.2d 463, 469 (Del. 1947)). As will be shown at trial, Keyser's actions in the fall of 2010, his acceptance of the benefits arising under the Notes Agreement and Series A Preferred Stock offering and his refusal to abide by the terms of the Settlement Agreement constitute unclean hands and he is not entitled to equitable relief.

* * *

At trial, Defendants will show that the equitable defenses described above bar Plaintiffs' claims.

IV. KEYSER'S SEVEN MILLION SHARES SHOULD NOT BE COUNTED

In Section 225 actions, the Court of Chancery will determine whether votes obtained through fraud or breach of contract should be counted. *E.g., Agranoff v. Miller*, 1999 WL 219650, at *18 (Del. Ch. Apr. 12, 1999); *Garrett v. Brown*, 1986 WL 6708, at *6-11 (Del. Ch. June 13, 1986); *Kahn Bros. & Co. v. Fischbach Corp.*, 1988 WL 122517, at *5 (Del. Ch. Nov. 15, 1988). Keyser's shares should not be counted because he breached the Settlement Agreement by failing to sell those shares to Ark. Pursuant to the Settlement Agreement, Keyser was required to sell his seven million shares of Common stock to Ark for the price agreed upon by Poliak and Keyser or, if they were unable to

agree, the price determined by a third party valuation firm recommended by Ark's general corporate counsel Bruce Rosetto and selected by Rosetto if the parties were unable to agree on the firm. Poliak and Keyser were unable to agree upon a price, but agreed on Skoda Minotti performing the valuation. Shek provided numerous materials to Skoda Minotti for the valuation and kept Keyser apprised of Skoda Minotti's work. When Keyser asked questions or for copies of the materials provided, Shek or Skoda Minotti responded and provided the materials to him. On October 6, 2011, Skoda Minotti indicated to Keyser that his Ark shares had little to no value. On October 11, 2011, Keyser purported to terminate the Settlement Agreement. After Skoda Minotti provided its valuation report estimating Keyser's shares were worth $0, Keyser failed to transfer his shares to Ark.

Keyser breached the Settlement Agreement by failing to transfer his shares to Ark. Ark and Poliak fulfilled their obligations under the Settlement Agreement. Although Keyser purported to terminate the Settlement Agreement because the valuation was not completed by July 31, 2011 as set forth in the Settlement Agreement, he cooperated with Skoda Minotti while they worked on the valuation in August and September. He also complained about the accuracy of certain documents provided to Skoda Minotti. Keyser, however, did not purport to terminate the Settlement Agreement until after learning his shares were likely to be valued for little to nothing. Apparently he believes Ark possesses warrants with significant value, but as will be shown at trial, most of these warrants have higher exercise prices than the current trading prices and therefore do not have significant value. Unless the warrants exceeded $3 million, which they do

not, Keyser's stock was worth little to nothing according to Skoda Minotti. If Keyser had transferred his seven million shares to Ark as required by the Settlement Agreement, Ark would have issued those shares to new and existing stockholders. Thus, as a result of Keyser's breach of the Settlement Agreement, his shares should not be counted toward the Written Consent.

If Keyser's seven million Ark shares cannot be voted, the remaining Plaintiffs do not have more than 50% of the Ark shares outstanding.[4] Nor should they be permitted to join with Keyser to further his breach of the Settlement Agreement with Ark by taking over Ark. All of the defenses applicable to Keyser (ratification, acquiescence, laches, equitable estoppel, waiver and unclean hands) apply to Salvatore, Kaiser, Schalk and John Keyser as well.

[4] John Keyser, Salvatore, Kaiser and Schalk own 10,154,000 shares of Ark, but as of the date of the Written Consent, Ark had 27,247,650 shares of common stock outstanding.

CONCLUSION

For the reasons set forth above, and the evidence that will be presented at trial, Defendants respectfully request that this Court rule in favor of Defendants and declare (i) the Written Consent invalid, (ii) Messrs. Curtis, Hands and Shek directors of the Company, (iii) the Series B Preferred Stock valid and (iv) Mr. Keyser in breach of the Settlement Agreement.

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