

UNITED STATES BANKRUPTCY COURT  
DISTRICT OF MASSACHUSETTS  
WESTERN DIVISION

**REDACTED**

_____	)	
In re:	)	Chapter 11
	)	Case No. 04-45386-JBR
GITTO/GLOBAL CORPORATION,	)	
	)	
Debtor	)	
_____	)	

**CORRECTED REPORT OF  
CHARLES L. GLERUM AND CHOATE, HALL & STEWART,  
CHAPTER 11 EXAMINER**

**February 23, 2005**

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## **I. SUMMARY DISCUSSION**

On October 14, 2004 this Court entered an order appointing an examiner in the Debtor's case pursuant to 11 U.S.C. 1104(c)(1) and ordered that the Examiner "immediately begin an investigation into the existence of any prepetition fraud, dishonesty, incompetence, misconduct, mismanagement or irregularity in the management and business affairs of the Debtor." This Court further ordered that the Examiner file a statement reporting the preliminary or final findings of the Examiner, along with any recommendations of the Examiner for further investigation.

The Court subsequently appointed Charles L. Glerum and Choate, Hall & Stewart as the Examiner. This Report is filed in accordance with the Court's orders and the Examiner's responsibilities under the Bankruptcy Code.

The activities of three individuals, Charles Gitto, Gary Gitto and Frank Miller, (collectively, the "Gitto Principals") who controlled the Debtor prior to its bankruptcy filing were the primary focus of this Report. Based on the information available to the Examiner, it appears beyond dispute that each of these individuals abused their positions of authority at the Debtor over a number of years in an effort to enrich themselves at the expense of the corporation and its creditors. Their specific roles in the misconduct described in this Report substantially differed and the Examiner lacks the information necessary to allocate precisely among the three Gitto Principals blame for the corporation's ultimate demise. The Examiner can only conclude, however, that each of the Gitto Principals knew of the widespread dishonesty and misconduct regularly employed by the corporation to deceive the corporation's lenders and other creditors. It also appears indisputable that each of the Gitto Principals personally profited from their misconduct.

The outright fraud and misconduct of the Gitto Principals and those directed by them appears to have overlapped with gross mismanagement of the legitimate operations that Gitto Global did conduct. The confluence of mismanagement and the misappropriation of corporate funds by the Gitto Principals rendered the company deeply insolvent and ultimately unable to continue as a going concern. The Examiner believes that the Gitto Principals defalcations and mismanagement should leave them liable to the Debtor's estate for the damages they caused.

The Gitto Principals' misconduct and fraudulent activities involved or implicated a number of other persons and business entities. Some of these persons and entities appear to have had actual knowledge of the Principals' misconduct and made substantial contributions to effecting the Principals' schemes; the knowledge and contributions of others cannot not yet been determined. This Report devotes substantial attention to a number of parties who appear to have played a significant role in the operations and failure of Gitto Global. An appropriate estate representative may well conclude that some of these parties represent sources of recovery for the Debtor's estate.

The Examiner attempts to explain in various parts of this Report that its investigation was hampered by various circumstances. The level of misconduct described in this Report certainly may give rise to criminal as well as civil liability and many of the persons who likely possessed valuable information – most notably, the Gitto Principals themselves – invoked their rights under the Fifth Amendment to the United States Constitution and refused to meet with, be examined by or produce documents to the Examiner. A number of other parties did meet with the Examiner and/or produced documents to the Examiner, the volume of which simply could not be reviewed thoroughly during the time prior to the filing of this Report. Consequently, while this Report is as complete as the Examiner could prepare under the circumstances, the Examiner has

recommended in a number of instances that further investigation be completed before definitive decisions are made as to the issues discussed in this Report.

## **II. INTRODUCTION**

### **A. Commencement of Bankruptcy Case and Appointment of Examiner**

On September 17, 2004, the Board of Directors of Gitto Global Corp. (the “Debtor” or “Gitto Global”) appointed Thomas Doherty (“Doherty” or the “CRO”) of Argus Management (“Argus”) to serve as the Chief Restructuring Officer of Gitto Global. *See Affidavit of Thomas Doherty, CRO of the Debtor* dated September 27, 2004 (the “Doherty Affidavit”) at ¶1. The following day, the directors and officers of Gitto Global resigned. *See Doherty Affidavit* at ¶3. Gitto Global filed a petition for relief under Chapter 11 of Title 11 of the United States Code on September 24, 2004 (the “Petition Date”).

On October 7, 2004, the United States Trustee (the “U.S. Trustee”) filed the *Motion of United States Trustee to Appoint Chapter 11 Trustee* (the “Trustee Motion”). As grounds for the Trustee Motion, the U.S. Trustee cited certain factual allegations set forth in the Doherty Affidavit. In particular, the U.S. Trustee cited Mr. Doherty’s allegations that Gitto Global had likely engaged in questionable business practices and accounting irregularities and likely had overstated its annual sales by a significant amount. The U.S. Trustee argued that the appointment of a Chapter 11 Trustee would be in the best interests of creditors, as the Chapter 11 Trustee could investigate the allegations of fraud and determine whether there may be a possible source of recovery for Gitto Global’s creditors.

The Court held a hearing on the Trustee Motion on October 14, 2004, at which several parties, including the Debtor and the Official Committee of Unsecured Creditors (the “Committee”), voiced their objection to the appointment of a Chapter 11 Trustee. Following the hearing on the Trustee Motion, the Court determined not to appoint a Chapter 11 Trustee, but

instead entered an order (the “Appointment Order”) directing the U.S. Trustee to appoint a Chapter 11 Examiner.

The U.S. Trustee consulted with counsel to various parties in this case, including counsel to the Debtor, the Committee, LaSalle Business Credit, LLC (“LaSalle”) and ORIX Financial Services, Inc. (“Orix”). Following such consultation, the U.S. Trustee appointed Charles L. Glerum (“Glerum”) and the law firm of Choate, Hall & Stewart (CH&S, and together with Glerum, the “Examiner”) to serve as the Chapter 11 Examiner of the Debtor. On October 19, 2004, the Court entered the Order Allowing Application for and Certifying Application of Chapter 11 Examiner (the “Examiner Order”). Pursuant to the Examiner Order, the Examiner was directed, by reference to the Appointment order, to investigate “the existence of any prepetition fraud, dishonesty, incompetence, misconduct, mismanagement, or irregularity in the management and business affairs of” Gitto Global. The Examiner was further ordered to file this Report with the Court.<sup>1</sup>

#### **B. Retention of Verdolino & Lowey as the Examiner’s Forensic Accountants**

Subsequent to its appointment, the Examiner determined that it would require the assistance of accounting professionals to assist in investigating Gitto Global. In particular, the Examiner determined that there was an immediate need for assistance in securing and completing an inventory of Gitto Global’s records so that evidence related to Gitto Global’s prepetition operations would be maintained and for to performance of forensic accounting services.

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<sup>1</sup> The Examiner Order initially directed the Examiner to file this Report within 45 days after entry of the Examiner Order, *i.e.* December 3, 2004. The deadline for the Examiner to file a report has since been extended to January 7, 2005.



The Examiner, and in particular, James A. Ring (“Ring”), the Director of Business Information Services at CH&S, interviewed four professionals and reviewed several other resumes to identify the professionals best suited to assist the Examiner. The Examiner also consulted with the CRO, counsel to the Debtor, counsel to the Committee, and counsel to LaSalle. Based on the interviews conducted by Ring and these consultations, the Examiner selected the firm of Verdolino & Lowey, P.C. (“V&L”) as best qualified to review Gitto Global’s financial and computer records and review and secure Gitto Global’s documents at the lowest cost to the Estate.

On October 29, 2004, the Examiner filed the *Examiner’s Application for Authority to Retain Verdolino & Lowey, P.C. as Forensic Accountants* (the “Accountants Motion”). The Court approved the Accountants Motion on November 12, 2004, and authorized the Examiner to retain V&L, *nunc pro tunc* to November 4, 2004, *inter alia*, to create a detailed inventory of the Gitto Global’s records, including all computer files, to secure and analyze information stored on Gitto Global’s computers related to Gitto Global’s accounting practices and to perform forensic accounting services to determine the methods used by Gitto Global to mislead its creditors.

### **III. PARTIES**

The focus of this Report are the three principals of Gitto Global, Charles Gitto, Gary Gitto and Frank Miller (collectively, the “Gitto Principals”). Numerous other persons and business entities are referenced or discussed in the following pages, particularly in the “Examiner’s Findings” section that begins on page 21:

#### **A. Corporate Entities**

1. **Gitto Global.** Gitto Global Corporation, a Massachusetts corporation, was formed in 1992 and maintained its principal place of business in Lunenburg, Massachusetts. Gitto Global was a plastics manufacturer and injection molder that sold products to the telecommunications, footwear, automotive, electrical, aerospace, construction, and petrochemical

industries. Gitto Global's compounds were used in products including wire and cable, footwear, sheeting, industrial systems, utilities, back-up power systems, portable chargers, consumer products, construction and fluid-transfer systems.

Gitto Global appears to have come into existence as a result of the merger of companies owned and/or controlled by Frank Miller, Gary Gitto and Charles Gitto. Global Products Corporation ("Global Products"), which was controlled by Frank Miller, was incorporated in 1985. On September 21, 1992, Global Products changed its name to Gitto Global Corporation. Based on the public records and the records of Gitto Global available to the Examiner, it is not clear how Gary Gitto and Charles Gitto came to have an interest in and/or be employed by Gitto Global. As of July 25, 2002, Gitto Global reported to LaSalle that Frank Miller was the President and Clerk of Gitto Global; Gary Gitto was the Treasurer of Gitto Global; Michael Angelini was the Assistant Secretary of Gitto Global; and each of Frank Miller and Gary Gitto was a director of Gitto Global. As of July 25, 2002, Frank Miller owned 50% of the outstanding shares of Gitto Global, Gary Gitto owned 40% of the outstanding shares of Gitto Global and Nancy Gitto-Panagiotes owned 10% of the outstanding shares of Gitto Global.<sup>2</sup>

2. **Tradex Corp.** Gitto Global's offices and manufacturing plant are located at 140 Leominster-Shirley Road in Lunenburg, Massachusetts (the "Gitto Plant"). Tradex Corp., a Massachusetts corporation which is controlled, and appears to be wholly-owned by Charles Gitto, leased the Gitto Plant to Gitto Global as of the Petition Date.

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<sup>2</sup> The percentage ownership of Gitto Global's stock by Gary Gitto and Nancy Gitto-Panagiotes is the subject of some confusion. Both Gary Gitto and Nancy Gitto-Panagiotes have stated that they own 40% and 10%, respectively, of the outstanding capital stock of Gitto Global, while Frank Miller owns the remaining 50%. For example, in paragraph 14 of the Affidavit of Nancy Gitto-Panagiotes (the "Gitto-Panagiotes Affidavit"), a copy of which is submitted herewith as Exhibit 1, Ms. Gitto-Panagiotes states that she owns "110 shares of [Gitto Global] (approximately 10%)." Further, in paragraph 3 of the Opposition of Gary Gitto to Motion of Worcester Telegram & Gazette Corporation to Intervene, a copy of which is attached hereto as Exhibit 2, Gary Gitto states that he is "owner of 40% of the stock of [Gitto Global]." There is also evidence, however, that Gary Gitto, Ms. Gitto-Panagiotes and Frank Miller own 45%, 5% and 50%, respectively, of the capital stock of Gitto Global. Gitto Global's "Security Ledger," produced to the Examiner by Ms. Gitto-Panagiotes and attached hereto as Exhibit 3, states that Gary Gitto owns 990 shares of Gitto Global's capital stock, Ms. Gitto-Panagiotes owns 110 shares of Gitto Global's capital stock, and Frank Miller owns 1100 shares of Gitto Global's capital stock. In addition, documents produced by Ms. Gitto-Panagiotes include Gitto Global stock certificates issued to Gary Gitto and Ms. Gitto-Panagiotes, copies of which are attached hereto as Exhibit 4, which indicate that Gary Gitto owns 990 shares of Gitto Global's capital stock and Ms. Gitto-Panagiotes owns 110 shares of Gitto Global's capital stock. Finally, it is worth noting that pursuant to a Voting Trust Agreement by and between Gary Gitto and Ms. Gitto-Panagiotes, dated November, 1994, a copy of which is attached as Exhibit B to the Gitto-Panagiotes Affidavit, Ms. Gitto-Panagiotes assigned her shares to Gary Gitto as Trustee. The Examiner, for the purposes of this Report, adopts the 40%/10%/50% allocation since that is what the shareholders appear to believe.

## **B. Gitto Principals**

1. **Charles N. Gitto, Jr.** Charles Gitto is the father of Gary Gitto and Nancy Gitto-Panagiotes. Although he is not listed in the corporation's public filings as a statutory officer or director, Charles Gitto drew a significant salary from Gitto Global, apparently had an active role in the day-to-day management of Gitto Global's production activities, had corporate funds expended for his personal use or benefit, and held himself out as an executive of the company, often as its "Chairman." A substantial number of records were removed from the Gitto Plant just before the arrival of the CRO and reportedly taken to Charles Gitto's residence and stored in his basement and garage under his personal direction.
2. **Gary C. Gitto.** Gary Gitto is a 40% owner and was an officer and director of Gitto Global active in its management from 1993 until shortly before the Petition Date. Gary Gitto is also an officer of at least four other corporations which either received substantial cash payments from Gitto Global or were fictitious customers or vendors of Gitto Global. The evidence compiled to date suggests that Gary Gitto was a primary economic beneficiary of schemes perpetrated by the Gitto Principals and had substantial corporate funds directed to him personally or for his personal benefit. See the Appendix and Section V. below.
3. **Frank Miller.** Mr. Miller is a 50% owner and was an officer and director of Gitto Global. It appears that Mr. Miller was primarily responsible for managing the company's financial affairs and formulated and directed the manipulation of the company's accounting systems to inflate artificially its borrowing capacity as described in Section V. below. It also appears that, as with Charles and Gary Gitto, substantial corporate funds were directed to Mr. Miller personally or for his personal benefit.

## **C. Current and Former Employees of Gitto Global**

1. **Rita Bartlett.** Ms. Bartlett is the accounts payable manager at Gitto Global and has held that position for approximately seven years. Ms. Bartlett reported to the company's controller, William Deakin. Ms. Bartlett also maintained the Debtor's accounts payable records, including the files of those payables that were not entered into the accounting system for Gitto Global on the Wang computer and which were later described as being kept in the "secret garden."
2. **Janice Chaisson.** Ms. Chaisson is employed at Gitto Global in its accounts receivable area. It appears, as discussed in Section V.G. below, that Ms. Chaisson maintained a spreadsheet that tallied fictitious sales to various entities. While initially cooperative with LaSalle, Ms. Chaisson has since retained counsel and invoked her Fifth Amendment rights.

3. **Dean Childs.** Mr. Childs has been employed at Gitto Global and appears to have managed the company's shipping department. His alleged involvement in the falsification of shipping records is discussed in Section V.F.2. below. The Examiner also has been advised that materials were removed from Mr. Childs' office immediately prior to the Petition Date and delivered to the home of Charles Gitto, as discussed in Section V.J. Mr. Childs invoked his Fifth Amendment rights and refused to be examined by or produce documents to the Examiner.
4. **William F. Deakin.** Mr. Deakin was hired in February of 1994 by Gitto Global to input collection, bookkeeping and journal entries. He was promoted to Controller in June 1994 and held that position until September 17, 2004. The Examiner conducted two interviews of Mr. Deakin, who provided detailed information concerning various matters described in this Report.
5. **Roger DeLisle.** Mr. DeLisle was hired by Gitto Global Corporation in October of 1996 as an engineer and became Vice President of Engineering in 2002. Mr. DeLisle is familiar with the expenditure of corporate funds to pay for household maintenance, improvements and other services rendered at the various residences owned by Gitto Principals, as well as the removal of corporate records from the offices at Gitto Global just prior to the arrival of the CRO.
6. **Nancy Gitto-Panagiotes.** Ms. Gitto-Panagiotes is the daughter of Charles Gitto and a sister of Gary Gitto. She is a 10% owner of Gitto Global and arguably could be described as a Principal, but she appears to have been materially less involved in the company's affairs than Charles Gitto, Gary Gitto and Mr. Miller. Ms. Gitto-Panagiotes performed the "marketing" function at Gitto Global until December, 2003, and stated to the Examiner that she worked one day a week in the office and four days a week at home. The Examiner conducted a Rule 2004 Examination of Ms. Gitto-Panagiotes on November 15, 2004.
7. **James J. Grimley.** Mr. Grimley is the Vice President of Sales and Marketing at Gitto Global and was first hired as a national sales manager approximately 11 years ago. Mr. Grimley advised the Examiner about questionable payments Gitto Global appears to have paid to certain of its customers, as discussed in Section V.K.2. below.
8. **Sharlene Powell-Kotoch (f/k/a Sharlene Enwright).** Ms. Powell-Kotoch served as an administrative assistant to Frank Miller and James Grimley and sat in the executive offices at Gitto Global near Helen Kozak. Ms. Powell-Kotoch has worked for Gitto Global since July of 1993 and has first-hand knowledge of various methods by which the Gitto Principals used corporate funds to pay personal expenses.

9. **Helen Kozak.** Ms. Kozak is a long time employee of Gitto Global and Charles Gitto and served as Executive Secretary to both Charles Gitto and Gary Gitto. Ms. Kozak reportedly played a role in facilitating the diversion of corporate funds to the Gitto Principals, as discussed in Section V.C. below, and the removal and possible destruction of corporate records prior to the CRO's arrival, as discussed in Section V.J. below. Ms. Kozak invoked her Fifth Amendment rights and refused to be examined by or produce documents to the Examiner.
10. **Robyn Merchant.** Ms. Merchant has been employed in inventory control at Gitto Global since November of 1998 and is reported to have participated with Frank Miller and Maria Miller in various schemes to inflate artificially the value of Gitto Global's inventory, as discussed in Section V.E.2. below.
11. **David Minardi.** Mr. Minardi has been a Gitto Global employee for the last 12 years and presently serves as the Purchasing Manager for raw materials used in the manufacturing process. Mr. Minardi reportedly played a central role in the scheme directed by Frank Miller and Maria Miller to manipulate the value of Gitto Global's inventory, as discussed in Section V.E.2. below.
12. **Maria Miller.** Maria Miller is married to Frank Miller. She worked at Gitto Global from 1987 until immediately prior to the Petition Date. Ms. Miller's central role in the manipulation of inventory records is discussed in Section V.E. below.
13. **John Moritz.** Mr. Moritz is a former employee of and consultant to Gitto Global. His alleged involvement in manipulating the company's accounts receivable records is described in Section V.F.2. below.
14. **Christopher Slattery.** Mr. Slattery worked at Gitto Global from 1999 to 2000, initially in receiving, then in scheduling and finally doing odd jobs for Charles Gitto. He agreed to be interviewed by the Examiner and his statements regarding the manipulation of the company's inventory and accounts receivable records are referenced in Section V below. Mr. Slattery also provided information concerning an unusual audit conducted by Guaranty Business Credit, a former lender to Gitto Global, as discussed in Section V.D.1.
15. **Oren White.** Oren White was a maintenance employee at Gitto Global. As discussed in Section V.J. below, at the direction of Ms. Kozak, Mr. White removed various boxes of records from the offices of Gary Gitto, Charles Gitto, Mr. Deakin, Ms. Chaisson and Mr. Childs and delivered them to the residence of Charles Gitto immediately prior to the CRO's arrival at the Gitto Plant.

#### **D. Kingsdale / J&J Chemical**

1. **Kingsdale Corporation, d/b/a J&J Chemical (“Kingsdale” or “J&J Chemical”).** Kingsdale was incorporated in 2001, apparently at Frank Miller’s direction. As discussed in Sections V.G.1. and V.H. below, Kingsdale was the primary entity utilized to inflate Gitto Global’s reported sales and inventory purchases to manipulate its borrowing base. The Kingsdale account at Clinton Savings Bank was apparently used as a mechanism to divert corporate funds to a personal account of Mr. Miller.

#### **E. Lenders and Depository Institutions**

1. **Clinton Savings Bank.** Clinton Savings Bank (“Clinton”) is a Massachusetts savings bank based in Clinton, Massachusetts, near the Gitto Plant. Clinton’s relationships with Gitto Global, the Gitto Principals and Kingsdale Corporation d/b/a J&J Chemical are discussed in Section V.H. below.
2. **Guaranty Business Credit Corporation.** Guaranty Business Credit Corporation (“Guaranty”) is a lending institution that appears to be based in Dallas, Texas. Prior to July 25, 2002, Guaranty was Gitto Global’s working capital lender and primary secured creditor. It appears, as discussed in Section V.D.1. below, that Guaranty became aware that Gitto Global was manipulating its borrowing base reports to Guaranty. The company’s obligations to Guaranty were refinanced with proceeds from the credit facility provided by LaSalle.
3. **LaSalle Business Credit, LLC.** LaSalle Business Credit, LLC (“LaSalle”) is a lending institution based in Chicago, Illinois. As of the Petition Date, LaSalle was the Debtor’s primary secured creditor. The terms of the July 25, 2002 loan agreement between LaSalle and Gitto Global are summarized in Section V.D.2. below. On October 25, 2004, LaSalle filed with the United States District of the District of Massachusetts a Complaint against each of the Gitto Principals and a number of other persons. On December 31, 2004, LaSalle filed an Amended Complaint (the “LaSalle Complaint”), a copy of which is attached hereto as Exhibit 5, in which Louis Pellegrine and Maria Miller were named as additional defendants.

#### **F. Third-Party Professionals**

1. **Michael Angelini.** Michael Angelini is a partner and chairman of the law firm Bowditch & Dewey LLP, in Worcester, Massachusetts. Mr. Angelini and his firm performed extensive legal work for Gitto Global as well as the Gitto Principals and various corporations that apparently were directly or indirectly controlled the Gitto Principals. The Examiner conducted a

Rule 2004 Examination of Mr. Angelini on December 6, 2004 and December 7, 2004.

2. **Louis J. Pellegrine.** Mr. Pellegrine is a certified public accountant who performed accounting services for Gitto Global starting in 1998 and, according to Mr. Pellegrine, ending in December 2002. Over the course of his retention, Gitto Global apparently paid Pellegrine \$1,253,311 for his services.

**G. VitroTech**

1. **VitroTech Corporation (“VitroTech”).** VitroTech is a publicly traded Nevada corporation with a principal place of business at 5 Hutton Centre Drive, Santa Ana, California. VitroTech and its affiliates and principals had extensive dealings with Gitto Global and the Gitto Principals in 2003 and 2004, as discussed at length in Section V.I. below. VitroTech’s termination of its proposed acquisition of Gitto Global’s compounding business was a proximate cause of Gitto Global’s bankruptcy filing.

**IV. INVESTIGATION CONDUCTED**

**A. Examiner’s Initial Steps**

**1. Initial Meeting with the CRO**

Immediately upon the Examiner’s appointment, Mr. Glerum called counsel for the Committee and counsel for the Debtor to schedule meetings so that the Examiner could get an overview of the case and develop a list of issues which merited investigation. The Examiner met separately with counsel for the Debtor and counsel for the Committee on Friday, October 15, 2004. Counsel for the Committee provided the Examiner with a list of individuals whom they thought would be worth interviewing, outlined their prior attempts to contact the United States Attorney’s Office and identified a series of issues that they considered significant. The Examiner also discussed with Committee counsel possible candidates to serve as the Examiner’s forensic accountant.

The Examiner’s meeting with Debtor’s counsel was devoted primarily to a discussion of possible claims that the estate might have against third parties. The Examiner also discussed

with Debtor's counsel potential candidates for forensic accountant as well as the circumstances surrounding the hiring of the CRO.

On Monday, October 18, 2004, representatives of the Examiner, including Messrs. Glerum and Ring and Ms. Herrington, visited the Debtor's facility and met with Andrew Lizotte, counsel for the Debtor, the CRO, and Derek Flanagan of Argus Management ("Argus"). A number of issues were discussed, including: (1) the Debtor's computer system and Argus' efforts to image the computers, principally through the efforts of Richard Fairfull of Blueflame Computer Service of Grafton, Massachusetts; (2) visits to the plant by representatives of the FBI and United States Attorney's Office; (3) the Debtor's relationship with Clinton Savings Bank; (4) the CRO's first few days at the plant, including his first conversations with the Gitto Principals and LaSalle Bank representatives and his discovery of substantial amounts of unbooked accounts payable obligations; (5) the Debtor's relationships with VitroTech, Kingsdale Corporation and John Tersigni; (6) potential forensic accountants; (7) allegations that the Debtor had paid "kickbacks" to certain customers; (8) the Debtor's various banking relationships; and (9) the Debtor's organizational structure. The Examiner then toured the facility with Argus representatives, viewed the locations of many of the Debtor's records, and discussed with Argus the security of, and need to inventory, such records.

While visiting the Debtor's facility, the Examiner was informed that the FBI and the U.S. Attorney's Office wished to have a conversation with the Examiner. Upon returning to Boston, the Examiner participated in telephone conversations with representatives of both the FBI and the U.S. Attorney's Office.



## **2. Initial Efforts Regarding Gitto Global's Records**

The Examiner, with the assistance of V&L, initially attempted to determine the status and location of corporate records, the security of corporate computer data, and the efforts made by the CRO to preserve computer data and retrieve deleted material.

Upon taking over management of the Gitto Plant, the CRO secured all executive offices, including those of Charles Gitto, Gary Gitto, Ms. Gitto-Panagiotes, Frank Miller and Maria Miller, and restricted access to those offices. Ms. Kozak's office was also secured. The CRO advised the Examiner that he had performed a general inventory to establish what records were physically on the premises after the takeover. Flanagan retained control of the keys to the above-referenced offices and provided access to those rooms on an as-needed basis. The CRO also advised the Examiner that the Gitto Principals were believed to have removed boxes of corporate records and shredded corporate records just prior to the takeover of the facility by the CRO.<sup>3</sup>

From the Examiner's initial review of the Gitto Global premises, it was apparent that corporate records, including records reflecting apparently fraudulent activity on the part of Gitto Global, were strewn about the building in a haphazard fashion. For example, suspected fraudulent invoices to Hitachi Cable were found stacked on top of boxes in a common area room next to the office of Ms. Miller. Further, numerous invoices purporting to reflect sales by Gitto Global to J&J Chemical were found on a table next to a shredder in one of the company's accounting offices. Not only were documents potentially critical to the Examiner's investigation located in any number of locations within the Gitto Plant, apparently false records created to

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<sup>3</sup> The circumstances of the rumored destruction and apparent removal of corporate records by the Gitto Principals are discussed at length in Section V.J, *infra*.

mask the suspicious activities of Gitto Global were found mixed in with what appeared to be legitimate corporate records.

V&L, the CRO and the Examiner subsequently examined the records in more detail, both in paper document and electronic form, in order further to secure the records, to create a detailed records inventory, and to determine the security status of computer data. V&L then proceeded to conduct a detailed inventory of each office, including the executive offices, each file cabinet, and each folder therein, as well as offsite record storage areas, in order to ascertain and record which documents were at each location.

The Examiner and V&L met with Mr. Fairfull of Blueflame Computer Service, who initially was engaged by the CRO to copy the Debtor's computer records in an attempt to preserve all available data. As a result of that meeting, the Examiner and V&L came to the following conclusions and undertook the following actions:

1. Mr. Fairfull had copied the data on the Debtor's IBM 5500 NT computer server. The server was substantially full and the addition of new data to the server likely had caused overwriting of other data on the server prior to and subsequent to his work.
2. Mr. Fairfull had copied the hard drives of all the personal computers and laptop computers located at Gitto Global.
3. Neither V&L nor Mr. Fairfull are Wang-certified technicians, which precluded them from imaging or copying data from the Wang computer (which contained all of the financial electronic records of Gitto Global). Initial analysis also showed that the Wang server was outdated and in danger of "crashing," which could result in a loss of data. V&L, through Mr. Fairfull, made arrangements with Gitto Global's Wang consultant to copy the data on the Wang system in order to secure the financial data that was stored thereon.
4. The Norton Ghost 2003 software program utilized by Mr. Fairfull had copied the logical hard drives of the IBM server and the personal computers, but did not forensically image them. As a result, the copies produced by Mr. Fairfull could not contain files which previously had been overwritten or deleted due to the systems' technical limitations, which files can only be imaged when a computer is imaged using forensic software. V&L imaged the IBM server and selected PCs utilized by critical personnel at Gitto Global. In carrying out this

work, V&L used certified EnCase software and write-protection hardware, which allowed for the taking of images and subsequent forensic examination of recovered data. V&L also was able to locate files that had been partially overwritten when additional space on hard drives was needed.

V&L made arrangements to secure Gitto Global canceled checks and other bank-related documents found on the premises in order to review as many bank-related documents as possible, to examine the documents for relevancy to the Examiner's investigation, and to preserve the documents in evidentiary form. Based on parameters provided by the Examiner, and in concert with its own professional judgment, V&L subsequently searched the records for specific documents that related directly to suspected improper conduct by the Gitto Principals and others directed by them.

V&L conducted an analysis of the personal computers used by Rita Bartlett, Janice Chaisson, William Deakin, Gary Gitto, Nancy Gitto-Panagiotes, Lucy Hawkins, Helen Kozak, Jennifer Lannigan, Robyn Merchant, Sharlene Powell-Kotoch, Nick Semenza and the laptop used by Frank Miller to determine which records existed on these computers, which e-mail files were stored on them, and which files had been deleted that could be restored. V&L restored all deleted files or portions thereof that could be restored and proceeded to examine this vast universe of electronic data based upon specific parameters set by the Examiner, and in concert with its own professional judgment, to identify relevant information.

Based on its intensive review of hard and electronic documents, V&L created numerous PDF files of documents that evidenced or addressed suspected fraudulent activities and provided such files to the Examiner.

From the outset, the Examiner worked closely with V&L to ensure that evidence that was being developed from the ongoing interview process concerning the various aspects of suspected fraudulent activity was passed on to the staff at V&L who were reviewing vast amounts of

physical and electronic data recovered from the corporation. This collaboration ensured that those searching records, checks and electronic data were provided with the most current information with which to conduct the most thorough searches possible early in the inquiry. The information gleaned from the data collection was then distributed to the Examiner for use in the interview process.

Despite the substantial efforts described above, many of the records obtained by the Examiner from Gitto Global have not been thoroughly examined given the short period of time that has passed since the Examiner's appointment and the vast number of records available.

#### **B. Interview and 2004 Examination Process**

Immediately upon his appointment, the Examiner, with the assistance of the CRO, counsel to the Debtor and counsel to the Committee, identified parties who were believed to possess knowledge and information regarding Gitto Global's operations. In particular, the CRO and Flanagan identified to the Examiner certain Gitto Global employees who, as result of their positions at Gitto Global, were believed to have first-hand knowledge of Gitto Global's operations and possible misconduct by the Gitto Principals. Additionally, the CRO identified certain third-party individuals and entities whose alleged interactions with Gitto Global suggested that they likely had similar knowledge. Some of the employees and third parties voluntarily participated in interviews and meetings with the Examiner and provided valuable information with respect to the subject matter of the Examiner's investigation.

Given the allegations of fraud, and the potential scope of the alleged improper conduct, the Examiner soon realized that it would need court authority in order to compel various parties to provide information, including testimony and documents, to further its investigation.

Accordingly, at the Examiner's request, on October 27, 2004, the Committee filed the *Omnibus Motion of Official Committee of Unsecured Creditors for Order Compelling Examinations*

*Pursuant to Fed. R. Bankr. P. 2004* (the “First 2004 Motion”). Pursuant to the First 2004 Motion, the Committee sought an order compelling the attendance at a 2004 Examination of, and the production of documents by: (1) Frank Miller; (2) Gary C. Gitto; (3) Charles N. Gitto, Jr.; (4) Nancy Gitto-Panagiotis; (5) Kingsdale; (6) Clinton Savings; (7) Fleet; (8) Mr. Pellegrine; (9) Mr. Angelini; (10) Bowditch & Dewey; (11) Tradex; and (12) VitroTech. On November 1, 2004, the Court entered an order granting the First 2004 Motion. Shortly thereafter, the Committee served subpoenas requesting the production of documents and/or the attendance at a 2004 Examination upon the parties who were subject of the First 2004 Motion.

As the Examiner’s investigation progressed, the Examiner identified additional parties likely to possess relevant information about Gitto Global. On November 6, 2004, the Committee, at the Examiner’s request, filed the *Second Omnibus Motion of Official Committee of Unsecured Creditors for Order Compelling Examinations Pursuant to Fed. R. Bankr. P. 2004* (the “Second 2004 Motion”). Pursuant to the Second 2004 Motion, the Committee sought an order compelling the attendance at a 2004 Examination of, and the production of documents by, (1) Mr. Deakin; (2) Ms. Chaisson; (3) Ms. Kozak; (4) Maria Miller; (5) Ms. Powell-Kotoch; (6) Stonefield Josephson; (7) Mr. Kelly; (8) Ms. Carland; (9) Sovereign Bank; (10) Marvin Miller; (11) Mr. Sullivan; (12) Mr. Tersigni; (13) Guaranty; (14) LaSalle; and (15) America Online. On November 15, 2004, the Court entered an order granting the Second 2004 Motion. Shortly thereafter, the Committee served subpoenas requesting the production of documents and/or the attendance at a 2004 Examination upon certain of the parties who were subject of the Second 2004 Motion.

Many of the parties whom the Examiner sought to examine or from whom the Examiner requested documents refused to be examined or to produce documents pursuant to the Fifth Amendment of the United States Constitution.

In particular, each of Charles Gitto, Gary Gitto, Frank Miller, Maria Miller and Ms. Kozak asserted his or her Fifth Amendment rights and refused to cooperate in the Examiner's investigation. Additional parties failed to comply, in whole or in part, with the subpoenas issued on behalf of the Examiner. Accordingly, on November 17, 2004, the Committee, at the request of the Examiner, filed the *Motion of Official Committee for Order to Show Cause Why Certain Persons and Entities Should Not be Deemed in Civil Contempt of Court for Failure to Obey Subpoenas* (the "Motion to Compel"). Pursuant to the Motion to Compel, the Committee sought entry of an order directing the following parties to comply with the Examiner's subpoenas and deeming such parties to be in contempt of court for their failure to do so: (1) Clinton; (2) Charles Gitto; (3) Gary Gitto; (4) Ms. Gitto-Panagiotes;<sup>4</sup> (5) Kingsdale Corp.; (6) Frank Miller; and (7) Tradex Corp. Following a hearing on November 22, 2004, the Court entered an order directing Kingsdale and Tradex Corp. to comply with the Examiner's subpoenas.

As of the date hereof, the Examiner has interviewed 30 parties, several of whom were interviewed on more than one occasion, and examined under oath Ms. Gitto-Panagiotes and Mr. Angelini. While in some instances these interviews were negotiated through counsel for the witness, at no time did the Examiner grant any consideration, waive any potential claims, or make any promises in order to obtain an interview. The Examiner has obtained affidavits from eight of the parties he has interviewed.

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<sup>4</sup> The Examiner subsequently determined that Ms. Gitto-Panagiotes had complied with the subpoena served upon her and the Committee withdrew the Motion to Compel as it pertained to her.

Eleven parties, including Bowditch & Dewey, Ms. Carland, Clinton, Fleet, Ms. Gitto-Panagiotes, Guaranty, Kingsdale, Mr. Pellegrine, Sovereign, Stonefield Josephson and VitroTech, have produced documents to the Examiner in response to a subpoena served by the Committee on behalf of the Examiner. In addition, Frank Miller returned certain of Gitto Global's records which were in his possession to the Debtor's counsel, and the Debtor's counsel made such records available to the Examiner. The Examiner and/or V&L have reviewed and catalogued many of the documents produced to the Examiner.<sup>5</sup> Copies of all of the documents produced to the Examiner are in the Examiner's possession.

A table containing a summary of the Examiner's discovery and interview efforts is attached hereto as Schedule 1.

#### **C. Section 363 Sale of Debtor's Assets**

The CRO made clear from the beginning of the case that he would pursue immediately a sale of all or substantially all of the Debtor's assets on a going concern basis under Section 363 of the Bankruptcy Code. At a hearing with respect to various motions held on November 10, 2004, the Bankruptcy Court, while granting the Examiner until December 10, 2004 (subsequently extended to January 7, 2005) to file an interim report, advised Mr. Glerum that if the Examiner had any knowledge relevant to the sale hearing that was scheduled for December 8, 2004, he should be sure that the Court had such information in advance of the sale hearing. As a result of that instruction from the Court, the Examiner, upon coming across any information that appeared relevant to the integrity of the sales process, brought certain facts to the attention of

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<sup>5</sup> Certain parties, such as Fleet, have produced documents to the Examiner on a rolling basis. Because some documents were produced to the Examiner only recently, the Examiner has not had the opportunity to review all of the documents that have been produced. For example, Fleet recently produced to the Examiner three (3) boxes containing copies of checks written on the accounts of various entities involved in this case that the Examiner has not had the opportunity to review.

counsel for the Debtor, counsel for the Committee, counsel for LaSalle, and counsel for any other interested party and sought an explanation. The Examiner engaged in a number of phone calls and wrote letters to the parties on November 17, 2004 and November 22, 2004. Responses were received and the Examiner filed, on December 6, 2004, the Examiner's Report with Respect to the Sale Hearing.

Although the Examiner played no role in the sale except as described above, the results of the process are relevant to this Report. The sale hearing occurred fewer than 75 days after the Debtor filed its Chapter 11 petition. The initial or stalking horse offer of GGC Acquisition LLC for substantially all of the Debtor's assets (including leased assets not subject to LaSalle's first priority security interest) was for \$8,550,000. The only counteroffer received was from Steven Graham, in the minimum overbid amount of \$8,977,500. The sale of the Debtor's assets to Mr. Graham for \$8,977,500 ultimately was approved.

The price received for *substantially all* of the Debtor's assets following an open bid process is compelling evidence that a fraud was perpetrated on the creditors of Gitto Global. The maximum amount that Gitto Global was entitled to borrow from LaSalle, as discussed extensively below, was capped at a fraction of the value of a *subset* of Gitto Global's assets, specifically accounts receivable and inventory. Despite these limitations, the Debtor's secured obligations to LaSalle as of the Petition Date exceeded \$31,000,000; *i.e.*, more than three times the realized purchase price. In the Examiner's view, this level of borrowing, especially when considered with the other evidence described in this Report, could have been achieved only through the willful deception of LaSalle and Gitto Global's other creditors. Further, Gitto Global produced financial statements for the three fiscal years prior to its bankruptcy filing that reflect annual sales as high as \$160 million and owned assets with a value in excess of \$48 million. In



the Examiner's judgment, there is no plausible explanation for the discrepancy between these figures and the result of the sale process except intentional, material misconduct by the Gitto Principals and those directed by them.

#### **D. Review of Gitto Principals' Assets**

The Examiner has identified possible claims held by the Debtor's estate against the Gitto Principals and other parties, but an investigation designed to uncover assets available to satisfy any judgment was beyond the scope of the Examiner's appointment. However, other parties, principally LaSalle and the Creditors' Committee, were interested in such information. When the Examiner came across such information, it was supplied to both LaSalle and the Creditors' Committee.

### **V. EXAMINER'S FINDINGS**

#### **A. Introduction**

This Report represents the best and most thorough document that the Examiner was able to produce in the time frame provided. The Examiner has gathered, through interviews, formal testimony and the review of certain documents, an understanding of the means by which the Gitto Principals, and possibly others acting in concert with them, seemingly plundered Gitto Global's assets and defrauded its creditors. Nonetheless, the examination of pre-petition misconduct at Gitto Global is not concluded. More people need to be interviewed, more documents need to be produced and reviewed, and more research must be conducted on potential claims and causes of action. This Report, the Examiner believes, is best considered as a foundation for continued investigation and possible recovery actions against the Gitto Principals and other parties discussed herein.

The Examiner's investigation to date has been hampered in many respects. As discussed herein, at the apparent direction of the Gitto Principals, a substantial number of documents were

removed from Gitto Global just prior to the arrival of the CRO. Witnesses also advise that many records may have been shredded during the days immediately prior to the CRO's arrival.

Perhaps even more significantly, the central parties to this story, Frank Miller, Charles Gitto and Gary Gitto, all have invoked their Fifth Amendment privilege and have not been interviewed or examined by the Examiner. Similarly, they have invoked their Fifth Amendment rights with respect to document production and the Examiner has not had access to any of the personal or corporate documents in their possession which may be relevant to this Report. Other potentially valuable witnesses also have refused to meet with or be examined by the Examiner or produce documents. Finally, Gitto Global's principal outside counsel, Michael Angelini, was not allowed to answer the Examiner's questions fully and completely because he apparently also has acted as an attorney for Charles Gitto, Gary Gitto and Frank Miller in their individual capacities and for certain other companies controlled by them. Each of the Gitto Principals invoked the attorney-client privilege periodically during Mr. Angelini's Rule 2004 Examination, which prevented him from testifying as to certain issues.

As a result, in many instances, the Examiner reports herein statements, often hearsay, which the Examiner has been unable to confirm independently, and with respect to which nobody has told "the other side of the story" (generally because the subject of the statements refused to speak with us). Given the nature of this Report, and the fact that others are likely to continue the Examiner's investigation, it seemed appropriate to include such statements, not so they would be assumed to be fact, but so they could be further investigated and not forgotten. In other instances, the Examiner did solicit and receive responses from parties who were the subject of allegations made by others or reviewed documents that supported such statements. The Examiner has attempted to present its findings in the most balanced manner possible under the

circumstances. Inevitably, though, the selection of which statements are discussed or relied on herein required the exercise of judgment by the Examiner. Continued investigation may lead to evidence which supports or contradicts those statements.

As the text which follows indicates, this Report includes in some places what can fairly be described as raw data. One of the challenges in creating this Report has been assembling such data in a coherent, readable format. It was particularly difficult to organize the raw data since there was no central storyteller. Because the parties with the most direct involvement in the improper conduct described herein have refused to cooperate with the Examiner, the Examiner has had to interview numerous individuals at the periphery of the various schemes and then attempt to piece together the whole picture from documents and the statements of these individuals. Finally, even as the Report is being drafted in its final stages in the days before it is due, parties continue to provide information to the Examiner, both in oral and written form.

A final note to the reader: other than those of the Gitto Principals themselves, the names most often mentioned in this Report are those of the persons who cooperated with the Examiner, told the Examiner what they remembered, and, in so doing, put themselves at risk of civil or perhaps even criminal sanction. The frequency with which a particular person's name appears, therefore, should not necessarily lead one to conclude that such person directed or profited from the activities detailed below.

## **B. Overview of Fraudulent Schemes Utilized by Gitto Global**

The Examiner believes that the myriad fraudulent schemes and other suspicious activity described in this Report are best understood as multiple means to a single end: the Gitto Principals' determination to misappropriate corporate funds to support their personal expenses and lifestyles in a manner that would have been impossible given the actual size and financial condition of Gitto Global. The fraudulent schemes were complex and appear to have been

carried out for a period of years. The Gitto Principals created and utilized a dizzying array of legal entities that appear in many instances to have had no purpose other than furthering the Principals' improper conduct. Much of the data reviewed by the Examiner is contradictory or indecipherable without explanation by individuals who have refused to speak with the Examiner. It is a daunting task to grasp the precise contours of the pre-petition misconduct of the Gitto Principals and others who may have acted in concert with them. By keeping in mind the common thread of personal enrichment, however, the essence of the fraudulent schemes can be discerned.

Each of the Gitto Principals was paid a salary by Gitto Global exceeding \$200,000 per year.<sup>6</sup> The Examiner has concluded that this is likely only a portion of the total sums that were taken from Gitto Global and directed to the Gitto Principals or used for their personal benefit in the years before the Petition Date. The precise amounts that the Gitto Principals received have not been ascertained. In Section V.C. below, however, circumstantial but persuasive evidence is presented that substantial sums of money were diverted from Gitto Global to the Gitto Principals in addition to the salaries paid to them. It is highly likely that Gitto Global was insolvent when a substantial portion of these funds were taken by the Gitto Principals.

While Gitto Global did conduct legitimate business operations, they were far too small to support the level of "compensation" that the Gitto Principals apparently desired. It also appears that the Debtors' legitimate operations contracted substantially and became unprofitable in recent years. It was imperative, therefore, that Gitto Global obtain sufficient financing from outside

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<sup>6</sup> For example, in 2003, Charles Gitto was paid a salary of \$249,810; Gary Gitto was paid a salary of \$396,875; and Frank Miller was paid a salary of \$259,700. Attached hereto as Schedule 2 is a table setting forth the salaries paid to the Gitto Principals in recent years.

sources to fund both the personal expenses of the Gitto Principals and the company's operating losses. This required the construction of elaborate schemes to mask the diversion of funds for the Gitto Principal's personal benefit and the company's true financial condition.

Gitto Global's outside funding was primarily received from a series of asset-based lending institutions, as it was able to obtain credit facilities of increasing size from seven different lenders in a roughly eight-year period. The willingness of the Gitto Principals and employees directed by them to provide blatantly false information to these lenders – some or all of which are federally insured or are affiliates of federally insured lenders – is at the heart of the pre-petition misconduct which the Examiner was appointed to investigate. In Section V.D. below, the Examiner discusses Gitto Global's relationships with its two most recent lenders to put into context why it was necessary to employ the categories of fraudulent conduct subsequently described.

Put simply, the Gitto Principals needed to convince their lenders that the company held substantially more valuable working capital assets than it truly owned and maintained a far higher volume of sales than it actually achieved. Three inter-related deceptions were necessary to create a "borrowing base" that supported high levels of secured debt: (i) the overstatement of inventory values, as discussed in Section V.E.; (ii) the overstatement of accounts receivable, as discussed in Section V.F., and (iii) the exaggeration of sales and purchases, as discussed in Section V.G. and in the Appendix. To construct this artifice, the Gitto Principals and employees acting at their direction appear to have regularly created false invoices, checks, shipping records, account verifications and other documents and relentlessly cycled money between Gitto Global and separate entities, primarily shell companies controlled by the Gitto Principals, in schemes that deceived each of its various lenders for at least some period of time.

The fraudulent schemes began to unravel in late 2003 and 2004. In particular, a depositary account established at Clinton Savings Bank by Kingsdale/J&J Chemical, the entity utilized as a primary means of facilitating fictitious sales and inventory purchases and diverting money to at least one of the Gitto Principals, fell under intense scrutiny, as discussed in Section V.H. The Gitto Principals frantically sought to avoid losing control of the situation by negotiating a sale of the business to VitroTech, as discussed in Section V.I. The sale negotiations were terminated by VitroTech late in the Summer of 2004, however, and within weeks the Gitto Principals had resigned and Gitto Global was in bankruptcy. Several events that took place immediately before Gitto Global's Chapter 11 filing, particularly the removal or destruction of a substantial quantity of corporate records, are discussed in Section V.J. Finally, other suspicious pre-petition activities involving the Gitto Principals that warrant additional investigation are discussed in Section V.K.

### **C. Misappropriation of Gitto Global Assets by Gitto Principals**

The Examiner has made an effort to determine if the Gitto Principals misappropriated assets, particularly cash, of Gitto Global for their personal use or benefit and, if so, what methods they used to effect such misappropriation. The Examiner concludes, based on an examination of certain financial records, as well as various interviews, that the three Principals regularly used Gitto Global funds for their personal enrichment through a variety of methods. Those methods included the direct or indirect misappropriation of funds, direct payment by Gitto Global of personal expenses of the Gitto Principals, the payment of family member "ghost employees" who performed little or no corporate services, and the "re-payment" of corporate loans to officers with Gitto Global's own funds.

While not a model of complete clarity, three documents found on the hard drive of William Deakin's computer appear to present evidence of the misappropriation of funds from

Gitto Global by the Principals. The three documents are spreadsheets and are entitled “Gitto/Global Corporation F.Y. \_\_\_\_\_ Eliminations” (the “Elimination Reports”). There is one for each of 2000, 2001 and 2002, all of which are submitted herewith, collectively, as Exhibit 6. Each Elimination Report appears to be an effort to take Gitto Global’s audited financials statements for the respective year and eliminate therefrom falsely reported sales and falsely reported or unnecessary expenses in order to show the company’s actual or potential performance in each of those years. For instance, in the year 2000, the company’s audited financial statements report \$60,114,825.56 of Net Sales, when the true number appears to have been \$50,040,625.12; in 2001 the audited financial statements report \$91,232,509.88 of Net Sales when the true number appears to have been \$47,440,784.47; and in 2002 the audited financial statements report Net Sales of \$120,674, 380.30, when the true number appears to have been \$36,484,884.79.

The last page of each of the Elimination Reports outlines officer expenses for cars, insurance, telephones, air fare, and travel and entertainment expenses for each respective year. The total expenses for the three Gitto Principals, in each of the three years, as described in the reports, are as follows:

	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b><u>Total</u></b>
<b>Charles Gitto</b>	\$359,727.16	\$365,961.60	\$260,850.18	\$986,538.94
<b>Gary Gitto</b>	\$281,505.90	\$299,096.33	\$220,866.48	\$801,468.71
<b>Frank Miller</b>	\$154,612.10	\$128,972.73	\$148,975.11	\$432,559.94

While it is unlikely that all of these expenses were inappropriate, certainly some charges, for instance Charles Gitto’s airfare of between \$190,000 and \$250,000 annually, appear

unjustifiable. Further, given their amount, all of these expenses merit substantial additional inquiry.

Mr. Deakin's Elimination Reports reference various family members in addition to Gary and Charles Gitto and Frank Miller and the costs associated with them. In the 2000 Elimination Report, Mr. Deakin indicates that Barbara Gitto, Charles Gitto's ex-wife, was provided medical coverage at a cost of \$4,358.76, Ms. Gitto-Panagiotes was paid \$127,054.92, Lori Gitto, Gary Gitto's now ex-wife, was paid \$82,536.55 and Gail Miller, Frank Miller's ex-wife, was paid \$46,342.26. These same persons were paid the same compensation in 2001 and, with some variation, in 2002. With respect to Ms. Gitto-Panagiotes, in each instance, Deakin noted that she works "1 day / week."

The foregoing suggests to the Examiner that further investigation should be undertaken to determine whether or not these persons actually provided services for which they were paid or whether they were in effect simply "ghost employees." Certainly, if Ms. Gitto-Panagiotes truly only worked a day a week, she would not appear entitled to an annual payment of \$127,594.32. Ms. Gitto-Panagiotes herself testified that she worked four days a week at home in addition to one day per week in the office, a statement that the Examiner cannot verify.

Brendan Burke, described as "Gary's boat captain," appears in both the 2001 and 2002 Elimination Reports as receiving payments from Gitto Global of \$15,165.44 in 2001 and \$70,246.60 in 2002. It appears from the Elimination Reports that these payments to Mr. Burke were characterized as a "Selling Expense," not as an employee expense. Memoranda in Gitto Global's files suggest that Mr. Burke has been paid by the company since December of 1997. There is also a memorandum dated February 17, 2000 in which Gary Gitto instructs Mr. Deakin



to begin payments of \$600 per week to Louis A. Rionda. Mr. Rionda is reported to have been the first mate on Gary Gitto's boat.

Another document apparently relevant to this inquiry, which was found on Mr. Deakin's computer hard drive, is a spreadsheet entitled "SaleData." A copy of this document, the first page of which contains the heading "Gitto/Global Corporation EBITA," is attached hereto as Exhibit 7. The spreadsheet is undated, but the data contained therein is comparable (though not identical) to the FY 2001 Elimination Report. On the last page of the document is a list entitled "Other Overhead Expenses to Eliminate." The overhead expenses, referenced in the SaleData spreadsheet, include the following:

	<u>Annual Savings</u>
Building Maintenance "Frank, Gary and Charlie's houses"	\$93,330.28
Grounds Maintenance "Frank, Gary and Charlie's houses"	\$78,419.90
Accounting and Auditing Fees 180,000.00 Less reasonable Fee (50,000.00)	\$130,000.00
Consulting Charlie Gitto	\$83,200.00
Insurance Administration Fees "Charlie's life insurance"	\$57,989.60
Total	\$442,939.78

According to Mr. Deakin, the first two entries are the costs incurred by Gitto Global in connection with work done at the residences of Frank Miller, Gary Gitto and Charles Gitto, the third entry is the excess fees paid to Lou Pellegrine and the fourth and fifth are payments for the benefit of Charles Gitto beyond his salary.

Listed below were additional items labeled under "Other Expenses:"

	<u>Annual Savings</u>
Terracat Monthly Payment ("Gary")	\$307,200.00
Zebulon ("Frank")	\$148,149.12
Total	\$455,349.12

The Terracat payment was money sent to John Tersigni and the Zebulon payment to Zebulon. Mr. Deakin states that these payments were made at the direction of Gary Gitto and Frank Miller and the Examiner believes that some or all of these funds may have found their way back to Gary Gitto and Frank Miller as suggested by the "Gary" and "Frank" notations.

The Examiner believes this document is further evidence of the misappropriation of funds by the Gitto Principals.<sup>7</sup>

This does not appear to be the extent of the personal expenses of the Gitto Principals paid by Gitto Global. The Principals appear to have caused Gitto Global to pay their personal income taxes. An I.R.S. Form 4549, Income Tax Examination Changes, relating to Charles Gitto and his wife, Christa Gitto, was found in the Gitto Global files. This document reflects an audit performed by I.R.S. agent Judith Brideau dated October 9, 2003. Based on the adjustment resulting from that audit, apparently related to Tradex International Corporation, it appears that the Gittos owed an additional \$24,993 to the government. On October 14, 2003, Charles Gitto forwarded a copy of that report to Mr. Miller stating in a cover letter as follows:

I received the attached report from the I.R.S. concerning my personal tax returns and those of Tradex Incorporated. The issue is the weekly \$1,600 that was paid to Tradex International during 2000 and 2001. I don't know why the payments were set up this way. It was done by Lou Pellegrini and either yourself or someone else here at Gitto Global.

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<sup>7</sup> The third page of Exhibit 7, entitled "Income Tax Benefit" presents a possible area of recovery for the estate as it itemizes a total of \$1,166,229.00 of income tax overpayments in fiscal years 1999-2001 which resulted from false statements of profits. Similar overpayments may have been made in subsequent years.

I am going to set this up for payment by the company. The payment is due by November 8. Your personal income taxes were paid for by the company and so were Gary's. My taxes will also be paid by the company and if not, I will have to turn this matter over to Bob Crowe.<sup>8</sup>

The Examiner concludes from this that Gitto Global paid at least a portion of the income taxes of each of the Principals.

There is evidence that suggests Frank Miller misappropriated funds through checks and wire transfers from the checking account of Kingsdale Corporation at Clinton Savings Bank. The check kiting scheme relating to that account is discussed extensively in Section V.G.1., but it appears that on at least twelve occasions between September 16, 2002 and March 17, 2004, Frank Miller caused checks and wire transfers in the aggregate amount of \$710,000 to be sent to his account at Fleet Bank. Copies of such checks and Outgoing Wire Transfer reports are attached hereto as Exhibit 8.

It also appears that Gary Gitto and Frank Miller, and possibly others, misappropriated funds from Gitto Global through a scheme whereby they utilized funds from Gitto Global to repay their debts to the company. During his interview, Mr. Deakin stated that loans made by Gitto Global to the Gitto Principals were repaid with the company's own funds for years. Mr. Deakin advised that Gitto Global would make checks payable to an entity controlled by Gary Gitto, such as Direct Wood or Direct Chemical, which were used for various purposes as fictitious vendors of the company.<sup>9</sup> The receiving entity would then write checks to Gary Gitto or Frank Miller, who in turn would issue personal checks back to Gitto Global in the same or roughly the same amount, to make it appear that they were paying off the loans made to them by

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<sup>8</sup> Mr. Crowe is an attorney with the Boston firm Perkins, Smith & Cohen LLP, which presently represents Charles Gitto and Tradex Corp.

<sup>9</sup> Direct Wood and Direct Chemical are discussed in more detail in the Appendix.

Gitto Global. The checks written by Gitto Global to Direct Wood or Direct Chemical were characterized in Gitto Global's books and records as a "cost of goods sold." V&L located in the office of Mr. Deakin a file marked "Due From Officers" and its analysis of a document in that file suggests that at least in 1997 and 1999 payments were made from Gitto Global to Direct Equipment (1997) and Direct Chemical (1999), which payments were followed immediately by checks from Gary Gitto and Frank Miller in similar amounts payable to Gitto Global to repay debts. The Examiner has not completed a thorough analysis of this file nor reviewed the relevant bank statements, but V&L's analysis appears to support Mr. Deakin's statements that loans to officers were repaid using Gitto Global's money.

Other evidence suggests that the misappropriation of funds by the Gitto Principals occurred over a period of many years. On June 7, 1996, Frank Miller wrote a memorandum to Charles Gitto, a copy of which is attached hereto as Exhibit 9, complaining about the "insinuation that I 'bleed this company off financially.'"<sup>10</sup> He then references "a clause in the lease [presumably the Tradex lease] that allows the rent . . . to move up or down based on interest rates" and appears to note that in 1995 lease payments "went up by \$4,000/month or \$50,000/year." He also notes that Charles Gitto's housekeeper's salary is paid "out of the company" and that one Leo Gaudet "does about 20% of his work for the company and the [rest of his] time is spent remodeling or rebuilding or repairing your house, Gary's house [and] Nancy's house." As a result, Mr. Gaudet "will probably take \$200,000 this year, of which \$50,000 . . . maximum is spent on company work." Mr. Miller goes on to state that Charles Gitto heats his home, plows his driveway and landscapes his yard, all at Gitto Global's expense.

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<sup>10</sup> The first page of Exhibit 9 was copied in a manner such that certain words on the right side of the page are lost.

He further notes that in connection with a preference claim related to "Pace," the company paid Mr. Gitto's share, presumably of a verdict or settlement, and also pays his "membership to Oak Hill Country Club, and the Faye Club, [and] when you have needed liquor for your house, the company has paid the bill." Mr. Miller concludes by noting that "the company also pays \$3,500/month life insurance policy on you."

Attached hereto as Exhibit 10 is what appears to be Charles Gitto's response of the same date to Frank Miller, in which he asserts that the company is paying alimony to Frank Miller's ex-wife Gail and defends the payments to his housekeeper, Lori Gitto and Leo Gaudet. He then goes on to point out that "Mike Angelini and Bill Corbin [Gitto Global's then accountant] both agree that it would be best for you and Gary to take higher salaries in proportion," a position that surprised Mr. Angelini and caused Mr. Angelini "to be skeptical about this document"

(Transcript of 2004 Examination of Michael Angelini, hereinafter, "Angelini Exam.," at 1-74).

Mr. Gitto concludes with the following paragraph:

The first order of business is to pay our suppliers. The second order is to keep the proper ratio of debt service versus net worth to the bank. The third order of business we have discussed and I will not put it in writing but you know what I am talking about. Also I would like to discuss with you the year-end inventory with you, Gary and Nancy so that everything is taken care of properly so that certified statements for suppliers and banks can be done.

It appears that the internecine squabbling among the Gitto Principals over the use of company funds did not cease with that exchange of memoranda in 1996. In April of 2002, Helen Kozak, who signs the document "Helen (I should have taken that other job) Kozak," sent Mr. Angelini a facsimile outlining a number of invoices that "Gary does not want to pay." A copy of the facsimiles is submitted herewith as Exhibit 11. The invoices include plane flights "down to

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The quotes reported herein are, therefore, not necessarily fully accurate

Vero for school vacation” for “Lori and the girls,” as well as an invoice that Christa Gitto, Charles Gitto’s wife, sent “for Gianna’s bedroom.” Two invoices are attached to that memorandum. One, while not addressed to any specific person, does indeed reference “Gianna’s room.” The other, a Tradex invoice addressed to Gitto Global for a flight to Reading, Pennsylvania for Jim Grimley and John Moritz, both Gitto Global employees, does not appear related to a trip to Vero Beach by “Lori and the girls” as Ms. Kozak reported. Also attached to the facsimile to Mr. Angelini appears to be a memorandum of April 8, 2002 from Charles Gitto to Gary Gitto complaining about Gary’s refusal to pay those invoices. Once again, Charles Gitto ends the memorandum with a paragraph that contains sentences with respect to which the Examiner would like more information:

I will wait to hear from you because there is a bank in Texas that has talked to me and presently is the same bank that Gitto/Global is doing business with. This could be very serious for everyone.

The Examiner is not certain what to make of this series of exchanges. Documents may have been lost or mixed up. Perhaps the dispute was over charges being made to Gary Gitto personally rather than to Gitto Global. Against the backdrop of the other evidence reported above, however, it is clear that substantial further inquiry should be considered, particularly if assets are available from which to obtain a recovery.

Other investigations have also raised concerns about the activities of the Gitto Principals in this regard. An Internal Revenue Service form, number 866-A, relating to taxpayer “Gary C. and Lori Ann Gitto” for the tax period ending December 2000 was located in Gitto Global’s files. A copy of the form is submitted herewith as Exhibit 12. The form notes that the IRS assessed a civil fraud penalty of \$103,619.25. The form notes that Gary Gitto is a 50% shareholder of the Gitto Global Corporation and goes on to state:

With non-existent internal controls, the two shareholders control and direct all transactions of the company. During an examination of this corporation, it was determined that fictitious journal entries were posted that reduced the shareholder loan accounts and increased fixed assets.

The report goes on to recite that in June 2000 there were three journal entries made reducing shareholder loan accounts by the amounts of \$258,281.37, \$227,088.26, and \$100,000.00.

The report further provides:

the shareholders of the corporation were unable to substantiate the increases in leasehold improvements and could not explain why the shareholder loans were decreased. These decreases were deemed to be constructive dividends taxable to each shareholder.

The "Facts" section of the form concludes:

[S]ubstantiated credits to Mr. Gitto's loan account for June 2000 totaled \$400,725.00 of which \$338,725.00 are related to the other mentioned adjusting entries.

During a prior examination unsubstantiated fixed asset additions were also discovered and adjusted. This adjustment was explained in full to Mr. Gitto. Although the company paid a tax preparer, the company's figures were used to prepare these returns. The preparer stated that he did not audit these figures and that he assumed the company had corrected their errors after the last examination.

Stating the "Government's Position," the report goes on to state:

The C.P.A., who prepares their tax returns and financial statements, have issued management letters to the company indicating their records keeping was below standards. Although, they were put on alert, the company continued to incorrectly handle transactions on their books and failed to maintain adequate books and records.

The above actions are a clear and convincing evidence that the taxpayer knowingly and willfully intended to evade taxes.

Again, there may be another side to this story that the Examiner has not heard, but the position of the IRS further demonstrates that a substantial review of the flow of funds between Gitto Global and the Principals is warranted.

#### **D. Manipulation of Asset Based Lenders**

##### **1. Guaranty**

According to Mr. Deakin and documents reviewed by the Examiner, Gitto Global has borrowed funds from a series of banks and institutional lenders since 1992. To secure its obligations to these lenders, Gitto Global would grant the lenders a security interest in all or substantially all of its assets, including inventory and accounts receivable. Gitto Global refinanced its secured debt frequently, indeed almost annually. In all, it appears that Gitto Global obtained secured loans from as many as seven different lenders.<sup>11</sup> Based on the information the Examiner has reviewed to date, it appears that Gitto Global's asset-based credit facilities can be summarized as follows:

<u><b>Lender</b></u>	<u><b>Year of Execution</b></u>	<u><b>Revolving Credit Limit</b></u>
U.S. Trust	1992	\$3.5 million (subsequently increased through various amendments to \$6.5 million)
First New Hampshire	1995	\$8.5 million (subsequently increased to \$10 million pursuant to a First Amendment)
Bank of Boston	1997	\$13 million (subsequently increased in 1998 to \$13.5 million)
CIT Group/Business Credit Inc.	1999	\$15 million

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<sup>11</sup> In recent years, Gitto Global used the services of Frank Kennedy of Salem Capital, Salem, Massachusetts to assist it in identifying and obtaining loans from new sources of capital. The Examiner has not been provided with any evidence that demonstrates or suggests Mr. Kennedy was aware of misconduct by the Gitto Principals.



<u>Lender</u>	<u>Year of Execution</u>	<u>Revolving Credit Limit</u>
National Bank of Canada	2000	\$21 million
Guaranty Business Credit	2001	\$27 million
LaSalle Business Credit	2002	\$27 million <sup>12</sup>

The National Bank of Canada loan was refinanced when Guaranty and Gitto Global entered into a Loan and Security Agreement dated as of August 3, 2001. It appears that the following representatives of Guaranty were involved in its relationship with Gitto Global: Elizabeth Helm, Harold Kessler, Judy Wills, Jim Johnson, David Helms, James Casper, and Michael Haddad. Ms. Wills was the original loan officer but she was replaced in that role by Mr. Casper, a Senior Vice President. Gitto Global was represented in the negotiation of the Loan and Security Agreement by George Tetler, Esq. of Bowditch & Dewey.

The Examiner's review of Gitto Global's relationship with Guaranty has been hampered by Guaranty's failure to respond in a timely manner to the Rule 2004 subpoena issued to Guaranty with respect to documents.<sup>13</sup> The document production of Bowditch & Dewey and the Rule 2004 examination of Michael Angelini, however, did result in some documents and information useful for understanding Gitto Global's relationship with Guaranty, which appears to have been structured as a conventional asset-based loan facility. In some instances, however, only further questions were generated.

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<sup>12</sup> LaSalle also made a term loan to Gitto Global in the original principal amount of \$3,000,000.

<sup>13</sup> The subpoena served on Guaranty required the production of documents to the Examiner by November 22, 2004. Guaranty failed to produce any documents by that date, and the Committee filed a Motion to compel Guaranty's production on December 13, 2004. In response to the Motion to Compel, Guaranty agreed to produce documents to

For example, on April 25, 2002, Frank Miller sent a facsimile to Mr. Angelini which enclosed a facsimile from Guaranty to Mr. Miller, a copy of which is submitted herewith as Exhibit 13. That facsimile from Guaranty consisted of a cover page in which Christina Rodriguez stated that Michael Haddad requested that the attached document, a one page form of authorization for Guaranty to discuss Gitto Global and its affairs with another person or company, be faxed to Frank. That form of authorization, if completed and executed, would have authorized Guaranty to talk with an as yet unnamed person (a blank was provided to be filled in) about Gitto Global. The Examiner is aware that at or about this time Dr. Alfred Arcidi<sup>14</sup> was contemplating an acquisition of Gitto Global (Angelini Exam. at 1-94) and that Dr. Arcidi may have had a conversation with representatives of Guaranty (Id. at 1-95), but the Examiner does not know what was said in that conversation, if in fact it occurred.

Bowditch & Dewey's files also reveal that in late April, 2002, less than a year after the execution of the Loan and Security Agreement, Guaranty sent to Gitto Global a draft First Amendment to Loan and Security Agreement with related documentation, a copy of which is attached hereto as Exhibit 14. The First Amendment is interesting for four reasons. First, it recites that Gitto Global had informed Guaranty that Gitto Global would be sold by June 28, 2002. Second, it amended the Loan and Security Agreement to require the maintenance of "Availability" in an as yet undetermined amount "plus the face amount of all Accounts that were Eligible Accounts on or after April 29, 2002 and thereafter ceased to be Eligible Accounts as determined by [Guaranty] in its sole discretion." Third, it amended the Loan and Security

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the Examiner, and in fact provided documents on or about December 29, 2004. The Examiner has not yet had an opportunity to conduct a meaningful review of the documents produced by Guaranty.

Agreement to provide that the Loan and Security Agreement would terminate no later than July 26, 2002.<sup>15</sup> Fourth, the Amendment provided that “Notwithstanding anything to the contrary in Section 9 of the Loan Agreement, [Gitto Global] agrees that [Guaranty] may perform all due diligence that [Guaranty] deems appropriate in its sole discretion to assure the validity of all Accounts.”

Gitto Global’s receipt of the First Amendment resulted in a telephone conversation between Charles Gitto and James Casper of Guaranty. Later that day, Charles Gitto sent a letter, a copy of which is attached hereto as Exhibit 15, to Mr. Casper intending to “follow-up” on that telephone conversation pointing out that “Dr. Arcidi and his team” were moving ahead in connection with the completion of a transaction of which Guaranty was aware. Charles Gitto states that he doesn’t understand Guaranty’s “lack of cooperation” as it is “very obvious to [us] now that the Bank prefers to terminate its relationship with Gitto Global.” Charles Gitto points out, however, that he advised Gary Gitto and Frank Miller not to sign the documents and that “[t]heir lawyers have also told them not to sign” the documents. Mr. Angelini, Gitto Global’s then counsel, did not recall having given that advice. (Angelini Exam. at 1-107)

Mr. Casper responded by letter dated May 1, 2002 to Charles Gitto, a copy of which is attached hereto as Exhibit 16, indicating that “the amendment was not intended to be an impediment to Gitto’s business or the possible sale of the company,” but was intended to document a discussion with Frank Miller. The rest of Mr. Casper’s letter suggests that Guaranty

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<sup>14</sup> The Examiner has yet to talk to Dr. Arcidi. His business address is believed to be Whittier Health Networks, 25 Railroad Sq., Haverhill, MA 01832 and the telephone number there is 978-372-5106 but he has yet to return the Examiner’s telephone call

<sup>15</sup> The original maturity date was August 3, 2004.

was prepared to limit its required amendments simply to the Availability reserve. Charles Gitto responded later that that was satisfactory.

It would be very interesting to know what prompted Guaranty to send the First Amendment. Mr. Casper's letter of May 1 suggests that the amendment was intended to document a conversation with Frank Miller to establish an availability reserve. He also notes that he has "on several occasions requested financial information regarding several of [Gitto Global's account] debtors for which public information was not available but [has] not yet received it." It certainly appears as if Guaranty had serious concerns about the validity of Gitto Global's reported accounts receivable.

There is reason to believe that during this time period, Guaranty also became aware that Gitto Global was misrepresenting the value of its inventory. For example, in the Examiner's interview with Christopher Slattery, Mr. Slattery described an occasion when Guaranty performed an inventory audit at Gitto Global. At that time Mr. Slattery was performing what he referred to as "odd projects" for Charles Gitto. During the audit, Guaranty desired to take photographs of containers of what was reported to be high-cost inventory. Apparently, Guaranty had taken pictures of the same inventory twice previously, and during a review had concluded that the photographed inventory had been reported as sold between the two days on which pictures of it had been taken. As a result, Mr. Slattery and Frank Miller and a number of Guaranty officers went to a warehouse to inspect the photographed inventory. The inventory that was reported to be there was known as "Vitron," a relatively expensive product. Mr. Slattery pulled out a couple of boxes from the stacks which did indeed contain Vitron and Guaranty took pictures of the contents. He was then asked to pull boxes out from the bottom of the stacks which actually contained calcium carbonate, a product with a much lower value than

Vitron. Mr. Slattery reported that “flashbulbs exploded” and many pictures were taken by the Guaranty representatives when he opened the box of calcium carbonate and that Mr. Miller suggested to the Guaranty representatives that the calcium carbonate was a “pulverized version” of Vitron.

Mr. Slattery’s description of events is consistent with that of Mr. Deakin, who remembers that Guaranty discovered Gitto Global’s mislabeling of cheaper inventory as Vitron inventory and thereafter advised Gitto Global that it no longer wished to do business with Gitto Global. Mr. Deakin recalls that Guaranty subsequently underscored its desire to terminate the lending relationship by refusing to honor checks written by Gitto Global, notwithstanding the presence of sufficient funds.

The Examiner’s inability to examine Guaranty in the time available before writing this Report, coupled with the refusal of the Gitto Principals to speak with the Examiner, leaves many unanswered questions about the level of Guaranty’s knowledge of Gitto Global’s apparently fraudulent conduct and the extent of any actions by Guaranty that contributed to the perpetuation of such conduct to the detriment of other creditors. One unverified allegation in this regard was made to the Examiner which fairly merits further investigation and has been shared with counsel for each of LaSalle, the Creditors’ Committee and the United States Trustee.

## **2. LaSalle**

When told that Guaranty wished no longer to lend to Gitto Global, Frank Miller contacted Frank Kennedy of Salem Capital, who proceeded to search for another source of funding for Gitto Global. Mr. Kennedy helped Gitto Global locate LaSalle as a potential lender and received \$150,000 for his efforts, an amount comparable to what he received when he brokered Gitto Global’s loan from Guaranty.

On July 25, 2002, Gitto Global and LaSalle entered into a loan and security agreement (the “LaSalle LSA”) pursuant to which LaSalle agreed to loan Gitto Global up to an aggregate of \$30,000,000.00 in the form of a term loan in the amount of \$3,000,000.00 (the “Term Loan”) and a revolving loan (the “Revolving Loan”) with a limit of \$27,000,000.00 (the “Revolving Loan Limit”). To secure its obligations to LaSalle, Gitto Global granted LaSalle a security interest in substantially all of its assets, other than equipment. A copy of the LaSalle LSA is submitted herewith as Exhibit 17. In consideration of the credit LaSalle extended to Gitto Global pursuant to the LaSalle LSA, each of Gary Gitto and Frank Miller delivered to LaSalle a limited guaranty in the maximum amount of \$3,000,000.00. With a portion of the funds borrowed from LaSalle, Gitto Global satisfied, in full, its obligations to Guaranty, which totaled \$28,841,980.22.<sup>16</sup>

Gitto Global’s ability to borrow funds from LaSalle pursuant to the Revolving Loan on any given day was subject to a borrowing base formula typical of such transactions. The borrowing base formula limited the amount Gitto Global could borrow to an amount equal to or less than the sum of (1) 85% of Gitto Global’s Eligible Accounts (as such term is described below), plus (2) the lesser of 65% of Gitto Global’s Eligible Inventory (as such term is described below), valued at the lesser of cost or market value, or \$6,000,000.00, less (3) reserves LaSalle had elected to establish (the “Borrowing Base”), subject to the Revolving Loan Limit. LaSalle LSA at Section 2.

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<sup>16</sup> A copy of the “pay-off letter” that Guaranty provided to LaSalle and Gitto Global is submitted herewith as Exhibit 18. Paragraph 6 of the letter states: “GBCC makes no representations, warranties, agreements and statements concerning Borrower, its business, financial condition, creditworthiness, prospects, the nature of the relationship between Borrower and its customers, the accuracy, genuineness or quality of Borrower’s accounts receivable or inventory or the financial condition of Borrower’s customers.” In the Examiner’s experience, such statements are not typically included in pay-off letters and suggest, inferentially, that Guaranty wished to distance itself from Gitto Global to the greatest degree possible

As such, Gitto Global's ability to borrow funds from LaSalle was dependent on the value of its Eligible Accounts and Eligible Inventory. Pursuant to the LaSalle LSA, an Eligible Account was a bona fide account owing to Gitto Global which, among other things, was payable within 30 days after the date of invoice and arose from goods sold by Gitto Global to a customer, which goods had been accepted by such customer and for which Gitto Global had received receipts evidencing the shipping and delivery to the customer. LaSalle LSA at Section 1. An account that was more than 60 days past due was excluded from the definition of Eligible Account and could not be included in the calculation of the Borrowing Base. LaSalle LSA at Section 1. Eligible Inventory was defined to include raw materials or finished goods owned by Gitto Global, held for sale by Gitto Global, located at one of certain facilities, and not otherwise unacceptable to LaSalle. LaSalle LSA at Section 1.

Each day upon which Gitto Global requested to borrow funds pursuant to the Revolving Loan, and at least once a week, Gitto Global was required to provide LaSalle with a loan report and borrowing base certificate (a "Borrowing Base Certificate"). LaSalle LSA at Section 9. The Borrowing Base Certificate set forth, on a form provided by LaSalle, activity related to Gitto Global's accounts for the previous week, information related to the total amount of Eligible Accounts and Eligible Inventory. The amount available for Gitto Global to borrow pursuant to the Revolving Loan at any given time was calculated pursuant to a Borrowing Base Certificate that Gitto Global submitted to LaSalle.

Pursuant to the LaSalle LSA, Gitto Global was required to enter into a blocked account agreement with LaSalle and Fleet, Gitto Global's depository bank. LaSalle LSA at Section 8(c). LaSalle, Gitto Global and Fleet entered into a blocked account agreement on or about July 25, 2002, which was replaced by a similar blocked account agreement by and among LaSalle, Gitto

Global and Fleet on or about February 21, 2003 (the “Blocked Account Agreement”). A copy of the February 21, 2003 agreement is submitted herewith as Exhibit 19. Pursuant to the Blocked Account Agreement, Gitto Global established a deposit account at Fleet (the “Fleet Account”). As Gitto Global received payment of invoices, Gitto Global was required to deposit such payments into the Fleet Account. In turn, Fleet was required to transfer the available funds from the Fleet Account to LaSalle, which LaSalle would apply to Gitto Global’s obligations under the Revolving Loan.

As set forth in the Motion of LaSalle Business Credit LLC for Order Lifting the Automatic Stay to Authorize LaSalle to Foreclose Upon Certain Property of the Debtor (the “Motion for Relief”) Gitto Global owed LaSalle \$31,389,963.91 as of the Petition Date. A copy of the Motion for Relief is attached hereto as Exhibit 20.

The familiar structure of LaSalle’s asset-based loan required that Gitto Global demonstrate that it maintained sufficient amounts of working capital assets to support the level of debt inherited from Guaranty. First, the Company had to report to LaSalle consistently high values of Eligible Inventory and Eligible Accounts. The eligibility of those assets was in large part measured by their age. Accordingly, Gitto Global needed to record a sufficiently dynamic sales volume so its inventory and accounts receivable would “turn” and be replaced by new working capital assets. These tasks could largely be completed by the day-to-day manipulation of the company’s financial records along with occasional additional efforts to deceive on-site auditors. Lastly, Gitto Global needed to show sufficient movements of actual cash out of the company (to demonstrate “purchases” of inventory it then borrowed against) and then into the cash management system controlled by LaSalle (to demonstrate “sales receipts” that reduced its secured loan obligations and created availability under the LaSalle LSA).



As discussed below, the Gitto Principals and others directed by them went to extraordinary lengths to mask Gitto Global's true financial condition and stay in compliance with the LaSalle LSA. The difficulty of their task, however, was exacerbated by a general slowdown in Gitto Global's actual business operations. Mr. Deakin and James Grimley, Gitto Global's sales manager, both advised the Examiner that the company's total annual sales never exceeded approximately \$56 million, which was achieved in 2000. They also advised that the extreme weakness in the telecommunications industry (to which Gitto Global sold many of its most profitable products) beginning in late 2000 and the economic effects of the events of September 11, 2001 materially decreased demand for Gitto Global's products; as a result, actual sales in 2001 dropped to \$42 million and likely dropped even lower in each of 2002, 2003 and 2004. Mr. Deakin also reported that the Gitto Principals failed to react to the slowdown in sales by cutting expenses. The drop in sales, coupled with ongoing, excessive overhead, appears to have put great strain on the company's cash flow and forced the Gitto Principals to construct ever more elaborate schemes to continue Gitto Global's existence.

## **E. Misrepresentation of Inventory Values**

### **1. Overview**

At the time of the CRO's arrival at Gitto Global, the company's internal records reflected that it owned inventory with an aggregate value of \$11.035 Million. The CRO conducted an audit and determined that on-hand inventory had an actual value of no greater than \$1.722 Million, a portion of which was likely unusable. Accordingly, Gitto Global had overstated its inventory by at least \$9.312 Million, or approximately 540%. The overstatement of inventory appears to have been a long-running practice at the company. Mr. Deakin advised the Examiner that as long ago as 1994, Gitto Global "puffed-up" its inventory by as much as \$1 million to increase the amount of its borrowing base and thereby increase its access to financing.

The overstatement of Gitto Global's inventory values appears to have been directed by Frank Miller and was largely an exercise in manipulating the company's internal accounting systems. Occasionally, however, Gitto Global's lenders would dispatch auditors to Gitto's places of business for the intended purpose of verifying the company's inventory values. In certain of these instances, it appears that Frank Miller and Maria Miller and others acting at their direction physically altered inventory packaging for the sole purpose of avoiding detection of the company's falsified inventory records.

## **2. Manipulation of Internal Inventory Records**

The overstatement of inventory values in Gitto Global's books and records involved two basis components: (i) recording fictitious inventory purchases, and (ii) inflating the value of inventory that was actually purchased.

In their interviews with the Examiner, Mr. Deakin and Ms. Merchant both admitted to posting fictitious entries in the inventory module of the company's accounting system. They advised that Frank Miller or Maria Miller regularly would instruct Mr. Deakin or Ms. Merchant to record fictitious inventory purchases on the Gitto Global perpetual inventory system. If challenged by an auditor to produce proof of these inventory purchases, they would use checks from Gitto Global made payable to companies controlled by one or more of the Gitto Principals, such as Kingsdale Corporation / J&J Chemical, which is discussed below in Section V.6. Mr. Slattery also stated to the Examiner that fictitious inventory was reported during his period of employment at Gitto Global and entered into the computer system by Ms. Merchant at the direction of Frank Miller, Maria Miller or Mr. Deakin.

The regular recording of fictitious inventory appears to have made Gitto Global's inventory accounting system wholly unreliable even to those aware of the practice. Mr. Deakin, who admittedly was an active participant in the records manipulation, described Gitto Global's