



UNITED STATES
CIVILIAN BOARD OF CONTRACT APPEALS

DENIED: November 23, 2010

CBCA 1115

ARUN ENTERPRISES, INC.,

Appellant,

v.

GENERAL SERVICES ADMINISTRATION,

Respondent.

Alvin R. Becker of Beerman Swerdlove LLP, Chicago, IL, counsel for Appellant.

Carl E. Smith, Office of Regional Counsel, General Services Administration, Chicago, IL, counsel for Respondent.

Before Board Judges **POLLACK**, **DRUMMOND**, and **STEEL**.

DRUMMOND, Board Judge.

This appeal is from a General Services Administration (GSA) contracting officer's (CO) final decision asserting a claim against appellant, Arun Enterprises, Inc. (Arun). GSA claims \$1,153,311.06 for unpaid rent and capital improvement deposits under a lease agreement in which GSA is the lessor and Arun is the lessee. Arun disputes GSA's right to the claimed costs.

A hearing was held in Chicago, Illinois, on November 4 and 5, 2009. The record includes the pleadings, the appeal file, the supplemental appeal file, the hearing transcripts, and the parties' post-hearing briefs.

For the reasons stated below, we conclude that GSA is entitled to \$1,153,311.06 and deny this appeal.

Background

On December 9, 2005, Mr. Pethinaidu Veluchamy, a successful businessman,¹ sold to GSA for \$14,000,000, an office building in Chicago, Illinois. The building featured approximately 198,400 gross rental square feet and is located within one block of the federal office building complex known as the Chicago Federal Center. Appeal File, Exhibit 3 at 1, 4, 5, 22; Transcript, vol. 1 at 9, 141, 208. While Mr. Veluchamy owned the building, it was managed by Arun,² one of his businesses.

On the same day that the building was sold, GSA and Arun entered into lease number GS-05B-33212, under which Arun would lease the building from GSA for a term of five years, to begin on December 9, 2005, and end on December 31, 2010. Appeal File, Exhibit 3 at 1, 45, 22; Joint Statement of Uncontested Facts (JSUF) ¶ 3.

Mr. Veluchamy testified that the bookkeeper assigned to Arun was responsible for maintaining Arun's books and preparing its financial statements, as well as performing similar duties for six other properties that Mr. Veluchamy owned. He testified further that Arun's property manager was responsible for the day-to-day operations at the GSA building in issue and was familiar with the tenant population of the building. Transcript, vol. 1 at 140-44, 151, 206-34. The bookkeeper and property manager did not testify at the hearing.

The recitals to the lease stated, *inter alia*, that before December 9, 2005, Arun was the tenant in possession; that GSA desired to lease the building to Arun until such time as the building was needed by GSA for construction purposes; and that it was in the public interest that existing leases remain in effect. Appeal File, Exhibit 3 at 4. The lease, however, included no recitals about the status of existing tenants or Arun's monetary return, if any, for managing the property.

¹ Mr. Veluchamy acknowledged during cross-examination that he owned numerous businesses, including a bank. He also acknowledged that a Fortune magazine article had reported him as the third wealthiest minority business person in the United States. Transcript, vol. 1 at 206-11.

² Mr. Veluchamy testified that Arun eventually became Anu, another corporation that he formed after the lease commenced. Transcript, vol. 1 at 206. The business relationship between Arun and Anu is not clear in the record.

The lease included several exhibits, including a list of tenants for the office building. Appeal File, Exhibit 3 at 27. The list identifies forty-two tenants, which included Arun and Arun's accountant. *Id.*; Transcript, vol. 1 at 46, 77. The record is not clear when the list was prepared or by whom. The record is also not clear regarding the actual number of tenants occupying the building as of December 9, 2005 or the number occupying the building during the course of the lease. The contracting officer (CO) testified that he never verified the accuracy of any of Arun's tenant lists. Transcript, vol. 2 at 16.

Under the lease, Arun was responsible for managing the property and had the exclusive right to sublease the property to current and future tenants and to retain the rental proceeds, less expenses. Appeal File, Exhibit 3 at 4; JSUF ¶ 7. The annual rent to be paid to GSA was \$600,000 (\$50,000 per month) in advance for the first year. Appeal File, Exhibit 3 at 5. For each succeeding year, the annual rent was \$550,000 (rounded to \$45,833 per month). *Id.*

The lease required Arun to pay an additional \$650,400 per year (\$54,200 per month) to GSA for capital improvements. *Id.* Arun was to deposit those funds into an escrow account. The lease provided that the escrow amount could be adjusted, at GSA's discretion. Appeal File, Exhibit 3 at 6, 7. Any balance remaining in the escrow account at the termination of this lease was to be retained by GSA. *Id.*

The lease called for Arun to submit to GSA financial statements for the building on a monthly basis and to submit financial statements audited by a reputable certified public accounting firm at least yearly. Appeal File, Exhibit 3 at 5. The lease included a Failure to Pay Rent or Abandonment clause which states, "Lessor reserves the right to terminate the . . . Lease in its entirety if the Lessee fails to make rental payments or is late and without due excuse in making rental payments for two consecutive months." *Id.* at 10. The lease also included a Default clause which states, *inter alia*:

Lessor may by written notice of default to the Lessee, terminate this Master Lease if the Lessee materially fails to perform any of the provisions of this Lease and does not make all reasonable efforts to cure such failure within a period of 45 days (or such longer period as the Contracting Officer may authorize in writing) after receipt of written notice from the Contracting Officer specifying such failure.

Id. at 18.

At the time they executed the lease and in anticipation that some of the existing tenants might leave after GSA acquired title to the property, Arun and GSA made a

handwritten amendment to the Rent clause. Appeal File, Exhibit 3 at 5. The amendment states, “Lessor and Lessee agree that periodic reevaluation of rent structure may be required due to the changes in revenue and expenses.” *Id.*

During negotiations for the sale and lease, Arun reported to GSA that its 2003 and 2004 net income for this property was \$972,921 and \$1,045,850, respectively, and it projected \$1,403,211 as 2005 net income. Appeal File, Exhibit 1. Arun also reported that its 2003 and 2004 operating expenses were \$1,000,224 and \$1,125,166, respectively, and projected \$1,021,629 as its 2005 operating expenses. Arun anticipated that it would receive a return of between 8% and 15% of the gross annual income through managing the property for GSA. JSUF ¶ 5. During the negotiations, Arun placed significant value on its 2003 and 2004 operating income and expenses reported to GSA. Appeal File, Exhibit 1. The record includes no evidence, such as business records and audited accounting statements, which corroborate the figures reported by Arun for 2003 and 2004.

After the lease commenced, Arun alleged that it experienced problems paying rent and making deposits for capital improvements. On March 22, 2006, Mr. James A. Regas, counsel for Arun, wrote a letter to the CO seeking to reduce Arun’s payments under the lease. The letter stated that due to “the defection of several major tenants, there is not enough income” to make these payments. Appeal File, Exhibit 5.

Mr. Regas’ March 22, 2006, letter proposed reducing Arun’s monthly rent to \$35,000 based on Arun’s 2005 cash flow statement which reported Arun’s 2005 final net income as \$1,834,646³ and projected a 2006 positive net cash flow of \$87,307. Appeal File, Exhibit 5 at 2, 4, 5. Mr. Regas testified on cross-examination that he had no personal knowledge concerning the figures on the cash flow statement or the alleged tenant defections. Transcript, vol. 1 at 96-98, 100-02, 128, 132-34. The record includes no persuasive evidence, such as balance sheets, to support the figures on the 2005 cash flow statement or the proposed rental amount as being reliable. We do not find Mr. Regas’ testimony to be credible.

The CO did not accept Arun’s excuses for failing to pay rent and make capital improvement deposits, and by letter dated July 13, 2006, he wrote to Arun stating that GSA would consider Arun’s request to modify rent only after the company submitted financial statements audited by a certified public accounting firm, as required by the lease. The CO repeated his request to Arun for audited financial statements in several subsequent letters and

³ This figure represents an increase of \$431,435 over the estimate Arun reported to GSA in November 2005.

one e-mail message. Appeal File, Exhibits 8, 10, 11; Supplemental Appeal File, Exhibit 40. The CO testified that prior to the lease termination, he met with Arun's accountant, Mr. Brad Dooley. Additionally, the CO testified that Mr. Dooley said he did not intend to provide an opinion concerning Arun's financial statements, citing a conflict of interest as the reason for his refusal. Transcript, vol. 2 at 43. Mr. Dooley did not testify at the hearing.

The CO testified that based on an operating statement furnished by Arun during lease negotiations, he expected Arun to net \$435,000 yearly from managing the building. Transcript, vol. 2 at 20-21. He stated that the unaudited financial statements provided by Arun during lease performance caused him concern due to the numerous errors and questionable expenses, such as for property tax and telephone services for a university account. *Id.* at 28, 30. He also testified that Arun's financial records were so disorganized that an auditor from GSA's Office of Inspector General (OIG) was unable to audit Arun's books. *Id.* at 44-50. Mr. Ray Gooch, an audit manager with over twenty-one years working in the OIG, also testified that Arun's financial records were extremely disorganized and unreliable and, as such, his office could not audit Arun's financial records. *Id.* at 83, 92-93. Mr. Veluchamy did not provide an explanation for the errors and questionable expenses included on Arun's unaudited financial statements. We do not find Arun's unaudited financial statements to be reliable.

Mr. Veluchamy acknowledged during cross-examination that he included Arun's operating expenses on his own federal income tax returns for 2003 and 2004. However, the expenses reported by Mr. Veluchamy on his tax returns do not reconcile with the same expenses reported by Arun to GSA before entering into the lease. Mr. Veluchamy reported on his own returns as Arun's 2003 and 2004 operating expenses \$2,019,181 and \$2,482,612, respectively—not the \$1,000,224 and \$1,125,166 reported to GSA at the time of the lease. Transcript, vol. 1 at 223-25. Mr. Veluchamy was unable to provide a reasonable explanation for the discrepancies, which he attributed to his accountant. *Id.* at 222. He also explained that he did not inform GSA of the expenses reported on his personal income tax returns because “[t]hey didn't ask . . . [for this information during negotiations].” *Id.* We do not find Mr. Veluchamy's testimony as to Arun's operating expenses to be credible.

Arun failed to pay rent for the six-month period of November 2006 through April 2007 and failed to pay the deposits for capital improvements for the seventeen-month period of December 2005 through April 2007. By letter dated April 24, 2007, the CO advised Arun that if the rent and deposits were not received within a specified time, “the Government will terminate this Lease and seek remedies” in accordance with the lease terms. Appeal File, Exhibit 12. By letter dated May 16, 2007, Mr. Regas replied to the CO's April 24 letter, stating that Arun had now paid rent for November and December of 2006. Mr. Regas also

stated that Arun could pay rent for January, February, and March 2007, but not for additional months. *Id.*, Exhibit 15 at 1, 2.

By letter dated June 13, 2007, the CO terminated the lease for default effective June 30, 2007, stating, *inter alia*, that rent for November 2006 through March 2007 was paid and credited to Arun's account, leaving delinquent rent for April, May, and June 2007. The letter stated further that Arun had failed to make any of the deposits for capital improvements for nineteen months. The letter concluded by stating that Arun owed GSA for the delinquent rent and capital improvement deposits. Appeal File, Exhibit 16.

On October 26, 2007, the CO wrote to Arun stating specifically that Arun owed the Government \$137,499 for unpaid rent for April, May, and June 2007 (\$45,833 times three). The CO also stated that Arun owed the Government \$1,015,812.06 for capital improvements. Appeal File, Exhibit 19. Arun was allowed time to remit payment or show cause why it should not be held liable for these amounts, after which period the CO would issue a final decision. Arun does not dispute GSA's calculations.

Arun responded to GSA's demand for damages for the unpaid rent and capital improvement deposits on November 5, 2007. Arun asserted that its "failure to perform under the Agreement is excusable and arose out of causes beyond the control and without the fault or negligence of Lessee." Appeal File, Exhibit 20. At the hearing, Mr. Veluchamy testified that Arun never had adequate income to make the rental payments and deposits for capital improvements. Transcript, vol. 1 at 180. According to him, Arun's cash problems began on the first day of the lease. *Id.* Arun produced no credible witnesses who could verify Arun's financial problems and losses under this lease. Rather, the record reveals that Arun began the lease significantly under-funded. Mr. Regas testified that Arun began the lease with a zero cash balance. *Id.* at 113. He testified further that the income from the prior years was not carried forward in Arun's cash reserves for the lease with GSA. *Id.* Arun offered no evidence to explain what happened to the \$14,000,000 it received from the sale of the property in 2005, nor what happened to the profit it allegedly received in 2003, 2004, and 2005 as a result of its ownership of the building during those years.

On December 17, 2007, the CO issued a final decision which referenced Arun's November 5, 2007 letter and the CO's October 26, 2007 show cause notice. The CO noted that Arun had failed to demonstrate through audited, certified financial statements that its failure to pay rent and capital improvement deposits was excusable. The CO reiterated GSA's demand for \$1,153,311.06 for unpaid rent and capital improvement deposits. Appeal File, Exhibit 21. The letter concluded by advising Arun about its appeal rights. *Id.*

On appeal, Arun asserts that it provided the CO with financial statements which documented that Arun had a net loss of \$268,316 on this lease. Arun argues that GSA's claim for \$1,153,311.06 should be vacated because GSA failed to provide Arun with the "equitable adjustment (reduced rent) contemplated and required by the contract between them." Complaint ¶ 8.

Discussion

In arguing that the rent should have been reduced, Arun points to the lease amendment providing that "the periodic reevaluation of the rent structure may be required due to the changes in revenue and expenses." The contractor asserts the termination was wrongful as the above clause entitled it to adjustments which could have avoided the termination.

As a threshold matter, the clause relied upon by appellant does not provide it a right to an adjustment; rather, the language is discretionary. Moreover, even if appellant had a right to a reevaluation, any reevaluation must be supported by demonstrated changes in revenue and expenses. That has not been established in this case. The contractor says that its inability to pay the claimed rent and capital improvement deposits was caused by tenant vacancies. Arun has not proved, however, that such vacancies existed or resulted in a loss of revenues. The contractor's financial statements are inconsistent and not credible. The contractor did not present testimony from the people whom its president identified as most knowledgeable about the matters critical to its position – its bookkeeper, accountant, and property manager – so we have no evidence on which to test its assertions. Put simply, Arun has provided insufficient evidence to support its position that GSA should have renegotiated the rental rates and that GSA is not entitled to the claimed amount. There is no basis for denying GSA's claim.

Decision

We conclude that the Government is entitled to \$1,153,311.06. This appeal is **DENIED.**

JEROME M. DRUMMOND
Board Judge

We concur:

HOWARD A. POLLACK
Board Judge

CANDIDA S. STEEL
Board Judge