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Arbitrator

IN THE MATTER OF

JAMS No. 1130006055

SMARTMED, INC., dba MEDSMART CONSULTING, a California Corporation
Claimant,

vs.

FIRSTCHOICE MEDICAL GROUP, INC., a California Corporation
Respondent.

FIRSTCHOICE MEDICAL GROUP, INC., a California Corporation
Counter-Claimant,

vs.

SMARTMED, INC., dba MEDSMART CONSULTING, a California Corporation, MATHEW ABRAHAM, an individual, and ROES 1 through 25, inclusive
Counter-Respondents

FINAL AWARD

INTRODUCTION

The above-entitled matter came on for hearing June 1 – 4, 2016, August 8 – 10, 2016, August 15 – 17, 2016 and September 19 – 21, 2016, before the Hon. Stephen J. Sundvold (Ret.).

Claimant and Counter-Respondent SmartMed, Inc., dba Medsmart Consulting (MedSmart), and Counter-Respondent Matthew Abraham (Abraham) were represented by Gordon & Rees by

Richard Sybert and Joni Flaherty. Respondent and Counter-Claimant FirstChoice Medical Group, Inc. (FirstChoice), was represented by McCormick, Barstow, Sheppard, Wayte & Carruth LLP, by Devon McTeer and Timothy Buchanan.

Jurisdiction to arbitrate this matter was pursuant to paragraph 16 of the Management Services Agreement dated August 1, 2013 (Exhibit 44) entered into by the Parties.

Both sides presented sworn testimony of witnesses, presented exhibits, written arbitration briefs and oral closing arguments. The matter was submitted for decision September 21, 2016.

The factual findings that follow are necessary to the Award. They are derived from admissions in the pleadings and the testimony and evidentiary exhibits presented at the Hearing. To the extent that these findings differ from any party's position, that is the result of determinations by the Arbitrator as to credibility and relevance, burden of proof considerations, legal principles, and the weight of the evidence, both oral and written.

FACTUAL BACKGROUND AND ANALYSIS

MedSmart's Amended Demand for Arbitration asserts a claim for breach of contract and fraud, asserting that FirstChoice terminated the agreement between them, the August 1, 2013 Management Services Agreement (MSA), without cause and that it suffered damages therefrom. FirstChoice denied the claim and asserted a claim for cancellation of the MSA on the basis that its members had been fraudulently induced to form an Independent Physicians Association (IPA) and to execute the MSA. They also alleged various breaches of duty, good faith, contract and conversion.

ISSUE No. 1. Existence of the Contract - Rescission?

In a nutshell, the basis for the assertion by FirstChoice that misrepresentations by MedSmart led it to form the IPA and sign the MSA was that MedSmart's principal, Abraham, himself, had six HMO contracts that would be immediately accessible to the IPA in order for it to perform medical and hospital services to Medicare patients on a full-risk basis in the Fresno, California area where the IPA was to be formed. The operation was to be a "turnkey" operation and all expenses in the start-up of the operation were to be paid by MedSmart. In order to have a more profitable "full-risk" Medicare contract, an entity is required to have a Knox-Keene license.

In actuality, the evidence showed that Abraham did not personally have any such contracts with HMOs, but rather his plan was to bring HMO contracts from Southern California to Fresno that were held by Choice Physicians Network, Inc. (CPN). The FirstChoice IPA would "piggyback" on those contracts and pay a fee to CPN for that service. CPN had a Knox-Keene license. Abraham did not.

Abraham contended that the FirstChoice members were aware of the details of the plan prior to the formation of the IPA and that they were well aware of the fact that Abraham did not and could not have contracts with the HMOs or a Knox-Keene license as he was not a physician.

The primary factual issue as to whether the members of the IPA were misled into entering into the IPA itself and the MSA with Abraham was what they were actually told or shown by Abraham in presentations that were made to them in May of 2013, prior to the formation of the IPA.

Much of the written evidence on both sides was alleged to have been altered or created after the fact to support each side's position. Witness memories were often perfect as to facts supporting the witness' position; and non-existent when potentially harmful. The Arbitrator struggled with the credibility of witnesses on both sides. In the end, the Arbitrator sought out evidence that was the least taint-able by the party proffering it.

The testimony of the Doctors was consistent as to the events that transpired at the meeting of May 29, 2013 and the power point presentation made by Abraham (Exhibit 25). They had nothing to do with its creation or choice of wording. Dr. N. Reddy and Dr. C. Nareddy insisted that they had not asked Abraham to insert the word "immediate" in slide 32. The concept of a pass-through (piggyback) agreement for access to a Knox-Keene license was set out in the presentation (Exhibit 25, slide 30) as one of the start-up functions.

The evidence clearly shows that the FirstChoice members knew about the "piggyback" concept and the need for a pass-through agreement at the latest by the first board meeting on July 10, 2013. This conclusion is derived from the testimony of Blair Bryson who was associated with CPN and was working with Abraham to set up the relationship between the IPA and CPN. Importantly, Bryson remained on, working with the IPA after Abraham was terminated and was in fact still working with FirstChoice at the time of his testimony at the arbitration hearing.

Early in the litigation process, Bryson had executed a Declaration under penalty of perjury (Exhibit 1) for the MedSmart lawyers. That Declaration was confirmed by him in his Arbitration testimony to be true. At Paragraph 4, he confirmed that he had explained "in detail the process of FirstChoice accessing HMO contracts through CPN." He also stated that Abraham did not state or imply that immediate access to the HMO contracts would exist after signing the pass-through agreement. Additionally, he noted that nothing said by the FirstChoice physicians lead him to believe that they mistakenly believed that HMO contracts already existed in the Fresno area. In his Hearing testimony, he confirmed that a pass-through contract relationship (to access the Knox-Keene license) would be used and the health plans that CPN had agreements with (Hearing Transcript (H.T.) pages 1848-1850).

FirstChoice also presented a Declaration from Bryson into evidence (Exhibit 126). That Declaration is of little evidentiary value as it does not contain any first-hand testimony from this witness. It is merely his impression of documents shown to him after the fact. The Arbitrator

finds his testimony at the Hearing and the Declaration (Exhibit 1) relating to events he saw and participated in to be of much greater evidentiary value.

The Doctors were consistent in their testimony that they were hurried into signing documents, never had the opportunity to ask questions, and never even read legal documents that Abraham wanted them to review and/or sign.

The Declaration of Bryson and his testimony directly refutes that contention as it relates to the basic claim of FirstChoice that they were to have immediate access to the HMO contracts. The Pass-Through Agreement itself (Exhibit 3) which was signed one week later, confirms the fact that it was CPN that had the HMO contracts and that FirstChoice's access to them was not guaranteed, but was dependent on HMO approval (Exhibit 3, paragraph 2.4). The only defense raised by the Doctors is that they didn't read it because they were told to sign it.

Contrary to the testimony of the Doctors, especially Dr. K. Reddy, Bryson confirmed that the Pass-Through Agreement, Schedule B signed by FirstChoice did contain the 3%, 4% and 5% CPN capitation withhold numbers. Interestingly, after Abraham's termination, CPN was paid those capitation withhold rates, not the numbers claimed by FirstChoice (Exhibit 48). Bryson confirmed in his testimony that these percentages were correct and that they had been discussed with the Doctors at the July 10, 2013 meeting (HT pages 1856-1860). It was not until after litigation began that any Doctor ever questioned Bryson about the percentage rate charged by CPN (HT pages 1860-1861).

The Arbitrator finds no merit in the claim by FirstChoice that MedSmart made any misrepresentations about having six HMO contracts upon which they relied in forming the IPA or entering into the MSA with MedSmart. There are no facts upon which rescission is warranted.

ISSSUE No. 2. Did MedSmart/Abraham breach the MSA?

It is important to note that MedSmart/Abraham did not "sell" any product or service to the FirstChoice Doctors and then walk away with their money. The contract between them was for a relationship going forward in which they would "share" the profits made by their venture. It was clear from the beginning that the Doctors did not want to spend any of their own money to develop the IPA or to further the relationship between FirstChoice and MedSmart. Abraham, in the Doctors' minds, was to bear all the monetary costs incurred going forward. This is contrary to the MSA itself which placed some monetary responsibilities on FirstChoice (Exhibit 44 Schedule A).

FirstChoice contends that Abraham committed several material breaches of the MSA which warranted termination of the MSA.

FirstChoice contends that Abraham wrongfully delegated his responsibilities under the MSA without their prior approval as required in the First Amendment to the MSA. The Arbitrator

finds that Abraham's contracting with Raven Resources or AMM, or any other entity, to provide services is not an assignment of the MSA, but a proper delegation of duties as contemplated by the MSA. These ministerial or clerical duties of accounting or claims processing are clearly responsibilities of MedSmart/Abraham that he was to "Perform or arrange to perform ...." (Exhibit 44 section 3).

FirstChoice contends that Abraham breached the MSA in not truthfully marketing the IPA to potential primary care physicians (PCPs). Again, this contention is based primarily on the alleged existence of the six HMO contracts. The Arbitrator finds, as set out above and discussed further below, that the evidence does not support this contention.

FirstChoice contends that Abraham breached his duty of good faith and fair dealing under the MSA by misrepresenting to the public the existence of the six HMO contracts. Again, the Arbitrator finds no evidence to support this contention.

FirstChoice also contends that Abraham caused "friction" among the members of FirstChoice. The primary evidence of this allegation is the letter Abraham sent to Dr. Manthani Reddy and copied to Dr. Bautista (Exhibit 60 and 61). The Arbitrator finds this letter to be compelling evidence of the facts of this transaction. It is one of the few documents that is not claimed to be after-created or altered in some way.

Neither Dr. Reddy nor Bautista responded to Exhibit 61 or testified that they didn't receive it or that it was untrue. It is a contemporaneous chronology of this relationship. Dr. Manthani Reddy testified that he was "offended " by it and thought that the references to Saint Agnes Hospital were "blackmail". Dr. Bautista testified that the letter made him "uncomfortable" and that it was not any of his business if there were issues between Abraham and Manthani Reddy. He did not respond (HT pages 1721-1722). The Arbitrator believes that this letter was sent in an attempt to rehabilitate the deteriorated relationship between the parties, not to cause friction.

FirstChoice's claim of conversion relating to original corporate documents and stock certificates not being returned by Abraham to the members after being requested may factually be true, but it is unclear that there is any real damage associated with this failure or that it would give rise to any lawful basis upon which they could have terminated the MSA. In fact, the Termination letter itself (Exhibit 68) is the document that first asks for the return of FirstChoice's documents.

It is unclear from a reading of the MSA and the Pass-Through Agreement as to who had the obligation to get the IPA providers accepted under the HMO contracts as they were extended into the Fresno healthcare market.

CPN had the ability or responsibility through its credentialing committee to review and approve the providers. Upon approval, they would then be "...identified by CPN to the Medicare Advantage Health Plans as part of the CPN provider network." (Exhibit 3 section 2.2).

In mid-September 2013, Bautista, Bryson and Abraham all participated in a conference call with a representative of Blue Shield discussing the possibility of getting FirstChoice access to the Blue Shield Medicare contract. All three entities were working together to get the desired access to the HMO contract.

The MSA (Exhibit 44) at paragraph 3(b)(i) indicates that Abraham, as the manager, was to "Coordinate the preparation, negotiation and renewal of all managed care contracts (Payer Contracts) with Payers...." This paragraph clearly indicates that HMO contracts needed to be "negotiated," i.e., they didn't exist at the time the MSA was signed. The Termination Letter (Exhibit 68) states that Abraham breached this responsibility in his failure to coordinate the preparation and negotiation of these contracts. If all six HMO contracts were believed to exist, what was there to prepare and negotiate? In any event, there is no evidence that Abraham or MedSmart failed to do what was otherwise necessary to get FirstChoice into the CPN contracts.

The Arbitrator finds no factual basis to support FirstChoice's claims that MedSmart or Abraham violated the terms of the MSA. There was also no evidence offered that any actions of Abraham or MedSmart somehow damaged FirstChoice's reputation among prospective "members" as stated in the Termination Letter.

ISSUE No. 3. Did FirstChoice breach the MSA ?

Abraham, through his MedSmart entity, brought to his doctor friends in Fresno a plan to form an IPA that could "piggyback" onto full-risk Medicare contracts that were held by CPN, an entity with whom Abraham had a relationship in Southern California. A new IPA would need to be formed and accepted by the HMOs to qualify to provide the medical and hospital services. Going into the transaction there was little reason to believe that there would be any roadblocks to the plan.

As the evidence showed, there were unanticipated issues that did arise. The primary problem was another IPA, Sante, was already in the Fresno area. Sante put pressure on the PCPs to not join the new IPA. An injunction was eventually sought by Saint Agnes Medical Group and FirstChoice against Sante (HT 1946-1950). It is clear that in the fall of 2013 there were conflicts between the Fresno area IPAs and the HMOs over healthcare delivery issues.

The MSA and MedSmart were terminated on December 12, 2013 in a letter from FirstChoice President Dr. Jose-Luis Bautista (Exhibit 68). In paragraph two of that letter, Bautista stated that FirstChoice entered into the MSA based upon MedSmart's representation "...regarding its ability to procure contacts with major insurers offering Medicare HMO programs...." It goes on to say that MedSmart failed "to procure contracts with multiple Medicare HMO programs in time for the 2014 Medicare HMO enrollment period (which) led to a failure to meet business objectives."

Exhibit 68 on its face says that FirstChoice was terminating Abraham because he failed to GET the HMO contracts by the beginning of the open enrollment period, NOT that they relied on a representation by him that he HAD six contracts prior to the formation of the IPA. It clearly states that the misrepresentation was that HE HAD THE ABILITY TO GET THE CONTRACTS AND HE FAILED TO DO SO.

The Arbitrator finds Exhibit 68 to be an accurate reflection of the position of the FirstChoice members in early December 2013. They were disappointed that they didn't have as many HMO contracts in place during the open enrollment period as they had hoped. The facts support this analysis. Sante had made it difficult for them. There was no evidence that anything Abraham did or failed to do prevented the HMO contracts from being obtained.

Exhibit 68 does not say that MedSmart is being terminated because it lied about HAVING six HMO contracts in May of 2013 when the IPA was formed or when the MSA was signed. The final paragraph of the termination letter again states that the contract is being terminated because MedSmart "has not substantially performed under the Agreement...."—i.e., it didn't get the six HMO contracts.

The Arbitrator concludes that FirstChoice understood from the beginning the concept and necessity of the Pass-Through Agreement with CPN and that CPN's contracts would be the basis for extension into the Fresno healthcare market. Further the Pass-Through Agreement was clear that there were no guarantees that the HMOs would contract with FirstChoice. They thought that MedSmart had the ability to PROCURE the contracts. When it didn't, they terminated MedSmart. The project with CPN went on without MedSmart. Bryson and CPN continued forward under the plan that MedSmart had created and brought to FirstChoice.

All of the costs and expenses spent to establish the FirstChoice IPA had been paid by Abraham and MedSmart. FirstChoice spent no money and refused to pay marketing expenses that were identified in the MSA (Exhibit 44 page 18-19). The only exception may have been "legal fees" paid to their "attorney" Shaka Scott. FirstChoice was given at no cost a functional IPA that was able to generate tens of millions of dollars in revenue over the next three years.

FirstChoice had no valid reason to terminate the MSA or Abraham. Its termination was therefore without valid cause. This action was a breach of the MSA.

ISSSUE NO 4. DAMAGES.

Almost from the very beginning of the relationship between Abraham and the principals of FirstChoice, there were disputes about how, how much and for how long Abraham would be compensated for his efforts to set up the IPA and for its management into the future.

The date the payments would begin pursuant to the MSA was changed from September 1, 2013, to the date the first patient was enrolled by Amendment 1 to the MSA. Later yet, the

Doctors took the position that they wouldn't pay Abraham until the funds had actually been received from the HMOs. They didn't want to go out of pocket for any payments.

The term itself of the MSA was changed several times. The initial ten-year term in the MSA was reduced to seven years in Amendment 1. Then, at the FirstChoice Board meeting on October 27, 2013, which Abraham was not invited to attend, the Board UNANIMOUSLY voted to reduce the term of the MSA an additional two years to a term of five years! Obviously without the consent of Abraham (Exhibit 128).

After the number of enrolled members reached 500, Abraham/MedSmart was to be paid 12% of the gross capitation payments received by FirstChoice. Prior to 500 members, they were to be paid $11,000 per month, after the enrollment of the first member which occurred in November 2013. MedSmart was also to be paid a bonus based on profits of the combined doctor-hospital pool. There were no profits.

The gross capitation payments received by MedSmart must be reduced by the costs that MedSmart would have incurred to reach a "net profit" number as their damages. Neil Beaton, MedSmart's damages expert calculated the net number to be 2% of the 12% (H.T. Pages 788-789). FirstChoice's expert Duross O'Bryan calculated the net to be in the 2-4% range (H.T. Page 1344). Both experts agreed that the payments to Advanced Medical Management (AMM) were the primary costs that MedSmart would have incurred.

Looking at the historical capitation numbers, it appears that FirstChoice first reached 500 members in March of 2014 (Exhibit 163 page 1328). Accordingly, MedSmart would have been entitled to receive $11,000 per month from November 2013 through February 2014 for a total of $44,000.

Due to severe financial losses claimed by the Doctors, FirstChoice sold its assets in early September 2016 to Vantage Healthcare. It apparently stopped receiving HMO capitation payments at that time. Thereafter the payments would go to Vantage Healthcare.

Taking 2% of the total capitation payments received by FirstChoice from March of 2014 through August of 2016 calculates a net profit loss for MedSmart of $827,560.

MedSmart invested $325,000 of its own time and money in its efforts to develop the FirstChoice IPA before it was wrongfully terminated. It is entitled to be compensated in that amount.

ISSUES RAISED AFTER THE INTERIM AWARD

1. MedSmart seeks supplementation for its damages sustained from September 2016 through August 2020, the end of the term of the MSA. This request ignores the fact that FirstChoice had failed as an enterprise due to catastrophic losses to the hospital pool incurred in connection with the long-term hospitalization of two patients at Stanford University Hospital. Those

expenses apparently were not covered by any re-insurance or other means to defer them. The Arbitrator understands that it is customary in the medical field to arrange for such stop-loss coverage. It was not done here. The FirstChoice entity ceased to be a viable entity after the asset sale and did not receive any further capitation payments upon which SmartMed was entitled to payment.

This is not a measure of damages question. There were no capitation payments upon which the net 2% damages could be applied after the asset sale. FirstChoice was no longer doing business. MedSmart is not entitled to return to the initial $11,000 per month base monthly payment as, again, FirstChoice was no longer a viable entity.

The request to supplement the damages awarded is DENIED.

2. MedSmart requests that the Asset Purchase Agreement's designation of "attorney's eyes only" be removed. MedSmart has shown good cause for the lifting of the designation. Equity demands that the request be GRANTED. The document is still however subject to the terms of the Protective Order that is in effect in this matter.

3. MedSmart requests the Arbitrator to make 36 specific findings of fact in connection with the Asset Sale by FirstChoice to Vanguard. The Arbitrator declines to make such findings.

4. MedSmart asks the Arbitrator to attach money held by FirstChoice which had been reserved to pay it legal expenses. This request is made pursuant to JAMS Rule 24 and California Code of Civil Procedure section 483.010(a-c). FirstChoice is correct that the Arbitrator is without authority to issue such provisional relief. Once this award is reduced to Judgment, the Superior Court can issue this relief. The Request is DENIED.

5. MedSmart also seeks to conduct additional discovery related to the Asset Purchase Agreement. This forum has no jurisdiction over Vanguard, the entity purchasing the assets of FirstChoice. The discovery in this matter has been completed. The Superior Court may allow such discovery during the judgment debtor phase of the case. The request is DENIED.

ATTORNEY FEES and COSTS

The Parties have submitted briefs in support of and in opposition to the request by MedSmart, as prevailing party, for attorney fees and costs. The parties also submitted a supplemental brief an opposition thereto relating to fees incurred in November and December 2016. The Arbitrator has considered these arguments and rules as follows:

MedSmart is granted attorney fees in the amount of $902,024.39. These fees were appropriately supported and documented. The hourly rates are proper.

Mediation and Arbitration fees in the amount of $70,515.15 are properly awarded. This amount reflects a refund credit of $5,000.38 to be issue by JAMS to MedSmart.

Costs in the amount of $25,945.72 are proper. Abraham's personal travel expenses are properly included.

Transcript costs in the amount of $29,060.01 were necessarily incurred and are properly awarded

Court-Ordered expert fees are DENIED. These fees were incurred due to issues regarding MedSmart's own improper handling of ESI issues. MedSmart did not prevail on these issues.

The Arbitrator declines to award non-court-ordered expert fees. Pre-judgment interest is not appropriate as the amount in controversy was not certain or liquidated.

Fees and costs in the total amount of $1,027,545.27 are awarded to MedSmart.

AWARD

Based on the testimony presented, the exhibits offered at the Hearing and the oral arguments of counsel, this Arbitrator finds as follows:

1. MedSmart is entitled to damages for FirstChoice's breach of the MSA in the following amounts:

A. $44,000.00 for monthly payments not made from November 2013 through February, 2014.

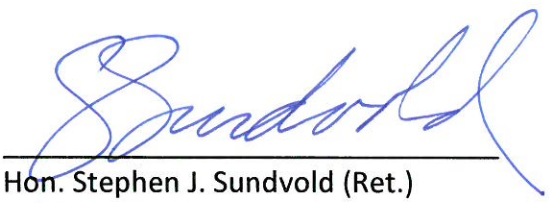
B. Net lost profits payable under the MSA from March 2014 through August 2016 in the amount of $827,560.00.

C. Lost investment of time and expenses incurred in the formation of the IPA in the amount of $325,000.00.

2. FirstChoice shall take nothing by reason of its claims.

3. Pursuant to Paragraph 16 of the MSA, MedSmart is determined to be the prevailing party and entitled to its costs and legal fees incurred for the arbitration in the amount of $1,027,545.27.

DATED: February 21, 2017



Hon. Stephen J. Sundvold (Ret.)
Arbitrator

PROOF OF SERVICE BY EMAIL & U.S. MAIL

Re: SmartMed, Inc. vs. First Choice Medical Group, Inc.
Reference No. 1130006055

I, Gloria Hong, not a party to the within action, hereby declare that on February 21, 2017, 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 Orange, CALIFORNIA, addressed as follows:

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I declare under penalty of perjury the foregoing to be true and correct. Executed at Orange, CALIFORNIA on February 21, 2017.

Gloria Hong
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