



IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

CASE FINANCIAL, INC.,)
a Delaware corporation,)
)
Plaintiff,)
)
v.) Civil Action No. 1184-VCP
)
ERIC ALDEN,)
)
Defendant.)

MEMORANDUM OPINION

Submitted: March 4, 2009
Decided: August 21, 2009

Richard L. Horwitz, Esquire, Kevin R. Shannon, Esquire, Berton W. Ashman, Jr., Esquire, POTTER ANDERSON & CORROON LLP, Wilmington, Delaware; Paul Mark Sandler, Esquire, Roderick R. Barnes, Esquire, John J. Leidig, Esquire, SHAPIRO SHER GUINOT & SANDLER, Baltimore, Maryland; *Attorneys for Plaintiff*

James S. Green, Sr., Esquire, SEITZ, VAN OGTROP & GREEN, P.A., Wilmington, Delaware; Nick A. Alden, Esquire, LAW OFFICES OF NICK A. ALDEN, Beverly Hills, California; *Attorneys for Defendant*

PARSONS, Vice Chancellor.

This case arises out of commercial substrata inhabited by those who finance plaintiffs and their attorneys. A company that financed plaintiffs and plaintiff attorneys through advances or high interest loans sold some of its assets and operations to a new company. For a time, the CEO of the old company remained on at the new company where he continued to act as CEO and as a director. At some point, the new company set up a wholly-owned subsidiary to comply with certain usury laws. The CEO of the new company also served as CEO of this wholly-owned subsidiary. Eventually, individuals associated with the new company began suspecting the CEO had committed fraud in the course of selling the old company's assets to it and had committed various breaches of fiduciary duty since the acquisition. One thing that sparked suspicions was the new company's failure to do as well as expected due to an increase in overhead. Suspicions also arose based on the CEO's allegedly improper diversion of the new company's funds, under the guise of lawsuit financing, to Las Vegas casino and Bahamian hotel projects.

After a falling out with the new company's largest investor, the CEO left the new company and in relatively short order entered into a settlement and mutual release agreement with the company. The new company later brought this action against the CEO for his alleged misconduct. The CEO has raised a number of defenses. Three of those defenses involve issues that were the subject of a short, bifurcated trial in March 2009: (1) whether the release bars prosecution of claims against the CEO; (2) whether language in the asset purchase agreement, concerning the expiration of representations and warranties, precludes an action for fraud; and (3) whether the new company has standing, where some of the wrongful conduct allegedly occurred at the subsidiary. For

the reasons stated in this memorandum opinion, I deny the former CEO's effort to narrowly circumscribe the scope of the crime exception to his release and to dismiss certain of the new company's claims based on the language of the asset purchase agreement and the statute of limitations. I also hold that the new company has standing to pursue claims against the CEO on its own behalf.

I. BACKGROUND

A. Parties

Plaintiff, Case Financial, Inc. ("Case Financial"), is a Delaware corporation with its principal place of business in California. By itself or through affiliates, Case Financial's primary business is litigation financing. Essentially, Case Financial participates in fronting plaintiff attorneys via high interest loans. The current iteration of Case Financial came into existence as a result of an asset purchase agreement (the "APA") between the original Case Financial, now referred to as "Old CFI,"¹ and a company called Asia Web Holdings, Inc. ("Asia Web"). On March 24, 2002, Asia Web bought substantially all of the operational assets of Old CFI and then changed the name of the resulting company to Case Financial.

Defendant Eric Alden is the former President, CEO, and Co-Chairman of Case Financial. He resigned as a director and was terminated as CEO in February 2004. He is also a certified public accountant and a former Israeli naval officer.

¹ Before the APA, Old CFI's name was also Case Financial, Inc. For convenience, I refer to the pre-APA Case Financial as Old CFI throughout this opinion.

B. Facts

Alden formed Old CFI sometime in 1998 with two other individuals.² Old CFI's original business plan was funding actual plaintiffs in personal injury cases.³ As the business developed, Old CFI started funding attorneys for plaintiffs instead of personal injury clients, because the attorneys were more likely to provide repeat business.⁴

Sometime in 2001, Old CFI came into contact with Michael Schaffer, Asia Web's CEO. At the time, Asia Web was a "public shell."⁵ Asia Web and Old CFI eventually agreed on an asset sale, memorialized in the APA, whereby Asia Web purchased Old CFI's "client list, management, and name."⁶ Asia Web also was to receive fifteen percent of the amount collected on the portfolio of Old CFI loans.⁷

² T. Tr. at 27 (Alden). The other two founders were Sam Schwartz and Jerry Lotterstein. *Id.* Unless the identity of the witness is clear from the accompanying text, the testifying witness's name is indicated parenthetically.

³ *Id.* at 28.

⁴ *Id.*

⁵ *Id.* Although it is not strictly relevant to this opinion, I assume that a "public shell" is a publicly-registered company with no operations that seeks to effect a merger, asset purchase, or other business combination so that it can market its securities publicly to investors looking for a company that actually generates cash flow. For a somewhat analogous business venture, see *Opportunity Partners, L.P. v. Transtech Serv. Partners, Inc.*, 2009 WL 997334, at *1 (Del. Ch. Apr. 14, 2009) (describing a special purpose acquisition company).

⁶ T. Tr. at 29 (Alden); *see also* PX 8, Asset Purchase Agreement ("APA").

⁷ T. Tr. at 30 (Alden).

Section 19.1 of the APA, entitled “Termination of Representations and Warranties,” reads:

The respective representations and warranties of Seller and Buyer contained in this Agreement shall expire and terminate on the Closing Date. The obligations under all covenants and agreements which are to be performed after the Closing Date shall survive the Closing Date. All other covenants and agreements shall expire and terminate on the Closing Date.⁸

At closing, Asia Web changed its name to Case Financial, and Alden became its CEO.

In 2003, Case Financial formed a wholly-owned subsidiary called Case Capital, Inc. (“Case Capital”). Until that time, Case Financial had been making, what Alden called at trial, “advances” to attorneys, but Case Financial wanted to make high interest loans instead. To make loans with the interest rates it wanted to charge, Case Financial had to be licensed as a financing company. To be licensed as a financing company, according to Alden, the State of California requires a balance sheet with “at least \$25,000 on it,” and Case Financial could not meet that requirement.⁹

On April 8, 2003, the Case Financial Board of Directors resolved to make Case Financial a holding company and its subsidiary, Case Capital, the operating company.¹⁰ Thereafter, Case Capital raised the funds needed in their business and made loans, including a credit agreement with Frederico Sayre, a class action plaintiff attorney who

⁸ APA § 19.1.

⁹ T. Tr. at 40.

¹⁰ See DX 3; T. Tr. at 41-42 (Alden).

also allegedly was involved in facilitating the challenged casino and hotel deals.¹¹ Case Capital eventually started charging between 70% and 180% per year in interest on funds loaned to attorneys.¹²

At some point, the situation soured between Alden and Case Financial's largest shareholder, the Canadian Commercial Workers Industry Pension Plan ("CCWIPP"), and Alden was fired as CEO and resigned as a director in February 2004.¹³ Between February and June of 2004, Alden and Case Financial negotiated a mutual settlement. Initially, Alden negotiated with Harvey Bibicoff, who was named acting CEO after Alden left.¹⁴ During this same time period, Alden believed CCWIPP was spreading rumors that he had embezzled money from Case Financial.¹⁵

Bibicoff and Alden reached an impasse concerning the value of Alden's shares in one or both of Case Financial or Case Capital.¹⁶ John Irvine, who was affiliated with CCWIPP, eventually took over the negotiations on behalf of Case Financial.¹⁷ On June 7, 2004, Case Financial entered into an Agreement and Mutual Release (the

¹¹ *Id.* at 42.

¹² *Id.* at 47.

¹³ *Id.* at 52.

¹⁴ *Id.* at 53.

¹⁵ *Id.* at 55.

¹⁶ *Id.* at 55-56.

¹⁷ T. Tr. at 57 (Alden).

“Release”) with Alden.¹⁸ The Release provided for the “release and discharge” by Case Financial of Alden from:

any and all debts, claims, demands, liabilities, obligations, contracts, agreements, guarantees, causes of action, known and unknown, against any of them which any of them now owns, holds or has at any time heretofore owned or held by reason of any act, matter, cause or thing whatsoever done prior to the execution of this Agreement.¹⁹

The Release does not, however, “release or discharge Alden from any act or conduct that constitutes a crime under California and/or federal law” (the “Crime Exception”).²⁰

Alden signed the Release on his own behalf, and Gary Primes signed it on behalf of Case Financial as President and Chief Investment Officer.

Alden testified that he discussed the Crime Exception with Gerald Chizever, a partner at Loeb & Loeb LLP, which acted as Case Financial’s outside legal counsel.²¹ Chizever drafted or oversaw the drafting of the Crime Exception. Alden claims Chizever said that the Crime Exception was “for the government to go after me and to keep the company basically out of harm’s way. If I did something wrong, they’ll turn to the

¹⁸ PX 1, the Release.

¹⁹ Release ¶ 4.

²⁰ *Id.* The parties to the Release waived the protections of Section 1542 of the California Civil Code (“Section 1542”), which provides: “A general release does not extend to claims which the creditor does not know or suspect to exist in his or her favor at the time of executing the release, which if known by him or her must have materially affected his or her settlement with the debtor.”

²¹ T. Tr. at 58.

government and the government would prosecute me.”²² Chizever does not remember the conversation. Alden also testified that Bibicoff told him the Crime Exception was intended to carve-out embezzlement from the Release, but not the kinds of claims at issue in this litigation.²³

C. Procedural History

On March 14, 2005, Case Financial authorized CCWIPP to proceed with a derivative suit on behalf of Case Financial against Alden, Gordon Gregory, Lorne Pollock, and Bibicoff. On February 22, 2006, the Court issued a Memorandum Opinion denying Alden’s motion to dismiss Count I of the Complaint for breach of fiduciary duty and Count III for fraud.²⁴

In November 2007 and after settling with Bibicoff, Pollock, and Gregory, CCWIPP withdrew as Plaintiff. Thereafter, Case Financial intervened to pursue the claims against Alden. On July 11, 2008, Case Financial filed a Motion for Partial Summary Judgment on the issue of Alden’s liability for fourteen acts of alleged misconduct. On October 31, 2008, Alden responded and filed his own Cross-Motion for Partial Summary Judgment.

²² *Id.*

²³ *Id.* at 59.

²⁴ *See Canadian Commercial Workers Indus. Pension Plan v. Alden*, 2006 WL 456786, at *1 (Del. Ch. Feb. 22, 2006).

On December 2, 2008, I denied both motions and ordered a bifurcated trial.²⁵ The first phase of the trial would address three threshold issues: (1) whether Case Financial has standing to sue Alden for breach of fiduciary duty or fraud arising out of transactions entered into by Case Capital, a wholly-owned subsidiary of Case Financial; (2) whether the Crime Exception in the Release enables Plaintiff to pursue civil claims against Alden for any act or conduct that constitutes a crime under California or Federal law; and (3) whether Case Financial is precluded from suing Alden for breach of fiduciary duty and fraud because the representations and warranties set forth in the APA expired upon the closing of the asset purchase transaction. The Court held a trial on these three issues in March 2009. This memorandum opinion contains my findings of fact and conclusions of law on these threshold issues.

D. Parties' Contentions

First, Alden argues that Case Financial does not have standing to pursue the claims in this action, because “[a]ll the actions complained about in the [First Amended Complaint] concerned activity within Case Capital.”²⁶ Case Financial urges the Court to disregard the corporate form in these circumstances and to find that its claims are really direct and not derivative. Second, Alden argues that the Crime Exception, when properly construed, bars the types of claims made here, and he offers extrinsic evidence as to the parties’ state of mind in entering into the Release. Case Financial disagrees and submits

²⁵ Summ. J. Hr’g Tr. at 121.

²⁶ Def.’s T. Br. at 25.

the plain meaning of the Release allows it to pursue its claims in this action. Third, Alden claims that a clause in the APA, regarding the expiration of representations, bars any claim based on misrepresentations made in the APA or during the course of the negotiations concerning the APA. Case Financial denies that the clause regarding the expiration of representations would bar a claim for fraud, because the clause does not clearly express an intent to derogate from the statute of limitations.²⁷

II. ANALYSIS

A. Does Case Financial Have Standing?

Alden has presented a thorny issue involving corporate standing. He maintains that the allegedly improper conduct at issue in this litigation occurred at Case Capital, and not Case Financial. Thus, according to Alden, Case Financial lacks standing to bring this action against him. Case Financial offers a couple of arguments in response. First, in its summary judgment and trial papers, Case Financial appears to argue for something like an alter ego theory. Second, Case Financial contends that it may bring a direct action against Alden, because he was an officer and director of both Case Financial and Case Capital.

1. Disregard of the corporate form

For the alter ego argument, Case Financial asserts that it and Case Capital are really the same company, so there should be no difference in standing. Essentially, Case

²⁷ Alden advances a few other secondary arguments and requests for relief on certain evidentiary matters. To the extent any of these are relevant and deserve additional discussion, I address them in the analysis of the three primary issues.

Financial seems to be trying to pierce its own corporate veil, which would be unusual to say the least. As support, Case Financial notes that it has filed consolidated financial statements with the SEC, which include Case Capital's results,²⁸ has overlapping boards of directors with Case Capital, and often causes actions of Case Capital to be taken by written consent, so that the subsidiary has had only a limited number of board meetings. Demonstrating that one company is an alter ego of another, however, is not that easy.

Delaware courts take the corporate form and corporate formalities very seriously, and Case Financial has not met its substantial burden in this respect. This Court will disregard the corporate form only in the "exceptional case."²⁹ Determining whether to do so requires a fact intensive inquiry, which may consider the following factors, none of which are dominant: (1) whether the company, Case Capital in this case, was adequately capitalized for the undertaking; (2) whether the company was solvent; (3) whether corporate formalities were observed; (4) whether the controlling shareholder siphoned company funds; and (5) whether, in general, the company simply functioned as a facade for the controlling shareholder.³⁰ There also must be an element of fraud to justify

²⁸ The evidence also shows, however, that Case Financial did not file a consolidated tax return with Case Capital. PX 4, Alden Dep. at 25.

²⁹ *Sprint Nextel Corp. v. iPCS, Inc.*, 2008 WL 2737409, at *11 (Del. Ch. July 14, 2008) (internal citations omitted).

³⁰ *Id.*

piercing the corporate veil.³¹ Although there are allegations of fraud in this case, none of the other factors severally or jointly support disregarding Case Capital's corporate form.

First, there is no evidence that Case Financial inadequately capitalized Case Capital. Indeed, Case Financial appears to have capitalized Case Capital with the amount necessary for it to operate as a financing company, and Case Financial offered no proof that Case Capital was undercapitalized thereafter. Second, Case Financial did not prove that Case Capital was insolvent under any plausible definition of insolvency, such as that its liabilities exceeded its assets or that it could not pay its debts as they became due. Third, Case Financial admits that Case Capital's Board of Directors had some formal meetings or acted by written consent in lieu of such meetings. Fourth, Case Financial does not allege that it, as the controlling shareholder, or any subsequent controlling shareholder siphoned funds from Case Capital. Fifth, Case Financial did not prove that Case Capital operated as a mere façade for Case Financial; rather, Case Financial acted as a holding company and Case Capital acted as an operating subsidiary, which served a specific purpose within the Case Financial corporate family. Thus, there is no basis for disregarding Case Capital's separate corporate existence and treating it as simply an alter ego of Case Financial.

2. Derivative versus direct

Alden's next argument, although not phrased in these precise terms, effectively states that Case Financial should have brought the claims against Alden derivatively on

³¹ *Mason v. Network of Wilm., Inc.*, 2005 WL 1653954, at *3 (Del. Ch. July 1, 2005).

behalf of Case Capital, rather than directly on its own behalf. The Delaware Supreme Court articulated the test for determining whether a claim is derivative or direct as follows: “Who suffered the alleged harm—the corporation or the suing stockholder individually—and who would receive the benefit of the recovery or other remedy?”³² The first question is, thus, whether Case Financial suffered a direct injury as a result of Alden’s alleged misconduct or whether it only sustained the alleged injury by virtue of its ownership in a company that was itself injured directly. The second question is which entity, the parent or the subsidiary, would receive the benefit of a recovery directly.

Alden premises his argument on the following assertion: “All the actions complained about in the [Complaint] concerned activity within Case Capital. As a result, Case Financial lacks standing to sue Alden on those transactions.”³³ Because the Complaint contains two remaining counts, I must determine whether those counts could be prosecuted directly or whether they should have been pleaded derivatively. Count I of the Complaint alleges breach of fiduciary duty and Count III claims fraud. I discuss the fraud claim first, because the analysis is fairly straightforward.

a. Fraud

The fraud count revolves around alleged misrepresentations and omissions made by Alden during the course of the sale of Old CFI’s assets to Case Financial. Alden allegedly perpetrated the fraud on Case Financial—not Case Capital. For example, Case

³² *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031, 1039 (Del. 2004).

³³ Def.’s T. Br. at 25.

Financial alleges that Alden intended to induce Case Financial to pay more than the assets transferred via the APA were worth by misrepresenting the “current and projected financial condition” of Old CFI.³⁴ Case Financial has alleged that it suffered a direct injury from the fraud and not an injury suffered solely by virtue of its ownership stake in Case Capital. Thus, Case Financial has standing to pursue the fraud count directly.

b. Breach of fiduciary duty

The breach of fiduciary duty count is somewhat more complicated, because some of the alleged misconduct occurred at or through Case Capital. At trial, Alden offered uncontroverted testimony that Case Capital was the company that directly raised funds to make loans and actually made the loans. Thus, Alden appears to be arguing that claims for breaches of fiduciary duty based on, for example, making inappropriate loans had to be pursued derivatively, because Case Capital would have suffered the direct injury, and Case Financial would have suffered whatever injury it did derivatively by owning the equity of Case Capital. In response, Case Financial notes the blurry distinctions between itself and Case Capital referenced in Part II.A.1 *supra*, and Alden’s role as the CEO and director of both companies.

Case Financial, as a 100% percent owner of Case Capital, theoretically could have caused Case Capital to bring suit or to allow Case Financial to bring suit on its behalf. Indeed, one might think that the derivative and direct distinction should be dispensed with in the case of a parent suing on behalf of a wholly-owned subsidiary, especially

³⁴ Compl. ¶ 85-86.

where, as here, the directors of Case Capital were at all relevant times a subset of the Case Financial directors. In that case, Case Capital’s acquiescence or consent might even have been a *fait accompli*.³⁵

For good reason, however, this Court has been reluctant to relax the distinction between a direct and derivative suit when dealing with Delaware corporations, because the distinction is difficult to grasp as it is and additional exceptions might cause confusion.³⁶ Moreover, it is black letter law that the “fact that a shareholder owns all, or practically all, or a majority of the stock does not of itself authorize the shareholder to sue as an individual.”³⁷ Courts still require a parent to sue on behalf of a subsidiary, when the claims are truly derivative, so that any damages recoverable by the subsidiary would be available not only to the shareholder-parent, as the residual claimant, but also to the subsidiary’s creditors.³⁸

Here, however, Alden’s duties to Case Financial spring from multiple sources and not solely from his role as a fiduciary of Case Capital. Alden was an officer and director

³⁵ *But cf. Next Level Commc’ns, Inc. v. Motorola, Inc.*, 834 A.2d 828, 832 (Del. Ch. 2003) (describing tender offer by controlling shareholder where board authorized company to file suit to enjoin the offer).

³⁶ *See Agostino v. Hicks*, 845 A.2d 1110, 1125 (Del. Ch. Mar. 22, 2004).

³⁷ William Meade Fletcher, *Fletcher Cyclopedia of the Law of Corporations* § 5910 (2009) (citations omitted); *see also Classic Commc’ns, Inc. v. Rural Tel. Serv. Co.*, 956 F. Supp. 910, 916 (D. Kan. 1997) (“[I]njury arising solely out of harm done to a subsidiary corporation is generally insufficient to confer standing . . . on a parent corporation.”).

³⁸ Fletcher, *supra* note 36, § 5910.

of Case Capital and Case Financial. As for Case Capital, Alden owed duties to it by virtue of his positions at the subsidiary. In turn, *as a shareholder of Case Capital*, Case Financial may have had standing to bring suit derivatively on behalf of Case Capital to seek a remedy for breaches of those duties owed to Case Capital. Nevertheless, in this litigation, Case Financial has not attempted to assert any derivative claim on behalf of Case Capital or to amend the pleadings to add Case Capital as a nominal party.

Similarly, Case Financial might have standing to sue on its own behalf *as a shareholder* of Case Capital to redress a breach by Alden of a duty owed directly to the shareholders. Because Case Capital is a California corporation, this Court probably would consider California law in determining whether the claims being asserted were derivative claims owned by Case Capital, as well as the requirements for bringing such a claim. In this connection, I note an unpublished California decision that held an equity holder of a parent could sue derivatively on behalf of the parent those that managed or controlled both the parent and its wholly-owned subsidiary for injuries suffered by the wholly-owned subsidiary without suing derivatively on behalf of the subsidiary, as would be the case in a typical double derivative action.³⁹ In that case, the court relied upon the following reasoning in reaching its decision:

³⁹ See *Pointe San Diego Residential Cmty., L.P. v. W.W.I. Props., L.L.C.*, 2007 WL 1991205, at *8-10 (Cal. App. July 11, 2007). Unlike Delaware, where unpublished opinions have precedential value, Rule 8.1115 of the *California Rules of Court* provides that, with exceptions not relevant here, “an opinion of a California Court of Appeal or superior court appellate division that is not certified for publication or ordered published must not be cited or relied upon by a court or a party in any other action.”

[A]s a general proposition, injury done to a subsidiary does not create a claim that may be asserted in a direct action by the subsidiary's parent corporation because the claim is the property of the subsidiary, not the parent. However, a parent corporation has standing to bring a direct action for breach of fiduciary duty against a defendant who owes duties to the parent as well as the subsidiary, as would an individual who serves as a director of both corporations.⁴⁰

As explained below, however, I need not rely upon California law, because even if no claim is asserted directly by Case Financial in its capacity as a shareholder or derivatively on behalf of Case Capital for breach of fiduciary duty, Case Financial has standing to assert a fiduciary duty claim against Alden.

Alden was an officer and director of Case Financial, a Delaware corporation. Thus, independent of Case Financial's status as a shareholder of Case Capital, Alden owed duties directly to Case Financial as a director and officer.⁴¹ In these specific

⁴⁰ *Pointe San Diego*, 2007 WL 1991205, at *9 (quoting DeMott, *Shareholder Derivative Actions: Law and Practice* § 2.2 (2006)).

⁴¹ As support for its argument that Alden owed duties to Case Financial directly, even where the challenged conduct occurred at Case Capital, Case Financial cites *Anadarko Petroleum Corp. v. Panhandle E. Corp.*, 545 A.2d 1171 (Del. 1988). There, the Delaware Supreme Court held, "in a parent and wholly-owned subsidiary context, the directors of the subsidiary are obligated only to manage the affairs of the subsidiary in the best interests of the parent and its shareholders." *Id.* at 1174. Although the selected language quoted from that opinion could be read as Case Financial would have it, this quotation does not definitively answer whether the parent could bring suit directly for an injury it sustained derivatively through a subsidiary's direct injury. The opinion could be read instead to indicate that the directors of a subsidiary, like directors at every corporation, ordinarily should be managing the corporation above all else to maximize shareholder value and that in a wholly-owned subsidiary context, the shareholders of the parent might have standing to sue the subsidiary double derivatively.

circumstances, Case Financial has standing to sue Alden directly for those breaches of the fiduciary duties he owes directly to Case Financial arising out of his position at Case Financial. Thus, I do not find that Case Financial can sue directly on the basis that Case Financial, as a shareholder of Case Capital, can make out a direct claim against Alden, as a director or officer of Case Capital. Rather, I do so on the basis that Alden owed Case Financial duties as a director and officer of Case Financial.

As Chancellor Allen once wrote:

The duty of loyalty includes, in some circumstances, a duty of disclosure. The intentional failure or refusal of a director to disclose to the board a defalcation or scheme to defraud the corporation of which he has learned, itself constitutes a wrong, unless a recognized privilege against disclosure pertains. . . . A director does breach his duty of loyalty if he knows that the company has been defrauded and does not report what he knows to the board, at the very least when he is involved in the fraud and keeps silent in order to escape detection.⁴²

Ultimately, Alden, as a director of Case Financial, had a duty not to intentionally or knowingly participate in conduct that would injure Case Financial. Because Alden owed this duty to Case Financial directly, Case Financial's ability to pursue a suit against Alden directly would not depend, in this sense, on whether the entirety of the damage was sustained directly by Case Financial or derivatively through Case Capital. To the contrary, if Alden was substantially certain his conduct would injure Case Financial unjustifiably, regardless of how far down the causal chain the injury would occur, Alden

⁴² *Hoover Indus., Inc. v. Chase*, 1988 WL 73758, at *2 (Del. Ch. July 13, 1988).

should have refrained from the conduct, especially where he stood to benefit at Case Financial's expense, and, at a minimum, should have disclosed those activities to Case Financial. Likewise, Case Financial has offered reasonable arguments that Alden may have violated his duties as a director of Case Financial by improperly misappropriating opportunities of Case Financial by virtue of his actions at Case Capital.⁴³ Accordingly, I find that Case Financial has standing to assert direct claims for breach of fiduciary duty against Alden.

B. Does the Release Bar Case Financial's Claims?

Alden next argues that Case Financial's claims are barred by the Release. As Case Financial's attorney Chizever stated at his deposition, the Release "starts off with the concept that Case releases Eric Alden from pretty much everything under the sun."⁴⁴ Indeed, the Release would be exceptionally broad if not for the Crime Exception, which carves out from the Release any "release or discharge [of] Alden from any act or conduct that constitutes a crime under California and/or federal law." Case Financial, therefore, counters that, in spite of the breadth of the Release, the claims asserted in this action fall within the Crime Exception, because they arise out of conduct that would constitute crimes under California or federal law.

⁴³ Due to the narrow scope of the first phase of the bifurcated trial in this action, I have addressed only the issue of standing and express no opinion on the merits of Case Financial's fiduciary duty claims. Moreover, I do not address whether there might be a situation where Case Capital would be able to recover a different amount in damages than Case Financial for the same underlying conduct.

⁴⁴ PX 4, Chizever Dep. at 13.

Neither party has provided any case law or learned commentary on the application of a crime exception in a release agreement. Under California law, however, a release should be interpreted as other contracts are.⁴⁵ Accordingly, I look first to general principles of contract interpretation prescribed by California for guidance in determining what the Crime Exception means.

The mutual intention of the contracting parties at the time the contract was formed governs contractual interpretation.⁴⁶ Courts also should consider the contract as a whole and interpret its language in context, rather than interpret a provision in isolation.⁴⁷ Words should be given their ordinary and popular sense, unless the words are used in a technical sense or a special meaning is given to them by trade or other specialized usage.⁴⁸ If contractual language is clear and explicit and does not involve an absurdity, the plain meaning governs.⁴⁹ California courts attempt to discern the plain meaning of an

⁴⁵ *Hess v. Ford Motor Co.*, 41 P.3d 46, 51 (Cal. 2002). California law governs the Release, because it was entered into in California by a California resident and makes explicit reference to California law. See *Canadian Commercial Workers Indus. Pension Plan v. Alden*, 2006 WL 456786, at *2 n.13 (Del. Ch. Feb. 22, 2006).

⁴⁶ *Cal. Civ. Code* § 1636.

⁴⁷ *Id.* § 1641.

⁴⁸ *Id.* § 1644.

⁴⁹ *Id.* § 1638.

agreement solely from the written contract, but they also may consider the circumstances under which the contract was made and the matter to which it relates.⁵⁰

Furthermore, under California law, parties are allowed to submit extrinsic evidence to prove that a contract is ambiguous:

Even if a contract appears unambiguous on its face, a latent ambiguity may be exposed by extrinsic evidence which reveals more than one possible meaning to which the language of the contract is yet reasonably susceptible. The test of admissibility of extrinsic evidence to explain the meaning of a written instrument is not whether it appears to the court to be plain and unambiguous on its face, but whether the offered evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible.⁵¹

Thus, extrinsic evidence is admissible in California to uncover a latent ambiguity that might not be readily apparent until the extrinsic evidence is examined. In fact, one California court held “it is reversible error for a trial court to refuse to consider such extrinsic evidence on the basis of the trial court’s own conclusion that the language of the contract appears to be clear and unambiguous on its face.”⁵² Following these principles, I will determine first if the Release has a plain meaning that is not unreasonable. I also will examine whether there are competing reasonable readings of the Release, *i.e.*, an

⁵⁰ *Id.* §§ 1639, 1647.

⁵¹ *Dore v. Arnold Worldwide, Inc.*, 46 Cal. Rptr. 3d 668, 673 (Cal. 2006) (internal quotations omitted).

⁵² *Morey v. Vannucci*, 75 Cal. Rptr. 2d 573, 578 (Cal. App. 1998).

ambiguity in the document. If there is an ambiguity, I will decide from the record developed at trial which reading reflects the parties' mutual intention.

In this respect, I begin by considering the circumstances in which the Release came into being. After a tumultuous relationship, Case Financial negotiated a settlement with its former CEO, Alden, whereby Alden released Case Financial and, in return, Case Financial appeared to agree to do something similar. In particular, Case Financial offered to give Alden a broad release, but insisted it be subject to the Crime Exception. In this regard, the record shows that during the time period before the signing of the Release, Case Financial expressed concern that Alden might have committed criminal acts, such as embezzlement.

Case Financial maintains that the circumstances under which the contract was made and the matter to which it relates support its view that the plain meaning of the Release and Crime Exception allow it to pursue against Alden any civil claims that are based on conduct which also would be considered criminal. Alden argues that Case Financial's literal reading is too broad in that it easily could lead to a situation in which the exception swallows the Release and renders it illusory. The difficulty, according to Alden, is that most conduct that sounds in tort or that forms the basis of a breach of a fiduciary duty claim has an analog in criminal law, and the two often overlap. Indeed, Case Financial's arguments to date confirm Alden's reasons for concern. The Company

has shown no restraint in trying to shoehorn even the most niggling disputes into some form of a crime.⁵³

In support of its construction of the Crime Exception, Case Financial offered the deposition testimony of Chizever to explain the meaning of that Exception in the Release. At trial, Alden objected to the frequent instructions by Case Financial’s counsel at the deposition they had called of Chizever that he not answer questions concerning what anyone at Case Financial told him about the Crime Exception or the Release. Alden never moved to compel answers to those questions, however. Instead, Alden objects that Case Financial is improperly picking and choosing its application of the attorney-client privilege.⁵⁴ If any of the challenged testimony revealed attorney-client privileged information and was material to the issues before me, Case Financial’s objection might have some merit. In fact, however, the vast majority, if not all, of Chizever’s testimony is neither relevant nor helpful to Case Financial. For example, he does not recall talking to Alden, and simply took the position that the Crime Exception “speaks for itself.”⁵⁵

⁵³ For example, Case Financial alleges that Alden “brazenly listed Case Financial’s address as the address for his CPA office and posted a sign on the wall by the entrance door of Case Financial’s office to advertise his CPA practice.” Pl.’s Mem. in Supp. of Mot. for Partial Summ. J. at 44. Case Financial maintains that this amounts to “theft” and “embezzlement.” *Id.* at 44-45. The record to date, however, suggests that Case Financial’s claim reflects overheated rhetoric and hyperbole more than fact. In any event, Case Financial is all too eager to convert what might be a garden-variety commercial dispute into a crime. Unfortunately, this is not an isolated example.

⁵⁴ See T. Tr. at 13.

⁵⁵ Chizever Dep. at 19-41.

Thus, I have not relied on any colorably privileged testimony by Chizever, and overrule Alden's objection to his testimony.

At the same time, I am mindful that in California "[a]ny contract must be construed as a whole, with the various individual provisions interpreted together so as to give effect to all, if reasonably possible or practicable."⁵⁶ Thus, I turn to Alden's interpretations of the Crime Exception to determine if he has offered any reasonable alternative readings.

Alden claims that neither party intended the Crime Exception to exclude from the scope of the Release civil liability for conduct that happens to be criminal. In connection with the summary judgment briefing, Alden submitted a declaration wherein he stated:

Before signing the Release, I was most concerned about the Crime Exception and discussed it with Case Financial's attorney and Harvey Bibicoff, then Chief Executive Officer of Case and the person with whom I negotiated the Release.

Alden also objects to the admission of the deposition of John Irvine. Def.'s T. Br. at 6-7. For that deposition, Irvine was in a hotel room in Kingston, Jamaica, and Case Financial took the deposition remotely. Alden claims that I ordered the parties to cooperate in the scheduling of the Irvine deposition, and that Case Financial refused to allow Alden to postpone it, thereby preventing Alden from preparing for or attending the deposition. *Id.* at 7. At a hearing on February 25, 2009, I instructed the parties to go ahead with the deposition, and also stated that if Alden's counsel wanted to re-depose Irvine in person, they could do so anytime before March 31, 2009. Alden chose not to participate in the telephonic deposition and evidently did not take his own deposition of Irvine. Alden, therefore, has not shown any unfairness in the procedure, and I overrule his objection to the Irvine testimony.

⁵⁶ *City of Atascadero v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 68 Cal. App. 4th 445, 473 (Cal. App. 1998) (citing *Cal. Civ. Code* § 1641; *Cal. Civ. Proc. Code* § 1858).

Both, Bibicoff and Case Financial's attorney, represented to me that said provision was not intended to reserve to Case Financial any rights to pursue me for any conduct that might constitute a crime under California and/or federal law. I relied on that representation because, to my understanding then, only the government can prosecute for crimes.⁵⁷

At argument on the summary judgment motions, I expressed a concern that, so construed, the Crime Exception might be virtually meaningless in that, with or without the Crime Exception, only the government can prosecute crimes and Case Financial has no power to grant Alden a release from criminal acts that would be binding on the government. Thus, I do not find reasonable this first alternative construction proposed by Alden.

At his deposition, Alden also offered a second explanation:

When I saw the release and I saw the crime exception, I said that, "If we are releasing, I want a full release, and each one of us go his way and continue his life." And I want that provision out. Harvey [Bibicoff], at that point, explained to me that this provision only remains to protect Case Financial in case the government bring a case against me to hold Case Financial harmless so that they don't have to defend me in case the government bring a case against me, or they don't have to be a part of it.⁵⁸

Through this somewhat different explanation, I understand Alden to suggest that the Crime Exception means that, if the government decided to prosecute Alden, Case Financial could refuse to indemnify or provide advancement to him in connection with those charges. In the same vein, Alden also stated at trial that the Crime Exception allowed Case Financial to turn him over to or cooperate with the authorities, without

⁵⁷ Alden Decl., dated Oct. 31, 2008, ¶ 36.

⁵⁸ PX 4, Alden Dep. at 14.

risking any liability to Alden.⁵⁹ In Alden’s view, however, the Crime Exception would be limited to these effects and would not otherwise reduce the scope of the Release. Although I can see why a company might want the assurances Alden posits, there were much clearer ways Alden and Case Financial could have expressed an intent to limit the Crime Exception to only these narrow circumstances. As it is, Alden’s second alternative construction is also unreasonable because it seeks to impose limitations on the Crime Exception carve out that are inconsistent with the plain language of the Exception.

Furthermore, Alden’s second interpretation does not make much sense in that Alden would be releasing Case Financial from its obligations to indemnify him from any claim there might be against him—not the other way around.⁶⁰ If Alden was correct about the Crime Exception being limited to barring his own claim for indemnification or advancement, then Alden would have released Case Financial from any claim he might have. But, in the context of construing Case Financial’s release of Alden, this argument is incoherent.

⁵⁹ T. Tr. at 147-48.

⁶⁰ Alden supports this interpretation of the Crime Exception with the deposition testimony of Bibicoff who stated that the Crime Exception was meant to absolve Case Financial in the event they turned Alden over to, or cooperated with, the authorities. PX 4, Bibicoff Dep. at 23. This reading suffers from the same weaknesses as those discussed in the text. Moreover, Bibicoff’s credibility is suspect, because Alden and other Alden family members participated in the purchase of a substantial amount of stock from companies that Bibicoff was promoting. T. Tr. at 77.

I do agree, in part, however, that a third reading of the Crime Exception Alden proffered at trial is plausible and would not render the Exception meaningless. Alden stated: “if I’m sued by the government, the government impose penalties on Case Financial, then Case Financial will have a claim against me, yes, under those circumstances, yes, they do; not under any other circumstances.”⁶¹ I agree that under the Crime Exception, it is reasonable to assume that if Alden committed crimes and Case Financial was forced to pay fines to the government, Case Financial could pursue him civilly to recover those damages.

Although Alden properly concedes there is at least one scenario where Case Financial could pursue him civilly for conduct that would be considered a crime, Alden’s attempt to limit his liability solely to those criminal acts that are prosecuted by the government is not persuasive. Similarly, I find no merit in his fourth argument, which was presented at trial, that the only criminal conduct for which he could be civilly liable would be conduct amounting to embezzlement. There is nothing in the plain meaning of the Release that suggests the Crime Exception was intended to be limited to the specific scenarios Alden has identified. Alden is a sophisticated businessman; if he wanted the Crime Exception to be limited to the specific situations he suggests, he should have insisted on language that said what he wanted or, at the very least, language that reasonably could be construed to imply the kinds of limitations he offers. Thus, Alden has not presented a reasonable alternative reading under which his liability would be

⁶¹ T. Tr. at 97.

limited only to cases brought by the government or to claims based on one and only one crime, like embezzlement. In this sense, Alden has not proven an ambiguity, but rather simply offered scenarios in which Case Financial could pursue him civilly, which is consistent with a reading of the Crime Exception that allows for civil claims against Alden for acts that constitute a crime.

Having considered all the evidence and the arguments of the parties, I conclude that the interpretation of the Crime Exception that best reflects the intent of the parties at the time they entered into the Release is the one advanced by Case Financial, but subject to one modification. I will not go through, at this point, each of the civil claims Case Financial asserts in this action to determine whether any or all of them might involve conduct that might be considered criminal. That inquiry is beyond the scope of the first trial. I note, however, that Case Financial's own attorney, who participated in the negotiations of the Release, did not believe some of the conduct that Case Financial now charges in its Complaint would be criminal and fall within the Crime Exception.⁶² Likewise, Gordon Gregory, an attorney and Case Financial board member who testified about the meeting at which the board discussed the Crime Exception, did not consider some of Alden's conduct that is challenged in this case to be criminal.⁶³ In this sense, I agree with Alden that the evidence shows the parties intended the Crime Exception to apply to allegedly criminal conduct of some reasonable level of severity, especially since

⁶² PX 4, Chizever Dep. at 30.

⁶³ PX 4, Gregory Dep. at 5, 10-11.

some of the crimes alleged by Case Financial probably would not be pursued in the real world with an exercise of reasonable prosecutorial discretion.⁶⁴

If the Release is to have any teeth, Case Financial should be barred from pursuing claims based on charges that Alden committed overly picayune or technical crimes. Therefore, I conclude the correct reading of the Release is that when the underlying conduct satisfies the elements of a crime and the crime has an analog in a civil claim, Case Financial may pursue the civil claim, provided that the elements of the crime include that Alden acted with criminal intent or scienter rather than simply recklessness, or some other comparable factor in addition to those necessary for a civil claim.⁶⁵ This modification, while still giving traction to the Crime Exception, avoids the problem noted earlier of the Exception being so broad that it renders the Release illusory and meaningless.

⁶⁴ This does not mean the Crime Exception would be limited to embezzlement, as Alden suggested at trial. *See* T. Tr. at 147. It likely would not exclude from the Release, however, certain technical, strict liability offenses that arguably would not require proof of scienter. *Cf. Wood v. Baum*, 953 A.2d 136, 141 (Del. 2008) (“Where, as here, directors are exculpated from liability except for claims based on ‘fraudulent,’ ‘illegal’ or ‘bad faith’ conduct, a plaintiff must also plead particularized facts that demonstrate that the directors acted with scienter, *i.e.*, that they had ‘actual or constructive knowledge’ that their conduct was legally improper.”)

⁶⁵ *Compare, e.g., U.S. v. O’Hagan*, 139 F.3d 641, 647 (8th Cir. 1998) (citing 15 U.S.C. § 78ff(a)) (“[A] negligent or reckless violation of the securities law cannot result in criminal liability; instead, the defendant must act willfully.”) *with Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2507 n.3 (2007) (“Every Court of Appeals that has considered the issue has held that a plaintiff may meet the scienter requirement [for civil claims of securities fraud] by showing that the defendant acted intentionally *or recklessly*.”) (emphasis added).

One last issue in this connection involves the question of the appropriate standard of proof for a civil claim Case Financial might bring under the Crime Exception: preponderance of the evidence or proof beyond a reasonable doubt? Predictably, the parties respectively urge the standard that favors them. Under California law, “it has long been settled that in civil cases even a criminal act may be proved by a preponderance of the evidence.”⁶⁶ Because Alden failed to offer any case law to the contrary, I hold that the proper standard is a preponderance of the evidence.⁶⁷

C. Does the Expiration of Representations and Warranties Bar Case Financial’s Claims?

Lastly, Alden urges the Court to interpret the first sentence of section 19.1 of the APA as effectively barring any claim against him for fraud. The relevant portion of section 19.1, entitled “Termination of Representations and Warranties,” reads: “The

⁶⁶ *Liodas v. Sahadi*, 19 Cal. 3d 278, 290 n.8 (Cal. 1977).

⁶⁷ Alden also argues that if this Court allows Case Financial to proceed with its civil claims predicated upon criminal wrongdoing, he is entitled to a jury. Def.’s T. Br. at 36. Alden cites to a California Supreme Court case that reaffirms the right to a jury in a criminal case. *Id.*, citing *People v. Izaguirre*, 42 Cal. 4th 126, 131 (Cal. 2007). As the case caption suggests, however, that decision involved a criminal conviction. Here, there is no threat of conviction, imprisonment, or a significant fine levied by the government. Indeed, as a court of equity, we often encounter, under the cleanup doctrine, legal, as opposed to equitable, claims where, if they had been brought in the Delaware Superior Court or any other court of law, a defendant could request a jury. In such cases, however, parties are not entitled to jury trials. See *McMahon v. New Castle County Assocs.*, 532 A.2d 601, 607 (Del. Ch. 1987); cf. *Dimeling, Schreiber, & Park v. Packaging Indus. Group, Inc.*, 1991 WL 260762, at *6 (Del. Ch. Nov. 15, 1991) (reaffirming settled Delaware law that a jury is not necessary for a fair trial in equity).

respective representations and warranties of Seller and Buyer contained in this Agreement shall expire and terminate on the Closing Date.”⁶⁸

Once again, neither party has cited any California case law directly on point or even any California law that deals with a clause that specifically provides for the expiration of representations.⁶⁹ Indeed, other than a conclusory statement that a claim of fraud is barred because the representations expired at closing, Alden does not describe how exactly he contends § 19.1 operates to limit Case Financial’s claims in this action.

Nevertheless, it appears most reasonable to read section 19.1 as a limit on the time in which a breach may occur and not on the time in which a claim may be brought. For example, a seller of a company may represent that the company has twenty-five tractors. The seller would vouch that the representation corresponds to reality at the time the representation was made and that the representation will remain true until the closing. The seller does not represent, however, that after the closing the representation will remain true. Thus, at closing, the representation will expire, but the buyer still may bring a suit for fraudulent inducement after the closing based on the falsity of the representation at or before the closing.

Another conceivable way of reading section 19.1 is as a contractual allocation of misrepresentation risk. Thus, in order to bring a claim for fraudulent inducement, a buyer

⁶⁸ APA § 19.1.

⁶⁹ The APA contains a choice-of-law provision specifying that California law controls. *See* APA § 19.3.

or seller would have to bring such a claim before closing, regardless of when the breach was discovered. On this reading, which is not irrational, the parties effectively would have contracted for a shortened statute of limitations. Indeed, the First Circuit has held that when an agreement states that representations expire after a certain time period following an event, the clause may be treated as a deadline for filing suit.⁷⁰

In the circumstances of this case, however, I do not find the latter reading persuasive. California courts disfavor contractual limitations on statutes of limitation.⁷¹ Therefore, any such stipulations “should be construed with strictness against the party invoking them.”⁷² To limit the statute of limitations in a context like this, the parties must clearly express their intent to do so. Here, in the absence of a California case interpreting the clause as Alden seeks, and where Alden easily could have drafted the clause to state explicitly what he contends it was intended to mean, I cannot find that section 19.1 clearly manifests the parties’ intent to derogate from the applicable statute of limitations. Therefore, section 19.1 does not bar a claim for intentional fraud based on a

⁷⁰ *State St. Bank & Trust Co. v. Denman Tire Corp.*, 240 F.3d 83, 87-88 (1st Cir. 2001).

⁷¹ *W. Filter Corp. v. Argan, Inc.*, 540 F.3d 947, 952 (9th Cir. 2008) (citing *Lewis v. Hopper*, 295 P.2d 93, 95 (Cal. Ct. App. 1956)).

⁷² *Id.*

representation Alden made before the closing that he knew was false sometime before the closing.⁷³

III. CONCLUSION

For the reasons stated in this memorandum opinion, I conclude that the evidence establishes: (1) that the Crime Exception to the Release granted to Alden by Case Financial means that Case Financial did not release Defendant Alden from civil liability for any conduct that constitutes a crime under either California or federal law, provided that the elements of the crime include that Alden acted with criminal intent or scienter rather than simply recklessness, or some other factor in addition to those necessary for a civil claim; (2) that the evidence establishes that the Expirations of Warranties clause within section 19.1 of the APA does not bar a claim for fraud brought after the closing of the asset purchase transaction based on misrepresentations made by Alden before the closing of the asset purchase transaction; and (3) that Case Financial has standing to assert claims for breach of fiduciary duty against its former director for conduct he engaged in that breached a duty owed to Case Financial, including any such conduct that also used the Company's wholly-owned subsidiary, Case Capital. Further, I deny

⁷³ Alden also included separate laches and unclean hands arguments in his trial brief. *See* Def.'s T. Br. at 28-34. Neither of those defenses were identified in a timely way as being part of the trial of the first phase of this action. I, therefore, do not address either one of them. In addition, Alden argued that because he was not a party to the APA, he could not be responsible for any alleged misrepresentations in it. There is no question, however, that Alden acted as a representative of the seller, Old CFI, in the asset purchase transaction. Hence, Alden conceivably could be liable for the type of misrepresentation posited here.

without prejudice the relief sought by Alden related to his defenses of laches and unclean hands, because those defenses were not identified by the Court or agreed to by the parties for consideration in the first phase of the bifurcated trial of this action.

IT IS SO ORDERED.