Arbitration Awards

Process, Content & Challenges

ADR Study Group ~ April 25, 2017 Meeting

Peter K. Rundle & Robert L. Brent

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1. INTRODUCTION.

Our goal today is to encourage and facilitate a lively discussion of arbitration awards. We have attempted to confine ourselves to the above-described three aspects of awards: Process, Content and Challenges.

As we have discussed various portions of the following outline, it has become readily apparent that each item has deep roots and spreading branches. Many items in the outline are worthy of individual attention.

We are cognizant that our audience is composed of some of the most experienced arbitrators in Southern California and have, therefore, not attempted to recite or refer to source materials (*e.g.,* statutes; practice guides; prior presentations, *etc.*)

We hope that with the help of the following outline – and the free flow of ideas and individual practices – we each will gain a better, more nuanced understanding of how best to craft arbitration awards.

2. PROCESS.

A. Starting the Process -

i. The Preliminary Hearing & First Procedural/Scheduling Order:

a. Who are the parties and their representatives; what are the claims and defenses; what are the underlying key documents and arbitration provisions; are there issues or jurisdiction or arbitrability; what rules, statutes and/or laws apply; what remedies are sought, and against whom; will motions be filed; are discovery disputes likely; *etc*?

b. How (if at all) do these (and other) issues and facts begin to frame the award?

ii. When do we begin writing the award?

a. When we receive pre-hearing documents (exhibits & briefs)? Even if we are only outlining or framing the award at this early stage, do we run the risk of forming substantive opinions too early?

b. Do we continue to write and edit the award as the hearing progresses (at lunch breaks; at the end of each day)? How do we guard against a sort of "implicit bias" that drafting too early might cause?

B. Creating the Award -

i. How do we craft the award?

a. Do we rely upon the pre- and post-hearing briefs by counsel to frame the issues? In *pro se* cases, or cases where one party is poorly represented, does over-reliance upon counsel's briefs created unintended consequences?

b. Do we ever adopt counsel's language as part of our award? Summaries of claims (*e.g.,* change order requests); proposed declaratory judgment; proposed injunctive relief, *etc*?

ii. Do we backstop our awards by addressing issues that may have been rendered moot? Is this ever proper?

a. "Having determined that the claim is barred by the applicable statute of limitations, determination of whether respondent's conduct constituted a breach has been rendered moot. Nevertheless, even if the claim were not barred by the statute of limitations, claimant failed to present evidence sufficient demonstrate that it suffered any damages as a result of the alleged breach."

iii. Panel Dynamics: “Too Many Cooks,” or “Spread the Burden”?

a. If we are the chairperson, do we assign different parts of the award to panel members? If we are a wing arbitrator, do we encourage such a division of labor?

b. When is the draft award circulated for comment?

c. Are dissents common? How do we resolve conflicts without abandoning principled decision?

C. Time and Effort –

i. How do we estimate the time required to create the award?

a. Scheduled length of hearing;

b. Number of witnesses;

c. Number of parties;

d. Number and complexity of claims;

e. Amount at stake;

f. All of the above, and then some?

ii. How accurate are our estimates?

a. Requesting additional deposits.

b. Requesting additional time.

D. Submission to and Review by AAA –

i. When should we submit our draft award to the AAA Case Administrator?

ii. What review takes place?

iii. The AAA / ICDR Arbitrator Checklist.

3. CONTENT.

For our purposes, “content” means structure, format, flow, *etc.* Each case will necessarily result in a unique award the characteristics of which are dictated by a myriad of factors. We are interested in common practices, trends and party / provider preferences.

A. Overview –

i. We have attached as **Samples 1, 2 & 3,** and in various degrees of "redaction" (outline / template – redacted – no changes), sample awards or templates that may raise issues for discussion, comment, *etc.*, all of which we welcome.

ii. Our perception is that the content (format) of arbitration awards is converging into something that is common or "standard." Is this perception accurate and, if so, (a) what are the causes, and (b) what are the benefits and drawbacks, if any?

a. Over time, as we see awards that are well-received, or otherwise appeal to our sense of style and effectiveness, we "take a little from here and there" so that good practices, phraseology, structure, *etc.* spread and take hold.

b. Does the same process work in reverse? Do we simply build a bigger more complex award by adding to the structure without a corresponding critical review of what might be superfluous content?

c. Is the "comprehensive" standard award serving the interests of the parties and their counsel well? Are these comprehensive awards an extension of trend toward a litigation style of arbitration?

B. Structure –

i. Narrative vs. Structured – For our purposes, a "narrative" award contains few headings, and its paragraphs are not numbered. Conversely, a "structured" award follows an outline format with many headings and subheadings, numbered and sub-numbered paragraphs.

a. One AAA administrator reports that counsel and AAA case managers prefer a structured format because, among other advantages, it enables counsel and the administrator to determine more readily whether and how particular issues have been addressed and resolved.

b. It is reported that narrative awards are more common in consumer and small-dollar commercial disputes. It is unclear, however, whether experienced arbitrators who serve on a wide-variety of disputes (as opposed to only smaller disputes) adopt differing format styles based upon the type of case.

* Is it more likely the case that inexperienced arbitrators do not have exposure to "comprehensive" and structured awards and, therefore, utilize a more narrative approach?

* In other words, do we utilize a common structure and format (trending toward a standard, structured, and comprehensive award), but simply scale up or down depending upon the unique characteristics of the case? If so, is this a good approach?

* Is one structure or format more expensive than the other? Does one structure provide a greater benefit (understanding process; experience of having been "heard," *etc.*)? Is this an issue of the parties "getting what they pay for?" Is this a cause for concern?

C. Format –

i. Single vs. Double Spaced;

ii. Footnotes;

iii. Lined vs. Unlined Paper;

iv. Format of Caption; Use of AAA / ICDR "Branding;"

v. Tables, Charts and Graphs;

vi. Exhibits and Attachments;

vii. Referencing vs. Reciting Prior Orders;

viii. Evidentiary Rulings – when, why, how much detail;

ix. Party Titles ("Claimant" and "Respondent") vs. Party Names; and

x. Title of Document (Arbitration Award; Award of Arbitrator; Final Arbitration Award; Final Award; *Etc.*).

D. Content –

i. List exhibits and witnesses?

ii. Describe witness testimony – how much detail?

iii. Describe conduct and demeaner of counsel, parties and/or witnesses – when (if ever), how, why, *etc*?

iv. Describe prior / parallel court proceedings and orders?

v. Is the content of our award affected, and if so how and why, by the following:

a. Belligerent counsel, party or witness;

b. *De novo* "appellate" rights;

c. Case type (*e.g.,* construction, IP, healthcare);

d. Other.

4. CHALLENGES.

A. Difficult issues – "challenges" – often become apparent only toward the end of the proceedings, and often only when we "put pen to paper" and begin preparing the substantive portion of the award. Where possible, anticipate the unexpected and establish mechanisms to deal with the issue if it arises. Some examples of potential difficulties include:

i. Statutory offers of compromise (*CCP § 998)* or other fee/cost shifting mechanisms;

a. Address this issue at the preliminary hearing (counsel to advise case manager; be careful to not "issue" final award without clearing this issue);

ii. Baseball, High / Low, and other "restrictive" awards;

iii. Out of time; parties will not consent to extend to render award;

iv. "Retaining jurisdiction;"

v. Award by arbitrator who previously served as mediator; and

vi. Other.

5. <u>DISCUSSION; ARGUMENT; RECENT ISSUES; FREE FOR ALL</u>.

As usual, at the end of our “featured” presentation, we encourage group and side discussions on any issues that may be of interest.

Thank you,

Bob & Peter

AMERICAN ARBITRATION ASSOCIATION

In the Matter of the Arbitration between:

Re: Case No. _____

_____,

Claimant and Counter-Respondent,

and

_____,

Respondent and Counter-Claimant.

AWARD OF ARBITRATOR

I, _____, THE UNDERSIGNED ARBITRATOR, having been designated in accordance with the arbitration agreements entered into by and between the above-named Parties and dated _____ and _____, having been duly sworn, and acting under the Commercial Arbitration Rules of the American Arbitration Association as amended and in effect 1 October 2013, and having heard and received all testimony, exhibits, submissions and arguments properly presented and submitted by the Parties and their representatives at the _____ Evidentiary Hearing, and also contained in the Parties' Closing Briefs submitted on _____, and the Parties and their representative having each confirmed upon resting their cases, and in response to the Arbitrator's specific inquiry, that they had no further evidence, testimony, documents or other proofs to offer, and good cause appearing therefor, now find, conclude and issue this Award as follows:

1. THE PARTIES AND THEIR REPRESENTATIVES.

1.1. Claimant and Counter-Respondent is . . .

1.2. Respondent and Counter-Claimant is . . .

1.3.

2. THE UNDERLYING CONTRACTS AND ARBITRATION AGREEMENTS.

2.1. The Parties' dispute arises from . . .

2.2. The Agreements each contain the following provisions (unless otherwise noted), among others:

2.2.1. ". . . ."

2.2.2. ". . . ."

2.3. The Parties' Agreements each contain the following identical arbitration provisions:

2.3.1. ". . . ."

3. THE PARTIES' CLAIMS, COUNTER-CLAIMS AND RESPONSES.

3.1. On or about _____, _____ filed its Amended Arbitration Demand against _____ seeking $_____, as well as attorney's fees, interest and arbitration costs.

3.2. On or about _____, _____ filed ____ Answering Statement and Counter-Claim against _____, as well as against _____. In ___ Counter-Claim, _____ sought $_____, as well as attorney's fees, interest, arbitration costs and punitive/exemplary damages.

3.3. On or about _____, _____ submitted a proposed amended counter-claim wherein _____ sought damages against _____, as well as _____, in the amount of $_____ based upon six asserted causes of action, to wit: (1) . . .

3.3.1. The AAA advised _____ in writing on _____ and _____ that because of the increased claim amount set forth in the proposed amended counter-claim, an additional filing fee would be required before the amended counter-claim would be deemed filed. _____ did not pay the additional filing fee and, therefore, on _____, the AAA wrote to _____ stating: "This will confirm we have not received the increased filing fee for the amended counterclaim as submitted by Respondent. Therefore, we are returning the amended counterclaim as it is not properly filed. We note the initial counterclaim, dated _____ remains active on this case as the filing fee was received for said counterclaim."

3.4. Pursuant to the Arbitrator's Order No. 3 concerning the amendment and/or specification of claims, on or about _____, _____ filed and served its Statement of Claim, and Response to _____'s Counterclaim. In its Statement of Claim, _____ stated that it was owed $_____ based upon four causes of action, to wit: (1) . . .

3.5. Also in response to the Arbitrator's Order No. 3, on or about _____, _____ filed and served ___ Response to Claimant _____ consisting of a general denial pursuant to *California Code of Civil Procedure, Section 431.20(d)*, together with twelve (12) affirmative defenses, to wit: (1) . . .

4. THE PARTIES' CONTENTIONS.

4.1. The Parties' contentions in this arbitration may be summarized, briefly, as follows:

4.2. ***Claimant and Counter-Respondent:***

4.2.1. _____ alleges that . . .

4.3. ***Respondent and Counter-Claimant:***

4.3.1. _____ alleges that . . .

5. PRELIMINARY ISSUES.

5.1. ***Procedural Motions and Rulings:***

5.1.1. _____ brought a Motion to Disqualify _____ from representing _____, which motion the Arbitrator denied in his _____ *Procedural Order No. 5 Ruling on Respondent's Motion to Disqualify Counsel*, as follows:

"The undersigned Arbitrator, . . .

5.2. ***Evidentiary Issues and Rulings:***

5.2.1.

5.3. ***Dispositive Motions and Rulings:***

5.3.1. _____ brought a Motion to Dismiss this arbitration proceeding, which motion the Arbitrator denied in his *Procedural Order No. 6 Ruling on Respondent's Motion to Dismiss,* as follows:

"The undersigned Arbitrator, . . .

6. ISSUES PRESENTED FOR DETERMINATION.

6.1. The Parties presented the following issues for determination in this arbitration:

6.1.1. ***The _____ Agreement:***

- Whether the _____ Agreement a valid, binding _____ contract between _____ and _____;

    - o If the . . . . *?*

- Whether _____ properly performed all obligations imposed upon it pursuant to the terms of the _____ Agreement;

    - o If not, . . .?

- Whether _____ has presented sufficient facts to support one or more of its twelve (12) affirmative defenses in order to defeat or diminish _____'s asserted claims.

6.2.1. ***Generally:***

- Whether the party prevailing in this arbitration is entitled to recover interest, attorney's fees and/or the costs of this arbitration, including the Arbitrator's fees;

    - o If such recovery is authorized and permitted, is there a prevailing party, who is it, and what is the appropriate amount of such interest, attorney's fees and/or costs?

7. THE EVIDENTIARY HEARING.

7.1. The following witnesses were called and testified:

7.1.1. _____, Esq. (Percipient) [Day 1]

7.1.2. _____, Esq. (Percipient) [Day 2]

7.1.3. _____, Esq. (Expert) [Days 2 & 3]

7.1.4. _____ (Percipient) [Day 3]

7.1.5. _____ (Percipient) [Day 3]

7.1.6. _____ (Percipient) [Day 3]

7.2. *Day One (_____, 2016)* – The first day of the Evidentiary Hearing commenced at approximately 9:00 a.m. and concluded at 4:00 p.m. . . . .

7.2.1. The proceedings opened with an informal discussion among the Arbitrator, counsel, _____, and _____ concerning, among other things, hearing procedures and expectations, and miscellaneous preparatory items. Having inquired of

everyone present whether any reason existed why the Evidentiary Hearing should not commence, and hearing none, the formal proceedings began.

7.2.2. Mr. _____ gave an opening statement. _____ then gave an opening statement. _____ then called and inquired of its first witness, _____, Esq. ("Mr. _____").

7.3. *Day Two (_____, 2016)* – The second day of the Evidentiary Hearing was scheduled to commence at 10:00 a.m. Mr. _____ had requested – at the end of the first day's proceedings – that the start of the second day's proceedings . . .

7.3.1. . . . .

8. THE EVIDENCE AND EVIDENTIARY ISSUES.

8.1. The Parties marked, identified, offered and introduced a large volume of documents at the Evidentiary Hearing. The following documents and exhibits offered were received into evidence:

Exhibit No.	Exhibit Description
1	Contract between ABC Corporation, Inc. and DEF, LLC, dated April 1, 2012

8.2. After the final witness, the Arbitrator specifically reviewed with Mr. _____, Mr. _____ and Ms. _____ the above-described exhibits that had been offered into evidence and received. The Arbitrator directly inquired of Mr. _____, Mr. _____ and Ms. _____ whether the record of exhibits was a complete list of all exhibits they wished to offer. In response, Mr. _____, Mr. _____ and Ms. _____ each said, "yes."

8.3. Further, the Arbitrator specifically inquired after the final witness whether either _____ or _____ had any further witnesses, evidence or proofs they wished to submit. In response, Mr. _____, Mr. _____ and Ms. _____ each said, "no."

9. THE POST-HEARING BRIEFS AND SUBMISSIONS.

9.1. On _____, following their presentations of evidence and argument during the Evidentiary Hearing, the Arbitrator issued his *Procedural Order No. 10 re: Post-Hearing Submissions*. The Parties and their counsel were directed to make any submissions they wished to make by way of written closing-argument on the issues presented, as well as any requests for interest, attorney's fees and costs, on or before _____, and to provide any reply submissions in response to the other Party's original submission on or before _____.

9.2. The Parties, through their counsel and representatives, each made post-hearing submissions pursuant to *Order No. 10.* The Evidentiary Hearing in this matter was thereupon closed on _____.

10. STATEMENT OF FACTS.

10.1. This Section 10 of the Award is a statement of those facts found by the Arbitrator to be true and necessary to the Award. To the extent that this recitation differs from any Party's position, that is the result of determinations as to credibility, determinations of relevance, and the weighing of the evidence, both oral and written.

10.2. . . . .

10.3. . . . .

10.16.1. Among other things, Mr. _____ testified on cross-examination to the following points:

- Exhibit "34" (_____) . . . .;
- . . . .;
- . . . .;

10.28.1. _____

Fees Billed	$91,220
Costs/Expenses Billed	7,369
Interest Billed	23,882
Total Amount Billed	122,471
Amount Paid	26,661
Amount Claimed	$95,810

10.28.2. _____

Fees Billed	$69,872
Costs/Expenses Billed	4,798
Interest Billed	18,147
Total Amount Billed	92,817
Amount Paid	17,257
Amount Claimed	$75,559

11. LEGAL ANALYSIS AND DISCUSSION.

11.1. . . . .

11.2. . . . .

12. RELIEF AWARDED.

12.1. _____ is entitled to prevail on its claim for _____ in the amount of $_____ as described in Paragraphs _____ and _____, *supra.*

12.2. _____ is entitled to prevail on its claim for _____ in the amount of $_____ as described in Paragraphs _____ and _____, *supra.*

12.3. . . . .

12.6. _____ has failed to present evidence sufficient to support or otherwise sustain any of its affirmative defenses or counter-claims.

12.7. As the prevailing party in this arbitration, _____ is entitled to an award of attorney's fees and costs in the amount of $_____ incurred in the prosecution of its claims, and the defense of _____'s counter-claims.

12.8. The administrative fees of the American Arbitration Association totaling $_____ shall be borne by _____, and the compensation of the Arbitrator totaling $_____ shall be borne by _____. Accordingly, _____ shall reimburse _____ the additional sum of $_____ representing such fees and compensation, upon demonstration by _____ that these incurred costs have been paid.

12.9. Accordingly, _____. shall have and recover from _____, _____, _____ Dollars and _____ Cents ($_____).

12.10. This Award of Arbitrator is in full resolution of all claims and counterclaims submitted to this Arbitration. All claims and counterclaims not expressly granted herein are hereby denied.

Dated: _____

Arbitrator's Signature _____

INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION

International Arbitration Tribunal

[redacted]

Claimants,

v. **ICDR Case No.** [redacted]

[redacted] **and**

Respondents

March 22, [redacted]

FINAL AWARD

I, THE UNDERSIGNED ARBITRATOR, having been designated in accordance with the arbitration agreement entered into between [redacted] Inc. and [redacted] dated December 8, [redacted] and having been duly sworn, and having duly heard the proofs and allegations of the parties, do hereby, make this FINAL AWARD.

Parties and Claims

Claimants and Counter-Respondents [redacted] and [redacted] bring this arbitration against [redacted] and [redacted] but [redacted] filed a counterclaim against Claimants.

Claimants are represented by [redacted] LLP, and Los Angeles. [redacted] Esq. o[redacted] LLP appeared for Claimants at one teleconference only. Respondents were originally represented by [redacted] and [redacted] of [redacted] attended the hearings as an observer for Respondents. Thereafter, th[redacted] withdrew and were replaced [redacted] and [redacted]

Claimants' First Amended Demand for Arbitration asserts two causes of action against Respondents, account stated and breach of contract, and seeks money damages of [redacted] pre-judgment and post-judgment interest, attorneys' fees and costs and other unspecified relief.

Respondents' First Amended Statement of Defense denies all claims and asserts nineteen affirmative defenses, which include unconscionability, failure to perform, setoff and recoupment.

The two [redacted] entities assert a counterclaim which alleges three causes of action, namely breach of contract, breach of the covenant of good faith and fair dealing, and a request for declaratory relief including a declaration that the subject Agreement between the parties is unenforceable and, alternatively, that Claimants' claims against the [redacted] entities are setoff or offset by the [redacted] counterclaim. The [redacted] entities also seek pre-judgment interest on their claims for set-off, attorneys' fees and other unspecified relief. [redacted] is not a party to this counterclaim.

Summary of Award

The Arbitrator finds the issues in favor of Claimants and finds that Respondents are jointly liable to Claimants for damages, attorneys' fees, costs of arbitration, pre-judgment interest and administrative fees of the International Center for Dispute Resolution (ICDR) in the total amount of [redacted] and awards that sum to Claimants jointly from Respondents jointly. The Arbitrator denies the counterclaim of the [redacted] entities in its entirety, including its request for declaratory relief.

The Agreement

The arbitration agreement is a Reseller Agreement (the Agreement) between [redacted] a Delaware Corporation and predecessor of [redacted], and [redacted] dated December 8, [redacted]

Law and Rules

The parties agreed that this arbitration is subject to the substantive law of California. Pursuant to American Arbitration Association (AAA) procedures, this arbitration is subject to the International Dispute Resolution Procedures of The International Centre for Dispute Resolution (ICDR, amended and effective June 1, 2010). The parties have agreed to hold the arbitration in Los Angeles, California and the California Arbitration Act applies.

Procedural History

The operative pleadings are Claimants' First Amended Demand for Arbitration and Statement of Claims; Respondents' First Amended Statement of Defense and Counterclaim; and Claimants' Statement of Defenses to the Counterclaims.

Several motions were adjudicated during the pre-hearing process.

1. Jurisdiction - First Order

In Procedural Order # 1, dated May 17, [redacted], the Arbitrator ordered the parties to brief two issues of jurisdiction. The parties did so and each party added a motion to dismiss. The jurisdictional issues were:

1. Do the Claimants have the right to maintain this arbitration under the Agreement as a non-signatory?
2. Do Respondents have the right to maintain a counterclaim against Claimants, a non-signatory to the Agreement?

The parties filed simultaneous opening briefs with declarations and supporting exhibits followed by simultaneous reply briefs. After briefing the first question on jurisdiction, Claimants filed a de facto motion to dismiss Respondents' affirmative defenses of setoff and recoupment and Respondents' counterclaims, contending that the defenses and the counterclaims were barred as a matter of law by 11 U.S.C. Sec. 3353 (f) and by related statues and case law. Respondents opposed this motion.

In addition, Respondents' opening brief included an informal, unscheduled motion to dismiss [redacted] Respondents' briefing also included an informal, unscheduled motion to dismiss Claiman[redacted] Claimants opposed both motions.

After review of the briefing, cited authorities and oral argument, the Arbitrator ruled as follows:

1. The Arbitrator has jurisdiction over [redacted] in this arbitration, both as Claimant and as Counter-Respondent.
2. Claimants' motion to dismiss the affirmative defenses and counterclaims was denied without prejudice to assert the subject contentions in opposition to the Respondents defenses and counterclaims at the merits hearing.
3. Respondents' motion to dismiss [redacted] was denied without prejudice.
4. Respondents' motion to dismiss [redacted] was denied without prejudice.

The above rulings were cited in Procedural Order # 3 as follows:

> Under ICDR rules, the Arbitrator may determine his or her own jurisdiction. The Arbitrator has jurisdiction over [redacted] a non-signatory to the arbitration [sic] agreement, both as Claimant and as Counter-Respondent. It is undisputed that in the Reseller Agreement between [redacted] the Agreement), those companies contracted to arbitrate disputes arising

from that Agreement. It is also undisputed that by a second contract, the Asset Purchase Agreement (APA), dated May 13, [redacted] after [redacted] entered bankruptcy, [redacted] assigned to Claimant [redacted] the right to certain accounts receivable which originated under the Agreement. As assignee of [redacted], a signatory to the [redacted] is bound by the arbitration provisions of the Agreement and may assert its claim as assignee in arbitration pursuant to the Agreement.

It is undisputed that the APA is governed by New York law. That law, consistent with established arbitration law, recognizes that an assignee of contract rights based on an agreement which contains an arbitration clause may invoke that arbitration clause notwithstanding that the assignee is not a signatory to the Agreement. See *Banque de Paris et des Pays Bas v. Amoco Oil Co.*, 573 F. Supp. 1464 (S.D.N.Y. 1983) [sic]; *GMAC Commer. Credit LLC v. Springs Indus., Inc.*, 171 F. Supp. 2d 209 (S.D.N.Y. 2001).

It is also undisputed that [redacted] assigned, on January 1, [redacted] its rights and obligations under the Agreement and that, subsequently, on February 17, [redacted] [sic] [redacted] with the consent of [redacted] assigned to [redacted] its rights and obligations under the Agreement. Therefore, [redacted] as a direct assignee of [redacted] and [redacted] as an assignee of [redacted] are both subject to the arbitration provisions of the Agreement, to which [redacted] a party.

Claimants' attacks on Respondents' affirmative defenses and counterclaims were not based on any issue of jurisdiction and Claimants did not contend that the Arbitrator lacks jurisdiction over Claimants as a Counter-Respondent.

Accordingly, I find that jurisdiction exists over [redacted] both as Claimant and as Counter-Respondent on the counterclaims.

The issue of jurisdiction was raised again by Respondents later in the proceedings and the Arbitrator permitted another round of briefing on jurisdiction after the evidentiary hearing.

Jurisdiction – Second Order

The Arbitrator permitted additional briefing on jurisdiction because, late in the proceedings, Respondents cited, for the first time, a [redacted] which, they contend, affects the Arbitrator's jurisdiction. The briefing was not limited to that decree. Respondents asserted arguments that had already been considered and provisionally rejected, e.g. that since [redacted] contends that it acquired the accounts receivable free and clear of all interest, it cannot invoke the arbitration clause in the Reseller Agreement. The Arbitrator's prior ruling on jurisdiction rejected [redacted] said contention, and the Arbitrator found tha[redacted] as, indeed, asserting rights under the Agreement which contained the arbitration clause.

Respondents also base their jurisdictional objections on legal positions that have been rejected in this Award, e.g. tha[redacted] was released from the Reseller Agreement.

Respondents also base their objection o[redacted] Legislative Decree No. 34. The[redacted] entities seek a ruling that the Arbitrator lacks jurisdiction to resolve this dispute because, they contend[redacted] Decree No. 34 of August 5, 1967, confers the[redacted] courts with exclusive jurisdiction over disputes implicating an exclusive distributorship that has been terminated prematurely. Respondents contend that Legislative Decree No. 34 also provides for an indemnity in situations where an exclusive distributorship is not renewed or terminated prematurely. Respondents claim that unde[redacted] aw, Legislative Decree No. 34 is a matter of mandatory public policy and, as such, must be applied by the[redacted] court irrespective of the parties' agreement. Accordingly, Respondents contend that the proper forum for the parties' dispute is th[redacted] court, not this arbitration.

This challenge to jurisdiction is rejected for several reasons. Article 15, Section 3 of the ICDR Arbitration Rules & Procedures provides:

> A party must object to the jurisdiction of the tribunal or to arbitrability of a claim or counterclaim no later than the filing of the statement of defense, as provided in Article 3, to the claim or counterclaim that gives rise to the objection. The tribunal may rule on such objections as a preliminary matter or as part of the final award.
>
> ICDR Procedures Article 15, Section 3.

This objection could have been raised at the outset of this arbitration. Since the basis of the objection is a 1967 Decree, there is no reason to extend the time limit as permitted by the Article.

Also[redacted] agreed, in the Reseller Agreement, that the agreement would be subject to California substantive law and this objection to jurisdiction is based on the claims of law and public policy o[redacted]

It would be highly prejudicial to Claimants at this point in the proceedings to derail the arbitration because of a [redacted] which is claimed to affect jurisdiction.

Based on said Article 15, Subsection 3, Respondents' protracted delay in raising this issue of jurisdiction, the parties' agreement to arbitrate under California substantive law, and the potential prejudice to Claimants of any ruling adversely affecting jurisdiction based on this Decree, I deny Respondents renewed objection to jurisdiction based on thi[redacted]Decree. I also make no finding as to whether this Decree, if considered on its purported merits, would, in fact, have any effect on the jurisdiction of the Arbitrator in this matter.

2. Motion to Dismiss Defenses and Counterclaims

Claimants filed a de facto motion to dismiss the[redacted]ounterclaims. That motion was denied. The ruling stated that Claimants' de facto motion to dismiss is a dispositive motion. Such motions are not favored in arbitration.

Such motions are granted only when it is clear that the party against which the motion is directed has had the opportunity to conduct all necessary discovery; that all relevant facts are undisputed; that there is no doubt as to the merits of the motion; and there is clearly no reason to conduct a full hearing on the subject issues at the merits hearing. There is no appeal in arbitration and the best practice, generally, is to provide for full hearings on all issues. Claimants have made no showing why this motion should be adjudicated as a threshold issue in advance of the other issues to be addressed at the merits hearing, nor have Claimants established beyond any doubt that the motion should be granted.

While the parties may have implicitly agreed in the briefing that all facts relevant to the motion are undisputed and that only issues of law are presented, it was appropriate to defer resolution of the issues presented until the evidentiary hearing for adjudication together with the other issues in this arbitration. Claimants did not sustain their considerable burden to justify the granting of this dispositive motion and it was denied without prejudice to Claimants to litigate at the merits hearing the issues raised as to the two affirmative defenses and the counterclaims.

3. [redacted] Motion that it be Dismissed

[redacted] motion that it be dismissed as a Respondent was denied without prejudice. This was another dispositive motion and, like Respondents' second motion to dismiss, discussed below, it is subject to the same considerations against the granting of such motions detailed above.

[redacted] contends that, having assigned the Reseller Agreement to [redacted] is absolved of any liability to [redacted] or to its assignee [redacted] under that Reseller Agreement because of the terms of the assignment and operation of law.

[redacted] failed to establish that there is merit to its motion that it be dismissed. There is no evidence that [redacted] was released from the obligations it undertook as a party to the Reseller Agreement. No persuasive authority is cited to establish that this assignment by [redacted] operates, as a matter of law, to release [redacted] from its obligations under the Reseller Agreement. [redacted] cites excerpts from the instrument of assignment to construct an argument that this assignment agreement effectively relieves [redacted] of all of its contractual obligations. The cited language does not evidence any explicit and unambiguous intention of the parties to the assignment that [redacted] urges. Moreover, other terms of the assignment Agreement support Claimants' opposition to the motion. Had the parties intended that [redacted] be relieved of all obligations, they could have so stated by including standard release language in the assignment agreement, which they did not do.

[redacted] was permitted to and did pursue this issue at the evidentiary hearing.

4. Motion to Dismiss Claimant [redacted]

Respondents' also made a de facto motion to dismiss Claiman [redacted] This is another dispositive motion and was denied without prejudice. It is undisputed that [redacted] and that [redacted] is a signatory to the Agreement. [redacted] has standing to assert claims on behalf of the Estate o [redacted] which contracted wit [redacted] *Skelton v. Clements*, 408 F.2d 353, 354 (9th Cir. 1969). See also *In re Mercurio*, 402 F.3d 62, 66 (1st Cir. 2005) ("[t]he Trustee stands in the debtor's shoes"). As appears from Exhibit J [redacted] eclaration, [redacted] has an interest in the claims asserted by [redacted] That fact was not challenged by Respondents.

The motion to dismiss [redacted] as a Claimant herein was denied without prejudice.

5. Motion for Remote Hearing Testimony

All direct testimony was submitted by sworn declarations. Respondent moved for permission to present 5 of its 6 witnesses for cross-examination by video-conference or telephone from [redacted] Claimants objected to this proposal. Relevant facts include:

- All direct testimony in this arbitration is by written submissions.
- Claimants seek damages of [redacted]
- Respondent seeks damages o[redacted]n setoff in its counterclaim.
- The parties agreed that all disputes between them would be arbitrated in Los Angeles.
- The request for remote testimony was submitted on November 10/[redacted] The merit hearing began on December 8/[redacted] That date was set in Order # 1 dated May 17/[redacted] The motion was denied as to [redacted] granted as to [redacted]

Witnesses [redacted] and [redacted]

[redacted]s the Chief Executive Officer of Respond[redacted]s employed by [redacted] The request for remote testimony was denied as to both of them.

While the ICDR Rules state that the Arbitrator "may determine the manner in which witnesses are examined." (Art. 20, Subsection 4), whether to so direct is clearly in the discretion of the Arbitrator. Article 16, Subsection 1 provides: "Subject to these Rules, the tribunal may conduct the arbitration in whatever manner it considers appropriate, provided that the parties are treated with equality and that each party has the right to be heard and is given a fair opportunity to present its case." The conduct of the arbitration is determined by the Arbitrator under Article 16 of the Rules. Parties do not have a unilateral right to present testimony by videoconference or telephone and, in this case, cross-examination by videoconference would be unduly prejudicial and unfair to Claimants.

Respondents cited numerous cases in which such remote testimony was permitted, but none involved the facts in this case. While such testimony is often permitted, the question was whether it is fair to Claimants to permit the requested remote testimony in this case. Since the request would have imposed an unfair burden on Claimants, Respondents must establish good cause for their request, which they did not do.

Such remote testimony imposes a substantial disadvantage on the party conducting the cross-examination. That disadvantage is compounded where, as here, the direct testimony is submitted in writing. In addition, the proposed remote testimony would create separate problems for the Arbitrator who must evaluate the testimony elicited on cross-examination.

Respondents cited the expense of having these two witness travel to Los Angeles to testify. That was a foreseeable expense of Respondents having agreed to an arbitration venue in California and does not constitute sufficient reason to prejudice Claimants by denying Claimants in person cross-examination.

Respondents did not establish good cause for their request. Cross-examination is an integral part of the adversarial process in arbitration and counsel's ability to conduct it and the Arbitrator's ability to evaluate the testimony on cross should not be adversely affected without good cause.

Witness [redacted]

The motion was granted as t[redacted]nly because Respondents stated that he did not currently have a visa to permit him to enter the United States. Respondents did not provide a clear explanation of wh[redacted]did not obtain a visa before now. It was Respondents' responsibility to insure that their witnesses had made necessary arrangements to attend the hearing. Respondents could not assume that their motion to permit remote testimony would be granted. Respondents had long known the date of the hearing and the fact that [redacted] would be a witness.

However, the Arbitrator was reluctant to exclude[redacted]as a witness notwithstanding that his inability to attend the hearing in person appears to have been preventable. The Arbitrator offered Claimants the option of postponing the hearing s[redacted]uld obtain a visa, which could take a substantial amount of time. While maintaining its objection, Claimants preferred to proceed with the hearing as scheduled. Under the circumstances, the motion was granted as t[redacted]nd he was permitted to be presented for cross-examination by videoconference fro[redacted]

Witness [redacted]

Respondents stated that these two witnesses were no longer employed by Respondent and that their current employer(s) were not affiliated with Respondents. They both work in [redacted] While they are not under the control of Respondents, they are willing to travel t[redacted] [redacted]o present themselves for cross-examination by videoconference. They are not willing to travel to Los Angeles to testify in person. Since Respondents do not control these witnesses and they cannot be compelled to travel to Los Angeles, the motion for remote testimony by

these two witnesses is granted. Respondents request is denied as t[redacted] and granted as t[redacted]

The Arbitrator ordered that the Claimants could seek reimbursement for expenses of having their own counsel attend the videoconference cross-examination o[redacted] because his inability to testify in person is not a matter beyond the control of Respondents. Claimants may arrange for their own counsel to attend the other proceedings in[redacted] at Claimants' own expense. Those witnesses which testified by videoconference were not permitted to communicate with or receive communications from any person in the room while testifying by videoconference, just as is the case when a witness testifies in person at a hearing.

6. Withdrawal of Counsel

After the evidentiary hearing but before post hearing briefing and final argument, Attorney [redacted] and the[redacted] moved to withdraw as counsel for Respondents. Claimants objected to the motion, primarily because it included Respondents' request for a ninety-day hiatus to permit Respondents to arrange for replacement counsel and time for that counsel to prepare for the post hearing briefing and final argument. The motion to withdraw was granted. The ninety-day hiatus was granted as well.

The Hearing

The evidentiary hearing was held on December 9, 10, 11, and 12,[redacted] Claimant offered[redacted] Respondents offered[redacted] The exhibits below were entered into evidence at the hearing:

1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11; 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25; 27; 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43; 46; 57; 59, 60, 61; 64; 68; 72; 77; 80, 81; 83; 85; 88, 89, 90, 91; 93; 97, 98; 100; 104; 112, 113; 116; 119, 120; 122, 123; 127, 128; 131; 137; 139; 142; 146; 148; 151; 158; 160; 162, 163, 164, 165, 166, 167, 168, 169, 170, 171, 172, 173, 174, 175, 176, 177, 178, 179, 180, 181, 182, 183; 189, 190; 192; 196, 197, 198, 199, 200; 204; 207; 209; 216; 221, 222, 223, 224, 225; 233, 234, 235, 236, 237, 238; 241; 243; 248; 252, 253; 258; 260; 263, 264; 284; 288, 289, 290, 291; 293, 294, 295; 297, 298, 299, 300, 301, 302, 303, 304, 305, 306, 307, 308, 309, 310, 311, 312, 313, 314, 315, 316, 317, 318, 319.

Exhibit C106, a demonstrative exhibit offered by Claimants with their post hearing brief, was, as detailed below, considered by the Arbitrator as a demonstrative exhibit.

The Arbitrator also granted Claimants' post hearing request for judicial notice of three exhibits, C103, C104, and C107, all of which relate to the filing of a [redacted] It is noted that these documents corroborate other evidence provided at the hearing on this subject. It is also noted that [redacted] testified that this [redacted] was filed "by mistake".

Statement of Facts

The Agreements

[redacted] was a company engaged in the development, manufacture and sale of [redacted] including [redacted] On December 8, [redacted] entered into a Reseller Agreement with [redacted] The Reseller Agreement (the Agreement) was negotiated between [redacted] and [redacted] in part, at a meeting between the [redacted] and the [redacted] Chief Executive Officers in [redacted] California. Under the Agreement [redacted] agreed that [redacted] would act as the exclusive reseller of [redacted] and all [redacted] countries [redacted] had previously contracted with non exclusive resellers of its products in these areas, but [redacted] agreed with [redacted] to terminate its non-exclusive resellers to give [redacted] exclusive rights to sell its products in these countries. [redacted] was authorized by the Agreement to set its own retail prices for [redacted] products.

The Agreement required [redacted] to meet certain sales goals to maintain its exclusive representation arrangement. [redacted] failure to meet the sales goals could result in termination of the Agreement by [redacted]

On March 29, [redacted] by the First Amendment to Reseller Agreement, (First Amendment) [redacted] assigned the Reseller Agreement to its subsidiary, [redacted] The assignment included "all of [redacted] and obligations under the [Reseller] Agreement. [redacted] consented in writing to this assignment.

The First Amendment (Ex. 2) provides that [redacted] shall be entitled to look to [redacted] for satisfaction of all of its rights under the [Reseller] Agreement." The amendment states that "[e]xcept as expressly modified by this Amendment, all terms and conditions of the [Reseller] Agreement will continue in full force and effect as set forth in the [Reseller] Agreement." As detailed below, this provision of the Amendment is a very important factor in this Award.

In February [redacted] quested that [redacted] llow its affiliate [redacted] another subsidiary of [redacted] to sell [redacted] products in [redacted] agreed on February 17, [redacted] by the Second Amendment to Reseller Agreement. (Second Amendment)

The Reseller Agreement was amended again and [redacted] agreed to be bound by the Agreement. [redacted] was not a party to the Second Amendment and did not execute any consent thereto.

The Second Amendment provides that that the Reseller Agreement and the First Amendment thereto "remain in full force and effect and govern the relationship between the parties with regard to the matters specified therein." The Second Amendment did not change any terms of the Agreement as amended by the First Amendment other than to permi [redacted] products to be sold i [redacted]

A [redacted] exclusive reseller, Respondents purchased products fro [redacted] and re-sold then to customers in the covered territory. Over time, more than [redacted] worth o [redacted] were sold to Respondents' customers.

The Reseller Agreement imposed certain purchase quotas on Respondents as a prerequisite to maintain exclusivity. Under the Reseller Agreement, Respondents were required to submit orders t [redacted] on written purchase order forms, which "constituted binding commitments to accept and pay for the number and types of products stated therein." Orders were not binding o [redacted] unless accepted in writing by [redacted] . . . through [redacted] written confirmation or shipment." I [redacted] ccepted an order, it was to ship the products to Respondents in various locations throughout th [redacted] and [redacted]

The Agreement required payment for the products as soon as they were delivered. Upon delivery, [redacted] was to issue an invoice for the amount owed, at which time payment was due within 75 days. The Agreement further provided that "[a]ll amounts paid t [redacted] by Reseller . . . are nonrefundable ...."

Products ordered by Respondents were sometimes delayed in shipment. Such delays occurred, according to Claimants, for a number of reasons including shortages in source materials available fro [redacted] suppliers or manufacturers and delays caused by [redacted] shippers. There was also evidence that [redacted] so withheld shipment of certain orders pursuant to the Agreement because of Respondents' failure to pay [redacted]

Many terms of the Agreement were unfavorable to Respondents.

For example, in general, any penalties incurred by Respondents due to delays in the delivery of purchased products to its customers were to be borne exclusively by Respondents. [redacted] shared in the allocation of responsibility for any penalties for delayed shipments only if Respondents notifie[redacted]at the time they placed the order that they could face a penalty for late delivery, and [redacted] accepted the order in writing. Even then, [redacted] reserved the right to notify Reseller that it [would] attempt to meet the delivery timeline on a best efforts basis and in such case [redacted] would] have no responsibility for penalties incurred by Reseller for failure to meet the delivery date."

The foregoing provision illustrates one of the disadvantages imposed or[redacted]by the Agreement, which also provides that Reseller agrees to indemnify and hold[redacted] harmless from and against any and all loss, damage, expense or liability, including reasonable legal fees that arise or result from Reseller's failure to discharge its obligations under clause 6 [Prices and Terms of Payment]. In addition[redacted] was entitled to charge interest on unpaid amounts in an annual rate of ten percent (10%) or the maximum interest rate allowed under applicable law, whichever is lower. (Id. at 4-5, ¶ 6.6.)

[redacted] was authorized to "stop delivery of Products to Reseller" until any overdue invoices have been "duly paid." (Id. at 4, ¶ 6.5.) The Agreement also barred all claims for consequential damages by Respondents for any breach b[redacted] a significant advantage fo[redacted]

[redacted] Purchase of the Receivables

While Respondents were operating as resellers o[redacted] products, [redacted] experienced financial setbacks. To raise capital, in September [redacted] entered into a secured credit agreement with [redacted] an affiliate of the global private equity firm, [redacted] Pursuant to this agreement, [redacted] advanced [redacted] The funds were to be used by [redacted] for working capital and other corporate purposes. Despite the infusion of capital fro[redacted] financial condition continued to decline. Ultimately [redacted] filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code.

[redacted] enior secured creditor was [redacted] (Ex. C13). [redacted] entered into an Asset Purchase Agreement (the "APA") on May 13[redacted] Ex. C16 [APA].) Pursuant to the APA, [redacted] agreed to: ". . . sell, assign, convey, transfer and deliver to Purchaser... all of Seller's right, title and interest in the Assets, free and clear of all Encumbrances . . . including all of Seller's right, title and interest in the following: . . . (f) any accounts receivable, notes receivable and other receivables of Seller."

On May 17 [redacted] the Bankruptcy Court approved the sale of the Purchased Assets from [redacted] as seller to [redacted] as buyer (the "Sale Order"). (Id. at 16, ¶¶ 18, 19.) The Sale Order transferred title of the Purchased Assets—including the accounts receivable [redacted] free and clear of all interests. (Id. at 16, ¶ 20.)

[redacted] Appointed Trustee

On June 11 [redacted] the Bankruptcy Court converted the [redacted] to a case under chapter 7 of the Bankruptcy Code (the "Chapter 7 Case"). (Ex. C17.) All orders entered in the Chapter 11 Case, including the Sale Order, remained binding. (Id. at ¶ 3.)

On the same day, the Office of the United States Trustee appointed [redacted] estate pursuant to 11 U.S.C. § 702 (d) [Ex. C53]. (Ex. C18.) The Chapter 7 Case is currently pending. Under an agreement to arbitrate entered into on April 2, [redacted] the trustee has an interest in the recovery from this Arbitration. (Ex. C19.)

Issues

1. Did Claimants' prove their claims for damages against Respondents?

2. Did the Asset Purchase Agreement (APA) transfer to Claimant the subject accounts receivable "free and clear" of Respondents' defenses?

3. Did the First Amendment and Assignment and/or the Second Amendment and Assignment of the Reseller Agreement release Respondent [redacted] from its obligations under the Reseller Agreement?

4. Is the Reseller Agreement unconscionable and therefore unenforceable?

5. Did Respondents prove any of their affirmative defenses?

6. Did the [redacted] ntities prove their claims of setoff and recoupment asserted in their counterclaim?

Discussion

1. Claimants proved their claims for breach of contract by non-payment against Respondents, subject to defenses.

I find that Respondents submitted purchase orders to [redacted] e.g. (Ex.299 – 305); [redacted] delivered and issued invoices fo[redacted] worth of products under those purchase orders, (Exs. 307, 308[redacted] eclaration items ¶¶ 80-85); but Respondents failed to pay for the products delivered.

[redacted] was the original contracting party to the Reseller Agreement and agreed to be bound by its terms. (Ex. 1 [redacted] 00137].) Nothing in the Reseller Agreement relieves [redacted] rom liability if othe[redacted] purchased products fro[redacted] As discussed herei[redacted] was never relieved of liability under the Reseller Agreement.

Extensive evidence was offered by Claimant to establish Respondents' failure to pay invoices due to Claimant. While some invoices were properly disputed by Respondents and there was evidence that some shipments by[redacted] ere delayed, or incomplete or included defective parts, Claimant established that Respondents had no defenses to certain invoices which required payment by Respondents of the amount of damages claimed by Claimants, namel[redacted] Ex. 307.)

Claimants have put forth evidence proving that[redacted] and the[redacted] are liable for breach of contract damages amounting[redacted] exclusive of interest, costs, and attorneys' fees. [redacted] ¶¶ 80-93; Exs. 299, 301-05, 307-08.)

[redacted] was in charge o[redacted] ccounting and financial management. (Hearing Tr. 460:18-23 [Ex. C101].) He did not offer any competent evidence to contradict the amounts claimed b[redacted] inst Respondents.

[redacted] id not question the validity of any of the invoices on which Claimants seek payment in this Arbitration. (*See* Hearing Tr. 485:11-486:4, 501:5-20, 508:4-8 [Ex. C101].) Nor di[redacted] testify as to any setoff exercised by Respondents in connection with the[redacted] worth of unpaid invoices here at issue. (Hearing Tr. 485:21-486:4, 507:3-508:3 [Ex. C101].) Because Respondents offered no specific evidence to rebut Claimants' evidence on these key issues, Respondents did not sustain their burden of defending against these claims as more fully detailed below.

It is not necessary to review in detail the history of communications between the parties concerning disputed claims for payment and payment plans allegedly proposed by Respondents, hypothetical or otherwise, because, apart from disputes about accounts receivable, Claimants' evidence established that, whatever other disputes arose between the parties as to payment issues, Respondents owed the amounts claimed based on invoices to which no defenses were proven.

In the end, Claimants proved that Respondents have not paid [redacted] invoices rendered to Respondents by [redacted] products ordered by and delivered to Respondents. This sum is based on invoices that Respondents did not show to be erroneous or overstated or in any way questionable. (See Exhibit 308.) These invoices were for products that were not rejected or defective or otherwise not subject to payment by Respondents.

The three Respondents, all of which signed and agreed to be bound by the terms of the Reseller Agreement, are jointly liable for the breach of contract damages. By the First Amendment to the Reseller Agreement (Ex. 2) [redacted] agreed that "(i)t shall be subject to and bound by the terms and conditions of the Agreement and shall assume all of the rights, responsibilities, obligations and liabilities [redacted] under the Agreement and that [redacted] shall be entitled to look t[redacted] r satisfaction of all of its rights under the agreement." (Ex. 2, p 3.) [redacted] s a party to the Second Amendment (Ex. 3) to the Reseller Agreement. This Amendment provides, at item # 3, "the Parties agree that [redacted] hall be subject to and bound by the terms and conditions of the Agreement."

Claimants also assert a cause of action for account stated to recover the same amount sought in the breach of contract claim. Respondents dispute that this cause of action is supported by the facts in this matter and that, in any case, Claimants have not proven their claims under this theory of action. Since I find that Claimant has established their breach of contract claims, subject to defenses, it is not necessary to review the merits of and the challenges to this second cause of action for Account stated which seeks the same relief as has been found due to Claimants under their breach of contract claim.

Based on the evidence, I find that, subject to defenses and claims for setoff, there is due to [redacted] the sum o[redacted] interest as discussed below from [redacted] and, as detailed below, from its [redacted] subsidiaries, for products purchased pursuant to the Agreement.

The critical issues in this arbitration concern the many defenses raised by [redacted] nd [redacted] ntities to the claims for payment and the issues raised by the counterclaim for setoff asserted by the [redacted]

2. The Asset Purchase Agreement Did Not Transfer the Accounts Receivable from [redacted] and Clear of All Defenses.

Claimants contend that the Asset Purchase Agreement (APA) by which Claiman[redacted] acquired certain assets o[redacted] including the accounts receivable here at issue, transferred those assets t[redacted] nd clear of defenses so that Respondents are now

barred from raising defense to the subject claims. Claimants' dispositive motion on this issue was denied without prejudice to Claimants to attempt to prove its contention at the hearing. Claimants failed to establish its claim that it acquired the subject assets free and clear of defenses.

While there may be room for argument in the abstract about the meaning of the a transfer of assets free and clear of all interests or free and clear of encumbrances, the facts of this case lead to a single conclusion, namely tha[redacted]id not acquire the subject accounts receivable in a vacuum free and clear of defenses. The rights which[redacted]sserts here are all based on the Reseller Agreement.[redacted]as not a party to the Reseller Agreement but acquired the right to enforce it when[redacted]oncluded the Asset Purchase Agreement. The APA did not simply assign some accounts receivable to[redacted]t transferred to[redacted]he rights which [redacted]had held under the Reseller Agreement, which right[redacted]ow asserts in this arbitration. As appears throughout this Award[redacted]nvokes terms of the Reseller Agreement, apart from the accounts receivables, to block Respondents' defenses and to buttress its claims against Respondents. Among the right[redacted]cquired from[redacted] is the right to require arbitration under the Agreement. A bare account receivable does not entitle the holder to arbitration. Claimants have exercised this right to require arbitration.

[redacted]submitted no persuasive authority that by virtue of the APA and the order of the Bankruptcy Court, it may assert rights under the Agreement but is not subject to any obligations under the same Agreement.

A case in point, cited by Respondents, is *Folger Adam Security, Inc. v. DeMatteis/MacGregor JV*, 209 F.3d 252 (3d Cir. 2000) (rejecting a bankruptcy asset purchaser's efforts to characterize a bankruptcy sale as "contract rights only" in accounts receivable, finding that such sales may never be made free and clear of obligations giving rise to defenses).

Claimants have failed to prove their contention that they acquired the account receivable free and clear of all defenses.

3. The Amendments and Assignments of the Reseller Agreement Did Not Release[redacted]rom its Obligations Thereunder.

The plain language of the First Amendment and Assignment establishes, by what is included and by what is not included, that[redacted]was not released from its obligations under the Reseller Agreement.

> Except as expressly modified by this Amendment all terms and conditions of the Agreement will continue in full force and effect as set forth in the Agreement and in the event of a conflict between the terms and conditions of their Amendment and the terms and conditions of this Amendment, the terms and conditions of this Amendment will prevail.
>
> The First Amendment, Ex. 2, dated January 1[redacted]states, at item # 6

This provision is not ambiguous, nor is the Amendment itself.

I find that this Amendment in no way "expressly modifies" the Reseller Agreement so as to release[redacted]rom its obligations thereunder. Not only is there no such express modification, there is also no such modification implied or suggested in the Amendment. Basic rules of contract construction require that all terms be accorded meaning, i.e. that they should be read as having been included for a purpose. This item # 6 is a common provision included in amendments to contracts and its purpose is very clear, namely to prevent uncertainty and ambiguity and to defeat the type of argument advanced here by Respondents. In plain language, this provision # 6 means that the Agreement remains unchanged unless it is expressly changed in the Amendment.

There is a second compelling reason why Respondents' argument that the Amendment affects a release is unavailing. That is the complete absence in the Amendment of the common language of release. Had the parties intended tha[redacted]e released from its obligations under the Agreement, they could have, but notably did not, include a standard provision releasing[redacted] from all of its obligations under the Agreement. Such a provision would not only have achieved what Respondents now seek, but it would also have complied with the "expressly modified" requirement of item # 6 cited above.

I find that this Amendment (Ex. 2) is not ambiguous as to whether it release[redacted] No express term therein remotely suggests any intent to release, item # 6 plainly requires an express modification to change the Agreement, and the Amendment notably lacks the classic release language which is commonly set forth in any contract intended to release a party thereto from an obligation or liability.

These principles of interpreting a contract apply with particular force to agreements between sophisticated parties such as[redacted]nd[redacted]

Because this Amendment is not ambiguous, there is no need to review here the copious extrinsic evidence offered to establish and to rebut an intent to release[redacted] It is sufficient to note that such evidence was disputed at length by Claimants and Respondents did not sustain their burden of proving either ambiguity or an intent to release by extrinsic evidence.

I also find that the Second Amendment to the Reseller Agreement did not release [redacted] from its obligations under the Agreement. This Second Amendment, Ex. 3, dated February 17, 2010, provides, at item # 4 "Except as provided above, the Agreement remains in full force and effect and governs the relationship between the parties with regard to the matters specified therein."

While the wording of this item # 4 is different from that of item # 6 of the First Amendment, the meaning is exactly the same. Nothing in the Second Amendment is "provided above" to suggest, no less "provide," that this Amendment released [redacted] from the Agreement. This Second Amendment also notably does not state, in referring to the Frist Amendment, that [redacted] had been released from its obligations under the Agreement by the First Amendment. It also notably does not include the standard release language by which [redacted] could have, but did not release [redacted] from that Agreement.

[redacted] was not a party to this Second Amendment but was identified therein as a party to the Reseller Agreement and as a parent corporation of [redacted] a party to this Second Amendment and the assignee under the First Amendment. Another party to this Second Amendment is [redacted] another subsidiary of [redacted]

This history recited in the Second Amendment did not state that [redacted] had been released of its obligations under the Reseller Agreement by the First Amendment. That is a minor, but not irrelevant, point.

The fact that [redacted] is not a party to this Second Amendment does not affect the interpretation of the document.

The Amendment and Assignment was effective to achieve its purpose without including [redacted] as a party since the assignor [redacted] had the power to enter this contract by virtue of the First Amendment. Indeed, had the parties intended that [redacted] be released from its obligations under the Reseller Agreement by this Second Amendment, one might expect [redacted] to be a party to this Second Amendment as a Release.

Claimant correctly argues that [redacted] admitted that it still has rights and obligations under the Reseller Agreement when, in Jun[redacted] three months before this Arbitration commenced), it filed a Proof of Claim in [redacted] ankruptcy seeking more than [redacted] Damages for breach of contract . . . ." At the hearing, [redacted] only explanation for the inconsistent positions it has taken in these two proceedings is that the filing of [redacted] Proof of Claim was a "mistake." It may not have been a mistake as to the

bankruptcy proceeding and if it was a mistake as to this arbitration, it is nevertheless an admission against interest.

Claimants cite *Holland v. Fahnestock & Co., Inc.*, 210 F.R.D. 487 (S.D.N.Y. 2002) [App'x I] in support of its opposition to Respondents' release arguments here. That case is on point and while it is not a California case, it commends itself as authoritative by its reasoning. Fahnestock (the assignor) argued—a [redacted] does here—that it was relieved of liability. *See id.* at 497. The court disagreed, reasoning that an assignment of all rights and obligations does not operate to release the assignor absent an express provision providing for such release. *Id.* at 499 ("Absent an express discharge of [the assignor's] obligations, the assignment provision can be interpreted as merely a consent to [the assignor's] delegation of duties.").

Last, neither the First nor the Second Amendment recites any consideration t[redacted]or the alleged release o[redacted] from its obligations under the Agreement. This omission is significant in a document claimed to release a party from a contract involving potential liability for millions of dollars.

Respondents argue in the alternative that the First Amendment was a novation by which the parties intended to extinguish all liability o[redacted]nder the Reseller Agreement.

Respondents cite the following California law on novation. In determining whether a novation occurred, California courts consider the agreements at issue, the changes between the old and new agreements, the parties' acts and conduct and the surrounding facts and circumstances. *Fanucchi & Limi Farms v. United Agri Prods.*, 414 F.3d 1075, 1082 (9th Cir. 2005); *Porter Pin Co. v. Sakin*, 112 Cal. App. 2d 760, 761-62, 247 P.2d 81, 82 (1952); *Alexander v. Angel*, 37 Cal. 2d 856, 860-61, 236 P.2d 561, 563-64 (1951). The focus of the inquiry is evidence of the parties' intent. *Fanucchi*, 414 F.3d at 1082 (citing cases). The cases are clear that an express oral or written statement is not required; intention to novate may be implied from surrounding facts and circumstances. *Id.* (citing *Hunt v. Smyth*, 25 Cal.App.3d 807, 818, 101 Cal. Rptr. 4, 11 (1972)).

Respondents' novation argument is not persuasive. First, *Porter Pin* was decided on its facts and may be distinguished on its facts. As the foregoing citations illustrate, a novation is a question of fact and of the intention of the parties. The novation which Respondents urge must be founded on a release of[redacted] To establish that there has been a novation—*i.e.*, that [redacted]ubstituted in for, or took the place of [redacted]nder the Reseller Agreement—Respondents must prove that the parties intended and agreed to release [redacted] *Alexander v. Angel*, 37 Cal. 2d at 860) [App'x B].

Most significant here is the utter absence in the First Amendment of any hint that the parties intended to release [redacted] from the [redacted] contract it had recently signed.

The only testimony that supports the novation argument is self-serving testimony from [redacted] that the agreement was merely a place holder for [redacted] until it could assign it to a subsidiary. No evidence from [redacted] corroborates this and the Respondent offered no persuasive reasons why [redacted] would agree to release [redacted] with all of its assets from this [redacted] deal.

Again, the First Amendment, did not state, but could have said, that [redacted] and [redacted] agree that all liabilities of [redacted] were extinguished. The intention of the parties to affect a novation could have been simply accomplished by expressing such intentions in writing, not by leaving the alleged novation agreement silent as to its purpose.

4. The Reseller Agreement is Not Unconscionable.

Respondents contend that, as a matter of law, the Reseller Agreement is unconscionable and therefore unenforceable. Respondents did not sustain their high burden of proof to establish this connection. Respondents contend that the Agreement was essentially a contract of adhesion, a so called "Take it or Leave it" deal because, they allege, they had no or practically no opportunity to negotiate it or to affect its content.

Respondents cite various harsh terms of the Agreement, some of which are detailed above in the Statement of Facts. For example, the agreement provides for essentially no compensation for Respondents if shipments of products are delayed or if other problems expose Respondents to liabilities to their customers. A formula to address these situations set forth in the Agreement is so restrictive in its application that it is practically useless to Respondents. Also, Respondents' only recourse for defective products is to return them for replacement, which is of little comfort to Respondents' customers whose projects may have been seriously affected by receipt of defective parts. The Agreement prohibits consequential damages for breaches by Claimants.

As to the " Take it or Leave it" claim, the CEO of [redacted] admitted and agreed that many of the provisions of the Reseller Agreement were modified at the request of—and to the benefit of [redacted] This testimony contradicts Respondents' claim that the Reseller Agreement is a one-sided contract that was presented to [redacted] on a "Take it or Leave it" basis. Claimant proved that not only did [redacted] negotiate the

Agreement and added provisions to it, but tha [redacted] personally attended a meeting wit[redacted] executives in California to discuss the Agreement.

Claimants correctly argued tha[redacted] knowledged tha[redacted] odified the following provisions of the Reseller Agreement at Respondents' request:

- Paragraphs 1.1.2 & 19.3(d) regarding the definition and effect of any "Change of Control" of[redacted] Hr'g Tr. 669:11-670:8, 674:9-675:12 [Ex. C101]);
- Paragraph 6.1 extending the amount of notic[redacted] as required to give [redacted] for any change in prices (Hr'g Tr. 737:12-738:6 [Ex. C102]);
- Paragraph 6.4 extending the amount of time Respondents had to make payments on invoices (Hr'g Tr. 738:8-16 [Ex. C102]);
- Paragraph 7.4 regardin[redacted] greement to use its best efforts to provide authorization letters to Respondents (Hr'g Tr. 738:17-739:14 [Ex. C102]);
- Paragraph 10.3 eliminating Respondents' liability for liquidated damages based on inaccurate or untimely sales reports (Hr'g Tr. 739:15-740:5 [Ex. C102]);
- Paragraph 12.7 requirin[redacted] o indemnify Respondents for any third-party intellectual property claims (Hr'g Tr. 740:6-744:13 [Ex. C102]); and
- Paragraph 23.1 permittin[redacted] o assign the Reseller Agreement to its subsidiaries (Hr'g Tr. 641:4-21 [Ex. C101]).

Claimants also cited testimony of the[redacted] hat Respondents realized a ten to twelve-percent gross profit margin on the more than[redacted] worth of products Respondents purchased from[redacted] which counters Respondents' lack of consideration defense. (Hearing Tr. 156:20-157:4 [Ex. C99].)

The evidence showed that both[redacted] and[redacted] ere very substantial corporations operating on an international basis. There was evidence that[redacted] Holding owns many businesses in addition to th[redacted] and that under the Reseller Agreement, the[redacted] ntities had over[redacted] Both parties were represented by sophisticated representatives in their negotiations.

[redacted] testified at the hearing and it was clear that he is a very sophisticated and experienced business executive. For example, he volunteered that he would have preferred that the arbitration Agreement had provided for arbitration i[redacted] nder [redacted] law rather than in Los Angeles under California law. There was no evidence that

[redacted] was the dominant party in the formation of the Agreement to the exclusion of [redacted] or tha[redacted] as in a position to take advantage of [redacted]

The most significant single factor in the assessment of whether the Agreement was unconscionable is the consideration flowing between the parties. While, as noted, the Agreement imposed some harsh commercial terms on [redacted] it also granted to [redacted] exclusive reseller rights fo[redacted] products in a vast territory, the entire[redacted] and the entire continent of [redacted] was added by the Second Amendment. Prior to making the Agreement, [redacted] had reseller agreements with several different distributors for this multi-nation territory, including [redacted] By this Agreement [redacted] eliminated all competition from this territory for sales of [redacted] products. This was the tradeoff for the contract terms [redacted] now cites as oppressive.

Respondents did not sustain their burden of proving that the Reseller Agreement was unconscionable and therefore unenforceable under California law.

Claimant's First Round Prehearing Arbitration Brief cites, at pages 27-28, many relevant authorities which support the conclusion that the Agreement is not unconscionable. It is not necessary to reiterate here these authorities.

5. Respondents Did Not Sustain Their Burden of Proof to Establish Any of Their Affirmative Defenses or Their Counterclaim of the [redacted] for Setoff or Recoupment.

Respondents plead nineteen affirmative defenses and [redacted] tities assert three causes of action in their counterclaim. Most of the affirmative defenses were abandoned at the hearing by failure to offer evidence in support of them. Respondents did pursue the defense of unconscionability, failure to perform, setoff and recoupment. The counterclaim asserted claims for breach of contract, breach of the covenant of good faith and fair dealing and sought declaratory relief. The defense of unconscionability has been discussed above. The other defenses pursued at the hearing and counterclaims are discussed below.

Apart from unconscionability, the defenses which Respondents pursued at the hearing concerned breach of the Agreement by failure to perform. Respondents offered copious testimony and emails and correspondence at the hearing about problems experienced with the performance by [redacted] late delivery of product, partial shipments of parts of products, and shipment of wrong products or allegedly defective products.

Respondents also recounted at length such testimony in their briefing, but Respondents did not translate these general narratives by their witnesses to concrete specific evidence that a certain shipment violated the Agreement and caused actionable damage to Respondents, in a quantifiable amount, i.e. a compensable injury under the Agreement. Nor did Respondents adduce specific evidence that an invoice on which Claimants' claims for payment are based was for a shipment to which Respondents have a defense based on the Reseller Agreement. Respondents' claims of nonperformance were problematic, in large part, because of the terms of the agreement which anticipated and rendered legally irrelevant certain types of common non-performance.

Testimony from [redacted] perating Office[redacted] and from its Commercial Director [redacted] nfirms tha[redacted] alleged delayed deliveries, partial deliveries, and deliveries of defective products did not constitute "failures to perform" under the Reseller Agreement. Not only did these witnesses admit that partial deliveries were allowed under the Reseller Agreement, but they also acknowledged that Respondents had not invoked the provisions of the Reseller Agreement concerning penalties for late deliveries (Paragraph 5) or for return or repair of defective products (Paragraph 15).

Regarding setoff[redacted] testified that he did not recall seeking a setoff fro[redacted] as to any of th[redacted] sought by Claimants in this Arbitration. Claimants correctly argue that because a setoff must actually be exercised to be effective, Respondents failure to exercise setoff forecloses Respondents' setoff claim.

Respondent's defenses are also stymied by the provision in the Agreement that prohibits claims for consequential damages. Claimants' properly argue that this prohibition applies to Respondents' counterclaims and most of their affirmative defenses.

Respondents also seek recoupment. None of Respondents' witnesses were able to identify any invoice on which Claimants sought payment that was improperly issued or that was related to any of Respondents' alleged damages due to partial shipments, delayed deliveries, or other similar issues.[redacted] estified that such damages did not correspond to the invoices on which Claimants are seeking payment. As noted above, the invoices on which Claimants base their claims are not invoices which Respondents cite in connection with their various complaints abou[redacted] erformance. These later disputed invoices cannot therefore be the basis for any claim of recoupment.

Despite a welter of exhibits, emails, letters and testimony, the critical facts are clearer. Respondents submitted purchase orders t[redacted] (Ex. 301)[redacted] elivered and issued invoices fo[redacted] orth of products under those purchase orders, (Ex. 308); but Respondents failed to pay for the products delivered, (Ex. 307).

While Respondents offered extensive testimony and many emails, they did not sustain their burden of proving by competent and relevant evidence as to any claims asserted in their counterclaim for setoff and recoupment.

Respondent's failed to connect their complaints to the specific invoices at issue and Respondents also failed to overcome the obstacle to their defense posed by the Agreement itself.

As mentioned above [redacted] expressly disclaimed in the Reseller Agreement any responsibility or liability for any special, incidental or consequential damages under the Reseller Agreement:

> [redacted] DISCLAIMS ANY AND ALL LIABILITY FOR SPECIAL, INCIDENTAL OR CONSEQUENTIAL DAMAGES (INCLUDING LOSS OF PROFITS) ARISING OUT OF THIS AGREEMENT OR WITH RESPECT TO THE INSTALLATION, USE, OPERATION OR SUPPORT OF THE PRODUCTS EVEN I[redacted] HAS BEEN APPRISED OF THE POSSIBILITY OF SUCH DAMAGES.
>
> (Id. at 8, ¶ 15.3.)

This provision not only bars claims for lost profits, but also bars claims for delay damages, claims for penalties resulting from delivery of partial shipments or defective products and all other consequential damages.

Specifically, I find that Respondents failed to prove the claims asserted in their counterclaim, namely breach of contract and breach of the covenant of good faith and fair dealing. I also find that Respondents have not proven entitlement to any of the several requests for declaratory relief.

Interim Award

After the evidentiary hearing and post hearing briefing and argument the Arbitrator issued an Interim Award finding that Respondents were jointly liable to Claimants for money damages and awarding to [redacted] and [redacted] jointly, and against [redacted] and [redacted] compensatory damages in the sum of [redacted] The interim award included an award of pre-judgement interest which is now outdated and which has been replaced herein by an award of interest calculated to March 11[redacted] detailed below.

Respondents did not sustain their burden of proof as to any of their affirmative defenses and the[redacted] tities did not sustain their burden of proof on their counterclaim for setoff and

recoupment. They also did not establish that they are entitled to any of the declaratory relief they sought. Accordingly, I find in favor of Claimants and against the [redacted]s to the counterclaim.

Prevailing Party

The Agreement (Ex1) at page 13, Section 30, provides that the prevailing party shall be entitled to an award of reasonable attorneys' fees and costs. Claimants are the prevailing parties. A second proceeding (Phase 2) was conducted to consider and rule on a motion by Claimants for attorneys' fees and costs.

Claimant's First Motion for Attorneys' Fees and Costs

The first motion concerned fees and costs incurred from the outset of the arbitration to the time the Interim Award was issued. The second motion concerned fees and costs incurred in connection with the first motions for fees and costs and the briefing and argument relating thereto. These two motions are treated separately.

First Motion for Attorneys' Fees and Costs

The Agreement of the parties provides, "The prevailing party shall be entitled to recover...its reasonable attorneys' fees and costs incurred in connection with any arbitration hereunder".

The defense objected to Claimants' motion on several grounds, both as to the fees and the costs requested. All objections raise issues of reasonableness. Respondents' seek the following reductions in the fees and costs incurred.

(1) [redacted] to account for time which was block billed and which included work done on the [redacted] personal arbitration;

(2) Deduct a total [redacted] for the fees of the three separate [redacted]

(3) Reduce the costs claimed by [redacted] to exclude the [redacted] expense, the [redacted] Private Investigator expense, and the [redacted] in costs incurred [redacted]

(4) Discount the remaining [redacted] of [redacted] by 10% to [redacted] for excessive hourly rates, inefficiencies, duplication, and unnecessary work.

1. [redacted] Fees

Respondents correctly object to any award of legal fees incurred by [redacted] for work on a second arbitration against [redacted] personally for breach of his warranty that he was authorized to execute the Agreement. This second arbitration proceeding is sometimes referred to as th[redacted]rbitration. While th[redacted]s related to the arbitration at hand, it is a separate proceeding in which the undersigned Arbitrator has not been appointed as arbitrator. There is no evidence that there has been any determination of a prevailing party in the[redacted] arbitration. Ha[redacted]ersonally been a party to this arbitration, the situation might be different. Respondents are correct that the Arbitrator has no jurisdiction to award fees for work done on the[redacted]rbitration.

Legal fees for th[redacted]arbitration are included in so called block billing by th[redacted] with no separate allocation of time for that second arbitration. Typically, the billing statements for the arbitration at hand include a 10 hour day for one attorney with many different tasks listed with no allocation of time to any task, including tasks concerning the[redacted] arbitration. Respondents contend that every such block billing entry should be disallowed in its entirety so that a total of [redacted] would be deleted from the award of legal fees. This claim is unpersuasive. Respondents have not met the burden of showing that the cases they cite apply here.

For example, in *Christian Research Institute v. Alnor*, 165 Cal.App.4th 1315, 1325 (2008), a fee request was substantially reduced based on the trial court's determination that "counsel inflated the fee claim with a multitude of time entries devoted to matters other than" the motion for which attorneys' fees were recoverable, thereby undermining the credibility of counsel's other entries. There are no such facts here. The inclusion of the fees for the[redacted] arbitration do not undermine the credulity of the other fee entries. They do, of course, make it impossible to determine exactly how much time in such a mixed block billing entry was billed to this arbitration.

Respondents request for a wholesale rejection of all block billing entries mentioning the[redacted] arbitration together with other compensable legal work in the total amount of [redacted] ejected. Instead, the Arbitrator has reviewed all of the block billing time entries on Claimants' billing highlighted in the document titled Annex A submitted by Respondents to identify block billing entries which mention this[redacted]rbitration. Based on said review the Arbitrator disallows billing by [redacted] or a total of [redacted] While this reduction is obviously based on rough approximations and may be more than what would have been deleted had the non-compensable entries been clearly separated, the manner of billing adopted[redacted]akes it impossible to be more precise.

Accordingly, as to Respondents' first objecti[redacted] disallowed on the claim for legal fees charged b[redacted]

Fees of Co-Counsel for Claimants

As noted above, Respondents seek a reduction [redacted]n the claim for fees paid to Co-counsel for Claimants. Respondent's objections to legal fees paid for investigation relating to Respondents corporate structure and work done for prospective attachment of assets of Respondents for enforcement of a potential award and for other services of local counsel in [redacted]re without merit.

This work is reasonably related to the arbitration even though it may also relate to future enforcement efforts after the arbitration is concluded. Information about enforcement of a potential judgment is relevant to the prosecution of the action including, among other things, to settlement strategy. This work was done "in connection with any arbitration," in the words of the fee shifting clause.

Participation of local counsel i[redacted]or videoconference testimony at hearing was reasonable and, in fact, was suggested by the Arbitrator as an option for Claimants to pursue when the Arbitrator granted the defense motion for permission to present several witnesses by videoconference fro[redacted]

Respondents also object to the [redacted]by other co-counsel, th[redacted] o[redacted] which rendered services in connection wit[redacted] primarily to support Claimants' unsuccessful contention that it acquired the subject accounts receivable free and clear of all defenses. That issue is discussed above. Claimants' dispositive motion on that issue was denied and the Arbitrator is familiar with the issue, the briefing and the oral argument thereon in which Attorne[redacted] of the[redacted]articipated.

Claimants make no showing as to wh[redacted]hould be disallowed in their entirety, but there is an issue as to whether the fees charged by that firm are reasonable for the work done in this arbitration.

[redacted]ssigned four attorneys to this work. Their billing rates were: [redacted] for Mr[redacted] [redacted]for two associates. While this prominent firm handles major bankruptcies that require highly sophisticated legal work, the issue here was not such an issue. Even though Claimants asserted their "free and clear" theory to preempt all defenses, it was not an esoteric issue of law and, in fact, this issue arises often when assets of a debtor are assigned to another party as was the case here. Claimants did not sustain thei[redacted]

in legal fees fo[redacted]as reasonable. I find that a reasonable fee for the work done by that firm i[redacted]and [redacted]

While it is reasonable that Claimants enlisted bankruptcy counsel to assist on this issue, Claimants did not sustain their burden of proof that the fees charged by[redacted]ere reasonable for the work done in this matter.

2. Costs

I agree with Respondents' contention that Claimants' request for reimbursement of[redacted] paid by Claimants fo[redacted]elating to Claimants' efforts to secure attachments of assets of Respondents[redacted] Claimants did not support this request with specific evidence as to the terms of this expense, e.g. whether it is a final out of picket cost or whether it is a recoverable expense in the nature of a cash bond to be returned after certain performance by Claimants relating to an attachment, or whether it is some expense to which Claimants have no prospect of recovery. Accordingly, this cost of[redacted] will not be reimbursed to Claimants as part of their costs or arbitration.

Respondents did not sustain their burden of proof as to why the Arbitrator should disallow the other costs contested by Respondents, namely costs for a private investigator and costs sustained by the[redacted]etained by Claimants to render legal services relating to bankruptcy issues in this matter.

3. Remaining Fees of[redacted]

Respondents also seek a flat 10% reduction in all legal fees charged b[redacted]that are not otherwise disallowed. This claim is based on an assertion that the fees reflect duplication, inefficiencies, unnecessary work and similar shortcomings. While the total legal fees are substantial, and while there could be some "fat" in these bills, these claims are not supported by any evidence and are therefore rejected.

4. Additional Deducted Costs

Claimants request for costs includ[redacted]aid to AAA for administrative fees. Sums paid to AAA by Claimants for such fees will be included in the final award as a separate item to be calculated by and provided to the Arbitrator by AAA. Accordingly, such administrative fees will not be awarded to Claimants as part of their attorneys' fees and costs but as a separate item as detailed below.

Consequentl[redacted]deducted from the Claimants' request for costs in this section of the award.

5. Recap of Fees and Costs

The following legal fees claimed by Claimants are disallowed:

[redacted] – Item # 1 above

[redacted] – Item # 2 above

Total fees disallowed on first motion [redacted]

The following costs claimed by Claimants are disallowed:

[redacted] Item #3 above

[redacted] – Item 5 above

Total Costs disallowed on first motion for fees and costs [redacted]

6. Award of Fees and Costs on First Motion for Fees and Costs.

Claimants' claim for attorney's fees in the first motion for fees and costs in the total amount of [redacted] is reduced by [redacted] Accordingly, I award attorney's fees to Claimant on this first motion in the amount of [redacted]

Claimants' request for costs on the first motion for fees and costs of the total amount of [redacted] is reduced by [redacted] Accordingly, I award to Claimant on the first motion for fees and costs the sum [redacted] for costs.

7. Claimants' Second Motion for Attorneys' Fees and Costs

Claimants moved for an award of fees and costs incurred after the first motion had been filed. In this second motion, Claimants seek attorneys' [redacted]

Respondents objected to this motion on two grounds. First, Respondents correctly object to more fees incurred in connection with the [redacted] arbitration discussed above. The Arbitrator has reviewed the parts of Claimants' legal fee statements referenced in Respondents' Objection and in Annex B thereto. I disallow [redacted] in legal fees sought by Claimants' in their second motion because the billing again relates, in part, to services concerning the [redacted] arbitration. This sum is based on my estimate of the fees detailed in two certain "block billing" entries.

Accordingly, Claimants' second motion for an award of fees is granted except to [redacted] that fees of [redacted] are awarded to Claimants on their second motion.

Respondent also objects to Claimants' request for legal fees relating to work done in connection with anticipated enforcement of the final award. As detailed above, such work is reasonable and would be expected of competent counsel in a case of this nature. Respondents are all foreign entities and the evidence at the hearing established that [redacted] has many subsidiaries. The amount of the award is substantial and preparation for enforcement of the award is a proper element of the Claimants' legal fees. Respondents' objection on this ground is overruled. Likewise, Respondents' objection to the costs incurred by Claimants for a private investigator working on this enforcement issue is denied.

Accordingly, on Claimants' request in its second motion for fees and costs, I award attorneys' fees o[redacted]

8. Summary of Award of Fees and Costs

I therefore award to Claimants and against Respondents total attorneys' fees in the amount of [redacted] nd total costs of arbitration in the amount o[redacted]

Award of Interest

Pursuant to the Agreement, I award pre-judgment interest to Claimants and against Respondents jointly on the damages awarded, calculated through March 11, [redacted] he best estimate of the approximate date when this Final Award will be issued. This amount is calculated, pursuant to the Agreement, based on an annual rate of ten percent from the date on which each invoice became overdue. As to the calculation of this interest, see [redacted] Declaration Sections 80 85, Exhibits 307 and 308 and see C106, a demonstrative exhibit attached to Claimant's post hearing brief. This demonstrative exhibit, C106, is based on other exhibits in evidence cited above and illustrates the interest calculations with respect to each unpaid invoice. Claimant has calculated the interest due under the Agreement to March 11, [redacted] No objection was asserted to that calculation and I award that amount to Claimant as pre judgment interest. I therefore award prejudgment interest to Claimants and against Respondents jointly in the amount o[redacted]

Arbitrator Compensation

The Agreement provides the parties shall share equally the compensation of the Arbitrator.

Award

For the reasons stated above, I award as follows:

(1) I find in favor of [redacted] and against [redacted] jointly on the claims asserted by Claimants. I find in favor of said Claimants and against the [redacted] asserted by them in their counterclaim for setoff and recoupment against the Claimants. I also find against Respondents on their claim for declarative relief, as to which they failed to support their burden of proof.

(2) Any affirmative defenses asserted by Respondents which were not specifically addressed in the foregoing Award are rejected and denied due to lack of supporting evidence.

(3) Respondents [redacted] shall jointly pay to Claimants [redacted] the following sums:

[redacted] r compensatory damages;

[redacted] r attorneys' fees;

[redacted] osts of arbitration;

[redacted] pre-judgment in interest.

The total of the above awarded damages, attorneys; fees, costs and interest is [redacted]

In addition, the administrative fees and expenses of the International Centre for Dispute Resolution ("ICDR") totaling [redacted] shall be borne entirely by Respondents [redacted] representing that portion of said fees and expenses previously incurred by [redacted] and expenses of the Arbitrator totaling [redacted] shall be [redacted]

(4) I therefore award to [redacted] and [redacted]

(5) This award is in full settlement of all claims submitted in this arbitration.

I hereby certify that, for the purposes of Article I of the New York Convention of 1958, on the Recognition and Enforcement of Foreign Arbitral Awards, this Final Award was made in the City and County of Los Angeles, State of California, United States of America.

[redacted]

Date

[redacted]

Arbitrator

A notary public or other officer completing this certificate verifies only the identity of the individual who signed the document to which this certificate is attached, and not the truthfulness, accuracy, or validity of that document.

State of California
County of Los Angeles

On March 22 [redacted] before me, [redacted] Notary Public personally appeared [redacted] who proved to me on the basis of satisfactory evidence to be the person whose name is subscribed to the within instrument and acknowledged to me that he executed the same in his authorized capacity, and that by his signature on the instrument the person, or the entity upon behalf of which the person acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

[redacted] (Seal)

Notary Public

[redacted]
Los Angeles County
My Comm. Expires [redacted]

AMERICAN ARBITRATION ASSOCIATION
INTERNATIONAL CENTRE FOR DISPUTE RESOLUTION
No. [redacted]

[redacted]

Claimants and Respondents by Counterclaim,

and

[redacted]

Respondent and Counterclaimant.

AWARD

Counsel:

[redacted]

[redacted]

[redacted]

[redacted]

Arbitrators:

[redacted]

[redacted]

[redacted]

Place of Arbitration: Los Angeles, California

Date of Award: April 16, [redacted]

THE UNDERSIGNED ARBITRATORS, having been designated in accordance with the Stock Purchase Agreement, dated December 20, [redacted], which contains an arbitration provision at ¶ [redacted], and having examined the submissions, proofs and allegations of the parties, find, conclude and issue this Award as follows

I. INTRODUCTION AND PROCEDURAL STATEMENT

Claimants are the former shareholders of [redacted], whose shares were sold to [redacted] an indirect subsidiary

of [redacted] in December, [redacted] for cash plus a contingent earn-out.[1] After the close of the transaction, Respondent operated the former [redacted] under the name [redacted]

Claimant's Demand for Arbitration (dated December 31, [redacted]) asserts claims for breach of contract, breach of the implied covenant of good faith and fair dealing and fraud based on allegations that Respondent's conduct (pre-and post-close) was fraudulent and resulted in the payment of no contingent compensation, all in breach of the Stock Purchase Agreement ("SPA") (Ex. 70). Respondent filed an Answer and Counterclaim on January 26, [redacted] Claimant filed a Response to Counterclaim and Supplemental Claim on February 12, [redacted]; Respondent filed a Response to the Supplemental Claim on March 6, [redacted]

The Panel was duly appointed; it issued a procedural order on May 13, [redacted], and further procedural orders (including rulings on discovery issues) on May 21, [redacted], June 9, [redacted], October 28, [redacted], December 11, [redacted] December 31, [redacted], and February 2, [redacted] and denied Claimants permission to file a dispositive motion on October 28, [redacted]. The Panel denied a request to continue the hearing on December 31, [redacted]. A final status conference was conducted on December 18, [redacted]

The Evidentiary Hearing. The Hearing was conducted on February [redacted] and March [redacted] Each side offered documentary evidence at the hearing, and such evidence was admitted without objection (Ex. 1-1303). Each side called witnesses and cross-examined opposing witnesses: [redacted] The hearing was not reported.

At the conclusion of the presentation of evidence, the parties stated that they had no further evidence to offer; the cause was argued orally on March 4, [redacted] and the matter was submitted for decision on that date.[2]

II. FACTS

The factual findings that follow are necessary to the Award. They are derived from admissions in the pleadings and the testimony and evidentiary exhibits presented at the hearing. To the extent that these findings differ from any party's position, that is the

[1] We refer to [redacted] interchangeably because the actors for both overlap, and there is in our view no distinction between them for purposes of actionable conduct.

[2] A closing order was issued on March 10, [redacted], after counsel submitted requested cost information and a reformatted exhibit list. The closing order recites that the parties granted the panel 45 days in which to issue this Award.

result of determinations by the Arbitrators as to credibility and relevance, burden of proof considerations, legal principles, and the weighing of the evidence, both oral and written.

Historical Business of [redacted]

[redacted], a [redacted] business for more than [redacted] years, began in the [redacted] business and more recently became expert at [redacted] employed [redacted] in the business from [redacted] and ultimately [redacted] of the business over time. [redacted] are the substantial principal shareholders of [redacted] also claimants herein, are minority shareholders). The business had as its principal customer [redacted] and also had a number of [redacted] customers.

[redacted] Relationship

The [redacted] relationship began in the early [redacted]; by [redacted] was [redacted] largest customer (about 50 percent of revenue), and [redacted] depended on [redacted] for the vast majority of its product (70-90 percent). Ordinarily neither supplier nor customer prefers such concentration for obvious reasons; in this case, however, each party regarded the concentration issue as beneficial (albeit risky) because of the strong and close partnership-like qualities that advantaged both sides of the transaction.

Overture by [redacted] in Mid-[redacted]

[redacted] was a [redacted] manufacturing company that had a substantial presence in the [redacted] business. That business took a significant dip in [redacted], when its principal customer, [redacted] exited that business. In response, [redacted] undertook a strategy to expand and grow its sales ("buy and build"), particularly in the [redacted] business by acquiring smaller companies in that segment in the United States. An investment banker [redacted] was tasked to identify several such companies and ultimately targeted [redacted] and a smaller company, [redacted] in San Diego, California. He approached both and was involved in the negotiations which followed and which led to the purchase of the stock of both companies by [redacted] effective year end [redacted].

Negotiation and Execution of the SPA

[redacted] were lead negotiators for [redacted] were lead for [redacted] hired [redacted] to conduct the due diligence for both the [redacted] acquisitions. The timetable was compressed on account of both [redacted] and [redacted] desiring a year-end closing.

[3] First names are used to avoid confusion; no disrespect is intended.

An obvious issue was the concentration of [redacted] business in [redacted] conducted extensive customer interviews and addressed with [redacted] and [redacted] the historical relationship and prospects for future business with [redacted]. The [redacted] sales in [redacted] reached $[redacted], an all-time high. Information provided to [redacted] in the course of the due diligence as to [redacted] (Ex. 77, 83) and later [redacted] sales forecasts provided various estimates for [redacted] sales volumes. See Ex. 57, 47, 78, 195, 48, 300, 170, 946, 145.

There was also concern about possible competitors for the [redacted] business and the prospect of [redacted] bringing some manufacturing in-house. Ex. 946, 1284. ([redacted] had been acquired in [redacted] by [redacted] brand merchant. [redacted] was known for its vertical integration, but had, as of [redacted], not required [redacted] to follow that business model.)

Ultimately the SPA contained two significant representations about the [redacted] business. SPA § [redacted] contained the following representation:

> **Section [redacted] Customers, Suppliers and Dealers**. Schedule [redacted] hereto contains a list of (a) the top ten (10) customers (based on consolidated gross sales) and (b) the top ten (10) suppliers (based on consolidated gross expenditures) of the Company on a consolidated basis, in each case, in each of the two most recent fiscal years and sets forth opposite the name of each such customer the percentage of consolidated net sales attributable to such customer. *Sellers have no knowledge that any of the customers described in Schedule [redacted] hereto will not continue to be customers of the Company after the Closing at substantially the same level of purchases as heretofore.*

(Ex. 70, emphasis supplied.

Schedule [redacted] added the following information:

> 2. Sellers anticipate that the Company's volume for its number one customer potentially will reduce, in the approximate amount of $[redacted] as a result of a potential 5% price reduction starting January 1, [redacted] for that customer.

The parties disagreed about the value of the [redacted] business. [redacted] and [redacted] asked for $[redacted] came back at a significantly lower number. The ultimate agreed price was $[redacted], with $[redacted] payable in cash (subject to a small hold back escrow account, which was eventually released to the shareholders) and a $[redacted] earn-out structured to pay the [redacted] shareholders $[redacted] for every $[redacted] of

EBITDA[4] between $[redacted] and $[redacted], or $[redacted] if $[redacted] in EBITDA was achieved.[5]

[redacted] and [redacted] also agreed to three-year employment agreements at $[redacted] and $[redacted] respectively, annually with provision for some bonuses. Ex. 71, 72.

In the course of negotiating the SPA, [redacted] disclosed it was also looking at another company and that it was possible that acquisition would also be made by year-end [redacted] observed to [redacted] and [redacted] that it regarded [redacted] management as superior to that of the other target and that the post-acquisition [redacted] would in the (indefinite) future be expected to manage that entity. Moreover, [redacted] saw the post-acquisition [redacted] business as a likely platform for [redacted] entire U.S. operations. Nothing specific on any of these points was agreed upon by the time of the close of the SPA transaction.

[redacted] also mentioned that at least for accounting purposes, the [redacted] business would need to be combined with its U.S. parent and ultimately with [redacted] Again, nothing specific was agreed upon as to this issue by the time of the close. (The parties in this proceeding have referred to these two issues as horizontal and vertical integration.)

The [redacted] (as used herein referring to [redacted] and [redacted]) made it clear that they regarded the earn-out as presenting a risk to them and that they needed the ability to operate the post-acquisition entity substantially in the "ordinary course" as it had been operated pre-acquisition, at least for the earn-out period. *E.g.*, Ex. 70, (Ex. A – earn-out calculation, definition of "Operations in the Ordinary Course"). The SPA defined Ordinary Course of Business (Ex. 394 at 13632) with respect to the Company [[redacted]] as "an action that is prudent, consistent with the past practices of the Company and taken in the ordinary course of the normal day-to-day operations of the Company." The EBITDA calculation excluded both revenues generated by [redacted] and related expenses as well as "any transaction entered into in [redacted] other than in the Ordinary Course of Business as in effect at Closing." Ex. A to the SPA. *See also* Ex. 265, 86, 344.

The SPA was signed on or about [redacted] The cash was delivered on or about December 28, [redacted] and the transaction closed effective year-end. The [redacted] transaction also closed by year-end [redacted]

[4] Earnings Before Interest, Taxes, Depreciation and Amortization. The price negotiations also involved the negotiation of the EBITDA target and ranged between $[redacted] and $[redacted] it ultimately settled at $[redacted]

[5] There are increases to the earn-out for EBITDA above $[redacted], but Claimants have not made any claim to amounts above the basic $[redacted] sum.

Operation of [redacted] in [redacted]

[redacted] (the immediate parent of [redacted]) announced the two acquisitions to be part of a strategy to enter the [redacted]. Ex. 424.

Shortly after the close, the new [redacted] was contacted by accountants for [redacted] for the purpose of integrating the subsidiary's financials with those of the parent in [redacted]. *See* Ex. 448, 501. Later, in March, [redacted] and [redacted] were advised of the need for them to integrate the financials of [redacted] into [redacted] Ex. 562. [redacted] also informed its new subsidiary that the entity would of course need to change its name. Ex. 541.

A consultant for [redacted] was engaged prior to [redacted] to address various integration issues for [redacted] including the integration horizontally and vertically of the two new U.S. entities. The overall integration project had the name "[redacted]" and eventually consisted of numerous sub-projects. Early projects involved financial reporting, the name change and identification of other potential areas of integration that would eventually be undertaken. Some management time was consumed by these early efforts (unquantified) and the work related to the integration grew somewhat through the first two quarters of [redacted]. Eventually 47 separate projects were identified and many were undertaken by [redacted] staff consuming attention and time in varying amounts. This is largely undisputed. *See, e.g.*, Ex. 615, 829, 833, 858, 877.[6]

[redacted] recognized these effects as well. *See* Ex. 602 ([redacted] suggesting that the earn-out was disruptive of the integration project rather than the obverse); Ex. 501 ([redacted] concern about the time consuming nature of the financial reporting interfering with the achievement of the earn-out); Ex. 941 ([redacted] recognized that integration certainly not beneficial to the achievement of the earn-out and that the [redacted] integration was not disclosed to Claimants prior to the closing); Ex. 1289 (same comments by [redacted].

No contemporaneous records were kept of this expenditure of time. General Ledger accounts for [redacted] revenues and [redacted] related expenses were maintained by the [redacted] accounting staff in order to make the EBITDA calculation contemplated by Ex. A to the SPA, but no time records or labor charges were booked to these accounts.

The major projects within [redacted] included [redacted] qualification under [redacted] (Ex. 884), technology upgrades and integration projects, sales force integration and adoption of a common relationship software [redacted]. *See* Ex. 910 (substantially all of

[6] Claimants created a large demonstrative exhibit, which depicted a range of exhibits illustrative of the scope and extent of [redacted]. It was authenticated by [redacted] as containing dozens of exhibits admitted in this proceeding: Ex. 608, 205, 206, 276, 391, 344, 429, 448, 930, 467, 541, 728A, 558, 560, 559, 604, 647, 660, 668, 686,726, 728D, 783, 823, 831, 844, 833 and 877. *See also* Ex. 533, 700.

[redacted] time was consumed by these projects). The scope and pervasiveness of [redacted] is supported by the documentary evidence accumulated in the demonstrative exhibit (*see* n.6) and by the testimony of percipient witnesses Messrs. [redacted] and the expert testimony of [redacted]

[redacted] Relationship Issues Post-Acquisition

Both Buyer and Seller recognized the importance of the [redacted] relationship to the success of the post-acquisition company. But no one at [redacted] reached out to [redacted] immediately after the close, and even issued a press release prior to year-end announcing the acquisition without warning to the [redacted] so that they could call key [redacted] contacts and advise them of this event ahead of the public announcement. (The press release emphasized the [redacted] product line, thus creating within [redacted] the impression that the [redacted] business might not be a priority for the new entity.) Ex. 424.

[redacted] encouraged [redacted] to meet with [redacted] as soon as possible, and a meeting was arranged in mid-January with [redacted] (a senior [redacted] executive); another executive, [redacted] participated from [redacted] by phone. At the meeting [redacted] was unable or unwilling to express [redacted] commitment to the [redacted] business; [redacted] was concerned and immediately convened an in-house meeting to develop contingent plans if it turned out that [redacted] would not provide necessary support for the [redacted] business. At a later meeting in March at [redacted] headquarters in [redacted] again failed to impress [redacted] or [redacted] management about the new company's desire to maintain the [redacted] relationship as it had been. [redacted], most of [redacted] top management, were all in attendance at that meeting.

[redacted] began diverting some of its business to competitors and began a serious effort to bring work in-house. Because of the lead time for [redacted] products, this had no dramatic immediate effect on [redacted] sales, but by mid-year sales had declined somewhat (Ex, 24, 25) and they continued to decline for the rest of the year. See Ex. 140.[7] In [redacted] revenue was $[redacted], down from $[redacted] in [redacted]. It is not disputed that [redacted] conduct at these meetings had an adverse effect on the [redacted] relationship.

Beginning in April, [redacted] and [redacted] began negotiations for a revised earn-out on the shared assumption that the earn-out prescribed in the SPA would not be achieved. *See* Ex. 616, 643. Essentially, the [redacted] parties assessed the likely effect of the [redacted] integration as interfering with the achievement in [redacted] of the $[redacted] EBITDA; they discussed extending the earn-out for a second year, adding the [redacted]

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[7] [redacted] regularly monitored financial results to track their likely success to achieve the earn-out. Results for Q1 for [redacted] were less than expected (Ex. 24, 25), and did not improve in Q2. A [redacted] ccounting (based on internal [redacted] data) projected mid-[redacted] that the EBITDA year end would miss the $[redacted] target.

revenues and expenses to the earn-out formula, and requiring a pay-out over two years in the aggregate amount of $ to the shareholders. In an undocumented side agreement, they discussed directing the Company separately to pay key management a total of $ (had previously decided to pay that same sum to the same key managers out of their $ earn-out, if it had been achieved.)

An amendment was negotiated and was signed by Ex. 75, 76. indicated that he would need approval of the supervisory board but believed it would be no problem to obtain approval. were aware of this requirement. Ex. 40. prepared minutes as and as the sole member of the management board documenting this deal and recommending it for approval. Ex. 616. It appears, however, that he never forwarded the minutes or the negotiated and partially signed amendment to the and the never took any action with regard to it. only learned of this late in

As the result of a take-over of a major shareholder of became chair of the replaced all prior members with his nominees and then fired [8] was appointed to replace sued and countersued. *See* Ex. 989. Many of the allegations made by Claimants in this proceeding, such as claimed misrepresentations made by in the course of the negotiation of the SPA, are made by in its countersuit against

The earn-out was not achieved. Ex. 73. sales revenues were about $. In attempted to negotiate the earn-out issue with arguing that they were never allowed to operate the company in a manner that would have allowed them to achieve the earn-out. As these negotiations became more contentious, handed off the Shareholder Representative responsibility to No agreement was reached between the parties.[9] Finally, Claimants engaged counsel and commenced this arbitration on In response, decided to terminate but to continue to pay them their base salary for the last year of their three-year employment contracts.

's Answer and Counterclaim was filed on . The counterclaim was for fraud in misrepresenting the value of the business; it sought compensatory and punitive damages. On the filing of the Counterclaim, issued a press release (Ex. 1028).[10]

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[8] This event raised additional concerns within about its ongoing relationship with Ex. 770.

[9] The parties' settlement negotiations were disclosed and discussed during the hearing, without objection. ultimately offered $, which they calculated would have been the earn-out under the (unsigned) amended earn-out, plus an additional $ That offer was rejected.

[10] contends that the filing of this press release was unauthorized under the SPA because the were not given an opportunity to review and approve it before it was filed (*see* Ex. 70, ¶ 8.03, and

Additional facts are addressed in the discussion that follows.

III. ANALYSIS

Claimant bears the burden of proof by a preponderance of the evidence as to their claims, and Respondent bears the burden of proof as to its counterclaims. California law applies, as provided in the Agreement, Ex. 70, ¶ [redacted]

A. Did Claimants Achieve the Earn Out?

Exhibit A to the SPA defines the method for determining the Sellers' entitlement to the Earn-Out. Full payment of the Earn-Out required achievement in [redacted] of EBITDA of $[redacted]. Respondent determined that the EBITDA of [redacted] was about $[redacted] (Ex. 73), and Respondent's expert verified this sum to within less than $[redacted] (Ex. 153).

Claimants presented evidence that the true EBITDA achieved in [redacted], consistent with the terms of the SPA, was in excess of the earn-out target of $[redacted]. This argument is supported by accounting testimony of [redacted] a highly qualified accounting expert [redacted] This testimony not only supports an accounting argument that Respondent breached the SPA by not properly applying the formula in determining the earn-out achieved in [redacted] but also supports the damage claims under all other legal theories asserted by Claimants -- fraud in the inducement, fraud, negligent misrepresentation and breach of the implied covenant of good faith and fair dealing.

Three categories of accounting adjustment to the earn-out calculation are advanced – that certain labor costs in [redacted] should have been capitalized because they supported the installation of equipment that was itself capitalized, that integration labor expenses were not but should have been excluded from the calculation of EBITDA, and that [redacted] sales revenues in [redacted] were diminished by the conduct of [redacted] and that revenues for [redacted] should therefore be adjusted upward (or certain expenses deducted).

Labor Costs. The resolution of the dispute as to the labor costs for the automation project (a capital project that occurred in part in [redacted] and in part in [redacted]) depends on whether the "historical" treatment of labor expended on capital project by [redacted] had been to capitalize or expense such costs. Capitalization is proper from a strict GAAP accounting perspective, but if the historical practice had been to expense such costs, no adjustment would be warranted under the SPA and the EBITDA calculation provision (Ex. A to the SPA). The maximum adjustment advocated by [redacted] is the sum of

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discussion below) and that it resulted in his not being offered a board seat on the [redacted] board of directors. *See* Ex. 1043.

$[redacted][11] Ex. 1300. As we shall see from the discussion below, it does not matter whether that adjustment is warranted or not, because the other adjustments are rejected by the Panel for sufficiency of evidence reasons, and the labor cost adjustment alone is inadequate to increase EBITDA from about $[redacted] to $[redacted] (where the first dollar of earn-out would be achieved).

Integration Labor Expense. The larger numbers that would affect the calculation of EBITDA for [redacted] are the integration labor costs and reduced [redacted] sales. We conclude for different reasons that neither was proven and therefore are not properly taken into account in calculating EBITDA under the SPA.

The integration of [redacted] into [redacted] and each of them (jointly or severally) into [redacted] was a major undertaking. It is undisputed that some substantial interference in the day-to-day operations of [redacted] was occasioned by the various aspects of vertical and horizontal integration, starting with the financial integration of [redacted] into [redacted] and then into [redacted] and the later integration of [redacted]'s financials into [redacted]. The legal name change was another early integration project. Later, [redacted] imposed time constraints on [redacted] management and employees and caused distractions from the running of the business in the ordinary course as contemplated by the SPA and as understood by all the participants to the negotiated deal.

The parties agreed that [redacted] revenues and related expenses were to be separately accounted for, and GL accounts were created and maintained for this purpose. Even after the negotiation of the revised earn-out, [redacted] accounting personnel continued to post entries to these accounts. It was also clear to [redacted] that the time of their employees was being consumed in part by integration activities and projects, but they never made any effort to track such time or such effects contemporaneously. So when [redacted] was asked to assess the effect of such labor expense on [redacted] EBITDA, he was only able to acquire such information by interviewing [redacted] in the weeks prior to the arbitration, to learn their best recollection of which employees were affected and to what extent, and then to calculate the labor expense he opined should have been deducted from the EBITDA calculation for [redacted].

[redacted] identified a number of employees (including themselves), about [redacted] in number, the estimated aggregate percentage of their time so consumed by [redacted] related activities during the year, and their [redacted] salaries so [redacted] could calculate the portion of the employee's annual salary that should be deducted from [redacted] expenses (plus a 28% labor burden).

No specific testimony from [redacted] was presented to support this calculation, or any of its details. No list was offered in evidence of the specific

[11] The parties also disputed what "burden" the labor costs should bear for employment taxes, *etc.* It is unnecessary to resolve this issue for the reasons articulated above.

employees or the attributed percentage impairment.[12] No detailed calculation was presented other than the aggregate conclusion of $[redacted] in labor costs fully burdened). Ex. 1300. In part this was because no report of [redacted] was prepared and presented as permitted by Scheduling Order No. 1, ¶ 8:

> (a) The parties shall exchange all documentary evidence, including reports of experts they intend to offer at the Hearing, excepting only documents to be offered solely for impeachment, not later than January 22, [redacted] These document designations may be supplemented by January 29, [redacted]
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> (b) Counsel shall identify all non-rebuttal percipient and expert witnesses expected to testify at the Hearing and shall indicate the manner in which each witness is expected to testify (in-person, telephonically or by affidavit or declaration), not later than January 22, [redacted] These witness designations may be supplemented by January 29, [redacted]
>
> (c) The purpose of the exchanges in this paragraph is to provide fair notice to the parties of documents and witnesses expected to be offered at the Hearing. Witnesses or documents not identified in accordance with these provisions will not be permitted to be offered at the hearing except on a showing of good cause, and more particularly a showing as to why they were not so identified.

Scheduling Order No. 1 dated May 12, [redacted]

Counsel are permitted to identify an expert and not to produce a report, but if no report is provided prior to the hearing, no report may be offered in evidence at the hearing. So Claimants were effectively limited by their decision not to have [redacted] author a report to oral testimony only from him about his methodology and conclusions; so no details about the make-up of his labor expense calculation were offered. By the same token, Respondent was unable to effectively test this testimony by, for example, knowing in advance of the hearing which employees were included in the analysis, and what percentage of their time was attributed to their integration work. There was no real opportunity to effectively cross-examine any of these employees (some of whom had previously testified at the hearing, including [redacted][13] and to test the data and assumptions on which the expert relied. As a result, the persuasive effect of this evidence was slight at best.

More fundamentally, the testimony is inherently speculative, on several levels. First is the absence of any contemporary evidence of employees affected and hours consumed. [redacted] complained to [redacted] and others from early in [redacted] about the distractions of the integration tasks to the day-to-day work of the business in the ordinary course. This is fully documented in exhibits admitted at the hearing and in their

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[12] [redacted] turned over his notes to Respondent during his direct testimony.

[13] All of that testimony occurred prior to [redacted] direct examination when Respondent learned for the first time what [redacted] opinions were and the basis for those opinions.

testimony. Some of their complaints were specifically directed to the earn-out itself and their right to be free of distractions from the effort to achieve the EBITDA target.[14] They knew that they and their key employees were being required to expend significant time in these efforts; they knew about the GL accounts which were intended to separate out revenues and expenses unrelated to the EBITDA target, and they knew that the labor hours they now complain about were affecting their ability to achieve the earn-out, but they never attempted in any fashion to capture this information contemporaneously in any form.

Estimates of personnel and percentages of time made in late [redacted] or [redacted] and related to work performed in [redacted] are highly unreliable. Moreover, it is not just a simple attribution of employee time as to one activity – [redacted] included a vast array of projects touching many aspects of the [redacted] business (and the relationship with [redacted]. It was estimated that [redacted] encompassed 47 separate projects, involving multiple teams of employees. Complicating that assessment, some of the work which might be characterized as "[redacted]" might as easily be characterized as improvements to the existing business in the ordinary course that would have occurred without regard to any integration. For example, [redacted] is a software-based sales relationship tool that was utilized by the [redacted] sales force. There was some integration of the [redacted] sales team, but there was also simple improvement to the [redacted] sales team's day-to-day use of this tool in the ordinary course of business. Whether it is wholly, partially or not at all an integration activity would therefore be subject to some uncertainty.

California law prohibits recoveries based on speculative damages. In *Westside Center Associates v. Safeway Stores* 23, 42 Cal.App.4th 507, 530-531 (1996), the Court of Appeal stated that: "A plaintiff seeking to recover for a future loss must show with reasonable certainty that the loss actually would have accrued. [Citations omitted.] Damages which are remote, contingent, or merely possible cannot serve as a legal basis for recovery" (*quoting California Shoppers, Inc. v. Royal Globe Insurance Co.*, 175 Cal.App.3d 1, 62 (1985)); *see also S.C. Anderson, Inc. v. Bank of America N.T. & S.A.*, 24 Cal.App.4th 529, 536 (1994).

These cases refer to the determination of future damages, but the rule is even more appropriately applied to proof of past damages because of the greater ability of the Claimants to have presented non-speculative evidence. In *Piscitelli v. Friedenberg*, 87 Cal. App. 4th 953, 989, 990 (2001), the court stated:

> Whatever its measure in a given case, it is fundamental that "damages which are speculative, remote, imaginary, contingent, or merely possible cannot serve as a legal basis for recovery. [Citations.]" (*Frustuck v. City of Fairfax* (1963) 212 Cal.App.2d 345, 367-368 [28 Cal.Rptr. 357]; see also *Mozzetti v. City of Brisbane*

[14] For example, they were not subject to termination not for cause during the first year of their employment contracts in order to protect the earn-out effort. Ex. 71, 72. If they were terminated not for cause during the first year, the earn-out had to be paid without regard to the EBITDA target. *Id.*

(1977) 67 Cal.App.3d 565, 577 [136 Cal.Rptr. 751] ["It is black-letter law that damages which are speculative, remote, imaginary, contingent or merely possible cannot serve as a legal basis for recovery"].) However, recovery is allowed if claimed benefits are reasonably certain to have been realized but for the wrongful act of the opposing party. (*Williams v. Krumsiek* (1952) 109 Cal.App.2d 456, 459 [241 P.2d 40].)

Citing the *Piscitelli* rule quoted above, another court observed that "damages for the loss of future earnings in this context are recoverable " 'where the evidence makes reasonably certain their occurrence and extent.' " (*Kids' Universe v. In2Labs* (2002) 95 Cal.App.4th 870, 883, 116 Cal.Rptr.2d 158.) *Toscano v. Greene Music*, 124 Cal. App. 4th 685, 694 (2004).

It is often said that where a defendant's wrongful conduct made the exact ascertainment of damages difficult, he cannot complain because the court must make an estimate of the damage and not an exact computation, provided, of course, that the estimate is a reasonable one. *Pet Food Exp. Ltd. v. Royal Canin USA, Inc.*, 2011 WL 6140874, at *5-6 (N.D. Cal. Dec. 8, 2011). That court went on to say that

> In weighing the evidence submitted as to damages, "[i]t is within the sound discretion of the trier of fact to select the formula most appropriate to compensate the injured party." *Marsu,* 185 F.3d at 938, 939 (citing *United States Liab. Ins. Co. v. Haidinger–Hayes, Inc.*, 1 Cal.3d 586, 599, 83 Cal.Rptr. 418, 463 P.2d 770 (1970)).
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> However, "damages which are speculative, remote, imaginary, contingent, or merely possible cannot serve as a legal basis for recovery." *Piscitelli v. Friedenberg,* 87 Cal.App.4th 953, 989, 105 Cal.Rptr.2d 88 (2001) (internal quotations omitted); *see, e.g., Greenwich S.F., LLC v. Wong,* 190 Cal.App.4th 739, 763, 118 Cal.Rptr.3d 531 (2010) ("The evidence in this case was insufficient to show that either Chan or Greenwich S.F. were established businesses or had track records of successfully developing or redeveloping properties.").

2011 WL 614087 at *5-6

Thus, a reasonable belief that some damages have been suffered, a reasonable methodology to determine those damages and a reasonable estimate of damages are required to establish recoverable damages. The Panel is, after all of this, left with the concern that we are lacking the "reasonable estimate" which is based on real data rather than supposition and surmise derived from the recollection of complex events occurring 2-3 years ago. We do not doubt the good faith and honesty of [redacted], but we do question anyone's ability to recall events and details of this sort in sufficient detail to justify an award of damages in [redacted] of dollars.

We also have concern that there was no fair opportunity of Respondent to test these estimates given the way the evidence was presented. Claimants did turn over to Respondent [redacted]'s notes (during his direct testimony), but this was not sufficient to allow any real inquiry into the accuracy of the assumptions on which his opinion was based.

Finally, if the parties had addressed these labor issues as they were being experienced, and if [redacted] had articulated their belief that the additional labor expense occasioned by [redacted] was causing expense that ought to be taken into account in the calculation of EBITDA for the purpose of determining entitlement to the earn-out, it would have been apparent that the effect each such dollar of claimed excess labor expense was occasioning [redacted] of potential earn-out consistent with the formula in Ex. A to the SPA. Were [redacted] aware of this position, it could have hired additional labor (at dollar for dollar) rather than bear the additional expense at a cost of [redacted]

[redacted] Sales. [redacted] offered two alternate theories to increase EBITDA on account of the decline in [redacted] sales – that [redacted] refused to allow reductions in staff in spite of declining sales or that [redacted]'s conduct caused a decline in sales, resulting in either increased expenses ([redacted] or decreased revenues [redacted]

These opinions suffer from several defects. There is insufficient supporting testimony that [redacted] management made timely requests to allow significant staff reductions that were refused, and the estimates of reduced sales on account of [redacted]'s conduct are speculative in fact and in amount in the face of ample testimony about the changing relationship between the parties unrelated to the claimed cause of the reduced sales. Finally, even assuming there is fault on the part of Respondent either in refusing to reduce staff or in causing a significant rupture in the [redacted] relationship, there is no liability on account of simple negligence on the part of the acquiring company when it fails to act perfectly in advancing the existing business. *See Careau v. Security Pacific Bus. Credit, Inc.*, 222 Cal. App. 3d 1371, 1394 (1990) (bad faith requires a conscious and deliberate act).

There is considerable evidence that [redacted] was intending to diminish its level of business with [redacted] from [redacted] into [redacted] without regard to anything [redacted] may have done. Claimants offer this evidence in defense of the Counterclaim which asserts fraud in misrepresenting the value of the business being sold based on knowledge of various indications that the [redacted] sales in [redacted] and going forward would decline at least somewhat. *See, e.g.*, Ex. 78, 57, 47, 195, 48, 300, 170, 946, 145, 70 (Schedule 5.24). Thus, even assuming [redacted]'s conduct affected sales in [redacted], there is a proximate cause issue as to the extent of that interference as contrasted with [redacted]'s internal decisions unaffected by anything [redacted] may have done.

Moreover, the actual sales loss (or, alternately, potential sales gains) are speculative for all of the reasons addressed above regarding the integration labor expense.

That case law need not be repeated. Ultimately it must be concluded, for the same reason that we rejected the labor expense calculation, that we must reject these expense and sales estimates.

Finally, even assuming non-speculative, proximately caused damages, there is no legal principle that would require an acquiring company to pay an earn-out where its ordinary negligence – or ordinary business judgment (no one has suggested that [redacted]'s conduct was intentional) caused the sellers not to achieve the earnings necessary to trigger the earn-out.

B. Claimants' Other Legal Theories.

Having reached this conclusion regarding the absence of proof of recoverable damages except for a possible several hundred thousand dollar adjustment for the failure to have capitalized that small amount of labor expense,[15] we now consider the legal theories other than breach of contract.

Claimants assert fraud in the inducement as to pre-acquisition conduct (misrepresentations and omissions – ordinary course operation of the business; omission of integration intentions). The elements of that claim require, *inter alia*, proof of damages. The labor expense is not a damage that would flow from that conduct, so there is a failure of proof as to this element and consequently as to this claim.

Claimants also allege post-acquisition fraud based on the claim that [redacted]'s dealings in the negotiation of the amended earn-out (either intentional or negligent) were wrongful in failing ever to submit the partially signed amendment to the [redacted]. This is claimed to have caused the [redacted] (1) not to work on achieving the old earn-out, and (2) to work instead on the revised earn-out which involved integration of [redacted] and related matters. In either event, proximately caused, non-speculative damages cannot be proven as to the former and may only be proven with respect to the latter based on the settlement negotiations (*see* n.9, *supra*) in which [redacted] conceded $[redacted] in potential earn-out under the unsigned amendment. The former claim is not established; the latter claim is established only if we are entitled to consider those revealed negotiations as an admission of damage because there was no proof otherwise. We are comfortable in adopting Respondent's concession of damages for this conduct and accordingly regard this claim as proven in that amount.

Alternately to the breach of contract claim, Claimants assert an implied covenant claim as to [redacted]'s conduct:

> Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement. (Rest.2d Contracts, § 205.) This duty has been

[15] Claimants missed the floor of the earn-out by more than $[redacted] in EBITDA and the target for the full $[redacted] earn-out by more than $[redacted] in EBITDA, so a [redacted] expense adjustment would have no economic consequence for these parties.

recognized in the majority of American jurisdictions, the Restatement, and the Uniform Commercial Code. (Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith* (1980) 94 Harv.L.Rev. 369.)" (*Foley v. Interactive Data Corp.* (1988) 47 Cal.3d 654, 683–684, 254 Cal.Rptr. 211, 765 P.2d 373 . . .)

Carma Developers (Cal.), Inc. v. Marathon Dev. California, Inc., 2 Cal. 4th 342, 371-72, (1992). *See also* Cal. Comm. Code § 1201(b)(20) (good faith among merchants involves a high standard including honesty in fact and observance of reasonable commercial standards of fair dealing).

We did find a small potential breach of contract as to the accounting treatment of the labor expense for the automation project, but it was not enough to reach any earn-out plateau. No breach of the implied covenant has been established.

C. The Counterclaim

Respondent claims that the value of the [redacted] business was misrepresented because it was based on inflated and false estimates of the future sales volume to be derived from the [redacted] relationship. The evidence of such representations is decidedly mixed. The due diligence report revealed different views about projected [redacted] sales, and the SPA itself also suggested reduced sales in [redacted] (Ex. 70, Schedule [redacted]). Of course, the SPA also contained an express (and contrary) representation (*id.*, ¶ 5.24). Thus, while Respondent may have some evidentiary basis for a misrepresentation claim, there is also evidence that the decline in [redacted] business was caused in part by the post-closing conduct of [redacted] Thus, we are unable to conclude that Respondent justifiably relied on the representations of sellers or that damages (in the form of the reduced value of the [redacted] business) were proximately caused by sellers' representations.

The Counterclaim is not established.

D. The Supplemental Claim

After Claimants filed their arbitration demand in this proceeding, Respondent filed an Answer and Counterclaim, seeking compensatory and punitive damages for the claimed misrepresentations. A brief announcement of this filing was made by [redacted] Ex. 1028. At the time, [redacted] was being considered for a board position on the [redacted] board. He disclosed the litigation and the Counterclaim to a board colleague and, eventually, he was asked to withdraw his name for the board seat because of his involvement in this litigation as a Respondent by Counterclaim. He seeks damages for the loss of the board seat based on a claimed violation of the SPA in that [redacted] made the announcement of the filing of the counterclaim without consulting with or seeking the prior approval of any of the Claimants.

Section [redacted] of the SPA provides:

> **Section [redacted] Public Announcements.** No press release or other public announcement related to this Agreement or the transactions contemplated herein shall be issued or made without the joint approval of Buyer and Seller Representative, unless required by Law or any stock exchange on which the securities of Buyer's Affiliates are listed or traded (in the reasonable opinion of counsel), in which case Buyer and Seller Representative shall have the right to review and comment on such public announcement prior to publication.

The provision of the SPA relied on was clearly not intended to cover the situation which is the subject of the Supplemental Claim. The announcement in [redacted] was not "related to [the SPA] or the transactions contemplated [by it]." The resurrection of a provision intended to control public communications about the acquisition of [redacted] by [redacted] two years later in connection with litigation between these parties, and after none of the [redacted] was still involved in the management of the new entity, is an unsupportable interpretation of this provision.

Moreover, it is clear that the communication that caused the [redacted] board to ask [redacted] to withdraw his application was a conversation between [redacted] and a colleague on the Board, not the announcement itself. If the announcement had never been made, the outcome would still have been the same.

The supplemental claim is not established.

E. Confidentiality of the documents exchanged in this case

The parties entered into a stipulated protective order ("SPO") dated [redacted]. Separate from the SPO, Respondent seeks an order preventing any use of the documents in this case elsewhere (including in a civil action pending in [redacted] between these same parties.) The matter was briefed prior to the hearing and a decision was deferred to this award. The Panel does not believe it has power to expand or alter the parties' stipulation; we decline to order any remedy or relief that is not within the terms of the SPO. We do not believe that Claimants' request in this regard is supported by the text of the SPO and we therefore decline to order the requested relief.

F. Costs.

The SPA provides that the parties shall bear their own fees and costs. Ex. 70, ¶ 12.06. The Panel has discretion to allocate the costs of arbitration (*id.*, ¶ 12.06). Our award of damages to Claimants (and the denial of the Counterclaim) makes them the prevailing party. They shall recover all of their arbitration fees and costs.

AWARD

1. Claimants [redacted]

Date [redacted]

State of STATE)
) SS:
County of COUNTY)

I, [redacted] do hereby affirm upon my oath as Arbitrator that I am the individual described in and who executed this instrument, which is our Final Award.

[redacted]
Date [redacted]

State of STATE)
) SS:
County of COUNTY)

I, [redacted] do hereby affirm upon my oath as Arbitrator that I am the individual described in and who executed this instrument, which is our Final Award.

[redacted]
Date [redacted]

[redacted] ("Claimants") are entitled to an award of $[redacted] in compensatory damages and a fee reimbursement in the amount of $[redacted] for a total award of $[redacted]

2. Respondent [redacted] (Respondent)'s Counterclaim is not established and is dismissed.

3. Respondent is responsible for the payment of all to be billed costs in this proceeding.

4. The administrative fees and expenses of the International Centre for Dispute Resolution (ICDR), totaling US$[redacted], and the compensation and expenses of the Panel, totaling US$[redacted] shall be borne by Respondent. Therefore, Respondent shall reimburse Claimants the sum of US$[redacted] representing that portion of said fees and expenses in excess of the apportioned costs previously incurred by Claimants, upon demonstration by Claimants that these incurred costs have been paid.

5. This Award resolves all issues submitted for decision in this proceeding.

DATED: [redacted]

[redacted]

We hereby certify that, for the purposes of Article I of the New York Convention of 1958, on the Recognition and Enforcement of Foreign Arbitral Awards, this Final Award was made in Los Angeles, California, USA.

State of STATE)
) SS:
County of COUNTY)

I, [redacted] do hereby affirm upon my oath as Arbitrator that I am the individual described in and who executed this instrument, which is our Final Award.