At an IAS Commercial Part 12 of the Supreme Court of the State of New York, held in and for the County of Kings, at the Courthouse, located at 360 Adams Street, Borough of Brooklyn, City and State of New York on the 28th day of September 2023.

P R E S E N T:
Honorable Reginald A. Boddie
Justice, Supreme Court

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MENACHEM FARRO, individually and derivatively as a shareholder in the right of LM INTERNATIONAL, INC., SELLER1ON1 INCORPORATED, WML COMMUNICATIONS, INC., and as a member in the right of LMEG WIRELESS, LLC,

Plaintiff,

-against-

ZALMAN SCHOCHET a/k/a SCHNEUR ZALMAN SCHOCHET, LEVI WILHELM, LM INTERNATIONAL, INC., SELLER1ON1 INCORPORATED, WML COMMUNICATIONS, INC., LMEG WIRELESS, LLC, SELLER WIRELESS LLC, LM WIRELESS INTERNATIONAL LLC, LMZT LLC and LMEG ACQUISITION LLC,

Defendants.

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Index No. 518007/2016

Cal. No. 9-11 MS 19-21

Decision and Order

The following e-filed papers read herein:	NYSCEF Doc Nos.
MS 19	526-560; 583-584
MS 20	561-574; 576-578 585-586
MS 21	579-582

Upon the foregoing papers and oral arguments held today, the motion by defendants-counterclaimants seeking partial summary judgment on their first and fourth counterclaims against plaintiff Menachem Farro ("Farro") (MS 19) and Farro's separate motions seeking (1) summary judgment dismissing defendants' counterclaims (MS 20); and (2) a stay of defendants' motion for

partial summary judgment on their counterclaims pending determination of the action entitled *Matter of the Application of LMEG Wireless, LLC*, Index No. 501508/2021, which is set for a bench trial on November 27, 2023 (hereinafter the "Valuation Proceeding") (MS 21) are decided as follows:

The following facts are not in dispute unless otherwise noted. The company, defendant LMEG Wireless, LLC ("LMEG") was formed by Farro and defendant Levi Wilhelm ("Wilhelm") in 2003. LMEG and its affiliated entities are primarily engaged in the business of selling and distributing aftermarket accessories for cellphones, refurbished phones and related products. Originally, LMEG's membership interests were owned equally by Farro and Wilhelm. Between 2003 and 2010, LMEG received loans from Farro's family members and friends to operate LMEG (such loans referred to as "Family & Friends Loans"). Based on Farro's deposition testimony, Farro caused LMEG to borrow more than $12 million from at least 13 private individual lenders, including: Abraham Lokshin, Farro's friend; Edna Cohen, Farro's grandmother, Neil Cohen, Farro's uncle, Haysha Deitsch, Farro's friend; and Izzik Ben-Abu, Farro's friend. Such loans were not formally documented. Rather, Farro tracked the Family & Friends Loans with a series of handwritten lists, which he created from memory and prior lists. The crux of defendants' counterclaims center on their contention that Farro "stole" far more funds from LMEG than he or his family and friends ever loaned to LMEG and that this was enabled by Farro's incomplete and haphazard record-keeping of the Family & Friends Loans.

In December 2011, defendant Zalman Schochet ("Schochet") became a one-third owner of LMEG. Previously, in 2008, Schochet had loaned LMEG $300,000, which was repaid. The following year, in 2009, Schochet loaned LMEG $4,000,000 pursuant to a Business Loan Agreement and other documents. These agreements were amended several times to permit LMEG to avoid default. In 2011, upon Farro and Wilhelm's request to Schochet for additional loan funds

to pay off some of the Friends & Family Loan debt or negotiate a more favorable interest rate, Schochet agreed to loan additional monies in exchange for a 33% equity interest in LMEG. Thus, in December 2011, Wilhelm, Schochet, and Farro signed an Amended Loan Agreement, acknowledging the new balance to Schochet of over $11 million, reducing the interest rate on Schochet's loans, and formalizing Schochet's status as a one-third member of LMEG.

In 2014, LMEG's members agreed to market LMEG for sale through an investment banking firm. In early 2015, the first of two private equity firms gave a letter of intent to buy LMEG. In late 2015, all three members signed a letter of intent with a second private equity firm with a "headline" valuation slightly over $100 million. However, in early 2016, Farro indicated his unwillingness to execute such deal. During the next eight months, the buyer, Wilhelm, and Schochet negotiated a "workaround deal" that would result in the cash-out of Farro's interest while requiring Schochet and Wilhelm to roll a portion of their ownership stake into the new equity capital structure put in place by the acquiring firm in lieu of receiving cash proceeds.

In October 2016, as the private equity deal was near closing, Farro filed the instant lawsuit asserting direct and derivative claims against Schochet and Wilhelm.[1] According to defendants, as a result of Farro's allegations that Schochet was not a member of LMEG and the deteriorating financial condition of LMEG, the private equity firm terminated negotiations with LMEG. In or about mid-November 2016, in an effort to salvage the private equity deal, and because Wilhelm and Schochet purportedly realized they would not be able to work with Farro going forward, Schochet and Wilhelm, as LMEG's majority members, signed written consents in lieu of meeting approving a merger of LMEG with and into LMEG Acquisition LLC. Under the "Agreement and Plan of Merger," Farro did not receive any membership interest in the surviving entity and instead

[1] By decision dated January 13, 2021, the Appellate Division Second Department dismissed all of Farro's claims in this action.

was offered the cash value of his interest and advised of his right to dissent and demand a judicial appraisal proceeding under LLC Law § 1005. The private equity deal, however, did not revive.

LMEG's Motion for Partial Summary Judgment

According to defendants, after the cash-out merger extinguishing Farro's interest, LMEG undertook an investigation of the payments to Farro during the years 2010 through 2016 using a forensic analyst. Defendants represent that between 2007 and 2016, LMEG's internal financial records reveal that LMEG paid Farro $4,975,206.90 in draws. In addition, during those years, defendants claim that Farro caused LMEG to pay him, in addition to his draws, another $4,644,426.23 in unexplained payments. Defendants represent that when Farro was questioned at his deposition about LMEG's payments to him over and beyond his draws, Farro repeatedly disclaimed reliance on LMEG's QuickBooks and refused to answer questions based upon QuickBooks reports showing the overpayment, demurring constantly to LMEG's bank records and that such bank records would reveal the "full story."

Defendants retained Yigal Rechtman of RSZ Forensic Associates ("Rechtman") as an expert witness to analyze LMEG's bank records. Rechtman's findings are set forth in his Report and Supplemental Report attached to his affidavit. Defendants represent that Rechtman's analysis distills the entire universe of LMEG's bank records from April 26, 2007 through December 11, 2017, which contain 41,495 transactions. According to defendants, no party contends that LMEG had any bank accounts or transactions not captured in Rechtman's analysis. Further, Rechtman determined that his dataset was complete because the cash balances on each of LMEG's monthly bank statements reconcile from one month to the next. Upon analyzing the data set forth in LMEG's bank statements and purportedly accounting for what could possibly be categorized as loans and repayment of loans, Rechtman calculated that, as of October 5, 2011, Farro had deposited into LMEG $142,500 more than LMEG repaid to Farro. However, thereafter, Rechtman avers that

LMEG's bank records show that, between October 5, 2011 and October 2013, Farro caused LMEG to pay him, in purported "repayment" of loans, $1,636,512.23 exclusive of monies paid to Farro for draws and interest on outstanding loans. During the same time, Rechtman found that Farro or his lenders only loaned LMEG $247,500.00. Thus, the overpayment in Rechtman's report is shown as follows:

Total paid by LMEG to Farro, Exclusive of Draw and Interest Payments	$1,636,512.23
Less: Surplus amount to Farro Prior to October 5, 2011	($142,500.00)
Less: Amount Farro paid to LMEG since October 5, 2011	($247,500.00)
Farro Overpayment	**$1,246,512.23**

Based on Rechtman's analysis of LMEG's bank records and transactions between LMEG and Farro, defendants contend that they have demonstrated prima facie that Farro breached his fiduciary duties to LMEG by causing the company to pay him $1,246,512.23 more than he actually loaned to the company. Defendants argue that given Farro's burden as a fiduciary, Farro's contention that Wilhelm consented to or ratified his misappropriation falls egregiously short of anything sufficient to defeat summary judgment.

As a direct and proximate result of Farro's breach of his fiduciary duty, defendants contend that LMEG suffered at least two forms of "definite and calculable" damages: (1) the misappropriated amount in the sum of $1,246,512.23; and (2) the amount LMEG spent in servicing high interest rate loans needed to fund the operating shortfall that Farro's misappropriation created. During the time of Farro's misappropriation, defendants assert that LMEG borrowed money between 15% and 48% per annum. Based on the foregoing, Rechtman calculated the cost-of-capital damages to LMEG by (1) assuming that LMEG could borrow funds at 24% per annum

from 2010-2012 because that was the lowest rate charged by Schochet; (2) assuming that LMEG could borrow at 15% per annum from 2018-2022 since Schochet's loans were renegotiated to 15%; and (3) using such rates, the cost-of-capital damages to LMEG purportedly amounts to $16,392,690 through the end of 2022 (NYSCEF Doc. No. 556, Rechtman Supplemental Report, ¶ 7).

In addition, defendants contend that, due to Farro's pervasive and severe disloyalty to LMEG, LMEG is also entitled to the amounts paid to Farro for compensation under the "faithless servant" doctrine. Specifically, that between 2007 and 2012, LMEG paid Farro $1,077,500, and between 2013 and 2016, LMEG paid Farro $3,897,706.90. Thus, that LMEG is entitled to summary judgment for the combined amount of $4,975,206.90.

Finally, it is defendants' position that, based on the foregoing, LMEG is entitled to summary judgment on its conversion counterclaim against Farro. For the foregoing reasons, defendants seek an order: (1) directing judgment on the first cause of action for (i) $1,246,512.23, representing the amount that Farro misappropriated; (ii) $16,392,690, representing the additional economic damages to LMEG as a result of Farro's misappropriation, and (iii) an order that Farro disgorge the $4,975,206.90 in distributions paid to him during the period of his disloyalty; and (2) directing judgment on the fourth cause of action for $1,246,512.23.

Plaintiff's Motion for Summary Judgment Dismissing Counterclaims

Farro moves for judgment dismissing defendants' counterclaims on the basis that the evidence fails to support their counterclaims. Specifically, Farro contends that the testimonies of both accountants used by LMEG, Shevy Halpern ("Halpern"), a CPA employed by LMEG, and Allan Greenwald, who has also performed accounting work for LMEG, demonstrate that Wilhelm was the Tax Matters Partner responsible for all statements on LMEG's tax returns as well as inventory counting and valuation and had full access to LMEG's books and records at all times.

Farro points out that Halpern testified, at her deposition, that she could not recall observing any widespread or systematic fraud committed by Farro during her employment with LMEG. Farro also contends that the evidence shows that defendants were fully aware of the loans extended from Farro's family and acquaintances and ratified them. Additionally, the fact that Wilhelm, Schochet, and the two accountants always had full and unfettered access to the books and records of LMEG, as conceded during their depositions, bars any claim sounding in fraud or negligent representation.

Plaintiff's Opposition to Defendants' Motion and Cross-Motion to Hold Such Motion In Abeyance

Plaintiff also moves, separately, for an order pursuant to CPLR 3213(e)(2) holding in abeyance defendant's motion for partial summary judgment pending disposition of the Valuation Proceeding which is scheduled for trial on November 27, 2023. According to Farro, LMEG was valued in excess of $100 million and he stands to receive a significant amount for his one-third interest which would offset any amounts sought herein by defendants. Farro further submits that he has no present means of income and would suffer extreme financial prejudice if any judgment is entered against him. Thus, Farro contends it would be prudent to stay entry of any award of partial summary judgment until after the November 2023 bench trial is completed.

As for Rechtman's report, Farro raises the following issues with his data analysis: (1) although Rechtman purported to opine on whether Farro was overpaid by LMEG, Rechtman did not consider the amounts paid to Wilhelm; (2) Rechtman did not analyze whether Farro repaid any loans to creditors, only as to whether Farro made payments to LMEG; (3) Rechtman never met with or even spoke with LMEG's accountant Greenwald prior to issuing his report and only had a "very limited" conversation with Halpern; (4) Rechtman did not analyze any loans made to LMEG that were listed on LMEG's tax returns; (5) Rechtman's report states that he relied on LMEG's QuickBooks records but he testified that Quickbooks was "unreliable;" and (6) Rechtman did not consider whether any payments made to Farro were for reimbursements of interest payments made

to lenders. It is Farro's position that there is no proof of any disparity between the amounts taken out by LMEG's members but, even if such disparity exists, Farro contends that such disparity is insignificant insofar as there was no written agreement between the parties regarding draws and defendants had full access to transactions and never complained or objected.

Regarding defendants' claim that LMEG suffered more than $16 million worth of damages based on the purported $1.2 million in "overpayments" to Farro, Farro contends that such damages are not only indirect, but that no rational connection between the alleged misconduct and the claimed damages exists. Farro points out that the record is replete with evidence that LMEG subsisted on loans for its entire existence. As such, that there is no nexus between the allegations of overpayments purportedly made versus the loans obtained by the company. In other words, Farro contends there is no basis to make the leap from $1.2 million to $16 million.

Regarding the faithless servant doctrine, Farro argues that such principle is inapplicable herein because case law is clear that the doctrine is reserved for limited scenarios involving employees who usurp corporate opportunities or who surreptitiously aid competitors and that such doctrine should be applied sparingly.

Defendants' Opposition to Plaintiff's Motion for Summary Judgment

In opposition to Farros' motion, defendants argue that Farro's undocumented and self-serving testimony that Wilhelm and Schochet were aware of his misconduct fails to entitle him to summary judgment or support his affirmative defense of ratification. Defendants further submit that Farro's assertions that he did not exclusively control LMEG's finances and Wilhelm was the Company's Tax Matters Partner are irrelevant since their contention is that Farro improperly inflated the amounts due on his Friends & Family Loans to cause LMEG to transfer to him—in purported repayment of those loans—more than he or his lenders ever transferred to LMEG.

To the extent that Farro relies on Wilhelm and Schochet's supposed knowledge about the loans, defendants submit that (1) such claim is contrary to Greenwald's testimony that "the only person who knew who the ins and outs were was Mendy" (Greenwald Tr. 276:23-277:2); and (2) even assuming Wilhelm and Schochet's approved every wire, the issue is Farro's deliberately haphazard recordkeeping that prevented defendants from seeing Farro's scheme of taking out more funds than he and his lenders ever put in. In any event, it is defendants' position that Farro, as the fiduciary of LMEG, had a non-delegable obligation to properly account for all transactions, especially self-interested transfers between LMEG and Farro and/or his friends and family. Moreover, defendants emphasize that Rechtman's analysis exposes more than $1.2 million in payments that Farro caused LMEG to make that were definitely not repayments of any loans that Farro made to LMEG. As Wilhelm avers that he did not authorize Farro to take from LMEG additional funds beyond the equal distributions to which each member was entitled (see NYSCEF Doc. No. 537, Wilhelm Aff., ¶ 12]), defendants argue Farro cannot demonstrate that either Schochet or Wilhelm ratified any payment to him "with full knowledge of the material facts."

Plaintiff's Reply

In reply, Farro contends that the record evidence undermines the foundational allegations upon which the counterclaims rest. Specifically, that Farro was never in sole control of LMEG's finances to the exclusion of defendants as Wilhelm had at least equal control over LMEG's wires and banking transactions. Farro further argues that he should not be held liable for the counterclaims simply because defendants say that he is.

Discussion

"The proponent of a motion for summary judgment must demonstrate that there are no material issues of fact in dispute, and that it is entitled to judgment as a matter of law" (*Alvarez v Prospect Hosp.*, 68 NY2d 320, 324 [1986]). The movant's burden is "a heavy one" and "on a

motion for summary judgment, facts must be viewed in the light most favorable to the non-moving party" (*William J. Jenack Estate Appraisers & Auctioneers, Inc. v Rabizadeh*, 22 NY3d 470, 475 [2013] [internal quotation marks and citation omitted]). "A motion for summary judgment should not be granted where the facts are in dispute, where conflicting inferences may be drawn from the evidence, or where there are issues of credibility" (*Ruiz v Griffin*, 71 AD3d 1112, 1115 [2d Dept 2010] [internal quotation marks and citation omitted]).

"In order to establish a breach of fiduciary duty, a plaintiff must prove the existence of a fiduciary relationship, misconduct by the defendant, and damages that were directly caused by the defendant's misconduct" (*J-K Apparel Sales Co., Inc. v Jacobs*, 189 AD3d 1011, 1013 [2d Dept 2020] [citations omitted]). To state a cause of action to recover damages for conversion, a plaintiff must allege 'legal ownership or an immediate right of possession to specifically identifiable funds and that the defendant exercised an unauthorized dominion over such funds to the exclusion of the plaintiff's rights'" (*DeMartino v Abrams, Fensterman, Fensterman, Eisman, Formato, Ferrara & Wolf, LLP*, 189 AD3d 774, 776 [2d Dept 2020] [citation omitted]).

Here, defendants, as counterclaimants, established through Rechtman's report, supplemental report and analysis, that Farro breached his fiduciary duty to LMEG by diverting corporate funds to himself in excess of any purported repayment of any loans made to LMEG by Farro or his family members or friends in the amount of $1,246,512.23 and that this was done without authorization. Defendants also established that the foregoing constitutes a conversion of LMEG's funds in the amount of $1,246,512.23. In opposition, Farro failed to raise a triable issue of fact rebutting Rechtman's analysis, specifically that Farro netted an additional $1,246,512.23 that could not be accounted for as a draw or a loan/interest repayment. Farro fails to identify a single item that Rechtman failed to account for in his analysis that puts into question the discovered overpayment. Farro's conclusory statements that, because Wilhelm and Schochet had equivalent

access to the funds and books and never objected, fails to raise an issue that defendants ratified Farro's conduct (*see Lipman v Vebeliunas*, 39 AD3d 488, 490 [2d Dept 2007] ["The act of ratification, whether express or implied, must be performed with full knowledge of the material facts relating to the transaction, and the assent must be clearly established and may not be inferred from doubtful or equivocal acts or language"]. Farro's additional claim that LMEG's accountants failed to indicate any specific misconduct by Farro equally fails to raise an issue of fact.

However, notwithstanding the foregoing, defendants fail to establish entitlement to "cost-of-capital damages" insofar as they fail to demonstrate that the capital cost of replacing a member's misappropriation of corporate funds constitutes direct damages for their breach of fiduciary duty claim. In addition, even if defendants were entitled to recover special damages, defendants fail to establish that such amounts would equate to approximately $16 million. Given LMEG's history of continuous borrowing to operate, including repaying high-interest loans with other loans, defendants fail to demonstrate that the $1.2 million overpayment equates to an approximate $16 million loss to LMEG, which is premised on interest compounding monthly through the "terminal date" of December 31, 2022. As such, defendants' request for summary judgment with respect to such damages is denied.

As for whether Farro must return the distributions earned by him between 2007 and 2016, it is well established that "[t]he faithless servant doctrine holds that [o]ne who owes a duty of fidelity to a principal and who is faithless in the performance of his [or her] services is generally disentitled to recover his [or her] compensation, whether commissions or salary" (*Matter of Panos v Mid Hudson Med. Group, P.C.*, 204 AD3d 1016, 1018 [2d Dept 2022] [internal quotation marks and citation omitted]. However, courts have recognized the right of an agent who breaches his or her duty of loyalty to nonetheless receive compensation where "the agent's disloyalty with respect to other tasks neither tainted nor interfered with the completion of the tasks as to which the agent

was loyal" (*id.* at 1019 [internal quotation marks and citations omitted]; *see G.K. Alan Assoc., Inc. v Lazzari*, 44 AD3d 95, 104 [2d Dept 2007]; *see also Wittels v Sanford*, 137 AD3d 657, 658 [1st Dept 2016).

Here, although application of the faithless servant doctrine is not limited to an employer-employee context (*see Wittels v Sanford, supra*), defendants fail to establish as a matter of law that Farro's overpayment to himself is sufficient to find that Farro should disgorge 100% of his distributions during the time requested by defendants. As such, defendants' motion for summary judgment with respect to these damages is also denied.

Turning then to Farros' motion to stay determination of defendants' motion until after resolution of the Valuation Proceeding pursuant to CPLR 3212(e)(2), such motion is granted to the extent that entry of the partial judgment granted herein shall be held in abeyance pending the determination or resolution of the Valuation Proceeding for the reasons stated by Farro.

Based on the foregoing, defendants' motion (MS 19) for partial summary judgment on their first and fourth counterclaims is granted to the extent indicated above. Accordingly, LMEG shall have judgment against Farro in the amount of $1,246,512.23. Farro's motion (MS 20) for summary judgment dismissing defendants' counterclaims is denied in its entirety. Farro's separate motion (MS 21) pursuant to CPLR 3212(e) is granted to the extent indicated herein.

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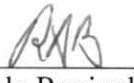

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