IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

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|---|---|
| DONALD A. KURZ and SEMS DIVERSIFIED VALUE, LP,<br><br>Plaintiffs,<br><br>v.<br><br>JAMES L. HOLBROOK, JR., STEPHEN P. ROBECK, HOWARD D. BLAND, JEFFREY S. DEUTSCHMAN, JORDAN H. REDNOR, JASON ACKERMAN, EMAK WORLDWIDE, INC., a Delaware corporation, and CROWN EMAK PARTNERS, LLC, a Delaware limited liability company,<br><br>Defendants.<br><br>and<br><br>JAMES L. HOLBROOK, JR., STEPHEN P. ROBECK, HOWARD D. BLAND, JORDAN H. REDNOR, and EMAK WORLDWIDE, INC.,<br><br>Counterclaim-Plaintiffs,<br><br>v.<br><br>DONALD A. KURZ and SEMS DIVERSIFIED VALUE, LP,<br><br>Counterclaim-Defendants, | C.A. No. 5019-VCL<br><br>**PUBLIC VERSION**<br>**FILED: February 18, 2010** |

and

JAMES L. HOLBROOK, JR., STEPHEN P. ROBECK, HOWARD D. BLAND, JORDAN H. REDNOR, and EMAK WORLDWIDE, INC.,

Third Party Plaintiffs,

v.

TAKE BACK EMAK, LCC,

Third Party Defendants,

and

CROWN EMAK PARTNERS, LLC, a Delaware Limited Liability Company,

Counterclaim and Third-Party Plaintiff,

v.

DONALD A. KURZ, SEMS DIVERSIFIED VALUE, LP, LLOYD M. SEMS, PHILIP S. KLEWENO, MICHAEL KONIG, and TAKE BACK EMAK, LLC, a California Limited Liability Company,

Counterclaim and Third-Party Defendants.

**PLAINTIFFS' CORRECTED PRE-TRIAL BRIEF**

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Dated: January 20, 2010

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## PRELIMINARY STATEMENT

The trial to be held on Friday involves two sets of claims respecting separate consent solicitations of the stockholders of EMAK Worldwide, Inc. ("EMAK" or the "Company"). One set of claims involves the effectiveness of consents solicited by Crown EMAK Partners, LLC ("Crown") and delivered on December 18, 2009, to amend the bylaws and thereby reduce the number of directors to three – notwithstanding that five directors held office at the time (the "Crown Consents"). The second set of claims involves the effectiveness of consents solicited by Take Back EMAK, LLC ("TBE") and delivered on December 20 and 21, 2009, to remove directors James Holbrook and Jordan Rednor and elect three new directors (the "TBE Consents").

The Crown Consents are a legally deficient means of pursuing the same inequitable goals that animated the original Exchange Transaction. The incumbent director defendants and Crown wanted to prevent holders of a majority of EMAK's common stock from consenting to the removal and election of directors. The incumbents and Crown were not content to inform stockholders of the facts and let the chips fall as they may. In the hope of ensuring the defeat of the TBE slate, they twice facilitated the transfer of control to Crown, despite Crown's motivation and threats to collect on a non-interest-bearing security with a $25+ million liquidation preference, an amount the Company has no ability to immediately pay.

The original Exchange Transaction was a decisive means of thwarting stockholder choice. It made the TBE consent solicitation unwinnable by conferring 28% voting power on Crown and creating a proxy put by which Crown could demand a $25+ million redemption

payment if Donald Kurz and his affiliates elected new directors. On the eve of a December 4, 2009 preliminary injunction hearing, the defendants rescinded the Exchange Transaction.

The Crown Consents are a legally defective Plan B. They purport to shrink the size of the Board to three members, two of whom are designated by Crown, with the third member to be elected by the common stock. The Crown Consents are an invalid means of circumventing the vote requirement to remove directors under Section 141(k) of the Delaware General Corporation Law (the "DGCL"), as Crown cannot vote to remove directors. Instead, the bylaw amendments purport to reduce the size of the Board and eliminate the terms of sitting directors elected by the common stock, in violation of Section 141(b) of the DGCL, which provides that "[e]ach director shall hold office until such director's successor is elected and qualified or until such director's earlier resignation or removal."

Even if Section 141(b) does not render the Crown Consents invalid, the incumbents breached their fiduciary duties by allowing the Crown Consents to be delivered prior to the December 21 deadline for the TBE consent solicitation. The Board refused to defend against the acknowledged threat posed by Crown, and refused to take the minimal step of setting a record date subsequent to December 21, which would allow common stockholders to elect new directors and provide time for a potentially reconstituted Board to consider taking defensive action. The Board purposefully allowed Crown and its allies in EMAK management to deliver consents that purported to give Crown control of EMAK for free. The appropriate remedy for that breach of duty is not to recognize the effectiveness of the Crown Consents delivered on December 18.

On December 20 and 21, TBE delivered consents signed by record holders and beneficial owners representing an absolute majority of the common shares. Following the close of business

on December 21, EMAK finally told TBE something EMAK and its advisors had already known and concealed from TBE – EMAK had not received an omnibus proxy from The Depository Trust and Clearing Corporation ("DTC"). TBE subsequently obtained a DTC omnibus proxy.

The lack of a DTC omnibus proxy as of December 21, 2009, is of no legal consequence. EMAK possessed consents submitted by Broadridge Financial Solutions, Inc. ("Broadridge") on behalf of multiple banks and brokers. The Broadridge consents identify DTC – the only depository in the country – as the depository for each of the listed banks and brokers. EMAK possessed a Cede breakdown setting forth the positions held by each bank and broker as of the record date. There is no question that Broadridge possessed the authority to dictate the vote of the shares held in record name by DTC. These facts thus present the "more compelling" scenario discussed by then-Vice Chancellor Berger in *Olson v. Buffington*, 11 Del. J. Corp. L. 687, 692 (1985), for dispensing with the "formality" of a DTC omnibus proxy in consent solicitations. *Id.* at 691. *See also* 2 David A. Drexler et al., *Delaware Corporate Law and Practice* § 31.03[2], at 31-9 (2009) ("A more recent authority applying the election review procedures of Section 225 to a consent action suggests that a beneficial owner may execute a valid consent without the formality of a proxy from the record holder, so long as the consent identifies the record holder and the authority of the beneficial holder to control voting of the shares is clear.") (citing *Olson*).

The inspector of elections, IVS Associates, Inc. ("IVS"), did not apply the rationale of *Olson*. IVS tabulated the street-name votes on the Broadridge client proxies, but deemed them invalid solely for lack of a timely submitted DTC omnibus proxy. TBE's *Olson*-based challenge was rejected by the inspector. Defendants made no challenges to the inspector's tally.

EMAK's counsel pointed out to the inspector on December 21 that the Broadridge consents reflected an incorrect record date, October 12, 2009, rather than October 22, 2009. IVS replied that the "record date on Broadridge forms does not impact our tabulations." (JX 136 at EMK019678) EMAK's counsel acknowledged the inspector's statement that a record date is something "you can adjust for." (JX 159 at EMK019498)

Here, it is clear by two different methods that TBE prevailed using the October 22 record date, which is hardly surprising given the minimal trading activity in EMAK shares over the prior ten days (JX 142). First, if the Cede breakdown of October 12, 2009 is compared with the Cede breakdown of October 22, 2009, one can see any decline in the share position of each bank and broker. When a consent is subtracted for each bank or broker to the extent of a corresponding decline in that firm's share position, a margin of victory remains. Second, TBE asked Broadridge to issue a new Client Proxy as of October 22, 2009. Broadridge did so on December 30, 2009, and then issued a Supplemental Client Proxy on January 7, 2010, which corrected an input error by a brokerage firm. (JX 116; JX 117) The new Broadridge Client Proxies show that TBE prevailed.

Crown and EMAK assert disclosure claims respecting the TBE consent solicitation, even though there can be no serious question that EMAK's stockholders were fully informed after two months of dueling disclosures. EMAK issued letters to stockholders when soliciting consents to ratify the Exchange Transaction. (JX 101; JX 102) EMAK continued its public relations campaign by soliciting revocations of TBE consents. EMAK released and mailed a lengthy document on December 7, 2009 (JX 103; JX 104), which included a supplement with the heading, "The Important Facts They Failed to Tell You." (JX 104) A week later, EMAK issued a lengthy letter from Stephen Robeck. (JX 107). TBE responded at length to the issues raised by

EMAK. (JX 109; JX 110) The two leading proxy advisory firms – RiskMetrics Group and Glass Lewis & Co. – took their measure of both sides and issued reports, both of which endorsed removing the incumbents and electing new directors. (JX 105; JX 108; JX 143; JX 144) Crown also retained a proxy solicitation firm and solicited consents. (JX 152)

Only one disclosure allegation is not a rehash of the public relations war, and it is frivolous. Crown contends that Kurz was required to disclose that he retained counsel on a contingent basis to challenge the Exchange Transaction. That fact is irrelevant for purposes of a stockholder's voting decision whether or not to support the TBE slate. Any fee award will be based on the successful challenge to the Exchange Transaction, without regard for the results of the stockholder vote. In any event, Plaintiffs' original complaint, which was posted on TBE's website, contains a request for attorneys' fees (JX 2 at 22), Delaware law recognizes the availability of a contingent fee award in an individual action vindicating franchise rights, *Tandycrafts, Inc. v. Initio Partners*, 562 A.2d 1162, 1164-67 (Del. 1989), a fee award would be sought regardless of the outcome of the election, and the fees may not ultimately be borne by the Company. Defendants have nobody to blame but themselves for failing to consider the extent of their damages exposure prior to implementing and defending a rescinded transaction that epitomizes their goal of derailing the TBE consent solicitation by transferring control to Crown.

Finally, in apparent desperation, Defendants will argue that TBE candidates elected by an absolute majority of the common stock should not be seated because Mr. Kurz bought a block of shares from a former employee while in possession of financial projections for the fourth quarter that are negative and not reflective of expected future performance in 2010, after the loss of the Burger King account. No law proscribes the purchase of stock while in possession of immaterial, negative information that can only be disadvantageous to the purchaser. Nothing

about the stock purchase casts doubt on either the integrity of Mr. Kurz or the integrity of the majority vote cast in favor of the TBE slate.

This brief is divided into two parts. Part I contains the facts and argument respecting the Crown Consents. Part II contains the facts and argument respecting the TBE Consents.

## PART I – THE CROWN CONSENTS

## STATEMENT OF FACTS

### A. Crown's Preferred Stock

In March 2000, EMAK's then-CEO Donald Kurz raised $25 million from Crown to diversify the Company's business. (Kurz 11/17/09 at 139) Crown received Series A Senior Cumulative Convertible Preferred Stock ("Series A Stock") with a face value and liquidation preference of $25 million, and warrants to purchase 750,000 and 166,666 shares of common stock at exercise prices of $16 and $18 per share, respectively, until certain dates in 2010, as well as a commitment fee of $1.25 million. The Series A Stock carried a 6% cumulative perpetual cash dividend, a right to convert into common stock at a conversion price of $14.75 per share, and the right to be redeemed and paid 101% of the liquidation preference plus accrued and unpaid dividends in the event of a "Change of Control." (JX 3) The terms of the Series A Stock reflected Kurz's insistence that the common stockholders determine the election of a supermajority of EMAK's directors. The Series A Stock was entitled to elect only two directors (plus one additional director if the Board was expanded to more than eight members). Crown possessed no voting rights in connection with the election of the other directors. (JX 3 at 12)

In 2004, EMAK and Crown agreed to exchange Crown's Series A Stock for slightly different Series AA Senior Cumulative Convertible Preferred Stock ("Series AA Stock").

In 2006, EMAK and Crown negotiated significant changes to the Series AA Stock. EMAK's 2006 proxy statement describes how Crown approached EMAK in December 2005 with a proposal to restructure the Series AA Stock. EMAK formed a special committee, retained a financial advisor, determined that Crown's proposal was not in the best interests of EMAK, and negotiated with Crown. In April 2006, EMAK and Crown reached a tentative agreement,

supported by a fairness opinion, in which Crown agreed to the elimination of its 6% dividend in exchange for lowering the conversion price from $14.75 per share to $9 per share and extending the warrants until 2012. The parties also agreed on a slight change to the circumstances when Crown could elect a third director. (JX 4 at 20-21) The stockholders approved the amendment, which was consummated on June 30, 2006. (JX 5)

The 2006 amendment to the Series AA Stock was a calculated gamble by Crown's Peter Ackerman. When the amendment was negotiated, EMAK common stock was trading in the vicinity of $7.80 per share. (JX 6) If the stock price reached the new, lowered conversion price of $9 per share, Crown could convert into common stock and own a significantly larger percentage of EMAK (an increase of 9.8% for a total of 32.4%). (JX 4 at 21-22) But if the stock price dropped and languished, Crown's security would have diminished value. The Series AA Stock did not pay a dividend, and Crown had no right of redemption in the absence of a "Change of Control," no right to a liquidation preference in the absence of dissolution, and no right to vote with the common stock in the election of directors.

### B. The Crown-EMAK Restructuring Standoff

In December 2008, Peter Ackerman demanded that Crown's Series AA Stock be restructured. EMAK CEO James Holbrook drafted a summary of the scene:

> At the December EMAK board meeting, the principal of Crown Capital, Mr. Peter Ackerman, formerly of Drexel Burnham Lambert, stated his demand for an exit of his investment. (As background, Crown made a $25M PIPE investment in EMAK in 2001. The preferred is structured with no maturity or dividend, but does fully redeem upon a change of control of EMAK.) Mr. Ackerman has demanded par redemption of the preferred, or $25M. His poignant comment to the board and management was, "the current situation is unacceptable to me".

(JX16 at EMK01244) In the same document Holbrook drafted a quote for himself expressing his frustration with Ackerman:

> "One idea that excites me," continues Holbrook, "is to find a way to restructure the preferred and find a more strategic investor, someone who also sees our future upside. I have deep respect for Mr. Ackerman, but he has been in this for too long and, for everyone's best interests, we need him out."

(*Id.* at EMK01245)

Throughout 2009, Ackerman consistently demanded that EMAK ultimately pay Crown the full $25 million face amount of the Series AA Stock (notwithstanding that the Series AA Stock pays no dividend and has no maturity). Holbrook testified that Ackerman once told him that "he [Ackerman] doesn't take haircuts, he gives them." (Holbrook 11/17/09 at 57) Ackerman's "point of view was – is, you know, 'Get me out for par.'" (*Id.* at 69) Holbrook could not remember Ackerman ever indicating a willingness to take less. (*Id.*) When asked how he valued Crown's preferred stock, Ackerman testified: "They owe me $25 million." (Ackerman 33)

Briefing at the preliminary injunction stage of this litigation summarized how EMAK and Crown were unable to reach resolution in the Summer of 2009 over Crown's demand that its preferred security be restructured. (Pls.' Op. Br. at 18-27) Peter Ackerman testified that at an August 31 face-to-face meeting in Washington, D.C., he delivered the following message to Holbrook: "Number one is the idea that the shareholders can finance off of perpetual zero coupon preferred, those days were over, because there wasn't enough residual value and all the risk was mine." (Ackerman 41) According to Ackerman, he said that if nothing was done to address Crown's preferred stock, "we would propose a variety of restructurings that might involve us buying assets, restructuring our preferred, a whole combination of things that were possibilities that would basically, make it very difficult to keep the status quo." (Ackerman 39-40)

EMAK's outside counsel, Christopher Austin of Ropes & Gray LLP, prepared for the Board a summary of the meeting that described with greater specificity what Ackerman would do if EMAK did nothing to address the preferred:

> Ackerman states that if we don't accept a proposal, he will find 22% of the common to vote with him and will use that majority to bid less than $25 million for the company. If no one counters, he believes that he can maneuver things so that he can force the sale at say $24 million, with all of that money going to the preferred and the common being wiped out.

(JX 40 at EMK02009; Holbrook 191-92) Austin provided vivid testimony of Ackerman's threats:

> What Mr. Ackerman said to us, directly, which I conveyed to the board members afterwards was, I am not prepared to stand still. I will, in fact, exercise my will on this corporation. I have the biggest economic stake here.
>
> He stated again, his view that he actually owns the company because his preferred reflects the greatest part of the value. And stated that he would use any and all means at his disposal to, if we did nothing, to get his preferred stock paid out one way or the other.
>
> One proposal that he suggested was that he would put in a bid for the company to the board of $23 million . . . .
>
> I pointed out the company doesn't have to sell just because we get an offer. And their basic point of view was regardless . . . there are many things we could do.
>
> We can sue the company. There's all the claims they've made before. In any event, the tone of this was very much, I've lost patience. . . .
>
> * * *
>
> . . . I think he was expressing his impatience and belief that he had been accommodating in the past to the company. And he wasn't prepared to do that anymore, and that he was going to use everything he could figure out and Jeff Deutschman has said to me on numerous occasions that A, Peter has the resources; B, Peter has the desire; and, I guess there's just A and B, there's nothing else. He has resources and desire. C would have the will to go forward and to do this. So that was the discussion.

(Austin 121-24)

On September 7, Holbrook wrote to the Board that he viewed Ackerman as a "real serious threat to EMAK's future" and a "devastating enemy if not on our team":

9. The real serious threat to EMAK's future is Peter. Peter does not believe that the board is acting responsibly in representing the interests of all shareholders. I do know what Peter's plan is, and I'm sure it is the best solution. If we fight or play rope-a-dope, I am worried that what Christopher Austin predicted will come true – hundreds of thousands of dollars in legal fees and damage to the operations, and then a settlement where Crown will get even more. This is self-inflicted punishment and is not in the best interests of the owners, employees, or clients.

The EMAK board absolutely must come to grips with reality and find a resolution. We will have to give Peter what he deserves, in order to have something for the rest of us....

...

We must convert, or support a rights offering, or restructure the preferred. We absolutely cannot survive without Peter on our side. I believe Peter can be a valuable partner in helping EMAK grow in the future, and I believe Peter will be a devastating enemy if not on our team. We really have little choice in the matter, in my opinion.

(JX 45 at EMK02122)

On September 10, amidst negotiations with Crown on a restructuring of the Series AA Stock, Holbrook wrote to Chairman Stephen Robeck and EMAK's counsel:

... we need to agree amongst us the following:
- no cash dividend works
- Peter needs to decide whether he's trying to take as much cash out as fast as possible, or if he's a partner to help build value... He seems to oscillate a bit on this point

(JX 50 at EMK020252)

On September 17, Holbrook summarized a call with Ackerman:

He hung up on me....
He said this deal bears no resemblance to anything remotely interesting to him or that he would ever consider....
...
His issues are:
1. no mandatory redemption on the whole
2. no 3 yr standstill (2 is all)
3. no discount
I explained to him the following:

- There is real value in this proposal, value that exceeds what he wants, if he is our partner
- I need something that we (Jim, Christopher, Tracy) feel may not be best deal, but is a deal the board should 'hold their noses' and approve

...

He said he'll be bidding on the company. I asked him if he wants his latest proposal voted on by the board and he said he'd think about it.
Then he hung up.

(JX 52 at EMK0438) Austin then sent an email to Crown in which he tried to explain the merits of EMAK's restructuring proposal. (JX 51) To this day, there reportedly have been no subsequent negotiations between EMAK and Crown for restructuring the economics of the Series AA Stock. (Deutschman 75; Holbrook 16-17; Ackerman 115; JX 80 at EMK014358)

EMAK and its Board acknowledged in their injunction brief the threat of predation posed by Peter Ackerman and Crown: "Crown was threatening to take draconian measures to ensure it received its liquidation preference, irrespective of the effect such measures would have on the value of the common stock or the future of EMAK." (JX 141 at 41; *see also id.* at 16 ("Crown was threatening to pursue a variety of options through which it would recoup most or all of its $25 million liquidation preference, which would clearly harm the common stockholders."); *id.* at 30 ("the genuine threat posed by Crown"); *id.* at 34 ("Crown's repeated statements that it would force EMAK to honor its liquidation preference despite the effect it would have on the value of the common shares"))

### C. Crown and EMAK Management Form a Secret Voting Alliance

Notwithstanding Crown's antagonistic economic interests vis-à-vis the common stock, Crown's threats, and Crown's uncompromising "no discount" negotiating position, EMAK's fiduciaries saw fit to secretly form a voting alliance with Crown and thereby defeat a consent solicitation from Donald Kurz and TBE. Holbrook's emails from September-October 2009 make clear his desire, and Crown's, to form a management-Crown, anti-Kurz voting alliance:

- On September 5, Holbrook broached the subject internally, writing:

  3. Recast the preferred: this is probably something we could get done quickly, getting Peter to stand still, giving him some cash and some rights…
  I think our best approach is to get #3 done asap, maybe even Wednesday ….

(JX 41 at EMK07318-19)

- On September 7, Holbrook explained the rationale:

  What Peter wants to do is to be able to not let Don get control of the board… So we could do something like he proposed, or something simple like giving him voting rights in return for a standstill. Lets discuss in the AM….

(JX 42 at EMK013933)

- On September 8, Theresa Tormey (EMAK's General Counsel) supplied Holbrook and Austin with a term sheet contemplating voting rights for the preferred stock, elimination of Crown's designated board seats and a voting agreement among Crown, management and two institutional stockholders for the election of a five-person Board, two of whom would be designated by Crown, two by management, and one by the institutions.

(JX 43 at EMK02028; *see also* JX 44)

- On September 10, Holbrook declared in an internal email that one of his objectives in negotiating with Crown was to "get the preferred full voting rights, so as to have a unified board."

(JX 50 at EMK02051)

- On September 17, Austin sent Crown a restructuring proposal that included a proposed voting agreement, which he described as follows:

  Note: **The Voting Agreement** is a private transaction not included in valuation rationale, but it **does provide assurance of board control by the Crown/Management group**, which we would all agree has value and brings needed stability to the Company after a time of turmoil.

(JX 51 at CROWN0380) (emphasis added).

- At 6:16 a.m. on September 24, Holbrook sent the following email to several of the directors (including Deutschman):

I suspect that Don's group may buy shares after any BKC announcement, assuming the price drop.... They are at roughly 2.6M shares or 37% of voting (for the board)... So they need an additional million shares to get to 51%....

(JX 55)

- At 8:12 a.m. on September 24, Holbrook circulated an "'ideal' press release" to management:

  EMAK today announces a new strategic direction for the company, including the following:
  - **the board has approved full voting rights for the preferred**
  ...
  The EMAK board has approved full voting rights for the preferred .... CEO Holbrook says, "this sets us up well for our future direction...yadda yadda"
  ...
  [EMAK] also reports that, after 20+ years of service, its relationship with Burger King is ending....

(JX 57) (emphasis added)

- A few minutes later, Holbrook sent the "'ideal' press release" to all of the directors other than Kurz (including Deutschman).

(JX 58)

- On the morning of September 25, Holbrook sent an email to an advisor stating, "Ackerman is now my partner."

(JX 59 at EMK014116)

- That same morning, Holbrook advanced the following idea: "do we change the preferred to be pill-like on a change of board?"

(JX 83 at EMK02157)

- On the afternoon of September 25, after reaching an understanding with Ackerman about Crown receiving full voting rights, Holbrook reported in an internal email:

  Ackerman says he'd be glad to let us quote him in this release [regarding the termination of the Burger King contract], show of solidarity and support etc... I think it's a great idea, the more we draw him in, the better ...

(JX 60; *see* Ackerman 110)

- On the morning of October 12, Austin sent an email to Holbrook and Robeck discussing a plan to ask two institutional investors to join Crown and management in acting by written consent to "rationalize the board":

  How long do we think it would take to get Heartland and Gruber McBain on board to sign a written consent? We need to plot out the actual time-line proposal for 1) signing the exchange agreement, 2) board approval of the exchange agreement and the amended certificate of designation, 3) board setting of record date for action by written consent and 4) stockholder vote to rationalize the board and possibly to change the name.

(JX 71)

- On October 13, Austin wrote to Crown about the voting effect of the Exchange Agreement they were negotiating:

  With regard to a CofC resulting from a proxy battle, please note that **Peter + management + board hold 47.2% of the voting common.** Don would have to get essentially every single share of publicly held stock, plus the couple of institutions, voting for him to get to 50.1%. We think that the chances of that are extremely small.

(JX 68) (emphasis added)

- On October 14, Austin to Holbrook and Crown:

  Jim – How did the Heartland meeting go?

  At this point, **I believe the proposal is just to change the voting and not yet to try to get the written consent to remove Don**. Let me know if you have a different view based on discussions with Heartland or others.

(JX 74) (emphasis added)

Peter Ackerman openly acknowledged the purpose of the Exchange Transaction. An affidavit he wrote in opposition to plaintiffs' motion for a preliminary injunction took pride in Crown "taking steps to block Mr. Kurz from taking control[.]" (JX 151 ¶ 18)

### D. EMAK's Board Sets a Record Date for the TBE Solicitation, Thereby Allowing for the Prior Consummation of the Exchange Transaction

TBE delivered an initial consent to EMAK on Monday, October 12, 2009, for the removal of directors Robeck, Holbrook and Rednor, and the appointment of new directors Philip

S. Kleweno, Michael A. Konig and Lloyd M. Sems. (JX 65) On Sunday morning, October 18, EMAK's General Counsel, Tracy Tormey, arranged for notice to go out 22 hours in advance of a special Board meeting scheduled for 8:30 a.m. on Monday, October 19, to consider and act upon a proposed Exchange Transaction, to confirm that Jeffrey Deutschman remained an EMAK director, and to set a record date for the TBE consent solicitation. (JX 69)

At the October 19 meeting, the Board, over Kurz's objection, approved the Exchange Transaction and set an October 22 record date for the TBE consent solicitation. (JX 146 ¶ 65; JX 147 ¶ 65; JX 148 ¶ 65; JX 149 ¶ 65) Asked why the Board set a record date after the effective date of the Exchange Transaction, Holbrook claimed that Tormey and Austin advised: "Here's the way we do it; here's the way we set the date. Its just normal practice of how these things go." (Holbrook 11/17/09 at 248) Holbrook did not know if either attorney had ever before been involved in setting a record date for a consent solicitation or what their basis was for opining on "normal practice." (*Id.* 248-50) The Board could have determined not to set a record date, in which case the default record date would have been October 12, 2009, one week prior to the consummation of the Exchange Transaction. (JX 84 § 2.13(c))

### E. EMAK Justifies the Exchange Transaction as a Defense to Crown

The Exchange Transaction contained no standstill provision. The only way it limited Crown's power was by preventing Crown from designating a second director to EMAK's Board in the interval prior to the next annual meeting, when Crown could vote its new 28% voting block in support of its favored slate of directors.

EMAK and its Board nonetheless touted the Exchange Transaction as having a desirable defensive aspect. They stated in their brief in opposition to plaintiffs' motion for a preliminary

injunction that the Exchange Transaction prevented Crown from "partnering with existing holders to assume control of the company":

> **if the Exchange Transaction were not consummated, the Preferred Stockholder could, and was threatening to, take unilateral actions – including** purchase of additional shares, **partnering with existing holders to assume control of the company**, seeking to buy the company, or initiation of litigation – that could have far more severe consequences for the common stockholders. **The Exchange Transaction reduced this pressure, avoided hostile actions by Crown**, and ultimately put the common stockholders in a position to command a better price for their shares than they could under the old capital structure.

(JX 141 at 43-44) (emphasis added) The answering brief further stated that the "situation" in which Crown threatened "to take draconian measures to ensure it received its liquidation preference" created a "compelling justification" for the Exchange Transaction. (*Id.* at 41, 42)

When seeking ratification of the Exchange Transaction, EMAK again touted the defensive benefit of the Exchange Transaction, telling stockholders that it prevented Crown from taking unspecified bylaw amendments seemingly related to its power to appoint directors:

> Crown gave up its ability to appoint two Directors to the Board (three in the event of a change of control). Moreover, in the absence of the Exchange Transaction, or if the Exchange Transaction were rescinded, **Crown, as the holder of 28% of the voting power of the Company, could partner with holders of 22% of the common stock to take corporate action, including amendments of EMAK's bylaws, that could be harmful to the holders of the remaining shares.**

(JX 101 at 5-6) (emphasis added)

Uncertainty about what bylaw amendments Crown might try to implement in the absence of the Exchange Transaction was dispelled by the filing of Crown's answering brief on November 29, 2009. It stated:

> with the support of 22% of the shareholders (or the purchase of 22% of the shares), Crown could have amended the bylaws to reduce the size of the Board to 3 and then appointed 2 of the directors....
>
> Crown does not know whether the Board understood that Crown had the precise ability to accomplish that ....

(JX 150 at 39-40)

The defendants' respective answering briefs on the injunction application invited obvious questions about the Board's responsibilities in the absence of the Exchange Transaction: (i) was Crown's proposed tactic for seizing control of EMAK legal under Delaware law?; (ii) were there alternative means to defend against Crown's proposed tactic?; and (iii) was EMAK's Board not obliged to defend against Crown by such alternative means, given their acknowledgement that Crown had made "draconian threats" that created a "compelling justification" for interfering with a stockholder vote? Those questions were soon posed to EMAK's Board.

### F. EMAK and Crown Rescind the Exchange Transaction

On December 3, 2009, on the eve of the preliminary injunction hearing, EMAK and Crown rescinded the Exchange Transaction. At the EMAK Board meeting, EMAK's outside counsel stated that the rationale for rescission was to curtail legal expenses and to prove that the Board's purpose for approving the Exchange Transaction was not to interfere with the TBE consent solicitation. (*See* JX 133 at EMK021059)

Those justifications were soon exposed as false. EMAK's fiduciaries remained intent on facilitating the transfer of control over EMAK to Crown, in a desperate effort to avoid being removed by holders of a majority of EMAK's common stock.

### G. Crown Pursues Its Plan B, Aided By EMAK's Management and Unhindered by EMAK's Board

Crown immediately put into motion the plan described in its answering brief. It designated a second director, Jason Ackerman, nephew of Peter Ackerman and longtime key

employee of Crown Capital. (JX 146 ¶ 13; JX 147 ¶ 13; JX 148 ¶ 13; JX 149 ¶ 13)[1] Crown also entered into a letter agreement, dated Monday December 7, 2009, with Georgeson Inc., for a consent solicitation "scheduled to commence December 8, 2009." (JX 152 at CROWN 0746)

On December 11, 2009, Crown delivered to EMAK its written consent to amend the bylaws in the following manner:

> RESOLVED: Article III, Section 3.1 of the Company's Bylaws is amended to read as follows:
>
> Section 3.1. Number and Term of Office. The Board of Directors shall consist of three members. As provided for in the Amended and Restated Certificate of Designation of the Series AA Senior Cumulative Convertible Preferred Stock, two directors shall be elected by the holders of the Series AA Senior Cumulative Convertible Preferred Stock. The directors shall be elected at the annual meeting of the stockholders, except as provided elsewhere in this Article III, and each director elected shall hold office until his successor is elected and qualified. Directors need not be stockholders, residents of Delaware, or citizens of the United States.
>
> RESOLVED: Article III, Section 3.1.1 is added to the Company's Bylaws:
>
> Section 3.1.1 If at any time the number of members of the Board of Directors shall be greater than three, unless a sufficient number of directors resign to reduce the number of members of the Board of Directors to three, the Chief Executive Officer shall promptly call a special meeting of the common stockholders of the Corporation, which meeting shall be held not later than 20 days following the first date on which the number of directors was greater than three (or in the case of the adoption of the bylaw establishing a three-member Board of Directors, 20 days after such bylaw amendment became effective), for purposes of electing the one director to be elected by the common stockholders of the Corporation, who shall be the successor to all directors previously elected by the common stockholders of the Corporation.

(JX 138)

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[1] *See Ackerman v. Commissioner of Internal Revenue*, 2009 Tax. Ct. Memo LEXIS 81, *12-14 (T.C. Apr. 15, 2009) (discussing Jason Ackerman). Jason Ackerman shares with Peter Ackerman and Jeffrey Deutschman the distinction of having his testimony rejected as unreliable in Peter Ackerman's Tax Court case (unlike the testimony of other witnesses for Peter Ackerman). *Id.* at *67-68.

On December 12, 2009, EMAK outside counsel Christopher Austin, whose law firm then represented Crown manager Jeffrey Deutschman in this litigation and related litigation in California, sent an email to the Board in which he attached Crown's consent and advised:

> Given all of the litigation and disputes currently in process, my recommendation to the Board is not to act and to let the date of receipt of the initial consent be the record date for the consent solicitation.

(JX 140) In other words, Austin was recommending that the Board allow Crown to deliver at any time sufficient written consents to give Crown control of the Board, even prior to the December 21, 2009 deadline for TBE's consent solicitation.

An alternative course of action under Section 2.13(c) of the Bylaws and Section 213(b) of the DGCL was to wait until December 21, 2009 to meet and then to set a record date for as late as December 31, 2009. (JX 84) The Board could also take defensive action in the interim, before sufficient post-record-date written consents were delivered.

On Sunday, December 13, Kurz sent an email to director defendants Holbrook, Bland and Rednor (Robeck having resigned on December 10 (JX 139)), in which he took issue with Austin's advice:

> I am writing to you in light of Chris Austin's email from Saturday afternoon and the fact that we constitute the non-Crown designees on the Board.
>
> I have a very different view of our obligations than those expressed by Chris. Less than two weeks ago, you represented to the Court of Chancery that "Crown was threatening to take draconian measures to ensure it received its liquidation preference, irrespective of the effect such measures would have on the value of the common stock or the future of EMAK." (12/2/09 Brief at 41) Crown now has two designees on the Board (out of 6 total directors), and Crown has delivered a consent to take action designed to give Crown control over a majority of the Board. From the inception of Crown's deal, it has never been contemplated by either party that Crown would ever have a majority of the board It is imperative that the non-Crown designees take all appropriate action to protect EMAK's common stockholders in light of Crown's threats and its recent actions. EMAK's directors have a compelling justification to take effective action to respond to the threat, and it would be an irresponsible abdication of responsibility not to do so.

> There are a variety of defensive steps and measures that we should consider promptly. Two that come immediately to mind are the adoption of a supermajority requirement for stockholder amendments to the bylaws (my preferred solution), and the adoption of a poison pill. I would like us to retain independent counsel (i.e., Delaware counsel not conflicted by simultaneous representation of Jeffrey Deutschman) and discuss potential defensive measures.
>
> I think it critical that the Board not abdicate its responsibility to set a record date respecting Crown's proposed actions by written consent. Section 2.13(c) of the Bylaws provides that the Board "shall" set a record date. I am advised that Delaware law recognizes the Board's "primary authority" to set a record date. *Edelman v. Authorized Distribution Network*, 1989 Del. Ch. LEXIS 156, *18 (Nov. 3, 1989). In view of all the current circumstances, I think it appropriate that the Board meet on December 21 for the purpose of setting a record date respecting Crown's consent, and that the Board then set a record date of December 31, 2009.

(JX 140) In a follow-up email on Monday, December 14, Kurz recommended that the Board create a committee represented by independent counsel to act on behalf of the Board respecting Crown. (*Id.*)[2]

On Wednesday, December 16, the Board of Directors met. Nobody supported Kurz's motion that the Board defer until a December 21 meeting the setting of a record date for the Crown solicitation. (JX 134 at EMK021063) Nobody supported Kurz's motion that the record date be set for December 24. (*Id.* at EMK021064) By not voting to set any record date, the Board allowed the record date to be the earliest date possible, December 11, the date when Crown delivered its initial consent.

On Thursday, December 17, the non-Crown designees met at Kurz's urging. They rebuffed Kurz's suggestions that the Company take action to oppose or defend against Crown's consent solicitation.

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[2] On Tuesday, December 15, Holbrook forwarded to the Crown designees Kurz's email of December 13 containing his confidential advice respecting Crown. Holbrook later claimed that he made an "inadvertent mistake." (JX 146 ¶ 94; JX 147 ¶ 94; JX 148 ¶ 94; JX 149 ¶ 94)

Meanwhile, Crown trolled inside EMAK for 22% support. Crown's earliest supporters were Robeck, Holbrook and various members of the EMAK management team (most of whom are slated to soon leave the Company with one year's severance and six-figure bonuses) who signed Crown consents before the Board met on December 16. (JX 158) On December 18, Crown delivered consents to EMAK and certified that they were sufficient to approve the bylaw amendments.

EMAK raised no legal challenge to the effectiveness of the Crown Consents. On the evening of December 21, Christopher Austin wrote an email to EMAK's five-member Board containing the following parenthetical concerning the Crown Consents:

> (if [they are] ultimately determined to have been effective, the board was shrunk to three members as of Friday, so we'll have to work with Delaware counsel to figure out the implications of that issue, though for now it makes sense to proceed as though the current board is still in place).

(JX 137)

## ARGUMENT

### I. THE CROWN BYLAW AMENDMENTS ARE LEGALLY INVALID

Section 109(b) of the DGCL states that bylaws may contain provisions "not inconsistent with law." 8 *Del. C.* § 109(b). Consequently, a bylaw is invalid if it "facially violate[s] any provision of the DGCL." *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227, 238 (Del. 2008). *See also Datapoint Corp. v. Plaza Sec. Co.*, 496 A.2d 1031, 1036 (1985) (striking down bylaw as "repugnant to the statute which the bylaw is intended to serve, not master") (internal quotation omitted); *Allen v. Prime Computer, Inc.*, 540 A.2d 417, 421 (Del. 1988) (enjoining enforcement of bylaw that deprives stockholders of statutory right to act by written consent).

Here, Crown engaged in an apparently novel effort to use a bylaw amendment to shrink the size of a board below the number of currently sitting directors. Typically, insurgent stockholders first act by written consent to remove unwanted directors and then act to reduce the number of directorships.[3] Crown did not try to remove any directors because it lacked sufficient support from Crown's common stockholders. Section 141(k) of the DGCL prevents Crown from voting its Series AA Stock to remove any director:

> Any 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 of directors**, except as follows:

8 *Del. C.* § 141(k) (emphasis added). Crown's Series AA Stock lacks voting power in the election of directors (JX 8 §§ 6, 7), and thus lacks voting power for purposes of removing directors. Crown was intent on rounding up 22% of the common shares, not 50% plus one.

Section 141(b) of the DGCL prevents Crown from removing directors indirectly by means of a bylaw amendment that shrinks the size of the board. The operative provisions are as follows:

> The number of directors shall be fixed by, or in the manner provided in, the bylaws, unless the certificate of incorporation fixes the number of directors, in which case a change in the number of directors shall be made only by amendment of the certificate.... Each director shall hold office until such director's successor is elected and qualified or until such director's earlier resignation or removal.

8 *Del. C.* § 141(b). "[T]he universal construction has been that § 141(b) refers to directorships, not directors actually in office." 1 David A. Drexler et al., *Delaware Corporate Law and Practice* § 13.01[2], at 13-5 n.24 (2009).

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[3] *See, e.g.*, *Waggoner v. Laster*, 581 A.2d 1127, 1129 (Del. 1990) (describing effort by written consent to remove board, reduce size of board, and elect new directors); *Kalageorgi v. Victor Kamkin, Inc.*, 750 A.2d 531, 536 (Del. Ch. 1999) (describing effort by written consent to remove directors and then reduce size of board); *AGR Halifax Fund, Inc. v. Fiscina*, 743 A.2d 1188, 1191 (Del. Ch. 1999) (describing effort by written consent to remove directors, reduce size of board, and elect new directors); *Olson v. Buffington*, 11 Del. J. Corp. L. 687, 690 (1985) (same).

Crown's proposed new bylaw Section 3.1 cannot be valid, standing alone. New Section 3.1 flatly states that the Board of Directors "shall consist of three members." (JX 138) Yet as of December 18, 2009, five directors were holding office.

New Section 3.1 cannot operate by itself to remove any directors from office. Section 141(b) provides for three exclusive means by which a director's term of service can end: (i) the election of a successor; (ii) the director's earlier resignation; or (iii) the director's removal. The enactment of a bylaw shrinking the number of directorships is not on the list.

Nor can Section 3.1 operate to reduce the number of directorships. "[I]t is necessary that a specific number of directorships be in place at all times, as quorum requirements are generally fixed by reference to the number of directorships and not merely to the number of directors in office." 1 David A. Drexler et al., *supra*, § 13.01[2], at 13-5. If the number of directorships must always be certain for quorum purposes, the number of directorships can never be a lesser number than the number of directors in office. At any given point in time, each director must be filling an existing directorship.

The statutory minimum quorum of "1/3 of the total number of directors," 8 *Del. C.* § 141(b), cannot be enforced if a bylaw amendment can decrease the number of directorships to a number fewer than the number of directors in office. Otherwise, a bylaw amendment converting a board of twelve directors into a board of three directorships would allow a single director to satisfy the statutory minimum one-third quorum requirement. EMAK has a majority quorum requirement. (JX 84 § 3.8) If the delivery of the Crown Consents on December 18, 2009 reduced the number of directorships to three, then the presence of just two directors would satisfy that majority quorum requirement. Yet five directors remained in office.

Standing alone, bylaw Section 3.1 is inconsistent with and repugnant to Section 141(b) of the DGCL, given that more than three directors were in office at the time when the Crown Consents were delivered. Crown anticipated but did not solve this problem by its proposal of new Section 3.1.1. Section 3.1.1 creates a director-shrinking mechanism that is triggered only in the event that the number of directors in office is greater than three. It provides for the calling of a special meeting of stockholders at which "one director" will be elected by the common stockholders "who shall be the successor to all directors previously elected by the common stockholders of the Corporation." (JX 138)

Section 141(b) does not authorize stockholders or directors to initiate such a game of musical chairs, in which multiple seats in the board room are taken away and a remaining seat is put up for election. In the absence of prior resignation or removal, "[***e***]***ach*** director shall hold office until ***such*** director's successor is elected and qualified[.]" 8 *Del. C.* § 141(b) (emphasis added). The words "each director" and "such director's successor" are inconsistent with the notion of a single successor to a multitude of directors. There is a direct correspondence between the director and his or her successor. *See* 1 Drexler et al., *supra*, § 13.01[3], at 13-6 ("The statute specifically provided that, absent resignation or removal, a director holds office until his successor is elected and qualifies.").

This identity in Section 141(b) between the number of sitting directors and the number of elected successors is consistent with the overall statutory scheme. Section 141(k) expressly sets forth the mechanism by which a director can be removed. Section 141(b) expressly sets forth the mechanism by which a director can resign. Section 211 provides for the election of new directors at a stockholder meeting. Section 223(a)(1) provides a mechanism for the filling of both vacancies and "newly created directorships resulting from any increase in the authorized

number of directors elected by all of the stockholders having the right to vote as a single class." 8 *Del. C.* § 223(a)(1). There is no prescribed statutory mechanism for selecting a new director or directors when a sitting director's seat has been shrunken out of existence. The device does not exist because it is inconsistent with Section 141(b) and the overall statutory scheme. New bylaw Section 3.1.1 is invalid.

## II. ALTERNATIVELY, THE CROWN CONSENTS ARE INVALID BECAUSE THEIR DELIVERY WAS THE PRODUCT OF A BREACH OF FIDUCIARY DUTY BY EMAK'S BOARD, AIDED AND ABETTED BY CROWN

Crown never should have been permitted to deliver the Crown Consents on December 18, 2009. The Board was duty-bound to take defensive action to prevent Crown from taking control of the Board of Directors for free, with the support of just 22% of the common stockholders, and potentially using that control to the detriment of the common stockholders as a whole, as Crown had threatened to do. At a minimum, the Board should have acted so that Crown's solicitation would not prevent a majority of the common stockholders from acting by written consent on December 21, 2009, to remove and elect directors. A newly reconstituted Board could then determine if defensive action against Crown is warranted.

### A. The Board Abdicated Its Responsibilities

"[A] board of directors is not a passive instrumentality," and their "duty of care extends to protecting the corporation and its owners from perceived harm whether a threat originates from third parties or other shareholders." *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954, 955 (Del. 1985); *see Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 68 (Del. 1989). A board "may not avoid its active and direct duty of oversight in a matter as significant as the sale of corporate control," and "[o]fficers and directors must exert all reasonable and

lawful efforts to ensure that the corporation is not deprived of any advantage to which it is entitled." *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1280, 1281 (Del. 1988).

These principles of fiduciary obligation were all flouted in this case in most egregious fashion. As recently as November 29, 2009, EMAK's incumbent director defendants argued to this Court that "Crown was threatening to take draconian measures to ensure it received its liquidation preference, irrespective of the effect of such measures would have on the value of the common stock or the future of EMAK." (JX 141 at 41) The Board touted the Exchange Transaction as a means of preventing Crown from "partnering with existing holders to assume control of the company." (*Id.* at 44) Yet when EMAK and Crown rescinded the Exchange Transaction later that week, and Crown embarked the following week on its effort to join with a minority of stockholders to take two out of three board seats, the Board did nothing.

Worse, the Board chose to do nothing without the benefit of independent legal advice and without forming a committee of independent directors. The Board relied on law firms who were simultaneously representing EMAK, its outside directors, Crown manager Jeffrey Deutschman, and CEO James Holbrook. Holbrook decided that it was in his best interest to cast his lot with Crown and thereby help defeat TBE, which was seeking to remove him and elect new directors on a platform of replacing Holbrook as CEO, and supporting Don Kurz, who made no secret of his opinion that Holbrook should be terminated for cause (JX 49 at EMK02690).

Any number of defensive actions would have been justified to prevent Crown from taking control of EMAK for free, in light of Crown's recent threats to take "draconian measures" if EMAK did not do Crown's bidding in restructuring Crown's Series AA Stock. (JX 141 at 41) One obvious potential response would be the adoption of a supermajority voting requirement for bylaw amendments, so that Crown would need to gain the support of more than just 22% of the

common stock. Regardless of the outer bounds of extraordinary action potentially available to the Board given the threat posed by Crown,[4] the directors certainly would have been justified in taking the minimal step of utilizing the ten days afforded by Section 2.13(c) of EMAK's bylaws to meet for the purpose of setting a subsequent record date. Such action would potentially delay Crown's consent solicitation by only a matter of days at most. Delaware law acknowledges a Board's authority to set a record date. *See Wyser-Pratte v. Smith*, 1997 Del. Ch. LEXIS 41 (Mar. 18, 1997) (dismissing complaint alleging inequitable setting of record date); *Edelman v. Authorized Distribution Network, Inc.*, 1989 Del. Ch. LEXIS 156 (Nov. 3, 1989) (denying motions for summary judgment and preliminary injunction respecting setting of record date for consent solicitation); *Empire of Carolina, Inc. v. Deltona Corp.*, 501 A.2d 1252, 1256 (Del. Ch. 1985) (finding that setting of record date conformed with 8 *Del. C.* § 213(a) and 8 *Del. C.* § 228). Nevertheless, the Board defaulted on exercising that basic authority and allowed Crown to obtain and deliver consents granting Crown control over EMAK at the earliest possible date.

### B. The Board Improperly Interfered with the TBE Consent Solicitation

The Board's abdication of responsibility to defend against Crown is all the more egregious because of its obvious purpose and effect -- to prevent holders of an absolute majority of the common stock from exercising their fundamental statutory right to remove and replace directors. TBE was in the closing stage of its consent solicitation, which had been effectively delayed by the pendency of litigation over the Exchange Agreement. The only clear consequence of not setting a post-December 21 record date for the Crown consent solicitation

[4] This Court has acknowledged the "possibility that a situation might arise in which a board could, consistent with its fiduciary duties, issue a dilutive option in order to protect the corporation or its minority shareholders from exploitation by a controlling shareholder who was in the process or threatening to violate his fiduciary duties to the corporation[.]" *Mendel v. Carroll*, 651 A.2d 297, 306 (Del. Ch. 1994).

was that it gave Crown the opportunity to deliver consents on behalf of 22% of the common stock before TBE could deliver consents on behalf of more than 50% of the common stock.[5] If that occurred, and the Crown Consents were deemed valid, then the TBE consent solicitation would be thwarted. No seats would be available for the election of new directors.

Delaware courts have not shied from acknowledging the improper purpose of a Board's actions to impede or defeat an election contest, based on the contextual facts. *See MM Cos. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1132 (Del. 2003) ("[T]he incumbent Board timed its utilization of these otherwise valid powers ... for the primary purpose of impeding and interfering with the efforts of the stockholders' power to effectively exercise their voting rights in a contested election for directors."); *Stahl v. Apple Bancorp*, 579 A.2d 1115, 1123 (Del. Ch. 1990) ("In each of these franchise cases the effect of the board action ... was practically to preclude effective stockholder action ... or to snatch victory from an insurgent slate on the eve of the noticed meeting ...."); *Packer v. Yampol*, 1986 Del. Ch. LEXIS 413, *48-49 (Apr. 18, 1986) ("[N]o reason has been shown why, at the very least, the transaction could not have been made conditional upon the Preferred not being voted until after the May 13, 1986 election of directors."); *Canada Southern Oils, Ltd. v. Manabi Exploration Co.*, 96 A.2d 810, 813 (Del. Ch. 1953) ("Hagan and his associates did too much too soon with too little disclosure to justify a contrary conclusion.").

Here, the motions under consideration at the Board meeting on December 16, 2009, may have been mechanical, and seemingly trivial if viewed in isolation, but the potential consequences were known and vast. Nothing less than control over the corporation was at stake, and the effective ability of holders of a majority of the Company's common stock to remove and

[5] The deadline for the TBE consent solicitation was set at December 21, 2009, pursuant to a Stipulation and Order entered in this litigation. (JX 145 ¶ 8)

elect a decisive number of directors, *in a few days or at any time in the Company's future*. If a mere 22% of the common stock could partner with Crown to shrink the Board, then only one non-Crown Board seat would remain, and Crown would obtain permanent control over the business and affairs of EMAK for free. There was only one reason why the director defendants were willing to grant Crown the immediate ability to seize control -- in the words of Peter Ackerman, "to block Mr. Kurz from taking control." (JX 151 ¶ 18) No other explanation is plausible.

### C. Crown Aided and Abetted the Board's Breach of Duty

In *Malpiede v. Townson*, 780 A.2d 1075, 1097 (Del. 2001), the Delaware Supreme Court elaborated on the "knowing participation" standard for aiding and abetting liability. Knowing participation in a breach of fiduciary duty requires "that the third party act with the knowledge that the conduct advocated or assisted constitutes such a breach." *Id.* For example:

- "a bidder may be liable to the target's stockholders if the bidder **attempts to create or exploit conflicts of interest in the board.**"
- "Similarly, a bidder may be liable to a target's stockholders for aiding and abetting a fiduciary breach by the target's board **where the bidder and the board conspire in or agree to the fiduciary breach.**"

*Id.* at 1097-98 (emphasis added).

There can be no serious question of aiding and abetting liability for Crown. Crown knew that it was obtaining the immediate right to obtain control for free and prevent the election of the TBE nominees, notwithstanding the Board's protestations just two weeks earlier that the prospect of Crown seizing control in that manner posed a serious threat to EMAK and its stockholders. Crown was in EMAK's Boardroom at all times. It had two designees on the Board immediately after the rescission of the Exchange Transaction. Their presence at the Board meeting raised the bar for how many votes were needed to set a record date. 8 *Del. C.* § 141( b)

(requiring vote of a majority of directors present). Crown also exploited the self-interest of Holbrook, who potentially faced termination for cause if the TBE slate was elected. Crown supported Holbrook as CEO, solicited and obtained his consent on December 15, and benefited from his refusal to support Don Kurz's motions in favor of a post-December 21 record date.

### D. The Appropriate Remedy Is Not to Acknowledge the Effectiveness of the Crown Consents Delivered on December 18, 2009

One of the maxims of equity is that "equity regards as done that which ought to be done[.]" *Freeman v. Fabiniak*, 1985 Del. Ch. LEXIS 486, *21 (Aug. 15, 1985). Here, what should have occurred, at a minimum, is the setting of a record date that would temporary delay delivery of the Crown consents and permit stockholders to make a final decision respecting the TBE consent solicitation. In the interim, the present Board, a newly reconstituted Board, or a committee of independent directors advised by independent counsel could then evaluate the appropriateness of defensive action.

Because that did not happen, an appropriate remedy must be tailored. Nothing forbids this Court from treating the delivery of the Crown consents on December 18, 2009 as invalid. In a Section 225 action, the Court "may make such order or decree in any such case as may be just and proper." 8 *Del. C.* § 225. In a breach of fiduciary duty action, the Court has great discretion to enter an appropriate remedy. *Hogg v. Walker*, 622 A.2d 648, 653-54 (Del. 1993). As this Court observed, in the context of a challenged transaction that granted insiders effective voting control:

> If there are findings of wrongdoing the Court will not hesitate to take *any* and *every* measure necessary to make the aggrieved parties whole for the losses they have suffered or to eradicate the effects of any allegedly inequitable behavior on the defendants' part. Defendants have not argued that the Court would not have the power to fashion complete and appropriate remedies if it is determined that the defendants are responsible for extraordinary harms, and I do not expect them to make such arguments in the event that I were to reach such conclusions.

> Admittedly, the type of remedy that would be necessary to address plaintiff's allegations may be without precedent under Delaware law. The litigants should remember, however, that the strength of the Court of Chancery has been its equitable power and historical ability to fashion creative and suitable relief as required by the facts of any given case. There should be no doubt as the Court's power to do so, in this or any other case, when the circumstances warrant.

*In re Dairy Mart Convenience Stores, Inc.*, C.A. No. 14713, Chandler, C., let. op. at 4-5 (June 9, 1999) (emphasis in original). At this stage of the control contest, not recognizing the effectiveness of the Crown Consents would remedy the wrong that has already occurred and otherwise cannot be undone by a future Board.

## PART II – THE TBE CONSENTS

### STATEMENT OF FACTS

TBE delivered its initial written consent to the Company on October 12, 2009. (JX 65) On October 19, 2009, TBE mailed its first fight letter to stockholders, along with an enclosed white consent card (JX 94). TBE mailed a second fight letter with an enclosed consent card on November 16, 2009. (JX 99) Shareholders could also print a consent card from TBE's website, www.takebackemak.com. Following the rescission of the Exchange Transaction on December 3, 2009, TBE issued a series of press releases and public statements, including: a December 7 press release respecting the rescission of the Exchange Transaction (JX 100); a December 9 press release respecting the favorable recommendation from RiskMetrics Group (JX 105); a December 14 press release respecting the favorable recommendation from Glass Lewis & Co. (JX 108); a lengthy December 14 posting on the website, entitled "Response to EMAK Incumbent Allegations" (JX 109); a December 15 press release, which is a lengthy open letter from Kurz (JX 110); a website posting, entitled "The Truth About Crown Capital And Peter Ackerman" (JX 111); a December 18 press release entitled "Take Back EMAK On Verge of Victory" (JX 112).

Meanwhile, EMAK solicited revocations of TBE consents, mailing a lengthy letter to stockholders on December 7, 2009, which included an eleven-page, single-spaced supplement entitled, "Who Is Don Kurz And Why Shouldn't His Campaign To Take Over EMAK Succeed?" (JX 104) EMAK issued a press release on December 7 (JX 103), and issued another press release on December 14, which consisted of a lengthy open letter from Stephen Robeck (JX 107). TBE and EMAK each retained proxy solicitors to assist in rounding up consents or revocations of consents. Simultaneously, Crown was soliciting its own consents.

EMAK stockholders who held their shares in street name returned their consent cards to Broadridge, which collected and recorded the votes on behalf of the banks and brokers. (Pasfield 9) Banks and brokers use Broadridge to collect the votes of their customers. On request, Broadridge issues a "Broadridge Client Proxy" that records votes for and against the various proposals, with the vote totals broken out for each participant bank and broker. (*See, e.g.*, JX 117) The positions listed on a Broadridge Client Proxy are held through DTC and reflected in both a Cede breakdown and a DTC omnibus proxy. Unlike the situation a generation ago, DTC is now the only depository. (Dennedy 56-57) No other depository holds EMAK shares. (JX 88; Dennedy 63) All of the banks and brokers listed on a Broadridge Client Proxy for EMAK are DTC participants. Each bank and broker listed on the Broadridge Client Proxy is identified with a DTC participant number or referenced to Cede & Co., a term used interchangeably with DTC. (JX 127; JX 128; Dennedy 54; Pasfield 10-11)

An omnibus proxy is the document by which DTC reassigns voting power to its participant banks and brokers for purposes of a consent solicitation or meeting of stockholders. A DTC omnibus proxy consists of a position listing showing how many shares of the issuer are held through each participant bank and broker, and a boilerplate proxy granting the participants

the right to cast the votes for those shares. (JX 115; Dennedy 91) A DTC omnibus proxy contains the same position listing information as is found on a Cede breakdown of the same record date. (*Compare* JX 115 *with* JX 122; Dennedy 89-90)

TBE's proxy solicitor, D.F. King & Co. ("DF King"), initially instructed Broadridge to use a record date of October 12, 2009. DF King later advised Broadridge that the true record date was October 22, 2009, but DF King did not instruct Broadridge during the consent solicitation to collect data as of October 22 and record votes as of that date. (JX 160 at BRO 088) There had been minimal trading of EMAK's de-listed, de-registered shares over the course of those ten days in October. (JX 142) (showing total volume of 16,712 shares traded over that period).

On November 6, 2009, Thomas Long, Senior Vice President of DF King, caused TBE's October 19 fight letter and consent card to be hand-delivered to appropriate personnel at DTC, in order to initiate the process by which DTC would issue an omnibus proxy to EMAK. (JX 155; JX 156; Long 116-18) Based on his 28 years of experience, Long believed that if DTC needed additional information, they would contact him. (Long 119-20) Long did not hear back from DTC. (Long 120)

On November 23, 2009, TBE delivered a package of stockholder consents to EMAK. (JX 86) The Broadridge Client Proxy in that package noted a record date of October 12, 2009, but EMAK did not bring that to TBE's attention. On November 28, 2009, in response to Plaintiffs' document request seeking stocklist information only as of October 22 (the record date for the TBE consent solicitation) and November 24 (the record date for EMAK's ratification consent solicitation) (JX 85), EMAK delivered to Plaintiffs record lists and CEDE breakdowns as of October 12, October 22, and November 24 (JX 87; JX 88; JX 89). On November 29, 2009,

EMAK's proxy solicitor (Daniel Burch of MacKenzie Partners, Inc.) submitted an expert report in which referred to "October 12 and October 22" as "the potential record dates for the TBE consent solicitation." (JX 163 ¶ 22)

DF King maintained tabulation reports by which it kept track of the consents submitted by registered holders and the street-name votes recorded through Broadridge. On December 20, 2009, it appeared that TBE had garnered consents representing a majority of the common stock outstanding. On that day, Peter Boutros, a former EMAK employee, sold to Don Kurz all EMAK shares he was permitted to transfer and signed a consent card in favor of the TBE slate for all shares he was permitted to vote. (*See* JX 127; JX 289)[6]

Late in the evening on December 20, 2009, TBE's counsel sent by email to Theresa Tormey, EMAK's General Counsel & Secretary, the Broadridge Client Proxy generated on November 23, 2009, plus written consent cards for record holders and a Certificate attesting to the good-faith belief of the soliciting stockholders that they had received the requisite number of valid and unrevoked consents. (JX 132)

On the morning of December 21, the same documents were hand-delivered to EMAK's registered office in Delaware. (JX 127) That morning, TBE also ordered a Supplemental Client Proxy from Broadridge, and hand-delivered it to EMAK's registered office later that day. (JX 128) The December 21 Broadridge Supplemental Client Proxy shows additional votes (net of revocations) since the original Broadridge Client Proxy generated on November 23, 2009. An additional 3,144 votes had been cast to remove the incumbents, and similar additional numbers were voted in favor of the TBE candidates. TBE also delivered additional consent cards from

[6] Boutros was one of the recipients of a combined 925,000 shares of unvested stock with full voting rights that were issued to key employees in early 2008.

registered holders to EMAK's registered office. (JX 129)[7] That same afternoon, plaintiffs filed a motion for leave to file a Verified Second Amended and Supplemental Complaint seeking relief pursuant to 8 *Del. C.* § 225, as well as a motion seeking to compel a prompt review of the TBE consents.

What EMAK knew on December 21, but TBE did not, was that a DTC omnibus proxy had never been sent by DTC to EMAK. At 12:23 p.m. (EST) on December 21, the inspector of elections, William Marsh of IVS, wrote an email to Tormey stating:

> As you are aware we have received a second set of consents that were solicited by a dissident group. We will again need a certified list as of the record date and a record date omnibus proxy and position listing from DTC reassigning the shares to participants who voted on the Broadridge multiple forms.

(JX 135 at EMK019809; JX 324) Tormey did not order the DTC omnibus proxy or inform director Don Kurz, his counsel or any representative of TBE that it was missing. Instead, in a 12:47 p.m. (EST) email copied to EMAK's outside counsel, Tormey responded to Marsh as follows:

> With respect to the second set of consents, I'm not certain whether DTC can go back in time to request the omnibus proxy. Is it the company's place to request an omnibus proxy, or should the dissident group do so? We do have a record list for October 22, 2009 (copy attached), so I'm sure we can get the transfer agent to certify.

(*Id.* at EMK019808) Marsh advised Tormey that he believed "only the company can request an omnibus from DTC." (*Id.*) Tormey responded to the email, but took no action. (JX 136)

At 5:54 p.m. (EST) on December 21, Christopher Austin advised TBE's counsel by email that EMAK did not have a DTC omnibus proxy. (JX 130) In an email to the Board a few minutes later, Austin stated: "I just sent a message to TBE's attorneys to let them know that we

[7] The Stipulation and Order entered by the Court on November 17, 2009 provides that "any other written consents to take the same action [as set forth in the original TBE consent of October 12, 2009] shall be deemed timely if delivered on or before December 21, 2009." (JX 145)

also need an omnibus proxy from DTC, and to see if that is something DF King can help us obtain. If not, we will make sure that it is obtained first thing in the morning." (JX 137 at RED062) By the time TBE received Austin's emails, it was too late to make contact with DTC and obtain a DTC omnibus proxy that day.

EMAK seized on the lack of a DTC omnibus proxy as of December 21, claiming that it had been TBE's responsibility to get it and that it was too late for a DTC omnibus proxy to be ordered. On December 23, 2009, TBE sent letters to DTC containing information prescribed by DTC in a form prescribed by DTC. (JX 153; JX 154) DTC later mailed an omnibus proxy to EMAK with a print date of December 24, 2009. (JX 115)

On December 23, 2009, IVS issued a preliminary report respecting the TBE consents. (JX 119) The preliminary report contains the following statement: "The 'Street' consents which total 15.01% of the outstanding shares are invalid due to the lack of a DTC Omnibus proxy on file." (JX 119) As EMAK's proxy solicitor confirmed, the preliminary report and the supporting tabulation both indicated that TBE would have prevailed but for the lack of a DTC omnibus proxy. (Dennedy 192; JX 119; JX 118) IVS tabulated "only the consents that were part of the original delivery to CSC," and not the additional votes reflected on the December 21, 2009 Broadridge Supplemental Client Proxy, or the additional consent card delivered on the afternoon of December 21, 2009. (JX 118)

IVS did not invalidate the Broadridge consents because of the incorrect record date. (Dennedy 192) As Marsh of IVS stated in a December 21 email: "The record date on Broadridge forms does not impact our tabulations." (JX 136 at EMK019678) IVS also noted that a record date is something "you can adjust for." (JX 159 at EMK019498)

On December 22, 2009, TBE, through DF King, ordered a Broadridge Client Proxy with a record date of October 22, 2009. (JX 160 at BRO 087) In order to generate such a document, Broadridge directed its client banks and brokers to inform Broadridge of the positions they each held as of the October 22, 2009 record date. Broadridge then recorded the votes for those positions based on the consent cards Broadridge had already received. (Pasfield 34-35)

Broadridge generated a Broadridge Client Proxy on December 30, 2009. (JX 117) That document showed markedly fewer votes for TBE than the prior Broadridge Client Proxies generated with a record date of October 12, 2009. The source of the discrepancy became quickly apparent. The December 30 document showed a Penson Financial position of 36,572 shares on October 22, of which 28,730 shares were cast for TBE. (JX 117) Yet the Broadridge Client Proxy of November 23 had shown a Penson Financial position of 152,971 shares as of October 12, of which 116,641 were voted for TBE (JX 127); the Broadridge Supplemental Client Proxy of December 21 had shown a Penson Financial position of 152,971 shares as of October 12, with an additional 28,630 shares voted for TBE (JX 128); and the DTC omnibus proxy showed a Penson Financial position of 150,271 shares as of October 22 (JX 115). TBE's investigation revealed that the Broadridge Client Proxy of December 30 did not reflect 113,641 shares that Trinad Capital Master Fund ("Trinad") owned through Penson Financial as of October 22 and had subsequently sold. (JX 120) When Penson Financial communicated the correct information to Broadridge, Broadridge issued a Supplemental Client Proxy on January 7, 2010, showing an additional 113,641 votes for TBE. (JX116; Pasfield 26-29)[8]

[8] Broadridge possessed the consent card from Trinad, dated October 30, 2009, prior to December 21, 2009. (JX 160 at BRO 092; Pasfield 28) There were no other Trinad cards. (Pasfield 9)

On January 14, 2010, TBE delivered a written challenge to the IVS Preliminary Tabulation Report. (JX 162) TBE contended that (i) the "Street" consents should be validated and (ii) the tally in favor of TBE should include all consents delivered to EMAK on December 21, 2009. On January 15, 2010, IVS issued its rulings. (JX 323) IVS determined that the "Street" consents were invalid because an DTC omnibus proxy was necessary and not timely. IVS also determined that the final tally should include the written consent card for Columbia University that was delivered on December 21, 2009. (*Id.*)

As of October 22, 2009, EMAK had 7,034,322 shares outstanding. (JX323) In order to prevail, TBE needed to obtain consents for 3,517,162 shares (50% + 1). According to IVS's final tabulation, TBE obtained 2,502,032 consents from registered stockholders to remove three incumbents and to elect each of its three nominees (Kleweno, Konig and Sems). (*Id.*) The balance required for victory on each issue is 1,015,130. The record establishes that TBE obtained more than this number of "Street" consents on each issue presented to the stockholders.

The following Street votes are reflected on the Broadridge Client Proxy of November 23, 2009 (JX 127), and the Broadridge Supplemental Client Proxy of December 21, 2009 (JX 128), both of which were delivered by December 21:

| **Issue** | **Street Votes Obtained** | **Street Votes Needed** | **Margin of Victory** |
|---|---|---|---|
| Removal of Directors | 1,058,959 | 1,015,130 | 43,829 |
| Election of Kleweno | 1,060,599 | 1,015,130 | 45,469 |
| Election of Konig | 1,058,252 | 1,015,130 | 43,122 |
| Election of Sems | 1,058,252 | 1,015,130 | 43,122 |

(Spreadsheets tabulating the consents for each listed bank and broker are attached as Exhibit A.) A victory for TBE can be confirmed in two ways to address the fact that the above-referenced Broadridge Client Proxies reflect an October 12, 2009 record date.

First, by comparing the Cede breakdowns as of October 12, 2009 and October 22, 2009 (which the Company obtained in November, 2009 (JX 89)), one can determine the amount of decline in the share positions held by each of the 31 banks and brokers that provided consents. That total reduction is 29,386 shares – less than the margin of victory for each issue. Even making the conservative assumption that TBE lost a consent for each and every decline in the position held by a consenting bank or broker, TBE would prevail:

| Issue | Initial Margin | Total Position Reductions | Adjusted Margin of Victory |
|---|---|---|---|
| Removal of Directors | 43,829 | 29,386 | 13,903 |
| Election of Kleweno | 45,469 | 29,386 | 16,083 |
| Election of Konig | 43,122 | 29,386 | 13,736 |
| Election of Sems | 43,122 | 29,386 | 13,736 |

Second, Broadridge generated a Client Proxy on December 30, 2009 (JX 117) and a Supplemental Client Proxy on January 7, 2010 (JX 116), using the October 22, 2009 record date. Those proxies confirm that TBE obtained sufficient Street consents to prevail on each issue:

| Issue | Street Votes Obtained | Street Votes Needed | Margin of Victory |
|---|---|---|---|
| Removal of Directors | 1,036,262 | 1,015,130 | 21,132 |
| Election of Kleweno | 1,037,902 | 1,015,130 | 22,772 |
| Election of Konig | 1,035,555 | 1,015,130 | 20,425 |
| Election of Sems | 1,035,555 | 1,015,130 | 20,425 |

## ARGUMENT

### I. THE CONSENTS REFLECTED ON THE BROADRIDGE CLIENT PROXIES ARE VALID

Section 228(a) of the DGCL authorizes stockholder action without a meeting, "if a consent or consents in writing, setting forth the action so taken, *shall be signed by the holders of outstanding stock*" having the requisite number of votes and delivered to the corporation in a prescribed manner. 8 *Del. C.* § 228(a) (emphasis added). The word "holders" is not defined in Section 228, leaving open the question whether the record owner must always sign the consent.

The use of the undefined "holders" in Section 228 stands in sharp contrast to Section 219(c), which states: "The stock ledger shall be the only evidence as to who are the stockholders entitled *by this section* to examine the list required by this section or *to vote in person or by proxy at any meeting of stockholders*." 8 *Del. C.* § 219(c) (emphasis added). When the General Assembly wanted to restrict stockholder voting power to record holders listed on the corporation's stock ledger, they knew how to do so. That rule applies to votes at stockholder meetings. It is not made applicable to stockholder action by written consent without a meeting.

The word "holders" does not have a technical meaning that is restricted to stockholders of record. A demand for inspection of a corporation's books and records may be made by any "stockholder," 8 *Del. C.* § 220(b), which is defined to mean "a holder of record of stock in a stock corporation, or *a person who is the beneficial owner of shares of such stock held* either in a voting trust or *by a nominee on behalf of such person*, . . ." 8 *Del. C.* § 220(a)(2). For purposes of the appraisal statute, "stockholder" is defined differently: "As used in this section, the word 'stockholder' means a holder of record of stock in a stock corporation . . . ." 8 *Del. C.* § 262(a).

The use of the word "holders," without any clarifying definition, appears to reflect a legislative intent to allow the judiciary to provide clarity as needed. By way of analogy, Section

327 refers to derivative lawsuits "instituted by a stockholder of a corporation," 8 *Del. C.* § 327, and it has long been interpreted as allowing the beneficial owner to file the action. *See* II Edward P. Welch et al., *Folk on the Delaware General Corporation Law* § 327.3.5., at GCL-XIII-67 (2010) (collecting cases).

The statutory ambiguity of Section 228 about who possesses the right to consent has persisted notwithstanding some conflict in generation-old case law and subsequent unrelated legislative amendments. The case addressing the issue most thoroughly is *Olson v. Buffington*, 11 Del. J. Corp. L. 687, 692 (1985), in which then-Vice Chancellor Berger discussed the very question of when a written consent signed by a brokerage house is valid in the absence of an omnibus consent from a depository.

When *Olson* was decided, the back-office process of delivering written consents was not as centralized as it is today. At issue in *Olson* were consents executed by individual brokerage houses, such as Bear Stearns & Co. and Prudential-Bache Securities, Inc., and others not identified in the post-trial opinion. *Id.* at 690-91. Today, Broadridge functions as the back-office processor for all the banks and brokers, and it issues a single Broadridge Client Proxy that compiles the votes for each firm. *Olson* also observed that "DTC is not the only securities depository. Other companies performing similar services and listed as record holders of Olson Farms include Pacific & Co., Philadep & Co. and Kray & Co." *Id.* at 691. Today, DTC has a monopoly. It is the only depository listed on EMAK's list of registered stockholders.

Nevertheless, *Olson* recognized that developments in the securities industry made it feasible to tabulate consents prepared in a certain form by a brokerage house, and to dispense with an omnibus proxy from a depository. This Court observed: "Defendants do not dispute that Cede breakdowns are readily available or that the Omnibus Proxy is but a formality." *Id.* Case

law under Section 220 already recognized that "Cede is but a name used for the convenience of the brokerage houses," and that "the company must identify the brokerage houses inasmuch as they are, effectively, the record holders." *Id.* at 692 (citing *Hatleigh Corp. v Lane Bryant, Inc.*, 428 A.2d 350 (1981)). The plaintiffs in *Olson* argued that the corporation must obtain a Cede breakdown and use it to determine if the brokerage house consents were executed by a listed stockholder.

The *Olson* Court reasoned that the plaintiffs' proposed rule would work if Cede was the only depository, but it would be unwieldy for a corporation with "scores of depository companies on its stocklist":

> **Plaintiffs' argument would be more compelling if either all of the consents identified Cede as the record holder or Cede was the only depository company listed as a record holder on Olson Farms' books.** However, neither of those facts are present in this case. As a result, Olson Farms would have had to obtain breakdowns from each of the four depository companies listed as record stockholders in order to determine the validity of the brokerage house consents. Although this task is far from onerous given the limited number of depository companies involved here, **another company could have scores of depository companies on its stocklist thereby significantly increasing the burden**.

*Id.* (emphasis added). Here, the Broadridge consents identify DTC as the depository for all of the banks and brokers. DTC is the only depository on the EMAK record list. Moreover, the distinction expressed by the *Olson* Court is now anachronistic, as DTC is the only depository in the country.

The *Olson* Court then suggested a rule for when a consent may be signed by a brokerage house – the consent must identify the depository:

> On balance, I conclude that the four brokerage house consents which did not designate Cede as the record holder are invalid. There well may be an exception to the *Grynberg* requirement that consents be executed by stockholders of record in cases where the consent is executed by a brokerage house and the record holder is a depository company. However, if such an exception were

> recognized, **it would be essential that the depository company be identified on the consent in order to provide the company a ready means of verifying the brokerage houses' holdings.**

*Id.* (emphasis added). Here, the Broadridge Client Proxy identifies DTC as the depository for each listed bank and broker. EMAK possessed a Cede breakdown and thus had a ready means for verifying the holdings of each institution as of the record date. Looking directly to the Broadridge Client Proxy, and dispensing with the formality and procedure of obtaining a DTC omnibus proxy, sacrifices nothing in terms of practicality or certainty.

The *Olson* Court did not have to decide if brokerage house consents identifying the depository are valid, because of the number of disqualified consents. Here, the suggested rule in *Olson* is squarely presented, and it deserves to be followed. As stated in a leading treatise: "A more recent authority applying the election review procedures of Section 225 to a consent action suggests that a beneficial owner may execute a valid consent without the formality of a proxy from the record holder, so long as the consent identifies the record holder and the authority of the beneficial holder to control voting of the shares is clear." 2 David A. Drexler et al., *supra*, § 31.03[2], at 31-9 (citing *Olson*).

No other case analyzes the issue in a satisfactory way. In *Grynberg v. Burke*, 1981 Del. Ch. LEXIS 487 (Aug. 13, 1981), then-Vice Chancellor Brown concluded, for reasons not apparent from the text of Section 228(a), that the signatories of a consent "must have such shareholder status as would enable them to vote at an annual or special meeting of shareholders." *Id.* at *17. The Court also expressed hostility toward action by written consent for a control dispute, observing that the statute was "obviously designed to facilitate shareholder action where the outcome is a foregone conclusion," and that the problem of two competing boards, both proclaiming their right to office, "could have been avoided at a noticed meeting." *Id.* at *18.

The Court continued that "it seems only a matter of common sense that [Section 228] should be strictly construed so as to limit its power to record owners," in order to lessen the "potential for corporate disruption" from a disputed control contest. *Id.* at *18.

That dicta is not good law. The Delaware Supreme Court subsequently reasoned that the ability to act by written consent in connection with a takeover battle is a clear statutory right, and that "the statute must be given its plain meaning." *Allen v. Prime Computer, Inc.*, 540 A.2d 417, 420 (Del. 1988). The advent of status quo orders also eliminated the problem of corporate disruption during the pendency of a Section 225 action. There is no policy basis or textual basis for applying a rule of strict construction to the word "holders" in Section 228(a). Indeed, if any principle of construction applies, it is that "the court should hesitate to deploy ambiguity in the record against the effective exercise of voting rights." *Commonwealth Assocs. v. Providence Health Care, Inc.*, 641 A.2d 155, 157 (Del. 1993).

*Freeman v. Fabiniak*, 1985 Del. Ch. LEXIS 486 (Aug 15, 1985), is another case that concludes, without analysis, that the stock ledger requirement for the power to vote at meetings of stockholders in Section 219(c) of the DGCL also applies to Section 228. *Id.* at *15. *Freeman* also shows unwarranted hostility to action by written consent: "it should be obvious that [Section 228] is an undesireable vehicle to resolve the disputes between the two factions. The Court will, therefore, carefully scrutinize the consents to see if they meet the mandate of the statute." *Id.* at *14. Mysteriously, the *Freeman* Court cites *Olson* with a "Cf." citation for the proposition that only persons identified on the stock ledger can act by written consent. *Id.* at *15. *Freeman* did not involve a consent signed by a brokerage firm for shares held in a depository, and it does not take issue with *Olson*'s reasoning on that subject.

*Freeman* does hold that registered holders of shares cannot "be allowed to vote shares against the wishes of the equitable owner." *Id.* at *20. By that logic, the voting instructions on each Broadridge Client Proxy must carry the day. The voting instructions from the beneficial owners in a contested consent solicitation should not turn on whether a soliciting stockholder's proxy solicitor followed up to ensure delivery of an omnibus proxy containing information that is already in the Company's possession, or a fiduciary's tactical decision not to procure the omnibus proxy or inform the soliciting stockholder/director of its absence.

## II. THE STOCKHOLDERS WERE FULLY INFORMED

This Court has assumed, but never held, that a fiduciary duty of disclosure applies to a director soliciting stockholder written consents. *Zaucha v. Brody*, 1997 Del. Ch. LEXIS 81, *14-15 (June 3, 1997), *aff'd*, 697 A.2d 749 (Del. 1997); *see Unanue v. Unanue*, 2004 Del. Ch. LEXIS 153, *35-45 (Nov. 3, 2004). Assuming such a duty does apply, the familiar standard is that a "material fact is one that a reasonable investor would view as significantly altering the total mix of information made available." *Unanue*, 2004 Del. Ch. LEXIS 153, at *36 (citing *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 944 (Del. 1985); *see id.* at *47-49. Defendants also bear the burden of demonstrating "that any purported disclosure violation justifies the discretionary equitable relief of setting aside the Consenting Stockholders' action by written consents, even if inadequate disclosure was made to the Consenting Stockholders." *Id.* at *64.

It is not clear what disclosure claims defendants are pressing. Crown alleged in its Counterclaim that TBE failed to disclose (a) the retention of counsel on a contingent basis to challenge the Exchange Transaction, (b) the size of the severance payment to which Holbrook would be entitled if terminated, (c) the $25 million allegedly owed to Crown if the TBE slate is elected, and (d) the circumstances surrounding Kurz's resignation as CEO. (JX 147 at 27-28)

Crown's Deutschman acknowledged that EMAK put forward its views respecting the severance obligation, the Crown obligation and Kurz's resignation. (Deutschman 83, 84, 87) EMAK stated its views at length on these subjects (JX 104; 107), and TBE responded (JX 109; JX 110).

On the subject of fee reimbursement, Deutschman testified that he thought that an intent to seek reimbursement of attorneys' fees should have been disclosed, regardless of whether counsel was retained on an hourly basis or on contingency. (Deutschman 82) His concern regarding a contingent fee is that it "talks to the type of people that are carrying out the proxy fight." (*Id.* 79) Deutschman was unaware that a fee application could be made to the Court regardless of who prevails in the election contest, and regardless whether the Company agrees to pay the requested fee. (*Id.* 79-80) The fee arrangement is not a material fact because a vote for or against the TBE slate has no logical bearing on a future fee application. A fee application is governed by legal principles that apply regardless of whether the suit is brought individually or in a representative capacity. *Tandycrafts, Inc. v. Initio Partners*, 562 A.2d 1162, 1166-67 (Del. 1989).

## III. THE BOUTROS CONSENT IS VALID

Defendants will argue that Kurz's acquisition of stock from Peter Boutros was improper and that it somehow affects the validity of the consent that Boutros signed for the TBE slate. Yet there is no prohibition against buying shares and obtaining a proxy or consent from the seller. Indeed, "the legally presumed implication, in a sale of the underlying stock, would be that the seller is contracting to sell and assign all of its rights, title and interest in the stock, including its right to grant a consent or a revocation with respect to a past record date, and that upon request the seller will, in good faith, take such ministerial steps as are necessary (e.g., granting proxies) to effectuate that transfer." *Commonwealth Assocs.*, 641 A.2d at 158. Here, Boutros had the

right to vote more shares than he could transfer, but that is a function of the type of restricted shares EMAK chose to grant him. He only sold that which he is entitled to sell. (JX 283) There is no public policy against Boutros exercising all of his voting rights in the manner favored by the purchaser.

At his deposition, Kurz was confronted with a company policy from several years ago restricting employees from trading in Company stock during "Quiet Periods." (JX 315; Kurz 119) Kurz had no reason to believe that the Company policy remained in place in 2009 (after the Company's stock was de-listed and de-registered) or that it covered him as a director, as he had not been provided with the policy upon becoming a director in June 2009, and he was not informed of any "Quiet Period." (Kurz 121)

The fact that Kurz possessed a financial projection for the fourth quarter does not render the acquisition of stock illegal or violative of fiduciary duty. Delaware law in this area "more or less tracks the key requirements to recover against an insider under federal law." *In re Oracle Corp. Deriv. Litig.*, 867 A.2d 904, 934 (Del. Ch. 2004). It is aimed at remedying "intentional misconduct" taken at the expense of "innocent buyers":

> *Delaware law has long held – see Brophy v. Cities Services, Inc. – that directors who misuse company information to profit at the expense of innocent buyers of their stock should disgorge their profits. This doctrine is not designed to punish inadvertence, but to police intentional misconduct.* As then-Vice Chancellor Berger noted, Brophy is rooted in trust principles that provide "that, if a person in a confidential or fiduciary position, in breach of his duty, uses his knowledge to make a profit for himself, he is accountable for such profit." Or as then-Vice Chancellor Hartnett put it, "it must be shown that each sale was entered into and completed on the basis of, and because of adverse material non-public information." *That is, Delaware case law makes the same policy judgment as federal law does, which his that insider trading claims depend importantly on proof that the selling defendants acted with scienter.*

*Id.* at 933-34 (emphasis in original; quotations omitted). This Court further explained that, to prevail on a *Brophy* claim, a plaintiff must show that: "1) the corporate fiduciary possessed

material, nonpublic company information; and 2) the corporate fiduciary used that information improperly by making trades because she was motivated, in whole or in part, by the substance of that information." *Id. at* 934. The evidence at trial will show that the transaction whereby Mr. Kurz bought the Boutros shares on December 20, 2009, was not motivated by the substance of a negative projection for the fourth quarter.

## CONCLUSION

For all the foregoing reasons, and on the basis on the evidence to be presented at trial, Plaintiffs respectfully request that the Court invalidate the Crown Consents and declare that James Holbrook and Jordan Rednor were removed as directors, that Philip Kleweno, Michael Konig, and Lloyd Sems were appointed as directors as of December 21, 2009, and that the Board of Directors of EMAK is comprised of Donald Kurz, Jeffrey Deutschman, Jason Ackerman, and newly appointed directors Philip Kleweno, Michael Konig, and Lloyd Sems.

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DATED: January 20, 2010

## CERTIFICATE OF SERVICE

I hereby certify that on February 18, 2010, I caused a copy of the foregoing **Public Version of Plaintiffs' Corrected Pre-Trial Brief** to be served on the following counsel in the manner indicated below:

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