EFiled: Mar 12 2012 3:58PM EDT
Transaction ID 43027115
Case No. 7109-VCN

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

ROBERT D. KEYSER, JR., FRANK SALVATORE, and SCOTT SCHALK,	)	
Plaintiffs,	)	
v.	)	C.A. No. 7109 – VCN
TOM CURTIS, THOMAS HANDS, DONALD SHEK, and ALBERT POLIAK,	)	
Defendants,	)	**PUBLIC VERSION FILED MARCH 12, 2012**
and	)	
ARK FINANCIAL SERVICES, INC. a Delaware corporation,	)	
Nominal Defendant.	)	

PLAINTIFFS' PRE-TRIAL BRIEF

POTTER ANDERSON & CORROON LLP
Michael A. Pittenger (No. 3212)
T. Brad Davey (No. 5094)
Ryan T. Costa (No. 5325)
1313 N. Market Street
Hercules Plaza – 6th Floor
P.O. Box 951
Wilmington, DE 19899-0951
(302) 984-6000

Attorneys for Robert D. Keyser, Jr,. Frank Salvatore and Scott Schalk

Dated: March 8, 2012
1047911

TABLE OF CONTENTS

Pages

TABLE OF AUTHORITIES

CASES

STATUTES

OTHER AUTHORITIES

NATURE AND STAGE OF PROCEEDINGS

Plaintiffs Robert D. Keyser, Jr., Frank Salvatore and Scott Schalk (collectively "Plaintifffs") 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. A trial in this action is schedule to begin on March 14, 2012. This is Plaintiffs' pre-trial brief.

PRELIMINARY STATEMENT

In December 2010, Poliak, at the time Ark's sole director, issued himself super-voting preferred stock representing more than half of the Company's outstanding voting power for nominal consideration. Poliak did so for the admitted purpose of preventing the holders of a majority of Ark's stock from removing him as a director and electing a new board. Delaware law is clear: You cannot do that. The preferred stock – the product of Poliak's disloyal entrenchment – is invalid and void. Defendants' contention that Poliak's ownership of the preferred stock renders the 2011 Written Consent ineffective is, therefore, entirely without merit.

Without any legally cognizable basis to defend seriously Poliak's self-interested, entrenchment-motivated conduct, Defendants ask this Court to deny Ark's stockholders the ability to elect directors based on a set of convoluted, and factually and legally baseless, equitable defenses. Aside from their lack of factual and legal merit, those defenses fatally suffer from the fact that Defendants offer nothing to show that, even if

colorable, those defenses would apply to all three plaintiffs. The defenses are a diversionary tactic, designed to remove the focus from Poliak's self-dealing. Defendants offer no reason why this Court, in its equitable discretion, should excuse Poliak's disloyalty.

The 2011 Written Consent should be declared effective.

STATEMENT OF FACTS

A. The Parties

Plaintiff Robert D. Keyser, Jr., is a stockholder of Ark, holding 7,000,000 shares of the Company's outstanding common stock. (PTO ¶ 61;[1] JX 153.) Keyser is a co-founder of Ark. (PTO ¶ 1.) Pursuant to the 2011 Written Consent, Keyser has been duly elected as a director of the Company. (JX 170.)

Plaintiff Frank Salvatore is a stockholder of Ark, holding 3,948,000 shares of the Company's outstanding common stock. (PTO ¶ 61; JX 153.) Until March 2010, Salvatore was a managing partner at the Company's subsidiary, Dawson James Securities, Inc. ("Dawson James"). Pursuant to the 2011 Written Consent, Salvatore has been duly elected as a director of the Company. (JX 170.)

Plaintiff Scott Schalk is a stockholder of Ark, holding 1,186,000 shares of the Company's outstanding common stock. (PTO ¶ 60; JX 153.) Schalk was the Managing Director – Capital Markets at Dawson James until January 2011. Pursuant to the 2011 Written Consent, Schalk has been duly elected as a director of the Company. (JX 170.)

Defendant Albert Poliak is a stockholder and former officer and director of Ark. Poliak was a co-founder of Ark, along with Keyser. (PTO ¶ 1.) Poliak owns 7,000,000 shares of the Company's outstanding common stock. (PTO ¶ 61; JX 153.) He also purports to be the holder of 25,000 shares of Series B Preferred Stock, which for the reasons explained herein are invalid and were not properly issued. (PTO ¶ 18; JX 153.)

[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).

Defendants Thomas Hands, Donald Shek, and Tom Curtis are officers of Ark and Dawson James. The Former Directors served as directors of Ark until they were removed by the 2011 Written Consent. (PTO ¶ 60.)

B. Ark Incurs Debt To Maintain Operations

Ark is a Delaware corporation with its principal place of business in Boca Raton, Florida. (PTO ¶ 1.) Keyser and Poliak founded the Company on April 18, 2002. (*Id.*) Ark acts as a holding company for Dawson James, an investment-banking firm based in Boca Raton, Florida and having offices in Boca Raton and Jacksonville, Florida; Baltimore, Maryland; New York, New York; Santa Clara and San Francisco, California; and Manasquan, New Jersey. (*Id.* at ¶ 2.) Ark also acts as a holding company for Dawson James Financial Services, Inc. and Dawson James Management, Inc. (*Id.*)

Until December 2009, Keyser and Poliak were the sole directors of, and shared administrative responsibilities at, Ark and Dawson James. Keyser was the CEO of Dawson James and Secretary of Ark, while Poliak served as President of both entities. In addition, Keyser provided investment banking services to Dawson James's clients.

In the years after its founding, Ark accumulated substantial debt. Allan R. Lyons, Kenneth A. Steel, Jr., Burton Koffmon, and their affiliates (collectively, the "Three Creditors") were a primary source of debt funding for Ark. 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, dated February 13, 2009, included an option allowing the Three Creditors, as the noteholders, 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.)

The Great Recession exacerbated the Company's losses, which continued to mount throughout 2008 and 2009. Growing frustrated with the Company's inability to satisfy its obligations on the Notes, much less turn a profit, the Three Creditors retained an independent consultant in 2009 to make recommendations to improve the Company's performance. (PTO ¶ 9; Lyons 11-12.) After a review of Ark's operations, the consultant recommended, among other things, that Keyser step down as CEO of Dawson James. (PTO ¶ 10; Lyons 12-13; Poliak 57.)

The Three Creditors agreed with the recommendation. They believed at the time that Poliak, rather than Keyser, was already effectively acting as the CEO and the business did not need both Keyser and Poliak to serve in that capacity. (Lyons 12-13.) Given Poliak's focus on the Company's finances and compliance issues, the Three Creditors then believed that Poliak was the appropriate person to lead the Company. (Lyons 12-13.) Nonetheless, the Three Creditors expected that Keyser would remain with the Company in an investment banking role. (Lyons 13.) Consistent with the consultant's recommendation, Keyser resigned his position as CEO of Dawson James and focused his attention on generating investment banking opportunities for the Company.

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 and Dawson James, as well as the President and CEO of both companies. (PTO ¶ 10)

C. Poliak Fails To Restructure The Company's Debt

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; Poliak 73.) The Three Creditors actively negotiated with Ark, from 2009 through most of 2010, and closely worked with the Company's

other creditors in efforts to find a mutually agreeable solution, but Poliak's efforts were unfocused and marked by long-periods of inattention. As Lyons explained, the negotiations proceeded "very slowly" – "things were just dragging and dragging" – and it was "very difficult" to get in touch with Poliak. (Lyons 14, 41-43.) As a result, the Three Creditors became increasingly frustrated with Poliak's leadership of Ark and concerned about Ark's continuing inability to meet its debt obligations. (Lyons 14-17, 41-43.)

After leaving Ark and Dawson James, Keyser maintained a business relationship with Lyons. They periodically met for lunch to discuss potential investments and business opportunities. During several of those meetings, Lyons expressed his growing concern about Poliak's management of Ark. Lyons indicated that the Three Creditors were increasingly worried about the Company's losses and believed they may need to call the Notes. 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. 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.) Reassured by the involvement of Armstrong, who had experience leading public and private companies,

the Three Creditors agreed. (Lyons 16.) 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.)

D. After Learning His Removal Was Imminent, Poliak Moves Swiftly To Entrench 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 the Option (the "Notice of Exercise"). (PTO ¶ 13; JX 14; Shek 16-17.) 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.)

Although the Notice of Exercise came as a surprise to Poliak (Poliak 14, Shek 17), he plainly understood that his control over Ark was in jeopardy and took swift action to entrench himself. 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 certain 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.) 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; Poliak 7, 42; Shek 28.)

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.)[2] 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 Stock – in this case, Poliak alone – are entitled to cast 1,000 votes per share on all matters to be voted on by the Company's stockholders, 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, through the issuance of the Series B Preferred, 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.[3]

Poliak readily admits that he adopted the Bylaw Amendments and designated and issued to himself the Series B Preferred in order to "prevent" a majority of the Company's common stockholders from removing him from the Board. (Poliak 14-15, 48, 89.) Poliak seeks to justify this egregious breach of the fiduciary duty of loyalty by asserting that he believed Keyser posed a threat to the Company and its stockholders, creditors, and employees. (Poliak 9-10.) The threat Poliak claims to have perceived was

---

[2] The Bylaw Amendments also purportedly amended Section 402 of the bylaws to require nominations for directors to be elected, other than nominations submitted by the incumbent Board, to be submitted ninety days in advance of the stockholders' meeting. (JX 24.) The advance notice provision had previously required only thirty days advance notice of nominations in connection with director elections at a meeting. (JX 2 at § 402.)

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

rooted in Poliak's personal belief that Keyser previously had been a poor manager of the Company and was likely to favor his own interests and those of the Three Creditors over the interests of the Company and its other creditors, employees, and stockholders. (Poliak 9-11, 17, 19-20.)

In the approximately forty-eight hours that elapsed between Poliak's receipt of the Notice of Exercise and his adoption of the Bylaw Amendments and issuance of the Series B Preferred, Poliak appears to have done virtually nothing to ensure that his actions were fair to the Company and its stockholders. He does not recall what steps, if any, he took to investigate the threat he claims to have perceived before he issued the Series B Preferred. (*See* Poliak 13-14, 27-28, 32-33.) Although he asserts that certain key personnel shared his view that Keyser was a poor manager, he does not recall having conversations with them on the topic before he took the steps to entrench himself. (Poliak 24-25.)[4] Poliak did not consider potential alternative means of addressing the purported threat. (*See* Poliak 87-88.) Similarly, he does not recall taking any steps to determine the fair price of the Series B Preferred or the value that he should have paid for control of the Company. (Poliak 95.) He testified that the economic terms of the Series B Preferred – the dividend rights, the liquidation 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. (Poliak 95-96.)

Poliak seeks to excuse this utter lack of process and, ultimately, his egregious, self-interested conduct, on the grounds that he relied on the advice of Locke Lord &

[4] Poliak identified Curtis as one of the key personnel who shared his view that Keyser was a poor manager. (Poliak 23-24.) Tellingly, Poliak did not even inform Curtis about Keyser's attempt to take control over Ark until weeks after he had already issued the Series B Preferred Stock to himself. (Curtis 13; *see* Poliak 24.)

Bissell ("Locke Lord"). Poliak retained Locke Lord as counsel the day before he issued the Series B Preferred to himself. (JX 17; PTO ¶ 14.) Poliak, however, does not recall the specific advice Locke Lord provided with respect to either the Series B Preferred or the Bylaw Amendments. (Poliak 38-42, 89-91.) While he recalls vaguely that Locke Lord informed him he owed fiduciary duties to creditors, he recalls no other specific (or even general) fiduciary duty advice from Locke Lord, let alone any advice about his fiduciary duties in responding to a threat to his own incumbency. (*Id.* at 44-49.)

While it is not clear what Locke Lord advised Poliak, the only contemporaneous written advice suggests that Locke Lord was rightly skeptical of the validity of the Series B Preferred and Bylaw Amendments. 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.) Sent just two hours before the certificate of designation was filed with the Delaware Secretary of State, this email is an obvious attempt by Pesch to protect Locke Lord and himself by memorializing the advice that he provided and Poliak elected to disregard. (*See* PTO ¶¶ 15-17.) Mr. 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.)

E. The 2010 Written Consent

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.) 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.) 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 the Three Creditors could not assign the Option without the prior-written consent of Ark. (JX 34.) Because the Three Creditors had not obtained Ark's consent, Locke Lord contended that the "assignment and exercise are patently invalid." (*Id.*) Locke Lord also asserted that the 2010 Consent Signatories possessed insufficient voting power to remove Mr. Poliak, because Keyser's exercise of the Option was not valid. (*Id.*) Locke Lord purposefully chose not to mention the Series B Preferred in the December 2 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 8,604,521 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.) On December 8, 2010, John Kloecker of Locke Lord emailed Armstrong and informed him that even with the issuance of the Option Shares, "we want to be clear that neither you, 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 8,604,520 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.) Although Poliak initially refused to recognize the assignment, he eventually acknowledged that Keyser owned the Option Shares. Even so, Poliak maintained the position that the Series B Preferred he issued to himself was valid and afforded him voting control. He also continued to take (and to this day maintains) the position that the 2010 Written Consent was invalid – wholly aside from his secret issuance of the Series B Preferred – because the Option was not validly assigned to Keyser and, even if it had

been validly assigned, Ark had not yet issued the Option Shares when the 2010 Written Consent was signed.[5]

On December 9, 2010, Poliak convened a Board meeting to paper over his issuance of the Series B Preferred. (JX 57.) According to the minutes, Poliak believed that Keyser's efforts to elect a new Board "would impair the ability of the Company to pay the claims of creditors of the Company, and put the jobs of the employees and the assets of the customers of the Company's affiliates at risk." (*Id.*) On that basis, Poliak concluded that "it was his fiduciary duty to act to protect these parties from the risks inherent in returning control of the Company to this group." (*Id.*)

Despite the Three Creditors' repeated requests that Poliak deal with Keyser and Auxol, Poliak sent the revised capitalization table reflecting the Series B Preferred to Lyons, rather than to Keyser or his counsel, as had been requested, and he sent it by mail, rather than email or fax. The record shows he took these steps to further postpone Keyser's efforts to gain insight into any recent changes in Ark's capitalization.

Immediately upon receiving a copy of the revised capitalization table from Mr. Lyons on December 20, 2010, Bell, on behalf of Keyser, emailed Kloecker and objected to the issuance of the Series B Preferred, writing "SUCH STOCK ISSUANCE IS VOID UNDER DELAWARE CORPORATION LAW SECTION 144." (JX 64 (emphasis in original); PTO ¶ 27.) Kloecker, who apparently was completely unfamiliar with DGCL § 144 and Delaware case law relating to self-dealing transactions (Kloecker 67-8), sought to prolong the dispute by requesting Bell to provide authority for the proposition that a

[5] Plaintiffs agree that Ark had fairly compelling arguments that the 2010 Written Consent was invalid for this reason, and therefore do not contend it was effective to remove Poliak from office. (PTO p. 12, ¶ 1.)

director breaches his duty of loyalty by issuing super-voting stock to himself for the express purpose of preventing stockholders from electing a new board. (JX 64.) Thereafter, counsel engaged in extensive communication debating the validity of the Series B Preferred and the Bylaw Amendments. Those discussions, and parallel discussions between the parties themselves, eventually evolved into discussion of a possible settlement that would avoid the cost and distraction of litigation.

F. 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.) 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 contain releases from Ark, Auxol, and their respective affiliates. (*Id.* at §§ 6.2, 6.3.) Section 6.4, however, makes 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 Keyser, Ark, or their counsel 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.) 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 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 the Sale Price to be determined on or before July 31, 2011 and the closing to take place no later than August 15, 2011. (*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).) Upon the closing, 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." (*Id.* at § 2.)) Until that time, however, Keyser specifically reserved his rights and claims pursuant to the express terms of the Keyser

Settlement Agreement, which 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.)

Poliak and Keyser were unable to agree upon the Sale Price, and Skodda Minotti, an accounting firm, was retained to determine the Sale Price. (PTO ¶ 49.) As Plaintiffs will show at trial, Keyser subsequently determined that Poliak was providing Skodda Minotti with inaccurate and incomplete information in connection with the valuation. In addition, due to that conduct and other delays on the part of Ark, the valuation process continued to drag on well beyond the mandatory August 15, 2011 closing date. As a result, on October 11, 2011, Keyser rescinded the Settlement Agreement. (PTO ¶ 52; JX 146.) Keyser continues to own 7,000,000 shares of Ark's common stock.

G. The 2011 Annual Meeting

In late 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. To comply with the FINRA sanctions, Poliak resigned as a director and officer of both Ark and Dawson James. (PTO ¶ 57.) Before resigning, Poliak nominated and oversaw the election of the Former Directors as his replacements on the Board.

At Ark's annual meeting of stockholders, held on November 1, 2011, the Former Directors were elected to the Board. (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. Specifically, Plaintiffs stated that they did "not recognize or believe that the issuance of Poliak's, or any, Series B Preferred, was proper or valid, and [demanded] that Poliak not vote these improper

shares so that the proper and valid shareholders have an effective vote representing their ownership interests." (JX 155.) 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 161; Shek 61-2.)

On November 10, 2011, Plaintiffs and one other Ark stockholder, Douglas Kaiser, executed a voting agreement in which they agreed to vote their respective shares "to find, appoint, confirm and/or elect a new Board of Directors consisting" of Plaintiffs (the "Voting Agreement"). (JX 159.) 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 Shek, Curtis, and Hands apparently determined it was unnecessary to 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. (Curtis 35-36.)

H. The 2011 Written Consent

On December 13, 2011, Plaintiffs and two other Ark stockholders, Douglas Kaiser and 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

The 2011 Written Consent, signed by holders of a majority of the Company's common stock, was effective to remove the Former Directors and elect Plaintiffs. Defendants maintain, however, that Poliak validly issued the Series B Preferred to himself and that the 2011 Consent Signatories, therefore, do not hold a majority of Ark's voting power. Incorrectly suggesting that a sole director's issuance of a control block to himself is subject only to enhanced scrutiny judicial review, not entire fairness, Defendants contend that the Series B Preferred was a reasonable response to a perceived threat. Poliak's issuance of the Series B Preferred, however, cannot withstand enhanced scrutiny, let alone the stringent entire fairness standard applicable to self-dealing. Defendants, thus, resort to a series of hopelessly confusing, makeweight equitable defenses. Those defenses are factually and legally baseless and should not operate to prevent Plaintiffs from obtaining the requested relief.

I. THE 2011 WRITTEN CONSENT WAS VALID TO REMOVE THE FORMER DIRECTORS FROM THE BOARD AND TO ELECT PLAINTIFFS AS THE DIRECTORS OF ARK.

A. The 2011 Written Consent Was Signed By Holders Of A Majority Of Ark's Outstanding Voting Power

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 election of Plaintiffs to replace them. (PTO ¶ 60.) It is undisputed that the 2011 Written Consent was delivered to the Company's registered office in the State of Delaware on December 13, 2011 in accordance with 8 *Del. C.* § 228. (*Id.*) 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. (*Id.* at ¶ 61; JX 61.)

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 Company's outstanding voting power.[6]

B. Poliak's Issuance Of The Series B Preferred To Himself Is Invalid

Poliak admits he issued the Series B Preferred to himself to "prevent" a majority of the Company's stockholders from removing him from the Board. (Poliak 14-15, 48, 89.) That self-dealing, entrenchment-motivated conduct violated Poliak's fiduciary duty of loyalty, and the Series B Preferred, therefore, is invalid and void. As a result, the Ark stock held by the 2011 Consent Signatories represented a majority of Ark's outstanding voting power at the time they delivered the 2011 Written Consent.

1. Poliak Breached His Fiduciary Duty of Loyalty When He Issued The Series B Preferred to Himself For The Sole Purpose Of Preventing The Stockholders From Electing Directors

It is well-settled that incumbent directors do not act loyally if they act to "deprive the stockholders of their right to elect new directors…." *Johnston v. Pedersen*, 28 A.3d 1079, 1091 (Del. Ch. 2011). This principle is so central to Delaware law that directors

[6] Defendants also contend that Keyser breached the Keyser Settlement Agreement and, therefore, should be prohibited from voting his 7,000,000 Original Shares. This contention is factually baseless and ultimately irrelevant. As Plaintiffs will show at trial, Keyser validly rescinded the Keyser Settlement Agreement after it was repeatedly breached by Ark and Poliak, including by their failure to close by the closing deadline and their providing incomplete and selective information to a valuation firm. In addition, Ark has never tried to pay for the Original Shares or requested that Keyser surrender them for payment; he remains the record holder of those shares. Moreover, even if the Court were to determine Keyser should have sold his shares back to Ark before December 13, 2011, they 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. Schalk, Salvatore, Kaiser, and John Keyser collectively hold 10,154,000 – a clear majority of the 20,247,650 shares that would be outstanding following the Company's acquisition of Keyser's Original Shares.

acting to deprive stockholders of the right to elect new directors will be found to have acted disloyally "even though they believed in good faith that they knew what was best for the corporation." *Id.* "The right to choose who should be members of the . . . board [does] not belong to the [incumbent] directors; it belong[s] to the . . . stockholders." *Id.* Poliak freely admits that he issued the Series B Preferred to himself to "***prevent*** Mr. Keyser and his group from coming over and taking control of the Company." (Poliak 15, 40-41, 48, 89 (emphasis added).) In doing so, he breached his fiduciary duty of loyalty even if he truly believed the self-interested transaction was in the best interest of the Company. The Series B Preferred, therefore, is invalid and void.

2. Poliak's Conduct Cannot Withstand Enhanced Scrutiny Review Under *Unocal* And *Blasius*

In an attempt to justify Poliak's disloyal, self-interested conduct, Defendants argue that Poliak's issuance of the Series B Preferred was a reasonable response to a takeover threat. Defendants' apparent invocation of the *Unocal* standard is unavailing. As explained below, Poliak's issuance of the Series B Preferred to himself is a quintessential self-dealing transaction and is, therefore, subject to the exacting standard of entire fairness. In any event, Poliak's conduct cannot even withstand the less arduous standard of enhanced scrutiny under *Unocal*.

a. Enhanced Scrutiny Under *Unocal* And *Blasius*

Under *Unocal*[7] and its progeny, when a board implements defensive measures in response to an alleged threat, Delaware law requires that the directors 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)

[7] *See Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985).

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)). Defendants can satisfy the first part of the *Unocal* test by "showing the reasonableness of their investigation, the reasonableness of their process and also of the result that they reached." *Chesapeake Corp. v. Shore*, 771 A.2d 293, 301 n.8 (Del. Ch. 2000).

The second aspect of the *Unocal* test involves its own two-part analysis. Defendants must establish both (1) that the defensive measure under review is not "coercive" or "preclusive" and (2) that such measure is otherwise within "a range of reasonable responses" to the threat perceived. *See Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1387-88 (Del. 1995). A defensive mechanism is considered "preclusive," and thus impermissible, if it renders the ability of stockholders to elect a new board of directors "either mathematically impossible or realistically unattainable." *See Versata Enters., Inc. v. Selectica, Inc.*, 5 A.3d 586, 601 (Del. 2010) (internal quotation marks & citation omitted); *Unitrin*, 651 A.2d at 1387-88.

As this Court recently explained in *Johnston v. Pedersen*, application of enhanced judicial scrutiny to defensive measures:

> requires that the defendant fiduciaries bear the burden of persuading the Court that their motivations were proper and not selfish, that they did not preclude stockholders from exercising their right to vote or coerce them into voting in a particular way, and that the directors' actions were reasonably related to a legitimate objective. If the fit between means and end is not reasonable, then the directors fall short.

Johnston, 28 A.3d at 1090 (citing *Mercier v. Inter–Tel (Del.), Inc.*, 929 A.2d 786, 810 (Del. Ch. 2007)).

Significantly, if the primary purpose of defensive conduct is to impede the exercise of stockholder voting power, directors carry 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 651, 661-62 (Del. Ch. 1988); *see also MM Cos., Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1129-30 (Del. 2003). As this Court explained in *Johnston*, "[t]he shift from 'reasonable' to 'compelling' requires that the board establish a closer fit between means and end." 28 A.3d at 1090. As explained below, Defendants are unable to meet even the traditional *Unocal* requirement of "reasonableness," let alone demonstrate a "compelling justification."

b. Poliak Failed To Conduct Any Meaningful Process, Much Less A Reasonable Investigation

The trial record will establish that during the roughly two-day period between 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 to himself on December 1, 2010, Poliak did nothing to ensure he employed a reasonable process to investigate the existence and nature of the threat he claims to have perceived, to consider the consequences of his actions, or to evaluate potential alternatives to his self-interested conduct. Defendants, therefore, cannot satisfy the first part of *Unocal*.

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 minority debt holders. (Poliak 10, 19-20; *see* Shek 17.) Even if true, those purported threats to the Company would not support Poliak's conduct. *See*

Johnston, 28 A.3d at 1091 ("The notion that directors know better than the stockholders about who should be on the board is no justification at all.") (quoting *Mercier*, 929 A.2d at 811; and citing *Blasius Indus., Inc.*, 564 A.2d at 663).

Moreover, Poliak's utter failure to investigate the purported threats is fatal to Defendants' *Unocal* defense. Poliak admits he undertook no steps – reasonable or otherwise – to investigate the nature of the alleged threats or whether they actually existed. In his deposition, Poliak confirmed that he did not know what Keyser and "his group" planned to do if they were successful in removing him and electing a new board. (Poliak 11, 32; *see* Shek 17.) Poliak does not even recall whether he spoke to Keyser, Armstrong, or any of the Three Creditors about their relationship or their plans for Ark before he issued the Series B Preferred. (*Id.* at 13-14, 27-28, 32-33.) Poliak concedes that he acted to prevent his own removal and the election of a new board in reaction to mere "concerns that whatever was going on between Keyser and Armstrong and possibly Steel or Lyons would not be for the benefit of all our creditors, all of our employees, all of our stockholders." (Poliak 26.) Poliak found it to be "at the very least curious what was going on…." (Poliak 11.) Yet he took no steps to investigate his professed "concerns" or to satiate his "curiosity" before permanently vesting control over Ark in himself for almost no consideration.[8]

[8] Poliak also never considered appointing independent directors to evaluate the supposed threat and consider potential responses. *See Air Prods. & Chems., Inc.*, 16 A.3d at 92 (explaining that proof of good faith and reasonable investigation under the first part of the *Unocal* test is "materially enhanced" if directors demonstrate that the board was comprised of a majority of outside independent directors).

c. 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*. First and foremost, Poliak's actions were preclusive. Poliak freely admits that he issued the Series B Preferred to himself to "***prevent*** Mr. Keyser and his group from coming over and taking control of the [C]ompany." (Poliak 15, (emphasis added); *id.* at 40-41, 48, 89.) Poliak issued 25 million votes to himself – outright control of Ark – making it "mathematically impossible" for other stockholders of Ark to ever again elect a board of their own choosing. His action was preclusive and, therefore, is invalid. *See Versata Enters., Inc.*, 5 A.3d at 601 (action making it "mathematically impossible" for stockholders to conduct a successful proxy contest is preclusive).[9]

In addition to being preclusive, Poliak's actions were not proportionate to the threat he claims to have perceived, much less based on a compelling justification. Poliak made no effort to ensure that his actions were reasonable and proportionate. (*See* Poliak 13-14, 32-33, 47-48.) He also did not consider any potential alternatives. In fact, he did not even know that reasonableness in relation to the threat posed was a requirement of Delaware law. (Poliak 48.) And he never identified any sufficient justification for his actions, let alone tailor them to a compelling justification. *See Johnston*, 28 A.3d at 1091.

Importantly, Poliak did not issue the control block to himself as a temporary defensive measure of limited duration. He permanently vested voting control in himself. He made no effort to tailor that permanent defensive response to the threat he claims to

[9] Likewise, the Bylaw Amendments were designed to preclude Ark's stockholders from acting by written consent to remove directors.

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.

For these reasons, Defendants cannot carry their burden under either part of the *Unocal* test, and Poliak's issuance of the Series B Preferred to himself is invalid.

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

The *Johnston* decision vividly demonstrates that Poliak's entrenchment-motivated issuance of a controlling stock interest to himself cannot withstand enhanced scrutiny review. 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. The preferred stock gave holders a separate class vote on all matters requiring a stockholder vote, including director electives.

The Court found that the defendant directors had issued the preferred shares "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. The Court credited the directors with the honest belief that issuance of the preferred stock was in the Company's best interest, in that they intended it to provide a "period of stability" by avoiding a change of control. *Id.* at 1091-92. In addition, the Court concluded that the directors believed it would be disastrous if one of the insurgents – a

founder of the company whom the incumbent directors suspected of having misused company funds – returned to power. *Id.* at 1090. Nevertheless, the Court – applying enhanced scrutiny – 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 issuance to prevent an insurgent group from waging a successful proxy contest." *Id.* at 1081.

The only material differences between the facts of this case and those in *Johnston* are differences that render Poliak's disloyalty all the more obvious and egregious. While the defendants in *Johnston* could credibly, though unsuccessfully, argue that they had authorized the issuance of the new series of preferred stock for the purpose of raising capital, Poliak was not trying to raise capital. He issued the Series B Preferred to himself for a penny per share (or $250 total). Poliak also did not have a good faith belief that a change in board control posed a threat to the Company. As discussed above, he undertook no efforts to investigate the existence or the nature of the supposed threat, he did not consider any potential alternatives, and he issued the Series B Preferred to himself, rather than to third parties (as in *Johnston*). Thus, as discussed below, Poliak's conduct is subject to the stringent entire fairness standard of review, rather than the somewhat less demanding enhanced scrutiny form of review the Court employed in *Johnston*. Regardless of the applicable standard of review, however, the *Johnston* decision demonstrates that 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 that reason alone, the issuance of the Series B Preferred is invalid and void.

3. Defendants Cannot Show That Poliak's Issuance Of Series B Preferred To Himself Was Entirely Fair

Even if Defendants could satisfy the enhanced scrutiny standard under *Unocal* and *Blasius* (and they cannot), the Series B Preferred would still be invalid and void. As a self-interested transaction, Poliak's issuance of the Series B Preferred to himself is subject to the entire fairness standard. Defendants cannot credibly contend that Poliak's conduct in issuing the Series B Preferred meets that exacting standard.

a. Poliak's Conduct Is Subject To Entire Fairness

Defendants argue that Poliak's actions in issuing the Series B Preferred to himself to prevent his own removal are subject to judicial review under the *Unocal* enhanced scrutiny standard, rather than entire fairness. (*See, e.g.*, Defendants' Opposition To Plaintiffs' Motion For A Protective Order ("Defs' Opposition") at ¶¶ 7, 9). This contention is frivolous. A transaction is subject to entire fairness if the directors who approved it "either stood on both sides of the 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.).[10] Poliak, the Company's sole director, stood on both sides of the transaction and dictated its terms. He also received a material personal benefit (outright

[10] A compendium of unreported decisions is being filed simultaneously herewith.

voting control) not enjoyed by other stockholders. Accordingly, the entire fairness standard applies.[11]

"Entire fairness is Delaware's most onerous standard" of judicial review and requires defendants to "demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain." *Encite LLC v. Soni*, 2011 WL 5920896, at *20 (Del. Ch.) (internal quotation marks & citations omitted).[12] To satisfy their burden, 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.

b. Poliak Made No Effort To Engage In A Fair Process

Defendants cannot show that Poliak undertook a fair process. He 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. Nor did he afford the holders of a majority of the minority of Ark's outstanding common stock an opportunity to approve his actions. He did not consult with an independent financial advisor or obtain

---

[11] *See*, *e.g.*, *In re Loral Space & Commc'ns Inc.,* 2008 WL 4293781, at *21 & n.109 (Del. Ch.) (holding that "the entire fairness standard presumptively applies" where "a majority of the board is interested or lacks independence from the interested party"); *Lewis v. Vogelstein*, 699 A.2d 327, 333 (Del. Ch. 1997) ("As the Plan contemplates grants to the directors that approved the Plan and who recommended it to the shareholders, we start by observing that it constitutes self-dealing that would ordinarily require that the directors prove that the grants involved were, in the circumstances, entirely fair to the corporation." (citing *Weinberger v. U.O.P., Inc.*, 457 A.2d 701 (Del. 1983))); *Packer v. Yampol*, 1986 WL 4748, at *13 (Del. Ch.) (concluding that, having benefitted from issuance of preferred stock to himself, a company's chairman and CEO was "clearly interested" in a stock issuance transaction).

[12] *See also Gesoff v. IIC Indus. Inc.*, 902 A.2d 1130, 1145 (Del. Ch. 2006) ("[Entire fairness] review requires the parties to be assiduous in fulfilling their fiduciary duties. Not even an honest belief that the transaction was entirely fair will be sufficient to establish entire fairness. Rather, the transaction itself must be objectively fair, independent of the board's beliefs.").

a fairness opinion, and he never even considered what a fair issuance price would be. (Poliak 95.) 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. (Poliak 40-49.)[13]

Poliak attempts to justify his self-dealing by claiming that he was protecting Ark from a takeover threat. Yet, he cannot show that he undertook the type of process contemplated by *Unocal* and *Blasius*. To establish that he conducted a fair process in these circumstances, Poliak must show "the reasonableness of his investigation, . . . and also of the result that [he] reached,"[14] that his actions were reasonable in relation to the threat he allegedly perceived,[15] and that there existed a compelling justification for his actions.[16] As discussed above, Poliak can make none of those showings. Defendants, therefore, cannot demonstrate a fair process.

c. Defendants Cannot Show That Poliak Paid A Fair Price For The Series B Preferred.

Under the second part of the entire fairness test, Defendants are required to prove that the price paid in the transaction was entirely fair. *Technicolor, Inc.*, 663 A.2d at 1162-63 (citing *Weinberger*, 457 A.2d at 711). Whether the price paid for corporate stock is entirely fair will depend upon "all relevant factors," including asset value, market value,

---

[13] 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.)

[14] *Chesapeake Corp.*, 771 A.2d at 301 n.8.

[15] *Air Prods. & Chems., Inc.*, 16 A.3d at 92.

[16] *Johnston*, 28 A.3d at 1090.

earnings, future prospects, and any other elements that affect the intrinsic or inherent value of the corporation's stock. *Id.* Where, as here, the transaction at issue involves a change of control, the Defendants are further required "to demonstrate 'that the price offered was the highest value reasonably available under the circumstances.'" *Technicolor, Inc.*, 663 A.2d at 1163 (quoting *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993)); *see Paramount Commc'ns Inc. v. QVC Network, Inc.*, 637 A.2d 34, 48 (Del. 1994); *Encite LLC*, 2011 WL 5920896, at *20.[17] By any metric, Defendants fail to satisfy the "fair price" aspect of the entire fairness test.

As previously noted, Poliak did not engage or consider the advice of a financial advisor or valuation firm, and he did not obtain a fairness opinion. (Poliak 95-96.) 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. (*Id.*) In fact, 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,* 1986 WL 4748, at *17 (criticizing a board's failure to explore adequately alternative financing options before issuing super voting preferred stock).

---

[17] Before Poliak issued the Series B Preferred, no single stockholder held more than 25.7% of Ark's voting power. When Poliak issued the Series B Preferred to himself, he gave himself voting control and ensured that, in the future, he alone – and not the stockholder base as a whole – would be entitled to receive any control premium. It is bedrock Delaware law that when a board approves a change of control transaction such as this, the directors have a fiduciary duty under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) and its progeny to obtain the highest price reasonably available under the circumstances. *See, e.g.*, *Binks v. DSL.net, Inc.*, 2010 WL 1713629, at *7 (Del. Ch.) (finding that *Revlon* duties arise when a board approves a transaction having a change in corporate control effect, "'specifically, . . . where corporate action plays a necessary part in the formation of a control block where one did not previously exist.'") (quoting *Equity-Linked Investors L.P. v. Adams*, 705 A.2d 1040, 1055 (Del. Ch. 1997)).

Even though 25,000 shares of Series B Preferred represented a control block, Poliak did not consider what such a control block was worth. (Poliak 96.) Nor did he consider the terms of the Series B Preferred in determining the issuance price. (Poliak 95-96.) In fact, Poliak testified that he believed the actual financial terms of the Series B Preferred were irrelevant to the determination of a fair price. (*Id.* at 96; *see* Shek 27-28.) In Poliak's view, it is not at all relevant that 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.[18]

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.

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

A. Poliak's "Advice Of Counsel" Defense Does Not Justify His Conduct

Defendants defend 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.) Defendants claim 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." (*Id.* at 10.) Defendants' "advice of counsel" defense is unavailing. First, directors cannot rely on advice of counsel to shield self-dealing conduct. *See Valeant*

[18] 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 having 25 million votes and the financial terms discussed above.

Pharms. Int'l v. Jerney, 921 A.2d 732, 750-51 (Del. Ch. 2007) (noting the absence of any case where the defendant's reliance on expert advice provided a defense in an entire fairness action, particularly where the person claiming the defense is interested in the challenged transaction); *Boyer v. Wilmington Materials, Inc.*, 754 A.2d 881, 910 (Del. Ch. 1999) (defendant directors who were interested in the transaction at issue could not rely on § 141(e) to shield themselves from liability).

Perhaps the most fatal flaw in Defendants' "advice of counsel" defense, though, is that neither Poliak nor any other witness seems to recall the substance of the advice upon which Poliak purportedly relied. An "advice of counsel" defense is an affirmative defense for which Defendants bear the burden of proof.[19] Defendants cannot satisfy that burden if they cannot point to specific advice upon which Poliak purportedly relied.

Poliak recalls none of the specific advice he claims to have received from Locke Lord. (Poliak 40, 41-45.) He recalls that Locke Lord "recommended" that he amend the bylaws and issue shares of super-voting Series B Preferred to himself to "prevent Mr. Keyser and his group from coming over and taking control of the [C]ompany." (Poliak 15, 40-41, 48.) Beyond that, he has no specific recollection of what steps Locke Lord recommended or why it supposedly recommended them.

Although Poliak claims to recall Locke Lord generally advising that he owed fiduciary duties to both creditors and stockholders (Poliak 44, 46), he has no recollection

---

[19] *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.").

of any other fiduciary duty advice from Locke Lord. (Poliak 43-44.) In particular, he has no recall of Locke Lord mentioning anything about an obligation to conduct a fair process or to consider alternatives. (*See* Poliak 40-45, 47-48.) Nor does he recall Locke Lord advising that he was required to conduct an investigation into any threat he claims to have perceived, or that any response would need to be reasonable in relation to the perceived threat. (Poliak 47-48.) Poliak now "guess[es]" that Locke Lord recommended that he issue the Series B Preferred to himself, but he is not sure. (Poliak 41.) He has no recollection of Locke Lord providing any advice about how he should value the Series B Preferred to ensure a fair issuance price. (Poliak 41.)

The only written advice that Locke Lord provided before the time Poliak approved the creation and issuance of the Series B Preferred to himself is in an email dated December 1, 2010 at 4:07 pm (less than 68 minutes before Poliak signed the written consent to amend the bylaws and to create the Series B Preferred and issue it to himself). (JX 22.) That advice was as follows:

> 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.

(*Id.*) The record is devoid of any specific advice other than this apparent admonition *against* Poliak's self-dealing issuance of the Series B Preferred. While Poliak now claims that Locke Lord "got comfortable" with the idea of his issuing a control block to himself, he has no recollection of when, how, or why Locke Lord supposedly "got comfortable" with the steps he took. (Poliak 90.) And he all but admitted he was not paying particularly close attention to this "blah, blah, blah" advice. (Poliak 87.)

Tellingly, Defendants do not offer the testimony of Christopher Pesch, the attorney who, while at Locke Lord, supposedly rendered the legal advice in question. The inference that the Court should draw, particularly given Poliak's purported lack of specific recollection, is that Pesch's testimony would not be helpful to Defendants.[20] *Cf. Zirn v. VLI Corp.*, 621 A.2d 773, 781-82 (Del. 1993) (finding that a party cannot shield inquiry into the nature of professional advice, when the advice, itself, is tendered as a defense or explanation for disputed conduct); *Chesapeake Corp.*, 771 A.2d at 304 (finding that because plaintiff could not examine the legal advice provided to defendants, the defendants could not rely upon that advice to support their position in the litigation).

Even if Defendants could offer some competent evidence of the advice Poliak supposedly received, they could not show that he "acted reasonably and in good faith" upon such advice, as required by 8 *Del. C.* § 141(e). *See Grubb v. Bagley*, 1998 WL 92224, at *2 (Del. Ch.). Defendants cannot show that Locke Lord was independent of Poliak or that the Locke Lord attorneys he selected were experts in the matters of Delaware law upon which he claims to have sought advice. Locke Lord had a pre-existing relationship with Poliak and the Company as its FINRA counsel, and stood to lose that engagement if Poliak was removed from office. Moreover, Pesch is not authorized to practice law in Delaware, and the evidence strongly suggests that he lacked familiarity with basic Delaware law concepts.[21] For these and the other reasons

[20] Pesch is no longer practicing at Locke Lord. (Kloecker 8.) John Kloecker, the Locke Lord attorney who provided litigation advice to Poliak, did not provide any of the advice upon which Poliak supposedly relied when he issued the Series B Preferred Stock and amended the bylaws, and has no knowledge of what advice, if any, was given to Poliak. (Kloecker 13, 19-20.)

[21] A particularly glaring example is that Pesch appears to have recommended revisions to Ark's bylaws that any competent corporate governance lawyer would have known were

explained above, Defendants' reliance on the advice of counsel defense cannot excuse Poliak's self-dealing, unfair, entrenchment-motivated conduct.

B. Defendants' Equitable Defenses Are Baseless

Defendants invoke an amorphous set of equitable defenses in an effort to absolve Poliak of culpability and thereby render the Series B Preferred valid. This equitable defense grab-bag includes ratification, acquiescence, estoppel, waiver, laches, and unclean hands. (*See* PTO ¶ IV(1)(i).)[22] As discussed below, none of these defenses has merit, and Defendants have failed to articulate any coherent explanation as to why this Court, in its equitable discretion, should condone Poliak's self-dealing.

1. The Equitable Defenses Do Not Apply To Salvatore and Schalk

As a threshold matter, all of Defendants' equitable defenses fail because they are premised on the purported action or inaction of Keyser alone. While Defendants make a half-hearted effort to identify "benefits" that Plaintiffs Salvatore and Schalk received as stockholders or employees of Ark, Defendants point to no specific conduct on the part of Salvatore or Schalk to support their defenses. Salvatore and Schalk had little

---

impermissible under the Delaware General Corporation Law (the "DGCL"). The Bylaw Amendments purport to permit the removal of directors only at meetings of stockholders (and not by written consent), only "for cause" (even though Ark does not have a classified board), and only by a supermajority (75%) stockholder vote. Those amendments violate Sections 102(b)(4), 141(k), and 228 of the DGCL (as well as Poliak's fiduciary duties). *See* 8 *Del. C.* § 102(b)(4) (if DGCL specifies vote required, certificate of incorporation (but not bylaws) may require a larger portion of stock for such action); 8 *Del. C.* § 141(k) ("[a]ny director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares then entitled to vote at an election"; "removal only for cause" not permitted unless board is classified pursuant to Section 141(d)); 8 *Del. C.* § 228 (stockholders are entitled to act by written consent "unless otherwise provided in the certificate of incorporation"); *Datapoint Corp. v. Plaza Secs. Co.*, 496 A.2d 1031, 1036 (Del. 1985) (holding that any restrictions on stockholders' right to act by written consent must be contained in the certificate of incorporation, rather than the bylaws).

[22] Defendants did not raise ratification as a defense in their Answer.

involvement in the underlying events before November 2011, and did not even learn of Poliak's issuance of the Series B Preferred until long after the shares were issued. (*See* Salvatore 17; Schalk 40.) This is fatal to Defendants' equitable defenses.

As this Court recently confirmed in *Johnston*, for defenses of this nature to function, they must apply to all plaintiffs. In *Johnston*, the Court declined to reach the merits of an unclean hands defense, holding that it 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]." 28 A.3d at 1092. The same result should pertain here.

2. Plaintiffs Have Not Waived Or Abandoned Their Right To Challenge Defendants' Inequitable Conduct

Defendants' waiver, equitable estoppel, acquiescence, and laches defenses are all premised, to one degree or another, on the absurd notion that Defendants were not aware during most of 2011 that Plaintiffs (and Keyser in particular) had preserved their right to challenge Poliak's issuance of the Series B Preferred and, therefore, that they somehow waived or abandoned that right. Waiver "requires proof that a person (1) had knowledge of all material facts relating to his rights and (2) intended to relinquish such rights voluntarily." *Prizm Group, Inc. v. Anderson*, 2010 WL 1850792, at *6 (Del. Ch.)). It is well-settled that waiver – either express or implied – must be "unequivocal." *Dirienzo v. Steel Partners Holdings L.P.*, 2009 WL 4652944, at *4 (Del. Ch.). None of Keyser, Salvatore, or Schalk ever indicated, by words or conduct, an intent to relinquish any rights with respect to Poliak's self dealing. In fact, the record shows that Keyser consistently and repeatedly apprised Ark and Poliak that he was continuing to preserve

all rights with respect to his ownership of Ark stock, specifically including his right to challenge the issuance of the Series B Preferred.

Defendants have known that Keyser disputes the issuance of the Series B Preferred since December 10, 2010, when Keyser's counsel objected to the issuance in a series of emails. After that, Keyser, Armstrong, and Auxol engaged in extensive settlement efforts with Ark and Poliak, which continued throughout 2011. (PTO at ¶¶ 18-19.) Ark and Poliak determined to pursue 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 the 7 million Original Shares owned by Keyser. At all times, Ark and Poliak were well aware that Keyser had preserved his right as a stockholder to challenge the Series B Preferred issuance until Ark closed both settlements.

The January 5, 2011 Standstill Agreement recited that "certain disputes," including "capitalization" and "voting rights" disputes, had arisen and that "the Parties have determined … to temporarily suspend or defer any … legal proceedings … pending a potential negotiated resolution." (JX 76 at 1.) The Standstill Agreement tolled "[e]ach and every limitations period, whether statutory, contractual, equitable or otherwise" applicable to the disputed matters. (*Id.* at 4.) It is absurd for Defendants to contend that Keyser somehow waived rights at that time.

On March 31, 2011, Ark and Auxol entered into the Purchase Agreement. This Agreement contemplated Ark's purchase of notes and stock from Auxol, but, as noted, did not govern Ark's purchase of the Original Shares from Keyser. Instead, it specifically contemplated that Ark and Keyser would endeavor to negotiate a separate settlement for the Original Shares. (JX 94 at § 7.4.) Critically, the Purchase Agreement

specifically reserved all rights and claims Keyser had as a stockholder with respect to the Original Shares: "[S]o 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).) It is frivolous for Defendants to now argue that the Purchase Agreement, or Keyser's conduct in the course of negotiating that Agreement, somehow resulted in a waiver or abandonment of his right as the owner of the Original Shares to challenge the Series B Preferred.

After Ark failed to close the transaction contemplated by the Purchase Agreement by the contractual closing deadline, Keyser's Delaware counsel sent a letter to Locke Lord on April 15, 2011. That letter threatened litigation and specifically 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.) Thus, Defendants cannot credibly argue that they were unaware in April 2011 that Keyser still disputed the validity of the Series B Preferred.

On April 29, 2011 (a few days before Ark finally closed on the purchase from Auxol), Ark, Poliak, and Keyser entered into the Keyser Settlement Agreement relating to the Original Shares. (JX 121.) Having previously agreed in the Purchase Agreement that Keyser was not releasing any rights or claims as the owner of the Original Shares so long as he owned them (JX 94 at § 6.4), Ark and Poliak further confirmed that "**nothing in this [Keyser Settlement] Agreement constitutes a waiver by any party of any claim the party may have against the other parties**." (JX 121 at § 5 (emphasis added).)

Defendants identify nothing that Keyser supposedly did after entering into the April 29 Original Shares Settlement that resulted in an abandonment of his right to challenge the Series B issuance. In fact, when Keyser, Salvatore, and Schalk delivered their proxies to Ark in connection with the November 1, 2011 annual meeting, they specifically included language in their proxy forms objecting to the Series B Preferred, and their objections were entered into the record of the meeting. (JX 154; JX 155.)

Thus, Defendants could not have believed in November 2011 – any more than they could have believed at any point earlier in the year – that Keyser or the other Plaintiffs had waived or abandoned their rights as stockholders to dispute the validity of the Series B Preferred. Mr. Shek frankly admitted he was under no such illusion:

> Q. But prior to resolving it [the dispute with Keyser] and closing out the [Keyser] [S]ettlement [A]greement, you understood that there was a possibility that [Keyser] might challenge [the Series B Preferred].
>
> A. I guess legally I knew there was a possibility.

(Shek 59.) This alone defeats nearly all of Defendants' equitable defenses. To the extent any of them are premised on the notion that Keyser or the other Plaintiffs waived or abandoned their right to challenge the Series B Preferred, those defenses are baseless.

3. Plaintiffs Did Not Engage 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. v. Tafeen*, 888 A.2d 204, 210 (Del. 2005). Defendants have failed to establish these necessary elements. It first warrants mention that Plaintiffs brought this action well within the presumptive three-year limitations period applicable to actions challenging breaches of fiduciary duty. Moreover, as explained above,

throughout the process of trying to reach and consummate the two separate settlements, Keyser repeatedly preserved his right as a stockholder to challenge the Series B Preferred issuance. Likewise, Salvatore and Schalk engaged in efforts to settle their differences with Poliak, and determined to join Keyser in electing a new board of directors only after those efforts became hopelessly frustrated. This Court has repeatedly held that, where a party brings its claims within the analogous statutory period, and where any period of delay has been occupied by settlement efforts, laches will not bar the viability of such claims.[23] Likewise, alleged delay in commencing litigation that results from settlement efforts should not support the defenses of estoppel or acquiescence because 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.").

4. Neither Plaintiffs Nor Ark's Other Common Stockholders Have Ratified Or Acquiesced In Poliak's Issuance Of The Series B Preferred To Himself

Defendants' have raised the defenses of ratification and acquiescence in an effort to show that Defendants, along with Ark stockholders who are not parties to this action,

[23] *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.").

have somehow implicitly agreed not to challenge Poliak's self-dealing activities. Defendants' arguments are factually incorrect and without basis in Delaware law.

a. Ark's Stockholders Have Not Ratified Poliak's Illegal And Inequitable Actions

Although Defendants did not raise the defense of stockholder ratification in their Answer or their responses to Plaintiffs' Interrogatories, their counsel asserted the defense during oral argument on Plaintiffs' motion for a protective order. There, counsel suggested that "the law of acquiescence, ratification, whatever the proper term is," might support an argument that "the majority of the stock outstanding has in some way approved of what Poliak did with the preferred stock." (Tr. of Hearing on Plaintiffs' Motion for a Protective Order, dated Feb. 2, 2012, at 14.)

Defendants have conflated the equitable doctrine of acquiescence with Delaware's carefully crafted doctrine of shareholder ratification. Our Supreme Court has told us that "the scope of the shareholder ratification doctrine must be limited to its so-called 'classic' form; that is, to circumstances where a ***fully informed shareholder vote*** approves director action that does ***not*** legally require shareholder approval in order to become legally effective." *Gantler v. Stephens*, 965 A.2d 695, 713 (Del. 2009) (emphasis added & in original). Moreover, "the only director action or conduct that can be ratified is that which the shareholders are specifically asked to approve." *Id.* No stockholder vote was ever conducted to ratify Poliak's issuance of the Series B Preferred to himself. The doctrine of shareholder ratification is therefore inapplicable.

b. Plaintiffs Have Not Acquiesced In The Issuance Of The Series B Preferred

Acquiescence is available only "where a complainant 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 believe the act has been approved." *NTC Group, Inc. v. W. Point-Pepperell, Inc.*, 1990 WL 143842, at *5 (Del. Ch.).[24] To succeed on their acquiescence defense, Plaintiffs 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. Given Keyser's consistent and repeated reservations of rights throughout 2011, not to mention his counsels' many written communications objecting to the issuance of the Series B Preferred, he in no way demonstrated an intent to accept, or freely recognized, the validity of the Series B Preferred. Nor can Defendants credibly contend that they were "led to believe" the Series B issuance had been approved.[25]

In support of their acquiescence defense, Defendants contend that, by allowing Poliak to remain in office and act on behalf of Ark (including by authorizing the Purchase Agreement with Auxol), Plaintiffs have somehow acquiesced in the validity of the Series B Preferred. This is a non sequitur. Poliak's issuance of the Series B Preferred to himself had absolutely nothing to do with his remaining in office.

While Keyser and other stockholders did attempt to remove Poliak as a director by the 2010 Written Consent, Poliak and Locke Lord took the position that the 2010 Written Consent was ineffective. They did not base that position on the existence of the

---

[24] As noted above, to the extent Defendants' acquiescence defense is premised on supposed delay, it is baseless.

[25] Defendants inability to show reasonable reliance under the facts and circumstances of this case is also fatal to their equitable estoppel defense. To show estoppel, Defendants must demonstrate that their reliance was "both reasonable and justified under the circumstances." *Pilot Point Owners Ass'n v. Bonk*, 2010 WL 3959570, at *1 (Del. Ch.). They cannot do so.

Series B Preferred, but argued that the assignment of the Option to Keyser and his attempt to exercise it were invalid and, therefore, he did not own the Option Shares when he signed the 2010 Written Consent. (JX 34; Poliak 39, 100-101.) No one disputes that if Keyser did not own the Option Shares on December 1, 2010, the 2010 Written Consent was not signed by holders of a majority of the common stock. Thus, the lack of effectiveness of the 2010 Written Consent had nothing to do with Poliak's issuance of the Series B Preferred to himself.

Later in December 2010, Keyser and Armstrong considered delivering a new stockholder consent to remove Poliak after the Option Shares had been issued to the Three Creditors and transferred to Keyser. They ended up not delivering a new removal consent and instead entered into the settlement process described above. To be sure, one result of the settlement process was that Keyser and Auxol permitted Poliak to remain in office and did not take further steps to try to remove him. But Keyser and Auxol insisted on including contractual status quo provisions in the Standstill Agreement, the Purchase Agreement, and the Keyser Settlement Agreement. They thus ensured that Poliak could not cause Ark to take actions outside of the ordinary course of business while the parties endeavored to consummate the two separate settlements. As discussed at length above, Keyser made it well known throughout this time that he had not waived or abandoned his right to challenge Poliak's issuance of the Series B Preferred. Under these circumstances, there is simply no logical or factual basis for concluding that Keyser's decision to allow Poliak to stay in office, subject to status quo agreements, was in any way related to the Series B Preferred issuance, let alone that it somehow amounted to Keyser's ratification of, or acquiescence in, that issuance.

5. Plaintiffs Cannot Be Barred From Seeking Relief Based On Representations Defendants Allegedly Made To Purchasers Of Series A Preferred

In support of their no-stone-left-unturned approach to affirmative defenses, Defendants also assert what appears to be an estoppel-based argument premised on representations that Defendants themselves supposedly made to purchasers of Ark's Series A Preferred during 2011. According to Defendants:

> Ark sold an additional $1 million of Series A Preferred Stock at the end of November, a benefit to Ark stockholders such as Plaintiffs, based on representations in the Series A Preferred Stock Offering materials to innocent third parties that Mr. Shek, Mr. Hands and Mr. Curtis would be running Ark and Dawson James, not Plaintiffs. Accordingly, Plaintiffs should be barred from now attempting to undo the November election.

(JX 174 at 15.)

Defendants' new-found concern for the supposed reliance-based rights of the purchasers of the Series A Preferred is curious. Defendants determined it was not necessary, before a second Series A closing on November 30, 2011, to inform potential purchasers that Keyser had terminated the Keyser Settlement Agreement, that all three Plaintiffs had once again voiced objection to the Series B Preferred at the November 1, 2011 stockholders' meeting, and that Plaintiffs had sent Mr. Shek a copy of the Voting Agreement to replace the Board. Given that defendants did not believe such disclosure to potential purchasers was warranted in November 2011, they cannot credibly contend any Series A Preferred holder relied upon supposed representations that "Mr. Shek, Mr. Hands, and Mr. Curtis would be running Ark and Dawson James," presumably forever.

Moreover, Defendants cannot show that any purchasers of Series A Preferred relied on the continuing incumbency of Defendants' slate when deciding to purchase

those securities. Defendants have not called a single third-party purchaser of Series A Preferred as a witness. If Plaintiffs intend to testify about the alleged understanding of the persons who purchased the Series A Preferred, as Poliak did in his deposition (Poliak 31-32), any such testimony is hearsay and not admissible. In all events, the purchasers of the Series A Preferred could not have reasonably relied on a belief that Poliak and his team would remain in power. The offering materials for the Series A Preferred included as a risk factor that "[t]here can be no assurance that we will be successful in retaining the services of our key executives ." (JX 157 at Exhibit A, p. 5.)[26]

6. Defendants Cannot Demonstrate Unclean Hands

Defendants' final equitable defense is unclean hands. Defendants assert that:

> Mr. Keyser's claims are barred by the doctrine of unclean hands as a result of his actions in the fall of 2010, his refusal to abide by the terms of the Settlement Agreement, his acceptance of the benefits arising under the Stock and Note Purchase Agreement and Series A Preferred Stock offering.

(JX 174 at 13.)

None of these allegations, even if true, would give rise to a viable unclean hands defense. For the defense 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.) (quoting *E. States Petroleum Co.*

[26] To the extent that Defendants suggest Plaintiffs were somehow complicit in representations made by Ark on which the Series A Preferred holders allegedly relied, they are mistaken. Plaintiffs were not involved in the Series A offering, and did not prepare the offering materials. Defendants delayed until the last possible moment to provide details about the offering and copies of the offering materials to Plaintiffs, and Defendants never requested that Plaintiffs comment on or approve the materials.

v. Universal Oil Prods. Co., 8 A.2d 80, 82 (Del. 1939)). 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)).

Keyser's alleged "refusal to abide by the terms of the [Keyser] Settlement Agreement," and "acceptance of the benefits arising under the Stock and Note 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. Moreover, these events are unrelated to Poliak's self-dealing in December 2010.[27]

In addition, Defendants' unclean defense suffers from the same fatal flaw as their other equitable defenses: It is leveled *only* against Keyser. Defendants seem to forget that Salvatore and Schalk are also Plaintiffs in this Action. Defendants have not even attempted to argue that Salvatore or Schalk is guilty of unclean hands. For this reason alone, the unclean hands defense must fail. *Johnston,* 28 A.3d at 1092.

* * *

[27] Defendants' reference to alleged actions undertaken in the "Fall of 2010" presumably refers to Keyser's efforts to remove Poliak from the board of Ark. Defendants fail to articulate, however, why an attempt by a company's stockholders to exercise the corporate franchise threatens to "tarnish the Court's good name," as is required to close the courthouse doors on the basis of unclean hands. *Nakahara v. NS 1991 Am. Trust*, 718 A.2d 518, 522 (Del. Ch. 1998).

For the foregoing reasons and many others Plaintiffs will show at trial, none of Defendants' equitable defenses is meritorious. Poliak engaged in self-dealing conduct of the most egregious sort in an admitted effort to deprive stockholders of the ability to remove him. This Court has never countenanced such behavior by a fiduciary and should not do so now on the basis of a hodge-podge of baseless equitable defenses asserted to divert attention from Poliak's self-dealing.

CONCLUSION

For the reasons set forth herein, the Court should declare that the 2011 Written Consent was valid and effective to remove the Former Directors and elect Plaintiffs as directors of Ark.

POTTER ANDERSON & CORROON LLP

By: */s/ Michael A. Pittenger*

Michael A. Pittenger (No. 3212)
T. Brad Davey (No. 5094)
Ryan T. Costa (No. 5325)
1313 N. Market Street
Hercules Plaza – 6th Floor
P.O. Box 951
Wilmington, DE 19899-0951
(302) 984-6000

Attorneys for Robert D. Keyser, Jr,. Frank Salvatore and Scott Schalk

Dated: March 8, 2012
1047911