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**SUPREME COURT OF THE STATE OF NEW YORK  
COMMERCIAL DIVISION, WESTCHESTER COUNTY**

Present: **HON. KENNETH W. RUDOLPH**  
Justice.

-----X  
FRANK LONGHITANO, ANTHONY LONGHITANO,  
ANDERSON STREET REALTY, EAST MAIN  
STREET, INC. and 515 HUDSON STREET  
CORPORATION,

Index No. 4586/02

Plaintiffs,

-against-

:

DECISION AND ORDER

JOHN McCLELLAND, JAF PARTNERS, INC.  
LANDEX, INC., HUDSON LAND DEVELOPMENT  
CORP., HUDSON VALLEY LANDING, INC. and  
RONDOUT LANDING AT THE STRAND  
HOMEOWNERS ASSOCIATION, INC.,

Defendants. :

-----X

The following papers and arguments numbered read on this motion.

PAPERS NUMBERED

Notice of Motion/ Affirmation/ Exhibits A-C	1-5
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Upon the foregoing papers, it is ORDERED that this motion by defendants pursuant to CPLR §3104(d) for an order vacating the order of the Special Referee, is decided as follows:

## INTRODUCTION

The individual parties, plaintiff ("Longhitano") and defendant, ("McClelland"), prior to this litigation, were joint stockholders and business associates in the various entities named in the caption of this action. The subject entities are primarily income producing real estate ventures and properties.

Disputes arose between Longhitano and McClelland resulting in a series of protracted litigated matters in Federal and State Court. Ultimately, on December 13, 2001, the parties entered into a global settlement agreement of all litigated matters.

At the time the parties entered into the settlement agreement, Longhitano (**in Westchester County**) operated and controlled the plaintiff entities to the exclusion of McClelland. McClelland (**in Ulster County**) operated and controlled the defendant entities named in the settlement agreement to the exclusion of Longhitano. Longhitano and McClelland operated these business entities from separate corporate offices under their individual control.

The plaintiff's entities were to become the sole property of Longhitano and the defendant entities named in the settlement agreement were to become the sole property of McClelland upon execution and delivery of all settlement documents and payment of all financial obligations set forth in the agreement. Longhitano and McClelland continued to operate their separate corporate offices to

the exclusion of each other after the execution of the settlement agreement.

In the settlement process, disputes arose between the parties after execution of the settlement agreement primarily concerning the appraisal process of the various entities. This was an important step in the financial structure of the settlement. As a result, plaintiffs commenced this action for specific performance of the settlement agreement in Westchester County on March 22, 2002. Three days later the defendants commenced a separate action for specific performance in Ulster County.

**TEMPORARY RESTRAINING ORDERS TO PREVENT DOCUMENT DESTRUCTION**

On March 25, 2002, upon plaintiff's application, the Court (*Colabella, J.*) ordered, inter alia, that:

Pending a hearing and determination in the . . . action . . . the parties are hereby enjoined and restrained as follows:

The defendants, their employees, agents, servants, and any and all other persons acting on their behalf or in concert with them, directly or indirectly, are enjoined and restrained from altering, destroying, removing or otherwise disturbing any files, books, records, ledgers, bank statements, deposit tickets, receipts, cash receipts, rent receipts, tax forms, accountants working papers and any and all other documents wheresoever they may be located reflecting or relating to the activities or rights of the defendant corporations.

Six days later, on April 1, 2002, the Court (*Moles, J.*) upon defendants' application ordered that:

Pending a hearing and determination in the . . . action . . . the parties are hereby enjoined and restrained as follows:

The plaintiffs, their employees, agents, servants, and any and all other persons acting on their behalf or in concert with them, directly or indirectly, are enjoined and restrained from altering, destroying, removing or otherwise disturbing any files, books, records, ledgers, bank statements, deposit tickets, receipts, cash receipts, rent receipts, tax forms, accountants working papers and any and all other documents wheresoever they may be located reflecting or relating to the activities or rights of the plaintiff corporations.

**CONSOLIDATION/CONTINUATION OF TEMPORARY RESTRAINING ORDER**

On May 24, 2002, after oral argument and submission on the issue of consolidation, this Court ordered that the Westchester and Ulster County actions be consolidated in Westchester County and that "all temporary injunctive relief granted shall remain in effect until further order of this Court." McClelland informed the Court that defendants had completed the appraisal process and were ready to proceed with the settlement. Longhitano informed the Court that the appraisal process could not be completed until it had access to corporate financial records at McClelland's offices. The Court adjourned the proceedings to June 3, 2002 to permit review of the defendants' financial records.

Longhitano claims that during this brief adjournment a second set of books was discovered at McClelland's office unknown to the plaintiffs at the time the settlement agreement was entered into.

On June 3, 2002, the plaintiffs informed the Court that they were considering a motion to amend the pleadings to plead an action for recision and fraud. After extensive oral argument, this Court modified the Temporary Restraining Orders (*Colabella, J., Molea, J., infra*) solely on the issue of disbursement of corporate assets in the "ordinary course of business," and continued as modified. The order and prohibition against the destruction of any and all corporate records by either party until determination of this action remains in force and effect.

**MOTION TO AMEND PLEADINGS/DISCOVERY SCHEDULE**

On August 30, 2002, this Court granted plaintiffs' motion to amend the pleadings to allege causes of action for monetary damages from alleged defalcations of corporate assets and indemnification from potential tax liabilities as against McClelland. However, this Court denied plaintiffs further motion to plead "equitable recision" of the settlement agreement. The Court thereupon entered an expedited discovery schedule order. The parties were unable to agree upon discovery issues and again judicial intervention became necessary.

APPOINTMENT OF A SPECIAL REFEREE

Defendants' counsel, Richard Miller Esq., submitted a letter dated October 30, 2002 requesting permission to file three motions; (1) defendants' motion to compel discovery, (2) defendants' motion for protective order and to quash third party subpoenas, (3) defendants' motion to enjoin plaintiffs from interfering with the operations of the corporations under receivership. This Court issued a decision and ORDER November 6, 2002, scheduling a conference to address the defendant's application for December 10, 2002. At the December 10, 2002 conference, the attorneys representing both parties requested a special referee to supervise and determine all discovery issues. The attorneys stipulated to the appointment of the Honorable Adolph C. Orlando as Special Referee pursuant to CPLR §3104. After conference with the Administrative Judge, permission to relieve Judge Orlando from his duties as JHO during the pendency of these discovery proceedings was granted and this Court issued an order on the same date that provided in part:

The Court . . . Pursuant to CPLR §3104, designates **Hon. Adolph C. Orlando**, JHO to supervise and determine all discovery issues in the above entitled action.

**IT IS ORDERED** that all discovery motions or applications made pursuant to CPLR §3104(c) shall be returnable before the **Hon. Adolph C. Orlando**, at 111 Dr. Martin Luther King Jr., Blvd., White Plains, New York (8<sup>th</sup> Floor), and it is further

**ORDERED**, that all motions or applications aforesaid shall be held in abeyance pending initial conference before the Hon. Adolph Orlando on December 13, 2002, at 111 Dr. Martin Luther King Jr., Blvd., White Plains, New York (8<sup>th</sup> Floor) at 1 P.M., and it is further

**ORDERED**, that upon consent of the parties, Hon. Adolph C. Orlando, shall be paid the sum of Two Hundred (\$200.00) Dollars per hour as reasonable expenses for supervision of disclosure, said sum to be shared equally between the parties.

**On March 26, 2003, the Honorable Adolph C. Orlando, Special Referee, entered an order striking the defendants' answer, including its counterclaims, due to spoliation of evidence.**

Defendants argue that the order of the Special Referee should be vacated pursuant to CPLR §3104(d) for the following reasons: (a) the Special Referee lacked authority to adjudicate the spoliation issue; (b) plaintiffs failed to prove that the spoliated documents were relevant and important or that the same were destroyed intentionally, contumaciously or in bad faith; (c) defendants were denied a fair trial because they were unable to proceed without incurring costs of the hearing before the Special Referee previously agreed upon.

#### **POWERS OF THE SPECIAL REFEREE**

**The First question this Court must consider is whether the Special Referee had the authority to hear and decide the plaintiff's motion for striking the defendants' answer due to spoliation of evidence.**

The special referee derives authority from two sources. First, CPLR §3104(c) establishes the inherent powers of the special referee. This section states the following regarding the powers of the special referee:

Powers of referee; motions referred to person supervising disclosure. A referee under this section shall have all the powers of the court under this article except the power to relieve himself of his duties, to appoint a successor, or to adjudge any person guilty of contempt. All motions or applications made under this article shall be returnable before the judge or referee, designated under this section and after disposition, if requested by any party, his order shall be filed in the office of the clerk.

The second source of authority stems from the designation order issued by the supervising Supreme Court Justice. The designation order may limit the authority and function of the referee. *Korobkin v. Chalek*, 7 A.D. 2d 924 (2<sup>nd</sup> Dept. 1959). If the special referee attempts to decide matters outside the designation order, the referee acts beyond and in excess of his/her jurisdiction. (See *L.H. Feder Corp. v. Bozkurtain*, 48 A.D.2d 701 (2<sup>nd</sup> Dept. 1975); *Korobkin, supra*). However, it is well established in New York law, that when a special referee acts within the scope of CPLR §3104 and the designation order, the referee is vested with all the powers of the court. *Buxbaum v. Buxbaum*, 118 Misc. 2d. 348 (Sup. Ct., Kings County 1983); *Glenmark INC, v. Chester Carity*, 229 N.Y.S.2d 255 (Sup. Ct., New York County 1962).

Therefore, the Court must consider whether the spoliation hearing and the order striking the defendants' answer was within the scope of the designating order issued by this Court to the Special Referee. The Court issued the designation order upon consent of both parties and neither party appealed the designation order. The designation order gave broad discretion to the Special Referee to "supervise and determine all discovery issues in the above entitled action." Courts have historically addressed issues regarding spoliation of documents or physical evidence during the discovery process. *Puccia v. Farley*, 261 A.D.2d 83 (3<sup>rd</sup> Dept. 1999); *Long Island Diagnostic Imaging, P.C. v. Stony Brook Diagnostic Associates*, 286 A.D.2d 320 (2<sup>nd</sup> Dept 2001). The policy behind addressing issues of spoliation during discovery is to promote fairness and integrity during this essential truth seeking process. Similarly, courts have routinely applied discovery sanctions to spoliating parties as an appropriate penalty. *Id.* The decision striking the defendant's answer as a result of spoliation of evidence was therefore within the bounds of authority set forth by CPLR §3104 and the designation order issued by this court.

It is the determination of this Court that the Special Referee had the authority to hear and decide the plaintiff's motion for striking the defendants' answer due to spoliation of evidence.

## RELEVANCE OF SPOILIATED DOCUMENTS

The second question this Court must consider is under what circumstances may the court imply the relevance and importance of spoliated documents, warranting the striking of the defendant's answer and counterclaim.

In order for the striking of the spoliating party's pleading to be justified, the court must determine that the destroyed evidence was relevant and important to the essential issues of the case. *Atlantic Mutual Insurance Company v. Sea Transfer Trucking Corporation*, 264 A.D.2d 659 (1<sup>st</sup> Dept. 1999). However, the court may imply the relevance and importance of destroyed discovery materials from the spoliator's bad faith and timing. *Sage Realty Corp. V. Proskauer Rose LLP*, 275 A.D.2d 11 (1<sup>st</sup> Dept. 2000).

The mere absence of spoliated documents does not disprove their relevance. *Sage Realty, supra*. Similarly, lack of knowledge as to the content of spoliated documents does not prevent the court from implying their relevance. *Id.* In *Sage Realty*, the defendants submitted testimony from several of plaintiffs' employees, in which the employees testified only to existence of audio tapes, that may or may not have been relevant. The plaintiffs' argued that the absence of evidence that the destroyed tapes were relevant to the issues of the case was sufficient to prevent the court from imposing discovery sanctions. The court, however, determined that this supposition by the plaintiffs was false:

Although plaintiffs now complain that relevance cannot be established in the absence of the tapes, it is the peculiarity of many spoliation cases that the very destruction of the evidence diminishes the ability of the deprived party to prove relevance directly, so that plaintiffs' objection will not under these circumstances, impede a finding of relevance. *Id.* at 17.

In the present case, defendants' similarly contend that the plaintiffs hold the burden of proof and must establish the evidentiary significance of destroyed documents and further show how the destruction of these documents has prejudiced them. As in *Sage Realty*, the defendant's seek to have this court impose a burden on the plaintiffs to prove the relevance of spoliated documents that the defendant's themselves destroyed. Such a burden defeats the interests of justice. **When a party spoliates documents, they do so at their own peril.**

Striking a party's pleadings is an appropriate remedy for spoliation of evidence. CPLR §3126 allows a court broad discretion, to impose a wide range of penalties upon parties who either refuse to obey an order for disclosure or willfully fails to disclose information that the court finds ought to have been disclosed, including striking the pleadings of the disobedient party. *DiDomenico v. Aeromatik Supplies, Inc.*, 252 A.D.2d 41 (2<sup>nd</sup> Dept. 1998).

However, "separate and apart from CPLR §3126 sanctions is the evolving rule that a spoliator of key physical evidence is properly punished by the striking of its pleading. This sanction has been applied even if the destruction occurred through negligence rather

than willfulness" *Id.* at 53. Striking the spoliating parties pleading is not only an allowed sanction it is also the proper sanction. *Long Island Diagnostic Imaging, P.C. v. Stoney Brook Diagnostic Associates*, 286 A.D.2d 320 (2<sup>nd</sup> Dept. 2001).

#### SPOLIATION OF EVIDENCE

In this case, this Court, has reviewed the prior orders of this court and the records submitted by the parties with respect to spoliation of evidence, and the decision of the Special Referee. The full transcript of hearings presented before the Special Referee has been submitted to this court for review.

The record on review has established that corporate records of the defendants were destroyed in late May early June 2002 under the direction of the defendant, McClelland, in contravention of the prior order of this Court (*Colabella, J. 3/25/02, supra*).

Upon the record before this Court, during the period of time that record destruction took place, McClelland, inter alia, was aware (1) that plaintiffs claimed to have discovered a second set of books maintained at McClelland's offices; (2) that discovery of defendants financial records maintained at McClelland's offices was ordered by the Court to complete the appraisal process required by the settlement agreement, infra, and (3) that a receiver was about to step in and take control of all corporate records of both plaintiffs and

defendants. There is no evidence before this Court that defendants' corporate records were destroyed in the ordinary course of business. The contrary is established from all the testimony and evidence before this Court.

A key indicator in determining the spoliator's bad faith and timing is an evaluation of the destruction of documents in comparison to the normal business practices of the spoliator. (*See Sage Realty Corp., supra; Puccia v. Farley*, 261 A.D.2d 83 (3<sup>rd</sup> Dept. 1999)).

The testimony before the Special Referee clearly demonstrates the aberrant nature in which the document destruction occurred. Renee Mensche ("Mensche"), Ronald Peterson, Charles Haight ("Haight") and Richard Wade, employees of the defendants who were under the direct supervision and control of McClelland at the time document destruction took place, each testified before the Special Referee.

In summary, Mensche testified that at the end of May or the beginning of June 2002, McClelland moved a shredding machine from the inner office to the outer office and placed it behind her desk. (*See Transcript at 69-76*). McClelland told Mensche that he was moving the shredder to the location behind her desk because he wanted to get rid of documents. *Id.* Mensche further testified that McClelland asked her to shred documents and that she with the assistance of other corporate employees, devoted a full business week, five days to shredding. *Id.* Mensche further testified that the first time she destroyed company documents at McClelland's direction was at the beginning of June 2002.

*Id.* Mensche had been an employee of the company under McClelland's direction for 2½ years prior to document destruction. *Id.* at 19.

Mensche testimony was corroborated by Ronald Peterson, Charles Haight and Richard Wade, all employees of the company who participated in the destruction and removal of corporate documents at McClelland's direction. These witnesses confirmed that the amount of destroyed documents was extensive; two pickup truckloads of destroyed documents were removed from the defendant's offices which consisted of roughly forty, fifty-five-gallon industrial trash bags full of destroyed documents. (*See Transcript* at 236-41,535-38,557-61).

Mensche testified that McClelland communicated his reasons for destroying company documents *infra*, and further informed her that he destroyed the documents at the direction of his attorneys. (*See Transcript* at 77-78).

Q: During the period of time that you were destroying documents at Mr. McClelland's direction, did you have a discussion with Mr. McClelland as to why the documents were being destroyed?

A: Yes

Q: What did he say to you, and what did you say to him?

A: He was advised - - he had spoken with his attorneys. And he was advised to get rid of anything that he shouldn't have in the office at that point in time in case a receiver stepped in. And that's why we were shredding them, to get rid of the documents?

Q: Did he indicate what attorneys had advised him to get rid of the documents?

A: Miller Boyce, which - - his attorneys would have been Rick Miller. And there was another - - I think his name was Mike Miller, was his IRS attorney.

Further, in support of this motion to vacate the decision of the Special Referee, McClelland submitted partial testimony from his own deposition in which he admitted that he destroyed copies of corporate documents, although he could not recall what documents he destroyed or when he had destroyed them. However, he testified that Mensche was present at the time he destroyed documents. (*See Defendant's Affirmation, Exhibit A, at 17-20*). Mensche testified that the first time she destroyed company documents at McClelland's direction was at the beginning of June 2002. *Supra*.

Charles Kellner, ("Kellner"), a computer forensics expert, testified that a significant number of Microsoft Word and Microsoft Excel documents were deleted from McClelland's personal office computer on May 8, 2002 and May 9, 2002. McClelland's computer was protected with a personal password. Kellner also testified that just preceding the deletion of files a software program was installed on the McClelland's computer which completely removes files from the hard drive. (*See Transcript, at 325-26*).

Q: Do you have an opinion as to how the other files that were deleted on May 9<sup>th</sup>, 2002 were deleted?

A: I do.

Q: Can you give us your opinion?

A: On May 8<sup>th</sup>, a software application developed by a manufacture called Ontrack, O-N-T-R-A-C-K, that software was installed on this computer.

That software, the primary use of that software, is to delete whole categories of certain kinds of files in ways that then those files cannot be recovered. It's a particular kind of software called a scrubbing software. Ontrack is one of

the Primary developers and marketers of this product.

I found evidence that this software was installed on this computer on May 8<sup>th</sup> and was used on May 8<sup>th</sup> and 9<sup>th</sup> to delete whole categories of files in ways they couldn't be recovered.

**It is unclear from the record below whether McClelland's office computer and its contents were the personal property of McClelland or the property of the corporate plaintiffs.**

Independent of the document destruction that took place in May/June 2002 the record establishes further violations of the Restraining Order of this Court, which occurred in July 2002.

On Saturday, July 27, 2002, two days before a scheduled shareholders meeting, boxes of records and files were removed from McClelland's offices. Charles Haight, employed by McClelland, testified that he observed McClelland's Mercedes SUV in the corporate parking lot on July 27, 2002, full of document boxes that the witness identified as the same boxes that had previously been located in McClelland's security closet. (See Transcript at 523-524). Haight further testified to observing McClelland's fiancée removing documents files from the corporate offices on that day. *Id.* at 525. Mensche and Haight testified that of the roughly twenty-five document boxes that they had observed in McClelland's security closet on July 26, 2002, only two remained on the morning of July 29, 2003. *Id.* at 154, 533. Mensche testified that at no time during the shareholders meeting of July 29, 2002 did she observe anyone removing files from the corporate

offices. *Id.* at 154. This removal of documents and files is uncontroverted and in further violation of the order of this Court, (Colabella, J., *supra*) enjoining McClelland from "removing or otherwise disturbing any files . . . etc." It is unclear from the record what happened to these documents and files.

Upon the totality of all the evidence and the prior orders of this Court the Special Referee properly "Ordered that the motion of plaintiffs for an order striking defendant's answer, including any counterclaims therein be, and the same hereby is, in all respects granted."

The final question this court must consider is whether the defendants were denied a fair hearing.

The defense argues that this Court denied McClelland a fair hearing in violation of his constitutional rights and applicable State law, guaranteeing all litigants free access to the courts. (1). This argument is without merit on the facts and the law.

Judge Orlando was appointed Special Referee pursuant to CPLR §3104 on consent of the parties at a stipulated and reasonable compensation approved by the Court, *Supra*. The parties stipulated before the Special Referee to split the costs of the stenographer. Judge Orlando was not appointed as a Judicial Hearing Officer, a cost ordinarily paid by the Office of Court Administration. Witness the

following colloquy from the record before Judge Orlando, which took place after the plaintiffs rested and several weeks into McClelland case. (See Transcript at 988-89).

. . . The Court: I understand that you have an application. What is it?

Mr Miller: Yes, Your Honor, an application that the proceeding be adjourned. My client can no longer afford to pay the cost associated with the Court and the Court Reporter, and we advised Judge Rudolph by Federal Express today, and I imagine that we'll have a conference as to how to proceed next.

The Court: I really don't understand your application, you're asking for an adjournment until when?

Mr. Miller: To get a resolution as to how the disputes are going to be adjudicated. My client cant afford-

The Court: He's resorted to the Courts. He can make an application to proceed as a poor person.

Mr. Miller: He resorted to the Courts, but the Courts do not require payment of a judicial entity and the Court Reporter to proceed with motions and hearings and Whatnot.

The Court: You stipulated to that. The Court doesn't require that, you stipulated to that Mr. Miller.

Mr. Miller: We agreed by consent to have your honor resolve discovery disputes. We had no way to see how lengthy and expensive it can be. And, even if we're wrong, he can't pay for it.

The spoliation hearing before the Special Referee was extensive. The plaintiffs completed their case in five days. The defense case then proceeded for weeks before the defense claimed economic hardship. A major portion of the hearing was spent on marking exhibits at the defense's request. The defense introduced twenty-five boxes of corporate records, subpoenaed from the court appointed Receiver. The defense sought to introduce these exhibit documents in mass, a request

that the Special Referee denied. The defense then requested that each individual document be marked as an exhibit. By the end of the spoliation hearing the Court had marked more than one thousand exhibits. Throughout the hearing the Special Referee made repeated attempts to mitigate court costs, including the marking of exhibits outside the presence of Court and the court reporter. It is apparent that the defense, by its own accord, chose the manner in which it proceeded with its case and knowingly accepted the costs associated with this strategy.

It is unclear from the record what the true financial status of McClelland was at the time that Mr. Miller moved to adjoin the hearing sine die.

What is clear, is that the hearing had gone very badly for the defense. McClelland admitted he destroyed corporate documents, but did not remember what documents he destroyed or when that destruction took place. However, McClelland did remember that Mensche was present when that document destruction took place (May/June 2002).

Even if this Court were to remand this case to the Special Referee for further hearings on the issue of financial hardship, the defendants would not be able to sustain their argument that all the documents destroyed were copies of corporate records and all the original corporate records are either in the custody of the Court or in the possession of the plaintiffs.

Furthermore, even if the court were able to conclude that the destroyed documents were copies, this destruction and the removal of documents in July 2002, constitute a serious violation of the Restraining Order issued by this Court (*Colabella, J., supra.*) and subject the defendants to the sanctions imposed by the Special Referee.

It is therefore the decision of this court that there is no basis in fact or law to remit this matter for further proceedings before the Special Referee or to vacate the order of the Special Referee.

Upon the foregoing, the motion by the defendants pursuant to CPLR §3104(d) for an order vacating the order of the Special Referee, is denied.

The foregoing constitutes the decision and order of the Court.

Dated: White Plains, New York  
June 27, 2003

E N T E R,



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HON. KENNETH W. RUDOLPH  
Justice of the Supreme Court

- (1) Defendants McClelland at all commenced an action in the United States District Court for the Southern District of New York, *03 Civ 2374*. Pursuant to 42 U.S.C 1983 seeking to enjoin the New York, State Supreme Court from adjudicating this subject matter. A motion to dismiss the complaint before the District Court is pending.