JAMS ARBITRATION CASE REFERENCE NO. 1110017521

Old Trace Partners, L.P.,
Claimant(s),

and

Sorensen, Theodore, et al.,
Respondent(s).

FINAL INTERIM AWARD

PRELIMINARY

This matter came on for regularly scheduled arbitration hearing on October 31, 2016 pursuant to notice and agreement of the parties. The matter was heard on the following dates:

October 31, November 1 through 4, November 14, 16, 17, 18, 19 & 22, 2016.

Counsel appearing for the parties were as follows:

Claimants/Counter Respondents: Julienne Nucum, Esquire, Preston Wong, Esquire, and Ronald Packard, Esquire.

Respondents/Counter-Claimants: William Milks, Esquire, Kathryn Barrett, Esquire, and David Duperrault, Esquire.

The arbitration agreement is contained in the 40 Main Street Offices Limited Liability Company Operating Agreement, as restated and amended on or about October 30, 2012. Portions of the amended and restated agreement are in dispute in this proceeding. The parties were ordered to arbitration in Case Number 11CV2066849, by Order of court dated November 17, 2014.

The law of the State of California and the JAMS Comprehensive Rules apply.

PARTIES

Claimants are each member investors in a Limited Liability Company, 40 Main Street Offices, LLC, a company which was formed to purchase real property and to develop a commercial office building on the property in Los Altos, California. The individual claimants are Old Trace Partners, L.P., Daniel Nero, Kimberly Nero, Paul L. Klein, Jr., Mary Ellen Klein, Alan E. Truscott, and Fick Investment Company.

The Respondents are Theodore Sorensen, Jerry Sorensen, 40 Main Street Offices, LLC, and Gunn Management Group, Inc. Respondents have alleged 65 affirmative defenses including the statute of limitations, and have counter claimed.

Following the completion of evidence, at the request of the parties, closing, opposition, and reply briefs were submitted as to all claims and counterclaims. The matter was deemed submitted on January 23, 2017 following the submission of such briefs. [1]

SUMMARY OF CLAIMS

The Claimants filed an action in the Santa Clara County Superior Court in Action Number 114CV266849, alleging causes of action which may be summarized as fraud and misrepresentation, breach of contract, false promises, breaches of fiduciary duties, violations of the Business and Professions Code, and false promises, seeking damages, an accounting, a constructive trust, declaratory relief, and a receivership.

Respondents have counter claimed alleging in essence that the Claimants interfered with their ability to develop the subject office building, breached the agreement by filing an action in

[1] Respondents were granted an extension of their opposition page limits to 35 pages. In addition, Respondents filed a separate document styled evidence objections which were, in effect, contrasting perceptions of the evidence and not truly legal objections. These so-called objections are merely argument and have little or no significance to the findings in the Interim Award. They should have been included within the 35 page limits.

the Superior Court, and violated the implied covenant of good faith and fair dealing, and seek both economic damages, liquidated damages, and punitive damages.

WITNESSES CALLED

The following witnesses were called to testify under oath: Erik Corrigan, Daniel Nero, Anna Christine Davis, Alan Truscott, James Walgren, Jeffrey K. Luney, Von G. Packard, Stephen Fick, Paul Butterfield, Gerald Sorensen, Paul Klein, Jeffrey Warmouth, Gerald Sorensen, Theodore Sorensen, Dennis Young, Michael Connor, Erin Uesugi, William Matson, Alfonso Diaz, Ronit Nodner, John Mordo, James J. Hill, Jr.

SUMMARY OF INTERIM FINAL AWARD

Claimants are entitled to an award vacating each of their investments based upon negligent misrepresentations of fact upon which they individually relied and which induced their investments in 40 Main Street Offices, LLC. The initial Operating Agreement signed by the Claimants, and any amendments and restatements of the same are vacated and set aside as to the Claimants, damages are awarded against respondents, jointly and severally, in the amount of the investment each Claimant made with interest from the dates of their investment at the legal rate. Claimants are also entitled to attorneys' fees and costs incurred. Arbitration fees are not included as costs in conformity with Article 14.10.5 of the Operating Agreement. Punitive damages are not awarded - there is no actual or subjective fraudulent intent - the misrepresentations are negligent. The reasons for the award are as follows below.

Respondents' counter claims are denied except that respondents are entitled to actual attorneys' fees and costs incurred in enforcing the arbitration provisions of the agreement.

PROCEDURAL HISTORY

Claimants initially filed their action in the Superior Court in Santa Clara County on June 19, 2014. An Amended Complaint was filed on September 25, 2014. Respondents filed a motion in Superior Court requesting that the court proceedings be stayed and that the matter be ordered to arbitration. In opposition to the Petition, Claimants contended that the arbitrator did not have authority to grant the relief requested in the Complaint, pointing to the limitation on the powers of the arbitrator contained in the arbitration agreement. On November 17, 2014, the Court granted the Petition and ordered the matter to Arbitration, and stayed the court action, providing that the arbitrator would decide any arbitrability issue in the first instance.

Following the granting of the Petition to Compel Arbitration, Respondents filed a motion asking the trial court for an immediate award of liquidated damages against Claimants for breaching the agreement to arbitrate under Paragraph 14.10 of the Amended and Restated Operating Agreement. The Trial Court, denied the motion, on the grounds that the matter was stayed, and that the claim for damages sought by Respondents was thus beyond the jurisdiction of the Court and was a matter to be decided by the arbitrator. Respondents appealed the denial to the Court of Appeal, thereby staying any further action by either the trial court or the arbitrator for a full year. The Court of Appeal entered an order dismissing the Respondent's appeal on November 16, 2015 as having been taken from a non-appealable order.

Claimants filed a motion to determine the scope of the arbitration proceedings herein and in particular to determine the legal effect of a provision in the Original and Restated Operating Agreements of the company relating to the scope of the powers of the arbitrator. Following briefing, the arbitrator rendered a decision defining the scope of the arbitrator's jurisdiction in the matter for the following reasons, which is hereby confirmed.

MOTION REGARDING THE SCOPE OF THE ARBITRATOR'S POWERS

At the time of the investment, all parties signed the initial Operating Agreement which set forth the rights and duties of the parties and specifically provided that "except as otherwise

provided in this agreement, any dispute, controversy or claim arising out of or related to this Agreement, or any breach thereof, including without limitation, that any claim that this Agreement, or any part hereof, is *invalid, illegal or otherwise voidable, or void*, shall be submitted . . . . to binding arbitration . . ." (Emphasis added). Operating Agreement Section 14.10

Following the Trial Court Order, Claimants filed their claims before JAMS seeking arbitration in compliance with the Court Decision, but still contended that the matter should be tried in Court because the arbitrator's powers were limited by the terms of the Operating Agreement. Respondents disputed that interpretation, and the arbitrator accordingly scheduled a hearing to consider the respective positions of the parties. The parties briefed their respective positions on the issue.

Claimants argued that the scope of the Arbitrator's powers must first be decided by the Court and that any matters properly to be decided by the arbitrator would then be remanded by the Court to the arbitrator for decision. The Claimants also requested that the Court be permitted to determine whether the amended and restated Operating Agreement is valid.

Respondents opposed the motion, argued that all issues must be decided by the arbitrator, and requested that the arbitrator immediately order specific performance of the claim for damages (liquidated) be paid by Claimants for breach of the obligation to submit the matter to arbitration.

The Superior Court had ruled that the determination of the scope of the powers of the arbitrator delineated in the arbitration agreement is an issue for the arbitrator to decide in the first instance and not the court contrary to claimants' arguments. The Claimants repeated their arguments here.

The language of the Arbitration provisions in the agreement is plain and clearly requires that ". . . any dispute or claim arising out of the Operating Agreement, including breaches thereof, or claims that it (the operating agreement) is voidable or void, or otherwise invalid, be submitted to arbitration" as set forth in Paragraph 14.10 in both the original and the restated agreements.

The clause in question that Claimants' contended limited the ability of the arbitrator to grant the relief requested (assuming Claimants successfully proved their case) is set forth in the

arbitration provisions. Paragraph 14.10.3 of the original and Paragraph 14.10.2 of the Amended and Restated Operating Agreements, provides as follows:

> The arbitrator shall not have any power to alter, amend, modify or change any of the terms of this Agreement nor to grant any remedy which is either prohibited by the terms of this Agreement, or not available in a court of law.

The language of the Agreement and the principles of applicable law provide the arbitrator all the powers needed to fully adjudicate any and all claims alleged in the Complaint under the powers set forth in the arbitration clause in Paragraph 14.10 in the Operating Agreement. There is a clear difference between the power to amend or revise any term of an agreement (not granted to the arbitrator) as opposed to the power as granted to the arbitrator to decide issues of void, or voidable provisions based on fraud or misrepresentation under California law. Paragraph 14.10.4 of the agreement. In effect, the agreement provides that the court has the same powers as a court.

Note that Paragraph 14.12 of the Agreement provides that if a part of the Agreement is found to be invalid for any reason the rest may be enforceable. Again, that power is not limited to a court and can be ruled upon by the arbitrator.

The arbitrator concluded following oral argument and consideration of the briefs that the arbitrator has all the powers necessary to fully adjudicate all the claims contained in the complaint which was filed in the superior court and remanded to be heard in arbitration.

Certain powers of a court may not be exercised by an arbitrator. That, however, does not preclude the parties' agreement to submit the issue to the arbitrator who may make findings of fact and submit the request based thereon to the court for implementation if the facts justify the action. See Marsch v. Williams, 23 Cal. App. 4th 238 (1994) which holds that only a court has the power to appoint a receiver.[2] See also Paragraph 14.10.1 of the Operating Agreement which specifically authorizes court action for appointment of a receiver.

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[2] Whether this rule would justify parties who are bound to arbitrate filing an action initially in court is not an issue that must be decided in view of other findings below.

MOTION FOR LIQUIDATED DAMAGES

By noticed motion, the Respondents sought an immediate order in this arbitration that Claimants be assessed liquidated damages for their filing of the law suit in Superior Court rather than seeking arbitration. The arbitrator deferred the issue concluding that there were several issues to be decided before that claim should be determined, including the validity of the amended and restated Operating Agreement and deferred it to the date of the arbitration, noting that the claim for liquidated damages is part of the Respondents' counter-claim.

As Respondents had at the Trial Court, they sought an order for Claimants to pay liquidated damages to Respondents for breach of the Arbitration Agreement pursuant to Paragraph 14.10 of the Amended and Restated Operating Agreement, citing Acosta v. Kerrigan 150 C.A. 4th 1124 as authority for the principle that a Court (or arbitrator) can award attorneys fees to a successful petitioner seeking an remand to arbitration of an action filed in superior court without waiting for a final resolution. The Acosta matter is not determinative of the issue.

Acosta was not a liquidated damages case; it involved attorney's fees and costs in connection with a motion to enforce an arbitration provision. Enforcement of Liquidated damages for breach of contract may implicate other issues as required in Civil Code Section 1671(b). See also Ridgley v. Topon Thrift and Loan Assn (1998) 17 Cal. 4th 970, Greentree Financial Group v. Execute Sports, Inc. (2008) 163. Cal. App. 4th 495.

The Court, and the arbitrator, as the case may be, have discretion as to the timing of the determination of such an award but in this instance, it required considerably more evidence and an opportunity of Claimants to adequately respond to the claim for the breach of contract. The determination of the enforceability of the liquidated damages provision is not totally dependent on the outcome of the dispute between the parties as to the claims set forth in the statement of claims by claimants and stands alone in some respects.

The demand for an order requiring Claimants to pay Respondents pursuant to the liquidated damages provision was denied without prejudice as being premature and without a sufficient foundation. The claim will be considered anew based upon the evidence submitted by the parties in the arbitration hearings themselves. That claim is renewed here in the counter claim of Respondents.

UNDISPUTED FACTS

Respondents Theodore and Jerry Sorensen identified real property located at 40 Main Street in Los Altos, California, as a potential development site for a new building and decided to seek investors for a development project at that location. In the spring of 2007, they prepared a written Project Plan and used the plan as promotional material to seek investors in a private offering. The project plan was revised and ultimately proposed the creation of a three story Class A office building with an estimated 20 parking stalls in the basement. The project plan also included alternate proposals for single story and two story alternatives.

Respondents Theodore and Jerry Sorensen created a Limited Liability Company, 40 Main Street Offices, LLC, (hereinafter Main Street), as an investment vehicle to acquire title to the property and to build the office building and a corporation named Gunn Management Group, Inc. (hereinafter Gunn), to manage the development project.

All of the alternatives for the development contemplated a total initial investment of $2,840,000 and the creation of the 40 Main Street Offices, LLC, to own the development. The LLC would have 10 units of ownership, a unit being valued for initial investment purposes at $284,000. Any one such unit could be owned by several individuals. The LLC provided that the project would be managed by Gunn Management Group, Inc., of which Theodore Sorensen, a California Licensed attorney, was President and Gerald Sorensen was Vice President.

CLAIMANTS CONTENTIONS AND CAUSES OF ACTION

A. FRAUD AND NEGLIGENT MISREPRESENTATION BY RESPONDENTS

The Project Plan was finalized and presented to claimants and other investors. Claimants allege the plan contained false statements which fraudulently induced them to invest in the project. Paraphrasing, the alleged false statements, may be summarized as follows:

1. That a Downtown Zoning Committee (DZC) recommended to the City Council that the subject property was included in a proposal to extend the floor area ratio to 250%. If the recommendation had been made and adopted, it would have modified the zoning requirements for the 40 Main Street Building to permit a larger building.

In fact, the evidence established that the so-called FAR recommendation was in a committee *draft* from the previous year and that the draft did not include any reference to the area which would include the subject property. The committee recommendation which was ultimately sent to the City Council did not ever include the 40 Main Street property. The FAR ratio for that area was never changed.

2. That Los Altos Planning Director had stated that the proposed conceptual design fit into the proposed zoning regulations.

There were no proposed zoning changes recommended for the area involving the subject property. Further, Mr. Walgren denied that he said such or that he was ever shown the four proposed design alternatives which were contained in the Project Plan. At no time was he ever told that the parties contemplated a three-story design with underground parking. Walgren also testified that he always reiterated to the Sorensen's that a three story office building was not acceptable nor was a mixed use building (which was one of the three story alternatives). Mr. James Walgren, then Planning Director, who was also a member of the Downtown Zoning Committee, testified that he was never told about proposed underground parking or the four alternative proposed buildings. The Town of Los Altos has a thirty foot height limit and that is inconsistent with a three story building (a thirty foot height limit would allow only 10 feet per story). Mr. Walgren also testified that a 45 foot high building was not supportable.

3. The proposed layout for the three story building can provide approximately 20 below grade parking spaces.

The evidence established that it would be impossible to place 20 parking stalls in the proposed three story building basement without stacked or tandem parking and valet service - none of which would be permitted under zoning ordinances, then or now. Respondents failed to perform any due diligence of consequence with regard to underground parking before making the representation. As early as August of 2007, respondents learned from an architect that the most basement parking spaces that could

be built would be a maximum of 12 (13 with tandem parking). That was confirmed the next year by a second architect.

It was not until 2012 that respondents finally stated publicly that underground parking was not economically feasible even though the evidence established that it was known, or should have been known, to respondents even before the plan was proposed.

4. That any of the four alternatives would produce a profitable venture when completed and sold. This relates to negligence and failure to investigate the reasonableness of the proposed options. It also ties into the issue of false promise. Any of the three-story options would exceed city height limits and during the ten year development process would always require a variance from the city. No other options by way of an application were ever presented to the city for approval.

B. FALSE PROMISE

The making of a promise without any intention to perform the promise may constitute fraud. Here it was represented by the Respondents that if one of the three-story options would not be approved, one of the other options (one or two story building) would be pursued and either would be profitable. The evidence to support this cause of action is non-performance of any of the other alternatives even when confronted with continual rejection of the three story plan. This was alleged to be a fraudulent promise based solely on circumstantial evidence that no effort was ever made to implement another option even when it became clear that there was continued opposition to the original three story plan. Other than the failure to ever try to obtain approval of the other options, no other evidence established that this was a false promise. See further discussion of this cause of action below.

C. BREACH OF FIDUCIARY DUTIES AND BREACH OF CONTRACT

The following allegations are alleged to constitute breach of the operating agreement and breach of fiduciary obligations owed by the promoters, managers, and officers of the company:

1. The $70,000 commission on acquisition of the property at 40 Main Street paid to the Sorensens who are not real estate brokers was improper and not adequately disclosed to the investors.
2. Improper front-loading of and retroactive payment of management fees and rent.
3. Overvaluation of project for determining management fees.
4. Failure to inform members which it became apparent that parking underground was not an option with continuing misrepresentation of underground parking even after it was clear it was not feasible.;
5. Failure to properly maintain accountings and books and records of the financial position of the LLC.(quarterly reports) and budget approvals.
6. Failure to comply with annual reporting and budgeting requirements of the LLC.
7. Failure to follow GAAP accounting principles thereby breaching bank requirements and jeopardizing bank loans.
8. Amendment of operating agreement to oust minority members, in effect. Not permitting reasonable opportunity to discuss and consider. Failure to fully disclose contents of the amendments.
9. Use of Indemnity provisions for attorney's fees in violation of amended statute provisions regarding breach of fiduciary duties.

RESPONDENTS' OPPOSITION TO CLAIMS

1. No standing to bring certain causes of action: 5th (breach of fiduciary), 6th (breach of contract), 7th (constructive trust), 8th (accounting), (9th (Declaratory relief), 10th (B & P 17200) , and 11th (receivership), must be brought as a derivative action.
2. No evidence of fraud or falsity or damages.
3. Statute of Limitations bars the causes of action.
4. Laches.
5. Equitable Estoppel.
6. Unclean Hands
7. Receiver cannot be created by arbitration award.

DISCUSSION

As to the Claimants' 1st (Fraud) 2nd (Misrepresentation), 3rd (Concealment), and 4th (False Promise) Causes of Action, these are direct actions alleging wrongful conduct in the form of pre-investment inducements that caused loss and damage to the claimants as individuals. Those causes of action are not derivative in nature but reside with the members. Any recovery therefore is to the members who have the burden of proving fraud and misrepresentation. The proper respondents as to those causes of action are the individuals who may have made such improper representations. The company may be a party to the extent that it was the recipient of the investments made by the claimants.

The managers and officers who are accused of mismanagement and breach of the fiduciary obligations belonging to the company as a matter of law do not owe a duty directly to the members. Corp. Code 17051 (d) (3), 17709.02. Effective 1/11/2014. See also PacLink Communications International, Inc., v. Superior Court (2001) 90 Cal. App. 4th 958. An action for damages to the Limited Liability Company, as with a corporation, may only be brought by members of the LLC against those causing the damage by filing a derivative action in the name of the company under circumstances when the company refused or fails to act.

The allegations of breach of fiduciary here do mostly relate to the fiduciary obligations owing to the company by its officer or managers. While claimants contend that the case has been treated by both sides as a direct action, in fact from an early point respondents have contended that much of the pleadings should be derivative and that there is no standing to bring them as direct actions. Until the final briefing neither party presented the issue for consideration in the arbitration.

While sellers of memberships in an LLC or a corporation generally do not have fiduciary obligations to purchasers, depending on the circumstances, such promoters do have a duty to advise the buyers that they are receiving money from the seller of the property to the LLC and not to conceal or disguise such payments so that it is not otherwise brought to the attention of the investors. Promoters must disclose their self-interest if the funds they will receive are from the monies invested by the investors. Here, the Sorensens' received a $70,000 commission when they acquired the property for the LLC and did not identify it as such other than in obscure

terms. It is noted that while an LLC acquiring real property might well pay a commission to a licensed real estate broker, neither Sorensens established that they were licensed brokers. Several members expressed the belief that the $70,000 as described in the books and records was a commission paid to third parties for the acquisition by the company of the property and had they known the true facts, they would not have invested.

The Sorensens valued their right to 50% of the profits in the company as "Profit Interest Holders" on the basis that they were making a contribution to the company which value was the combination of their right to buy the property for themselves and the $70,000 commission combined. Full disclosure would have been to disclose in writing that the Sorensens had a contractual right to acquire the property at 40 Main Street and that they would receive a commission from the LLC in consideration of assigning the right to purchase the property to the LLC. But that injury is to the LLC to which a fiduciary duty is clearly owed by the Sorensens and not to the members itself (although lack of knowledge of that type of self-dealing was a factor in several parties making their investment in the LLC) and does fall within the category of concealment.

As to the other causes of action which belong to the LLC, the issue is whether the pleadings are sufficient to allege that this action is by the LLC sufficient to permit the award of whatever damages there may be to the LLC from the Respondents. Those damages would be the commission received by the Sorensen's for the acquisition of the real property located at 40 Main Street; the allegedly improperly assessed management fees; damages from the failure to provide accountings and budgets; damages from the failure to obtain approval before loaning funds to the LLC, and damages for the failure to provide quarterly reports to the members.

As a matter of law, the Sorensens were not fiduciaries to the claimants. There is no basis in law for an individual claim by Claimants for such alleged violations. Each of those causes of action allege facts that establish damage to the company and not to its members under the law. The Limited Liability Company would in fact have a cause of action for such alleged conduct.[3]

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[3] The Members representing 60% of the voting rights of the company have signed after the fact confirmation of all acts of the individual respondents which are the source of the allegations of wrongdoing by the officers and

In order to bring such an action when the company fails to do so require compliance with certain statutory requirements as set forth in California Corporations Code Section 17709.2. The action here is against the company and others and fails to plead any such compliance.

There is ample evidence that the terms of the operating agreement were not complied with in terms of reporting requirements, disclosures of advances made by the managers, failures to maintain proper accountings, questionable computations of management fees, and other operational violations. But none of those matters can be the subject of a personal law suit by a minority of members other than under Jones v. H.F. Ahmanson (1969) 1 Cal. 3rd 93 for breach of a fiduciary obligation arising under unusual circumstances, for example, disadvantaging a minority by a majority interest. The relief requested cannot be granted without joining all the other members who constitute a majority of members. The proper cause of action could be for a dissolution of the company and damages under the terms of the corporations' code. Under ordinary circumstances, that would give the majority members a right to buy out the interests of the minority with protection of all interests under the terms of the law. Alternatively, if the company had suffered damages, a derivative law suit will permit all members, whether they joined in the law suit or opposed it, to in effect, receive the benefit to which they all may be entitled (except the wrong doers, if any).

FRAUD AND FALSE PROMISE VIOLATIONS

The evidence does not support findings of intentional fraudulent acts or a specific intent to defraud. But it does reflect a careless use of language which fits within the category of negligent misrepresentations and potentially an action based on a false promise.

Making a statement of fact known to be untrue (or without having investigated the validity of the same can be the equivalent of an intentional misstatement if done recklessly, without knowledge of whether or not the fact represented is true or not) is an element of fraud

managers of the company. That would not foreclose a derivative law suit by non-consenting members such as claimants here had such a derivative suit have been filed.

and deceit. Civil Code Section s 1709 and 1710(1). For example, a statement that "a proposed layout for a proposed underground parking garage can provide approximately 20 spaces in the below ground area . . ." as a fact without knowing whether or not it is feasible because of a failure to investigate the issue, may be the equivalent of an intentional false statement in the context in which it is made if made with an intent to defraud. In this case, the statement relates to what kind of building may be built, valuing the completed building, and the ability to obtain permit approval because of parking requirements, all of which is a material inducement to make an investment in the project.

Negligent misrepresentation is "a positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though one believes it to be true." California Civil Code Section 1572(3).

The misrepresentation of underground parking occurred because of a failure to investigate. There may not have been a subjective intent to defraud but a misrepresentation made recklessly, even with a "hope" that it can be accomplished, but no real belief in the certainty of it, is sufficient to constitute a negligent misrepresentation, if the misrepresentation is material and causes conduct by party to who the representation is directed- in this case investments in the project. See Christiansen v. Roddy (1986) 86 Cal. App. 3rd 788.The evidence here establishes is that there was a failure to adequately investigate, it was relied upon by each of the Claimants. And evidence establishes that there are other negligent misrepresentations.

Other representations that were based on facts that were neither true nor reasonably based include that the extension of the Floor Area Ratio to 250 as applied to the 40 Main Street property (paraphrasing) was virtually a "done deal", the feasibility of building a three story building in concept that would exceed the zone height limits of 30 feet, was within the city's proposed recommended changes, with a **favorable** likelihood of a zoning amendment or waiver, and that if three story concept could not be built, a one or two story building would be profitable and would be pursued. Taken together, these representations were false and based upon the evidence presented,

Claimants relied on the facts represented and would not have invested had they known the true facts. The law is clear that a misrepresentation of a fact, as opposed to opinions, is actionable, whether negligently or intentionally made. And while some of the statements of expectation in the "plan" were clearly opinion, underlying all were what purported to be facts. Bobak v. Mackey (1951) 107 Cal. App. 2nd 55. The defendant represented that land was zoned C-2 when in fact it was zoned R-3, which prevented manufacturing use.

A period of almost 10 years has elapsed, there have been numerous obstacles to the construction of a three story building, and it has still not been approved although the same proposal as previously submitted and rejected has been resubmitted. Whether it will ever be approved by the city is not determinative of the outcome of this claim. The LLC has been mismanaged and has been economically damaged although the non-claimant majority (60%) have apparently waived the right to sue on behalf of the company against the managers and officers of the company. The investor claimants are entitled to rescind, to receive their investments back as damages with interest at the legal rate.

While the prospectus lists multiple risks to be considered by investors, the risks do not vitiate false statements or statement made to induce the investment which may have been made without a sufficient basis for believing in the truth of the statements.

FALSE PROMISE

While the "prospectus" stated four alternatives, the primary plan intended was the three story plan with office and or residential which presumably would present the greatest return on investment. While the three story plan was repeatedly denied by the City of Los Altos because of height and parking issues, no action was ever taken to implement a lesser plan which the evidence establishes could have been built and completed long ago. The officers and managers of the company had a duty develop the property in accordance with their representations to the investors. The testimony from respondents that they told the city they would build whatever they would be allowed to build does not satisfy that obligation. It is not the duty of the city to present

a plan for the company to build. The fact that no alternatives were every presented by the respondents represents a failure of their duty. That fact lends some credence to the claim that the other two alternatives were never intended to be built.

But the mere failure to perform without any other corroborating evidence is generally deemed to not be sufficient for a finding that the promise was not intended to be performed at the time it was made. Here there is no other evidence. See Tenzer v. Superscope (1985) 39 Cal. 3d 18.

As to the causes of action for breach of contract, declaratory relief, and breach of fiduciary, while some of the conduct alleged to be wrongful and reflects violations of a managerial and fiduciary duty to the company, all are clearly a violation of a duty owed to the company as discussed above. However, the prospectus itself essentially was a promise to investors that one of the proposed building options would be built within a reasonable period of time. The investors all accepted that offer by investing in the company. The failure to do so constitutes a breach of that promise which, while it may not reach the level of a fraudulent promise, is inevitably a breach of the contractual promise. Because the promise is material, and a constructive condition, the breach will support a decision by the promisee to withdraw from the contract and seek damages which, under those circumstances would be the same damages assignable to the claimant for a negligent representation inducing the purchase of the membership.

AMENDMENTS TO THE OPERATING AGREEMENT

Amendments to the restated operating agreement clearly impact the rights of the claimants who are minority members, individually, and the approval by the majority implicates the duty that majority members of a corporation, partnership, and Limited Liability Company owe to minority members,

The majority members may not act to injure the rights of the minority members by company action or modification of the operating agreement. See Jones v. H.F. Ahmansom & Co., (1969) 1 Cal.3d 93. In deciding the issues, the arbitrator must evaluate both the intent and the effect of such conduct by the majority. Several of the modifications of the operating agreement were specifically designed and intended to deprive the minority members of rights to inform themselves as to management and operational issues. All members have a right to determine whether there was mismanagement and violations of the fiduciary duties of the officers and managers. The reporting requirements by the managers and officers was designed to ensuring that the members were informed and to permit approval of budgets and other decisions.

The amendment authorizing the respondents to indemnify themselves for attorneys' fees and costs from company funds equally violates the minority interests since the allegations are of fraud, breach of fiduciary, and violations of the operating agreements. While such indemnification might be appropriate were the managers to prevail, since they have not prevailed, payment of such expenses is a furtherer impropriety. It is noted the indemnity provisions were never presented for signature to the minority parties here. Again, however, the injury caused by the indemnity provisions is to the company and not the members individually.

In particular, the method of obtaining approval of the amendment demonstrates an attempt by the majority (at the time) to marginalize the minority who were raising legitimate concerns about the operation of the company, including the failure to abide by the reporting requirements, budget approvals, availability of records and documents maintained by the LLC., with the imposition of draconian penalties for violations of the LLC, real and imagined.

Without simultaneously presenting the amendments and the justification for them to the two leading minority parties, Old Trace and Nero, at a time other than normal business hours, the proposed amendments were sent to the other 80% of members' interests, urging that they be approved and, in effect, stating that must be signed immediately and returned for the good of the company and to protect member's investments. At that urging, most were signed and returned the evening sent. None who signed and were called to testify by Respondents testified that they

knew what they were signing or even that they read or understood the documents or the reasons for the amendments before signing. They were signed solely on the urging of Theodore Sorensen on his representation that if they did not sign them, they stood to lose their investments. The next day, copies of the amendments were sent to Old Trace and Nero with no expectation they would be approved.

It appears that the entire construct of the amendments was designed to provide a basis for ousting the minority members from the company with minimal cost. It is noted that subsequently, an additional 20% of members interests who had approved the modifications without reading them, at the behest of respondents, joined the claimants in this action and in their opposition to the management of the Respondents here. Their testimony as to how the amendments were presented was consistent- no explanation and that the amendments were not read before signing them. Apart from the method of creating the amendments, the provisos themselves are severe and draconian in effect and some lack certainty and clarity.

LIQUIDATED DAMAGES

1. Civil Code Section1671(b) provides, in effect, that the party seeking to invalidate a liquidated damages provision has the burden of establishing that it was unreasonable at the time the agreement was made. It is noted that Section 1671 (b) refers to provisions in a contract where the parties have agreed to liquidated damages. Clearly the parties here did not so agree to those provisions and should not be bound by terms that were inserted without an opportunity to consider them or to ensure that those who did approve them read and considered them.

   It is also unclear by the language of the provision itself as to the number of multiples that can be assessed if, as here, more than one member files or joins a single law suit. The lack of any relationship to actual damages is demonstrated by Respondents' own claim for $250,000 for having filed the law suit in Superior Court. Clearly such an amount is unreasonable as reflecting actual damages.

2. The $50,000 liquidated damages is unreasonable and is nothing more than a penalty. It bears no relationship to actual damages or costs. Reasonably moving a court to compel arbitration should not require attorneys' fees of $50,000. And certainly not $250,000 which would be the cost of all five claimants who were involved in the court proceedings. Costs and fees incurred in moving to compel arbitration are readily capable of calculation. It is noted that in this case when the trial court granted the motion to compel arbitration, Respondents exacerbated their expenses by appealing the court decision.

3. While the burden is on the party opposing the liquidated damages provision to show that the provision is unreasonable, the Arbitrator is satisfied from the circumstances presented that such a penalty, especially as framed in this matter, is unreasonable, in particular as viewed in conjunction with the other amendments which may best be described figuratively if not literally as the midnight changes.

4. Filing a law suit by a member of a limited liability company (even to seek dissolution of the company) against the company forces an involuntary sale of the members interest at a substantially reduced price reduced further to 90% less damages tantamount to a forfeiture, even if justified.

STATUTE OF LIMITATIONS

Respondents assert by way of an affirmative defense that the action by claimants is barred by the statute of limitations. All of the evidence submitted by Respondents addressing the knowledge of the Claimants at a period more than three and four years prior to initiation of the action in superior court relate to the actual manipulation of the company, including the management fees, the failure to present a budget for approval, the regular reports required by the Operating agreement, the approval of advances to the company, and the like, all of which

aroused suspicions but no knowledge sufficient to cause the statute of limitations to begin running.

None of the facts known to claimants relate to any knowledge of the false representations which induced the investment in the company in the first instance, including the height issues, the underground parking, the city zoning requirement that would have to be waived since contrary to the prospectus there was no evidence it would be amended.

The knowledge of those causes of action which might belong solely to the company against its managers aroused suspicions in the members, but the falsity of the representations, negligent or intentional, were neither known to nor suspected by claimants. Moreover, Respondents always assured claimants that all was well and that matters were progressing as late as 2011 up to January 2012 and beyond.

When it became apparent later in 2012, when the claimants began to probe the issues more closely, respondents immediately began to circle the wagons, creating first an unlawful amendment that permitted them to restrict information to which the Claimants would otherwise have access, and then putting in place an amended and restated operating agreement with draconian consequences to any efforts by members who were questioning the value of the operational efforts of the respondents with the intent of ousting the questioning members. That was later followed by an ex post facto approval of the acts of the officers and managers by members who have not joined in this action (without a specification of what acts were being "forgiven.". It is noted than a number of such non-dissenting members are close Sorensen family members and close friends of the Sorensens.

Thus, while the knowledge pointed to by respondents affecting the statute of limitations relates to the "derivative actions" none of it established the type of "on notice" knowledge relating to the intentional or negligent misrepresentations nor the "false promise" or breach of the promises in the prospectus.

Moreover, continued assurances by respondents to claimants which caused the claimants to defer filing a claim or a cause of action justifies delayed deferral or accrual of the cause of actions and continued concealment of the actual functioning of the company adds to the justification for any delays as to those causes of action.

COUNTER CLAIM BY RESPONDENTS

Respondents have filed a counter-claim against all claimants alleging a violation of the Amended and Restated Operating Agreement of 40 Main Street, LLC.

The specific provisions of the amended operating agreement which Respondents claim are violated by Claimants, are as follows:

1. Breach of the Amended and Restated Operating Agreement.
    a. Breach of 5.1.1.1: Interfering with the LLC operation and management of the company.
    b. Breach of 14.10: Refusing to arbitrate- filing law suit (liquidated damages).
    c. Breach of 14.26: Disclosing confidential information to third parties.

2. The Acts alleged as violations are as follows:
    a) All Claimants (Sean Corrigan, Erik Corrigan, Dan Nero, Alan Truscott, Paul Klein, and Fick for engaging Ronald Packard as counsel to obstruct and interfere with the management and development of the project as proposed; Packard authoring an ordinance which was adopted in October 2012 altering the height provisions affecting 40 Main Street; Multiple other acts by Packard in opposition to the 40 Main Street project;
    b) Erik Corrigan contacting Bridge Bank and interfering with the LLC relationship with the bank;
    c) Dan Nero contacting Bridge Bank through his attorney and interfering with the LLC relationship with the bank;

d) Sean Corrigan interfering with the LLC efforts to seek approval by communicating negative information about the LLC to Council person Mordo

e) Truscott, Fick and Klein for interference.

DISCUSSION

Respondents' counterclaims of specific violations of the provisions of the Amended Operating Agreement require a discussion of several matters preliminarily before addressing the acts themselves:

1. The validity of claimants' causes of action for fraud and misrepresentation;
2. The validity of the amendments;
3. The conduct complained of;
4. The liquidated damage provisions.

As found in the decision above regarding the fraud and misrepresentation provisions, there is insufficient evidence of intentional fraud by even a preponderance of the evidence. On the other hand, the respondents were found to have made factual representations that were not justified by the information they possessed and without any basis for a reasonable belief they were true. That falls within the definition of a negligent misrepresentation. The evidence also supports the conclusion that claimants relied on the representation made at the time of their investments.

Claimants in their complaint, which is the basis for the claims in arbitration, seek a finding that the Operating Agreement is null and void. The finding herein that the representations were false, and that the respondents were responsible for making negligent representations which induced the claimants to invest in the company, justifies the award setting aside the investment agreement, ordering rescission, and damages to claimants. That finding nullifies not only the original agreement which is claimed to be violated, but also the amended and restated agreement with its severe penalties and consequences.

As the membership in the company is rescinded because of the misrepresentations, the Operating agreement and its amendments are voided. Voiding and setting aside the operating agreement and the amended and restated operating agreement, since there is no cause of action by respondents outside the operating agreement, it is technically unnecessary to evaluate the other grounds of opposition to the counter claim. Notwithstanding, the other issues will be discussed.

First, the validity of the Amendments:

The method and timing of adoption suggests that it was an effort by the managers and promoters to insulate themselves from any inquiry by concerned members who were dissatisfied by the operational management of the company and who believed that the managers were fraudulently or otherwise making decisions adverse to the best interest of the company and its members.

It had been more than five years from the time of the creation of the company and an application for a permit to develop the property had been rejected by the city council as nonconforming to the city zoning requirements. Regular reports had not been submitted to the members in accordance with the operating agreement. Annual budgets had not been submitted and requests for books, records, and check records had not been produced in compliance with the operating agreement.

It had become apparent to the managers and officers of the company, and to some other members, that there was dissatisfaction by some members who might be willing to take some action against the company and its officers. As reflected above, severe and to some extent illegal and unenforceable provisions were placed in a proposed amended operating agreement.

The method of adoption of these provisions was surreptitious and coercive. The proposed amendments were circulated somewhat late in the day by e-mail to all but the Old Trace and Nero claimants with a follow up telephone to some urging the members to sign immediately to protect their investments. There was no discussion of the details of the amendments with the members who signed. There had been discussion among some of the members and the officers

and managers that Nero and Old Trace were going to adversely affect the company. The Old Trace and Nero claimants only received the proposed amendments after they had been approved by a supermajority of members. The approval was given near the end of October 2012.

It is noted that a meeting was held on October 17, 2012 among all investors, called by members to discuss the project. Respondents failed to attend though they had notice of the meeting. The meeting was followed by a letter from Sean Corrigan to all, including respondents, setting forth the agenda that had been discussed, concerns about operational decisions, and some proposed solutions. See Arbitration Exhibit 37.

The amendments to the operating agreement, obviously drafted by an attorney for the respondents, followed in less than 2 weeks. The objective was to stifle concerns and prevent inquiry among the dissenting members or any action by members to rectify, modify, amend, or end the project.

Although the operating agreement permitted amendments upon an affirmative vote by a super majority, and 80 % approved these provisions, the method of approval did not permit all voices to be heard, or for reasonable discussion, and it is noted that among the so-called super majority, 20% were votes by members who are now claimants here, and among the other approval voters, over 25% are respondents or close relatives of respondents. If those 25% are not independent but subject to control of the respondent s, there is not a supermajority in favor of the amendments.

The specific provisions precluding right of examination of the books and records, imposing severe penalties for violations by way of monetary and involuntary buy-outs, bear no reasonable relationship to any actual harm and on the face of it are purely punitive.

The involuntary buy-out for filing a law suit is at 90% of the fair market value at the time of the violation. Of course, respondents have already received the full benefit of the investment dollars of claimants as well as of borrowed money.

As discussed above, the so called liquidated damages bear no resemblance to estimated actual damages and are unreasonable. By the terms of the amendments, if a member files a law suit in superior court, the company is entitled to a liquidated damage amount of $50,000 against each member who files the law suit. In this case respondents seek $250,000 against the 5 claimants. Moving to compel arbitration against 5 united plaintiffs is on its face not 5 times more expensive or time consuming than a motion to compel on the same grounds against one plaintiff.

Imposing a $50,000 penalty against a member who is trying to ascertain the propriety of conduct of the operating company can only be a penalty to deter inquiry. Particularly here where all the testimony was that no tangible damage was suffered by anything done by any member.

Causation: Assuming that all of the conduct complained of in fact violated the Operating Agreement, has the LLC suffered any damages as a consequence? The failure to obtain approval for the proposed three story office building was caused by the failure to propose a building that met city zoning standards or acceptable provisions for waivers of some zoning provisions. There were two predominant causes that the evidence established as the cause for the rejection of the application to the city: city height limitations and the inability to satisfy city parking requirements, which could not be satisfied by a three-story building, and the refusal to propose a lesser building which could have been approved within a short period of time after formation of the company.

Other claimed violations include the engagement by claimants of Ronald Packard as consultant, and then attorney of record in these proceedings in the fall of 2012. Mr. Packard is and was an avowed opponent of the three story project who not coincidentally was an adjacent property owner whose property would be affected by the 40 Main Street building as proposed. Claimants by 2012, more than 5 years after the formation of the LLC and after the failure to get approval of respondents for the three story concept, were questioning the propriety of the management of the company and its books and records, and were considering what alternative might be available to them. A member of an LLC is not barred from seeking remedies if the member is reasonable justified in believing there is mismanagement or fraud by the managers or officers of the company. This was the period of time when they had also learned that a usable 20

car parking garage was not feasible. Respondent argues that this conduct violates the Section 5.1.1.1 of the Amended Operation Agreement.

Members who spoke with bank officers had an absolute right to talk with them because of the risks to their investment dollars if the bank foreclosed or defaulted the loans. One way of protecting one's interest is by acquiring a loan before it is defaulted. While the inquiry concerning acquiring the banks' loan could have nefarious intent, it may also be a proper protective effort which would gave the member more ability to protect his interest in the company.

Speaking with council members even in a disparaging way about the building is alleged to have occurred in 2016. It is noted that in 2016 the case was being fully litigated in arbitration and respondents had already advised claimants that they were no longer members of the company and were subject to the involuntary termination of their membership.

The wisdom of engaging an avowed opponent as counsel who has an interest in the case once litigation is contemplated or commenced is questionable but such counsel was not called as a witness. Such counsel, it should also be noted, was a former mayor of the city and sat on the city council as a member during a portion of the time the project was pending. He had a strong bias against the proposed building but it was a bias he was entitled to have as an adjacent property owner. Claimants had a right to defend themselves and their investment in the project. Mr. Packard had early on expressed objection to the building as proposed in discussions with Theodore Sorensen and expressed his opposition to the height and concerns about the parking problems. The evidence does not establish that hiring Mr. Packard as an attorney had anything to do with the disapproval of the building application. Nor did it have any effect on Mr. Packard's already formed objection to the building.

While the evidence established that Mr. Packard as a councilman and an adjacent property owner recused himself from any part of the city's processes in considering the 40 Main Street plan and there was no physical or other evidence of improper conduct by him at any time, the fact that the other council members were undoubtedly aware of his opposition, might have

influenced the council planning department, planning commission, and the council in not approving the three story plan. Whether that is true or not, there was no evidence presented to establish any impropriety by Mr. Packard as a public official although that has no real bearing on the outcome of this arbitration.

The ordinance affecting the height limits might have made it more difficult to justify the three story version of the building, but by its terms when introduced by Mr. Packard expressly did not include his or the property at 40 Main Street, noting that with or without the amended ordinance, the 40 Main Street building was nonconforming as to both height and parking. There also is no evidence that claimants had anything to do with the enactment of the ordinance.

Much of the complained of activity of claimants regarding the bank, city council members, and the like, occurred well after the 2012 rejection of the plan by the city and continued even during the arbitration proceedings at a time when the claimants had asserted causes of action for fraud and misrepresentation and were questioning the validity of the amendments to the operating agreement.

Respondent who are seeking damages against the claimant include the Sorensens. The Sorensen's have no standing in their own names to sue the members for damages as pleaded. If the claimants were liable for liquidated or other damages, their liability would be to the company and not to its managers or employees in their own right.

Confidential Information and Privacy rights of the LLC. Certain information that was private information and writings of the company was used by claimants in discussions with third parties who had some relationship to the project and who might have some relationship to the project in the future. None of those contacts had any economic or other known impact on the company or the project. Because the liquidated damages provisions are not enforceable, either because of their method of approval, or because they do not constitute proper liquidated damages and are a penalty, or because they are subject to the rescission based on misrepresentation and fraud at the inception, and because no actual damages are proved, even assuming that such disclosures were a violation by claimants, respondents are not entitled to an award for any such violation. The same is true of any other alleged violations by the claimants of the operating agreement.

LACHES AND ESTOPPEL

There is no factual evidence establishing any of the affirmative defenses of laches, estoppel, or unclean hands, that would preclude the action by claimants.

CONCLUSION

Claimants are entitled to an Award voiding their acquisition of a membership in the 40 Main Street Offices, LLC based upon the negligent representations made by the Sorensens, setting aside and rescinding the 40 Main Street Development Agreement as to them, , and a return of their investment with interest at the legal rate from May of 2007. Claimants are entitled to an Award of attorneys' fees and costs. Costs do not include the arbitration costs.

Claimants were wrong in filing the action in view of the agreement to arbitrate disputes notwithstanding that the agreement is set aside as to claimants . As the arbitrator is reserving jurisdiction to determine attorneys' fees to be awarded to claimants, it also finds that respondents are entitled to actual attorneys' fees and costs incurred in enforcing the arbitration provision.

Claimants seek an award that the entire Operating Agreement be set aside for fraud and misrepresentation and mismanagement. If all of the members had joined in the law suit, that relief could be available along with the appointment by the Court of a receiver to take charge of the company. However, 60% of the members have not joined in this action and the company remains a viable company for all purposes. Claimants however are entitled to an award finding that they are may rescind the acquisition of their memberships in the company and, by way of damages, a return of their investment with interest at the legal rate from May of 2007.

This Award is an Interim Final Award. The arbitrator retains jurisdiction to issue a Final Award, computing interest, fees, and costs and any other ancillary or collateral relief justified by the findings herein.

IT IS SO ORDERED.

Date: February 8, 2017

Hon. Jack Komar (Ret.)
Arbitrator

PROOF OF SERVICE BY EMAIL & U.S. MAIL

Re: Old Trace Partners, L.P. vs. Sorensen, Theodore, et al.
Reference No. 1110017521

I, Michelle Penuliar, not a party to the within action, hereby declare that on February 10, 2017, I served the attached Final Interim Award on the parties in the within action by Email and by depositing true copies thereof enclosed in sealed envelopes with postage thereon fully prepaid, in the United States Mail, at San Jose, CALIFORNIA, addressed as follows:

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I declare under penalty of perjury the foregoing to be true and correct. Executed at San Jose, CALIFORNIA on February 10, 2017.

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