SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NASSAU
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THOMAS JOHN, derivatively on behalf of
DUTCHESS GARDENS REALTY, LLC,

Plaintiff,

Index No. 602306/15
Hon. Timothy S. Driscoll, J.S.C.

-against-

GEORGE VARUGHESE, C.P.A.,

Defendant.
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PLAINTIFFS' POST-TRIAL

MEMORANDUM OF FACTS AND LAW

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PRELIMINARY STATEMENT

This action was brought by plaintiff Thomas John on behalf of DUTCHESS GARDENS REALTY, LLC (hereinafter, "the Company") against defendant GEORGE VARUGHESE, C.P.A., for his gross negligence, breach of fiduciary duty, waste, and gross misrepresentation during his management of the Company from late 2009 until May 2013.

As established at trial, during the period of his management of the Company that owned and operated a small shopping plaza, defendant used the Company like a "piggy bank" for his own personal benefit, diverting Company assets to charge expenses and pay bills unrelated to the Company, continuously paying himself and his cronies, yet not paying the Company's necessary expenses. Defendant used the Company's resources for his own benefit while actively deceiving the Company's members as to its financial condition, the security and physical state of the Company's shopping plaza, and of course, his own wrongful diversions and cover-up. Not only did defendant refuse the Company's members' demand for an accounting, but he actively prolonged his personal access to the Company's revenue stream by concealing from the members crucial events that would have surely led to his removal: that fire insurance had been lost due to his own gross negligence, that a catastrophic fire had subsequently destroyed one-third of the shopping center, that a mortgage foreclosure action had been commenced against the Company, that he was reporting to the members less than he was taking, and reporting to IRS more than he was taking, and that he was siphoning off whatever money the Company earned, and covering it up.

In so doing, defendant sabotaged the Company's viability, and left it compelled in 2014 to sell its single asset – the shopping plaza – at a nearly total loss.

At trial, defendant largely denied without any substantiation that he was involved in the looting and misrepresentations, though he had no viable explanation for the fraudulent and greedy practices that characterized his tenure as the Company's ostensible managing member.

Mostly, defendant's trial defense featured an elaborate and irrelevant distraction, consisting of defendant's implausible, personal counterclaims against Thomas John for his alleged missteps when he managed the Company prior to 2009, all of those counterclaims failing as immaterial, unsubstantiated in fact and, most critically, not brought by the Company and its members or with their consent. Ironically, defendant's purported counterclaims address John's alleged improprieties that occurred during a period when defendant was the Company's accountant and a member, and he approved and ratified all of John's transactions about which he now complains. Defendant's counterclaims – which he advanced seeking some offset for *his* looting the company -- were not only left unsubstantiated at trial, but even had they been proven, they would have been irrelevant. The alleged counterclaims would be claims owned by the Company alone, which has not authorized any such counterclaims, and such claims could not offset the Company's claims herein against defendant for his fraudulent, larcenous scheme.

For the reasons adduced at trial, and as set forth below, judgment should be entered for the Company.

STATEMENT OF FACTS

In 2000, some thirty individuals formed the Company for the purpose of purchasing and operating a small shopping plaza in Wappingers Falls, New York (P. exh. "1" and "2"; tr. 15-16).[1] Thomas John, the member with the largest ownership interest, arranged the $3.45 million mortgage loan (on a $4.4 million purchase), provided his personal guarantee, and served as managing member (as elected by the members) until 2009 (tr. 15-17). John owned and operated a real estate management company that he used to manage the premises (tr. 17-18).

The Company earned revenues from rental income for its 15 or 16 commercial units, and was obligated to pay its mortgage, maintenance and utilities costs, insurance, and management and professional fees (tr. 18-19). John's management company (American Gardens) charged a management fee of 4% of rent collections (tr. 19-20).

At times, the Company's revenues did not cover its expenses – the $53,000 monthly mortgage being the largest component thereof (tr. 35) – and John made loans to the Company to cover the shortfall. Evidence of these types of loans appears in the Company's 2007 bank records, the only available records from the period preceding 2009 (tr. 20-22, 29-34; P exh. "29").

During the period 2000 to 2009, John managed the Company, and reported to the members at quarterly meetings at which defendant made accounting presentations (tr. 22). Defendant was the Company's accountant throughout, and prepared annual income tax returns in consultation with John or his management company (tr. 24), and defendant was paid an accounting fee (tr. 196). Defendant had unfettered access to the Company's books and records (tr. 24, 224).

[1] Referenced to "P exh." are to plaintiff's exhibits admitted into evidence at trial, and references to "D exh." are to defendant's exhibits admitted into evidence at trial. The transcript of trial is annexed hereto; references to pages of the transcript are noted as "tr.".

During John's term as managing member, the mortgage loan was refinanced twice, both times with the approval and resolution of the members, including defendant (tr.224). In 2003, a loan refinance was undertaken in order to make some capital improvements and to distribute dividends (tr. 24-26); in 2008, a refinance was made to repay a portion of the loans John had made to the Company, leaving a balance due to John for which he filed a UCC security statement (tr. 34-35).

In late 2009, the Company members met and agreed that John would relinquish his role as the managing member, as he could no longer afford to subsidize the Company's losses (tr. 42). Defendant assumed the functional role of managing the Company in or about September 2009, though not officially appointed until January 2010 (tr. 42, 190; P exh. 16). Defendant had already surreptitiously opened a Company bank account at TD Bank in September without authorization, and began collecting rent from tenants and writing checks (tr. 231; P exh. 23).

Defendant's early activities reflect his intention from the outset: to use the Company's checking account and stream of rental revenue to pay himself and his associates who worked on his other investment properties. Checks beginning in 2009 (P exh. 23) show thousands of dollars being disbursed to contractor N.Y. Wonder Construction, property manager Jeff Crumpton, cash, and defendant himself.

N.Y. Wonder Construction was a contractor whose principal, Ghayoor Hussein, was like a son to defendant (tr. 324), invested at least $100,000 with defendant in other projects (tr. 330-31), and performed work for defendant on four of defendant's other properties and his home (tr. 234, 328-29). Defendant paid Hussein over $30,000 of Company funds in the first few weeks after gaining control of Company finances, ostensibly to make good on a check bounced by the Company under John's management. But defendant – a licensed C.P.A. – and Hussein could not

get their story straight regarding the alleged "bounced check": defendant claimed that Hussein brought him documentation including the bounced check, but he lost it (tr. 232); Hussein testified that he did not show defendant any bounced check, but just told him that he needed to be reimbursed (tr. 328). Indeed, whether Hussein or his business did anything at all to justify the payments is doubtful, given that he alleged without any supporting documentation the fantastic claim that he traveled more than 100 miles round-trip to the Company's property some 40 or 50 times in the span of six months to perform the alleged work (tr. 326-27). Crumpton – who managed the property at the end of John's tenure – had no recollection of Hussein doing any work at the property prior to defendant assuming control.

Defendant also paid Crumpton substantial management fees, in addition to paying himself management and accounting fees. Crumpton, who also managed some of defendant's other properties, had been hired at defendant's urging about one or two months before John was replaced, and John's management company had paid him a 3% commission, coming out of John's 4% management fee commission (tr. 58, 351-52). Somehow, in the first few months of defendant's stewardship of the Company, Crumpton was paid substantial sums that seem to be unrelated to any work he could have done for the Company (tr. 58, P exh. 23)[2]. Worse, from 2009 to 2013 Crumpton was paid his increased management fee directly by Company funds – not out of defendant's management fee – as defendant paid himself Company funds as an additional management fee blended with accounting fees, and also paid Crumpton's daughter some fees for management (tr. 58, 272-73, 351).

[2] Crumpton had been an employee of John's management company for one or two months prior to defendant's assuming control of the Company, and any commissions allegedly owed to him were not liabilities of the Company.

With the Company's cash flow steered toward defendant's associates and himself, defendant in 2010 expanded his abuse of the Company's assets. He secretly used the Company's TD Bank account to fund hardware purchases for other investment properties and businesses (P exh. 24-A, 24-B, 24-C, 24-E,), his travel to India, hotel stay, and entertainment in matters admittedly unrelated to the Company (P exh. 24-B, 24-C), home appliances (P exh. 24-D), and miscellaneous unsupported cash withdrawals (P exh. 24-E, 24-F, 24-G, 24-I, 24-J; tr. 249). Only years later – at deposition – did defendant claim that he would reflect these wrongful diversions as such on the Company's books, but he never did so and he never revealed these diversions to the members. Further, two entire months of rental revenue totaling some $70,000 – in June 2011 and December 2011 – disappeared completely, with no deposits reflected in either of those months' bank statements, or delayed (as defendant assured the Court they were) to the following months' statements (P exh. 24-H, 24-I, 24-K, 24-L).

Meanwhile, defendant's self-interested management of the Company's actual business eroded into gross mismanagement. In September 2010, the Company's property insurance carrier advised defendant that the Company was required to have a hood duct in one of the shopping plaza's stores cleaned, or else its fire insurance coverage would be terminated (P exh. 5). The cost of such a cleaning is about $100 (tr. 246), yet defendant did not have it done. Instead, in reckless disregard for the severity of the matter by someone acutely aware of the crucial need for fire insurance (tr. 250-51), he allowed the fire insurance to be terminated, and did absolutely nothing and enlisted no assistance to replace that coverage for at least the next eight months (tr. 248; P exh. 6). Defendant's claims of being unaware of the loss of fire insurance coverage is belied by reason and common practice of mortgagees, who repeatedly notify mortgagors of such coverage lapses

prior to securing their own insurance (as the bank did here), inasmuch as a loss of fire insurance coverage can be grounds for foreclosure.

Unfortunately, it was then, on May 31, 2011, that a devastating fire ravaged the Company's shopping plaza and destroyed five stores, causing close to one million dollars of uninsured damage and loss of rent (tr. 253, 354-56; P exh. 18).

With the Company's revenue now impaired by the loss of tenants due to the fire, and with defendant continuing to pay himself and his cronies, he negotiated a reduced "interest-only" payment on the mortgage of $20,000 per month.[3] Soon after, he could not sustain even this payment and falling six months behind on the mortgage, the Company's mortgagee commenced foreclosure proceedings in February 2013 (tr. 201-02; P exh. 19). Of course, one reason for the continued shortfall in mortgage payments was that under John's management, as a 35% owner of the Company and a personal guarantor of its mortgage loan, he had loaned the Company the funds necessary to keep the mortgage current; under defendant's management, there was no similar financial rescue (tr. 21). That, combined with defendant's self-serving abuse of the Company, left the property vulnerable, and defendant concealed that vulnerability from the members.

Meanwhile, as defendant continued to have the Company pay himself, he ceased paying property taxes, exacerbating the Company's financial condition. Despite his assertions to the contrary, he was unable to substantiate any property tax payments for 2010 and 2011 for the Company (tr. 268-69).

In May 2013, defendant called a meeting of the Company's owners – the first investors' meeting called by defendant in over two years! (tr. 257-58) – purportedly to apprise them of the

[3] This sum was substantially less than the $53,000 per month in mortgage payments under John's stewardship (P exh. 29).

Company's condition. His notice for the meeting (P exh. 10) makes no mention of defendant losing the fire insurance, his continued failure to replace that insurance coverage, the devastating fire itself, the monthly shortfall, or even the foreclosure. Instead, the notice references only a "threat" of foreclosure, and a passing barb at John, who received notice of the meeting after it had been held (see P exh. 10, p.2; tr. 65). Defendant did want the only member who would ask him difficult questions to attend the meeting. Instead, he was content to lie to the Company members by claiming that the Company was "free from all accumulated liabilities" (P exh. 9).

At the meeting itself, defendant (who somehow could not recall at trial whether his allowing the property to have no fire insurance, the horrible fire, the mortgage shortfall, or the foreclosure were discussed [tr. 258]) distributed to the Company's members a spreadsheet he had prepared (P exh. 4; tr. 69, 145). The spreadsheet cemented defendant's pattern of obfuscation, containing numerous distortions, including the following:

- defendant failed to account to the Company's owners for the period in late 2009, when defendant appointed himself managing member, opened a bank account without authorization, and began disbursing collected rents to himself, Crumpton, and Hussein (tr. 71-72);
- defendant's spreadsheet showed nearly $20,000 less in accounting fees than he actually paid himself (tr.74-75);
- the spreadsheet alternated between the cash and accrual methods of accounting, which guaranteed a gross distortion;
- defendant's spreadsheet also underreported management fees he paid himself and Crumpton, his long-time manager in other investment properties (tr.74-75);

- defendant's deceptive spreadsheet reflected bank balances for 2010, 2011, and 2012 that were underreporting some $170,000 in total; and
- defendant also reflected a bank balance in 2013 for the Company of some $57,000, when in fact he had already pilfered most of that money (tr. 74).

As to the last of these irregularities, only a month before the May 2013 meeting, defendant had taken $50,000 of Company funds for himself by surreptitiously writing a check for that amount to "Legacy Accounting", a corporation he owned with his daughter and controlled (P exh. 22; tr. 263-64). Legacy Accounting had no business with the Company and was owed nothing by the Company. Defendant now claims that he took the Company's $50,000 without telling anyone because he feared that John's creditors might access the Company's funds, though even had that alleged fear somehow been reasonable, he could have simply distributed the balance to the Company's members rather than taking it for himself (tr. 263-64). Without seeking a legal opinion, without documentation, and without any disclosure to the Company members, defendant took that money on his own authority, and has never returned it (tr. 264-67, 270-71). He first claimed: "In a sense, it's in escrow" (tr. 286), and then admitted he used the money to pay his legal fees (tr.287).[4]

Indeed, Suman Patel testified (tr. 150) that when he asked defendant why those funds were not being distributed to the Company's members, defendant did not even suggest that he had any rationale at all for keeping the money. He simply delayed and obscured, in furtherance of the cover-up of his scheme.

[4] Defendant's conversion and deception about these funds is especially galling, as it unveils his distortions made even to this Court. This Court's Order of July 8, 2015, denying the Company's motion seeking that defendant pay into Court the $57,000 he claimed to be holding, in part because he represented, and the Court found, that "Defendant had acted within the scope of his fiduciary duties by continuing to maintain the disputed Funds intact and without reduction" (Order, July 8, 2015, p.8). At trial, defendant revealed that he had indeed dissipated these Company funds by using them to pay his personal legal fees, which he incurred after being sued by the Company.

During his time defendant had his hand in the Company's proverbial "cookie jar", defendant also paid himself increased accounting fees, claiming that he earned them because his role was greater than it had been when John managed the Company, but he also paid Crumpton significantly higher management fees for managing the Company's property (tr. 273-76). In fact, even after the fire destroyed about one-third of the property, and thus revenues from rent declined dramatically, defendant did not reduce his management fees or Crumpton's fees (tr. 313).

Several months after the May 2013 meeting, a controlling group of the Company's members wrote to defendant demanding by certified mail an accounting, and the associated production of a number of key financial documents (P exh.10; tr. 280-81). Defendant did not reply in writing, instead telling just one of the letter's signatories that he refused to respond (tr. 280-82).

In February 2014, with no relief from the mortgage arrears, the fire damage, or its weakened financial condition, the Company determined to sell the property to the mortgage lender, recovering some $200,000 less the tenant's security deposits (P exh. 11; tr. 282). The resolution (P exh. 11) was executed by a controlling number of members, approving the sale, removing defendant from Company management, and authorizing John to bring this legal action for defendant's looting the Company while its revenues collapsed and the mortgage on its property foreclosed.

Defendant now claims that he had better offers to sell the property, but these unproven "offers" were at most verbal expressions of interest, not even made to defendant, that were non-binding and legally unenforceable (tr. 283-84, 357-58).

Defendant also contends that the arrears were somehow John's fault, though in August 2009, the Company had only missed the preceding month's $53,000 mortgage payment (P exh. 15). John, no longer able to fund the Company's shortfall as he had for years, allowed defendant

to assume the management duties, which defendant used as a pretext to conceal the Company's true financial and physical condition for four years, and squeeze out of the Company whatever he could for himself and his business associates in other investments. Indeed, defendant's claim that John did not manage the property well is an outrage, but is also legally insignificant, as the instant litigation was brought by the Company against defendant (and not against John) for defendant's avaricious abuses and elaborate deceptions to hide them during the period September 2009 through 2013. Only the Company could assert any claims against John, if they existed, and only for the period of John's management which ended in 2009. Defendant attempts the classic "misdirection play", hoping to point the finger elsewhere to evade any scrutiny of his own nefarious conduct, but this effort to deceive the Court is to no avail. Even assuming *arguendo* that John had somehow wronged the Company prior to September 2009, this is irrelevant to the campaign of looting and active obfuscation that defendant wielded against the Company thereafter.

In sum, nothing defendant alleges against John or anyone else can absolve him of his liability to the Company for his pilfering Company assets, using Company funds to pay his own bills, appropriating Company deposits, traveling at Company expense, underrepresenting his accounting and management fees to Company members, overstating legitimate Company expenses, and hiding his own gross mismanagement from the Company and its members so he could continue to perpetuate his scheme.

ARGUMENT

PLAINTIFFS HAVE PROVED THEIR ENTITLEMENT TO THE COURT'S VERDICT

At trial, plaintiff established all the elements of their first four causes of action, and are thus entitled to judgment. Plaintiff alleged in the Complaint defendant's gross negligence, breach of fiduciary duty, waste, and misrepresentation.

"To constitute gross negligence, a party's conduct must smack of intentional wrongdoing or evince a reckless indifference to the rights of others". *Ryan v. IM Kapco, Inc.*, 88 A.D.3d 682, 683, 930 N.Y.S.2d 627 (2d Dep't 2011). "[A] party is grossly negligent when it fails to exercise even slight care or slight diligence." *Ryan, supra*, 930 N.Y.S.2d at 627. *See Dolphin Holdings, Ltd. v. Gander & White Shipping, Inc.*, 122 A.D.3d 901, 902, 998 N.Y.S.2d 107, 109 (2d Dep't 2014); *Goldstein v. Carnell Assoc., Inc.*, 74 A.D.3d at 747, 906 N.Y.S.2d 905 (2d Dep't 2010). Here, as detailed below, defendant was grossly negligent in his self-dealing, deceptive mismanagement of the Company, having acted intentionally in an unreasonable manner, "in disregard of a known or obvious risk that was so great as to make it highly probable that harm would follow" and he did so with conscious indifference to the outcome. *See Matter of N.Y. City Asbestos Litig.*, 89 N.Y.2d 955, 956–57, 678 N.E.2d 467, 468 (1997).

A breach of fiduciary duty is established when a plaintiff proves the existence of a fiduciary relationship, misconduct by the defendant, and damages that were directly caused by the defendant's misconduct. *See Kurtzman v. Bergstol*, 40 A.D.3d 588, 590, 835 N.Y.S.2d 644, 646 (2d Dep't 2007); *Ozelkan v. Tyree Bros. Envtl. Servs. Inc.*, 29 A.D.3d 877, 879, 815 N.Y.S.2d 265 (2d Dep't 2006). A defendant managing a company who was engaged in self-dealing has breached his fiduciary duty. *Nathanson v. Nathanson*, 20 A.D.3d 403, 404, 799 N.Y.S.2d 83, 85 (2d Dep't 2005). Moreover, a managing member, like a corporate director, may be held accountable for the

waste of company assets whether intentional or negligent without limitation to transactions from which he benefits. *Rapoport v. Schneider,* 29 N.Y.2d 396, 403 (1972); *see 770 Owners Corp. v. Spitzer*, 25 Misc. 3d 1204(A), 901 N.Y.S.2d 902 (Kings Cty. 2009).

A fraudulent misrepresentation is established when the evidence shows a misrepresentation or a material omission of fact by a defendant which was false and known to be false by defendant, made for the purpose of inducing the other party to rely upon it, justifiable reliance of the other party on the misrepresentation or material omission, and injury. *Mandarin Trading Ltd. v. Wildenstein*, 16 N.Y.3d 173, 178, 944 N.E.2d 1104, 1108 (2011); *Lama Holding Co. v. Smith Barney,* 88 N.Y.2d 413, 421, 646 N.Y.S.2d 76, 668 N.E.2d 1370 (1996); *Channel Master Corp. v. Aluminium Ltd. Sales,* 4 N.Y.2d 403, 406–407, 176 N.Y.S.2d 259, 151 N.E.2d 833 (1958).

Defendant's liability to the Company on these causes of action must be viewed, first, against the backdrop of the inapplicable limitation of liability contained in the Operating Agreement (P exh. 1), which insulates a managing member from his acts of simple negligence or breach of duty, unless there is an adjudication that the managing member's "acts or omissions were in bad faith or involved intentional misconduct or a known violation of law . . . ." (Operating Agreement, ¶ 7[g]). The evidence at trial established defendant's gross negligence, willful breach of his fiduciary duty, intentional misrepresentation, and his grand cover-up, none of which is exculpated by the Operating Agreement. In context, and taken together as the hallmark of defendant's reign of greed over the Company, these facts establish his bad faith and intentional misconduct. Thus, the Operating Agreement's exculpatory language is of no avail.

Defendant's intentional and deceptive conduct was egregious from when he first captured control of the Company by defrauding the membership into believing he was qualified and well-intentioned. In September 2009, defendant – a CPA who had been the Company's accountant for

nine years, and was intimately familiar with its operations – launched immediately into his scheme of abusing his unchecked, unsupervised power over the Company's finances. Without any Company resolution and without even informing the Company's members, defendant opened a new bank account, collected and deposited rents from the Company's tenants, and wrote Company checks to himself, and his cronies Crumpton and Hussain, both of whom worked for defendant at other investment properties. Defendant gave himself and Crumpton raises (P exh. 23; tr. 235, 351-52), and defendant – a Certified Public Accountant -- paid Hussein (with whom he invested, and who admitted to a close personal relationship [tr. 324]) for what he claimed at trial were previously-earned fees, without any backup or proof (tr. 329). Indeed, defendant claimed that Hussein had the proof (tr. 233), and Hussein claimed that defendant had it (tr. 329). Nothing was reported to the Company's members.

Further, Hussein claimed that he had earned the Company funds that defendant gave him in 2009 by making an impossible 40 to 50 trips to the property in Wappingers Falls (90 miles away) during just a few months in 2009 before defendant assumed control (tr. 327-27).

By early 2010, defendant had expanded his scheme to using the Company as his personal stash, taking Company funds to pay for his Home Depot and fixture purchases for other investment properties, his personal appliances, cash withdrawals, travel to India, personal hotel stays, and entertainment (P exh. 25-A through 25-O; tr. 238-43). He never accounted to the Company or its thirty members for these amounts, and only at trial did he claim to have reckoned his thefts through some accounting maneuvers he could not describe, simply reassuring the Court without any proof that "[e]verything is adjusted." (tr. 239).

Even more suggestive of defendant's manipulations of Company funds for his own benefit is the mystery of no deposited rental income in June 2011 and December 2011, when rent would

have totaled in excess of $70,000 (P exh. 25-H, 25-K). Defendant's predictable excuse is that the rents were deposited late, and appear in the following months' bank statements (tr. 243), but this is pure fiction: the July 2011 statement (P exh. 25-I) and the January 2012 statement (P exh. 25-L) reflect only the normal monthly deposit amounts for those months, and not the missing months' revenues. Defendant could not trace the missing June 2011 rental deposit through any of the ensuing months (tr. 243-44). Again, no information, explanation, or accounting were provided to the Company's members/investors.

Instead, at trial defendant tried his hand at expanding his cover-up to attempt to deceive this Court by producing an unverified, unreconciled, self-serving summary he prepared for trial (D exh. X), despite having had years to investigate how these rents "disappeared". The summary does not reflect where the missing deposits went, but simply provides in table format the same unsupported excuse.

It is in the context of these manipulations and diversions of Company assets that defendant must be judged for his other misconduct. As defendant was running the Company for his personal benefit from September 2009 through 2013, he passionately sought to avoid detection and investigation into Company affairs. After he mismanaged the fire insurance fiasco -- by effectively ignoring a $100 repair and thus costing the Company its fire insurance coverage -- defendant was assiduous in keeping this perilous situation from the Company's members, lest they realize that defendant was unqualified to operate the Company, and thus might take away his "piggy bank". He held no meetings at all, and issued no notification to the members whatsoever to apprise them of the property's exposure, and he made no effort and enlisted no help from members to place new insurance (tr. 248-49). Risk of fire was known to defendant, having had a destructive fire at a

different property he managed (tr. 250), yet he kept the loss of insurance coverage a secret for the next eight months -- when fire ravaged the shopping plaza – and beyond.

Even though one-third of the shopping plaza was destroyed by fire, defendant refused to call a meeting or notify the members that their asset had been crippled (defendant claimed that notification was unnecessary because "[i]t was in the news" [tr. 253]), largely because to do so would have surely led to a discussion of insurance coverage, its absence, the reason for its absence, and generally whether the Company was in good hands. To avoid that, and the risk that he would lose his personal access to Company funds, defendant reported nothing. He also reported nothing to the Company – to which he owed a fiduciary duty – when the mortgagee commenced foreclosure proceedings, and in fact, as detailed above, defendant conducted a meeting of Company members soon after the foreclosure and told them that a threat of foreclosure was looming, when he had already been served with process in the foreclosure action and had stopped paying the mortgage. All the while, payments to defendant and his associates continued unabated, even as property taxes went unpaid, and mortgage payments stopped.

In a last grab at the "golden goose", defendant then snatched the Company's bank balance by taking $50,000 and sending it to his own private company (P exh. 22) and took some $6500 for himself, offering the unlikely excuse that he was protecting it from unnamed creditors. Rather, as the evidence shows, defendant simply bled the Company of whatever he could get away with, reporting no issues and certainly no acts of his own gross negligence, abuse, or embezzlement, as he perpetuated the grand deception on the Company and its members to keep the scheme going. At trial, he alternated creatively between claiming that he still held the money in escrow, that he used it to pay legal fees, and that these two are essentially the same thing (tr. 286-87).

Emblematic of defendant's hubris as regards his misconduct, and his imaginative statements at trial that he was keeping some unidentified record of what he had taken from the Company, he was asked if he had authority via a written agreement to take what he wanted and perhaps repay it later (which he never did):

Q: Did you do that pursuant to a written agreement?

A: No. In our business, that is not – everything is handshake, good faith.

Q: Who did you shake hands with on this $50,000?

A: I was the caretaker. I didn't have to shake hands.

Q: You could decide, it was your call?

A: I was the manager. I was the caretaker. I don't need anybody's approval.

(tr. 265-66).

Defendant committed gross negligence in allowing insurance coverage on the Company's single asset to lapse and in allowing the shopping plaza property to remain uninsured thereafter. Defendant did nothing reasonable or meaningful to remedy that failure, as he failed to exercise even slight care or diligence. *See Ryan, supra*, 930 N.Y.S.2d at 627. Defendant acted "in disregard of a known or obvious risk that was so great as to make it highly probable that harm would follow" and he did so with conscious indifference to the outcome. *See Matter of N.Y. City Asbestos Litig., supra*, 89 N.Y.2d at 956–57. He owed the Company a fiduciary duty, and he breached it by concealing matters of enormous importance – loss and lack of insurance, calamitous fire, foreclosure, non-payment of taxes – only to allow his continued thefts and diversions from the Company's assets. *See Kurtzman, supra*, 40 A.D.3d at 590. He induced the Company's reliance by portraying himself as a knowledgeable and reputable CPA, while he obfuscated so his

conversion of funds could continue unchecked, until the Company's property lost almost all of its value and was sold back to the mortgagee.

Defendant's liability turns on two categories of damages he caused. First, he is liable for the monies he took from the Company: some $6,300 in funds as reflected in the bank statements (P exh. 24); approximately $30,000 paid to N.Y. Wonder Construction, apparently for some other defendant project; some $48,000 in accounting and management fees he took but never reported to the Company; some $20,000 in fees he billed the Company that are not reflected in his own spreadsheets; at least $70,000 in missing rents; and the $50,000 he gave to his Legacy Accounting firm, and $6500 he took when he cleaned out the bank balance, yielding a total of $230,300 in direct diversions by defendant.

Second, by inducing the Company's reliance upon him, and willfully doing nothing to secure fire insurance so that his boondoggle and looting of the Company could continue, he caused two crucial losses: the uninsured fire damage loss of $875,966.93 (as reflected in the mortgagor's claimed loss statement, P exh. 20, p.2), and the inevitable consequence of that uninsured loss, namely, lost revenues, yielding a default on the mortgage and eventually the sale of the $4.4 million property for a net payment of $155,000. While this last and ultimate loss may be attributed in part to other contributing market factors, the record established conclusively that defendant's malfeasance, bad faith, gross negligence, breach of duty, greed, and fraud had a significant role in the financial collapse of the shopping plaza, and should bear proportionate liability, at no less than 50%.

Even aside from the loss of the property, defendant is liable to the Company for the other damages (*i.e.*, his thefts and the fire losses), which total, which total $1,106,766.93.

Defendant's counterclaims – which remained unproved at trial – allege mismanagement by John prior to 2009, but as described above, that counterclaim is of no moment. Defendant concededly has no Company authority to make such claims, and in any case, even if he did, and even if he had somehow proved those derivative Company counterclaims at trial, the damage allegedly inflicted by someone other than defendant on the Company prior to 2009 is immaterial to and does not offset the damage inflicted by defendant on the Company after 2009.

Illustrative of defendant's desperate obfuscation was his submission to this Court at trial of an exhibit: an unsigned 2005 Company tax return (which ostensibly he found the day before trial), which defendant himself had prepared. In an effort to confuse the issue and deceive this Court into believing that John had *borrowed money from the Company*, counsel for defendant emphasized that the return carried an entry of some $700,000 denominated as "loan to partners". The implication was flatly false.

First, the entry's designation was an accounting error -- by defendant himself! -- as the entry actually represented a distribution to the members (including defendant) following the first refinance transaction. It was labeled a loan – which it was not – to <u>partners</u>, as all members received a dividend distribution..

Second, there was no evidence of any loans to John or any other partners; on the contrary, John had loaned money consistently to the Company, and it was undisputed at trial that the Company – and defendant himself! – allowed him to file UCC security statements for his loans *to the Company*, and defendant <u>twice</u> approved the refinance of Company debt so it could repay John what it owed him (tr. 37-38, 224-25; P exh. 12).

Of course, when defendant began to run the Company without John, he realized (as detailed above) that without such loans, the Company's rent roll was often insufficient to cover its

expenses. Indeed, John testified that in the one year of the period of his management for which bank statements were still available (2007), he consistently made such loans to cover the Company's shortfall (P exh. 29; tr. 26-35).

All of this, though, is a red herring. Even if defendant could succeed in distracting this Court from his own fraudulent, malicious, and greedy conduct, and the devastating damage he inflicted on the Company, by pointing at something John did or did not do during his tenure, that dodge would fail to accomplish either of the two strategies defendant prays might succeed: substantiating his bogus counterclaim or blaming John for the Company's eventual losses.

As to the former, defendant does not even state a counterclaim, as he does not even allege claims for which he has been damaged. If he instead purports to make a pseudo-third-party claim against John on behalf of the Company (which he does neither derivatively in the Company's name nor with Company approval), that claim also fails as the Company has no such claims, and even if it did, they would all be untimely as having occurred a decade or more before this litigation began. Moreover, even if the Company had a tenable claim against John and pursued it, that recovery would obviously not be an offset to the Company's claims against defendant.

As to the latter strategy, defendant cannot blame John for defendant's ravaging of the Company for his own personal gain during his reign of greed from 2009 through 2013. He assumed complete control (having been the Company's accountant for the preceding nine years) when the Company was only one month behind in its mortgage, still had fire insurance coverage, still had paying tenants, was depositing rents collected to be spent on Company expenses, and did not have to face a disastrous fire without even compensation for clean-up, much less rebuilding. More to the point, when defendant took over, he grabbed the purse strings and controlled the

information, and he manipulated both in dereliction of his fiduciary duties for his own benefit for as long as he could.

In short, defendant's purported counterclaim is not a counterclaim, and even if it were merely an untimely claim against John, defendant lacks standing to assert derivative claims. Further, even if such derivative claims were viable, they cannot offset defendant's liability to the Company for his breaches of duty, misrepresentations, and conversions.

Defendant's only excuses and defenses at trial were his unsupported contention that he was keeping track somewhere of all his pilfering of the Company and will pay it back one day, and that while he was manifestly incompetent in his mismanagement of the Company and actively hid his incompetence and corrupted accounting from the Company's members as best he could for as long as he could, these were mere errors and not a breach of his fiduciary duty, gross negligence and misrepresentation.

Defendant is plainly wrong. The evidence at trial showed that he acted in disregard of the obvious risk of not having fire insurance coverage, and made no effort whatsoever to solve this problem (by simply getting a new policy) for over eight months, so that the highly probable harm that followed – an uninsured fire loss – crushed the Company financially. *See Matter of N.Y. City Asbestos Litig., supra,* 89 N.Y.2d at 956–57. Defendant managed the Company to his own interest, engaging in unabated self-dealing right down to his theft of the last $56,500 in the Company's bank account, all the while reporting nothing to the Company's members, thus breaching his fiduciary duty. *See Nathanson, supra,* 20 A.D.3d at 404. The evidence also showed defendant's wanton misrepresentations (in his distortions in the spread sheet finally presented to the members) and his conscious material omissions by informing none of the members of the Company about the loss of insurance, the fire, his thefts, the mortgage foreclosure -- all misrepresented for the

purpose of pacifying the Company's members, inducing their reliance so they would probe no deeper, so he could continue to raid his "piggy bank" without interference. *See Mandarin Trading Ltd., supra,* 16 N.Y.3d at 178. As he so eloquently testified at trial: "I don't need anybody's approval." (tr. 266).

CONCLUSION

Plaintiff DUTCHESS GARDENS REALTY, LLC established and proved at trial the elements of its causes of action for gross negligence, breach of fiduciary duty, waste, and misrepresentation against defendant. Defendant has no viable defenses, and certainly proved none at trial; he has no authority or standing to assert counterclaims for the Company, and has none of his own. Accordingly, a verdict for the plaintiff should be found, and a judgment should be entered against defendant GEORGE VARUGHESE in the amount of $1,106,766.93, plus $2.1 million for the proportionate loss of plaintiff's asset, for a total of $3,206,766.93 plus interest from March 2014.

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Respectfully submitted,

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