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IN THE SUPREME COURT OF THE STATE OF DELAWARE

ALBERT POLIAK, Defendant Below, Appellant, v. ROBERT D. KEYSER, JR., FRANK SALVATORE AND SCOTT SCHALK, Plaintiffs Below, Appellees, and ARK FINANCIAL SERVICES, INC., Nominal Defendant Below, Appellee.	)	No. 478, 2012 On appeal from the Court of Chancery of the State of Delaware in C.A. No. 7109-VCN **PUBLIC VERSION** **FILED: October 19, 2012**

OPENING BRIEF OF
DEFENDANT BELOW, APPELLANT ALBERT POLIAK

MORRIS JAMES LLP

Edward M. McNally (I.D. 614)
Katherine J. Neikirk (I.D. 4129)
500 Delaware Avenue, Suite 1500
P.O. Box 2306
Wilmington, DE 19899
(302) 888-6800
emcnally@morrisjames.com
kneikirk@morrisjames.com
Attorneys for Defendant Below, Appellant Albert Poliak

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NATURE OF PROCEEDINGS

This is an appeal from the August 3, 2012 Order and Final Judgment implementing the July 31, 2012 Memorandum Opinion (the "Opinion") of the Court of Chancery in an action brought to determine the members of the board of directors of Ark Financial Services, Inc. ("Ark") pursuant to 8 *Del. C.* § 225. The complaint was filed on December 13, 2011 by Plaintiffs Below, Appellees Robert D. Keyser, Jr., Frank Salvatore and Scott Schalk (collectively the "Plaintiffs") who alleged they comprised Ark's board of directors by virtue of a stockholders' consent signed on December 13, 2011 (the "2011 Written Consent").

The Plaintiffs contended that the 2011 Written Consent was effective because Ark's Series B Preferred Stock held by Defendant-Below, Appellant Albert Poliak should not be counted in determining what constituted a majority of the Ark stock outstanding and entitled to vote. That Series B Preferred Stock was issued a year earlier, in December 2010, by Mr. Poliak to block a prior takeover attempt by Mr. Keyser.

Following the 2010 issuance of the Series B Preferred Stock, the groups contending for control of Ark negotiated a series of agreements that ultimately led to Ark issuing $4,000,000 in new Series A Preferred Stock to third party investors. In the Series A Preferred Stock Offering materials, Ark informed investors that Mr. Poliak controlled Ark through the Series B Preferred Stock. The sale of the Series A Preferred Stock permitted Ark to negotiate settlements with its creditors on its past-due, multi-million debts and stay in business. Without the sale of the Series A Preferred Stock, Ark would have failed and landed in bankruptcy.

After Ark sold the Series A Preferred Stock, Mr. Keyser again sought to take control of Ark by the 2011 Written Consent and his Section 225 complaint in the Court of Chancery. The complaint named as defendants the Ark board of directors elected at Ark's annual stockholders' meeting, held on November 1, 2011, namely Tom Curtis, Thomas Hands and Donald Shek (the "Director Defendants") and also named Mr. Poliak as a defendant. Following expedited proceedings, the Court of Chancery held a two-day trial on March 14-15, 2012. Post-trial argument was held on April 23, 2012.

The principal issue resolved by the Court of Chancery's July 31, 2012 Opinion was whether Plaintiffs were entitled to challenge the issuance of Ark's Series B Preferred Stock after waiting over a year to do so and after Ark had sold $4,000,000 of its Series A Preferred Stock to new investors through an offering memorandum that disclosed that Mr. Poliak controlled Ark through his Series B Preferred Stock. The Court of Chancery held that Plaintiffs could challenge the issuance of the Series B Preferred Stock and that the Series B Preferred Stock was invalid under the entire fairness standard of review. As a result, Mr. Keyser took control of Ark under the August 3, 2012 Final Judgment.

Mr. Poliak filed his Notice of Appeal on August 30, 2012. This is his Opening Brief in support of that Appeal.

SUMMARY OF ARGUMENT

1. Stockholders who are fully informed about the issuance of a control block of a corporation's stock and who accept the benefits of a subsequent sale of corporate stock to third party investors that is based on the existence and identity of the controlling stockholder may not later attack the issuance of the control block of stock. Laches bars that attack.

2. Stockholders who accept the benefits of a corporation's sale of its stock with full knowledge ratify, acquiesce or waive objections to the transaction that made that sale of stock possible.

STATEMENT OF FACTS

A. Poliak And Keyser Found Ark And Dawson James

In 2002, Albert Poliak and Robert D. Keyser, Jr. decided to start their own securities firm. (Appendix (hereinafter cited as "A__") at 17 ¶ 1; A110, Keyser.) Both men were experienced brokers and had already worked together at other brokerage firms. (A109, Keyser.) Poliak and Keyser formed Dawson James Securities, Inc. ("Dawson James") as their operating entity. (A110, Keyser.) Because a brokerage firm is required to have certain levels of net capital under federal law, Poliak and Keyser also formed Ark as a separate holding company to both own Dawson James and to serve as the vehicle to borrow the funds needed to capitalize their new companies. (A17 ¶¶ 1, 2; A110, Keyser.)

Poliak and Keyser focused on different areas in the firm. Keyser was the Chief Executive Officer ("CEO") and Secretary of Ark and Dawson James. (Opinion at 2; A18 ¶ 10.) Until December 2009, Poliak and Keyser were the only directors of Ark. (A18 ¶ 10.) Keyser supervised the investment banking efforts of capital raising for public and private companies. Poliak acted as President of Dawson James and supervised the brokerage operations.

Dawson James expanded from a single office in Fort Lauderdale to multiple offices in Florida, Maryland, New York, New Jersey and California with 60 employees. (*Id.* ¶ 2.) This growth was financed with borrowed funds. Ark initially borrowed $125,000 from Lyonshare Venture Capital ("Lyonshare") and $175,000 from Vestal Venture Capital

("Vestal"). (*Id.* ¶¶ 3, 4; A705-09; A710-14.) Allan R. Lyons is a principal of both Lyonshare and Vestal. (A17 ¶¶ 3, 4.) In 2005, Ark borrowed an additional $500,000 from Vestal. (*Id.* ¶ 5.) In 2007, Ark borrowed $2,000,000 from HSK Funding, Inc. ("HSK"). (A18 ¶ 6.) Kenneth A. Steel, Jr. and Burton Koffman are principals of HSK and had prior financial dealings with some of Lyons's entities, including Vestal. (A114, Keyser; A705-26; A18 ¶ 6.) Steel, Koffman and Lyons are the "Three Creditors" referred to in the Opinion. (Opinion at 4.)

B. Ark Struggles And Lyons And Steel Make Keyser Leave

Ark was eventually unable to pay all of its debt in accordance with the terms of that debt. (A1345-47; A206, Keyser.) The Great Recession of 2008 further hurt Ark and Dawson James. (A116, Keyser.) The investment banking business dried up and brokerage commission revenues declined. For the years ended December 31, 2008 and 2009, Ark lost $1,800,000 and $1,900,000 and shareholders' net worth declined to ($4,165,470) and ($6,147,534) respectively. (A1345-47.) As Dawson James' business evaporated, it could no longer pass through funds to its parent Ark. Ark was insolvent. (A206, Keyser; A487-88 Shek; A1343-63.)

By early 2009, Ark was forced to pay whatever was demanded to obtain continued support from the Three Creditors. Thus, in February 2009, Ark borrowed $300,000 from the Three Creditors (the "$300,000 Note"). (A727-34.) The $300,000 Note included a $60,000 "Origination Fee" and the option to acquire 24% of Ark's common stock "for a purchase price of $1.00" (the "24% Option"). (A727.) The interest rate on the $300,000 Note was 24% per annum. (A337-38, Poliak; A727.)

In addition to the terms of the $300,000 Note, Lyons and Steel insisted that Ark hire an outside consultant, at Ark's expense, to evaluate Ark and its management and to decide how to reduce expenses if necessary. (A18 ¶ 9; A679 at 11-12.) Lyons and Steel, as well as the management and employees of Dawson James, were already aware that Keyser was an absentee CEO, working only a few days a week and spending summers in Missouri. (A343-44, Poliak; A467, Curtis; A459, Hands.) As the financial condition of Ark and Dawson James deteriorated, Lyons and Steel expressed their displeasure with Keyser's performance. (A343-44, Poliak; A679-80 at 12-13.) The consultant concluded that Keyser should step down as CEO to reduce expenses and improve leadership. (A345, Poliak.) The consultant also recommended and the Three Creditors agreed that Poliak would operate Dawson James and Ark. Keyser informally stepped down as CEO in mid-2009. (A117-18, Keyser.) In December 2009, Keyser resigned as an officer and director of Ark and of Dawson James. (A18 ¶ 10.) That left Poliak as the sole director of Ark and CEO of Ark and Dawson James. (Opinion at 4.) No one else would agree to be a director given Ark's problems. (A346, Poliak.)

C. Lyons And Steel Demand Ark Pay Them Extra Money

To save Ark and Dawson James, in 2009 Ark began to negotiate with all of its creditors, including Dawson James' landlord. (A492-93; A497-500, Shek.) For those creditors holding Ark notes, Ark's basic plan was to convince them to convert their Ark notes into preferred stock. (A339-41, Poliak.) By mid-2010, Shek and Poliak were eventually able to convince the majority of Ark's creditors to go along with Ark's restructuring plan and convert their debt. (A499, Shek.) Once the smaller creditors agreed, however, the Three Creditors suddenly balked. (A501-02.) They wanted a better deal than the other Ark creditors, but Ark declined to prefer them over the other debtholders. (A342, Poliak; A500-02, Shek.)

In 2009, the Financial Industry Regulatory Authority ("FINRA") ruled that Ark had violated FINRA's rules by giving Lyons' group the underwriting warrants they had demanded to avoid foreclosure on their claims against Ark. (A735-43.) Lyons agreed to resolve this violation by signing a letter stating he could not receive such warrants. (A710-14; A715-21; A682 at 21.) But when Ark was about to complete its debt restructuring in mid-2010, Lyons demanded money for those warrants. (A501, Shek.) He made other demands as well, including participation in future earnings and warrants, to cause his group to receive more than the other debtors on a *pro rata* basis. (A500-02.)

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

Not making headway with their demands on Poliak, Lyons and Steel changed tactics. They turned to Keyser. Their basic plan was to "sell" the Ark $300,000 Note and other debt to a new entity controlled by Keyser, Auxol Capital LLC ("Auxol"), and to transfer their 24% Option to Keyser. (A120-21, Keyser; A744-47; A748-52; A753-57; A758-69.) As Auxol literally had no capital of its own, the plan was for

Auxol to pay the Three Creditors by collecting on the Ark notes. (A207-09, Keyser; A684 at 32.) The Three Creditors would then make Ark pay what they wanted by putting Keyser in control of Ark. (A123, Keyser.) This would be done by having Keyser exercise the 24% Option, then have Keyser vote that 24% interest with other Ark shares he controlled to throw out Poliak and install Keyser and his colleague, R. Douglas Armstrong as the board of directors of Ark. (A758-69.)

This plan was then reduced to an "[A]greement [F]or [P]urchase [A]nd [S]ale [O]f [C]ertain [A]ssets" (the "Three Creditors' Agreement"). (A209, Keyser; A758-69.) The Three Creditors' Agreement required "Keyser and Armstrong, while in majority control of the ARK board of directors [to] support and will not alter the distribution to Vestal, on behalf of Holders [defined as Vestal, Lyonshare and HSK] 100% of all proceeds for any Accrued Financial Value." (Opinion at 5-6; A210, Keyser; A760 § 3.5(b).) The "[A]ccrued [F]inancial [V]alue" included monetized warrants. (A682-83 at 24-25.) Further, the Three Creditors' Agreement mandated additional, substantial payments of "$395,000 [per] year" to Lyons, Steel and Koffman "[after Auxol gains] majority control of the ARK board of directors." (A210, Keyser; A760 § 3.4(a).)

On November 29, 2010, Keyser announced to Ark that he held the 24% Option and was exercising it for 8,604,521 shares ("Option Shares"). (A124, Keyser; A754.) This turn of events alarmed Poliak and his advisors, including his Chief Financial Officer, Donald Shek. (A250, Poliak; A511-12, Shek.) They understood that the Three

Creditors would not have aligned themselves with Keyser, except to obtain an advantage vis-à-vis the other creditors and stockholders that they could not obtain from Poliak. (A250, Poliak; A511-12, Shek.) After all, those same Three Creditors had forced out Keyser previously and knew that many Ark and Dawson James employees had no confidence in Keyser and did not want to work for him. (A247-48, A343-44, Poliak; A459-60, Hands; A466, Curtis.) The Court of Chancery found that Poliak was, in fact, "afraid that Keyser [would] . . . sacrificed the best interests of Ark for either his own best interests or the best interests of the Three Creditors." (Opinion at 6.)

E. Poliak Prevents The Raid On Ark

Poliak consulted with the large Chicago law firm of Locke Lord Bissell & Liddell LLP ("Locke Lord") on November 30, 2010. (A253, Poliak.) Locke Lord had previously advised Ark on regulatory compliance matters. (A272-73, Poliak; A770-846.) Locke Lord attorneys advised Poliak that as Ark's sole director he had a fiduciary duty to all of Ark's creditors because Ark was insolvent. (A255-57.). Locke Lord then prepared corporate documents for Poliak to sign authorizing Ark's board of directors to issue super-voting preferred stock. (A847-52; A866-79; A880-87.) On December 1, 2010, acting on Locke Lord's advice, Poliak approved the issuance of 25,000 shares of Series B Preferred Stock to himself in exchange for $250. (A888-96.)[1] Each share of Series B Preferred Stock had 1,000 votes so

[1] In setting the price for the Series B Preferred, Poliak focused on the fact that Ark was insolvent and close to going out of business. (A261, Poliak.) While the Series B had a redemption price of $1 per

Poliak secured voting control over Ark. (A892; Opinion at 7.)[2]

In issuing the Series B stock to himself, Poliak was necessarily constrained by time pressures. He already knew that other people had declined to be on the Ark board of directors due to liability concerns based on its insolvency. (A346, Poliak.) He also knew that FINRA rules limited those who could be in control of a securities firm to only an "approved person." (*Id.* at A355.)[3] After all, that rule was why the Three Creditors limited their option to 24% of Ark because FINRA holds "control" includes "the right to vote 25 percent or more of the voting securities." (A214, Keyser.) Thus, Poliak, who already owned over 25% of Ark's stock, chose himself given that he had little other choice. (Opinion at 8-9.)

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

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share, Poliak did not intend to redeem the stock. (A158, Poliak.) Of course, under Delaware law, the stock could not be redeemed unless Poliak could take Ark from underwater by $7,000,000 to where it was solvent. 8 *Del. C.* § 160. In any case, the total Poliak would receive upon redemption, if that ever were to occur, was only $25,000.

[2] Because the time to consider how to act was so short, there is no written memorandum setting forth Locke Lord's advice. Not surprisingly after more than a year, memories of exactly what Locke Lord said to Poliak and Shek are admittedly vague, even among the lawyers involved. What is clear, however, is that what is available in writing supports Poliak and Shek's testimony they were advised that they were permitted under Delaware law to issue the Series B Preferred Stock. (A254-258, Poliak; A510-11, Shek; A880-87.)

[3] *See* FINRA Rule 2, Rule 311(b) (A101) requiring "every person who controls such corporation [to be] a member [defined by Rule 2 as one "approved by the Exchange], principal executive or approved person."

Written Consent"). (A899-902.) The 2010 Written Consent purported to remove Poliak from the board and replace him with Keyser and Armstrong. (A125, Keyser; A899-902.) Ark's counsel challenged the validity of the exercise of the Option as well as the effectiveness of the 2010 Written Consent. (A20 ¶ 20; A903-04.) Beginning on December 10, 2010, a flurry of attorney letters went back and forth between the Poliak and Keyser camps, arguing over the validity of the issuance of the Series B Preferred Stock. (Opinion at 10-11; A129-30, Keyser; A903-04; A996-1003; A1017-23.) While Ark eventually recognized the exercise of the 24% Option Shares by Steel, Lyons and Koffman to Keyser, it did not recognize the 2010 Written Consent. Poliak remained in control of Ark. (A133, Keyser.)

F. Plaintiffs Learn Of The Series B Preferred Stock And Stand By While Ark Issues Series A Preferred Stock To Third Party Investors

By mid-December 2010, the parties began negotiating a resolution of the disputes over the issuance of the Series B Preferred Stock and the demands of the Three Creditors. (A21 ¶ 28.) On January 5, 2011, Ark and Auxol (on behalf of Keyser, his colleague Armstrong and the Three Creditors) executed a Confidentiality and Standstill Agreement ("Standstill Agreement"). (A140, Keyser; A1028-33.)[4] The Standstill Agreement contemplated a "Notes Buy-Out Offer" of the promissory notes held by the Three Creditors ("Former Noteholders"). A draft proposal

[4] The Standstill Agreement recognized that Ark might be damaged by a delay in resolving the control dispute and provided that "[e]ach and every limitations period, whether statutory, contractual, equitable or otherwise" would only be "tolled and suspended during the Standstill Period" that expired on January 21, 2011. (A1031 ¶ 9.)

soon followed. (A1034-36.)

Keyser and the Three Creditors also reached a side "Memo of Understanding" between themselves. (A1039.1-1039.2.) That Memo provided for a payment to the Three Creditors of $1,785,000, if Keyser reached a deal with Ark, with Keyser to also get paid a fee. (*Id.*) By the end of January 2011, Ark and Auxol did reach a Confidential Agreement In Principle that contemplated Auxol receiving $2,200,000 by April 2011 ("Confidential Agreement"). (A143, Keyser; A1037-39.) The Confidential Agreement also contemplated the acquisition by Ark of "all equity interests in Ark owned by Robert Keyser." (A1038 ¶ 2(b).)

Keyser recognized that if the Confidential Agreement was carried out and the definitive agreements it contemplated were signed, that would end the dispute over the Series B Preferred Stock. Thus, the Confidential Agreement provided "[t]here will be a total settlement of all claims between the parties and their affiliate . . . except claims relating to the breach of this Agreement in Principle or Definitive Note and Stock Purchase Agreement as applicable. (*Id.* at ¶ 4.) Keyser said they would only "litigate" if Ark failed to close. (A144, Keyser.) Otherwise, "it [was his] understanding that the basic plan, if this agreement were carried out, was to settle all of the disputes between the note holders and [Keyser] and Ark and Mr. Poliak." (A218, Keyser.)

On March 31, 2011, Ark and Auxol entered into a Stock and Note Purchase Agreement (the "Notes Agreement"). (A149; A1267-93.) This Notes Agreement confirmed the parties' intent to settle their dispute, subject to further negotiations with Keyser over his Ark stock. (*Id.*; A1267-93.) Thus, the Notes Agreement provided:

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

(A1274.)

The parties all understood that Ark did not have the funds needed to buy the Former Noteholders' notes or Keyser's Ark stock. The funding plan for Ark's $2,200,000 purchase of the Three Creditors' notes, the Option Shares and some Dawson James common stock held by Auxol was to have Ark issue Series A Preferred Stock in a private placement to third party investors. (A22 ¶ 32.) Poliak and his colleagues at Ark began the process of securing the new investors required. (A294, Poliak.) They also negotiated with other note holders to convert their notes into Series A Preferred Stock or to buy back their notes at a discount to the actual amounts owed. (A1053-1146; A1147.)

The private placement of the Series A Preferred Stock required the use of a Subscription Agreement and Offering Memorandum to meet Securities and Exchange Commission rules (the "Subscription Agreement"). The Subscription Agreement expressly noted "the existence of Series B Preferred Stock which provides super voting control to Albert J. Poliak" and that "Albert J. Poliak has voting control of our outstanding capital stock pursuant to his Series B Preferred Stock and such voting control will exist indefinitely into the future." (A1081; A1083.) In bold and italicized font, the Subscription Agreement stated:

> ***The one member of our Board of Directors is our principal stockholder and has super majority voting power in the form of Series B Preferred Stock and may take actions that may not be in the best interests of our other stockholders.***

(A1083.)

The purchasers of the Series A Preferred Stock relied on the Subscription Agreement's disclosures of Poliak's control of Ark and his management team. (A301, Poliak.) Shek and Poliak traveled to the new, potential investors and made them "comfortable with the management of the company." (A358-60, Poliak.) In fact, the sale of the Series A Preferred Stock would never have occurred if the investors "thought" for a moment that the Series B Preferred Stock was an issue. (A368, Poliak.) Curtis explained, "the most important thing that [investors are] betting on, you're betting your money on [your] management team." (A470, Curtis.)

The Subscription Agreement was circulated to Keyser, Schalk and others by early April 2011. Keyser received his copy after his attorney advised Ark that it was required to give Keyser "all relevant material information about ark [sic] - which clearly would include, among other things, the financing documents being used by ark [sic] to raise new funding at this time." (A1294.) Salvatore and Kaiser were also aware of the Series A Preferred Stock Offering (as well as the Series B Preferred Stock) by this time based upon repeated conversations they had with Poliak. (A362-65, Poliak.) The Court of Chancery specifically found that "By the spring of 2011, all of the Plaintiffs were aware of the proposed private placement of Series A Preferred Stock." (Opinion at 12.)

The circumstantial evidence also confirms all of the Plaintiffs knew about the issuance of the Series A Preferred Stock and the disclosures to the new investors that Poliak was in control by virtue of his Series B Preferred Stock ownership. All of the Plaintiffs are knowledgeable about private placements, they all agreed the Subscription Agreement must have disclosed Poliak's control of Ark and they all agreed that matter was important to investors. (A223, Keyser; A412, A416, A419, A426, Schalk; A445, A454-56, Salvatore.) It was important to them as well, for Ark stock is a substantial part of their personal assets. (A414, A423-24, Schalk; A449, Salvatore.)

Ark did not meet the April 1, 2011 deadline to close with the creditors and Keyser. As Ark's attorney explained in an April 1, 2011 email: "the major remaining issue is the sale of the Keyser interest in Ark. Many of the investors want to know that the issues related to Mr. Keyser's interest in Ark and its affiliates . . . have been resolved prior to funding their investment." (A1297.) On April 15, 2011, Keyser's attorney advised Ark that based on the 2010 Written Consent Keyser would "promptly . . . commence an action in the Delaware Court of Chancery under Section 225 of the DGCL" to have the Series B Preferred Stock invalidated and to remove Poliak as the Ark director. (A158, Keyser; A1308.) Ark's attorney responded on April 19, 2011 that litigation "would likely dissuade new investors from investing" and "would . . . likely make an agreement to satisfy the Notes impossible." (A160, Keyser; A1310.)

Two agreements were then reached. First, the parties agreed to extend the closing date on the Notes Agreement. (A161, Keyser; A1321-22.) Second, Keyser, Ark and Poliak signed a Settlement Agreement ("Settlement Agreement") that dealt with Keyser's rights or claims as the owner of his Ark stock. (A163, Keyser.) The Settlement Agreement provided that Keyser would sell his Ark stock to Ark at a to-be-negotiated purchase price or if the price negotiations failed, then "the Sale Price shall be submitted to an independent third party valuation firm to value the Shares and determine the Sale Price" "as of April 30, 2011." (A1332-33 § 3(b).)

On or about May 2, 2011, Ark closed on the Series A Preferred Stock Offering with its investors and raised $3,000,000. (A1341-42.) Ark paid Auxol $2,200,000; approximately $400,000 went directly to Keyser as his compensation under his Memo of Understanding with the Three Creditors. (Opinion at 15; A229, Keyser.) Keyser then made no more threats about filing legal action to challenge the Series B

Preferred Stock.

G. Keyser Breaches The Settlement Agreement

Following the May settlement, Ark and Keyser were not able to negotiate a price for his Ark stock. Thus, pursuant to the Settlement Agreement, they agreed to retain the firm of Skoda Minotti to value Keyser's stock. (A167-68, Keyser; A1323-24; A1364.) Ark supplied voluminous materials to Skoda Minotti, with copies to Keyser as well, and arranged for Keyser to contact Skoda Minotti directly. (A1343-63; A1364-65; A1366-70; A1371-1432; A1432.3-A1432.100; A1433-1475.) On August 29, 2011, Keyser asked for additional information concerning "underwriter warrants and any other equity related compensation received in 2010 through the valuation period." (A171, Keyser; A1432.1.) These warrants permitted Dawson James to purchase securities at a fixed price for a limited period of time of some of the companies it had served as an underwriter or placement agent when those companies had sold their securities to third parties. (A148, Keyser.) The value of the warrants would depend on the price of the underlying stock. (A204-05.)

Skoda Minotti reviewed the materials on the underwriter warrants and on October 3, 2011 requested a teleconference with Keyser and Ark's representatives. (A1483.) Skoda Minotti cautioned that "[b]ased on our analysis to date, the warrants would need to have significant value in order for the common stock to have value." (*Id.*) For even by 2011, Ark's liabilities exceeded its assets. (A1498-1510.) Keyser was provided copies of information about Ark's warrants. (A1489-1510.) During a telephone call with Keyser on October 6, 2011, Skoda Minotti pointed out that unless the value of the warrants exceeded $3,000,000, Keyser's 7,000,000 remaining shares of Ark Common stock likely had little to no value. (A236, Keyser; A532-33, Shek; A1484-88.)

On October 11, 2011 Keyser's counsel notified Ark that Keyser was rescinding the Settlement Agreement. (A168, Keyser; A1519.1-1519.3.) The Court of Chancery rejected Keyser's claim he had the right to rescind the Settlement Agreement, after a detailed analysis. (Opinion at 25-28.) Plaintiffs did not appeal that ruling. The Court, however, noted that even without the Keyser stock, the Plaintiffs had a bare majority of Ark's stock other than the Series B Preferred. (Opinion at 30.)

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

In order to comply with certain sanctions imposed by FINRA, Poliak had to temporarily step down as an officer and director of Ark and Dawson James. (A25 ¶ 57.) On November 1, 2011, Curtis, Hands and Shek were elected to the Ark board. (*Id.* ¶ 56.) Plaintiffs Salvatore and Schalk voted in favor of Curtis, Hands and Shek, while objecting for the first time to the Series B Preferred Stock. (A1555-58.) Keyser purported to not vote for Shek, but to vote in favor of Curtis and Hands. (A1560.)

At the end of November 2011, Ark was able to sell an additional $1,000,000 in Series A Preferred Stock. (A25 ¶ 59.) Once again, the Subscription Agreement for that stock disclosed that Poliak controlled

Ark through the Series B Preferred Stock.

I. Keyser Tries To Mount Another Hostile Takeover Of Ark

After Keyser tried to terminate his Settlement Agreement with Ark, he next began recruiting Ark stockholders to join with him (and his brother) to take over Ark. (A191-92; A194-97, Keyser.) As was the case in his 2010 takeover attempt, Keyser had support from Schalk, a former Dawson James broker. This time, Keyser also obtained the cooperation of two other Ark stockholders, Salvatore and Kaiser. (A191-92.) Previously in 2010, Salvatore and Kaiser had declined to support Keyser's takeover attempt. (A434-35, Salvatore.) In late 2011, they changed their minds when Ark would not purchase their Ark shares at the price they demanded. (A442-44; A453.)

Salvatore and Kaiser are long-time close friends. (A453.) They had worked at Dawson James, but left in 2010 when Ark was in severe financial trouble. (A361-62, Poliak.) After they left Dawson James, they kept in touch with Poliak because they each had 3,948,000 shares of Ark Common stock and continued to receive certain benefits such as health insurance and broker registration fees from Ark. (A362-66, Poliak; A455-56, Salvatore.) They wanted Ark to buy back their stock at a price that Poliak refused to pay because that was not in the best interest of Ark. (A364-65, Poliak.)

Salvatore and Kaiser (as well as Schalk) were well-aware that Keyser's 2010 takeover attempt had not succeeded and that Poliak remained in control of Ark. (A434-35, Salvatore.) Poliak told Salvatore and Kaiser about the issuance of the Series B Preferred

Stock and kept them informed about Ark's plans to issue Series A Preferred Stock to raise cash for fulfillment of the Notes Agreement with Auxol and to convert debt to stock. (A363-65, Poliak.) Both Salvatore and Kaiser supported the Series A Preferred Stock Offering because it would benefit them by "reducing the debt and possibly increasing the worth of the common shares of the company." (A365.) Only after Ark sold the Series A Preferred Stock and they became dissatisfied with the price offered by Poliak, did Salvatore and Kaiser decide to team up with Keyser in order to obtain a buyout price that would satisfy them. (*Id.*)

On December 13, 2011, Plaintiffs Keyser, Salvatore and Schalk, along with non-parties Kaiser and John Keyser, executed the Written Consent, which provided for the removal of all members of the Board of Directors of Ark and the election of Plaintiffs. (A1704-06.) They then filed this Action. As a result, Ark returned money held in escrow to a prospective purchaser of Series A Preferred Stock. (A481, Curtis.)

ARGUMENT

I. LACHES BARS A STOCKHOLDER FROM CHALLENGING ISSUANCE OF A CONTROL BLOCK OF STOCK WHEN THAT STOCKHOLDER DELAYS IN FILING SUIT UNTIL AFTER THE COMPANY SELLS STOCK TO THIRD PARTY INVESTORS WHO RELIED ON THE EXISTENCE OF THE CONTROLLING STOCKHOLDER IN MAKING THEIR INVESTMENT

A. Question Presented

Did the Court of Chancery err in refusing to find laches barred Plaintiffs' challenge to issuance of the Series B Preferred Stock? This issue was raised in Defendants' post-trial brief and addressed in the Opinion. (A66-77; Opinion at 40-41.)

B. Standard Of Review

The Court of Chancery's decision to permit Plaintiffs to recover involved the application of the Delaware law of laches to largely undisputed facts. Appellate courts review a trial court's legal conclusions *de novo*. *Bank of New York Mellon Trust Co., N.A. v. Liberty Media Corp.*, 29 A.3d 225, 236 (Del. 2011). To the extent that the Court of Chancery's decision on laches was a mixed question of law and fact, the Court will accept the trial court's findings of fact if they are supported by the record and the product of an orderly and logical deductive process. *Hunter v. State*, 783 A.2d 558, 561 (Del. 2001); *Sternberg v. O'Neill*, 550 A.2d 1105, 1126 (Del. 1988).

C. The Merits Of The Argument

1. The standard for laches

The Court of Chancery correctly recited the elements of laches. (Opinion at 40.) It specifically recognized that "unusual or extraordinary circumstances [may] exist which make it inequitable to

[wait] to . . . file suit." (*Id.*) To invoke laches, the Court must find: (1) Plaintiffs knew or should have known of their rights or claims; (2) Plaintiffs unreasonably delayed in asserting their rights or claims; and (3) defendants and/or third parties are injured or prejudiced by the delay. *Fike v. Ruger*, 752 A.2d 112, 113 (Del. 2000); *Nevins v. Bryan*, 885 A.2d 233, 246-47 (Del. Ch. 2005); *President and Fellows of Harvard Coll. v. Glancy*, 2003 WL 21026784, at *17 (Del. Ch. Mar. 21, 2003); *Stengel v. Rotman*, 2001 WL 221512, at *6 (Del. Ch. Feb. 26, 2001), *aff'd*, 783 A.2d 124 (Del. 2001).

Nonetheless, the Court held that laches did not apply because there was no prejudice to defendants <u>or</u> third parties by reason of Plaintiffs' one-year delay in attacking the issuance of the Series B Preferred Stock in 2010. The Court reasoned that the investors who eventually purchased $4,000,000 of the Series A Preferred stock while Plaintiffs were silent did not really care who managed Ark and thus suffered no prejudice when Plaintiffs delayed in filing suit to remove Ark's directors. Indeed, it is a fair reading of the Opinion that but for this "no prejudice" conclusion, the Court would have held laches applied.

2. The court below erred in finding laches did not bar Defendants' challenge to the Series B Preferred Stock

It is clear from the record that:

1. the purchasers of the Series A Preferred Stock were told, repeatedly, that Ark was controlled by Poliak (A358-59, Poliak; A1083);

2. those Series A Preferred stockholders made their investment because they were relying on Ark's management as controlled by Poliak (A470, Curtis); and

3. those investors would not have made their investment had they known there was a dispute over Poliak's Series B Preferred Stock.

Here is all the evidence on those points:

1. The offering materials given to the new investors stated Poliak owned the "Series B Preferred Stock which provides super voting control to Albert J. Poliak" and, in bold, italicized letters:

> ***The one member of our Board of Directors is our principal stockholder [Poliak] and has super majority voting power in the form of Series B Preferred Stock and may take actions that may not be in the best interests of our other stockholders.***

(A1083.)

2. Shek and Poliak traveled to visit the new, potential investors and made them "comfortable with the management of the company." (A358, Poliak.)

3. Curtis, who invested $250,000 of his own money, testified "the most important thing that [investors are] betting on, you're betting your money on [the] management team." (A470, A472, Curtis.)

4. The Defendants themselves testified:

a. "[I]t is a big concern . . . because investors in companies like [Ark] want to know who is on the management team." (A222-23, Keyser.)

b. Based on his 20 years of experience, Schalk expected the private placement memorandum would tell investors Poliak controlled Ark. (A412, A419, Schalk.)

c. Salvatore agreed the "private offering would tell those investors who was in control of Ark in terms of the voting stock." (A454, Salvatore.)

There is no evidence in the record that the new investors did not care who controlled Ark. None. All the evidence in the record is that the new investors cared who controlled Ark. They were told who controlled Ark because that was material to them.

Thus, the Court of Chancery upset the reasonable expectations of third party investors regarding the Delaware corporation they were investing in after they made that investment. It is impossible now to undo that investment decision. The purchase of Series A Preferred Stock by third party investors is precisely the structural change that once it occurs should warrant the application of laches. The Court below erred when it concluded Poliak's control over Ark was not "hard to undo." (Opinion at 41.)

The lower court's erroneous reasoning is also apparent from its comments that a "controlling stockholder may not be viewed as a positive" and that investing in a company because it had a controlling stockholder is "an atypical view of controlling stockholders." (Opinion at 44.) There is no evidence to even suggest that the Series A Preferred investors failed to view Poliak as "a positive." (*Id.*)

Why else would they invest $4,000,000 in Ark? As far as the claim that it is "atypical" to invest because of a controlling stockholder is not only unsupported, it is illogical. Investors often put their money on the Warren Buffets of business.[5]

Finally, it is worth noting what the potential investors would have been told about Ark's management had Keyser asserted his right to control Ark by the 2010 Written Consent. The offering memorandum would have then described Keyser as the former CEO who had been forced out for ineffective management by Ark's creditors and who had gained control of Ark by signing the Option Purchase Agreement with the Three Creditors to guarantee them preferential treatment on Ark's assets. *See supra* Statement of Facts §§ B, C, D. Had the Plaintiffs asserted their rights before the new investors purchased Series A Preferred Stock, the sale of the Series A Preferred Stock would never have closed. Keyser withdrew his April 15, 2011 attorney's threat to file suit when Ark's attorney told Keyser that "would likely dissuade new investors from investing" and kept Keyser from getting the $400,000 promised him by the Three Creditors. (A1310.) The simple truth is that Keyser's own actions show that the identity of Ark's management was important to the new investors.

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[5] The Court's comment that "managers quit, they get fired" also misses the point. (Opinion at 44 n.149.) Any company's future may change, for worse or better. That does not mean that investors ignore the current reality of who is running the company or who controls the selection of management.

It was error for the Court of Chancery to let these Plaintiffs deliberately delay suit until after Ark sold stock to innocent third-party investors. Accordingly, the Opinion should be reversed.

II. A STOCKHOLDER WHO ACCEPTS THE BENEFITS OF A TRANSACTION MAY NOT ATTACK THE BASIS FOR THAT TRANSACTION

A. Question Presented

Did the Court of Chancery err in finding that the Plaintiffs did not ratify or acquiesce in the Series B Preferred Stock issuance? This issue was raised in Defendants' post-trial brief and addressed in the Opinion. (A78-83; Opinion at 42-47.)

B. Standard Of Review

The Court of Chancery's holding that the equitable doctrines of ratification, acquiescence and waiver did not bar Plaintiffs from challenging the issuance of the Series B Preferred Stock involved the application of Delaware law to undisputed facts. Appellate courts review a trial court's legal conclusions *de novo*. *Bank of New York,* 29 A.3d at 236. To the extent that the Court of Chancery's decision was a mixed question of law and fact, the Court will accept the trial court's findings of fact if they are supported by the record and the product of an orderly and logical deductive process. *Hunter*, 783 A.2d at 561; Sternberg, 550 A.2d at 1126.

C. The Merits Of The Argument

1. The legal standard for ratification, acquiescence and waiver

The Court of Chancery correctly set out the Delaware law on ratification as an "equitable defense," including implied ratification. (Opinion at 42-48.) It also correctly found that Keyser benefited from the Series A Preferred Stock Offering. (Opinion at 44.) Of course, so too did the other Plaintiffs benefit because all of their Ark stock would have become hopelessly underwater but for the compromise with Ark's creditors made possible by the Series A Preferred Stock Offering.

As the Court quoted from *Genger v. TR Investors, LLC,*:

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

26 A.3d 180, 195 (Del. 2011) (citations and internal quotations omitted).

Similarly, the Court recognized that:

> Acquiescence occurs when a party 'has knowledge of an improper act by another, yet stands by without objection and allows the other party to act in a manner inconsistent with the claimant's property rights.'

TR Investors, LLC v. Genger, 2010 WL 2901704, at *15 (Del. Ch. July 23, 2010) (quoting *Brandywine Dev. Group, L.L.C. v. Alpha Trust,* 2003 WL 241727, at *4, (Del. Ch. Jan. 30, 2003), *aff'd,* 26 A.3d 180 (Del. 2011). "Waiver is the voluntary and intentional relinquishment of a known right." *Realty Growth Investors v. Council of Unit Owners,* 453 A.2d 450, 456 (Del. 1982) (citation omitted).

2. The court below erred in finding these equitable defenses did not bar Plaintiffs' claims

The Court of Chancery decided that the Series A Preferred Stock Offering did not satisfy the "receives and retains the benefit" test for ratification. The Court reasoned that the benefit test was only satisfied if the transaction to be ratified itself conferred the benefit retained. Thus, as it is the issuance of the Series B Preferred Stock that Defendants argued was ratified (not the Series A Preferred Stock), the Court held there was no ratification because "Defendants have not shown that Keyser (or the other Plaintiffs) received a benefit as a result of the Series B Issuance." (Opinion at 44.)

Given the Court's factual findings, that conclusion is not the product of an orderly and logical deductive process. Prior to spending months lining up investors from January to April, 2011 and prior to negotiating with the Three Creditors and Keyser the multiple agreements with them in those same four months, Poliak secured control of Ark for himself and his management team. But for the issuance of the Series B Preferred Stock to Poliak, there would not have been any investor efforts and there would not have been any compromises with the Three Creditors. Instead, Plaintiffs would have thrown Poliak and his team out of Ark. Certainly Curtis would not have invested $250,000 of his own money absent Poliak's control of Ark. (A473.)

The Court of Chancery's interpretation of what "benefit" must be retained to constitute ratification is simply too narrow. Instead, the proper question is would Keyser have received the benefits he kept from the Series A Preferred issuance without Poliak having control of Ark? By accepting those benefits, he necessarily ratified the transaction that directly led to those benefits - the retention of Poliak and his management team through the Series B issuance.

The Court of Chancery's error is also reflected in its discussion of whether Poliak was authorized to approve the Series A Preferred Stock issuance as Ark's President. The Court concluded that as President, Poliak had the authority to issue Ark stock. (Opinion at 46-47.) Of course that is technically wrong, because only a board of directors may issue new stock in a Delaware corporation. But more to the point, the sole reason that Poliak was still the only director of Ark in 2011 was because he had issued the Series B Preferred Stock. Otherwise, Keyser's vote to remove Poliak by the 2010 Consent would have deprived Poliak of any authority to act for Ark.

What Keyser's argument boils down to is the recognition that Poliak had the authority to act in 2011 for Ark because of Poliak's Series B Preferred Stock. That is ratification of what Poliak did to have that Series B Preferred Stock, when Keyser took benefits as a result. What Keyser did is undisputed. So too should the Court hold that Keyser, who owned a majority of disinterested Ark shares at the relevant time, ratified the Series B Preferred Stock issuance.

The Court of Chancery nonetheless held that the doctrine of ratification did not bar Keyser's claim because it "was not inequitable" for Keyser to wait to assert those claims while he was negotiating to sell his stock to Ark. (Opinion at 45-46.) The same "justification" also applied to Salvatore and Schalk, who also waited until after the Series A Preferred Stock was sold to attack the issuance of the Series B Preferred.

The Court of Chancery's rationale is not legally sound. It does not matter that the Plaintiffs hoped to sell their Ark stock. With full knowledge of the facts, they stood by when Ark sold $4,000,000 of Series A Preferred to investors based on management of Ark by the Poliak team because they hoped to get a better price for their stock. What does matter is that they did all the law requires to ratify the basis for the Series A Preferred sale or acquiesce in the issuance of the Series B Preferred Stock. Plaintiffs' motives do not excuse the consequences of their actions - ratification, acquiescence and waiver. To avoid those consequences, they needed to tell Ark's new investors that Poliak had no right to act as the Ark board of directors.[6]

The Court of Chancery's discussion of why the Plaintiffs did not acquiesce in the issuance of the Series B Preferred Stock is also illogical. Again, the Court concluded that Poliak as Ark's President had the authority to issue the new Series A Preferred. (Opinion at 46.) However, what Poliak actually did was act as Ark's sole director to authorize the issuance of the Series A Preferred Stock. Plaintiffs agreed to his doing so and thereby acquiesced in his power derived solely from the Series B Preferred Stock. Otherwise, the 2011 Consent

[6] While seeking a settlement may justify some delays in filing litigation as the Court of Chancery noted (Opinion at 41 n.141), that does not justify delay when a plaintiff is aware that the rights of third parties will be prejudiced by his delay. No Delaware decision has justified delay because of some settlement discussions under those circumstances.

would have removed Poliak. The Court of Chancery also held that Plaintiffs did not acquiesce because "Defendants have failed to show that Poliak's control of Ark was the reason for the success of the Series A offering." (Opinion at 47.) Yet all the evidence is to the contrary.

The Court's conclusion that Plaintiffs did not waive their challenges to the Series B Preferred Stock issuance was based upon language in the Notes Agreement stating so long as Keyser retained ownership of his Ark shares, he did not release any rights or claims. (Opinion at 47.) Under that language, however, Keyser essentially reserved his rights to assert a monetary damages claim based on his Ark stock ownership. He did not reserve his right to seek invalidation of a stock issuance that changed the capital structure of the company at some indefinite time in the future. Salvatore and Kaiser knew Poliak controlled Ark through the Series B Preferred Stock, but rather than challenge that stock, encouraged Poliak to pursue the Series A Preferred Stock Offering and negotiated with Poliak for the sale of their stock. *See supra* Statement of Facts § F. Similarly, Schalk knew Poliak defeated Keyser's attempt to take over Ark and controlled Ark, but failed to voice any objection to this control until October 2011. *See supra id.* Accordingly, the Court erred in finding Plaintiffs had not waived their challenges to the Series B Preferred Stock issuance.

CONCLUSION

Plaintiffs cannot be permitted to stand by while a Delaware corporation issues its stock to new investors who are investing because of current management and then later seek to take control of the corporation based on legal claims Plaintiffs knew of, but did not assert, before the stock was issued. Any other rule harms innocent investors. Plaintiffs' claims were thus barred by their own delay, their ratification of the Series B Preferred Stock, their acquiescence in the Series B Preferred Stock issuance and their waiver of objections to that issuance. The judgment of the Court of Chancery should be reversed.

MORRIS JAMES LLP

/s/ Katherine J. Neikirk
Edward M. McNally (I.D. 614)
Katherine J. Neikirk (I.D. 4129)
500 Delaware Avenue, Suite 1500
P.O. Box 2306
Wilmington, DE 19899
(302) 888-6800
emcnally@morrisjames.com
kneikirk@morrisjames.com
Attorneys for Defendant Below Appellant Albert Poliak

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