IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

Jerald Hammann,

Plaintiff,

v.

CytRx Corporation, a Delaware Corporation, et. al.

Defendant.

C.A. No. 2021-0676-PAF

PLAINTIFF'S REPLY BRIEF IN SUPPORT OF
HIS MOTION FOR A TEMPORARY RESTRAINING ORDER

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Plaintiff

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CASES

Plaintiff Jerald Hammann ("Hammann") herein replies to Defendants CytRx Corporation ("CytRx" or the "Company"), Steven A. Kriegsman ("Kriegsman"), Louis Ignarro ("Ignarro"), Joel K. Caldwell ("Caldwell"), and Earl W. Brien's ("Brien") (collectively, "Defendants") August 9, 2021, Response to his motions for a Temporary Restraining Order and to Expedite proceedings.

PRELIMINARY STATEMENT

[redacted] While the individual Defendants are shareholders, they never actually paid for their own shares. Instead, they simply awarded the shares to themselves as an alleged form of "incentive" compensation. The "shareholders"

[redacted] are of a different kind, those who pay money for their shares.

[redacted] It is the exact conflict the Company has repeatedly faced since 2013. Sometimes the Company's management and directors win a battle in the conflict. Sometimes the shareholders – the ones who actually pay money for their shares – win. But the conflict continues unabated because Defendants continue to repeatedly breach their duty of loyalty to these shareholders.

Because Hammann, a shareholder himself, was intimately aware of this conflict, he added the phrase, "the non-employee, non-Board-member stockholders," to Defendants' proposed language seeking to permit an escape clause from the anti-dilution provisions of the Cooperation Agreement. Now, Defendants come to try convincing the Court that the Cooperation Agreement states something vastly less specific.

OBJECTIONS TO RESPONSE STATEMENT OF FACTS

A. The Parties.

Defendants' false statements and mischaracterizations of fact begin in the first line of their "Statement of Facts." They state as a fact that Hammann is a serial litigant. Response at 7. In their footnote, they list a number of cases, most of which related to Hammann, but one of which does not. They neglect to state that the vast majority of cases cited involve real estate and that the vast majority of these real estate cases involve breaches of contract, often a real estate developer's failure to return earnest monies after it failed to perform under the purchase agreements upon which the earnest monies were deposited.

While they claim Hammann's serial litigacy targets publicly-traded companies (Response at 7), to the best of Hammann's knowledge, only one of the cases Defendants' characterize this way involves a publicly-traded company. While they claim Hammann targets publicly-traded companies based on their stock value, citing Hammann's investor activism website (Response at 7), there is no indication on the website to support this contention and a deep review of the website refutes this contention. As it relates to CytRx, Hammann became an investor advocate because of Defendants' conduct in 2019 which awarded compensation, a revenue skim, and stock options to Kriegsman and the other Directors, which collectively were so lavish that they directly implicated a gross breach of Defendants' fiduciary duties to shareholders. Moreover, as to Defendant CytRx, Hammann has been an

investor in the Company since July 15, 2016, more than five years. His investor advocacy relating to CytRx began almost four years later in 2020. Further, as the website demonstrates, CytRx was the first proxy contest Hammann ever initiated.

[redacted]

B. Hammann initiates a proxy contest against the Company. (No Reply)

C. Hammann and the Company enter into a Cooperation Agreement.

Defendants contend they have "scrupulously honored [CytRx's] obligations" set forth in the Cooperation Agreement. Response at 9. To support this contention, they claim they have honored the Cooperation Agreement in relation to its Paragraph 1(a), titled "Board Matters." Likely not true. The relevant portion of Paragraph 1(a) states:

> As promptly as practicable after the selection of the New Director, but in any event no later than the first anniversary of the 2020 Annual Meeting, the Board and all applicable committees of the Board shall take all necessary actions to increase the size of the Board's membership by one (1) and appoint the New Director as a Class I director of the Company with a term expiring at the 2022 annual meeting of stockholders (the "2022 Annual Meeting"). The Company agrees to nominate the New Director at the 2022 Annual Meeting unless a quorum is not deemed present for the purposes of conducting all the business of the 2022 Annual Meeting.
>
> HammannDecl. Ex. A, ¶1(a).

As of the date of this Reply, while it is unknown whether Defendants have taken "all necessary actions to increase the size of the Board's membership by one (1)," they have not publicly reported doing so. While it is further unknown whether Defendants have "appoint[ed] the New Director as a Class I director of the Company with a term expiring at the 2022 annual meeting of stockholders," they have not publicly reported doing so. Simpson was instead a replacement director to Klein, and is a Class III director with a term expiring at the 2024 annual meeting. See the Company's SEC Form DEF 14A, filed on June 14, 2021, at 6.

Defendants, however, have until September 3, 2021, to comply with Paragraph 1(a) of the Cooperation Agreement. They may therefore still honor this provision of the agreement.

[redacted] Moreover, Simpson has been a member of the Board for a grand total of **12 days** as of the date of this Reply.

Hammann and many of the non-employee, non-Board-member stockholders have been observers of the Company for substantially longer periods of time. Hammann has been reading the Stocktwits message board relating to the Company

since engaging in his 2020 proxy contest with the Company. While Hammann only actively watches message boards where he is engaging in investor advocacy, he has never once observed unanimity in thought on any shareholder voting proposal until the Company's proposal to increase the share count. Not one single shareholder posting on Stocktwits has come out in support of the proposal. Even management's usually-reliable cheerleaders – at least those actively posting – are against it.

D. <u>The Company faces a severe need to obtain financing to avoid designation as a "going concern" by its auditor.</u>

[redacted] See the Company's 2019

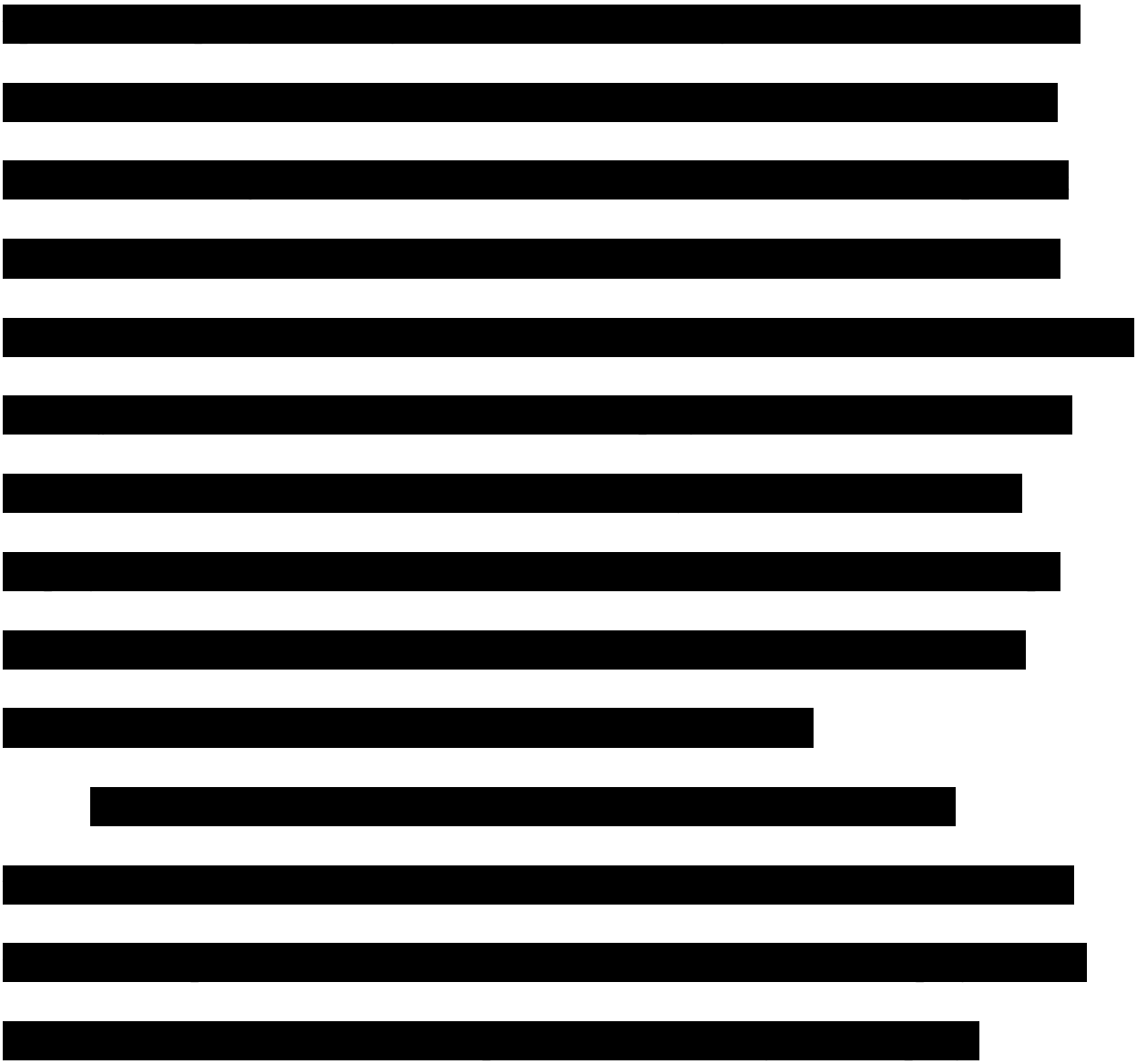
SEC Form 10-K at 48. It did not bother them on December 13, 2019, when the Company extended this minimum $1 million annual obligation to Kriegsman through 2027, inclusive of a 3-year severance provision, when it granted him 3,000,000 immediately-vested stock options, and when it granted him a permanent right to 10% of the milestone and Royalty payments from the Arimoclomol License previously sold on May 13, 2011. See the Company's December 13, 2019 SEC Form 8-K. [redacted]

It also did not bother them on December 13, 2019, when in addition to awarding Kriegsman 3,000,000 options, the Board awarded themselves and a select few others an additional 2,400,000 immediately-vested stock options, thereby depleting all of the remaining available authorized and unissued or unreserved shares. Id. See also the Company's 2020 SEC Form 10-K at 11. [redacted]

[redacted] See also Complaint ¶46 (March 16, 2021, offer to purchase Hammann's shares at a slight premium over the previous closing share price).

E. <u>The Company enters into a securities purchase agreement and files a preliminary proxy statement.</u>

[redacted]



The Response at 14 claims it is "notable" that the Board unanimously supports the proposal. To be clear, during July 2021 while all of this activity was taking place, Defendant Brien had already resigned from the Board and Simpson had not been elected. Therefore, all of these decisions were developed and voted on by Defendants Kriegsman, Ignarro, and Caldwell. Ignarro and Caldwell had control of the Compensation Committee during the entirety of the 2019 actions, acting as accomplices to Kriegsman by creating and enacting plans to strip assets

from the Company and hand them to the Company's executives and Board at the direct expense of the non-employee, non-Board-member stockholders. [redacted] It is primarily the actions of these three Defendants which have placed the Company in its current predicament. Further, as previously stated, Simpson has been a member of the Board for a grand total of **12 days** as of the date of this Reply.

F. Hammann files his Complaint, Motion to Expedite, and Motion for Temporary Restraining Order. (No Reply)

ARGUMENT

I. Hammann Asserts Colorable Claims that Defendants have Breached the Cooperation Agreement and Their Fiduciary Duties.

A. Plaintiff Alleges a Colorable Claim for Breach of the Cooperation Agreement.

Defendants' begin their argument that Hammann cannot present a colorable claim by excising critical language from the Cooperation Agreement. The description in the Response at 16-17 expressly excludes the final terms of the escape clause it introduced into the Cooperation Agreement: "unless the Board determines in good faith, after consulting outside counsel, that the lack of such action would prohibit Board members from complying with their fiduciary duties

as directors of the Company to the non-employee, non-Board-member stockholders." HammannDecl. Ex A ¶3. Defendants are simply trying to pull the wool over the Court's eyes.

The Response at 17 next contends that "the Company has repeatedly disclosed in its public filings with the SEC, CytRx faced a grave risk of being deemed a 'going concern'." The language the Response cites in support of this "disclosure" is the same language the Company has used since at least 2018. This language was in the Company's 10-Q before Defendants increased this disclosed risk by awarding Kriegsman an exorbitant Employment Agreement. See the Company's November 2, 2018 SEC Form 10-Q at 19. It was in the Company's 10-Q before Defendants' dramatically increased this disclosed risk by expropriating from the Company three more years for the Kriegsman Employment Agreement, a 10% skim off the top of the Arimoclomal License for Kriegsman, and 5,400,000 authorized shares for stock options for themselves, including specifically, 700,000 and 450,000 options, respectively, for the persons approving these self-interested decisions, Ignarro and Caldwell. See the Company's November 14, 2019 SEC Form 10-Q at 18.

Hammann does not deny that protecting the going concern value of the Company is important to shareholders. He simply argues that the Company has numerous better options to do so that breaching the Cooperation Agreement and

diluting the existing shareholders by 49.75%. Complaint ¶90. Any reasonable, disinterested person would agree with Hammann. Because Defendants are self-interested in a capacity other than as a shareholder, they refuse to exercise any of these better options. The Response at 17 describes this as "no choice." To the contrary, several choices better than the 49.75% dilution of shareholders are available:

[redacted]

(c) Otherwise significantly reducing its approximately $6 million annual spend would also lengthen the Company's cash runway, removing any going

concern threat. By way of example, see Orphazyme's own signification cost restructuring in response to the Complete Response Letter.[1]

[redacted] This is not a circumstance that fell upon Defendants unawares. They've known for two years that their self-interested 2019 actions had depleted and would continue to deplete the Company's resources.

The Response at 18 and fn.4 claims that Hammann's efforts to protect himself and CytRx's shareholders from imminent harm resulted in the premature filing of his action. Hammann need not remind the Court of its ruling against his TRO Motion in the Adamis Action in part for being too cooperative while the Adamis defendants and their counsel stalled for time. Here too, Defendants were simply stalling for time. They could have approached him as early as March of 2021 if they wished to share information with him. Hammann is, unfortunately, too familiar with CytRx and its counsel's delay tactics. Agreeing to "discuss the matter" would simply be agreeing to waste another week – and jeopardize the viability his TRO Motion. See e.g., Complaint ¶49-¶52 and HammannDecl. Ex. B (wherein Defendants waste 20 days without even agreeing to produce anything and, in fact, questioning Hammann's right to even request information). A Section

[1] https://www.sec.gov/Archives/edgar/data/0001764791/000156459021034679/orph-ex991_6.htm.

220 request would have similarly wasted weeks as evidenced by Defendants' and its counsel's past practices with Hammann of simply refusing to provide certain information pursuant to this statute. Any analysis of the adequacy of the allegations contained in the Complaint must take into consideration the urgency of its required filing and the evidence available to plaintiff prior to filing. Here the filing was urgent and Defendants were intentionally withholding information from Hammann for the purpose of delay and obfuscation. If some deficiency is found by the Court, Hammann must be given the opportunity to cure the deficiency.

The Response at 19 contends that Hammann must prove subjective bad faith to prevail on his claim. Not true, for several reasons. First, starting with the language of ¶3 of the Cooperation Agreement:

> Proposals to Increase the Number of Authorized Shares. From the Effective Date until the Termination Date (as defined below) (the "**Standstill Period**"), the Company shall not take any action in support of or make any proposal to increase the number of the Company's authorized outstanding shares of Common Stock, unless the Board determines in good faith, after consulting outside counsel, that the lack of such action would prohibit Board members from complying with their fiduciary duties as directors of the Company to the non-employee, non-Board-member stockholders.

The language of the Cooperation Agreement provides a contractual obligation more restrictive of the Board's conduct than the Board's common law duties to shareholders, without excluding these common law duties. See e.g., ¶18 (remedies under contract in addition to other remedies at law or equity). It does not deal with the Board's general common law fiduciary duties, but instead with the

fiduciary duties to a specific class of stockholders, the "non-employee, non-Board-member stockholders." Moreover, the escape clause can only be invoked in the most unlikely of circumstances where "the lack of such action would prohibit Board members from complying with their fiduciary duties as directors of the Company to the non-employee, non-Board-member stockholders."

These facts distinguish the present case from *Norton v. K-Sea Transp. Partners L.P.,* 67 A.3d 354, 361 (Del. 2013), which addressed provisions in an agreement which "modified, waived, or limited" common law fiduciary duties. Therefore, the "subjective bad faith" argument fails.

Moreover, subjective bad faith is evident from Defendants' conduct. See e.g., Complaint ¶46-47 (attempt to purchase Hammann's shares), ¶48 (inequitable provisions if shareholders reject the proposal), ¶49-52 (interposing delay in providing information). See also Complaint ¶23-28 (other bad-faith conduct), ¶90-92 (massive dilution attempt despite repeated opposition; misalignment of interests; coercive conduct). These are not the actions of parties engaging in good faith conduct.

Finally, the Response at 19-21 contends that Hammann cannot allege damages. As an initial matter, Defendants have already contractually acknowledged "irreparable injury." The Cooperation Agreement at ¶18 provides:

> "Specific Performance. Each of the Parties acknowledges and agrees that irreparable injury to the other Party would occur in the event any of the provisions of this Agreement are not performed in accordance with their specific terms or are otherwise breached and that such injury would not be adequately compensable by the remedies available at law (including the payment of money damages). It is accordingly agreed that each of the Parties (the "**Moving Party**") shall be entitled to specific enforcement of, and injunctive or other equitable relief as a remedy for any such breach or to prevent any violation or threatened violation of, the terms hereof, and the other Party will not take action, directly or indirectly, in opposition to the Moving Party seeking such relief on the grounds that any other remedy or relief is available at law or in equity. The Parties further agree to waive any requirement for the security or posting of any bond in connection with any such relief. The remedies available pursuant to this Section 0 shall not be deemed to be the exclusive remedies for a breach of this Agreement but shall be in addition to all other remedies available at law or equity."

Moreover, the share price of Hammann's stock has declined since the announcement that Defendants intend to dilute the shareholders by 49.75%. On July 9, 2021, the last trading day before the Securities Purchase Agreement was entered into, the Company's closing stock price was $0.93 per share. On August 9, 2021, the closing share price was $0.73. Therefore, Hammann has also suffered actual monetary damages.

Defendants have therefore failed to show that Hammann lacks a colorable claim for breach of the Cooperation Agreement.

B. Plaintiff Alleges a Colorable Claim for the Breach of the Duty of Loyalty.

In Counts II – IV of the Complaint, Hammann alleges three counts of a breach of the duty of loyalty to shareholders against Kriegsman, Ignarro, Caldwell,

and Brien. Counts II and IV are alleged against Kriegsman, Ignarro, and Caldwell while Count III is alleged against Brien.

Citing ¶8(a) of the Cooperation Agreement, the Response at 22-23 argues that Hammann's breach of duty of loyalty claims "fail as a matter of law." Not true. At most, these claims would be premature until the Standstill Period expires, which would entail a dismissal without prejudice to Hammann's right to raise these claims then. However, Hammann contends that the phrase "lawsuit, claim or proceeding," as used in ¶8(a) is further defined by the phrase immediately thereafter, "before any court or governmental, administrative or regulatory body." In other words, ¶8(a) uses the word "claim" as a synonym for "lawsuit" and "proceeding," tailored to the various names that might be given to the same operative document in the four identified fora: (a) a court; (b) a governmental body; (c) an administrative body; or, (d) a regulatory body.

The Response at 22-23 then cites a host of cases involving covenants not to sue. However, ¶8(a) of the Cooperation is not a universal covenant not to sue. It is instead a time-limited covenant not to sue unless a breach of the Cooperation Agreement occurs, whereupon a Legal Proceeding is permitted, and the covenant is deemed inapplicable insofar as that Legal Proceeding.

Hammann has also included in the Prayer for Relief of his Complaint a request that the Court enjoin Defendants from enforcing ¶8(a) of the Cooperation

Agreement. Piecemeal litigation is normally discouraged by the Courts because of the increase in costs to achieve final resolution without associated benefit. Moreover, the equitable remedies available after the Standstill Agreement expires would very likely be inadequate to cure the damages caused by the breaches of loyalty.

The Response at 23-25 next argues that Hammann's claims are derivative. Not true. Employing the first part of the two-part *Tooley* test, "who suffered the alleged harm," Hammann contends that it is himself and certain stockholders, but not other stockholders. The Cooperation Agreement distinguished the "the non-employee, non-Board-member stockholders" as a specified group. The Complaint alleges one additional sub-set from this "group:" the new shares and voting rights provided pursuant to the Stock Purchase Agreement. See e.g., Complaint ¶57-59 (describing voting blocks), ¶30-37 (describing various genres of stockholders). As evident, the Complaint distinguishes between those stockholders whose interest in the Authorized Share Increase Proposal is solely as a stockholder and those stockholders whose interest in the Authorized Share Increase Proposal is greater than solely as a stockholder, either because they are being paid by the Company in some way or intend to vote for a benefit they exclusively negotiated for themselves to the intended detriment of the other stockholders. Therefore, the alleged harm will be suffered by a preponderance of stockholders, including Hammann, but not all stockholders. Further, Count II makes clear that it is addressed to an exclusive

right vested in shareholders by 8 Del. C. ¶242 to increase the Company's authorized capital stock.

Moving next to the second part of the two-part *Tooley* test, "who would receive the benefit," Hammann contends again that it is himself and certain stockholders, but not other stockholders. It is also certainly not the Company.

Based on the allegations contained in the Complaint, there can be no doubt that Hammann's claims are not derivative.

The Response then goes into arguments regarding demand (at 25), demand futility (at 25-26), self-interest (at 27-28), and reason to doubt (at 28-29). While none of these arguments are relevant because Hammann's claims are not derivative, they nonetheless wholly ignore the allegations contained in the Complaint. Demand is demonstrated by Complaint ¶49-52 (wherein Defendants wasted 20 days while continuing to intimate Hammann had no right to demand anything). Demand futility is demonstrated by same and also by Complaint ¶46-47 (wherein Defendants attempted to purchase Hammann's shares, potentially to reduce his standing to bring these claims). Self-interest is demonstrated by the entire complaint, including Complaint ¶22-29, 35, 37-38, 47, 57, and 90-91. Reason to doubt is demonstrated by same.

Finally moving back to arguments related to his direct claims, the Response at 30 claims that Counts II-IV are not colorable "because they fail to allege that the

Director Defendants engaged in self-dealing." Self-dealing is demonstrated by the entire complaint, including Complaint ¶22-29, 35, 37-38, 47, 57, and 90-91.

Moreover, self-dealing is only one type of breach of the duty of loyalty. Directors can breach their duty of loyalty to shareholders in other ways, like, as alleged in the complaint, interfering with the shareholders' exclusive and unfettered right to "increase . . . its authorized capital stock." 8 Del. C. ¶242(a)(3), (b)(2). As demonstrated by the allegations contained within the complaint, this shareholder right is of critical importance to the ability of shareholders to exercise control over the Company. See e.g., Complaint ¶22-29, 35, 37-38, 57, and 90-91.

Defendants have therefore failed to show that Hammann lacks a colorable claim for breaches of their duty of loyalty.

II. Defendants' Conduct Will Irreparably Harm Hammann.

The Response at 31-34 claims Defendants" conduct will not irreparably harm Hammann absent injunctive relief. However, pursuant to ¶18 of the Cooperation Agreement, Defendants already:

> "18. . . . agreed that each of the Parties (the "Moving Party") shall be entitled to specific enforcement of, and injunctive or other equitable relief as a remedy for any such breach or to prevent any violation or threatened violation of, the terms hereof, and the other Party will not take action, directly or indirectly, in opposition to the Moving Party seeking such relief on the grounds that any other remedy or relief is available at law or in equity. . . ."
> HammannDecl. Ex. A.

Defendants now breach this provision too. Response at 31-32.

Additionally, the Response at 32-33 cites numerous cases finding that shareholder dilution, by itself, does not represent adequate grounds for irreparable harm. The present case is distinguished based on the facts from these cases because the dilution in on a substantially more massive scale (49.75%) and Hammann specifically alleges its material impact on the voting rights of specific stockholders, the ones most opposed to the Board, having observed its past conduct. Complaint ¶22-29, 34-38 (dilution of targeted shareholders from 53.6% to 31.1%), 57, and 90-91.

Therefore, irreparable harm exists both to CytRx's shareholders and to Hammann.

III. The Balance of Hardships Favors Hammann and Shareholders.

The Response at 35 contends that Hammann's request for a TRO will actually deny the Company's then-existing stockholders . . . the right to vote on these proposals." There are two problems with this argument. First, Defendants are not actually offering the shareholders the unfettered and uncoerced right to vote, only a coerced and punitive right. The outcome of the vote might therefore say nothing at all about whether shareholders want to further dilute their rights out of existence so management and the Board can continue to reward themselves lavishly or protect the lavish awards they have already given themselves.

[redacted] Defendants

also gave Armistice the rights to vote 5,109,553 shares, even though they do not own that many shares and all of these shares are subject to the Stock Purchase Agreement. Combine all of these shares with the broker discretionary shares that normally vote for management proposals, and the Defendants already have approximately 18.2 million shares in their favor, comprised of approximately 8.7 million highly-interested shares and approximately 9.5 million too-demoralized-to-vote shares that may instead be voted by brokers in favor of the Authorized Share Increase Proposal. See Complaint ¶57-62. The shareholders who have been fighting against the Defendants' unrelentingly self-interested behavior since 2017 (and, in fact, since 2013, including the Company's spring-loaded options and unlawful stock promotion cases) are very likely to lose, and it will likely be their final battle against the Board as the Board will have finally diluted these shareholders out of relevance.

Finally, the Response at 35 alleges that none of the Company's existing stockholders have sought to stop the proposals from going to a vote. However, Hammann's Cooperation Agreement with the Company is widely known – perhaps even universally known – among the larger retail stockholders. [redacted]

[redacted] Absent the Cooperation Agreement, both because it places Hammann in the best position to address the wrong and because it prevents Hammann from helping others address the wrong, it is quite possible, Hammann contends even likely, that another action would have been filed or, in the alternate, that a proxy contest would be initiated.[2] There are so many aspects to undertaking either of these two actions which make them difficult and overwhelming for a retail shareholder to undertake without sound guidance.

IV. CONCLUSION

Plaintiff's motion for a TRO to prevent Defendants from holding the Special Meeting until the dispute between the parties is resolved should be granted. Additionally, the TRO should prevent CytRx from enforcing and excuse Hammann from any breach of Cooperation Agreement ¶9(a)(xiii) (proposals to amend or

[2] As a counter to this prospective effort, however, the Stock Purchase Agreement requires the Company to run new proxy votes on the Authorized Share Increase Proposal every 90 days. While the retail shareholders would likely win the first shareholder vote by removing the too-demoralized-to-vote shares from the Company's "win" column (because these shares are not permitted to be voted by brokers in a "contested" vote), ultimately the retail shareholders will run out of money. Further, with each passing vote, more shareholders will become demoralized, convincing some to vote in favor of the Authorized Share Increase Proposal simply to stop the self-harm.

waive the Standstill provisions), ¶9(a)(vi) (public comments on the Company's business affairs), ¶7(a) (communication of derogatory information), and ¶4(a) (required sale of shares by August 31, 2021).

Finally, Plaintiff's Motion to Expedite Proceedings should be similarly granted.

Dated: August 10, 2021

Signed: _/s/ Jerald Hammann_____

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