

VERDICTS & SETTLEMENTS

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CONTRACTS

BREACH OF CONTRACT Shareholder Liability

SETTLEMENT: \$9.5 million.

CASE/NUMBER: Edward G. Nalbandian, Edward M. Nalbandian, Zachary All Inc. v. Ki Won Chun, Christopher K. Chun, David Chun, James Edmond Inc. / SS013734.

COURT/DATE: Los Angeles Superior Santa Monica / Nov. 17, 2005.

ATTORNEYS: Petitioners - Joan B. Kessler (Kessler & Kessler, A Law Corp., Los Angeles).

Respondents - J. Larson Jaenicke (Rintala, Smoot, Jaenicke & Rees, LLP, Los Angeles).

FACTS: Petitioners Edward G. Nalbandian, Edward M. Nalbandian and Zachary All, Inc. ("Zachary"), (collectively, "Petitioners" or "Nalbandians") petitioned the Los Angeles Superior Court, West District (Case No. SS013734) on Aug. 26, 2005 for an order to confirm the Arbitration Awards of the Hon. Alan B. Haber (Ret.) made on Aug. 16, 2004, Sept. 25, 2004, Nov. 4, 2004, June 10, 2005, July 3, 2005, and July 25, 2005 (collectively, the "Arbitration Award").

Respondents are Ki Won Chun, Christopher K. Chun, David Chun, and James Edmond, Inc. ("Edmond"), (collectively, "Respondents" or "Chuns"). Edmond paid the entire Arbitration Award obligation of over \$9.5 million consisting of: principal, interest, and prevailing party fees, after the petition was filed but before the hearing to confirm set for Nov. 17, 2005 in Los Angeles Superior Court, West District before Judge Paul G. Flynn.

The dispute in the underlying arbitration involved the valuation of Zachary's 50 percent ownership of Edmond and the buyout of Zachary's shares by the Chuns, the owners of the other 50 percent of Edmond. In 1985, Zachary and the Chuns entered into a Shareholder's Agreement (the "Agreement") which provided that if either party wished to sell its shares in Edmond, that party must offer to sell their shares to the other 50 percent shareholder.

In July 2003, the Chuns asked Zachary to sell its 50 percent shares in Edmond to the Chuns. A dispute then arose between Zachary and the Chuns as to the equity value of Edmond. The Agreement provided for arbitration of all disputes arising out of the Agreement. Subsequently, the Chuns filed a Demand for Arbitration. Zachary and the Chuns agreed to submit their dispute to ADR Services, Inc. ("ADR"). Zachary then filed an Answering Statement and Cross Claim in February 2004 with ADR against Edmond and the Chuns for improper devaluation and intentionally understating the net book value of Edmond on the eve of the sale, among other claims. The Hon. Alan B. Haber (Ret.) of ADR was chosen by the parties to conduct the arbitration.

PETITIONERS' CONTENTIONS: Zachary (the Nalbandians) claimed that the inventory was understated and, therefore, undervalued by \$4,243,698. Further, Zachary (and the Nalbandians who held all shares in Zachary) claimed that \$61,468 in expenses was improperly reimbursed to the Chuns as business expenses. These claimed expenses were for reimbursement of expenses claimed to have been incurred as early as in some instances 1999, 2001, and 2002. Zachary also claimed that \$407,000 was an unreasonable amount to set aside for the potential bankruptcy claim against Edmond in a vendor's bankruptcy proceeding. The Nalbandians also made claims for fraud, breach of fiduciary duty, and punitive damages.

RESPONDENTS' CONTENTIONS: The Chuns claimed that the inventory evaluation as of Dec. 31, 2003 was proper under generally accepted accounting practices (GAAP) and claimed that all claimed business expenses were proper.

The Arbitrator found that, "The totality of the evidence presented established that Chun engaged in a conscious effort to bring about as low an equity valuation as possible of the entity's inventory, all in anticipation of an agreed buy out of the Nalbandian shares. One significant factor in my consideration of how to resolve the equity value issue is whether in previous years, the entity had utilized the practice of liquidation (or as Nalbandian would characterize it), a "fire sale" of its inventory. The evidence established that this was the only time in the entity's long history, of engaging in such a practice." (Aug. 16, 2004 Arbitration Award at 3:15 22).

The Arbitrator also found that: "It is not reasonable to submit an expense reimbursement claim four to five years after the expense was incurred, yet alone a year or so later. GAAP principles would not permit such reimbursement, and there was no evidence presented that the entity had approved of such a method of seeking reimbursement in the past. This conduct is also one of the factors that I considered in evaluating the Nalbandian claim that Chun engaged in a pattern of conduct intended to cause a devaluation of the entity's inventory." (Aug. 16, 2004 Arbitration Award at 5:28 29 and 6:1 5).

THE RESULT: Before the Nov. 17, 2005 state court confirmation hearing Edmond paid to Zachary the entire amount, which totaled over \$9.5 million (including principal, interest, and prevailing party fees).

OTHER INFORMATION: After six days of arbitration proceedings, Judge Haber rendered his award in writing and determined Zachary's equity in Edmond. The shareholders' equity was increased by the Arbitrator by \$4,243,698 attributable to the inventory, by \$61,468 attributable to improper expense reimbursement sum, and by \$407,000, relating to a potential bankruptcy claim in a vendor's bankruptcy proceeding. Zachary's equity in Edmond was to be 50 percent of the total Shareholders equity minus losses for the period Jan. 1, 2004 to May 31, 2004 of \$840,450, plus \$300,000 pursuant to the Agreement, for a total of \$9,743,175 to be paid to Zachary over five years. Judge Haber denied Zachary's claim that the compensation paid to the Chuns was excessive. The Arbitrator later adjusted the Award down by 50 percent of the amount ultimately found due on the bankruptcy claim to a vendor of \$79,457. Finally, the Arbitrator later reduced the amount by \$935,859 for "adverse tax liability" as a result of the Arbitration Award, leaving an award of \$8,727,860 plus pre-

vailing party's attorneys' fees and costs and interest from Sept. 9, 2004 due to Zachary.

The Arbitrator also awarded Zachary \$241,795 (after offsets) and \$1,764 (after offsets) in prevailing party's attorneys' fees and costs. Zachary's counsel was ordered to prepare the Promissory Note and Guaranty. Eventually a down payment of \$2,618,358 plus interest was agreed to and a Promissory Note in the amount of \$6,109,502 plus interest, along with the Guaranties, were executed by the parties, for a total of \$8,727,860 in principal, plus interest, attorneys' fees and costs due Zachary. The arbitrator ruled against the Nalbandians on their claims for fraud, breach of fiduciary duty, and punitive damages.

In September 2004, Edmond served its Motion For Reconsideration/Correction/Clarification/Modification Of Arbitration Award ("Chuns' Motion"). Subsequently, the Arbitrator issued the Sept. 25, 2004 Award, wherein the Arbitrator denied Edmond's Motion for Reconsideration. The Arbitrator found that the Nalbandians were prevailing parties related to the Chuns' Motion.

On or about Sept. 7, 2004, the Chuns paid Zachary the \$241,795 for the prevailing party's attorneys' fees and costs awarded by the Arbitrator, which was the sum due after offsets. On or about Oct. 7, 2004, the petitioners served their Motion For Determination Of Prevailing Party For Attorneys' Fees And Costs Incurred In Connection With Opposition To Motion For Reconsideration, to which the respondents served their Opposition on or about Oct. 19, 2004. Subsequently, on or about Nov. 10, 2004, the Arbitrator ruled that Zachary was the prevailing party. The Chuns paid \$1,764 to Zachary for the prevailing party's attorneys' fees and costs award pursuant to the November 2004 Arbitration Award which was the sum due after offsets.

On or about Aug. 5, 2005, the Promissory Note, Guaranty and Redemption Agreement were fully executed pursuant to the Arbitration Award. The Promissory Note was dated Sept. 9, 2004. The down payment paid by Chun to Zachary was \$2,618,358 plus interest of \$106,523. Additional principal to be paid by Chun to Zachary pursuant to the Promissory Note was \$6,109,502 and the Note provided for 5 payments of \$1,221,900 each, payable on Sept. 9, 2005, Sept. 9, 2006, Sept. 9, 2007, Sept. 9, 2008, and Sept. 9, 2009, together with interest on the unpaid balance from time to time at the Bank of America, N.A. prime rate of interest in effect three working days prior to the due date of each installment first accruing on Sept. 9, 2004.