ORANGE COUNTY

BUSINESS LAW

Breach of Duty of Good Faith and Fair Dealing

Buyer and seller of business disputed payment terms

DECISION (P)	**$800,000**
CASE	Ray Harmon, an individual; and Builders Appliance Supply Inc., a California corporation v. James A. Cozby, an individual; Tolar N. Hamblen III, an individual; Bas Appliance Gallery LLC, a Delaware limited liability company; Champ Industries Inc., a Delaware corporation; and Does 1 through 10, inclusive, No. 01 CC 05715
COURT	Superior Court of Orange County, Santa Ana, CA
JUDGE	James M. Brooks
DATE	6/23/2003
PLAINTIFF ATTORNEY(S)	**Daniel J. Callahan**, Callahan & Blaine, Santa Ana, CA **Kathleen L. Dunham**, Callahan & Blaine, Santa Ana, CA
DEFENSE ATTORNEY(S)	**Neil Kenton Alexander**, Porter & Hedges, Houston, TX **Paul J. Schumacher**, Keesal Young & Logan, Long Beach, CA

FACTS & ALLEGATIONS Plaintiffs Ray Harmon and Business Appliance Supply Inc., located in Orange County, sued Business Appliance's purchaser, BAS Appliance Gallery LLC, of Houston, its principals, Tolar N. Hamblen III and James A Cozby and Champ Industries, Inc., of Houston (a sister company of BAS.) They alleged that the defendants had failed to pay the full purchase price for the appliance business, as required by the terms of the agreements entered into between the parties in September 2000, including five annual principal payments of $140,000 each and additional monthly interest payments due on preferred units held by Harmon.

The plaintiffs also alleged that the defendants had failed to pay on two additional promissory notes, failed to make payments due under a non-competition agreement and failed to pay the proceeds of accounts receivable which had been assigned to Harmon.

Finally, the plaintiffs claimed that the defendants did not provide them with monthly financial statements for BAS Appliance Gallery and with supporting documentation for outstanding accounts receivable in a timely manner.

The defendants and counter-claim plaintiffs alleged that the plaintiffs sold the business on fraudulent financial statements that materially overstated the value of the business's inventory. Furthermore, payments were not yet due to the plaintiffs once the contracted-for purchase price adjustments were taken into account.

The parties entered into a partial settlement in August 2002, resolving all fraud and breach of contract issues except for future obligations with respect to "Preferred Units" that Builders Appliance held in defendant BAS. The purchase price of the business was reduced and the resulting overpayment applied to two promissory notes the plaintiffs had received as part of the sale.

In March 2003, the plaintiffs asserted that BAS had failed to make payments on the "Preferred Units." The defendants contended that those units were similar to preferred stock and the payments were owed but not yet due because: 1) under the LLC agreement that created them, BAS was obliged to make payments on the units only if it had the cash available to do so and if BAS was not in default to its senior lender Transamerica, and 2) under a subordination agreement signed by the parties and Transamerica, BAS was explicitly prohibited from paying, and the plaintiffs were prohibited from receiving, payments on the units while the Transamerican loan was in default. (It was undisputed that the Transamerica loan was in default.)

INJURIES/DAMAGES The plaintiffs sought to recover the five $140,000 annual principal payments and the monthly interest payments thereon. They also sought to recover payments on the two promissory notes, payments due under the non-competition agreement, the proceeds of accounts receivable which had been assigned to plaintiffs, and prompt delivery of monthly financial statements and accounts receivable documents from defendants.

RESULT The court awarded the plaintiff a gross verdict of $800,000.

The parties reached a settlement agreement with regard to payments on the two promissory notes, payments due under the non-competition agreement and the proceeds of accounts receivable. The issue of the $140,000 annual principal payments and interest thereon was tried in front of the judge who found in the plaintiffs' favor, awarding them $800,000 in damages. The judge further ordered the defendants to timely provide the plaintiffs with monthly financial statements and accounts receivable documents. The plaintiffs have petitioned the court for a further award of attorney fees, on which the court will rule at a later date.