

Deer Park Enter., LLC v Ail Sys., Inc.

2010 NY Slip Op 30881(U)

April 14, 2010

Supreme Court, Nassau County

Docket Number: 010910/2005

Judge: Ira B. Warshawsky

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SHORT FORM ORDER

**SUPREME COURT : STATE OF NEW YORK
COUNTY OF NASSAU**

PRESENT:

**HON. IRA B. WARSHAWSKY,
Justice.**

TRIAL/IAS PART 8

DEER PARK ENTERPRISE, LLC,
Plaintiff,

INDEX NO.: 010910/2005
MOTION DATE: 03/15/2010
MOTION SEQUENCE: 003, 004
and 005

-against-

AIL SYSTEMS, INC., n/k/a EDO CORPORATION,
Defendant.

The following papers read on this motion:

Plaintiff's Rule 19 Statement	1
Defendant's Response to Plaintiff's Rule 19 Statement	2
 <i>Motion Sequence No. 003</i>	
Motion for Partial Summary Judgment on Liability and Determination that Material Closure occurred not later than 9/1/05	3
Defendants Memorandum of Law in Support of Motion	4
Affirmation of Patrick B. Fife in Support of Motion with Vol. 1	5
b) Vol. 2 - Exhs. 11 — 34	6
c) Vol. 3 - Exhs. 35 — 87	7
Affidavit of David Blumenthal and Affirmation of Aaron E. Zerykier in Opposition to Motion and in Support of Cross-motion for Spoliation	8
Vol. 1 - Exhs. A — Q	9
Vol. 2 - Exhs. R — VV	10
Plaintiff's Memorandum of Law in Opposition to Motion and in Support of Cross-Motion for Spoliation	11
Reply Affirmation of William B. Fife in 2 Volumes	
a) Vol. 1 - Affirmation with Exhs. 1 — 8	12

b) Vol. 2 - Exhs. 9 — 13 13
 Defendants Reply Memorandum of Law in Support and in Opposition
 to Cross-Motion for Spoliation 14

Motion Sequence No. 004

Plaintiff’s Motion for Partial Summary Judgment on 1st and 2nd Causes of Action
 and Dismissing Counterclaims 15
 a) Vol. 1 - Exhs. A — P 16
 b) Vol. 2 - Exhs. Q — EE 17
 Plaintiff’s Memorandum of Law in Support of Motion 18
 Affidavit of Angel Venecas in Opposition to Motion 19
 Affirmation of Patrick Fyfe in Opposition to Motion 20
 Defendant’s Memorandum of Law in Opposition 21
 Reply Affirmation of Aaron E. Zerykier 22
 Exhs. WW - ZZ attached to Reply Affirmation 23
 Plaintiff’s Reply Memorandum of Law in Support of Partial SJ Motion ... 24

Motion Sequence No. 005

Motion pursuant to CPLR § 3126 for sanctions for spoliation, including
 imposition of adverse inference against defendant EDO 25

PRELIMINARY STATEMENT

In a series of three motions defendants seek partial summary judgment on the issue of liability and a determination that “Material Closure” in respect of the Sale and Leaseback Agreement between the parties occurred not later than September 1, 2005. Plaintiff moves for partial summary judgment on Causes of Action 1 and 2 of the complaint, and dismissal of counterclaims. In a separate motion, plaintiff seeks sanctions for spoliation of evidence, including the imposition of an adverse inference against defendant.

BACKGROUND

Amended Verified Complaint.¹

This action is an outgrowth of a sales-leaseback agreement between Deer Park

¹ Exh. 1 to Affirmation of Patrick B. Fife in Support of Motion Sequence 03.

Enterprises, LLC (“Deer Park”), as purchaser, and EDO Corporation (“EDO”) as seller, of an 81 acre parcel of land located at 455 Commack Road, Deer Park, Suffolk County, New York, which was improved with 725,000 square feet of buildings and other structures. The property had been utilized by the seller for the manufacture of electronics and other products, primarily for the defense industry. It is now the site of the Tangers Arches Outlet Center. At the time of the Agreement the premises were environmentally contaminated.

Among the conditions to which the contract was subject was a requirement that seller remediate certain environmental hazards. The transaction was subject to a purchase money mortgage in the amount of \$7 million and a leaseback from Deer Park to EDO. Deer Park commissioned an environmental review which produced a document referred to as the “Report”. Article IV of the Purchase Agreement² provided that if the report indicated an environmental condition, exclusive of asbestos containing materials, a “due diligence environmental condition” or an environmental condition discovered other than those found in a report which was caused during the EDO’s or its predecessor’s ownership of the premises would require EDO to obtain “Closure” for these environmental conditions.

The term “closure” is differentiated in the purchase agreement as being either “Material Closure” or “Final Closure”. The former is “the investigation, assessment and remediation of an Environmental Condition sufficient to not cause any material interference with Purchaser’s [Deer Park’s] ability to develop, construct, finance or lease the Property”. Final closure, on the other hand is defined as “the investigation, assessment and remediation of an environmental condition, together with the monitoring required by and the actual receipt of a final, unconditional ‘no further action’ letter, certificate of completion, or equivalent document evidencing regulatory closure from the

² Exh. “A” to Motion.

Governmental Authority having jurisdiction of such Environmental Condition. It is specifically agreed and understood that the remediation of the Property which is required of seller [EDO] in order to achieve Closure shall be to put the property in a condition which would permit the development thereof for office, industrial and retail use only, and taking into account any Use Restriction”.

The parties entered into the Purchase Agreement on or about July 31, 2003. As part of the agreement, Deer Park agreed to lease the premises back to EDO for two years, while retaining the right to terminate the lease after 18 months. On or about October 10, 2003 Deer Park, as landlord and owner, entered into a lease agreement with EDO, as tenant for the premises.³ Pursuant to the lease, EDO was obligated to pay base rent for the first 18 months in an annual amount of \$2,600,000. Beginning with the 19th month of the lease, EDO was to pay base rent in amount of \$2,200,000 per year, the “fixed rent”, and also pay “additional rent”, including real estate taxes, insurance costs, assessments, water costs, sewer costs and levies. These were substantial charges. For example, the real estate tax for the property was in excess of \$2 million per year. The expiration date quoted in the lease agreement was for the date immediately preceding two years from the commencement date.

Article 34 of the lease authorized Deer Park to terminate the lease on 6-months notice after the expiration of the first year of the term.⁴ Deer Park executed its option by serving a Termination Notice to EDO dated November 1, 2004, advising EDO that the lease was terminated as of May 1, 2005. EDO vacated and surrendered the premises on May 1, 2005.

At the same time of the lease, October 10, 2003, Deer Park executed a Mortgage

³ Exh. B to Motion.

⁴ *Id.* at page 35.

Note secured by the property, in the amount of \$7,000,000.⁵ The mortgage matured on the later of October 5, 2005 or the date of Material Closure and Tenant's Closing Obligations as defined in the lease.

Plaintiff contends that at the time EDO vacated the premises they had not achieved Material Closure, and in fact had not begun to perform certain of their below-grade cleanup obligations, which were, they allege, to be completed before the termination of the lease. EDO eventually completed the subsurface remediation, but never paid basic rent or additional rent after May 1, 2005. Plaintiff contends that defendant achieved Material Closure in June, 2006, 14 months after surrender of the premises. In September, 2006 the DEC issued a letter of closure, which constituted Final Closure under the terms of the agreements. Plaintiff claims entitlement to rent from May 1, 2005 through June 2006, the claimed date of Material Closure.

On or about October 3, 2006, Deer Park transmitted to EDO the sum of \$7,000,000, which was intended to fully satisfy the October 2005 Mortgage. By letter dated October 5, 2006, EDO advised Deer Park that it treated \$1,740,278 as accrued interest between October 10, 2005, the earlier of the conditional maturity dates, and October 3, 2003, the date of payment. The only interest provided for in the Mortgage Note was default interest, payable at the maximum rate permissible by law. Plaintiff alleges that the rate charged exceeded 25%, and that interest was not chargeable at all until June 2006, when defendant achieved Material Closure. Because of economic exigencies, involving certain "swap transactions" with adjoining property owners, plaintiff was compelled to pay an additional \$1,740,278 in order to obtain a mortgage satisfaction.

By letter dated December 12, 2006, EDO further demanded from plaintiff payment of additional interest in the amount of \$91,849.01 as well as a claim for "Costs and

⁵ Exh. C to Motion.

Expenses" in the amount of \$233,314.68. For the same economic reasons, plaintiff paid the further sum of \$325,163.69, for a combined total of \$2,065,440.69, under protest, claiming that no interest was due until June 2006 and that the additional costs and expenses were not provided for in the mortgage note.

Plaintiffs claims are for unpaid rent and additional rent, and the refund of interest and costs demanded of them in order to satisfy the purchase money mortgage.

Defendant's Memorandum of Law in Support of Motion for Summary Judgment

EDO claims that it achieved "Material Closure" by September 1, 2005, 9 months sooner than alleged by plaintiff. They assert that as of September 1, 2005 EDO had completed all of the investigation, assessment and remediation of Environmental Conditions at the site. Their failure to complete the process as to two areas, known as LP-12 and the Degreaser Pit as of that date, was because Deer Park had not yet fulfilled its asbestos removal and demolition obligations, and they were thereby precluded from completing this aspect of the work. Despite their failure to do so, they contend that their failure did not cause any material interference with landlord's [Deer Park's] ability to develop, construct, finance or lease the premises.

DISCUSSION

Defendant' Motion Sequence No. 003

Defendant seeks a determination that they completed material closure as defined in the agreements not later than September 1, 2005 and that they are not required to pay rent and additional rent beyond that date. The issue is whether or not the failure on their part to demolish the building at LP-12 and remove the degreaser caused material interference with the ability of Deer Park to develop, construct, finance or lease the premises; and, if it did constitute a material interference, it was caused by the actions of the Plaintiff in failing to abate asbestos and obtain a demolition permit so as to enable Defendant to complete their environmental obligations. The eventual solution was achieved when Deer Park obtained a permit for partial demolition to enable EDO to complete the

environmental work at LP-12 and the Degreaser Pit.

Material closure and final closure are not the same. The latter occurred in September, 2006 when the DEC issued a letter of closure, that no further remediation or supervision was required. In fact, the September closure letter was generated by the completion of the work in June. At some point prior to that date, material closure occurred.

It is significant to note the scope of the work and size of the project which remained after September 1, 2005, and before the project received final closure by letter dated September 28, 2006. The final closure letter was in response to an Areas of Concern Final Closure Report from Arcadis, EDO's environmental consultant, dated June 23, 2006.

According to the Affidavit of Daniel G. Sullivan, P.G., a geologist retained by defendant, the grease pit area was 16' x 16', with a depth of 13'. It was determined that although the contents were removed, there remained a ground cover of chromium immediately surrounding the pit.⁶ The area of contamination was in the vicinity of the north wall of the main building, and excavation of the contaminated soil could not be done without undermining the building.

The second area of contamination involved an old heating oil spill which affected a 50' x 100' area in the area of leaching pool # 12. EDO submitted plans to treat the spill area, which extended beneath the boiler room, from the exterior. NYSDEC, however, rejected EDO's alternative plans because neither of them adequately addressed the area under the building. When the building was demolished in June 2006, EDO completed the excavation of 5,240 tons of petroleum-impacted soil and removal 15,854 gallons of oily water. It is incomprehensible that the existence of these two minimal areas lying within an 81-acre parcel had a significant impact on the ability of the plaintiff to develop,

⁶ Affidavit of Daniel G. Sullivan, attached to Affirmation of Patrick Fife, Esq.

market, finance or lease at the premises.

Defendant accomplished everything it could physically accomplish by September 1, 2005. The delay in completing treatment at the greasepit or the site of the old oil spill was beyond their control, and, their continued existence were insufficient to impede plaintiff's efforts at developing and marketing the property, including potential financing. For example, the Town of Babylon issued its Zoning Board of Appeals approval by letter dated May 5, 2006,⁷ a demolition permit was applied for, but was denied by letter dated May 31, 2005.⁸ There is no evidence that leasing was in any way hampered by the existence of the two open environmental issues. During the deposition of Lisa Morrison, Vice-president of Tangers for Leasing, she indicated that the Tangers model was to achieve 50% pre-leasing even before acquiring the property,⁹ and that there were no unique leasing problems involving this project, other than the unusually large Gross Leaseable Area compared to prior projects.¹⁰ Similarly, Frank Vero, Sr., an owner of Aurora Contractors, Inc., the general manager of the construction project, indicated that the only delay in commencing construction was because of the failure to demolish the existing buildings. Once this occurred there were no delays incurred in the project of construction. He was not familiar as to the interplay of environmental conditions and demolition.¹¹

⁷ Exh. 65 to Affirmation of Patrick Fife, Esq.

⁸ Exh. 70 to Affirmation of Patrick Fyfe, Esq. The Town originally denied approval for demolition before final cleanup of the contamination, but demolition ultimately completed before final cleanup at the greasepit and under the boiler room.

⁹ Exh. QQ to Affirmation of David Blumenthal, Esq. in Opposition to Defendant's Motion at p. 77.

¹⁰ *Id.* at p. 118.

¹¹ Exh. WW to Reply Affirmation of Aaron Zekyier, Esq. in Support of Plaintiff's Motion.

Plaintiff argues that EDO did not act in a commercially reasonable fashion to remediate the environmental conditions, but this position is inconsistent with the facts on the ground. With the exception of two areas, which DEC prohibited EDO from remediating without first demolishing buildings, the work was completed within 5 months of their vacating the premises. Of all the persons who have addressed this issue, only Daniel G. Sullivan has hands-on experience in the remediation of contaminated properties. His affidavit unqualifiedly concludes that the necessary tenant work was accomplished in a commercially reasonable manner, and in full compliance with their obligations under the agreements. It is also obvious that final closure would have occurred essentially contemporaneously with the demolition of buildings, which was the responsibility of Deer Park.

Plaintiff contends that the failure of EDO to conclude the greasepit and fuel oil spill remediation before June 2006 precluded them from proceeding with the development of the project.¹² It is true that the Town of Babylon would not issue a demolition permit until the contamination under the building was fully remediated; but the DEC would not approve the plan to remediate in the absence of demolition. Ultimately, partial demolition preceded remediation, and the issues were resolved in June. This was not caused by EDO's failure to act in a commercially reasonable fashion, nor did it materially impair the ability of Deer Park to negotiate for tenants or financing.

Defendant's motion is granted to the extent that the Court determines that they achieved material closure as of September 1, 2005. Defendant is obligated to plaintiff for basic rent and additional rent for the period commencing May 1, 2005 and terminating August 31, 2005.

Plaintiff's Motion Sequence No. 004

Plaintiff moves for an Order granting summary judgment on the First and Second

¹² Plaintiff's Memorandum of Law in Support of Motion at p. 17.

Causes of Action and dismissing Defendant's counterclaims.

First Cause of Action

The First Cause of Action of the Amended Verified Complaint¹³ alleges breach of lease in the failure of EDO to pay fixed and additional rent for the period May 1, 2005 — June 30, 2006. Plaintiff claims entitlement to a minimum of 14 months of fixed rent at a rate of \$2,200,000 per annum and a minimum of 14 months of additional rent, plus late charges and interest, in an amount to be determined at trial, but believed to be in excess of \$2,818,000.

Plaintiff's motion as to the First Cause of Action is granted in part and denied in part. In accordance with the Court's analysis of Motion Sequence No. 3, Plaintiff is entitled to payment of fixed rent at the rate of \$183,333.33 per month for the period May 1, 2005 — August 31, 2005, totaling \$733,333.32. Plaintiff is also entitled to payment of additional rent for the period of May 1, 2005 — August 31, 2005, including \$161,603.93 per month in real estate taxes, totaling \$646,415.72, for a combined total of \$1,379,749.04.

Second Cause of Action

The Second Cause of Action alleges breach of Mortgage and Note in the form of claimed extortionate demands of additional interest, fees and expenses.¹⁴ Plaintiff claims that there was no interest provided for in the purchase money mortgage, with the exception of default interest at the rate of 25%. The principal amount of the mortgage was not due until the later of EDO's achievement of material closure or October 5, 2005. Deer Park tendered \$7,000,000 on or about October 3, 2006. This is essentially consistent with their contention that material disclosure did not occur until June, 2006.

The Mortgage Note specifically deals with the issue of interest at ¶¶ 2 and 6, and

¹³ Exh. 1 to Affirmation of Patrick Fyfe, Esq. at ¶ 56 et seq.

¹⁴ *Id.* at ¶ 66 et seq.

with costs and expenses, including reasonable attorneys' fees and disbursements of the Payee's counsel in ¶ 4.¹⁵ The loan was to bear no interest, except for Default Interest, which occurs only if the debt is declared immediately due and payable by Payee pursuant to the provisions of the note, or if the debt is not paid in full on the maturity date.¹⁶ The Default Rate is the maximum interest rate permissible by law.

The Note was intended to be without interest. There is no record of the payee, EDO, having triggered a default by service of a notice declaring the debt immediately due and payable, although they theoretically could have done so on October 9, 2005, the later date after their claim of material closure on September 1, 2005. Although there was not final closure until June 2006, the Court has concluded that material closure occurred on September 1, 2005. The maturity date of the mortgage was therefore October 9, 2005.

Every contract contains an implied covenant of good faith and fair dealing. EDO, upon receiving payment in full of \$7,000,000, retrospectively concluded that since they achieved material closure on September 1, 2005, they were entitled to interest from October 9, 2005. The Mortgage Note explicitly provides in ¶ 2 that "(t)he Principal Balance shall not bear interest, except for Default Interest (as hereinafter defined), if applicable". ¶ 6 provides as follows:

In addition to any late payment charge which may be due under this Note, if the Debt is declared immediately due and payable by the Payee pursuant to the provisions of this Note or the Mortgage, or if the Debt is not paid in full on the Maturity Date, the Maker shall thereafter pay interest ('**Default Interest**') on the Principal Balance from the date of such declaration or the Maturity Date, as the case may be, until the date the Principal Balance is paid in full at a rate per annum (calculated for the actual number of days based upon a thirty (30) day month elapsed over a year of 360-days) equal to the

¹⁵ *Id.* at Exh. C, ¶¶ 2, 6, and 4.

¹⁶ Later of Material Closure or October 9, 2005.

maximum interest rate which the Maker may by law pay (the **'Default Rate'**).

Only EDO concluded that they had achieved material closure on September 1, 2005, and the first time they enunciated this position was after receipt of payment, when they unilaterally deducted \$1,740,278 as interest from October 10, 2005, the later of September 1, 2005, the claimed date of material closure, and October 9, 2005, as provided in the Note. It is clearly stated that interest was payable only upon default. EDO never declared the mortgage in default, and there is no evidence that they ever claimed payment on the basis of material closure in September 2005.

¶ 7 provides that "(t)he Maker hereby waives presentment and demand for payment, notice of dishonor, protest and notice of protest of this Note. If any payment under this Note is not made when due, the Maker agrees to pay all costs of collection when incurred, including reasonable attorneys' fees (which costs shall be added to the amount due under this Note and shall be receivable therewith)". Such a waiver is certainly applicable when the date upon which payment is due is certain, and each party is chargeable with knowledge of it. Here, however, the Note became due on the later of two dates, one known and the other unknown. Under these circumstances it is manifestly unfair to permit the payment of default interest, at the maximum rate permissible, no less, to be based upon a retrospective interpretation of the date upon which material closure occurred.

Equally unfair is the imposition of the costs of collection, including reasonable attorneys' fees. Deer Park voluntarily paid \$7,000,000 in October 2006, almost immediately after the receipt of the closure letter from DEC. No legal action was required to obtain payment. Deer Park also grudgingly paid some \$1,832,119.01 in interest and \$233,314.58 for Costs and Expenses upon demand. Again, no legal intervention was required to obtain these payments, even though there was no justification for them.

EDO is not entitled to retain payments received for interest or for "costs and expenses". There was never a default in payment as contemplated by the parties and both

interest and payments of costs and expenses are dependent upon there being a default. Plaintiff's motion for summary judgment on the second cause of action is granted, and defendant is directed to refund to plaintiff interest payments in the amount of \$1,832,119.01 and "costs and expenses" in the amount of \$233,314.58, together with interest from the date of payment by plaintiff.

Defendant's Counterclaims

Defendant alleges 3 counterclaims in its Verified Answer to the Amended Verified Complaint:¹⁷

First Counterclaim - Defendant EDO claims that because they are not obligated to pay rent or additional rent as alleged in the Complaint, plaintiff is obligated to pay EDO's reasonable legal fees in the defense of the action, in an amount believed to be not less than \$250,000. While defendant is not liable for 14 months rent and additional rent as alleged in the complaint, they are responsible for the payment of rent and additional rent for May 1, 2005 — August 31, 2005, which they had failed to pay.

To that extent EDO is not the successful party and is not entitled to payment of legal fees incurred in the defense of the claim for unpaid rent. Plaintiff's motion to dismiss the First Counterclaim is granted.

Second Counterclaim - Defendants contend that they paid all real estate taxes on the premises through the surrender date of May 1, 2005. The assessment for the tax period December 1, 2004 through May 31, 2005 was subsequently reduced, producing a refund of real estate taxes in the reported amount of \$493,174.29. Plaintiff opposes the request for a refund and seeks dismissal of the counterclaim on the ground that Defendant is in default under the terms of the lease, and is therefore ineligible to receive a refund.

Defendant unquestionably paid the taxes for the period beginning December 1 and ending April 30, 2005, 83% of the amount refunded. They are entitled to a refund of

¹⁷ Exh. 2 to Affirmation of Patrick Fife, Esq. at pp. 15 et seq.

\$409,334.36 with interest from the date of receipt by Plaintiff.

By this Order, Defendant is directed to pay rent, and additional rent, including real estate taxes, for the period May 1, 2005 — August 31, 2005. Defendant is entitled to a credit for the period of May 1 — May 31, 2005 in the amount of \$82,195.72, and for the months of June — August if a reduction in the assessment for those months has been awarded.

Defendant's default for the four-month period commencing May 1, 2005 does not require them to forfeit the return of excess taxes which they have paid prior to May 1, 2005. Their entitlement to a credit or reimbursement of excess taxes subsequent to May 1, 2005 is contingent upon their compliance with their obligation to pay rent and additional rent through August 31, 2005. Plaintiff's motion to dismiss the Second Counterclaim is denied.

Third Counterclaim - Defendant claims that plaintiff failed to cooperate with EDO's efforts to remediate the contamination below structures on the property, and they thereby incurred additional expenses, primarily as a result of the failure of Deer Park to demolish buildings. The motion to strike this counterclaim is granted. A reading of the rather voluminous documents submitted on this motion makes it clear that both parties made a concerted effort to accomplish their respective obligations in an expeditious fashion. Unfortunately, they were caught in an administrative conflict in which the Town would not issue a demolition permit without the earlier removal of contaminants below the structures; on the other hand, NYSDEC would not approve a remediation plan for the extraction of contaminated soil and water without demolition of the structure. The delay was, in effect, unavoidable, and was not caused by the inaction of either.

The motion to dismiss the third counterclaim is granted.

Plaintiff's Cross-Motion Sequence No. 005

Plaintiff seeks an Order imposing sanctions upon defendant for spoliation of evidence, to include an adverse inference instruction against them. Annexed to this

motion is the affidavit of David Blumenthal, the VP of BDG Asset Management, Inc., the General Manager of BDG Deer Park Associates, LLC, the managing member of Deer Park Enterprise, LLC. It is an extensive elaboration of the claims that EDO's conduct materially affected the ability of Deer Park to finance, lease and construct the development, and in support of the contention that material closure did not occur until the end of June 2006, when EDO completed its remedial work. The Court has already determined that material, as opposed to final, closure, occurred as of September 1, 2005.

The Affirmation of Aaron E. Zerkier, Esq., annexed to the motion, identifies a series of e-mails at Exh. UU which were received by plaintiff from Arcadis, a non-party, but not received from defendant EDO. It refers to the memorandum of law submitted in opposition to defendant's motion for summary judgment and in support of plaintiff's cross-motion for spoliation sanctions. Commencing at p. 21 of that document, plaintiff makes its argument that "EDO's Destruction of Evidence Requires an Adverse Inference Against It".

The thrust of the argument is that EDO failed to properly secure computers and e-mail, failed to properly and timely search for emails which they were later unable to produce, and never issued a litigation hold notice to its employees. Discovery obligations in connection with this litigation were assigned to a single individual, Angel Venegas. At p. 24 the memorandum identifies five issues with respect to lost backup tapes for EDO's EDOcorp.com server for the New York City office which closed, and first discovered missing in November 2008, and inability to perform additional searches for email from Angel Venegas, William Frost and Jim Smith.

The destruction of evidence which is described in the memo is that of Mr. Sredniawski's disposal of copies of documents in his desk, which he knew to be only duplicates and otherwise available. There is really no substantial claim that material which EDO was unable to produce was never recovered, or that its initial absence in any way hampered the ability of Plaintiff to proceed in the litigation. To the contrary, the material


was ultimately received from Arcadis.

While counsel have obviously devoted hundreds of hours to this litigation, the matter ultimately boils down to an interpretation of the Purchase Agreement, the Lease, and the Promissory Note. The actions complained of were hardly evidence of willful noncompliance with an Order of the Court, or electronic discovery rules. Certainly, the fact that the sought-after was ultimately received, and it does not appear to constitute a form of "smoking gun", which would leave to the implication that such documents were intentionally destroyed or lost. In fact, the overhead photographs on which are identified the location of the two areas for which remediation did not occur until June, 2006 are seemingly beneficial to the position of the defendant that they are minimal in size and relatively close to one another, tending to dispel claims that their continued existence for approximately 10 months after September 1, 2005 materially hampered the ability of plaintiff to proceed with the project.

Plaintiff's cross-motion for the imposition of sanctions, including a negative inference, is denied.

This constitutes the Decision and Order of the Court.

Dated: April 14, 2010



J.S.C.

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