IN THE SUPERIOR COURT OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

AFH HOLDING ADVISORY, LLC, GRIFFIN VENTURES, LTD., and THE AMIR & KATHY HESMATPOUR FAMILY FOUNDATION,	)	
Plaintiffs, Counterclaim Defendants,	)	
v.	)	C.A. No. N12C-09-045 MMJ CCLD
EMMAUS LIFE SCIENCES, INC., a Delaware corporation,	)	
Defendant, Counterclaim and Third-party Plaintiff,	)	
v.	)	
AMIR HESHMATPOUR,	)	
Third-Party Defendant.	)	

Submitted: April 18, 2013
Decided: May 15, 2013

On Defendant and Counterclaim/Third Party Claim Plaintiff
Emmaus Life Science, Inc.'s Motion for Partial Summary Judgment
GRANTED

On Plaintiffs' and Third-Party Defendant Amir Heshmatpour's
Motion for Summary Judgment
GRANTED IN PART, DENIED IN PART

MEMORANDUM OPINION

Daniel Y. Zohar, Esquire (Argued), Zohar Law Firm, P.C., Chad M. Shandler, Esquire (Argued), Brock E. Czeschin, Esquire, Nicole C. Bright, Esquire, Jason J. Rawnsley, Esquire, Richards, Layton & Finger, P.A., Attorneys for Defendant, Counterclaim and Third-party Plaintiff

Sean J. Bellew, Esquire, David A. Felice, Esquire (Argued), Ballard Spahr LLP, Attorneys for Third-party Defendant

Johnna M. Darby, Esquire, Darby Brown-Edwards LLC, Anthony Galano, III, Esquire, Jordan Wolff, Esquire (Argued), Ellenoff Grossman & Schole LLP, Attorneys for Plaintiffs and Counterclaim Defendants

JOHNSTON, J.[1]

[1]Designated pursuant to Del. Const. art. IV, §13(2) to sit on the Court of Chancery for the purpose of hearing and determining all issues in this case.

INTRODUCTION

This litigation arises from a contract dispute. Plaintiffs AFH Holding & Advisory, LLC (AFH), Griffin Ventures, LTD. (Griffin), and The Amir & Kathy Heshmatpour Family Foundation (Foundation) (collectively Plaintiffs) filed suit against Defendant Emmaus Life Sciences, Inc. (Emmaus). The Complaint seeks damages for breach of contract, declaratory relief preventing the cancellation of certain shares of Emmaus stock, and alternative relief in the form of *quantum meruit.* Emmaus filed an Answer and asserted counterclaims against Plaintiffs, and third-party claims against Amir Heshmatpour (Heshmatpour). Emmaus is requesting declaratory relief affirming its cancellation of Plaintiffs' shares and its termination of Letter of Intent III (LOI III); an order compelling Plaintiffs to physically return all shares certificates; compensatory and punitive damages; plus costs and attorneys' fees.

Emmaus filed a Motion for Partial Summary Judgment. Emmaus's motion requests that the Court should rule as a matter of law that Emmaus: properly terminated the offering that was the subject of LOI III; properly canceled shares of Emmaus stock issued as compensation; and properly terminated LOI III. Emmaus further requests that the Court order Plaintiffs to return the shares to Emmaus.

Finally, Emmaus asserts that the Court should grant summary judgment in favor of Emmaus on all of Plaintiffs' claims.

Heshmatpour filed a Motion for Summary Judgment, which was joined by Plaintiffs. Plaintiffs' and Heshmatpour's motion argues that the fraud and fraud in the inducement claims alleged by Emmaus should be dismissed.

FACTUAL AND PROCEDURAL CONTEXT

For the purposes of these motions, the following facts are undisputed. To the extent that some facts asserted by the parties are disputed, these facts either were not material[2] or not relevant for purposes of the Court's rulings.

AFH is a Delaware limited liability company engaged in the business of providing financial advisory services. Griffin is a Nevada corporation. The Foundation is a Delaware non-profit corporation. Heshmatpour is AFH's managing director, and also owns and operates Griffin.

Emmaus, formerly known as Emmaus Medical, Inc., is a Delaware corporation that conducts research and development of treatments for rare diseases. In January 2010, Emmaus received FDA approval to begin a clinical trial of an experimental treatment for sickle cell disease. Emmaus began exploring options for raising the funds necessary to bring the sickle cell treatment to market.

[2]*See* Super. Ct. Civ. R. 56(c).

In August or September of 2010, Dr. Yukata Niihara, Emmaus' CEO and founder, met with Heshmatpour to discuss raising capital for Emmaus. AFH and Heshmatpour informed Emmaus that they had experience and past success in completing reverse mergers and in raising capital through the IPO process. Plaintiffs and Heshmatpour do not dispute that these representations were made. Each party conducted due diligence. Emmaus performed a background check on Heshmatpour, which was completed by Katz Investigations in 2010.

Emmaus and AFH entered into a business relationship, memorialized by a series of letters of intent. Each letter of intent included a clause providing that it superseded all prior letters of intent between AFH and Emmaus. The initial letter of intent (LOI I) was executed November 10, 2010. LOI I contemplated a reverse merger between a shell corporation owned by AFH ("AFH Shell") [3] and Emmaus. LOI I required AFH to use its best efforts to assist Emmaus in raising capital. AFH and Emmaus entered into the second letter of intent (LOI II) on April 21, 2011. LOI II increased the amount of funds AFH was required to raise from $10-$20 million to $25-$50 million. The transaction contemplated in the Merger Agreement (also dated April 21, 2011) was completed on May 3, 2011.

[3] The shell corporation is registered with the Securities and Exchange Commission as AFH Acquisition IV.

The third letter of intent (LOI III) is the focus of this litigation. Following the May 3, 2011 closing of the merger, AFH agreed to assist Emmaus in conducting a sale of "Offering Shares." The "Offering" was defined in LOI III as "resulting in gross proceeds in the amount of between $25 million and $50 million."

LOI III delineated each party's contractual responsibilities and, in particular, the nature of the consideration to be afforded AFH in exchange for obtaining funding. The stockholders of AFH Shell, Heshmatpour and his relatives, assignees, and affiliates (the "AFH Group") were to receive varying levels of monetary compensation and shares of Emmaus stock (the "Advisor Shares"), depending upon the degree of success in raising funds for Emmaus. LOI III conferred on Emmaus the right to terminate the Offering, at Emmaus's "sole and absolute discretion," if "the Offering cannot be consummated to provide for minimum gross proceeds to [Emmaus] of at least $5 million."

Further, if the $5 million threshold is not met, and Emmaus exercises its right to terminate the Offering, "then all Advisor Shares shall be canceled." In this circumstance, the parties agreed "to equitably allocate the risk of the inability to consummate the Offering" through Emmaus paying AFH 50% of certain defined costs and expenses. Finally, LOI III may be terminated upon "written election of

[Emmaus] if AFH [] does not deliver firm underwriting commitments for at least $10 million Offering on or prior to the date provided for in the 'Offering' section."

The parties disagree respecting the extent of Emmaus's right to cancel Offering and the Advisor Shares, to terminate LOI III, and whether AFH successfully obtained certain levels of funding pursuant to LOI III. Portions of the Merger Agreement, particularly the warranties agreed to by the parties, also are contested.

After the merger closed, Mark Diamond, the lead investment banker at Sunrise Bank and Aegis Bank, was approached for the purpose of obtaining "firm underwriting commitments" for Emmaus stock. Diamond testified under oath that neither bank made any firm underwriting commitment to Emmaus. The due diligence caused Diamond concern about Heshmatpour's character and representations to Emmaus, specifically: Heshmatpour did not graduate from Penn State University; Heshmatpour was a party in litigation involving allegations of a $10 million check-kiting scheme; other civil litigation; Heshmatpour's arrest record; tax liens and judgments against Heshmatpour; and a bankruptcy filing. As a result of these findings, as well as Diamond's stated personal observations of apparent misrepresentations by Heshmatpour, Diamond and his associates determined that they would not proceed with financing commitments "as long as [Heshmatpour] is a significant shareholder."

After being notified of Aegis' position on the public offering, Emmaus sent a letter to AFH and Heshmatpour dated July 19, 2012. Emmaus declared that pursuant to LOI III, it was exercising its right to terminate the Offering, stating: "In short, [Hesmatpour's] representations about his education, the facts concerning his prior business dealings including numerous lawsuits against him for fraud and check kiting, and his conduct in connection with the private placement for AFH Acquisition IV immediately prior to its merger with [Emmaus] has caused [Emmaus] to conclude that the Offering cannot move forward successfully and must be deemed terminated. As a consequence of the election to terminate the Offering, [Emmaus] has canceled all Advisor Shares....The Private Financing Shares are not included in this action." The letter further informed AFH and Heshmatpour that Emmaus would seek return of all consideration paid pursuant to LOI III, in addition to damages.

AFH contends that it assisted Emmaus in consummating a variety of private and public financings, each of which would qualify as part of the Offering defined in LOI III. AFH asserts that the total amount of these financings "far exceeds the $10 million dollar benchmark for the Offering," the minimum requirement for Plaintiffs to maintain a 10% ownership interest in Emmaus. Additionally, AFH argues that it "also assisted Emmaus in obtaining firm commitments from investment banks to work towards taking Emmaus public through an IPO." AFH cites an executed

engagement letters that provided "for a firm commitment from Sunrise to complete a placement of $24 million worth of shares in Emmaus [and] a firm commitment from Aegis to complete a placement of $40 million."

AFH also argues that "the information that Emmaus claims to have uncovered, specifically Heshmatpour's prior litigation,...had already been fullly disclosed to Emmaus over a year and a half prior to [June 21, 2012] via the background check that was commissioned by Katz Investigations." AFH maintains that Emmaus's real motivation was to "cut Plaintiffs out of the deal because of 'ratchet' provisions in [LOI III] that would increase the value of the Plaintiffs' ownership interest upon the completion of a public offering."

Plaintiffs filed this action against Emmaus on September 7, 2012. Plaintiffs request: a declaratory judgment that Emmaus may not cancel Plaintiffs' shares (Count I); damages for breach of contract (Count II); damages for breach of contract with Griffin as third-party beneficiary (Count III); damages for breach of contract with the Foundation as third-party beneficiary (Count IV); and *quantum meruit* compensation (Count V).

On October 12, 2012, Emmaus filed an Answer to Plaintiffs' Complaint and asserted counterclaims and third-party claims. Emmaus requests: a declaratory judgment that its cancellation of Plaintiffs' shares was proper, and an order

compelling Plaintiffs to return the share certificates (Count I); damages for Breach of Contract (Count II); a declaratory judgment that LOI III is void, rescissory damages and punitive damages for fraud in the inducement, against Plaintiffs and Heshmatpour (Count III); compensatory and punitive damages for fraud, against Plaintiffs and Heshmatpour (Count IV); and restitution for unjust enrichment (Count V).

On March 13, 2013, Emmaus filed a Motion for Partial Summary Judgment. Emmaus requests that the Court hold as a matter of law that:

(1) the Offering has been terminated;

(2) the Advisor Shares have been properly canceled;

(3) LOI III has been properly terminated by Emmaus; and

(4) Plaintiffs must return all Advisor Shares certificates.

On the same day, Heshmatpour filed a Motion for Summary Judgment. Plaintiffs joined in Heshmatpour's motion. Plaintiffs and Hesmatpour request that the Court dismiss Emmaus's fraud and fraud in the inducement claims, on the grounds that:

(1) Emmaus has failed to demonstrate that the corporate veil should be pierced;

(2) Emmaus has failed to demonstrate justifiable reliance;

(3) the alleged fraudulent representations were known to Emmaus, or were mere "puffery" or promises of future performance; and

(4) the claims are barred by the Merger Agreement's one-year survival provision.

Following briefing, the Court heard oral argument on the pending motions on April 18, 2013. Trial is scheduled to begin on May 30, 2013.

STANDARD OF REVIEW

Summary judgment is granted only if the moving party establishes that there are no genuine issues of material fact in dispute and judgment may be granted as a matter of law.[4] All facts are viewed in a light most favorable to the non-moving party.[5] Summary judgment may not be granted if the record indicates that a material fact is in dispute, or if there is a need to clarify the application of law to the specific circumstances.[6] When the facts permit a reasonable person to draw only one inference, the question becomes one for decision as a matter of law.[7] If the non-moving party bears the burden of proof at trial, yet "fails to make a showing sufficient

[4] Super. Ct. Civ. R. 56(c).

[5] *Hammond v. Colt Indus. Operating Corp.*, 565 A.2d 558, 560 (Del. Super. 1989).

[6] Super. Ct. Civ. R. 56(c).

[7] *Wootten v. Kiger*, 226 A.2d 238, 239 (Del. 1967).

to establish the existence of an element essential to that party's case," then summary judgment may be granted against that party.[8]

ANALYSIS

BREACH OF CONTRACT CLAIMS

Principles of Contract Construction

Where the language of a contract is clear and unambiguous, the Court must construe the contract terms by their ordinary and usual meaning.[9] "Contract terms themselves will be controlling when they establish the parties' common meaning so that a reasonable person in the position of either party would have no expectations inconsistent with the contract language."[10] Upon a finding that the contract clearly and unambiguously reflects the parties' intent, the Court must refrain from destroying

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[8] *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986).

[9] *GMG Capital Invs., LLC v. Athenian Venture Partners I, L.P.,* 36 A.3d 776, 780 (Del. 2012) (citing *Paul v. Deloitte & Touche, LLP*, 974 A.2d 140, 145 (Del. 2009)). *See also Rhone-Poulenc Basic Chems. Co v. American Motorists Ins. Co*., 616 A.2d 1192, 1196 (Del. 1992) ("Ambiguity does not exist where the court can determine the meaning of a contract 'without any other guide than a knowledge of the simple facts on which, from the nature of the language in general, its meaning depends.'").

[10] *GMG Capital Invs*, 36 A.3d at 780 (citing *Eagle Indus., Inc. v. DeVilbiss Health Care, Inc.*, 702 A.2d 1228, 1232 (Del. 1997)).

or twisting the contract's language, and confine its interpretation to the contract's "four corners."[11]

A contract is not rendered ambiguous merely because the parties dispute the meaning of its terms.[12] "Rather, a contract is ambiguous only when the provisions in controversy are reasonably or fairly susceptible of different interpretations or may have two or more different meanings."[13] "[W]here reasonable minds could differ as to the contract's meaning, a factual dispute results and the fact-finder must consider admissible extrinsic evidence."[14]

Termination of the Offering

LOI III provides, in relevant part:

> Offering: Following the Closing, AFH Advisory shall assist [Emmaus] in conducting a sale of the Offering Shares, through either a private or public financing, resulting in gross proceeds in the amount of between $25 million and $50 million, at a minimum estimated pre-money valuation of $90 million and a maximum estimated pre-money valuation of $155 million, to be mutually agreed upon (the "Offering Price") and other terms and conditions to be based upon market conditions (the "Offering"). Sunrise Securities is expected to act as underwriter for the

[11] *Doe v. Cedars Academy, LLC*, 2010 WL 5825343, at *5 (Del. Super.); *O'Brien v. Progressive Northern Ins. Co.*, 785 A.2d 281, 288-89 (Del. 2001).

[12] *GMG Capital Invs*, 36 A.3d at 780 (citing *Rhone-Poulenc*, 616 A.2d at 1195).

[13] *Rhone-Poulenc*, 616 A.2d at 1196.

[14] *GMG Capital Invs*, 36 A.3d at 776.

> Offering. [Emmaus] also agrees to a 20% over allotment at AFH Advisory and/or the underwriter's discretion.
>
> * * *
>
> If the Offering cannot be consummated to provide for minimum gross proceeds to [Emmaus] of at least $5 million, [Emmaus] shall have the right to terminate the Offering at its sole and absolute discretion.

Emmaus contends that the Offering was properly terminated pursuant to the plain language of LOI III. Emmaus notes that LOI III grants it absolute authority to terminate the Offering should an IPO, resulting in at least $5 million of gross proceeds, not go forward. Emmaus argues that an Offering has not been consummated, and will never take place so long as Hesmatpour is associated with Emmaus. Investment banker Mark Diamond, on behalf of underwriter Aegis, testified during deposition that Aegis would not go forward with the Offering due to the results of the background check conducted on Hesmatpour.

AFH argues that it "assisted Emmaus in raising approximately $10,159,628 in worth of private financing through an assortment of loans. These loans were comprised of no less than $5,210,169 of notes that are convertible into shares of Emmaus...and $4,949,459 worth of non-convertible loans....In March 2011, Emmaus raised approximately $1.2 million dollars through a private rights offering....Also, on September 21, 2011, Emmaus raised $841,728 from Equities First Holdings, LLC, pursuant to a promissory note that was secured by shares of stock that Emmaus

owned in CellSeed, Inc....Therefore, AFH has assisted Emmaus in raising approximately $12,201,356 worth of private financing, all of which is included in the Offering."

AFH further claims that all investments that were made in Emmaus following AFH's engagement were received by virtue of AFH's assistance, as it was the holder of "the exclusive right[] to act as advisor to [Emmaus] on all financings and mergers and acquisitions for a period of 2 years from November 10, 2010." Finally, AFH asserts that it assisted Emmaus in securing public financing. AFH contends that it is entitled to credit for engagement of Sunrise to complete a placement of $25 million worth of shares in Emmaus, and engagement of Aegis to complete a placement of $40 million worth of shares.

It is undisputed that Dr. Niihara, his friends and family in Japan, and the friends and family of Emmaus officers, invested in Emmaus by means of loans (some convertible to Emmaus shares). During his deposition, Hesmatpour conceded that only one investor – EFH (which provided a loan of just under $1 million, secured by Emmaus stock in another company) – was brought in by AFH or Heshmatpour. Heshmatpour further testified that no other investor had a relationship with AFH or himself prior to investing in Emmaus.

LOI III clearly requires AFH to "assist" Emmaus in selling Offering Shares by obtaining financing resulting in minimum gross proceeds of $5 million. AFH is not contractually entitled to credit for all investments made in Emmaus following the execution of LOI III. It would be patently unreasonable, and contrary to the unambiguous terms of LOI III, for AFH to be credited with ***all*** financing, whether or not funds were obtained through the assistance of AFH.

The record evidence demonstrates that AFH failed to assist Emmaus in securing a sale of Offering Shares, resulting in minimum gross proceeds to Emmaus of at least $5 million. It is undisputed that no Offering has taken place, and that financing is not in place to enable an Offering in the near future. Under the clear and unambiguous terms of LOI III, because the Offering could not be consummated as contemplated, the Court finds that Emmaus properly exercised its sole and absolute discretionary right to terminate the Offering.

Cancellation of Advisor Shares

LOI III provides in the section entitled "Business Combination and Consideration":

> Upon consummation (the "Closing") of the Merger . . . the stockholders of AFH Acquisition IV immediately prior to the Merger, [Hesmatpour] and his relatives, assignees, and affiliates ("AFH Group") own Ten Percent (10%) of the issued and outstanding common shares of [Emmaus] (the "Advisor Shares") . . ..

> The Advisor Shares held by the AFH Group shall be decreased, at the rate of 1% of post-Offering outstanding common shares, for each $1 million or fraction thereof that the gross proceeds to [Emmaus] from the Offering are less than $10 million. In the event of such reduction, AFH Advisory agrees to reduce the number of Advisor Shares by appropriate percentage. If the Offering cannot be consummated to provide for minimum gross proceeds to [Emmaus] of at least $5 million, and [Emmaus] exercises its right to terminate the Offering, then all Advisor Shares shall be canceled.

Emmaus contends that the Advisor Shares were canceled upon termination of the Offering. Emmaus further asserts that AFH is entitled at most to 50% of the Shell Cost and Transaction Expenses, as defined in LOI III:

> If the Offering cannot be consummated to provide for minimum gross proceeds to [Emmaus] of at least $5 million, and [Emmaus] exercises its right to terminate the Offering, then, to equitably allocate the risk of the inability to consummate the Offering, [Emmaus] will pay to AFH Advisory (I) fifty percent (50%) of the Shell Cost and (ii) fifty percent (50%) of the Transaction Expenses actually incurred to the date [Emmaus] exercises its right to terminate the Offering. AFH Advisory, in its discretion, has the option to be reimbursed by [Emmaus] in cash or to convert such amounts (or any portion thereof) into common stock at a conversion price equal to 75% of the per share price of the shares of common stock sold in [Emmaus's] most recently completed private offering of common stock.

Emmaus claims entitlement to return of the Advisor Shares under the terms of LOI III. Additionally, Emmaus argues that permitting AFH to retain 10% ownership interest in Emmaus, without a successful Offering, would be "an absurd result…that no reasonable person would have accepted when entering the contract."

AFH responds that LOI III only gives Emmaus a very limited right to cancel the Advisor Shares. AFH contends that LOI III must be interpreted to mean that once AFH has assisted Emmaus in raising $5 million in gross proceeds from the Offering, Emmaus does not have the right to cancel Plaintiffs' entire interest in Emmaus, because AFH is entitled to at least a 5% ownership interest. Additionally, according to AFH, once it has assisted Emmaus in raising $10 million in gross proceeds from the Offering, Emmaus has no right to cancel any of Plaintiffs' Advisor Shares.

The Court finds AFH's contentions unreasonable and contrary to the plain terms of LOI III. The language relied upon by AFH specifically refers to "post-Offering outstanding common shares" and "gross proceeds…from the Offering." As the Court previously has found, there was no completed Offering. Further, once Emmaus properly exercised its right to terminate the Offering, "then all Advisory Shares shall be cancelled," as clearly set forth in LOI III.

Termination of LOI III

Emmaus argues, that LOI III was terminated properly, pursuant to the plain meaning of LOI III:

> Termination: After the execution of this LOI by the parties, this LOI may be terminated upon: (I) mutual written agreement of AFH Advisory and [Emmaus], (ii) written election of either party if that party or its counsel identifies any information, item or other matter in the course of its due diligence investigation of the other party that it deems

> unsatisfactory, provided that such other party shall be entitled to cure any such item or other matter if such item or other matter is capable of being cured within 30 days after written notice of such item or other matter from the terminating party, (iii) written election of AFH Advisory or the Company if the parties are unable to agree to a valuation, as set forth by an investment bank mutually agreed to by AFH Advisory and [Emmaus] and retained by [Emmaus] (the "Investment Bank") within 45 days following completion of satisfactory Due Diligence by the Investment Bank, (iv) written election of the Company if AFH Advisory does not deliver firm underwriting commitments for at least $10 million Offering on or prior to the date provided for in the "Offering" section, or (v) upon written election of either party upon material breach of any material binding terms or conditions of this LOI and failure to cure such breach within 30 days of receipt of written notice by the terminating party.

This subsection permits Emmaus to terminate LOI III through written notice to AFH in the event that $10 million of firm underwriting commitments have not been obtained with the assistance of AFH. According to Emmaus, AFH has failed to obtain any firm underwriting commitments. Emmaus propounded the following interrogatory directed to AFH: "If you contend that AFH Holding & Advisory delivered firm underwriting commitments for at least a $5 million offering for Emmaus, please describe all facts supporting your contention." In response, AFH identified three documents: two letters of intent - executed by Sunrise Securities Corp. and Aegis Capital Corp.; and an oral commitment, as reflected in a power point presentation by Wedbush Securities, Inc.

Emmaus maintains that a firm underwriting commitment is a specific financial agreement, the details of which can be discerned through reference to accepted industry standards, the depositions of Diamond, Madden, and Hesmatpour, and case law. Emmaus argues that the documents referenced by AFH do not constitute firm underwriting commitments, and that no firm underwriting commitments were obtained. Pursuant to the terms of LOI III, Emmaus concludes that AFH has failed to deliver or to assist in obtaining any firm underwriting commitments, and that LOI III has been properly terminated. Emmaus also asserts that the vagueness of the timeframe within which AFH was to obtain the firm underwriting commitments is not relevant, because AFH would have been unable to obtain firm underwriting commitments at any time in the future due to Heshmatpour's past conduct.

AFH disagrees with the definition of firm underwriting commitments proposed by Emmaus. AFH urges the Court to consider the definition proffered by Hesmatpour in his deposition, and by AFH in response to interrogatories - that AFH had obtained "firm commitments" from Sunrise, Aegis and Wedbush, even though "the receipt of the funding was only to be completed after the approval of Emmaus' SI statement by the SEC, satisfactory due diligence, and a successful road show." AFH argues that the engagement letters of Aegis and Sunrise should count towards the $10 million threshold articulated in LOI III. If the Court were to accept AFH's definition, AFH

argues that its efforts would have resulted in firm underwriting commitments in significant excess of the threshold. In addition, AFH asserts that it is entitled to additional time to meet the benchmarks, because LOI III contains no date limiting when performance must be achieved.

AFH further argues that any delay in taking the Offering public can be attributed solely to Emmaus. In particular, AFH states that Emmaus had difficulty in completing an Offering because Emmaus's CEO, Dr. Niihara, was unable to properly manage Emmaus, and because Emmaus failed to meet milestones and objectives, failed to appoint a different CFO, and had problems with the sickle cell treatment during the final stages of testing. Therefore, AFH concludes that Emmaus's activity in failing to correct these issues denied AFH the opportunity to perform under the contract.

Emmaus provided written notice of its intent to terminate LIO III on July 19, 2012, which states in part:

> The reasons for the termination are known to you and were set out in our counsel's prior letter to you of June 21, 2012. In short, Amir F. Heshmatpour's representations about his education, the facts concerning his prior business dealings including numerous lawsuits against him for fraud and check kiting, and his conduct in connection with the private placement for AFH Acquisition IV immediately prior to its merger with [Emmaus] has caused [Emmaus] to

> conclude that the Offering cannot move forward successfully and must be deemed terminated.

The referenced June 21, 2012 letter states in part:

> Aegis Capital and Mark Dimond [sic] (the underwriter you identified for [Emmaus]) have now confirmed to [Emmaus] that Aegis cannot take the steps necessary to complete the IPO so long as you are associated with [Emmaus] in any way, even as a shareholder. [Emmaus] still desires to complete the anticipated IPO, and if it cannot do so because your continued connection with [Emmaus] blocks the path, then [Emmaus] will take the legal steps necessary to rescind the LOI and seek a return of all stock paid thereunder and all funds paid, in addition to seeking damages for your looting of the proceeds from the private placement as well as damages suffered by [Emmaus] as a result of its inability to complete the IPO due to your wrongful acts.

"Firm commitment underwriting" is a term of art that describes a specific financial arrangement. Pursuant to Section 270.10f-3 of Title 17 of the Code of Federal Regulations, "Firm Commitment Underwriting" is defined as: "The securities are offered pursuant to an underwriting or similar agreement under which the underwriters are committed to purchase all of the securities being offered, except those purchased by others pursuant to a rights offering, if the underwriters purchase any of the securities."

A firm commitment underwriting guarantees funding of a certain amount by assuring the purchase of shares of stock at a public offering.[15] An investment banking firm commits to buy and sell an entire issue of stock and assumes all financial responsibility for any unsold shares.[16]

AFH lists the following as amounts raised by Emmaus through the assistance of AFH:

> $1.2 million raised through a private rights offering in March 2010;
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> $5,210,169 raised through loans convertible into shares of Emmaus, beginning in November 2010;
>
> $4,949,459 raised through loans not convertible into shares of Emmaus, beginning in November 2010;
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> $841,728 from Equities First Holdings, LLC, pursuant to a promissory note secured by shares of CellSeed, Inc., that were owned by Emmaus;

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[15] *See SEC v. Coven,* 581 F.2d 1020, 1022 n.2 (2d Cir. 1978) ("In a 'best efforts' underwriting, the underwriter undertakes to sell the offering to the public but assumes no responsibility for any shares not sold. Such an arrangement may be contrasted to a 'firm commitment' underwriting, in which the underwriter assumes the risk of loss on the unsold portion of the distribution.").

[16] *See Collins v. Signetics Corp.,* 605 F.2d 110, 113 (3d Cir. 1979); *Equity-Linked Investors, L.P. v. Adams,* 705 A.2d 1040, 1044-45 (Del. Ch. 1997); *Norman v. Paco Pharmaceutical Services, Inc.,* 1992 WL 301362, at *1 (Del. Ch.).

Engagement letter dated December 17, 2010 executed by Emmaus and Sunrise Securities Corporation to complete a placement of $25 million in Emmaus shares; and

(6) Engagement letter dated February 3, 2012 executed by Emmaus and Aegis Capital Corporation to complete a placement of $40 million in Emmaus shares.

The Sunrise document titled "Engagement Agreement" contains the following language: "Prior to the firm commitment underwriting" and "proposed financing." The Sunrise agreement specifically contemplates "due diligence examination" prior to "execution of a definitive underwriting agreement." The Aegis engagement letter states: "However, except as expressly provided herein, this engagement letter is not intended to be a binding legal document, as the agreement between the parties hereto on the matters relating to the Offering will be embodied in the Underwriting Agreement (as defined below)."

The Court finds that the undisputed facts demonstrate that AFH did not assist Emmaus in obtaining "firm underwriting commitments" of a minimum of $10 million for Emmaus. A loan plainly is not a firm commitment underwriting. An engagement letter is not a firm commitment underwriting. At most, AFH raised $1.2 million through a private rights offering.

LOI III does not contain any specific dates within which firm underwriting commitments were to be obtained, or by which an Offering must close. When a contract is silent as to time of performance, the Court will imply a reasonable period of time under the circumstances.[17]

The Court finds that Emmaus properly exercised the termination clause in LOI III. Further, AFH had a reasonable amount of time, under all circumstances, within which to raise Offering funds. Emmaus's conduct did not deny AFH the opportunity to perform under LOI III.[18]

Having determined that Emmaus acted in accordance with the plain and unambiguous terms of LIO III, the Court need not resolve whether LOI III contemplated a private or public offering.[19]

FRAUD CLAIMS

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[17]*LaPoint v. AmerisourceBergen Corp.,* 2007 WL 1309398, at *5 (Del. Ch.).

[18]*See TWA Resources v. Complete Production Services,* 2013 WL 1304457, at *10-11 (Del. Super.).

[19] The Court notes, however, that the deposition testimony, as well as the plain language of LOI III, indicate that a public offering was contemplated by the parties. For example, LOI III provides: "Upon completion of the Offering, AFH Acquisition IV shall satisfy the Public shareholders/Public float listing standards for original listing of the Company's securities on the NYSE, AMEX, or NASDAQ."

Emmaus filed five counterclaims against Plaintiffs. The third and fourth counterclaims are fraud in the inducement, and fraud. Emmaus filed the same fraud claims against Third-Party Claim Defendant Hesmatpour.

Heshmatpour's Contentions

Plaintiffs and Heshpatpour have moved for summary judgment on three grounds: (1) Emmaus neither required nor relied upon individual representations from Hesmatpour; (2) as of September 2010, the time the Katz Investigations were commissioned, Emmaus had actual or constructive knowledge of Heshpatpour's background, thus Emmaus cannot demonstrate reasonable reliance; and (3) pursuant to the Merger Agreement, all representations and warranties terminate after one year.

Emmaus's Contentions

Emmaus states that its fraud claims against both Plaintiffs and Hesmatpour are based upon misrepresentations and omissions made to induce Emmaus to enter into the letters of intent. Because there are no fraud claims for breach of any representations or warranties contained in LOI III or the Merger Agreement, no survival provision precludes Emmaus's fraud claims. Emmaus's fraud claims are separate and distinct from its breach of contract claims and do not rely on the same underlying facts. Emmaus asserts that its fraud claims are based on the allegedly

false information Plaintiffs and Hesmatpour provided to Emmaus prior to their retention as financial advisor.

Specifically, Emmaus claims to have relied upon Plaintiffs' and Heshmatpour's allegedly false representations that: (1) Heshmatpour graduated from Pennsylvania State University, and was founder of a successful multi-million dollar company, Metrophone; (2) Heshmatpour and AFH had expertise and experience with reverse mergers and public offerings similar to those contemplated by Emmaus; and (3) AFH and Heshmatpour represented that a reverse merger with a publicly-listed company was necessary to take Emmaus public.

Personal Liability for Fraudulent Acts

Heshmatpour argues that Emmaus has failed to properly plead an express claim against him on the basis of *alter ego* or piercing the corporate veil. Emmaus responds that the Court need not pierce the corporate veil to find Hashmatpour personally liable.

Delaware law provides that "corporate officials may be held individually liable for their tortious conduct, even if undertaken while acting in their official capacity."[20]

[20]*Duffield Assocs., Inc. v. Meridian Architects & Engineers, LLC,* 2010 WL 2802409, at *4 (Del. Super.) (citing *Donsco, Inc. v. Casper Corp.,* 587 F.2d 602, 606 (3d Cir. 1978)("[A] corporate officer is individually liable for the torts he personally commits and cannot shield himself behind a corporation when he is an actual participant in the tort.")).

"Various courts of this State have recognized that executives, directors and officers of an entity can be held *individually* liable for the fraudulent or tortious acts which they, in their official capacities, commit, ratify or approve, despite the fact that they may have acted as an agent for or performed for the benefit of that entity at the time the fraudulent or tortious act was committed, ratified or approved."[21]

The Court finds that Hesmatpour, as an executive of AFH, is not immune from individual personal liability if he is found to have engaged in fraudulent conduct. Therefore, the Court need not address the issue of whether Emmaus has established a *prima facie* case for piercing the corporate veil.

Survival Provision

Article VI of the Merger Agreement contains the following provision:

> 6.03 Survival of Representations, Warranties and Agreements. All of the representations, warranties and agreements in this Agreement or in any instrument delivered pursuant to this Agreement shall survive the Effective Time, for a period of one year from the Closing Date, except for those related to Taxes, which shall survive as long as the applicable statute of limitations.

Plaintiffs and Hesmatpour contend that Section 6.03 precludes all of Emmaus's claims because Emmaus filed its fraud claims more than one year after the Merger

[21] *St. James Recreation, LLC v. Rieger Opp. P'rs, LLC,* 2003 WL 22659875, at *6 (Del. Ch.) (emphasis in original).

Agreement closed. They rely on *GRT, Inc. v. Marathon GTF Technology, LTD*,[22] for the proposition that where a merger agreement contains a survival clause establishing a one-year limitations period for filing claims based on breach of representation, the non-representing party cannot bring suit beyond the survival period.[23]

Plaintiffs and Hesmatpour further argue: "The fact that the Third LIO was executed after the Merger Agreement does not impact the applicable law nor change the ultimate result. This is true because Emmaus provided sworn interrogatory answers and affirmative Rule 36 admissions clearly setting forth that it relied on Heshmatpour's alleged misrepresentations and omissions when entering into all three LOIs and the Merger Agreements. By Emmaus' own account, Heshmatpour's alleged misrepresentations were already subjected to the Merger Agreement's integration provision and contractual statue of limitations period. Emmaus cannot revive alleged misrepresentations previously made and allegedly relied upon by way of the Third LOI."

Plaintiffs and Hesmatpour fail to provide any authority to support the proposition that Section 6.03 - a survival provision - applies to a subsequently-executed contract. It is undisputed that the LOI III was executed after the Merger

[22] 2011 WL 2682898 (Del. Ch.).

[23] *Id.* at *3.

Agreement. LOI III contains neither a survival provision, nor a clause integrating other agreements. The Court finds that the Merger Agreement survival clause, set forth in Section 6.03, does not control the subsequent LOI III.

Additionally, Section 6.03 is not an anti-reliance provision. "The presence of a standard integration clause alone, which does not contain explicit anti-reliance representations and which is not accompanied by other contractual provisions demonstrating with clarity that the plaintiff had agreed that it was not relying on facts outside the contract, will not suffice to bar fraud claims."[24]

Therefore, Plaintiffs' and Heshmatpour's motion for summary judgment must be denied on this issue. Emmaus's fraud claims are not precluded by any provision in the Merger Agreement.

Fraud Claims or Breach of Contract Claims

On the basis of its counterclaims and third–party claims, Emmaus requests the following relief:

> (1) An order declaring that LOI III has been terminated, the Offering has been terminated, [Emmaus] has properly elected to cancel the Advisor Shares, the Advisor Shares are canceled, and that Counterclaim Defendants cease to maintain any ownership interest in such shares;
>
> (2) An order requiring Counterclaim Defendants to physically return any and all share certificates of the Advisor Shares to [Emmaus];

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[24] *Kronenberg v. Katz,* 872 A.2d 568, 593 (Del. Ch. 2004).

(3) Counterclaim Defendants and Heshmatpour should be ordered to pay compensatory damages in an amount shown at trial;

(4) Counterclaim Defendants and Hesmatpour should be ordered to pay punitive damages in an amount to punish and deter future wrongful conduct by Hesmatpour and AFH Advisory;

(5) An order requiring Counterclaim Defendants to pay restitution, in an amount to be determined at trial;

(6) Counterclaim Defendants and Hesmatpour should be ordered to pay costs of suit, including reasonable attorneys' fees; and

(7) Such other relief as the Court deems just and appropriate.

These prayers for relief are not specifically delineated among Emmaus's causes of action for declaratory relief, breach of contract, fraud in the inducement, fraud, and unjust enrichment. Rather, Emmaus claims entitlement to monetary damages for all of its counts of breach of contract, both fraud claims, and unjust enrichment. The only claims for relief unique to the fraud claims are for punitive damages.

As this Court noted in *Cornell Glasgow, LLC, v. La Grange Properties, LLC*:[25]

> It seems more and more that breach of contract claims will not suffice to ameliorate the sense of betrayal parties feel when they come out on the losing end of a contractual business relationship. Often parties feel compelled to punctuate their breach claims with claims that the breaching party committed fraud, either by inducing performance without any intention of reciprocating, or by misrepresenting facts or circumstances relating to the performance of the contract in advance of or in connection with the alleged breach. The aggrieved party seeks tort

[25] 2012 WL 2106945 (Del. Super).

> damages, usually including exemplary damages, in addition to breach damages. A claim for extra-contractual attorney's fees will typically be thrown in for good measure. [26]

Tort claims must involve violation of a duty arising apart from the contractual agreement. To survive as a separate claim, a fraud claim must be collateral to the breach of contract claims. The party asserting fraud must plead damages separate and apart from the alleged damages for breach of contract. The fraud damages must be more than a "rehash" of the contract damages.[27]

Emmaus states that its "claims for common law fraud and fraud in the inducement are not based on its execution of the Merger Agreement, or any representation contained therein. Rather, Emmaus's fraud claims center solely on the Letters of Intent, particularly LOI III."

Emmaus sets forth several alleged misstatements made by AFH and Hesmatpour regarding their expertise and experience, and omitting "key information regarding Heshmatpour's background, when soliciting Emmaus's business."[28] Emmaus asserts in its counterclaims and third-party claims that it justifiably relied upon these misstatements and omissions in executing LIO III and its earlier versions.

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[26] *Id.* at *1.

[27] *Id.* at *7-8.

[28] *Id.* at 14.

As a proximate cause of the alleged fraudulent conduct, Emmaus requests declaratory relief, return of all consideration paid to AFH, and damages (including punitive damages).

The Court finds that Emmaus's breach of contract claims and fraud claims are based on the same operative facts. Additionally, Emmaus has not demonstrated a *prima facie* basis for damages for fraud or fraud in the inducement, separate and apart from any compensatory damages or declaratory relief to which Emmaus may be entitled for breach of contract or unjust enrichment.

Punitive Damages

The goal of a damages award is just and full compensation, with the focus on the plaintiff's injury or loss.[29]

> Punitive damages are fundamentally different from compensatory damages both in purpose and formulation. Compensatory damages aim to correct private wrongs, while assessments of punitive damages implicate other societal policies. Though the injured plaintiff may receive the punitive damage award, to the extent the plaintiff has already been fully compensated by actual damages, an award of punitive damages is, in a real sense, gratuitous.[30]

The purpose of punitive damages is to punish outrageous conduct and to deter others from similar conduct in the future. "The penal aspect and public policy

[29] *Jardel Co., Inc. v. Hughes,* 523 A.2d 518, 528 (Del. 1987).

[30] *Id.*

considerations which justify the imposition of punitive damages require that they be imposed only after a close examination of whether the defendant's conduct is 'outrageous,' because of 'evil motive' or 'reckless indifference to the rights of others.'"[31] The wrongdoer's acts must have proximately caused the injuries. The effects of the wrongful or fraudulent acts must have been reasonably forseeable.[32]

In this case, even assuming the accuracy of Emmaus's assertions of fraudulent misrepresentations, it is not clear that those specific acts of alleged fraud and fraud in the inducement proximately caused the harm to Emmaus. The causal connection is somewhat attenuated. And, as to certain statements, such as college graduation from a particular university, it is difficult to ascertain how that explicit representation, however patently false, proximately caused harm to Emmaus.

Nevertheless, the Court finds that Emmaus has set forth a *prima facie* case for entitlement to punitive damages based on Plaintiffs' and Heshmatpour's alleged fraud in the inducement and fraud. There are genuine issues of material fact regarding whether certain statements were intentionally fraudulent, and whether Heshmatpour acted with an "evil motive' or "reckless indifference to the rights of others." Both of these questions ordinarily involving credibility determinations by the trier of fact.

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[31] *Id.* at 529.

[32] *See id.*

Therefore, summary judgment cannot be granted on the narrow issue of punitive damages at this stage in the proceedings.

However, the Court has reviewed the extensive factual record presented in conjunction with the pending summary judgment motions. Although the Court will not grant summary judgment on punitive damages, the parties should be aware that the Court is not persuaded that Emmaus has a particularly strong basis to obtain this requested relief. In other words, based upon the Court's perusal of the evidence, there is not a likelihood of success on the merits of Emmaus's claim for an award of punitive damages. It appears that the declaratory, injunctive and other monetary relief granted by summary judgment to Emmaus for breach of contract will adequately compensate Emmaus.

CONCLUSION

Defendant and Counterclaim/Third Party Claim Plaintiff Emmaus Life Science, Inc.'s Motion for Partial Summary Judgment is hereby **GRANTED.** The Court declares as a matter of law that:

(1) the Offering has been terminated;

(2) the Advisor Shares have been properly canceled;

(3) LOI III has been properly terminated by Emmaus; and

(4) AFH Holding Advisory, LLC, Griffin Ventures, LTD., The Amir & Kathy Hesmatpour Family Foundation, and Amir Hesmatpour must return all Advisor Shares certificates.

Plaintiffs' and Third-Party Defendant Amir Heshmatpour's Motion for Summary Judgment is hereby **GRANTED IN PART and DENIED IN PART.** The Court finds that Hesmatpour, as an executive of AFH, is not immune from individual personal liability if he is found to have engaged in fraudulent conduct. Therefore, the Court need not address the issue of whether Emmaus has established a *prima facie* case for piercing the corporate veil. The Court further finds that Emmaus's fraud claims are not precluded by any provision in the Merger Agreement.

However, Emmaus's breach of contract claims and fraud claims are based on the same operative facts. Partial summary judgment is **GRANTED** in favor of Plaintiffs and Hesmatpour on the grounds that Emmaus is not entitled to compensatory damages on its fraud and fraud in the inducement claims. Such damages would be duplicative of Emmaus's damages on its breach of contract claims.

Partial summary judgment is **DENIED** against Plaintiffs and Hesmatpour on the grounds that Emmaus has set forth a *prima facie* case for entitlement to punitive damages based on Plaintiffs' and Heshmatpour's alleged fraud in the inducement and

fraud. Nevertheless, although the Court cannot grant summary judgment in favor of Emmaus on the issue of punitive damages, the Court finds that Emmaus does not have a likelihood of success on the merits of Emmaus's claim for an award of punitive damages.

THE PARTIES SHALL CONFER TO SUBMIT AN IMPLEMENTING ORDER. The pre-trial conference scheduled for May 23, 2013, and the trial scheduled to begin May 30, 2013 will be removed from the Court's calendar.

/s/ Mary M Johnston
The Honorable Mary M. Johnston