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 29, 2012**

<u>PLAINTIFFS' POST-TRIAL BRIEF</u>

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NATURE AND STAGE OF PROCEEDINGS

Plaintiffs Robert D. Keyser, Jr., Frank Salvatore, and Scott Schalk (collectively "Plaintiffs") brought this action pursuant to 8 *Del. C.* § 225 against defendants Tom Curtis, Thomas Hands, Donald Shek (collectively, the "Former Directors"), and Albert Poliak (together with the Former Directors, "Defendants"). Plaintiffs seek an order declaring that the December 13, 2011 written consent of stockholders (the "2011 Written Consent") validly and effectively removed the Former Directors from the board of directors (the "Board") of Ark Financial Services, Inc. ("Ark" or the "Company") and elected Plaintiffs to the Board. The Court conducted a two-day trial in this action on March 14 and March 15, 2012. This is Plaintiffs' post-trial brief.

PRELIMINARY STATEMENT

Despite Defendants' efforts to sow confusion, this is not a complicated case. In December 2010, when Poliak was Ark's sole director, he issued himself super-voting preferred stock representing outright voting-control of the Company for the express purpose of preventing the holders of a majority of the Company's common stock from removing him from office. To prevail in this litigation, Defendants must demonstrate that the preferred stock – the product of Poliak's faithless conduct – is valid. Barring that, Defendants can only prevail by convincing the Court that it should exercise its discretion to close the doors of equity to – not one, not two, but all three – Plaintiffs, and prohibit them all from challenging Poliak's egregious conduct and exercising their rights as stockholders to elect directors of their choosing. Defendants utterly failed to make either showing.

Because Poliak issued the preferred stock to *himself* the issuance is a self-interested transaction subject to the entire fairness standard. By his own admission, Poliak did nothing to try to ensure the issuance was entirely fair. He did not investigate the nature or existence of the threat he claims Keyser posed to the Company. Although he sought legal advice prior to the issuance, Poliak does not recall the advice he received. The only written advice contained in the record indicates that Poliak's legal advisors were rightly suspect of the validity of the issuance. Poliak did not seek third-party valuation advice or a fairness opinion to support his decision to pay just $250 for control of the Company. Instead, the trial record demonstrates that the $250 price was "arbitrarily determined" and, therefore, "arbitrary." Defendants dispute none of these facts, and thus cannot demonstrate that the issuance was entirely fair. The preferred stock is void.

Perhaps recognizing as much, Defendants asserted a set of convoluted, and factually and legally baseless, defenses in a desperate attempt to excuse Poliak's self-interested, entrenchment-motivated conduct. Each is nothing more than a blind alley. Yet the Court need not run to the end of any of those alleys. So long as any one of the Plaintiffs has standing to challenge the validity of the preferred stock, Defendants cannot use the preferred stock as a basis to deny the effectiveness of the 2011 Written Consent. Defendants failed to demonstrate that their defenses apply to any of the Plaintiffs, let alone all three of them, and devote most of their efforts to attacking Keyser, making almost no effort to show their defenses apply to Salvatore or Schalk. That fact is fatal to their defense. The Court, therefore, should enter the attached proposed order declaring the 2011 Written Consent effective.

STATEMENT OF FACTS

A. Ark Incurs Debt To Maintain Operations

Ark is a Delaware corporation. (PTO ¶ 1.)[1] Keyser and Poliak founded the Company in 2002. (*Id.*) Ark acts as a holding company for Dawson James, an investment-banking firm. (*Id.* at ¶ 2.) Until December 2009, Keyser and Poliak were the sole directors of, and shared administrative responsibilities at, Ark and Dawson James. (Tr. 241.) Keyser was the CEO of Dawson James and Secretary of Ark, (Tr. 11), while Poliak served as President of both entities. (PTO ¶ 10.) In addition, Keyser provided investment banking services to Dawson James's clients. (Tr. 13.)

The Company incurred substantial debt since its formation in order to maintain its operations. (PPB 4-5; *see* Tr. 9.) Allan R. Lyons, Kenneth A. Steel, Jr., Burton Koffman, and their affiliates (collectively, the "Three Creditors") were a primary source of debt funding for Ark. (Tr. 9.) Between July 2002 and February 2009, Ark issued at least five promissory notes payable to some or all of the Three Creditors with an aggregate principal amount of $3.1 million (the "Notes"). (PTO ¶¶ 3-7; JX 16; JX 51.) One of the Notes included an option to acquire 24% of Ark's common stock (the "Option"). (PTO ¶ 7; JX 8 at § 5.) Keyser and Poliak both personally guaranteed two of the Notes. (*See, e.g.*, JX 8 at ARK00001510; Tr. 10.)

B. Poliak Takes The Helm, But Fails To Restructure The Company's Debt

The Company struggled to meet its debt obligations, particularly following the Great Recession. (Tr. 11-12.) In June 2009, Keyser stepped down as CEO of Dawson

[1] Unless otherwise indicated, citations herein to the Joint Pretrial Stipulation and Order ("PTO") are to Section II (Facts Which Are Admitted And Require No Proof).

James at the recommendation of a consultant retained by the Three Creditors. (Tr. 12-13.) In December 2009, Keyser left Ark and Dawson James to join Aurora Capital LLC. (PTO ¶ 10.) Upon Keyser's departure, Poliak became the sole director of Ark, as well as the President and CEO of both Ark and Dawson James. (PTO ¶ 10; Tr. 13.)

During 2010, the Company remained unable to meet its debt obligations. Poliak sought to restructure the Company's debt, including the Notes, through an exchange of debt for preferred stock. (PTO ¶ 8; Tr. 235.) The Three Creditors negotiated with Ark, from 2009 through most of 2010, and worked with the Company's other creditors to find a mutually agreeable solution. Those efforts were unsuccessful because Poliak was unfocused and allowed the negotiations to suffer from long periods of inattention. As Lyons explained, the negotiations proceeded "[v]ery slowly" – "things were just dragging and dragging" – and it was "very difficult" to get in touch with Poliak. (Lyons 14, 41-43.) The Three Creditors became frustrated with Poliak's leadership of Ark and concerned about Ark's inability to meet its debt obligations. (Lyons 14-17, 41-43.)

During this time, Keyser maintained a business relationship with Lyons. They periodically met for lunch to discuss potential business opportunities. (Tr. 14.) During several of those meetings, Lyons expressed his growing concern about Poliak's management of Ark. (Tr. 14.) As a stockholder of the Company and a personal guarantor of two of the Notes, Keyser was concerned about the likely consequences for him and the Company if the Three Creditors called the Notes.

Through additional discussions with the Three Creditors, Keyser concluded they might support a change in Ark management that would be more focused on and attentive to the need to find a mutually acceptable resolution of the Company's debt crisis. Keyser and a colleague at Aurora Capitol, Doug Armstrong, developed a plan to remove Poliak and install a new board of directors at Ark. (Tr. 15-16.) Specifically, Keyser proposed that the Three Creditors assign the Option to him and sell the Notes to Auxol Capital LLC ("Auxol"), an entity owned by Keyser and Armstrong. (PTO ¶ 11; Lyons 16; Tr. 15.) Reassured by the involvement of Armstrong, who had experience leading public and private companies, the Three Creditors agreed. (Lyons 16; Tr. 21.) On November 29, 2010, the Three Creditors assigned the Option to Keyser and executed a purchase and sale agreement transferring the Notes to Auxol. (PTO ¶¶ 12-13; JX 15; JX 16; Tr. 17.)

C. Poliak Moves Swiftly To Entrench And Enrich Himself

Later in the afternoon of November 29, Keyser notified Poliak and Ark's outside legal counsel that the Three Creditors had assigned the Option to him and that he was exercising it (the "Notice of Exercise"). (PTO ¶ 13; JX 14; Tr. 18-19.) Keyser requested that Ark issue him a stock certificate evidencing 24% of Ark's common stock (or 8,604,521 shares). (PTO ¶ 13; JX 14.)

After receiving the Notice of Exercise, Poliak understood that his control over Ark was in jeopardy and took swift action to entrench himself. (Tr. 140-41.) Even if the Option Shares were not issued, Poliak did not own a majority of Ark's common stock, and he knew that Keyser could work with other dissatisfied stockholders to remove him and elect a new board. On December 1, 2010 – just two days after receiving the Notice of Exercise – Poliak executed a written consent, in his capacity as Ark's sole director, approving and adopting amendments to the Company's bylaws (the "Bylaw Amendments") and creating 50,000 shares of a new series of super-voting preferred stock that he designated Series B Preferred Stock (the "Series B Preferred"). (PTO ¶ 16; JX 24; Tr. 141-43.) That same day, Poliak caused the Company to issue him 25,000 shares of the Series B Preferred, giving him more than 50% of the Company's voting power, for $250 – only a penny per share. (PTO ¶ 18; JX 57; Tr. 141-43.) Poliak admits that he issued himself the Series B Preferred in order to "prevent" the holders of a majority of the Company's common stock from removing him. (Tr. 149.)

The Bylaw Amendments purported to amend Section 412 of the bylaws to permit the removal of directors only "for cause," only at a meeting of stockholders (and not by written consent), and only by a supermajority (75%) stockholder vote. (JX 24.) The Bylaw Amendments, on their face, violate the Delaware General Corporation Law.

The Series B Preferred that Poliak designated and issued to himself carries exorbitant voting and economic rights. Pursuant to the certificate of designations, the holders of the Series B Preferred – in this case, Poliak alone – are entitled to cast 1,000 votes per share on all matters, including the removal and election of directors. (JX 28 at § 4.) The Series B Preferred has a $1.00 per share liquidation preference and is redeemable at any time upon the demand of the holder for $1.00 per share. (*Id.* at §§ 3, 5.) Consequently, Poliak gave himself not only voting control of the Company, but also the right to demand $25,000 from the Company at any time. Incredibly, Poliak paid just $250 – a penny per share – for this windfall, which substantially diluted the common stockholders' economic and voting rights.[2]

In the approximately forty-eight hours that elapsed between Poliak's receipt of the Notice of Exercise and his issuance of the Series B Preferred, Poliak did virtually nothing to ensure that his actions were fair and reasonable. Although he claims to have believed Keyser posed a threat (Tr. 142-44), he did not investigate that purported threat before

[2] The Series B Preferred also is entitled to share ratably in any dividends on the Company's common stock. (*Id.* at § 2.)

issuing the Series B Preferred. (Tr. 145-47.) At most, Poliak called one of the Three Creditors to ask about their plans. (Tr. 146-47.) But Poliak does not recall whether he did so before or after he issued the Series B Preferred. (*Id.*) Poliak also did not consider potential alternatives to issuing the Series B Preferred, other than fabricating a story that he had promised to issue common stock to certain employees and issuing that stock – an alternative that those employees rejected due to its fraudulent nature. (Tr. 293-94.)

Poliak also claims to have relied on the legal advice of Locke Lord & Bissell ("Locke Lord") in issuing the Series B Preferred. (Tr. 147.) Poliak, however, does not recall the specific (or even much of the general) legal advice he claims to have relied upon. (Tr. 150-51.) The only contemporaneous written advice suggests that Locke Lord was rightly skeptical of the validity of the Series B Preferred. In a December 1, 2010 email to Poliak attaching a draft of the certificate of designations for the Series B Preferred, Christopher Pesch of Locke Lord wrote: "As we discussed, Delaware courts don't like provisions that look like self[-]dealing. The courts especially don't like provisions that appear to take away or reduce the voting power of the common stockholders." (JX 22; PTO ¶ 15; JX 160-62.)[3] Tellingly, Defendants elected not to introduce testimony from Pesch regarding the advice he purportedly provided Poliak.

Poliak took no steps to determine a fair price for the Series B Preferred or the value that he should have paid for control of the Company. (Tr. 155-60.) He testified that the economic terms of the Series B Preferred – the dividend rights, the liquidation

[3] Poliak, however, neither focused on this advice nor took it particularly seriously at the time it was given: "[T]hey were explaining to us that if we're dealing, you know, if we're issuing special shares to me specifically, to benefit me specifically, personally, so on and so forth, that was something that they – that may be improper, blah, blah, blah." (Poliak 87; Tr. 162.)

preference, and the immediately exercisable $1.00 per share redemption right – were irrelevant to determining a fair price, and that he did not even consider those terms. (Tr. 160.) Poliak did not attempt to get a third-party valuation report or a fairness opinion. (Tr. 156.) Instead, the price of the Series B Preferred was "arbitrarily determined" and, thus, "arbitrary." (Tr. 156, 484-86.)

Poliak was not content to simply entrench himself. He also misappropriated Company assets. Ark often receives underwriter warrants from issuers as compensation for investment banking services. (Tr. 43, 211.) Some are allocated to Company employees, while the remaining underwriter warrants are held for the benefit of the Company. (Tr. 44.) In December 2010, following receipt of the Notice of Exercise, Poliak unilaterally assigned to himself 1,000,000 underwriter warrants for Elephant Talk Communications that belonged to the Company and its employees (the "Elephant Talk Warrants"). (Tr. 208-11.) Poliak claims he took the Elephant Talk Warrants because he feared Keyser would reallocate them if Keyser gained control of the Company. (Tr. 209-10.) Poliak claims he later returned the Elephant Talk Warrants. (Tr. 210.) Defendants, however, failed to produce any documentary evidence corroborating his testimony.

D. Poliak Conceals His Self-Interested Entrenchment From Plaintiffs As Well As Company Insiders

Late on December 1, 2010, Armstrong sent a written consent of stockholders (the "2010 Written Consent") to Ark's outside counsel by email. (PTO ¶ 19; JX 32; Tr. 20.) The 2010 Written Consent attempted to remove Poliak as the Company's sole director, expand the size of the Board to two directors, and elect Keyser and Armstrong as directors of the Company. (PTO ¶ 19; JX 32; Tr. 20-21.) The 2010 Written Consent was signed by Keyser and Schalk, and two other Ark stockholders (the "2010 Consent

Signatories"). (PTO ¶ 19; JX 32.) The 2010 Consent Signatories collectively held 18,802,521 shares of Ark's common stock, including the 8,604,521 shares Keyser claimed as a result of his exercise of the Option (the "Option Shares"). (JX 32.)

The following day, Locke Lord sent a letter to Keyser and Armstrong on behalf of Ark contesting the assignment and exercise of the Option and the validity of the 2010 Written Consent. (PTO ¶ 21; JX 34.) Locke Lord asserted that Keyser did not own and could not vote the Option Shares because the Option was not assignable and because the Three Creditors had not obtained Ark's prior written approval of the assignment of the Option to Keyser. (JX 34.) Locke Lord chose not to mention the Series B Preferred in the letter. (*Id.*)

In view of the position Ark and Poliak had taken that the assignment of the Option to Keyser on November 29 was ineffective, out of an abundance of caution, the Three Creditors submitted a "back-up exercise" of the Option to Ark on December 3, 2010. (PTO ¶ 22.) The Three Creditors directed Ark to issue a certificate for the Option Shares in the name of Keyser. (JX 48; JX 71.)

In an effort to postpone further attempts at his removal and to conceal the existence of the Series B Preferred, Poliak determined to delay the actual issuance of the Option Shares and secretly determined he would disregard the instruction to issue those shares to Keyser and instead would issue them in the name of the Three Creditors. (JX 46; JX 53; JX 58.) After repeated inquiries from Armstrong, Keyser, and the Three Creditors asking when the Option Shares would be issued, John Kloecker of Locke Lord finally emailed Armstrong on December 8, 2010 to confirm that Ark would issue the Option Shares. (PTO ¶ 25; JX 56.) In the email, Kloecker advised for the first time that even with the issuance of the Option Shares, "we want to be clear that neither you, Mr. Keyser or the noteholders have voting control of the company." (PTO ¶ 25; JX 56.)

Armstrong and Knox Bell, counsel to Auxol and Keyser, both responded to Kloecker's email and asked whether the Company had recently issued additional shares. (JX 54; JX 56.) Instead of responding to these questions in a forthright way, Kloecker merely reiterated that even with the Option Shares, Keyser and the other 2010 Consent Signatories would not have voting control of the Company. (JX 56.)

On December 9, 2010, Ark issued a certificate for the Option Shares to the Three Creditors, instead of to Keyser as the Three Creditors had requested. (PTO ¶ 26; JX 68.) The Three Creditors subsequently assigned the Option Shares to Keyser. (PTO ¶ 26.) Despite the Three Creditors' repeated requests that Poliak deal with Keyser and Auxol directly, Poliak sent the revised capitalization table reflecting the Series B Preferred to Lyons, rather than to Keyser or his counsel, and sent it by mail, rather than email or fax. Immediately upon receiving the revised capitalization table from Lyons on December 10, 2010, Bell, on behalf of Keyser, emailed Kloecker and objected to the Series B Preferred, writing "SUCH STOCK ISSUANCE IS VOID UNDER DELAWARE CORPORATION LAW SECTION 144." (JX 64 (emphasis in original); PTO ¶ 27.)

Although Poliak claims to have issued the Series B Preferred, in part, to protect the Company's employees, the record demonstrates he was no more forthcoming with them about his faithless conduct. For instance, Poliak did not tell Curtis, one of the Company's key employees, that Keyser had attempted to take over the Company until several weeks after he had issued the Series B Preferred to himself. (Tr. 371.) When he did so, Poliak did not disclose that he had issued the Series B Preferred, but rather vaguely reported that "he had taken the necessary steps to hold off the takeover." (Tr. 371-72.) Poliak did not tell Curtis about the Series B Preferred until they began preparing the Series A Preferred offering materials and, even then, Poliak failed to report that he paid just a penny per share. (Tr. 372-33.) Despite having served as a director of the Company since November 2011, Curtis did not learn that information until this litigation. (Tr. 373.)

E. The Attempted Settlements And The Series A Preferred

Ark and Auxol entered into a confidentiality and standstill agreement (the "Standstill Agreement") on January 5, 2011. (PTO ¶ 29; JX 75.) In the Standstill Agreement, the parties agreed to defer litigation to provide time to negotiate a transaction whereby Ark would purchase the Notes and other Ark securities from Auxol. (JX 75.) Section 9 of the Standstill Agreement specifically tolled each and every limitations period, statutory or equitable, during the standstill period. (*Id.* § 9.) Because Keyser and Auxol were agreeing, for the purposes of facilitating a settlement, to defer any action to effectively remove Poliak as a director or to commence litigation over Poliak's issuance of the Series B Preferred to himself, the Standstill Agreement also contained a "Status Quo" provision. It prohibited Ark from taking "any actions outside the ordinary course of business," including amending the charter or bylaws, the issuance of stock or other securities, changes in corporate structure, and sales of significant assets. (*Id.* at § 6.)

On March 31, 2011, Ark and Auxol entered into a Stock and Note Purchase Agreement (the "Purchase Agreement"). (PTO ¶ 35.) The Purchase Agreement provided that Ark would purchase the Notes, the Option Shares, and the Dawson James shares held by Auxol for $2,200,000 on April 1, 2011 (or such other date agreed to by the parties), the Closing Date. (PTO ¶ 35; JX 94.)[4] The Purchase Agreement expressly did not apply to the 7,000,000 shares of Ark common stock (the "Original Shares") owned personally by Keyser. The Purchase Agreement contemplated that the parties would endeavor to reach a separate settlement agreement pursuant to which Ark would purchase those shares. (JX 94 at § 7.4.) Sections 6.2 and 6.3 of the Purchase Agreement contained releases from Ark, Auxol, and their respective affiliates. (*Id.* at §§ 6.2, 6.3.) Section 6.4, however, made very clear the releases are not applicable to Keyser for so long as he owns the Original Shares. (*Id.* at § 6.4.) It provides: "For the 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." (*Id.*)

To raise funds for the Purchase Agreement, the Company began marketing the sale of a new series of preferred stock on or around March 15, 2011 (the "Series A Preferred"). (PTO ¶ 32.) The private placement memorandum produced by the Company in connection with the Series A offering (the "PPM") discloses, as a risk factor, Poliak's control over the Company through his ownership of the Series B Preferred. (JX 87.) None of Keyser, Salvatore, or Schalk were involved in drafting the PPM, and Ark and Poliak never requested their participation in the process or their input on the content of the PPM. They were not given the opportunity to review the PPM before the Company distributed it, and, in fact, Ark was very reluctant to provide any details to

[4] The Purchase Agreement formally documented the concepts from an earlier agreement in principle (the "Agreement in Principle"). It also incorporated certain terms from the Agreement in Principle, including the continuation of a status quo provision, which restricted Ark from taking action outside the ordinary course. (JX 79 at § 3; JX 94 at § 11.4.)

Keyser or Auxol about the financing efforts or status of the financing and did so only reluctantly toward the end of April 2011. (*See* JX 97; JX 98; JX 106; JX 111; JX 116.)

The Company failed to close under the Purchase Agreement by April 1, 2011, and the parties had not agreed to a different Closing Date. (PTO ¶ 36.) In view of Ark's breach and its failure to be forthcoming about financing efforts, Delaware counsel to Keyser and Auxol sent a letter to Locke Lord reiterating that Poliak's issuance of Series B Preferred to himself was invalid and void and that Keyser, Armstrong, and Auxol intended to commence litigation. (*Id.* at ¶ 38; JX 101.) Locke Lord responded by letter dated April 19, 2011, claiming that litigation would undermine the preferred stock offering and imploring Keyser, Armstrong, and Auxol to give Ark more time. (PTO ¶ 39; JX 102.)[5] On April 20, Auxol and Ark executed an Extension Agreement postponing the Closing Date to April 29, 2011. (PTO ¶ 41; JX 111 at § 2.)

On April 29, 2011, Ark, Poliak, and Keyser executed a separate settlement agreement pursuant to which Ark would acquire the Original Shares from Keyser (the "Keyser Settlement Agreement"). (PTO ¶ 45, JX 119.) The Keyser Settlement Agreement contemplated that the parties would attempt to negotiate a price for the Original Shares (the "Sale Price") and, if those negotiations failed, would select an independent third-party valuation firm to determine the Sale Price. (JX 119 at §§ 3(a)-(b).) The Keyser Settlement Agreement required, unless the parties agreed otherwise in writing, the Sale Price to be determined on or before July 31, 2011 (the "Valuation Deadline") and the closing to take place no later than August 15, 2011 (the "Closing

[5] Subsequent to Locke Lord's letter, Bell and Kloecker further engaged in correspondence via email. In those emails, Bell continued to make clear that Keyser and Auxol still contested the validity of the Series B Preferred. (JX 110.)

Deadline"). (*Id.* at § 3(b).) It further provided that "Ark shall pay Keyser in cash no less than $50,000, together with a Secured Promissory Note … for the remaining balance." (*Id.* at § 3(c).) The Keyser Settlement Agreement also required the parties to "use commercially reasonable efforts to … execut[e] and deliver[] such …documents…as may be necessary or appropriate to effectuate" the terms of the agreement and to "cooperate and take such actions as may be reasonably requested by any other party in order to carry out the provisions and purposes" of the agreement. (*Id.* at §§ 6(v), 10(a).)

Under the Keyser Settlement Agreement, Keyser would "relinquish all of his right, title and interest in and to Ark and any of the rights, privileges, duties, responsibilities and authority therewith shall be automatically transferred to Ark" upon the closing. (*Id.* at § 2.) Until that time, however, Keyser expressly reserved all claims he had against Poliak. The Keyser Settlement Agreement provided "nothing in this Agreement constitutes a waiver by any party of any claim the party may have against the other parties." (*Id.* at § 5.)

F. Poliak And Ark Breach The Keyser Settlement Agreement And Keyser Rescinds It

Poliak and Keyser were unable to agree upon the Sale Price. (PTO ¶ 49.) In accordance with the Keyser Settlement Agreement, the Company engaged an accounting firm, Skoda Minotti, to value the Company and determine the Sale Price. (*Id.*) Shek took the lead in providing Skoda Minotti information about the Company needed to complete the valuation.

On August 22, 2011, Keyser asked Poliak and Shek to provide him "the financial information that you have provided to Skoda Minotti…." (JX 133; Tr. 65-66.) Keyser also requested certain information regarding underwriter warrants held by the Company (the “Warrant Information”):

> In addition if it is not part of what has been provided I would like to have you forward me the schedule of all underwriter warrants and/or equity related compensation received in 2010 and through the valuation date. Please provide me with specific information on the total amount received and the breakdown of who it was issued to. Also I would like to see the calculation you are using to determine the value of the warrants held be the firm (Black Scholes?).

(JX 133; Tr. 66.) Keyser requested the Warrant Information because he believed the underwriter warrants were a critical component of the Company’s value. (Tr. 74.) Keyser was concerned that Poliak was trying to deflate the value of the Company by concealing information about the value of the underwriter warrants and distributing a larger than normal percentage of the underwriter warrants to Poliak and management as equity-compensation and, thereby, retaining fewer underwriter warrants for the benefit of the Company. (Tr. 68, 73.)

On August 29, 2011, in response to Keyser’s request, Shek sent Keyser the information Shek had previously provided to Skoda Minotti. (JX 133; Tr. 68-69.) Shek, however, did not include any of the Warrant Information. (JX 133; Tr. 69.) Later that day, Keyser repeated his request for the Warrant Information. (*Id.*) Neither Shek nor anyone else at the Company ever responded to his request.

On August 31, 2011, Shek provided Skoda Minotti minutes of the Company’s board meetings by email. (JX 135.) In reviewing the minutes, Keyser discovered that someone had altered the minutes for one of the meetings after the Board had approved them. (JX 136; Tr. 70.) Keyser was shocked and immediately raised the issue with Shek, Poliak, and Skoda Minotti. (JX 136; Tr. 69-71.)

On September 2, 2011, Keyser emailed Skoda Minotti to express to them his concerns about Poliak's efforts to conceal and distort the value of the underwriter warrants. (JX 147; Tr. 71.) Keyser informed Skoda Minotti that the Company had not responded to his requests for the Warrant Information. (JX 147; Tr. 72) Based on public records, Keyser also identified certain underwriter warrants the Company should have received as a result of recent investment banking transactions. (JX 147; Tr. 74.) Keyser also reported that he had discovered that Poliak had issued the Elephant Talk Warrants to himself in December 2010. (Jx 147; Tr. 72-73.)

On September 19, 2011, in response to Keyser's request for an update, Skoda Minotti indicated that the only open issue concerned the value of the underwriter warrants. (JX 138.) Skoda Minotti reported that the Company still had not provided Skoda Minotti with an inventory of the underwriter warrants (the "Warrant Inventory"). (*Id.*) Although Shek first asked Poliak for the Warrant Inventory in July 2011 (Tr. 465), the Company did not provide the inventory to Skoda Minotti until September 30, 2011. (JX 140.) Despite Keyser's repeated requests for the Warrant Information (JX 133, Tr. 466-67), Shek did not provide the Warrant Inventory to Keyser when he sent it to Skoda Minotti. (JX 140). The Warrant Inventory did not contain all of the Warrant Information. (Tr. 80-82.) In particular, it did not identify how the warrants the Company had received had been allocated between the Company and its employees. (Tr. 80-81.)

On October 3, 2011, Skoda Minotti emailed Shek, Poliak, and Keyser regarding the Warrant Inventory. (JX 140; Tr. 75.) Skoda Minotti noted that the value of the underwriter warrants "has not been included in the Company's financial statements historically since it cannot include the value of these assets in computing net capital for regulatory purposes." (*Id.*) But, Skoda Minotti expressed that it was "necessary for [Skoda Minotti] to consider the value of these warrants … in determining the value of the Company." (*Id.*) Skoda Minotti proposed two options for valuing the underwriter warrants: (i) Skoda Minotti could "independently determine the value of the warrants using the Black-Scholes method" or (ii) the parties could "stipulate to the value of the warrants…." (*Id.* at 76-77.)

On October 6, the parties convened a conference call to discuss how to value the warrants. (Tr. 82.) Prior to the call, Keyser requested and obtained a copy of the Warrant Inventory that Shek had provided to Skoda Minotti, but withheld from Keyser. (JX 141; Tr. 80-81.) During the call, Keyser raised a number of questions regarding the accuracy of the Warrant Inventory. (Tr. 83.) Poliak acknowledged that it was incomplete and inaccurate and undertook to provide a revised Warrant Inventory. (*Id.*)

At this point, Keyser was exasperated. Despite his repeated requests, the Company still was refusing to provide him or Skoda Minotti with the Warrant Information – in particular information regarding the allocation of underwriter warrants. (Tr. 63, 80-81, 83.) At trial, Shek admitted he had not provided the Warrant Information to Keyser because "I don't work for Bob." (Tr. 466.) As a result, Keyser was unable to ensure that the Warrant Inventory was accurate or to determine whether warrants had been distributed to employees in a manner designed to drive down value. (Tr. 81.) Even without the information, however, Keyser knew the Warrant Inventory was inaccurate and incomplete. (Tr. 81-82.) Poliak admitted as much. (Tr. 83; Poliak 207.) Moreover, due to the Company's delay in providing information to Skoda Minotti, the Company had failed to meet the Valuation Deadline and Closing Deadline. (Tr. 63, 83.) Keyser, therefore, believed "his only real option … was to terminate the [Keyser Settlement Agreement]" and seek "books and records…." (Tr. 83.)

On October 7, 2011, Keyser submitted a books and records request pursuant to 8 *Del. C.* § 220, and on October 11, 2011, Keyser rescinded the Keyser Settlement Agreement. (PTO ¶ 52; JX 146.) The Company never produced documents in response to the books and records request. Skoda Minotti, however, continued to prepare a valuation report. On October 18, 2011, Shek provided a revised Warrant Inventory to Skoda Minotti. (JX 180; Tr. 467-68.) At trial, neither Shek nor Poliak wanted to take responsibility for creating the Warrant Inventory. (*See* Tr. 268-70, 470-71.) Their refusal was for good reason. Shek admitted that the revised Warrant Inventory was still incomplete – at the very least, it failed to account for the Elephant Talk Warrants and certain other underwriter warrants the Company received from ImmunoCellular Therapeutics. (Tr. 470-72.)[6] Shek also admitted that, in creating the Warrant Inventory, the Company did not consider whether the strike price for any of the underwriter warrants had been reduced as a result of a reset provision. (Tr. 471.)

At the instruction of Shek and Poliak, Skoda Minotti did not independently value the underwriter warrants identified on the incomplete, revised Warrant Inventory. (JX 167 at KSS00382; Tr. 215-17.) Instead, Skoda Minotti relied exclusively on an estimate of the value of the warrants provided by Shek and Poliak. (JX 167 at KSS000382; Tr. 215-17.) On November 30, 2011, Skoda Minotti issued its valuation report. (JX 167.) It concluded that Company's common stock was worthless. (*Id.*) The Company never

[6] Plaintiffs were able to establish these deficiencies in the revised Warrant Inventory based on public information alone. Defendants still have failed to produce the Warrant Information detailing the underwriter warrants received by the Company and their allocation among the Company's employees and the Company itself.

offered to pay anything to Keyser in exchange for his 7,000,000 shares of Ark's common stock, which Keyser continues to hold. (Tr. 200.)

G. The 2011 Annual Meeting And The Voting Agreement

In early October 2011, Poliak learned that the Financial Industry Regulatory Authority ("FINRA") intended to sanction him for unethical conduct (unrelated to his issuance of the Series B Preferred) in his capacity as a principal of Dawson James. (JX 150 at ARK00000119; Tr. 218.) Before resigning to comply with the FINRA sanctions (PTO ¶ 57), Poliak nominated and oversaw the election of the Former Directors as his replacements on the Board at Ark's annual meeting of stockholders. (PTO ¶ 56).

On October 14, the Company distributed a notice of the annual meeting to Ark's stockholders (the "Meeting Notice"). (JX 149; Tr. 303.) The Meeting Notice identified the Former Directors as Poliak's nominees. (JX 149; Tr. 335.) It also disclosed that, due to his ownership of the Series B Preferred, Mr. Poliak's presence alone at the meeting would be sufficient to satisfy the quorum requirement. (JX 149; Tr. 303-04.) As Schalk explained, this was the "first time" Poliak disclosed that he had "issued himself voting control of the [C]ompany." (Tr. 304; *see* Tr. 336-37.) Alarmed by this disclosure, Schalk, Salvatore, and another Ark stockholder, Douglas Kaiser, discussed the matter with Keyser. (Tr. 86-87.) After discussion with counsel, they each included a written objection to the issuance of the Series B Preferred on their proxies. (Tr. 86-89; JX 161 at ARK00006545 to ARK00006549.)

The Former Directors were elected to the Board at the annual meeting on November 1, 2012. (PTO ¶ 56.) Plaintiffs voted their shares in the election by proxy, but did not attend the meeting. At Plaintiffs' request, the Company's counsel read into the record at the meeting Plaintiffs' objections to the Series B Preferred, which each of the

Plaintiffs had included on their proxy cards. (JX 155; Tr. 87-88.) In tallying the results of the director elections, the Company counted Plaintiffs' shares, including the 7,000,000 votes cast by Keyser by virtue of the Original Shares he continues to own. (JX 154; Shek 61-2; Tr. 473-74.)

Shortly after the annual meeting, Poliak renewed discussions with Kaiser and Salvatore regarding acquiring their stock. (Tr. 337.) Poliak asked them to submit a proposal with the terms on which they would be willing to sell all of their stock. (*Id.*) Before submitting the proposal, Kaiser and Salvatore expressed concern that Poliak would use their proposal to seek more favorable terms from Keyser for the acquisition of his stock. (Tr. 339.) Kaiser, Salvatore, and Schalk understood that if Poliak acquired Keyser's stock, their ownership position would "become[] much more meaningless." (Tr. 341.) Poliak assured them that they "didn't have to worry about that." (Tr. 340.) On November 4, 2011, Salvatore submitted a proposal on behalf of himself, Kaiser, and Schalk to Poliak. (JX 158.) Poliak did not respond. (Tr. 339.)

A few days later, Keyser informed Kaiser, Salvatore, and Schalk that Poliak was seeking a meeting with Keyser to discuss purchasing Keyser's stock. (Tr. 340.) Keyser, Kaiser, Salvatore, and Schalk decided to present a unified front to combat Poliak's apparent divide-and-conquer strategy. (Tr. 341.) On November 10, 2011, they executed a voting agreement, in which they agreed to vote their respective shares "[t]o find, appoint, confirm and/or elect a new Board of Directors consisting" of Plaintiffs (the "Voting Agreement"). (JX 159 at § 2.03.) They further agreed not to sell their shares to any third-party, including the Company, until they had elected Plaintiffs to the Board.

(JX 159 at § 4.02.) Keyser's counsel mailed a copy of the Voting Agreement to Ark, which Ark received by November 15, 2011. (JX 160.)

On November 30, 2011, Ark sold additional shares of Series A Preferred for approximately $1 million. (PTO ¶ 59.) Before doing so, Defendants did not supplement the PPM to disclose that Keyser had terminated the Keyser Settlement Agreement, that Plaintiffs had again raised objections to Series B Preferred at the annual meeting, and that Plaintiffs had entered into a voting agreement to replace Ark's Board. (Tr. 374-75, 446.)

H. Plaintiffs Act By Written Consent To Remove The Former Directors And Elect Plaintiffs To The Board

On December 13, 2011, Keyser, Kaiser, Salvatore, Schalk and another Ark stockholder, John Keyser (together with Plaintiffs, the "2011 Consent Signatories"), executed and delivered a written consent to the Company's registered office in Delaware pursuant to 8 *Del C.* § 228. (PTO ¶ 60; JX 170.) The 2011 Consent Signatories collectively hold 17,154,000 shares of Ark's Common Stock. (JX 170; JX 153; PTO ¶ 61.) The 2011 Consent Signatories own approximately 63% of the 27,247,650 shares of validly issued and outstanding Ark Common Stock. (JX 153; PTO ¶ 61.) Because Poliak issued the Series B Preferred to himself in violation of his fiduciary duties, the 2011 Consent Signatories' holdings also represent approximately 63% of Ark's valid and outstanding voting power. The 2011 Written Consent removed the Former Directors from the Board and elected Plaintiffs to fill the vacancies. (PTO ¶ 60; JX 170.)

ARGUMENT

I. THE 2011 WRITTEN CONSENT WAS VALID TO REMOVE THE FORMER DIRECTORS AND TO ELECT PLAINTIFFS

As detailed below, the 2011 Written Consent was executed by holders of a majority of Ark's outstanding common stock. Because Poliak created and issued the Series B Preferred to himself for entrenchment purposes and in violation of his fiduciary duty of loyalty, the issuance of the Series B Preferred is void and invalid under Delaware law. As such, the 2011 Consent Signatories' holdings represented a majority of the Ark shares entitled to vote and, thus, the 2011 Written Consent was valid and effective.

A. The 2011 Written Consent Was Signed By Holders Of A Majority Of Ark's Common Stock, With Or Without Keyser

On December 13, 2011, the 2011 Consent Signatories executed and delivered the 2011 Written Consent providing for the removal of the Former Directors and the elections of Plaintiffs to replace them. (PTO ¶ 60.) The 2011 Consent Signatories collectively held 17,154,000 shares of Ark's common stock, representing 62.9% of the 27,247,650 shares of common stock outstanding as of that date. (PTO ¶ 61; JX 153.) Because, as explained below, Poliak issued the Series B Preferred in flagrant violation of his fiduciary duties, the 2011 Consent Signatories' holdings also represented a majority of the Ark shares "entitled to vote." 8 *Del. C.* § 228(a).

Defendants contend that Keyser breached the Keyser Settlement Agreement and, therefore, that the Court should deem the Original Shares to have been purchased by Ark so that Keyser is no longer entitled to vote them. This contention is factually baseless and ultimately irrelevant. As shown at trial and detailed below (*see supra*, Section II.D), Keyser validly rescinded the Keyser Settlement Agreement after Ark and Poliak breached it repeatedly. Keyser remains the record holder of the Original Shares. Even if the Court were to determine Keyser should have sold his shares back to Ark before December 13, 2011, those shares would have become treasury shares that are no longer outstanding or entitled to vote (8 *Del. C.* § 160(c)). The remaining 2011 Consent Signatories thus would still hold a majority of the outstanding common stock. Schalk, Salvatore, Kaiser, and John Keyser collectively hold 10,154,000 – a majority of the 20,247,650 shares that would be outstanding and "entitled to vote" following the Company's acquisition of Keyser's Original Shares.[7] (8 *Del. C.* § 228(a); JX 182; Tr. at 476-79.)

B. Because Poliak Breached His Fiduciary Duties In Issuing The Series B Preferred The 2011 Written Consent Was Signed By A Majority Of Ark's Outstanding Voting Power

1. Poliak's Self-Interested Issuance Of The Series B Preferred Is Subject To Entire Fairness

Poliak's issuance of the Series B Preferred to himself to "prevent" a majority of the Company's stockholders from removing him is a quintessential self-dealing transaction. While Defendant's Pre-Trial Brief failed to address the governing standard of review, Defendants previously suggested that the less stringent *Unocal* standard, rather than entire fairness, should apply. That contention is baseless. A transaction is subject to entire fairness if the director(s) who approved it "either stood on both sides of the

[7] Defendants have claimed that an informal plan existed to reissue the Original Shares and distribute them to Poliak's allies. (Tr. 265-66.) Much like Poliak's prior scheme to falsely claim he promised Schalk, Shek, and Brett Shapiro stock in order to block the 2010 Written Consent (Tr. 293-94), the apparent purpose of this alleged plan is to block an insurgent shareholder action, this time by diluting Salvatore, Kaiser, Schalk, and John Keyser. Also, the metadata from the document Defendants used to support this argument plainly shows that the document was created ***before*** the parties entered into the Keyser Settlement Agreement. (Tr. 278-79; JX 179.) Any argument that Keyser should be prohibited from voting the Original Shares, but that those shares should still be treated as outstanding shares and entitled to vote can find no basis in law or equity. 8 *Del. C* §§ 160(c), 219(c) ("The stock ledger shall be the only evidence as to who are the stockholders entitled . . . to vote . . . .").

transaction and dictated its terms in a self-dealing way, or the directors received in the transaction a personal benefit that was not enjoyed by the shareholders generally." *Chaffin v. GNI Group, Inc.*, 1999 WL 721569, at *5 (Del. Ch.). Poliak, the Company's sole director, stood on both sides of the transaction and dictated its terms. He also received material personal benefits (outright voting control and close to a $25,000 redemption right windfall) not enjoyed by other stockholders. (Tr. 453-54.) Accordingly, the entire fairness standard applies and Defendants must prove *both* that the transaction was a product of fair dealing and that it resulted in a fair price. *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1163 (Del. 1995). Defendants can satisfy neither aspect of this stringent standard.[8]

2. Poliak's Self-Interested Issuance Of The Series B Preferred Was Neither Fair As To Process Nor Fair As To Price

As demonstrated at trial, Poliak failed to undertake any process, let alone a fair process, in creating and issuing to himself the Series B Preferred. Poliak neither considered nor utilized any of the customary means of ensuring such a process. He made no effort to appoint independent directors to consider the matter.[9] Nor did he afford the holders of a majority of the minority of Ark's outstanding common stock an opportunity to approve his actions. Poliak undertook no effort to investigate the nature of the threat to which he claims to have been reacting (or even if it actually existed), and he did not evaluate any alternatives or endeavor to structure a response that was reasonable and

[8] For a more detailed analysis of the entire fairness form of review, Plaintiffs refer the Court to their Pre-Trial Brief. (PPB 29-30.)

[9] At trial, Poliak claimed that, aside from him, no one was willing to sit on the Board at the time he issued the Series B Preferred because there "was too much liability involved." (Tr. 159, 241-42.) He makes this claim, despite the obvious fact that he was acting to block the efforts of two individuals seeking to replace him on the Board: Keyser and Armstrong.

proportionate. He literally laughed at trial when asked if he had obtained a fairness opinion or third-party valuation. (Tr. 156.) While Poliak claims to have relied upon the advice of counsel in issuing the Series B Preferred, neither he nor any other witness is able to recall with any specificity the advice counsel supposedly provided. (Tr. 151.)[10]

Defendants have likewise failed to prove that the price paid by Poliak in the transaction was entirely fair. The price, a mere penny per share, was "arbitrarily determined" and was, therefore, "arbitrary". (Tr. 156, 482-84.)[11] Poliak did not consult with an independent financial advisor or obtain a fairness opinion. (Tr. 156.) He made no efforts to determine what a fair price for the Series B Preferred would be, let alone what the highest price reasonably obtainable under the circumstances might be. He considered no alternatives (including the issuance of the Series B Preferred to a third party who might pay more than a mere $250 for control of Ark). *See Packer v. Yampol*, 1986 WL 4748, at *17 (Del. Ch.) (criticizing a board's failure to explore adequately alternative financing options before issuing super voting preferred stock).

Even though 25,000 shares of Series B Preferred represented a control block, Poliak did not consider what such a control block was worth. (Tr. 157-58.) Nor did he consider the terms of the Series B Preferred in determining the issuance price. (Tr. 158; Poliak 95-96.) In fact, Poliak testified that he believed the financial terms of the Series B

[10] Poliak's haste alone shows the absence of a reasonable process. Poliak approved the issuance of Series B Preferred and the bylaw amendments no more than two days after Keyser delivered the Notice of Exercise. (PTO ¶¶ 13, 16.) He took just over one hour to consider and evaluate the terms and consequences of the draft certificate of designation, draft bylaws, and proposed form of resolutions provided by his counsel. (*Id.* at ¶¶ 15, 16; JX 22; JX 23; JX 27.)

[11] Shek's tortured effort to distinguish between "arbitrary" and "arbitrarily" was unavailing. (Tr. 484-86.) "Arbitrarily" means to act "in an arbitrary manner." (Webster's Third New International Dictionary of the English Language Unabridged (The Merriam-Webster Editorial Staff, 1966).)

Preferred were irrelevant to the issuance price. (Tr. 160; *see* Shek 27-28.) The Series B Preferred had a liquidation preference of $1.00 per share and was mandatorily redeemable at any time for $1.00 per share at Poliak's sole option. Poliak chose not to consider those important financial aspects of the Series B Preferred when he issued it to himself for a penny per share. That penny per share price is *per se* unfair.[12]

In short, Defendants can come nowhere close to satisfying their significant burden of establishing "fair process" and "fair price." Poliak's actions, thus, constituted a breach of his fiduciary duty of loyalty and the Series B Preferred is invalid and void.

3. Poliak's Self-Interested Issuance Of The Series B Preferred Does Not Even Satisfy Enhanced Scrutiny Under *Unocal*

Even if Poliak's conduct were subject to the less stringent enhanced scrutiny form of review derived from *Unocal* and its progeny, Defendants still could not satisfy their burden. Under enhanced scrutiny, directors must show: "(1) that [they] had 'reasonable grounds for believing a danger to corporate policy and effectiveness existed' (i.e., the board must articulate a legally cognizable threat) and (2) that any board action taken in response to that threat is 'reasonable in relation to the threat posed.'" *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 92 (Del. Ch. 2011) (quoting *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361 (Del. 1995)). Significantly, if, as here, the primary purpose of defensive conduct is to impede the exercise of stockholder voting power, directors have the much weightier burden within the *Unocal* framework of "demonstrating a compelling justification for [their] action." *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d

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[12] It is also significant that Defendants offer no expert testimony to establish that the price of one penny per share (or $250 in the aggregate) represented a fair price for the issuance of Ark shares with the financial terms discussed above and constituting outright voting control.

651, 661-62 (Del. Ch. 1988); *see also MM Cos., Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1129-30 (Del. 2003).[13]

a. Defendants Have Failed To Articulate A Legally Cognizable Threat

Defendants have failed to show that the Company faced a legitimate threat and so failed to satisfy the first part of the *Unocal* test. Poliak contends that he issued the Series B Preferred to himself because (1) he believed he was a better CEO than Keyser, who, in Poliak's view, had previously done a poor job managing Ark; and (2) he had an unsubstantiated "fear" or "concern" that Keyser and "his group" planned to take control of Ark and then act to benefit themselves at the expense of Ark's other stakeholders. (Tr. 142-45) Even if true, those purported threats to the Company would not justify Poliak's conduct. *See Johnston v. Pedersen*, 28 A.3d 1079, 1091 (Del. Ch. 2011) ("'The notion that directors know better than the stockholders about who should be on the board is no justification at all.'") (quoting *Mercier v. Inter-Tel (Del.), Inc.*, 929 A.2d 786, 811 (Del. Ch. 2007); and citing *Blasius Indus., Inc.*, 564 A.2d at 663). Indeed, action by the existing holders of a majority of a company's voting power to elect a new board, as happened here, is a far cry from the typical "takeover threat," in which a hostile third party seeks to purchase majority control on unfair or coercive terms.

As was demonstrated at trial, Poliak did nothing to ensure he employed a reasonable process, to investigate the existence and nature of the threat he claims to have perceived (Tr. 145), to consider the consequences of his actions, or to evaluate potential alternatives to his self-interested conduct during the roughly two-day period between

[13] For a more detailed analysis of the enhanced scrutiny form of review under *Unocal* and *Blasius*, Plaintiffs refer the Court to their Pre-Trial Brief. (PPB 22-24.)

Ark's receipt of the Notice of Exercise on the afternoon of November 29, 2010 and Poliak's creation and issuance of the Series B Preferred Stock to himself on December 1, 2010. Thus, Defendants have failed to show that the Company faced a legitimate threat and failed to satisfy the first part of the *Unocal* test.

b. Because Poliak Took Preclusive Action And Did Not Act Reasonably Or With A Compelling Justification Defendants Cannot Satisfy The Second Part of *Unocal*

Defendants also cannot satisfy their burden under the second part of *Unocal*. It is well-settled that if a Board's action is preclusive (such as where it makes it "mathematically impossible" for stockholders to conduct a proxy or consent contest to elect a new board), it is an unreasonable response to the threat posed and so violates *Unocal*. *See e.g., Versata Enters., Inc. v. Selectica, Inc.*, 5 A.3d 586, 601 (Del. 2010); *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1387-88 (Del. 1995). Poliak issued 25 million votes to himself – "outright control over the [C]ompany" (Tr. 160) – making it "mathematically impossible" for other stockholders of Ark to ever again elect a board of their own choosing. He freely admits that he issued the Series B Preferred to himself to "***prevent[]*** Mr. Keyser's group from electing a new board…." (Tr. 149 (emphasis added; Poliak 15, 40-41, 48, 89.) A defensive action specifically designed to "prevent" stockholders from electing a new board is, by definition, preclusive and, thus, unreasonable.

In addition to being preclusive, Poliak's actions were wildly disproportionate to the threat he claims to have perceived. Poliak never identified any sufficient justification for his actions, let alone tailor them to a compelling justification. *See Johnston*, 28 A.3d at 1091. He made no effort to ensure that his actions were reasonable and proportionate. (*See* Poliak 13-14, 32-33, 47-48.)[14]

c. This Court's Recent Decision In *Johnston v. Pedersen* Demonstrates That Poliak's Conduct Cannot Withstand Enhanced Scrutiny Under *Unocal* and *Blasius*

As discussed in detail in Plaintiffs' Pre-Trial Brief, the *Johnston* decision vividly demonstrates that Poliak's entrenchment-motivated issuance of a controlling stock interest to himself cannot withstand enhanced scrutiny review. (PPB 27-29.) Like this case, *Johnston* involved an action brought under Section 225 to determine the validity of stockholder action by written consent to remove incumbent directors and elect a new board. The defendant directors in that case issued a new series of preferred stock into friendly hands, though not their own, "for the specific purpose of preventing holders of a majority of [the company's] common stock and Series A Preferred from electing a new board." *Johnston*, 28 A.3d at 1090.

Applying enhanced scrutiny, the Court explained that corporate directors cannot act to deny stockholders the right to vote on company leadership, even if the directors believe in good faith that their actions will benefit the company. *Id.* at 1091. According to the Court, "[a]lthough [the directors] honestly believed they were acting in the best interests of the company, they breached their duty of loyalty by structuring the stock

[14] Poliak's attorneys at Locke Lord specifically advised him that his actions must be of limited duration and tailored to the perceived threat. (Kloecker 77-78; JX 67.) Defendants now admit that the Series B Preferred and Poliak's voting control over Ark are permanent. Despite advice of counsel, Poliak made no effort to tailor that permanent defensive response to the threat he claims to have perceived – that once in control, Keyser would take actions to favor the Three Creditors over other Ark creditors. (Poliak 10-11.) Ark has since repurchased all the debt and other Ark securities that were previously owned by the Three Creditors. Thus, even if Poliak's "concerns" and "suspicions" about Keyser's motives in December 2010 were the stuff of a cognizable "threat," any such threat has since been extinguished. Yet Poliak's control block endures.

issuance to prevent an insurgent group from waging a successful proxy contest." *Id.* at 1081. Thus, the *Johnston* decision demonstrates that, regardless of the applicable standard of review, Poliak's conduct was disloyal because it was designed to prevent the exercise of perhaps the most fundamental of all stockholder rights – the right of a majority to elect directors of their choosing.

For these reasons and others, including those previously detailed in Plaintiffs' Pre-Trial Brief, Poliak's issuance of the Series B Preferred to himself is void and invalid.

II. NONE OF DEFENDANTS' DEFENSES IS VALID, AND PLAINTIFFS ARE ENTITLED TO RELIEF UNDER SECTION 225

A. Poliak Abandoned His "Advice Of Counsel" Defense After Discovery And Trial

From the start of this litigation, Defendants consistently defended Poliak's issuance of the Series B Preferred to himself by contending that he "relied upon the advice of counsel." (JX 174 at 10-11; Tr. 147-48; *see* Poliak 43, 90-91.) Defendants claimed that, faced with a purported "threat to Ark, Mr. Poliak consulted counsel, was advised of his duty to Ark and all the creditors and took the steps recommended to him to protect Ark." (JX 174 at 10.)

Despite asserting this "advice of counsel" defense, Defendants repeatedly failed to point to any specific advice upon which Poliak purportedly relied. Neither Poliak nor any other witness could recall the substance of the advice he claims to have received from Locke Lord. (*See* Tr. 151; Poliak 40, 42; Kloecker 13.) The only written advice that Locke Lord provided before Poliak approved the creation and issuance of the Series B Preferred to himself actually cautioned *against* his self-dealing issuance of the Series B Preferred. (JX 22.) Defendants elected not to call the attorney that gave that advice, Christopher Pesch, as a witness. The Court may conclude that Pesch's testimony would not have been helpful to Defendants.[15]

It therefore came as little surprise at trial when Defendants could not satisfy their burden of proof for this affirmative defense.[16] What was a surprise, however, was Defendants' assertion, after trial, that they had never really raised "advice of counsel" as a true, "show stopper" defense. (Tr. 495.) [17] In doing so, Defendants abandoned this defense.

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[15] *See, e.g., Kahn v. Lynch Comm'cn Sys, Inc.*, 638 A.2d 1110, 1118 n.7 (Del. 1994) ("[T]he production of weak evidence when strong is, or should have been, available can lead only to the conclusion that the strong would have been adverse.").

[16] *See Manzo v. Rite Aid Corp.*, 2002 WL 31926606, at *3 n.7 (Del. Ch.) (noting that the protection of 8 *Del. C.* § 141(e) is an affirmative defense for which the defendant must bring evidence at trial), *aff'd*, 825 A.2d 239 (Del. 2003) (TABLE); Douglas W. Hawes & Thomas J. Sherrard, *Reliance on Advice of Counsel as a Defense in Corporate and Securities Cases*, 62 Va. L. Rev. 1, 66 (1976) ("Reliance on advice of counsel has traditionally been an affirmative defense, and, as such, it must be raised and proved by the defendant.").

[17] As this post-trial admission reveals, Defendants knew all along that their "advice of counsel" defense was frivolous. Nevertheless, they took this baseless position and then sat by and allowed Plaintiffs to devote significant time, resources, and cost during discovery and in their briefing to defend against it. They also allowed extensive questioning on the "advice of counsel" defense at trial. By forcing Plaintiffs to incur extensive time and expense in defending against a frivolous defense, Defendants acted in bad faith. As such, Plaintiffs will seek fees and expenses under the bad faith exception to the American Rule.

B. Keyser Validly Rescinded The Keyser Settlement Agreement And Is Entitled To Vote His Shares

Defendants contend that Keyser wrongfully rescinded the Keyser Settlement Agreement and, therefore, was not entitled to vote the Original Shares on December 13, 2011. The evidence adduced at trial demonstrates otherwise. Keyser rescinded the Keyser Settlement Agreement after Poliak and the Company repeatedly breached it.

Poliak and Shek blatantly disregarded Keyser's repeated requests for the Warrant Information. (Tr. 69, 466-67) Although the Keyser Settlement Agreement required the Company to cooperate with Keyser and respond to reasonable requests for information (JX 120 at §§ 6(v), 10(a); Tr. 480), Shek explained that he ignored Keyser's requests because he "d[id no]t work for Bob." (Tr. 466.) Without the Warrant Information, which should have included (at a minimum) a list of all warrants received and how they were allocated, Keyser and Skoda Minotti were unable to independently verify the accuracy of the financial information the Company was providing. (Tr. 69.) Even without the Warrant Information, Keyser discovered, based on publicly available information, that the information the Company was providing to Skoda Minotti was inaccurate and incomplete. (Tr. 63, 80-81, 83.) Ark and Poliak also provided doctored meeting minutes to Skoda Minotti, further increasing Keyser's legitimate concerns that the Company was providing inaccurate information. Moreover, Ark's and Poliak's unreasonable delays and their steadfast refusal to provide requested information to Keyser and Skoda Minotti caused the Company to miss the Valuation Deadline and the Closing Deadline. (Tr. 63.)

Keyser therefore had a more than adequate basis to rescind the Keyser Settlement Agreement on October 11, 2011.[18]

Even after Keyser rescinded the Keyser Settlement Agreement, Poliak and the Company failed to abide by its terms. For instance, the Keyser Settlement Agreement clearly provided that an independent valuation firm would conduct the valuation (JX 120 § 3(b)), but Poliak and Shek refused to allow Skoda to conduct an independent valuation of the underwriter warrants. (Tr. 75-77; 214-215.) Instead, Poliak and Shek directed Skoda Minotti to rely on their own estimate of the value of the underwriter warrants. Likewise, although the Keyser Settlement Agreement requires the Company to pay Keyser at least $50,000 in cash for the Original Shares (JX 120 § 3(c)), Poliak admitted that the Company never made any payment to Keyser for the Original Shares. (Tr. 200.) Keyser, therefore, was entitled to vote his shares on December 13, 2011.

C. Defendants' Failed To Demonstrate That Any Of The Equitable Defenses Apply To Salvatore And Schalk

Defendants have raised an amorphous set of equitable defenses in an effort to absolve Poliak of culpability and thereby render the Series B Preferred immune to challenge. This hodge-podge of equitable defenses includes ratification/acquiescence,

[18] Defendants appear to be focused on whether the warrants held by the Company (even if wrongfully misappropriated by Poliak or purposefully or inadvertently omitted from the Warrant Inventory) would have sufficient value to increase the common stock value above zero. This is irrelevant. As Keyser testified at trial, he was concerned that Poliak and Shek were providing incomplete and inaccurate information to Skoda Minotti, refusing to provide the Warrant Information, and otherwise failing to cooperate with his reasonable request for the Warrant Information. (Tr. 63-68.) Moreover, Poliak and Shek were preventing Skoda Minotti from performing an independent valuation of the warrants. (Tr. 77-78.) Had Ark and Poliak not repeatedly breached the Keyser Settlement Agreement in a manner that cast significant doubt on the entire valuation process, Keyser would have abided by any Sale Price determination made by Skoda Minotti. (Tr. 133-34.)

estoppel, waiver, laches, and unclean hands. (*See* PTO ¶ IV(1)(i).) As a threshold matter, each of these equitable defenses requires Defendants to show that each Plaintiff was fully aware of all material facts.[19] With respect to Salvatore and Schalk, Defendants have failed to satisfy even this basic requirement.

Both Salvatore and Schalk testified that, before their receipt of the Notice of Annual Meeting of Stockholders to be held on November 1, 2011 and the accompanying proxy statement, they had only a vague understanding that Poliak had made some "moves" to frustrate the 2010 Written Consent. (Tr. 297, 324, 330-31; JX 149.) It was upon reviewing that proxy statement that they discovered Poliak had issued to himself a control block of Series B Preferred. (Tr. 303-04, 306, 336-37.) Salvatore and Schalk further testified that they learned about other material aspects of the transaction, including the price Poliak paid for the Series B Preferred, for the first time through this litigation. (Tr. 306-07, 341-42.) Defendants have offered no credible evidence challenging this testimony.[20]

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[19] *See, e.g. Homestore, Inc. v. Tafeen*, 888 A.2d 204, 210 (Del. 2005) (finding that laches requires a defendant to establish, among other things, "knowledge by the claimant"); *Prizm Group, Inc. v. Anderson*, 2010 WL 1850792, at *6 (Del. Ch.) (stating that waiver "requires proof that a person (1) had knowledge of all material facts relating to his rights . . . ."); *Mitchell v. Reynolds*, 2009 WL 132881, at *11 (Del. Ch.) (noting that ratification "requires awareness of all material facts"); *NTC Group, Inc. v. W. Point-Pepperell, Inc.*, 1990 WL 143842, at *5 (Del. Ch.) (observing that acquiescence is available only "where a complainant has full knowledge of his rights and the material facts . . . .")

[20] Defendants claim that Poliak actually informed Salvatore of all material aspects of the Series B Preferred. (*See* Tr. 258-59.) Such a claim lacks credibility. It conflicts with Salvatore's sworn testimony. It is also belied by evidence that Poliak consistently withheld material information regarding the Series B Preferred transaction. For example, Poliak failed to tell his own allies in the Company, including Curtis and Hands, about the Series B Preferred issuance until well after the fact. (Tr. 371-73; Hands 33-35; *see also supra*, Statement of Facts, Section D.)

As this Court recently confirmed in *Johnston*, for defenses of this nature to function, they must apply to all plaintiffs. 28 A.3d at 1092 (holding that defendants' unclean hands defense could not possibly apply to two of the plaintiffs and that the participation of those two plaintiffs in the proceeding "supports relief regardless of any defense against [one plaintiff]"). Thus, Salvatore and Schalk's lack of material knowledge is fatal to Defendants' equitable defenses. For this reason alone, they cannot function to defend Poliak's self-dealing.

D. Defendants' Stockholder Ratification Defense Is Premised On A Misstatement of Black Letter Delaware Law

Defendants' ratification argument conflates two distinct concepts under Delaware law and fails to meet the requirements of either. In the section of their Pre-Trial Brief addressing ratification, Defendants rely primarily on *Genger v. TR Investors, LLC*, 26 A.3d 180, 195 (Del. 2011), a decision involving the *equitable defense of ratification*. (DPB at 20-22.) Defendants also cite *In re PNB Holding Co. S'holders Litig.*, 2006 WL 2403999, at *14 (Del. Ch.), a case that turned on the *doctrine of stockholder ratification*. (*Id.* at 20 n.2.) These are not equivalent concepts. Defendants nevertheless pair them together and cherry-pick the most convenient aspects of each in an apparent attempt to create an entirely new defense. Such a defense, however, would run counter to Delaware's black-letter law and, consequently, must be rejected.

Defendants first recite that "[r]atification precludes a party from accepting the benefits of a transaction and then attacking that transaction." (DPB at 20.) This proposition invokes the equitable defense of ratification. To the extent that Defendants argue equitable ratification, the defense is similar to acquiescence, and differentiated only by the time at which the alleged approval occurred.[21] As described below in connection with their other purported equitable defenses, Defendants have failed to plead the necessary elements to establish either an equitable defense of acquiescence or ratification.

To the extent Defendants intend to invoke the doctrine of stockholder ratification as a defense, they are similarly unsuccessful. In *Gantler v. Stephens*, 965 A.2d 695, 713 (Del. 2009), the Delaware Supreme Court held that stockholder ratification in this state may only apply "to circumstances where a fully informed shareholder vote approves director action that does ***not*** legally require shareholder approval in order to become legally effective." *Id.* at 713 (emphasis in original). The Court also explained that "the only director action or conduct that can be ratified is that which the shareholders are specifically asked to approve." *Id.* No vote ever occurred to ratify the issuance of the Series B Preferred, much less a fully informed one.[22] Any reliance by Plaintiff on the stockholder ratification doctrine to shield Poliak's self-dealing is, accordingly, ineffective.

E. <u>All Of Defendants Equitable Defenses Are Baseless</u>

Defendants offer the bulk of their equitable defenses only against Keyser, and not against Salvatore and Schalk. As shown above, it is unnecessary to consider defenses against just one Plaintiff. Plaintiffs nonetheless address these defenses here. As

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[21] *See Giammalvo v. Sunshine Min. Co.*, 1994 WL 30547, at *10 (Del. Ch.) (cited in *Genger*, 26 A.3d at 195) ("The equitable defenses of ratification and acquiescence are closely related. . . . Generally, acquiescence occurs when one consents to a course of action, by words or conduct, while that action is taking place. . . . Ratification suggests an assent after the fact."), *aff'd*, 651 A.2d 787 (Del. 1994) (TABLE).

[22] Moreover, although Defendants argue to the contrary, Poliak clearly engaged in waste when, as the sole director, he paid just $250 for control of Ark. Poliak's actions were void – not voidable – and therefore subject to ratification only by a *unanimous* vote of Ark's stockholders. *See Gantler*, 965 A.2d at 713 n.54.

discussed below, Defendants have failed to offer factual or legal support for their contention that any of the Plaintiffs should be denied relief.

1. Defendants Failed To Demonstrate That Plaintiffs Waived Their Rights To Challenge Poliak's Inequitable Conduct

The equitable defense of waiver requires Defendants to prove that each Plaintiff "(1) had knowledge of all material facts relating to his rights and (2) intended to relinquish such rights voluntarily." *Prizm Group, Inc.*, 2010 WL 1850792, at *6. Any waiver of rights – either express or implied – must be "unequivocal." *Dirienzo v. Steel Partners Holdings L.P.*, 2009 WL 4652944, at *4 (Del. Ch.). The record shows that none of Keyser, Salvatore, or Schalk ever waived his right to challenge the validity of the Series B Preferred, let alone in an unequivocal manner. Schalk and Salvatore did not have all material information about the Series B Preferred until after this litigation commenced, and Defendants identify nothing they did to result in an unequivocal expression of intention to waive their rights. As to Keyser, he repeatedly reserved his rights with respect to his ownership of Ark stock, specifically including his right to challenge the issuance of the Series B Preferred.

Keyser did not learn of Poliak's issuance to himself of the Series B Preferred until December 10, 2010 because Poliak determined to conceal the issuance from Keyser, Armstrong, and their counsel for as long as possible. (Tr. 26; 29-32; JX 54; JX 56.) Immediately upon learning that Poliak had issued super-voting preferred stock to himself, Keyser, acting through counsel, challenged the legality of the Series B Preferred issuance under Delaware law. (JX 65.)[23] Concerned that "it could jeopardize the firm and cause it

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[23] The record suggests that Defendants expected resistance to the Series B Preferred issuance well before Keyser learned of it. As already discussed, the only documented evidence that Poliak received from counsel regarding the Series B Preferred was an

to go out of business," Keyser decided not to initiate litigation immediately. (Tr. 34-35.) Instead, he decided to "sit down with Mr. Poliak and try to work out something…." (*Id.*)

Ark and Poliak insisted upon separate settlements with Auxol and with Keyser: one in which Ark would purchase notes and stock from Auxol and another in which Ark would purchase Keyser's 7 million Original Shares. (Tr. 40-42; JX 79.) Each set of settlement negotiations was documented and, in each case, Keyser reserved his rights to challenge Poliak's self-dealing. As Keyser explained at trial, he, Armstrong, and Auxol sought the January 5, 2011 Standstill Agreement after being physically excluded from Ark's premises by a security firm hired by Poliak and after nevertheless deciding that immediate litigation would not be in Ark's best interest. (Tr. 37.)

To further safeguard their rights and to avoid any ambiguity, Keyser, Armstrong, and Auxol insisted on the inclusion of status quo provisions in the Standstill Agreement and the confidential agreement in principle, and Keyser expressly reserved all rights and claims he had as the holder of the 7 million Original Shares in the March 31, 2011 Purchase Agreement.[24] Poliak testified at his deposition, and acknowledged at trial, that he "knew at the time that Ark entered into [the Purchase Agreement], that for the 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." (Tr. 188 (quoting Poliak Dep. 152).)

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admonishment that Delaware Courts "don't like" such dealings. (JX 22.) Counsel also emailed Poliak – four days before Keyser learned of the Series B Preferred through Lyons – to suggest a plan to "kick things down the road" by delaying providing notice of the Series B Preferred to Keyser. (JX 46.)

[24] That provision indicated that "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.**" (JX 94 at § 6.4 (emphasis added); Tr. 48.)

Keyser ensured an additional reservation of his rights in the April 29, 2011 Keyser Settlement Agreement, which stated "**nothing in this [Keyser Settlement] Agreement constitutes a waiver by any party of any claim the party may have against the other parties**." (JX 120 at § 5 (emphasis added).) Moreover, Keyser also kept Defendants apprised of his challenge to the Series B Preferred through communications from his counsel. After Ark was unable to close on the Purchase Agreement by the April 1, 2011 deadline, Keyser's Delaware counsel sent a letter to Locke Lord on April 15, 2011. (Tr. 46, 49.) That letter threatened litigation and articulated that the Series B Preferred issuance constituted a "flagrant breach of fiduciary duty" and that the Series B Preferred was "invalid and void under Delaware law." (JX 102 at 2; Tr. 53-54.) Strangely, despite the unambiguous language of the April 15, 2011 letter, Poliak continued to maintain at trial his "absolut[e]" position that, even after reading the letter, he was unaware "that Mr. Keyser continued to contest the Series B preferred stock[.]" (Tr. 197-98.)[25]

Defendants offer no credible basis to believe that Keyser ever intentionally waived his right to challenge the Series B Preferred. Indeed, Poliak admitted at trial, once faced with his earlier deposition testimony, that he had not been able to recall a single instance in which Keyser or any of the Plaintiffs clearly articulated a waiver of their rights. (Tr. 223:5-13.) Similarly, Shek admitted – again, when presented with his

[25] (*See also* Tr. 229-230.) In response to his own counsel's questions, Poliak backtracked somewhat from this position, agreeing that he received no notice of a challenge to the Series B Preferred "[a]fter [he] got the letter from Mr. Pittenger and [he] sent the response by [his] attorney . . . until the day [he] got notice in 2011 in December…." (Tr. 263.) But the Keyser Settlement Agreement itself, which the parties signed after the April 15 letter from counsel, expressly stated that Keyser was not waiving any claims against Poliak and Ark (JX 120 at § 5); those claims would only be relinquished if and when Ark closed on the purchase of Keyser's shares (JX 120 at § 2).

deposition testimony – that he was aware of the possibility that Keyser might challenge the Series B Preferred any time "prior to resolving it and closing out the settlement agreement…." (Tr. 488.) In the absence of such proof, Defendants allege that "Mr. Keyser waived his rights to challenge the Series B from the moment that he understood and knew that we were raising money from investors, public investors, based on the representation that [Poliak] had voting control in the company and issued [himself] those preferred B shares." (Tr. 202; *see also* 203.) Even if this were true, these arguments have nothing whatsoever to do with the doctrine of waiver.[26] Defendants have failed to establish the elements of this defense, not only as a technical matter, but in any sense that could invoke the equitable discretion of this Court.

2. Defendants Failed To Demonstrate That Any Of The Plaintiffs Engaged In Inequitable Delay

A defense of laches requires a defendant to establish "first, knowledge by the claimant; second, unreasonable delay in bringing the claim; and third, prejudice to the defendant." *Homestore, Inc.*, 888 A.2d at 210. Plaintiffs brought their challenge well within the presumptive three-year limitations period for an action challenging a breach of fiduciary duty – less than one year after they learned of the conduct (and only weeks after Schalk and Salvatore learned the material terms of the Series B Preferred issuance – except the price, which they only learned after initiating the litigation). (Tr. 306-07; 337;

[26] To the extent that Defendants premise their waiver argument on representations made to prospective Series A Preferred Stock holders, that is merely a restatement of arguments that Defendants raise elsewhere, and that Plaintiffs address at length below. This redundant and doctrinally baseless argument is reflective of the intentionally convoluted nature of Defendants' approach to equitable defenses throughout this litigation.

341-42.)[27] Defendants offer no justification to shorten this period on equitable grounds. As explained above, throughout the process of trying to reach and consummate two separate settlements, Keyser repeatedly reserved his right as a stockholder to challenge the Series B Preferred. It is clear that laches will not bar a plaintiff's right to bring a claim where the only delay was taken up by reasonable efforts at settlement – particularly where that delay does not even approach the statutory limit.[28] To the extent that Defendants premise any of their equitable defenses on inequitable delay, such defenses must fail.

3. Defendants Failed To Demonstrate That Plaintiffs Ratified Or Acquiesced In Poliak's Issuance Of The Series B Preferred To Himself

Defendants can only avail themselves of the equitable defenses of after-the-fact ratification or during-the-fact acquiescence by showing that a plaintiff "has full knowledge of his rights and the material facts and (1) remains inactive for a considerable time; or (2) freely does what amounts to recognition of the complained of act; or (3) acts in a manner inconsistent with the subsequent repudiation, which leads the other party to

[27] Although Keyser learned of the Series B Preferred on December 10, 2010, the confidentiality and standstill agreement tolled all equitable limitations periods for over a month thereafter. (JX 75 § 11.)

[28] *See Whittington v. Dragon Group L.L.C.*, 2010 WL 692584, at *6 (Del. Ch.) (no laches where plaintiff brought suit within presumptive limitations period and engaged in negotiations during the period between injury and filing suit), *aff'd & remanded on other grounds*, 998 A.2d 852 (Del. 2010) (TABLE); *Facchina v. Malley*, 2006 WL 2328228, at *3 (Del. Ch.) (holding, in a contest for control of an LLC where effectiveness of written consents was at issue, that "[m]ere delay cannot sustain the result sought by the Defendants. Accordingly, their reliance on equitable defenses is misplaced."). *See also Bay Newfoundland Co. v. Wilson & Co.*, 4 A.2d 668, 673 (Del. Ch. 1939) (no laches where plaintiff delayed filing suit during pendency of settlement negotiations, and where defendant was timely put on notice of plaintiff's challenge); *Air Reduction Co. v. Airco Supply Co.*, 258 A.2d 302, 307 (Del. Ch. 1969) ("I believe plaintiff having put defendant on notice and having sought to negotiate in good faith . . . defendant may not successfully invoke the defense of laches as a means of aborting an otherwise meritorious action.").

believe the act has been approved." *NTC Group, Inc.*, 1990 WL 143842, at *5; *see also*, *supra* n.19. To succeed on their acquiescence defense, Defendants must prove that Plaintiffs "clearly demonstrate[d] intent" to accept the validity of the Series B Preferred or acted in a manner amounting "to a free recognition" of its validity. *Dirienzo*, 2009 WL 4652944, at *7. Defendants have not established any of these elements.[29]

As discussed above, Keyser repeatedly reserved his rights throughout 2011, and in no way demonstrated an intent to accept, or freely recognized, the validity of the Series B Preferred. Nor were Defendants "led to believe" that Keyser had somehow approved of the Series B Preferred issuance. Although Keyser, along with Armstrong and Auxol, allowed Poliak to remain in office during the settlement process, he insisted on contractual status quo provisions in the Standstill Agreement, the Purchase Agreement, and the Keyser Settlement Agreement to ensure that Poliak could not cause Ark to take actions outside of the ordinary course of business. (Tr. 37.) As discussed at length above, Keyser made certain that Ark and Poliak knew, throughout this time, that he had not waived or abandoned his right to challenge Poliak's issuance of the Series B Preferred. The defense of acquiescence is therefore inapplicable here.[30]

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[29] To the extent Defendants' acquiescence defense is premised on supposed delay, it is baseless. Just as Delaware law will not countenance a defense of laches where a limited delay resulted from a plaintiff's settlement efforts, such delay should not support the defenses of estoppel or acquiescence. Such a policy would discourage, rather than encourage, settlements. *See Snug Harbor Condo. Council v. Sullivan*, 2011 WL 567453, at *3 (Del. Ch.) ("Our law favors the voluntary settlement of contested lawsuits.").

[30] As explained above, Salvatore and Schalk did not have all material information about the Series B Preferred until after they initiated this litigation and took no action manifesting their acquiescence. *See supra*, Section II C.

4. **Representations Made By Defendants To Purchasers Of The Series A Preferred Is Not A Basis To Bar Plaintiffs From Seeking Relief**

Defendants have offered an apparent estoppel-based defense arguing, in essence, that prospective Series A Preferred owners relied on the prospect of Shek, Hands, and Curtis continuing on Ark's board indefinitely, that Keyser somehow knew of such reliance, and that it would therefore be inequitable to let him exercise his rights as a stockholder now. That proposition is factually and legally baseless.[31]

Keyser had no involvement in the sale of the Series A Preferred. He was never provided with an opportunity to comment on disclosures made in connection with the Series A Preferred offering and, as Poliak admitted at trial, "Mr. Keyser was not involved in soliciting customers to purchase the Series A preferred…." (Tr. 189-90; *see also* Tr. 50.) Indeed, Poliak withheld Series A Preferred documentation (including specifically the subscription agreement and related disclosures) from Keyser, Armstrong, and Auxol as a bargaining chip in negotiating an extension agreement (Tr. 192-93; JX 104), and as a consequence, Ark did not provide copies to Keyser and his counsel until several days before the closing on the purchase of securities from Auxol under the Stock and Note Purchase Agreement. Once Ark tendered payment, Auxol was contractually obligated to close because it had signed the Extension Agreement. Defendants are unable to say what Keyser was supposed to do in the short interim time period to correct disclosures he did not even know about (including, as described below, the disclosures Poliak now claims to

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[31] Indeed, one need not delve deeply into the record to see that Defendants' position is facially untenable. When the first round of the Series A Preferred offering closed, *Poliak* was still Ark's sole director. (PTO ¶¶ 32, 57). He would not learn that he would be forced to step down until October 2011. (Tr. 218.) Defendants fail to explain how the early Series A Preferred buyers relied on a board comprising Shek, Hands and Curtis when they were not selected as directors until over eight months later.

have made outside the four corners of the offering materials). Defendants cannot craft an equitable defense based on disclosures over which they prevented Keyser from having any influence.

The depth of Defendants' failure to fully apprise Keyser of representations made to prospective Series A Preferred holders was revealed during Poliak's cross examination, conducted by his own counsel. On direct examination, Poliak did not dispute that the Series A Preferred offering documents cited as a risk factor that Ark could not be certain it would permanently retain his management team. (Tr. 195:6-196:23). On cross examination, Poliak later revealed that, despite this disclosure, he had provided a different message to prospective Series A Preferred holders during conversations to which Keyser was not a party. Poliak testified that, while marketing the Series A Preferred, he and Shek met with prospective holders. (Tr. 249-50.) When asked by his counsel what representations he and Shek made at these meetings, Poliak testified:

> We assured them that the past management group was no longer there; that the dysfunctionality no longer existed, and that this was a new management team, and that we were going to continue to operate the company in the fashion that they have seen or we have shown them over the last 12 months call it.

(Tr. 254-55.) Poliak thus admitted, at trial, that he and Shek provided information to prospective Series A Preferred holders that differed from, and contradicted, the little information that Keyser had received. Defendants nevertheless have the audacity to argue that Keyser should be somehow estopped from exercising his right to challenge Poliak's self-dealing because of these representations supposedly *made by Poliak himself* and as to which Keyser lacked any knowledge. Such a position only highlights the extent to which Defendants misapprehend the operation of equitable defenses in this Court, and provides a further reason that such defenses must not be given any credence.[32]

Even if any of the Series A Preferred holders had relied on the prospect of Poliak and his team remaining in control of Ark forever (of which reliance Defendants have produced no reliable evidence), such reliance would have been the product of disclosures selected exclusively by Defendants. Yet the information they selected for disclosure belies their concern for the Series A Preferred holders' reliance interests. It was Defendants – not Keyser or any other Plaintiff – who chose not to reveal that Keyser and other stockholders submitted proxy forms for the November 1, 2011 stockholders meeting, in which they stated their challenge to the Series B Preferred and Poliak's ability to elect Ark's directors. It was Defendants who chose not to disclose the Voting Agreement, in which Keyser and other stockholders formally agreed to replace the Former Directors. The final round of Series A Preferred closed without supplemental disclosure of these events. (Tr. 356.) If Defendants believed that prospective Series A Preferred holders had reason to rely on Poliak and his management team remaining in control, they had a duty to disclose the imminent challenge to that continuing control. Defendants' election not to make such disclosures renders their claim of detrimental reliance on behalf of the Series A Preferred holders peculiar at best.

[32] Defendants' "Series A Preferred Reliance" defense also fails because the Defendants failed to call a single third-party purchaser of Series A Preferred as a witness and identified no documentary evidence showing that the Series A Preferred Stockholders relied as Defendants claim.

5. **Defendants Failed To Demonstrate That Keyser Has Unclean Hands**

In their pre-trial brief, Defendants' unclean hands argument was limited to the following statement: "As will be shown at trial, Keyser's actions in the fall of 2010, his acceptance of the benefits arising under the [Purchase] Agreement and Series A Preferred Stock offering and his refusal to abide by the terms of the [Keyser] Settlement Agreement constitute unclean hands…." (DPB at 25). Defendants showed none of these things at trial. Even if they had, such a showing could not support an effective unclean hands defense.

For a defense of unclean hands to apply, "the plaintiff's inequitable conduct must have an immediate and necessary relation to the claims for which the plaintiff seeks relief." *Kousi v. Sugahara*, 1991 WL 248408, at *2 (Del. Ch.) (internal quotations omitted). This Court has recognized that "[t]he timing of the alleged misconduct plays an important role in determining whether the inequitable acts preclude relief," and has "decline[d] to apply unclean hands when the conduct occurs subsequent to the plaintiff's cause of action." *Mangano v. Pericor Therapeutics, Inc.*, 2009 WL 4345149, at *8 (Del. Ch.) (citing *Walter v. Walter*, 136 A.2d 202, 207 (Del. 1957)).

With respect to the obliquely-described "actions in the Fall of 2010," Defendants adduced no testimony showing that Keyser attempted to take any actions in that time period except attempting to exercise the franchise right and replace the sitting board. There is nothing inequitable about that.

With respect to any benefits that Keyser allegedly accepted as a result of the Series A Preferred issuance, Defendants fail to explain how mere acceptance of a benefit gives rise to a defense of unclean hands. It does not, and the defense should fail for that reason alone. In addition, however, Defendants failed to established that any such benefits accrued to Keyser as a result of Poliak's self-dealing, thereby providing a separate but sufficient reason to reject the argument. Quite simply, there is no logical connection or nexus whatsoever between Poliak's self-dealing entrenchment and Auxol's acceptance of a benefit under a negotiated settlement agreement. This is particularly true when all parties knew that Keyser was retaining his claims to challenge the Series B Preferred as the holder of the 7 million Original Shares that Ark did not repurchase when it closed the transaction with Auxol.

Finally, with respect to Keyser's repudiation of the Keyser Settlement Agreement, evidence adduced at trial amply showed that Keyser only took that step when Poliak's actions left him with no other choice. *See supra*, Section II.D. Even if Defendants had established the necessary factual predicates for their argument that Keyser was not entitled to terminate the Keyser Settlement Agreement (and they have not), their unclean hands defense would fail as a matter of law. Keyser's alleged "refusal to abide by the terms of the [Keyser] Settlement Agreement," and "acceptance of the benefits arising under the [] Purchase Agreement and Series A Preferred Stock offering" took place, regardless of their propriety, long after Poliak breached his fiduciary duties by issuing the Series B Preferred to himself. (JX 174 at 13). For this reason alone, they cannot establish an unclean hands defense. *See Mangano*, 2009 WL 4345149, at *8.[33]

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[33] In addition, it bears noting that Defendants' unclean hands defense suffers from the same fatal flaw as their other equitable defenses: It is leveled *only* against Keyser. Salvatore and Schalk are Plaintiffs in this Action as well as Keyser and, to be effective, any equitable defense must apply to them. *Johnston,* 28 A.3d at 1092. Defendants have not even attempted to argue that Salvatore and Schalk are guilty of unclean hands; nor have they adduced any credible evidence to suggest that any of their other equitable defenses would apply against them. This defense, like the rest, should therefore fail.

From the outset of this litigation, Defendants' purported equitable defenses have been an undefined and doctrinally inconsistent jumble. They have relied on scant briefing, inarticulate explanation, and continued vague promises that more would be shown later. They have forced Plaintiffs to expend countless hours to formulate coherent replies, and have wasted the time of this Court. Far from demonstrating inequitable conduct on the part of Keyser or any other Plaintiff, these equitable defenses have revealed only Defendants' desperation to defend otherwise indefensible self-dealing. Defendants have come nowhere near satisfying their significant burden of showing that some sort of conduct or inaction on the part of Plaintiffs is inequitable at all, let alone so inequitable that this Court should exercise its discretion to condone self-dealing entrenchment and to preclude the holders of a majority of Ark's voting power from exercising their statutory right to elect a board of their choosing.

III. THE COMPANY SHOULD BE ORDERED TO REIMBURSE PLAINTIFFS' LITIGATION EXPENSES

It is well-settled that "[t]he purpose of § 225 'is to right wrongs done to a corporation, not to its individual stockholders, through the unlawful usurpation of its management and offices by persons not entitled thereto.'" *W. Ctr. City Neighborhood Ass'n v. W. Ctr. City Neighborhood Planning Advisory Comm., Inc.*, 2003 WL 241356, at *6 (Del. Ch.) (quoting *Fleer v. Frank H. Fleer Corp.*, 125 A. 411, 416 (Del. Ch.1924)).[34] Where stockholders have created a benefit for the corporation through successful pursuit

[34] *See also Kirby v. Kirby*, 1987 WL 14862, at *7 (Del. Ch.); *Young v. Janas*, 136 A.2d 189, 190 (Del. Ch. 1954) ("The Chancellor [in *Fleer*] stated that the statute provides for a review of grievances which are common to the entire corporate body and so provides every stockholder with an interest thereunder.") (citing *Fleer*, 125 A. 411).

of a Section 225 action, it is therefore proper to grant a fee award pursuant to the corporate benefit exception to the American rule.[35]

This Court has previously awarded fees where plaintiffs created a corporate benefit through an action pursuant to Section 225. In *Allied Artists Pictures Corp. v. Baron*, 413 A.2d 876 (Del. 1980), the Supreme Court affirmed a grant of fees for benefits conferred on the subject company in consolidated actions brought under Sections 225 and 227. Though not a Section 225 case, in *Niehenke v. Right O Way Transp., Inc.*, 1995 WL 767348 (Del. Ch.), this Court awarded a plaintiff his reasonable costs, including attorney's fees, when he successfully petitioned for appointment of a custodian under 8 *Del. C.* § 226. The Court identified appointment of the custodian and consequent breaking of a board deadlock a sufficient corporate benefit to justify the fee award. *Id.* at *11. A decision in favor of Plaintiffs here will accomplish significantly more than simply blocking a corporate deadlock. It will confirm the right of stockholders to vote for directors of their choosing free from faithless, entrenchment-motivated conduct designed to thwart the will of the majority. An award of expenses, including attorney's fees, is therefore justified.[36]

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[35] The corporate benefit doctrine will justify an award of attorneys' fees and expenses where litigation confers a substantial, though non-monetary, benefit on the corporation to the benefit of all stockholders. *San Antonio Fire & Police Pension Fund v. Bradbury*, 2010 WL 4273171, at *7 (Del. Ch.). The corporate benefit doctrine is not limited to class and derivative litigation. As the Delaware Supreme Court has observed, "[t]he form of suit is not a deciding factor; rather, the question to be determined is whether a plaintiff, in bringing a suit either individually or representatively, has conferred a benefit on others." *Tandycrafts, Inc. v. Initio Partners*, 562 A.2d 1162, 1166 (Del. 1989).

[36] *See William Penn P'ship v. Saliba*, 13 A.3d 749, 751, 759 (Del. 2011) (affirming award of fees and costs in suit challenging LLC managers' "faithless prelitigation conduct" where defendants failed to establish entire fairness of challenged transaction).

Although the Company should reimburse Plaintiffs for the bulk of their reasonable fees and expenses,[37] Defendants themselves should be responsible for a portion of these fees and expenses to the extent such fees and expenses arise out of Defendants' bad faith conduct. In particular, Defendants should be made responsible for Plaintiffs' reasonable fees and expenses incurred in responding to Defendants' reliance on advice of counsel defense. Defendants were aware throughout the litigation that it was frivolous, but continued to assert it until after trial when the Court questioned Defendants' failure to bring Pesch to trial. *See supra*, n. 17. Defendants acted in bad faith by forcing Plaintiffs to incur time and expense in defending against it. Plaintiffs are accordingly entitled to fees under the bad faith exception to the American rule.

[37] Plaintiffs do not mean by this statement to concede that Defendants, and in particular Poliak, are not ultimately responsible for all fees and expenses consumed by both sides in this litigation. Following their confirmation as directors, Plaintiffs intend to evaluate Poliak's actions and, if appropriate, cause Ark to bring a plenary action against him for breach of fiduciary duty in issuing the Series B Preferred to himself for entrenchment purposes and to recover all damages flowing from that breach, including all costs and fees he caused Ark to incur in this action.

CONCLUSION

For the reasons set forth herein, the Court should (i) declare that the 2011 Written Consent was valid and effective to remove the Former Directors and elect Plaintiffs as directors of Ark, (ii) award Plaintiffs their reasonable costs and fees, and (iii) enter the attached proposed order.

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