

JAMS ARBITRATION CASE REFERENCE NO. 1100079509

STEVEN BRULL,

Claimant,

and

JAMES PREIMESBERGER, MERIDIAN HEALTH SERVICES HOLDING, INC., McCLURE PROPERTY PARTNERS, LLC, and SAN FRANCISCO PROPERTY PARTNERS, LLC,

Respondents.

FINAL AWARD

Parties and Counsel. The parties to this arbitration are identified in the caption and are represented as follows:

Marco Quazzo, Esq.
Bartko Zankel Bunzel & Miller
One Embarcadero Center
Suite 800
San Francisco, CA 94111
(Tel): 415-956-1900

Counsel for Claimant

Eric P. Early, Esq.
Christopher I. Ritter, Esq.
Peter D. Scott, Esq.
Early Sullivan Wright Gizer & McRae LLP
6240 Wilshire Blvd., 17th Floor
Los Angeles, CA 90048
(Tel): (322) 301-4660

Counsel for Respondents

Arbitrator:

Hon. J. Richard Haden (Ret.)
JAMS
401 "B" Street, Suite 2100
San Diego, CA 92101
(Tel): 619-237-0805; 619-236-9032 (fax)

Case Manager:

Jenny Truex
JAMS
401 "B" Street, Suite 2100
San Diego, CA 92101
(Tel): 619-237-0805; 619-236-9032 (fax)

PLACE OF ARBITRATION: Orange, California

DATE OF INTERIM AWARD: August 21, 2015

The undersigned Arbitrator, having been selected by stipulation of the parties, and having been duly sworn and examined the submissions, proof and allegations of the parties, finds, concludes, and issues this Final Award as follows:

I. INTRODUCTION AND PROCEDURAL STATEMENT

Mr. Brull invested in two LLCs which own nursing home properties. He seeks damages for breach of fiduciary duty, negligence, fraud, and a violation of the Corporations Code from Mr. Preimesberger and Meridan, who managed these LLCs. Mr. Preimesberger denies all Mr. Brull's claims.

The arbitration clause is contained in the Operating Agreements Article 11.2. The arbitration was ordered by the Los Angeles Superior Court, Case No. SC121282 ("Order") dated August 30, 2013. The claims are stated in the Demand for Arbitration dated December 18, 2014, and the First Amended Complaint dated June 11, 2014. The claims are arbitrable. The substantive law of California and the California Arbitration Act together with the JAMS Comprehensive Rules ("Rules") shall apply in this proceeding.

The evidentiary hearing took place June 10-12, 18-19, and July 21-23, 2015, in the JAMS offices, 500 North State College Blvd., 14th Floor, Orange, California. Each side offered documentary evidence (Exh. 2-7, 10, 12-14, 16-18,

20, 22-23, 28-29, 31-33, 35-36, 41-43, 49, 52-57, 59, 61-70, 79, 81-83, 86-89, 93-112, 114-127, 131-135, 137, 139-141, 145-146, 151-152, 155-159, 163-164, 166-168, 174, 177, 205-208, 218-219, 224, 226-240, 248, 250-252, 254-255, 257-258, 261, 263-265, 266, 268-270, 272, 276-284). The following witnesses testified: Steven Brull, James Preimesberger, Greg Regan, Amit Nayyar, Keith Simpson (by Skype from Japan), Abe Bak, Eric Sussman, and Barbara Luna. The hearing was not reported.

At the conclusion of the testimony the matter was argued. Counsel submitted post hearing briefs on July 31, 2015, and the matter was submitted for an Interim Award. Following submission of the Interim Award, Respondent submitted an application for fees, costs, and expenses and Claimant submitted an opposition. The parties stipulated to modify the 180 day arbitration time limit set out in Operating Agreements Article 11.2 to provide the Arbitrator shall have jurisdiction until October 1, 2015, to issue a Final Award.

II. FACTS

The following is a statement of the facts found by the Arbitrator to be 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 and relevance, burden of proof, and the weighing of evidence.

A.

PERCIPIENT TESTIMONY

James Preimesberger is a licensed nursing home administrator with a Master's Degree in Gerontology. He has been in the nursing home industry twenty-seven years and is a state approved trainer of nursing home administrators. He attended law school to become a better nursing home operator and is a member of the California Bar. Over his career he has cared for 20,000 – 40,000 patients and managed 4,000 – 5,000 nursing home beds.

Mr. Preimesberger began Meridian Health Services in 1999 to manage nursing homes. He explained because costs are constantly increasing,

preventative maintenance at the homes is essential, and the industry is labor intensive, the only way to remain solvent is to increase rates. Most patients receive benefits from Medicare or Medi-Cal which base reimbursement rates on what the facility spends on patient care and the quality of the facility itself. While only certain profit margins are allowed or Medicare and Medi-Cal will lower reimbursement rates, above market rents as expenses are acceptable. Hence, Mr. Preimesberger's goal has been to expense everything through the nursing home operators including rents paid to the LLC property owners of the homes. This made it possible for LLC property owner members to earn generous returns on their investments.

In sum, the investment structure was for Meridian, which operated the nursing homes on property owned by the LLCs, to transfer profits to the LLCs by paying above market rents from revenue derived by operation of the nursing homes. This investment structure was dependent on reimbursements to Meridian from Medicare and Medi-Cal. The LLCs had a direct interest in nursing home operations because the homes were only able to pay above market rents if they were operating well in a manner which satisfied Medicare and Medi-Cal.

Steven Brull holds an M.A. in journalism from Columbia. He covered the Tokyo stock market for Reuters for four years then became Bureau Chief in Tokyo for the International Herald Tribune where he reported on the economy and business affairs four additional years. He then was technical correspondent for Business Week in Tokyo two years before moving to Los Angeles where he covered technology three more years for Business Week. The next eight years he reported on venture capital, pensions, and technology for Institutional Investor Magazine until he was laid off in 2009 as a result of the Great Recession. After four months at Guggenheim writing commentaries on market direction, he became a financial writer at PIMCO, an investment company, where he has been employed since 2012. He is also a General Securities Representative with a license to trade securities.

In 2007, Mr. Brull learned about an investment opportunity in SFPP, an

LLC which would own a nursing home, from his friend Keith Simpson. Mr. Simpson explained Mr. Preimesberger was both president of Meridian, manager of SFPP, and operator of the tenant nursing home. Meridian would pay rents from the tenant to SFPP. The goal was to obtain above market rent which would yield LLC investors a 14% annual return. Tenant's ability to pay rent was directly subject to Medicare and Medi-Cal reimbursements which can go up or down.

Mr. Brull understood it was "unseemly" for the nursing homes to reveal they were making a lot of money, so the LLCs were set up to "channel" profits from Meridian to the LLC investors without arousing the suspicion of state regulators. Mr. Preimesberger had explained to maintain positive growth in Medicare rates it was necessary to expense all he could through the operating entity. This was possible because Mr. Preimesberger was in control of both Meridian and the LLCs. This conflict did not trouble Mr. Brull because having Mr. Preimesberger "on both sides of the equation" worked to Mr. Brull's advantage. Mr. Brull was clear that rents could vary depending upon Medicare and Medi-Cal reimbursements which could go up or down. (Exh. 258.) Mr. Simpson had explained reimbursements had gone down in the past and could go down in the future.

Mr. Brull reviewed an extensive list of disclosures about this investment. He acknowledged he had sufficient experience in financial and business matters, was capable of evaluating merits and risks of purchase and did not require a financial advisor's aid in evaluating the transaction. The SFPP Operating Agreement (Exh. 2), which is the same as the McClure Operating Agreement (Exh. 16), makes no assurances regarding distributions and clearly states distributions are up to the manager. After considering all these factors, Mr. Brull then invested \$69,151 in SFPP. (Exh. 3, 4.)

Following receipt of funds from Mr. Brull and many other investors, Mr. Preimesberger, through Meridian, purchased SFPP which entered into a ten-year triple net lease with Meridian as tenant to operate the nursing home on the premises. (Exh. 86.) Under a triple net lease the tenant was responsible for

maintenance, insurance, and property taxes. The lease provided rent would be adjusted according to Medi-Cal reimbursement rates. SFPP paid Meridian a \$400,000 lease acquisition fee for raising investment capital and securing purchase of the property. (Exh. 10, 22.)

In 2008 Meridian purchased Foresight which managed nine nursing homes including McClure. (Exh. 87.) This purchase included options on the real estate on which some of those homes were located. The option for McClure cost \$750,000. To exercise this option and purchase the McClure property, Meridian once again sought investors.

Mr. Simpson again told Mr. Brull about this investment opportunity and explained structure and risks which were the same as previously explained regarding SFPP except the anticipated return was 12%. In 2008 Mr. Brull invested \$40,000 then an additional \$200,000 in McClure. Just as before, Mr. Brull acknowledged such an investment is speculative and involves a high degree of risk of loss, financial projections are estimates and may be incorrect, all his questions had been answered, and he had no need for liquidity and could afford to lose the entire amount of his investment. (Exh. 168.) Mr. Brull also reviewed the McClure subscription agreement which stated neither the LLC nor manager had a financial or operating history and the investment was speculative with a high risk of loss. (Exh. 18.)

Mr. Brull testified he felt "hurried and pressured" to invest. He asked Sandy Millar, an attorney friend, "would I be a fool to sink a fair amount of change into this?" (Exh. 20.) After a discussion over lunch, Mr. Millar declined to offer advice because he could not understand how these rates of return could be sustained without making a further analysis. The business model was unclear to him and the operating agreement was poorly written with no specific details of revenue. In short, Mr. Millar raised serious questions. Nevertheless, Mr. Brull then borrowed the \$200,000 on his home equity line of credit to invest further in McClure.

Meridian allocated \$525,000 as a lease acquisition fee and McClure

transferred \$750,000 on the books to Meridian for the option to purchase. Exh. 6, 14, 177, 279.)

In 2009 Mr. Preimesberger arranged loans from Capital Source Banks (CapSource) of \$2.5 million each to SFPP and McClure plus a line of credit. Mr. Preimesberger first obtained the written consent of a majority of investors, including Mr. Brull, for these loans. (Exh. 28, 29.) CapSource required cross-default and cross-collateralization provisions as well as personal guarantees from Mr. Preimesberger and Meridian. These loans were used to provide much needed operating capital because of delays in Medicare and Medi-Cal reimbursements. The loans were also used to buy out §1031 investors which increased property value (Exh. 12, 14, 23, 42, 43), to pay off a prior loan, and for capital improvements. (Exh. 235-239, 248.) Mr. Brull spoke directly with Mr. Preimesberger and Mr. Simpson about these loans. Mr. Preimesberger testified the loans went to pay SFPP and McClure expenses. (Exh. 140, 141.) All transfers to Meridian were for specific business purposes.

Following the purchase of SFPP and McClure, each operated profitably and paid distributions to their investors including Mr. Brull until September 2011. (Exh. 135.) However, the Great Recession did impact SFPP and McClure. Medicare and Medi-Cal payment delays created cash flow problems which the CapSource loans alleviated, but CapSource became concerned about these reimbursement delays and the entities' inability to pay Quality Assurance fees to the state. When CapSource claimed the loans were in default, Mr. Preimesberger hired Latham and Watkins to negotiate a workout. (Exh. 205.) In August 2011, CapSource instructed Mr. Preimesberger to cease paying above market rents and installed a Financial Monitor who billed \$202,365 for his services (Exh. 207, 240). As required by the Forebearance Agreement negotiated with CapSource, Mr. Preimesberger stopped monthly distributions to SFPP and McClure investors. (Exh. 63, 224, 207, 208.) He also laid off Meridian staff and cut expenses.

By October 2011, Medicare had cut reimbursement rates and Medi-Cal

had delayed payments. Mr. Preimesberger was under enormous pressure. He explained if nursing home operators could not pay their bills, the property owner would become liable for patient care. To avoid foreclosure and a \$3 million prepayment loan penalty, he decided to sell some nursing home properties, including SFPP and McClure. He first formed an advisory group of key investors to assist him in the decision to sell and in finding a qualified purchaser. Mr. Preimesberger sought approval for the sale from the investors and obtained consent from a majority in April 2012. (Exh. 225, 226, 281, 282.) Mr. Brull refused to consent.

Properties including SFPP and McClure were sold to Abe Bak for \$23 million. (Exh. 64, 73-276.) As a condition of sale, the past due rent was waived, the leases were terminated, and Meridian remained as operator for HUD to guarantee the deal. Mr. Preimesberger explained this high price was justified by the high reimbursement rates these properties commanded. In an email exchange in which Mr. Preimesberger announced the sale, Mr. Brull responded, "Congrats!" (Exh. 232.)

In distributing the proceeds of the sale to investors, Mr. Preimesberger offered Mr. Brull \$38,889 for his SFPP shares and \$135,000 for his McClure shares. (Exh. 81, 82.) Mr. Brull declined to sign these repurchase agreements. (Exh. 234, 254) In determining the amounts and characterization of these distributions, Mr. Preimesberger sought to maximize tax advantage for the investors. (Exh. 234, 254.)

Mr. Preimesberger testified his salary at Meridian was \$100,000 per year plus car and airplane expenses. He used the airplane to visit the far flung nursing homes he managed. He never was paid a stock dividend, made no other personal gain from these entities, and did not profit personally from any distributions.

Mr. Brull began to object to the management of SFPP and McClure when the monthly distributions stopped. (Exh. 52.) In 2012 he sought a list of investors and various records (Exh. 62, 65, 66.) Mr. Preimesberger made records

available electronically to all investors using a drop box system, but explained he could not release investor names without their permission and expressed concerns about privacy of patient records. When Mr. Brull asked to inspect documents at Meridian's office, Mr. Preimesberger replied there were thousands of pages at six different law firms in four different states and most of the records had already been provided by drop box. (Exh. 79.) When Mr. Brull claimed he was unable to access the drop box, Mr. Preimesberger simply did not believe him. Mr. Brull also sought property appraisals which Mr. Preimesberger attempted unsuccessfully to locate on a CD. (Exh. 89.) Mr. Preimesberger explained this was a stressful and hectic time for him and he regretted he probably did not get back to Mr. Brull timely. His focus was on avoiding default and bankruptcy. However, he did meet with Mr. Brull and felt he had provided essentially everything he requested.

Mr. Preimesberger had made several efforts to keep LLC investors informed. Early on he sent a letter to all LLC investors offering the assistance of a corporate compliance officer who was available to provide any information an investor might need. (Exh. 13.) Mr. Brull never contacted her. Mr. Preimesberger sent investor letters in November 2011 about his efforts to weather the economic storm (Exh. 53); in January 2012 about options including sale (Exh. 57); in February 2012 about refinancing (Exh. 63); in March 2012 about the sale to Mr. Bak (Exh. 64); and in April 2012 further explanation of the sale (Exh. 266). Mr. Brull acknowledged the Great Recession commencing in 2008 was a terrible time for the economy, yet he expected his LLC investments to perform well because they were government funded and the population was aging.

Daniel Genis, another LLC investor, testified he never received timely financial reports from Mr. Preimesberger and did not understand LLC funds would be used by Meridian for the benefit of the nursing homes. He claims he was never informed about LLC debts but did know about the CapSource loans. He may have signed some loan consent forms but not others, but his wife, another investor, did not sign. (Exh. 225, 227, 228, 281, 282). He did state he

and his wife never refused to sign any consent form they received because they wanted to prevent bankruptcy of the entities. He was unaware of the availability of the drop box.

Amit Nayyar has been CFO of Meridian since 2006. While a CPA maintained the general ledger and prepared tax returns, Mr. Nayyar assisted Mr. Preimesberger with consent forms and distributions which involved creating the mailings and including stamped return envelopes then tallying the consents and comparing signatures when he received them in the mail. He then forwarded the consents to Latham and Watkins for review. Because he is also an investor, Mr. Nayyar received a consent form with attachments before signing and returning it. When there was a question about how to allocate an expense, he booked it as a loan to provide “wobble room” to determine the classification later. While he does not remember specifics about the drop box procedure, he does recall “all sorts of stuff” was posted and the boxes remained active at least six months. In April 2012 investors received letters that advised all pertinent documents were in a drop box. (Exh. 71, 72.) One investor had difficulty so Mr. Nayyar walked him through the procedure. He was then able to access the drop box. Lease acquisition fees paid to Meridian were used for operations and patient care.

Keith Simpson has been a California attorney since 1998. He met Mr. Preimesberger in 2005 because their offices are on the same floor. He represents both Mr. Preimesberger personally and Meridian. He prepared the LLC operating agreements, subscription agreements, investor questionnaire, and spousal consent for the LLCs. He met Mr. Brull the same year because their wives are friends. He has represented Mr. Brull in a dispute with an employer, a dispute with a neighbor, and an auto accident. The two men became friends. Because Mr. Brull is a financial writer, Mr. Simpson enjoyed discussing investments with him. Mr. Simpson invested \$50,000 in SFPP and discussed this with Mr. Brull. Mr. Preimesberger never asked Mr. Simpson to solicit investments for his entities and he made no attempt to solicit Mr. Brull. He never received a commission or compensation of any kind for finding investors for Mr.

Preimesberger who had no idea Mr. Simpson was discussing SFPP with Mr. Brull.

Mr. Simpson made no promises to Mr. Brull about the nature of the investment, but he did explain the risks of fluctuating Medicare and Medi-Cal reimbursement rates. He never promised Mr. Brull would always receive a return on his investment. He explained the state had previously stopped paying reimbursements and it could happen again. Mr. Brull was his friend and he would have never misled him. After Mr. Brull invested in SFPP, he asked Mr. Simpson to let him know if other similar opportunities arose. When McClure became available, Mr. Simpson told Mr. Brull. While he never gave him an investment deadline, he did say if Mr. Brull was not interested someone else would be. Mr. Simpson met with Mr. Brull and Mr. Preimesberger annually for lunch. He recalls at one lunch Mr. Preimesberger explained the need to take out the CapSource loans and answered Mr. Brull's questions. Mr. Brull was also told about the §1031 exchange investors.

Abraham Bak is an investor in a plastics company, residential apartments, and nursing homes. In 2012 some investors contacted him to meet with Mr. Preimesberger. He learned the dispute with CapSource was expensive and time consuming so Mr. Preimesberger needed to pay off those loans which were restricting Meridian's ability to operate, and generating mounting legal fees. Mr. Bak changed direction from refinancing the CapSource loans to purchasing the properties. He obtained a thirty day Forebearance Agreement and made a \$3 million nonrefundable deposit against the purchase of five nursing homes including SFPP and McClure. In Mr. Bak's view he paid a high price for these properties because they had smaller than optimum patient counts, the employees were unionized, and profit margins seemed low to him. Although he initially agreed to pay \$24 million for the five properties, declining valuations caused him to renegotiate and he ultimately paid \$23 million. Although Mr. Preimesberger initially continued to manage these properties for Mr. Bak, he no longer does.

Mr. Bak explained a nursing home becomes the responsibility of a landlord if a tenant operator becomes financially unable to function. Both the state and landlord prefer the landlord take charge rather than a receiver. The only remaining option is to move the patients out of the facility.

B.

EXPERT TESTIMONY

Greg Regan is a forensic accountant with an MBA who reviewed the Meridian, SFPP, and McClure records. (Exh. 120.) He explained the LLCs' sources of cash were member contributions, rents, and sale of the properties. Cash was used to purchase the properties, pay operating expenses, and make distributions to members. A considerable amount of income was loaned or given to Meridian or affiliates and recorded as receivables. However, he opined there was insufficient documentation for these transfers. In his view, the CapSource loans and lines of credit were unnecessary and the proceeds were actually for the benefit of the tenant operators and Meridian. The LLCs themselves were solvent and did not require loans.

SFPP did not receive rents specified in the lease agreement and its profits were further understated because it incurred expenses such as property tax, insurance, and loan interest which should have been the responsibility of the tenant operator. SFPP's tenant was substantially larger than SFPP and consistently generated income on an accrual basis. That is, it was entitled to income it may not have actually received, and while the books might reflect a profit, in reality a substantial cash flow problem could exist. Rents were typically 10% of revenue.

Property sale was a capital event pursuant to the Operating Agreement §1.13 (Exh. 2) and profits from a capital event should have been allocated to the LLC members as soon as practicable according to the Operating Agreement §§ 4.6 and 4.14. (Exh. 2.) Instead, \$3.6 million was distributed to Meridian despite the fact Meridian had made no capital contribution. While SFPP should have had about \$7.9 million available for distribution to members, only \$2.2 million

was distributed to them, leaving a \$5.6 million shortfall. (Exh. 123, 125.)

Mr. Regan's opinion is essentially the same regarding McClure. McClure is also owed significant unpaid rent, its capital was also diverted for the benefit of affiliated entities, and loans on McClure's behalf were similarly unnecessary. McClure's tenant was substantially larger than McClure and its rent was 8-13% of revenue. McClure also paid expenses such as property tax and loan interest which should have been the responsibility of the tenant operator. Ultimately, in numerous instances, McClure's assets were diverted to Meridian or its affiliates.

On sale, \$6.8 million should have been available for distribution to McClure members. Instead, \$3.4 million was distributed, representing a \$3.4 million shortfall. In numerous instances, McClure's capital was diverted to Meridian or its affiliates. (Exh. 123, 125.)

Mr. Regan did acknowledge that tenant improvements paid for by both LLCs did increase property values and this should be an offset. He understood rents and distributions would cease if tenants went under, but felt tenants should have taken out the loans or the LLCs should have found other tenants. He did not consider the April 2012 Consent Agreements which called for forgiveness of remaining balances (Exh. 225, 226(a)(j)) because Mr. Brull's counsel asked him to assume they were invalid. He understood the Forebearance Agreement required distributions to LLC members stop and severely restricted expenditures. (Exh. 224(f) and (g).) However, he maintained the loans which generated the Forebearance Agreement were unnecessary to the LLCs and should never have been made. He similarly did not consider the \$750,000 McClure option or the lease acquisition fees (Meridian \$525,000 and \$400,000 for SFPP) because they were not documented timely or properly.

Eric Sussman is a CPA with an MBA and tenured member of the faculty of the UCLA Anderson School of Management. He is also a partner in a real estate investment company for which he has managed fifty LLCs over twenty years. (Exh. 122.) He reviewed pertinent records to opine on the reasonableness of Mr. Preimesberger's acts as manager of SFPP and McClure as well as president

of Meridian.

He explained the symbiotic relationship between the LLCs and Meridian in which the LLCs would receive artificially high rents from Meridian. Everyone concerned understood from the outset that these entities were “joined at the hip.” If Meridian lacked access to cash, it was a problem for all parties; if Meridian went under, the LLCs would be wiped out. Accordingly, Mr. Preimesberger acted reasonably and prudently in obtaining the CapSource loans which made perfect sense given the extraordinary relationship of the parties. Further, the LLC investors consented to the CapSource loans. In negotiating the CapSource Forebearance Agreement with the aid of Latham and Watkins, Mr. Preimesberger also acted reasonably and prudently. Without funds to repay the loans, foreclosure was imminent.

Mr. Sussman noted that Mr. Brull, as a sophisticated investor, understood this symbiotic relationship between the parties and there had been full disclosure from the outset. For him now to claim he was “robbed” is in Mr. Sussman’s view “absurd.” The fact Mr. Brull only lost \$10,000 on his investment during the Great Recession was remarkable. In sum, Mr. Preimesberger satisfied his fiduciary duty to investors by providing transparency and full disclosure of all material information. He acted reasonably and prudently in his management of all entities.

Barbara Luna is a CPA and Certified Fraud Examiner with a Ph.D. in mathematics. She is a Diplomat in the Board of Certified Forensic Examiners and has taught forensic accounting at several universities. (Exh. 283.)

Dr. Luna noted Mr. Brull was a knowledgeable and sophisticated investor who listed himself in the LLC Confidential Questionnaire as having sufficient knowledge and experience to evaluate the merits and risks of an investment. He signed the Subscription Agreements in which he acknowledged the substantial risk incident to ownership of these LLC investments as well as the investment’s speculative nature and high risk of loss. He further identified himself as a qualified investor with a net worth greater than \$1 million. Each LLC Operating

Agreement states:

“...available cash shall be distributed as soon as practicable following the Manager’s determination that such cash is available for distribution. The parties acknowledge that no assurances can be given with respect to when or whether said cash will be available for distribution....”

Dr. Luna explained Mr. Brull understood from the beginning that these entities were run for the joint benefit of the LLCs and Meridian. Higher reimbursements from upgraded facilities yielded higher rents. The consents Mr. Brull and other members signed recognize this symbiotic relationship.

Dr. Luna explained cuts and delayed payment in Medicare and Medi-Cal reimbursements had a substantial negative impact on both LLCs and their tenants’ ability to meet rent obligations. Mr. Brull had been advised of this specific risk before he invested and Mr. Preimesberger kept investors informed as these problems emerged. Specifically, in July 2011 nursing homes lost the guarantee of prompt Medicare payments. Medicare reimbursement rates were cut eleven percent and Medi-Cal reimbursements were reduced or delayed due to the state budget crisis.

Dr. Luna also considered the fact Mr. Brull consented to the CapSource loans and a majority of members consented to the Forebearance Agreement which provided forgiveness of receivables. In her view, the Forebearance Agreement was the most financially advantageous action Mr. Preimesberger could have taken considering the financial crisis facing the properties. The alternatives were a cash call on investors or foreclosure and bankruptcy, which would have substantially lowered the market value of the properties. Given the Forebearance Agreement, Mr. Bak purchased SFPP and McClure for a price above market value. Historically high rents, capital improvements, and Mr. Preimesberger’s ability to bundle these two properties in combination with others for sale all contributed to the high price.

Dr. Luna calculated Mr. Brull’s total LLC investments, distributions, and

lost profits in the following manner:

MR. BRULL'S INVESTMENT RETURNS

	<u>INVESTED</u>	<u>DISTRIBUTIONS</u>	<u>PROFIT</u>
SFPP	\$ 69,151	\$ 90,987	\$ 21,836
McClure	\$240,000	\$207,595	(\$32,405)
TOTALS:	\$309,151	\$298,582	(\$10,569)

Dr. Luna next turned to Mr. Regan's analysis. She noted he failed to consider the fact Mr. Brull made these investments in 2007 and 2008 when the economy entered the Great Recession with banks failing and financial markets experiencing massive losses. However, Mr. Brull continued to receive distributions from both LLCs during these tumultuous financial times. Mr. Regan also failed to consider reductions and delays in Medicare and Medi-Cal reimbursements which created a cash flow crisis for the nursing homes. He dismissed the positive impact of the Forebearance Agreement given the crisis facing the nursing homes. Further, Mr. Regan did not consider the McClure option to purchase, deferred lease acquisition costs, capital improvements, legal fees, accounting and loan costs, and costs of sale -- all of which benefited LLC members.

Dr. Luna concluded Mr. Preimesberger's returns on investment for the LLCs were similar to those of other shareholders with similar ownership interests. With regard to Mr. Brull, she said, "No one promised him a rose garden. These were not Treasury Bills." Mr. Brull, in her opinion, not only did better than the stock market, he sustained no damages because he retains his interest in both LLCs which he declined to sell and which may retain some residual value. (Exh. 284.)

III.

ANALYSIS

Based on the facts identified above and additional facts included here

relevant to the analysis, Mr. Brull has failed to carry his burden of proof on any of his claims.

A.

Breach of Fiduciary Duty

Managers of LLCs such as Mr. Preimesberger owe fiduciary duties not only to the entity but also to the other members, including duties of loyalty and care. Corp. Code §17704.09(a). The duty of loyalty is limited to accounting for and holding company property as a trustee for the benefit of the company and not for personal enrichment at the expense of the company, refraining from having an interest adverse to the company, and from competing with the company. *Id.* §17704.09(b). As for the duty of care, a member must refrain from “engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.” *Id.* §17704.09(c). A member must not misappropriate funds for his personal benefit.

The elements of a cause of action for breach of fiduciary duty are: 1) the existence of a fiduciary duty; 2) a breach of that duty; and 3) damage caused by the breach. *Masier v. Southern Cal. Physician’s Ins. Exchange* (1998) 63 Cal.App.4th 1022, 1044.

Mr. Brull argues Mr. Preimesberger breached his fiduciary duty of loyalty and care. He breached his duty of loyalty by failing to place the interests of the LLCs above his own. Because Mr. Preimesberger had an inherent conflict of interest he commingled funds, funneled LLC money to Meridian, and diverted loan proceeds. Mr. Preimesberger breached his duty of care by failing to disclose material facts and denying Mr. Brull his right to inspect LLC books and records. Mr. Preimesberger denies all these allegations.

1. Duty of Loyalty.

Mr. Brull understood and agreed to the interrelated and symbiotic relationships between the entities; and he knew Mr. Preimesberger’s actions were designed to increase rents for the benefit of LLC members. Mr. Brull testified his friend Keith Simpson explained Mr. Preimesberger was both president of

Meridian, manager of the LLCs, and operator of the nursing homes. This conflict did not concern him at the time because it enabled Meridian to pay above market rent which would yield investors 12% and 14% returns. Mr. Simpson made it clear rents were based on Medicare and Medi-Cal reimbursement rates which could go up or down. Mr. Brull understood it was “unseemly” for the nursing homes to reveal they were making a lot of money, so the LLCs were set up to “channel” profits from Meridian to the LLCs without arousing the suspicion of state regulators. In other words, having Mr. Preimesberger “on both sides of the equation” worked to Mr. Brull’s advantage.

In managing the LLCs Mr. Preimesberger did exactly what Mr. Brull expected him to do. He acted in the best interest of both the LLCs and Meridian and received no profit beyond that received by other members. He maintained an outstanding return on investment based on above market rents until the Great Recession which brought reimbursement decline and delays necessitating loans. Only through Mr. Preimesberger’s Herculean efforts were the LLCs able to avoid cash calls, foreclosure, or bankruptcy. He and Meridian personally guaranteed the CapSource loans. Because Mr. Preimesberger had provided above market rents and because he was able to bundle these two properties with others, he obtained an above market price for the properties.

Mr. Brull consented to the loans and a majority of investors consented to the Forebearance Agreement which caused investor dividends to cease. Mr. Brull actually congratulated Mr. Preimesberger on the sale and declined a buyout of his interests. For these reasons Mr. Brull has waived any right to assert he was harmed by any alleged conflict. Waiver is the intentional relinquishment of a known right after full knowledge of the facts. *Ringler Associates Inc. v. Maryland Cas. Co.* (2000) 80 Cal.App.4th 1165, 1189.

In any event, there has been no showing of a conflict of interest because there is no evidence Meridian or Mr. Preimesberger received a benefit disproportionate from that which other members received. Funds received by Meridian, including lease acquisition fees, were used for necessary operating

expenses which ensured the survival of the LLC. See *Jones v. H.F. Ahmanson & Co.* (1969) 1 Cal.3d 93, 114.

Mr. Regan opines Mr. Preimesberger should never have obtained the CapSource loans – even though Mr. Brull consented to them – and should have continued to demand above market rents regardless of the reduced and delayed reimbursements which put the nursing homes in a cash flow crisis. This is analysis in a vacuum which completely disregards the consequences that befall a nursing home landlord when a tenant operator defaults.

An owner is obliged to ensure his property is safe and in compliance with the law. Civil Code §1714. While some of those obligations may shift to a tenant, once that tenant is evicted those obligations shift back to the owner. *Stone v. Center Trust Retail Properties, Inc.* (2008) 163 Cal.App.4th 608, 614-615.

In the case of a single purpose property on which a nursing home operates, the owner's liability is increased due to California's Elder Abuse Act, which is broadly and liberally interpreted to protect elders and other dependent adults who may be subjected to abuse, neglect, or abandonment. Welf.&Inst.Code §15600(a); Welf.&Inst.Code §15610.57. Indeed, anyone who potentially is in a position to provide care for an elder could be held liable for elder abuse, including the owner of a single use property on which operates a nursing home by a lessee. *Mack v. Soung* (2000) 80 Cal.App.4th 966, 973.

Mr. Preimesberger explained the LLCs had a direct interest in nursing home operations because the homes were only able to pay above market rents if they were operating well in a manner which satisfied Medicare and Medi-Cal. This required cash. Mr. Bak understood a nursing home landlord becomes responsible for operations and patient safety if an operator is financially unable to function. Both the state and landlord prefer the landlord take charge rather than a receiver because there are few qualified receivers and they are expensive.

As applied to this case, the LLCs as owners of the property undeniably owed obligations of care to the patients in the nursing homes which were

operated on their single use properties. In the event that SFPP and McClure evicted the tenant operators, then they, as owners in possession of the properties, would be required to care for the patients in the facilities or face liability for elder abuse. See Cal.Civ.Code §1714; Cal.Welf.&Inst.Code §15600(a); Cal.Welf.&Inst.Code §15610.57; *Stone, supra* at pp. 614-15; *Mack, supra* at p. 973.

The bottom line here is that the State of California will ensure that someone is liable for the care and well-being of the patients in the nursing home. It is either the owner or the tenant and, in the case of eviction or abandonment, it is undisputedly the owner as they have the right to possession. Qualified replacement operators are difficult to locate and receivership compounds delay and expense. Accordingly, attempts to deny landlord responsibility here are contrary to law, public policy, and common sense. Mr. Preimesberger simply did not breach his duty of loyalty.

2. Duty of Care.

Next, Mr. Brull claims a breach of the duty of care because he was kept in the dark about these LLCs and denied access to their records. Both operating agreements at Article 6.1 permit owners to inspect and copy LLC records. Here, the evidence shows Mr. Preimesberger did make all material facts available to investors through correspondence with them, providing a corporate compliance officer who was available to provide any information an investor required, establishing a drop box for myriad LLC records, forming an advisory committee of key investors, and meeting periodically with Mr. Brull and Mr. Simpson. Therefore, Mr. Preimesberger did disclose material facts, did make the records available and took reasonable steps to keep investors informed. In fact, Mr. Brull only became interested in the records when his monthly checks stopped and his claim he could not access the drop box distinguishes him from all those investors who were able to do so. Arguably, Mr. Preimesberger could have turned his attention to the many demands and complaints of Mr. Brull. Instead, he chose to focus on avoiding bankruptcy and negotiating a property sale at an optimum

price, thereby benefiting all the investors, including Mr. Brull. In sum, Mr. Preimesberger did not breach his duty of care.

B.

NEGLIGENCE

The elements of a cause of action for negligence are: a) a legal duty to use care; b) a breach of duty; c) the breach as the proximate or legal cause; and d) damages. *Ladd v. County of San Mateo* (1996) 12 Cal.4th 913, 917.

Mr. Brull alleges Mr. Preimesberger breached his duty of care to LLC members by failing to collect rents owed, failing to disclose material facts, canceling the ten year leases, and failing to obtain full value of the properties on sale. These are the same allegations underlying the breach of fiduciary duty claim and they fail for the same reasons previously explained. Confronted with the Great Recession, Medicare and Medi-Cal cuts, and the threat of imminent foreclosure, Mr. Preimesberger avoided bankruptcy and secured a significant return for investors. Any arguable losses Mr. Brull may have sustained were caused by the Great Recession, not Mr. Preimesberger, who simply did the best he could under these circumstances. Mr. Brull has not proved a breach of the duty of care essential for negligence.

C.

FRAUD

The elements of fraud are: 1) a misrepresentation, concealment or nondisclosure; 2) knowledge of the falsity or scienter; 3) intent to defraud or induce reliance; 4) justifiable reliance; and 5) resulting damage. *Ragland v. U.S. Bank National Assn.* (2012) 209 Cal.App.4th 182, 196.

Mr. Brull claims he was induced to invest in the LLCs by “false promises” from Mr. Preimesberger’s agent, Keith Simpson, that Mr. Brull would receive a “fixed return” of 14% on SFPP and 12% on McClure. Both Mr. Preimesberger and Mr. Simpson unequivocally deny this allegation.

Mr. Brull spoke with his friend, attorney Keith Simpson, about both the SFPP and McClure investments. Although Mr. Simpson officed in the same building

as Mr. Preimesberger and was his attorney, he had also acted as an attorney for Mr. Brull. Mr. Preimesberger never asked Mr. Simpson to solicit investors for him and Mr. Simpson never received a commission or compensation of any kind for finding investors for Mr. Preimesberger. For his part, Mr. Preimesberger had no idea Mr. Simpson had these discussions with Mr. Brull. At the time Mr. Brull invested, Mr. Preimesberger had never met him.

Mr. Simpson made absolutely no promises to Mr. Brull about the nature of the investment. He did explain the risks of fluctuating reimbursement rates and never promised receipt of a permanently fixed return. Mr. Simpson did provide Mr. Brull with disclosures and operating agreements. Mr. Brull was absolutely clear the reimbursements on which rents were based could go up or down and had gone down in the past.

Before his second investment in McClure, Mr. Brull spoke with his friend, attorney Sandy Millar, who declined to offer any advice because the business model was unclear to him and the Operating Agreement was poorly drafted. Mr. Brull also reviewed extensive disclosures about these investments, claimed he was knowledgeable and capable of evaluating the risks and acknowledged the substantial risk of loss inherent in these investments as well as their speculative nature. Mr. Brull has an impressive background as a financial commentator and reporter of economic issues. He is, as he claimed, a sophisticated investor.

In short, no one misrepresented anything to Mr. Brull; he understood exactly what he was doing when he invested. He may have failed to perform due diligence and did ignore Mr. Millar's admonitions and the written disclosures, but there was no fraud.

D.

CORPORATIONS CODE VIOLATION

Corporations Code §17704.10(b)(1) provides each member of an LLC has the right upon reasonable request, for purposes reasonably related to the interests of that person as a member, to inspect and copy during normal business hours any applicable corporate records including financial statements.

The Operating Agreements also provide for the right of inspections. Mr. Brull maintains Mr. Preimesberger violated the Corporations Code by denying him his statutory and contractual right to inspect records.

These are the same allegations underlying the breach of fiduciary duty claim and they fail for the same reasons previously explained. Mr. Preimesberger did make all material facts available by providing a corporate compliance officer, establishing a drop box, forming an investor advisory committee, and meeting periodically with Mr. Brull. In short, Mr. Brull has not proved a statutory or contractual violation of the right to inspect records.

E.

SUMMARY

After speaking with his friends, Mr. Simpson and Mr. Millar, Mr. Brull acknowledged in writing he was able to analyze the risks inherent in these speculative investments and could afford to make them. He was clear about the interrelated and symbiotic relationships between these LLCs and Meridian and welcomed that relationship because it carried with it the prospect of generous returns on investments. However, when the Great Recession intervened, like many investors who failed to realize hoped for returns, he was disappointed. In this case, that disappointment does not translate into actionable claims for breach of fiduciary duty, negligence or fraud. Mr. Brull has simply not sustained his burden of proof. As Dr. Luna aptly noted, “No one promised him a rose garden.”

IV.

CONCLUSION AND FURTHER PROCEEDINGS

1. Mr. Brull has not sustained his burden of proof on any of his causes of action.
2. Mr. Preimesberger and Respondent entities are the prevailing parties and are entitled to reasonable attorney fees, costs, and arbitration expenses incurred in connection with the arbitration or litigation pursuant to the

Operating Agreements, Article 11.2 (SFPP Exh. 2, McClure Exh. 16).

Respondents seek \$782,387.08 representing a 20% reduction in those fees, costs, and related expenses actually incurred of \$977,983.86. Specifically, the amount is itemized as follows:

<u>ITEM</u>	<u>AMOUNT</u>
Jeffer Mangels Attorneys' Fees	\$120,974
Early Sullivan Attorneys' Fees	\$625,042
Expert Witness Fees	\$172,101.37
JAMS/Arbitration Costs	\$ 52,951.19
Deposition Transcripts	\$ 3,801.15
Trial Exhibit Copy Fees	\$ 2,814.15
TOTAL:	\$977,983.86

These fees do not include those fees incurred in complying with Mr. Brull's Corporations Code inspection requests prior to the October 18, 2014, writ proceeding. Mr. Brull objects to any claim for expert fees and seeks a substantial reduction in attorney fees because bankruptcy advice is not recoverable, Respondents utilized three attorneys during arbitration while he had only one with a law clerk, and fees associated with representation of Meridian should be disallowed because Meridian was not a signatory to the Operating Agreements. He does not object to the costs request.

The broad contractual language in the Operating Agreements contemplates an award of reasonable expert fees to the prevailing party. The parties may, and have, chosen by contract to shift expert expenses to the losing party. See *Arntz Contracting Co. v. St. Paul Fire & Marine Ins. Co.* (1996) 47 Cal.App.4th 464, 490-491. Moreover, given the complexity and volume of the financial records, the Arbitrator would have appointed accounting experts had the parties not already done so. It would have been difficult to find a more qualified or capable expert than Dr. Luna whose testimony was a tremendous aide to the Arbitrator. Dr. Luna and her staff devoted hundreds of hours to

review and analyze voluminous records. The charge for this work is reasonable. Mr. Brull also argues Dr. Luna's fees were not "pleaded and proved" as contemplated by *Artanz*. On the contrary, both sides sought expenses pursuant to the agreed upon terms of the Operating Agreements, Dr. Luna was questioned extensively including the time devoted to her work, she brought boxes of her work with her to the hearing which were available for review, and the quality of her presentation speaks for itself. Hence, expert fees as reduced in Respondent's request are allowed as both reasonable and contractually anticipated in the Operating Agreements.

Factors considered to assess reasonableness of attorney fees include the nature of the litigation, the skill required, experience of counsel, attention given, and results achieved. *EnPalm, LLC v. Teitler* (2008) 162 Cal.App.4th 770, 774. In assessing reasonableness, a party's relative ability to pay fees becomes irrelevant. *Ticor Title Co. of California* (2012) 204 Ca.App.4th 363, 373.

Mr. Brull objects to attorney fees for bankruptcy advice provided by Mr. Eisenberg, which amounts to two hours in December 2014 totaling \$1,850. Because that amount is already subsumed in the 20% reduction of all fees, a further reduction for such advice is unnecessary.

Mr. Brull also objects to any fees expended on behalf of Meridian which is not a signatory to the Operating Agreements. This objection is without merit because Mr. Preimesberger, a signatory to the Operating Agreements, acted on behalf of Meridian. In fact, all Meridian's acts were by Mr. Preimesberger and Meridian could not and did not act except through Mr. Preimesberger. Therefore, it would be impossible to separate representation of Meridian from that of Mr. Preimesberger.

The fact Respondents chose to divide the litigation work load among three attorneys, utilizing each for specific tasks, was a reasonable strategy here given the time constraints imposed by the applicable arbitration clauses, the complexity of the case, the voluminous documents, and the many legal issues involved. Respondents' counsel demonstrated a high degree of skill, experience

and attention during this complex case and achieved a successful result. This was no small matter given Mr. Brull sought \$9 million in damages and disgorgement of assets as well as punitive damages, and his own fees, costs and expenses. Further, Respondents' counsel Mr. Scott managed all the exhibits and projected them as requested by both Respondent and Claimant, thereby saving hearing time. Having reviewed the rates of each attorney and the hourly records of both firms involved, the Arbitrator finds the fees as reduced are reasonable.

Accordingly, Respondents are entitled to \$782,387.08 in reasonable fees, costs, and related expenses.

This Final Award resolves all issues between the parties presented in this arbitration.

IT IS SO ORDERED.

DATED: September 14, 2015.


HON. J. RICHARD HADEN (Ret.),
Arbitrator

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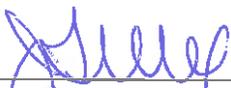
Re: Brull, Steven vs. Preimesberger, James, et al.
Reference No. 1100079509

I, Jenny Truex, not a party to the within action, hereby declare that on September 15, 2015 I served the attached FINAL 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 Diego, CALIFORNIA, addressed as follows:

Marco Quazzo Esq.
Bartko Zankel Bunzel & Miller
One Embarcadero Center
Suite 800
San Francisco, CA 94111
Phone: 415-956-1900
mquazzo@bzbm.com
Parties Represented:
Steven Brull

Christopher Ritter Esq.
Eric P. Early Esq.
Peter D. Scott Esq.
Early Sullivan Wright Gizer & McRae LLP
6420 Wilshire Blvd.
17th Floor
Los Angeles, CA 90048
Phone: 323-301-4660
CRitter@earlysullivan.com
eearly@earlysullivan.com
pscott@earlysullivan.com
Parties Represented:
James Preimesberger
McClure Property Partners LLC
Meridian Health Services Holding, Inc.
San Francisco Property Partners LLC

I declare under penalty of perjury the foregoing to be true and correct. Executed at San Diego, CALIFORNIA on September 15, 2015.



Jenny Truex
jtruex@jamsadr.com