Wednesday, September 15, 2004, Ms. Kozak contacted Mr. White directly to remove "things" from various offices and place them directly in the garage of Charles Gitto's residence.

Mr. White stated in an affidavit that at approximately 5:00 p.m. on Wednesday, September 15, 2004, Mr. Delisle told him that Ms. Kozak wanted some boxes removed from Gary Gitto's office. He removed seven or eight previously packed boxes and placed them in the company pick-up truck. He also recalled removing one box from Charles Gitto's office. Thereafter, he took these boxes to the residence of Charles Gitto in Leominster, where he was admitted by Charles Gitto's wife, Christa Gitto. Ms. Gitto instructed Mr. White to put the boxes in the basement of the Gittos' residence. While placing the boxes in the basement, Charles Gitto entered the basement to ensure that Mr. White knew where to put them.

Mr. White further testified that on Thursday, September 16, 2004, the day before the CRO arrived at the company, Mr. Delisle again informed Mr. White that Ms. Kozak had more boxes for him to remove. Mr. Delisle instructed Mr. White to meet Ms. Kozak in William Deakin's office. Mr. White observed three or four packed, white file boxes just outside the door of Mr. Deakin's office. Ms. Kozak again requested that Mr. White deliver these boxes to the residence of Charles Gitto. He placed these boxes in the pick-up truck and, while he removed them, observed Ms. Kozak outside of Ms. Chaisson's office packing two more boxes. When Mr. White completed removing the boxes from Mr. Deakin's office, he was instructed by Ms. Kozak to take the two boxes from Ms. Chaisson's office and place them in the truck. Ms. Kozak further requested that Mr. White meet her in the office of Dean Childs, the company's shipping manager.

After placing the two boxes from Ms. Chaisson's office in the pick-up truck, Mr. White went to the office of Mr. Childs as requested by Ms. Kozak. Mr. White observed Ms. Kozak

packing three more boxes. Ms. Kozak instructed him to take these three boxes and put them in the pick-up truck with the other boxes removed from the offices of Ms. Chaisson and Mr. Deakin. After Mr. White had loaded all of the boxes in the pick-up truck, Charles Gitto instructed him to take the boxes to Mr. Gitto's residence and place them in the garage against the wall on the left-hand side, which Mr. White did.

None of the records moved by Mr. White to Charles Gitto's residence have been produced to date. Charles Gitto's current counsel, Juliane Balliro, has stated that "everyone knows that the records were removed from Charlie Gitto's residence and if counsel would ask around they would find out how the records left there." The Examiner does not know the meaning of Ms. Balliro's statement.

K. Other Suspicious Pre-Petition Activities

There were additional suspicious pre-petition activities that came to the Examiner's attention during its investigation. These activities do not necessarily "fit" within the borrowing base manipulation that was the primary catalyst for the Gitto Principals' misappropriation of corporate assets, but nonetheless appear worthy of additional investigation.[46]

1. Potential Equipment Fraud

Gitto Global's conduct with respect to one of its equipment lessors merits mention in this section given the extensive evidence of misrepresentations to lenders. As reported in its Motion for Relief from Automatic Stay filed on November 12, 2004, Wells Fargo Equipment Finance Inc.'s $900,000 loan to Gitto Global in March 2003 pertained to an equipment refinance. The Debtor represented that it had recently paid $1,175,000 for the equipment. Wells Fargo

[46] In addition to the activities described in this Section, the Examiner also has reviewed evidence that suggests the Gitto Principals may have directed improper payments to a public official. The payments appear to have coincided

submitted pleadings to the Court that suggest that the documents the Debtor provided evidencing the $1,175,000 purchase price may have been altered and that the original purchase price was actually only $175,000.

2. Improper Payments to Customers

The Examiner has reviewed evidence which suggests that Gary Gitto and possibly others at Gitto Global affected a scheme of "kickbacks" with certain representatives of its customers. The schemes appear to follow the same general pattern. Gitto Global would agree to sell a certain high-priced product to a selected customer but would in fact deliver to the customer an inferior product that ordinarily would have been sold at a lower price. The customer nonetheless would pay the higher quoted price and the differential was used, in part, to fund an improper payment to the conspiring representative of the customer. The payment was then entered in Gitto Global's records as a "commission" with the remaining differential available to Gitto Global. It appears that Gitto Global's share of the differential either was directed to one or more of the Gitto Principals personally or used to boost the company's profitability.

As noted above, the kickback scheme was not a central feature of the borrowing base manipulation that ultimately forced the company out of business. Accordingly, the Examiner did not devote substantial resources to gathering evidence pertaining to these activities. The activities do warrant further investigation, however, as they could lead to recoveries by the Debtor's estate. Thus, the Examiner sets forth the specifics of the individual kickback schemes below

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with an investigation of potential violations by Gitto Global of certain environmental regulations. The Examiner has been advised that the FBI is aware of such evidence and is investigating the matter.

a. Lake Electronic Cable ("Lake")

Gitto Global's general ledger identifies Lake as customer number 862. Lake first appears in the general ledger in October 1995. For the year 1995, Gitto Global's total sales to Lake were $26,530.04; in 1996, Gitto Global's total sales to Lake were $77,017.63. There are no further sales to Lake recorded in the general ledger until June 2001. After that time, the company began to record very substantial sales to that customer, as summarized below:

Year	Sales
2001	$ 415,768.30
2002	$3,507,554.19
2003	$2,885,369.64
2004	$2,186,762.51
Total	$9,099,002.36

James Grimley, Gitto Global's Sales Manager, advised the Examiner that he was aware of Gitto Global paying commissions to John Motine, whom he knew to be an engineer at Lake. Mr. Grimley questioned Gary Gitto about these commissions and Gary Gitto admitted to Mr. Grimley that he was making payments to Mr. Motine and Jamie Martinez, who worked in Lake's purchasing department, to secure Lake's business. Ms. Powell-Kotoch, an administrative assistant to Frank Miller and Mr. Grimley, also advised the Examiner that she too was familiar with the payment of improper sums to Mr. Motine. Further, William Deakin confirmed to the Examiner that he knew of Gary Gitto's arrangements with Mr. Motine and Mr. Martinez to secure Lake's business. According to Mr. Deakin, Gary Gitto put in place the payment arrangements with Mr. Motine and Mr. Martinez and Ms. Chaisson coordinated the payment of checks to them at Gary Gitto's direction.

Gitto Global's general ledger lists Mr. Motine as vendor number 2873. Payments to him were posted to general ledger account number labeled "commissions–John Motine." His associated vendor address is Naperville, Illinois. According to the general ledger, the amounts paid by Gitto Global to Mr. Motine from December 7, 2001, through August 31, 2004, totaled $91,269.09 with checks issued at least monthly and, at times, three-to-four times per month.[47]

Gitto Global's general ledger lists Mr. Martinez as vendor number 2889. Payments to him were posted to general ledger account number labeled "commissions–Jamie Martinez." His associated vendor address is Chicago, Illinois. From January 25, 2002, through September 5, 2003, Mr. Martinez appears to have received at least $37,872.70 from Gitto Global.[48]

Among the Debtor's records, the Examiner discovered a memorandum Gary Gitto to Ms. Chaisson, copied to Mr. Deakin, dated April 8, 2002, regarding commissions. Gary Gitto states "regarding motine and martinez, give them one and one half cents on 8120 each. new compound has been approved. if you have any questions, please let me know." A copy of the memorandum is attached hereto as Exhibit 36.

b. Hitachi Cable

Hitachi Cable, as discussed in the Appendix, was a customer of Gitto Global. The Examiner has been provided with evidence that suggests the Gitto Principals directed improper

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[47] The initial Gitto Global checks to Mr. Motine bore an address of 1527 Watkins Lane, #201, Naperville, Illinois 60540. In June 2003, Mr. Motine's address on the checks changed to 503 Chamberlain Lane, #202, Naperville, Illinois 60540. The majority of the Motine checks appear to have been deposited into a BankOne account, number 1110615361570, in Chicago, Illinois.

[48] The checks to Mr. Martinez bore an address of 2507 W. Diversey, Chicago, Illinois 60647. These checks appear to have been negotiated at Western-Elston Currency Exchange and then further deposited to Corus Bank.

payments to representatives of Hitachi Cable, for the apparent purposes of obtaining additional business and misappropriating corporate funds.

i. Brian Griggs-Nutmeg Tool Corporation (NTC)

Mr. Grimley, Mr. Deakin and Ms. Kotoch also advised the Examiner that Gary Gitto had an arrangement to make improper payments for the benefit of Brian Griggs, a representative of Hitachi Cable. The payments were posted as "commissions" in Gitto Global's general ledger and paid to a company called Nutmeg Tool Company, Inc. ("NTC"), which Mr. Griggs appears to control.

NTC has an address of Delta Drive, Londonderry, New Hampshire 03053, and a Federal Employee Identification Number of 020499129. The company is incorporated in the State of New Hampshire under charter number 293364. It was incorporated on May 12, 1998, and is currently active. Mr. Griggs is the corporation's resident agent. He reportedly resides at 209 Tibbetts Hill Road, Goffstown, New Hampshire 03045. In reviewing historical addresses for Mr. Griggs, the Examiner noted that in October 2002, he listed an address of 601 East Causeway Boulevard, Vero Beach, Florida 32963. In November 2002, he showed an address of 9335 Frangipiani Drive, Vero Beach, Florida 32963. Charles Gitto and Gary Gitto have been known to frequent and/or own property in Vero Beach.

Gitto Global's general ledger has listed NTC as vendor number 1457 since the first recorded payment to that entity on May 4, 1998. From that date to August 31, 2004, Gitto Global paid NTC a total of $872,936.60. Payments to NTC were posted to general ledger account number labeled "commissions–NTC (Griggs)." The associated vendor address is P.O. Box 400, Auburn, New Hampshire. All of the NTC checks appear to have been deposited at the Triangle Federal Credit Union, account number

The Examiner located in Mr. Deakin's office at Gitto Global a facsimile cover sheet on Hitachi Cable letterhead from Mr. Griggs to Gary Gitto. Listed on the cover sheet are apparent product descriptions, along with the address C.N.E.C., Inc., P.O. Box 400, Auburn, New Hampshire 03032 (the same P.O. Box as NTC.). Attached to that document is an order form, from Hitachi Cable to Gitto Global Corporation and dated March 6, 1998, for product in the amount of $13,480.00. Written on the top of the order form is a hand-written notation indicating that someone gave it to "Tracy" on March 19 with the instruction to begin giving commissions in April.

Another attachment to the cover sheet is a speedy reply message from an illegible signatory dated March 16, 1998. The message is directed to "Tracy" with a carbon copy designated for Mr. Deakin. The subject matter is listed as Hitachi Cable and in the message body is the following: "Confidential: on these products only Brian Griggs will be getting a see below per pound commission per Gary Gitto DO NOT mail it to Hitachi mail check to Brian Griggs NTC, Inc., P.O. Box 400, Auburn, New Hampshire 03032-0400." The message continues "Per Gary tally up monthly and send Brian a check monthly" and further notes to "pls. do this 1st one attached right away for March." The document also bears the notation "Okay Gary." The four products for which Griggs was to receive a commission are also set forth in this document.

Subsequent e-mails provide further evidence of the kickback scheme. For example, in an e-mail dated March 28, 2003, to Ms. Chaisson, Gary Gitto states "what are the status of blakley [*sic*], ntc, motine, martinez." In another e-mail from Gary Gitto to Ms. Chaisson on October 29, 2003, Gitto states "janice what is the status of ntc." Later, on June 14, 2004, Ms. Kozak sent an e-mail to Gary Gitto that states "I'm going to have to use a portion of that NTC deposit to pay

the personal portion of Amex re: Luis Vitton. About $7,000. I was hoping to save it all for Julie Country Day [school], but can't."

On November 18, 2004, counsel for LaSalle furnished the Examiner with copies of a deposit slip dated February 17, 2004, for Equitech, LLC, P.O. Box 583, Lunenburg, Massachusetts, account number at the Commerce Bank and Trust Company, Worcester, Massachusetts.[49] This deposit slip reflects the deposit of a check for $18,610.00 dated February 2, 2004, from Nutmeg Tool Co., Inc., 1D Commons Road, Ste. 23, Londonderry, New Hampshire 03053-3467. The check number is 1443 and the payee is Gary Gitto. The check appears to bear the signature of Mr. Griggs. The check is drawn on Triangle Credit Union account number This is the same account to which the Gitto Global checks to NTC were deposited.

Also provided by LaSalle Bank was check number 1455 dated April 12, 2004, in the amount of $8,670.00. The check was made payable to Gary Gitto and drawn on the NTC account at the Triangle Credit Union. The check is allegedly signed by Griggs and the memo notation reads "Dec'03." LaSalle Bank further provided the Examiner with check number 1453 dated April 19, 2004, in the amount of $12,000.00. This check was also payable to Gary Gitto and drawn on the account of NTC at the Triangle Credit Union. The check is purportedly signed by Griggs.

Thus, between February 2, 2004, and April 19, 2004, it appears that Mr. Griggs and NTC returned $39,280.00 to Gary Gitto. It appears reasonable to conclude, therefore, that although Gitto Global may have paid bribes to Mr. Griggs through NTC, Mr. Griggs returned some of this

[49] As noted in the Appendix, it appears that Gary Gitto owns and/or controls Equitech, LLC.

alleged bribe money to Gary Gitto through his Equitech account at Commerce Bank and Trust Company. A complete audit of both of the above bank accounts is necessary to determine the exact nature of the transactions between Gitto Global, NTC, Equitech, and Gary Gitto.

ii. Blakely-Hutchinson, LLC

Gitto Global's general ledger lists Blakely-Hutchinson, LLC ("B-H"), as vendor No. 2262 and charges payments to B-H as commission expenses. The associated vendor address is 2 Copeland Drive, Bedford, Massachusetts 01730, although there is a second entry of 75 Tyngsboro Road, Westford, Massachusetts 01886. The ledger lists the following payments to B-H by Gitto Global per year:

Year	Sales
1999	$ 67,334.49
2000	$247,848.24
2001	$145,757.40
2002	$112,863.36
2003	$ 91,978.90
2004	$ 79,599.38
Total Payments	$745,381.77

Mr. Deakin was the only Gitto Global employee who spoke to the Examiner about B-H. He stated that two employees at Hitachi Cable got paid a percentage of what Hitachi Cable bought from Gitto Global. Deakin identified one individual as Ronald Ruggiero, stating that payments for his benefit were made out to B-H. According to corporate records, Mr. Ruggiero is the President of Hitachi Cable. As noted above, Mr. Deakin also said a second employee, Mr. Griggs, was also receiving improper payments.

The Examiner located a Massachusetts corporation identified as Blakely-Hutchinson, Inc., which filed as a domestic corporation in the Commonwealth of Massachusetts. The date of

its organization was May 7, 1993, and the location of its principal office is One Boston Place, Suite 2645, Boston, Massachusetts 02108. David Godbout, of 81 Horatio Street, New York, New York, is listed as the corporation's President and Treasurer. The Secretary is listed as Ronald A. Borino, One Beacon Street, Boston, Massachusetts. The last activity recorded in the file of the Massachusetts Secretary of State for the corporation is July 15, 1998, at which time annual reports for 1996 and 1997 were filed. There are no records of any corporate filings since that date.

The Examiner further determined that on January 20, 1999, an entity also known as Blakely-Hutchinson was formed in the State of Delaware. That entity has now been cancelled for failure to file annual reports and pay required fees. Records of that entity are being obtained.

Consistent with the general ledger, Gitto Global checks made payable to B-H bear two different addresses. In 1999, B-H used an address of 2 Copeland Drive, Bedford, Massachusetts 01730. On check number 004206 dated November 21, 2000, the address of B-H is listed as 75 Tyngsboro Road, Westford, Massachusetts 01886. From computer database research, it appears that Mr. Borino and Maria Borino owned the property at 2 Copeland Drive, Bedford, Massachusetts 01730. Middlesex County Register of Deeds records indicate, however, that Mr. Borino and Ms. Borino sold the property located at 2 Copeland Drive to Gary Gitto. A search also located UCC filing number 99615285 dated March 8, 1999, indicating that Gary C. Gitto, 140 Leominster Shirley Road, Lunenburg, Massachusetts, held a lien on certain assets of Ronald and Maria Borino, 2 Copeland Drive, Bedford, Massachusetts. Other records indicate that Mr. Borino resided at 75 Tyngsboro Road, Westford, Massachusetts, from October 1998 to December 2004. Public records indicate that Maria Borino purchased 75 Tyngsboro Road on November 4, 1999.

As noted previously, the original filing of Blakely-Hutchinson, Inc., in Massachusetts lists Mr. Borino as the corporation's Secretary. Thus it would appear that the Blakely-Hutchinson entity that filed incorporation papers in Massachusetts is connected to Mr. Borino and further that Mr. Borino is a debtor to Gary C. Gitto. Further, at least one Gitto Global check made payable to B-H was sent to an address related to Mr. Borino.

A computer database search also revealed that Mr. Borino formerly practiced as an attorney. According to records of the Massachusetts Board of Bar Overseers (the "BBO"), Mr. Borino was admitted to the bar on June 15, 1988. The BBO's disciplinary history states that on August 30, 2001, R. Borino was temporarily suspended from the practice of law and that on March 7, 2002, he resigned and was disbarred.[50]

A review of the Gitto Global checks made payable to B-H indicate that from November 29, 1999, to June 9, 2000, the checks were deposited to Fleet Bank account number apparently in the name of B-H. B-H checks from June 26, 2000, to May 27, 2004, were deposited to Sovereign Bank New England account number These accounts have not been reviewed by the Examiner. Both Frank Miller and Gary Gitto appear to have signed the checks made payable to B-H.

Again, subsequent e-mails provide further evidence of the apparent kickback scheme. As noted earlier, Gary Gitto sent Ms. Chaisson an e-mail on March 28, 2003, in which he asked "what are the status of blakley [*sic*], ntc, motine, martinez." The Examiner located a separate Gitto Global e-mail from Ms. Kozak on December 18, 2003, to "rBorino1@comcast.net." The

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[50] According to published reports, Mr. Borino was convicted, along with several other individuals, of stealing money from the unpaid check fund maintained by the Treasury Department of the Commonwealth of Massachusetts. Benoit Denizet-Lewis, *The Crooks, Their Greed, Their Mistresses & The Crime*, BOSTON MAGAZINE, February, 2002.

subject matter of that e-mail is "Equitech Technologies, LLC" and the e-mail states: "I can't seem to put my finger on the paperwork that would identify where this partnership was established and when...I need it. I think you handled this. I need it asap. Thank you!!." On January 14, 2004, rBorino1@comcast.net sent an e-mail to Kozak at Gitto Global. The subject line was "quick question." The e-mail states as follows:

> "Hey Helen, I have a quick question for you. I have in my drawer three Blakely checks: (1) Equitec's [*sic*] payment from last quarter, (2) Brian's check for this quarter and (3) Equitec's [*sic*] check for this quarter. Could you let me know when, if at all, I should deposit these checks? No rush or anything, no one is bothering me about it, but I was just wondering. Thanks. Hope all is well. Bye."

Kozak responded to this e-mail thirteen minutes later, stating "ronny-b....how much is each check....then i can get you an answer." Later that day, rBorino1@comcast.net responded to Kozak as follows:

> "1. 10,192.18.
>
> 2. 10,379.81.
>
> 3. 10,379.81."

Subsequently, on January 15, 2004, Kozak forwarded this e-mail to Deakin adding "I need a schedule for these checks."

On November 18, 2004, counsel for LaSalle provided the Examiner with B-H escrow check number 18 dated March 8, 2004, for $9,250.00 payable to Equitech. The check is drawn on account number at Sovereign Bank. This is the same account to which the Gitto checks made payable to B-H had previously been deposited. This check was located in a deposit item for the account that Gary Gitto maintained at the Commerce Bank and Trust Company for Equitech under account number The records of these bank accounts are not yet available to the Examiner.

Ultimately, it appears that what purports to have been commissions paid to B-H for materials that Hitachi Cable purchased from Gitto Global is far more complicated. Further, the Examiner learned on December 8, 2004, that Hitachi Cable is also a client of Bowditch & Dewey, the same law firm that served as counsel to Gitto Global. The Examiner believes that further investigation should be undertaken to determine the relationship between B-H and Equitech and the nature of other possible financial transactions between Gary Gitto, Mr. Barino and potentially Mr. Ruggiero.

VI. POTENTIAL CLAIMS AVAILABLE TO GITTO GLOBAL'S ESTATE

As described above, the pre-petition misconduct that the Bankruptcy Court charged the Examiner with investigating was widespread and potentially implicates a number of persons and business entities. The Examiner attempted throughout its investigation to tie its findings to potential recoveries that the appropriate estate representative could pursue for the benefit of the Debtor's estate and creditors. Set forth below is an overview of potential claims against certain parties that may be pursued, or at least considered, by an estate representative in light of the findings discussed in this Report.

This discussion of potential claims itself must be considered preliminary. The Examiner, in many instances, has recommended that additional investigation be considered or pursued. Any determination of whether viable claims exist likely will be inextricably tied to such additional investigation. The viability of many of the claims below will require an analysis of when Gitto Global became insolvent, a question the Examiner has not pursued in any detail. Further, the Examiner lacks sufficient information as to whether any of the potential defendants identified below or elsewhere in this Report has sufficient resources to satisfy any judgment that is ultimately obtained.

A. Role of Gitto Principals and Theories of Liability

1. Theories of Potential Liability

Based on the findings discussed above, the Examiner is of the view that the remarkable downward spiral of Gitto Global over the past five years resulted in large part from various schemes that the Gitto Principals orchestrated for their personal benefit. It appears that the Debtor's estate has claims against the Gitto Principals for the misappropriation of corporate funds, as discussed below. Additionally, the Examiner evaluates the conduct of the Gitto Principals against the following legal theories:

- *Breach of fiduciary duties* – whether there is sufficient evidence for a finder of fact to conclude that the Gitto Principals breached their fiduciary duties such that they may be liable for damages to the Debtor;

- *Civil RICO* –whether there is sufficient evidence for a finder of fact to conclude that the Gitto Principals engaged in the conduct of an interstate enterprise through a pattern of racketeering activity that damaged the Debtor's estate; and

- *Deepening Insolvency* –whether there is sufficient evidence for a finder of fact to conclude that the Gitto Principals improperly prolonged Gitto Global's life by hiding its true financial condition while incurring additional liabilities or dissipating assets.

The Examiner considers each of these legal theories in the sections below.

a. Misappropriation of Corporate Funds

Section 6.40 of the Massachusetts Business Corporations Act provides that a corporation shall not make a distribution to its shareholders (i) in violation of a restriction in the corporation's articles or organization or (ii) if after the distribution the corporation would be insolvent. Mass. Gen. Laws ch. 156D, § 6.40. "Distributions" include virtually all transfers of money or the incurrence of indebtedness by a corporation to or for the benefit of its shareholders in respect of any of its shares. Mass. Gen. Laws ch. 156D, § 1.40; see also Mass. Gen. Laws ch. 156D, § 6.40, cmts. (noting that distributions encompass regular dividends of cash or property)

Section 6.40 measures insolvency in both the equity and bankruptcy sense, providing that a distribution may not be made if either: (i) the corporation will not be able to pay its debts as they become due in the usual course of business; or (ii) the corporation's total assets would be less than the sum or its total liabilities plus the liquidation preferences of senior equity securities. Mass. Gen. Laws ch. 156D, § 6.40(c)(1)-(2). Directors may make the determination of insolvency on whether a distribution on the basis of either financial statements prepared using accounting practices and principles that are reasonable under the circumstances or a fair valuation or other method that is reasonable under the circumstances. Mass. Gen. Laws ch. 156D, § 6.40(d).

A director who votes for or assents to a distribution to shareholders that violates section 6.40 will be personally liable to the corporation if the director fails to perform his duties in compliance with section 8.30, which governs the general standard of conduct of directors. Mass. Gen. Laws ch. 156D, § 6.41(a); see also supra Section VI(A)(1)(b) (outlining a director's fiduciary duties under § 8.30). The director's liability equals the amount of the distribution that could have been distributed without rendering the corporation insolvent. Mass. Gen. Laws ch. 156D, § 6.41(a). Thus, if a corporation is insolvent prior to making the distribution and the director fails to comply with the standard of conduct set forth in section 8.30, the director will be personally liable for the entire amount of the distribution. Any director compelled to pay the corporation on account of an improper distribution may obtain contribution from every other director liable under section 6.41. Mass. Gen. Laws ch. 156D, § 6.41(b)(1).

While sections 6.40 and 6.41 of the Massachusetts Business Corporations Act establish the tests for the validity of distributions and give rise to potential director liability, the federal Bankruptcy Act and the Massachusetts fraudulent conveyance statute enable the bankruptcy

trustee or other estate representative to recapture, in certain circumstances, funds distributed to others. Section 548 of the Bankruptcy Code enables the trustee to avoid fraudulent transfers made within one year of bankruptcy. 11 U.S.C. § 548(a)(1). In addition, section 544(b) of the Bankruptcy Code allows the trustee to attack transfers voidable under state law. 11 U.S.C. § 544(b). Thus, the trustee will use section 544(b) if the transfer took place outside the one-year reachback period contained in section 548 and the state fraudulent transfer law provides for a longer reachback period. Notably, Massachusetts has adopted the Uniform Fraudulent Transfer Act (the "UFTA"),[51] which generally provides for a four-year reachback period. See Mass. Gen. Laws ch. 109A § 10.

Transfers are voidable under section 548 of the Bankruptcy Code and the UFTA if either: (i) made with actual intent to hinder, delay, or defraud creditors; or (ii) made for less than "reasonably equivalent value" by an insolvent debtor. 11 U.S.C. § 548(a)(1)(A)-(B); Mass. Gen. Laws ch. 109A, § 5(a), 6(a). Under both section 548 of the Bankruptcy Code and the UFTA, the burden of proof rests upon the party challenging the allegedly fraudulent transaction. See In re R.M.L., Inc., 195 B.R. 602, 617 (Bankr. M.D. Pa. 1996) (applying section 548); Ward v. Grant,

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[51] The UFTA replaced the Massachusetts Uniform Fraudulent Conveyance Act ("UFCA") on October 8, 1996. While there are some differences between UFTA and UFCA, both contain similar principles of law. However, UFTA will not apply to any actions based on transfers that occurred prior to the effective date of UFTA. First Federal Savings & Loan Ass'n. v. Napoleon, 701 N.E.2d 350, 352 (Mass. 1998). Ultimately, the UFTA attempts to update fraudulent conveyance law so as to be consistent with the changes incorporated into the Bankruptcy Code in 1978 and to respond to changes occurring in other areas of the law, such as in the areas of bulk transfers and perfection of security interests. See Paul P. Daley & Mitchel Appelbaum, *The Modernization of Massachusetts Fraudulent Conveyance Law: The Adoption of the Uniform Fraudulent Transfer Act*, 83 MASS. L. REV. 337, 339 (1998) (noting that under the two bodies of law "a Massachusetts lawyer would have to evaluate the debtor's solvency under the slightly different definitions of both the UFCA and the Bankruptcy Code/UFTA standards, and would have to determine whether the debtor was receiving 'fair consideration' (UFCA) or 'reasonably equivalent value' (UFTA/Bankruptcy Code)").

401 N.E.2d 160, 162 (Mass. App. Ct. 1980) (applying the former Massachusetts fraudulent conveyance statute).

Actual intent is usually proven circumstantially and inferentially. Palmer v. Murphy, 677 N.E.2d 247, 255 (Mass. App. Ct. 1997). Courts usually look for the presence of certain "badges of fraud" in determining actual intent. Id. Generally, they include: (1) actual or threatened litigation against the debtor; (2) a purported transfer of all or substantially all of the debtor's property; (3) insolvency or other unmanageable indebtedness on the part of the debtor; (4) a special relationship between the debtor and the transferee; and (5) retention by the debtor of the property involved in the putative transfer. Id.; see also Mass. Gen. Laws ch. 109A, § 5(b) (providing eleven factors that court may consider in determining the debtor's actual intent). The presence of one badge of fraud may only spur a suspicion but the existence of several can "constitute conclusive evidence of an actual intent to defraud." Hasbro v. Serafino, 37 F. Supp.2d 94, 98 (D. Mass. 1999) (applying the UFTA).

Rather than showing actual intent, the creditor may prove that an insolvent company did not receive "reasonably equivalent value" in exchange for the transfer. Subject to varied interpretation by the courts and not defined in the statutes, the "reasonably equivalent value" determination should be based on all of the facts and circumstances of the case. See In re Tri-Star Techs. Co., 260 B.R. 319, 325 (Bankr. D. Mass. 2001); In re Kemmer, 265 B.R. 224 (Bankr. E.D. Cal. 2001); In re Colonial Realty Co., 226 B.R. 514, 523 (Bankr. D. Conn. 1998). In particular, the court should "compare what was given [by the debtor] with what was received." In re Gerdes, 246 B.R. 311, 313 (Bankr. S.D. Ohio 2000); see In re Tri-Star Techs. Co., 260 B.R. at 325; In re Nelco, Ltd., 264 B.R. 790, 814 (Bankr. E.D. Va. 1999); In re Guerrera, 225 B.R. 32, 36 (Bankr. D. Conn. 1998); Barber v. Golden Seed Co., 129 F.3d 382, 387 (7th Cir. 1997). The

value or benefit received by the debtor, however, need not equate dollar-for-dollar with the market value of the interest transferred or obligation incurred. See In re Tri-Star Techs. Co., 260 B.R. at 325; In re Kemmer, 265 B.R. 224 (Bankr. E.D. Cal. 2001); Unif. Fraudulent Transfer Act § 3 cmt. 2.

In addition to showing that the debtor company transferred an interest or incurred an obligation and in exchange received less than "reasonably equivalent value," the creditor must prove that the transaction was made while the debtor was insolvent or that the transaction rendered the debtor insolvent. 11 U.S.C. § 548(a); Mass. Gen. Laws ch. 109A, § 6(a). If the entity allegedly making the fraudulent transfer is not insolvent, no fraudulent conveyance exists unless the creditor can prove actual intent. Both the UFTA and the Bankruptcy Code adopt an objective "balance sheet " test for insolvency, whereby the debtor is insolvent if "at a fair valuation" the sum of the its debts is greater than all of its assets. Mass. Gen. Laws ch. 109A § 3; 11 U.S.C. § 101(32); see In re Tri-Star Techs. Co., 260 B.R. at 325. The calculation requires more than a simple comparison of assets and liabilities, however, often necessitating the exclusion of particular assets and the consideration of the probable liability on existing debts. See In re Bay Plastics, Inc., 187 B.R. 315, 330-31 (Bankr. C.D. Cal. 1995) (holding that adjustments to the values of assets must be made to update such valuations in light of their use and market conditions and that, in a liquidation, goodwill must be disregarded in determining debtor's solvency); In re R.M.L., Inc. , 187 B.R. 455 (Bankr. M.D. Pa. 1995) (holding that courts are not strictly bound by generally accepted accounting principles in making solvency determinations under 11 U.S.C. § 548); see also In re Goldstein, 194 B.R. 1 (Bankr. D. Mass. 1996) (holding that a contingent liability is not per se probable and that, for the purposes of establishing a debtor's solvency, the bankruptcy trustee must show that the contingency was

likely to occur); cf. In re Smoot, 265 B.R. 128 (Bankr. E.D. Va. 1999) (stating that all liabilities, contingent or otherwise, must be considered in determining whether debtor was insolvent at time of transfer in question). Unlike the Bankruptcy Code, however, the UFTA also establishes a rebuttable presumption of insolvency if the debtor is generally not paying its debts as they become due. See Mass. Gen. Laws ch. 109A § 3(b).

The evidence reviewed in Section V. C. of this Report compels the conclusion that the Gitto Principals misappropriated corporate funds for their personal use or benefit. Whether characterized as improper dividends or fraudulent transfers, the sums received (in an admittedly undetermined amount) appear to be subject to recovery by an estate representative.[52]

b. Breach of Fiduciary Duties

The fiduciary duties of a corporation's directors and officers are governed by the law of its state of incorporation. See Slattery v. Bower, 924 F.2d 6, 9 (1st Cir. 1991) ("Under Massachusetts law, any question pertaining to the duty owed by the director of a corporation is governed by the law of the state of incorporation."). Gitto Global is incorporated under the laws of the Commonwealth of Massachusetts and Massachusetts law therefore governs the fiduciary duties of Gitto Global's directors and officers. Generally, the directors of a Massachusetts corporation stand in a fiduciary relationship to the corporation. Demoulas v. Demoulas Super Mkts., Inc., 677 N.E.2d 159, 179 (Mass. 1997). They owe to the corporation both a duty of care and a duty of loyalty. Id.[53]

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[52] The Examiner is mindful that Charles Gitto apparently was not a statutory officer or director of Gitto Global. The Examiner has concluded, however, that he was a *de facto* principal of the company with substantial authority over its operations and hence should be considered as potentially falling within the purview of this section and the Breach of Fiduciary Duties discussion below. See also footnote 59, infra.

[53] Generally, a director's duties are owed to the corporation's shareholders. When Gitto Global became insolvent or nearly so, however, the duties of the Gitto Principals likely expanded to include Gitto Global's creditors. While the Examiner has not located a case in which a court has considered this presumptive expansion under Massachusetts

On July 1, 2004, Massachusetts General Laws Chapter 156D, the Massachusetts Business Corporations Act, became effective. Mass. Gen. Laws ch. 156D. Chapter 156D, based largely on the 1984 Revised Model Business Act developed by the Committee on Corporate Laws of the Section of Business Laws of the American Bar Association (the "Model Act"), applies to all business corporations organized in Massachusetts before or after the effective date. See Mass. Gen. Laws ch. 156D, § 17.01; ABA Model Bus. Corp. Act Ann. (3d ed. 2000). Because there are relatively few published opinions regarding fiduciary duties under the new Massachusetts Business Corporations Act, this Report will also refer to the corporation law of other states, particularly those also based on the Model Act.[54]

i. Duties of Care and Good Faith (and the Business Judgment Rule)

Section 8.30 of the Massachusetts Business Corporations Act defines the general standard of conduct that directors of a corporation must meet. See Mass. Gen. Laws ch. 156D, § 8.30. Despite minor differences in language, it "is to the same general effect as [the old corporation law of Massachusetts] insofar as it relates to the liability of directors." Mass. Gen. Laws ch. 156D, § 8.30, cmts. Furthermore, "§ 8.30 does not try to codify the business judgment rule" or

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law, courts applying the laws of other states have consistently found this to be the case. See, e.g., Brandt v. Hicks, Muse & Co. (In re Healthco Int'l, Inc.), 208 B.R. 288, 300 (Bankr. D. Mass., 1997) (applying Delaware law and finding that "[w]hen a transaction renders a corporation insolvent, or brings it to the brink of insolvency, the rights of creditors become paramount"). Furthermore, courts have held that directors owe a fiduciary duty to creditors even when the company operates in the undefined "vicinity of insolvency." See, e.g. Carrieri v. Jobs.com, Inc., 2004 U.S. App. LEXIS 25133 (5th Cir. 2004) (finding that "when a corporation reaches the 'zone of insolvency,' as with actual insolvency, the officers and directors have an expanded fiduciary duty to all creditors of the corporation, not just the equity holders."); see also Weaver v. Kellogg, 216 B.R. 563, 583-584 (D. Tex., 1997) (noting that under Delaware and Texas law, directors may have a fiduciary duty to the corporation's creditors when the corporation is in "the vicinity of insolvency.")

[54] See Mass. Gen. Laws ch. 156D, § 1.50, cmts. ("[A]s the courts of other jurisdictions interpret the [Model Act] as adopted in their states, those interpretations should be given significant weight in the interpretation by Massachusetts courts of identical or comparable provisions of the Act.")

to delineate the differences between the common law rule and the standards of conduct set forth in the statute. Mass. Gen. Laws ch. 156D, § 8.30, cmts.

In evaluating the conduct of a director, therefore, Section 8.30 must be considered first. Section 8.30 provides that the directors and officers of a Massachusetts corporation must discharge their duties: (1) in good faith; (2) with the care that a person in like position would reasonably believe appropriate under similar circumstances; and (3) in a manner the director or officer reasonably believes to be in the best interests of the corporation. Mass. Gen. Laws ch. 156D, §§ 8.30(a)(1)–(3).[55] In discharging their duties, directors and officers are entitled to rely on information prepared or presented by: (1) one or more officers or employees of the corporation whom the director or officer reasonably believes to be reliable and competent; or (2) legal counsel, public accountants, or other personnel retained by the corporation as to matters involving skill or expertise whom the director or officer reasonably believes to be reliable and competent.[56] Mass. Gen. Laws ch. 156D, §§ 8.30(b)(1), (2), 8.42(b)(1), (2). When relying on others, however, the director or officer must not have any personal knowledge about the matter in question. Mass. Gen. Laws ch. 156D, § 8.30(b). Ultimately, directors and officers are not liable to the corporation for any action, or the failure to take any action, if their duties are performed in compliance with these standards. Mass. Gen. Laws ch. 156D, §§ 8.30(c), 8.42(c).

If compliance with the standard set forth in section 8.30 is not established, then a court may still consider whether the director's conduct is protected by the common law business judgment rule. See Mass. Gen. Laws c. 156D, § 8.30(a), (c), cmts. In Harhen v. Brown, 431

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[55] Officers must meet a similar standard. See Mass. Gen. Laws ch. 156D, § 8.42(a)(1)–(3).

[56] The director may also rely on information provided by a committee of the board of directors of which the director is not a member if the director reasonably believes the committee merits confidence. Mass. Gen. Laws ch. 156D, § 8.30(b)(3).

Mass. 838 (2000), the Massachusetts Supreme Judicial court recently affirmed the essence of the business judgment rule, that directors "are presumed to be acting, not fraudulently, but with fair discretion in obedience to law, and in good faith toward all concerned, and with a consciousness of duty toward the corporation and all its stockholders." Solomont & Sons Trust, Inc. v. New England Theaters Operating Corp., 93 N.E. 2d 241, 248 (Mass. 1950). Thus, to overcome the business judgment rule and hold a director liable, plaintiffs must show "clear and gross negligence." Spiegel v. Beacon Participations, Inc., 8 N.E. 2d 895, 904 (Mass. 1937). "[M]ere errors in judgment" will not suffice. Crowell & Turlow S.S. Co. v. Crowell, 182 N.E. 569, 578 (Mass. 1932).

ii. Duty of Loyalty

The Massachusetts Supreme Judicial Court has explained that corporate directors owe their corporation a paramount duty of loyalty. Demoulas v. Demoulas Super Mkts., Inc., 677 N.E.2d 159, 179 (Mass. 1997). Directors "are bound to act with fidelity and must place their duties to the corporation above every other financial or business obligations . . . They cannot be permitted to serve two masters whose interests are antagonistic." Id. *quoting* Spiegel v. Beacon Participations, Inc., 8 N.E.2d 895 (1937).

The Massachusetts Business Corporations Act also addresses the director's duty of loyalty to the corporation.[57] Mass. Gen. Laws ch. 156D, § 8.31. To meet a fiduciary's duty of loyalty, a director who wishes to take advantage of a corporate opportunity or engage in self-dealing must first disclose the material details of the venture to the corporation. Mass. Gen.

[57] Section 8.31 "rejects the common law view that all conflict of interest transactions entered into by directors are automatically voidable at the option of the corporation without regard to the fairness of the transaction or the manner in which the transaction was approved by the corporation." See Mass. Gen. Laws ch. 156D, § 8.31, cmts. The Examiner has considered that the statute does not expressly apply to officers, but deems the point moot in this case as all of the officers implicated by these claims are also directors of the Debtor.

Laws ch. 156D, § 8.31(a)(1). Subsequently, the director must either: (i) receive the assent of disinterested directors or shareholders,[58] or (ii) otherwise prove that the decision is fair to the corporation. Mass. Gen. Laws ch. 156D, § 8.31(a)(1)–(3). If the venture is disclosed to the corporation but approved by self-interested directors, then those who benefit from the venture must prove that the decision was fair to the corporation. Mass. Gen. Laws ch. 156D, § 8.31(a), (c); see also Demoulas, 677 N.E.2d at 181 (director and officer of supermarket corporation breached fiduciary duties by transferring assets and diverting business opportunities away from the corporation into other businesses that were solely owned by the director/officer and members of his family). The transaction, evaluated pursuant to the facts and circumstances as they were known or should have been known at the time the director or officer entered into the venture, ultimately will be deemed fair if it resembles deals entered into at arms-length by disinterested persons. See Winchell v. Plywood Corp., 85 N.E.2d 313, 318 (Mass. 1949); see also Mass. Gen. Laws ch. 156D, § 8.31, comts.

The Examiner has reviewed overwhelming evidence that each of the Gitto Principals violated the duties of care, good faith and loyalty they owed to Gitto Global and, at some point, the company's creditors. The actions of the Gitto Principals described in this Report, in the Examiner's view, cannot reasonably be viewed as "mere errors in judgement." They constitute willful misconduct designed to enrich the Principals to the material detriment of the corporation and its creditors. It appears beyond dispute that the Gitto Principals regularly engaged in self-dealing that could not possibly have been viewed as fair to Gitto Global's corporate interests.

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[58] The transaction in question must be approved by a "majority of the directors on the board of directors (or on the committee) who have no direct or indirect interest in the transaction ...." Mass. Gen. Laws ch. 156D, § 8.31(c) The transaction may not be authorized, however, by a single director, even if uninterested. Mass. Gen. Laws ch. 156D, § 8.31(c).

It also should be noted that by willfully failing to act in good faith, with due care, and in the best interest of Gitto Global, the Gitto Principals should not have the right to invoke the business judgment rule. The Principals' apparent gross mismanagement, therefore, should give rise to liability. It appears that the Gitto Principals' failure to react to the dramatic slowdown in Gitto Global's legitimate business beginning in late 2000 was a material factor in the company's failure. The Gitto Principals' self-dealing appears to have occurred over a lengthy period while the company managed to stay afloat; the combination of such self-dealing and managerial incompetence, however, was more than the business could withstand.

c. Civil RICO

The Racketeering Influence and Corrupt Organization Act ("RICO") imposes civil liability on those persons who engage in: (1) conduct (2) of an interstate enterprise (3) through a pattern (4) of racketeering activity. See 18 U.S.C. § 1962(c); Sedima, S.P.R.L. v. Imrex Co., Inc., 473 U.S. 479, 496 (1985); Doyle v. Hasbro, Inc., 103 F.3d 186, 189 (1st Cir. 1996). "In addition, the plaintiff only has standing if, and can only recover to the extent that, he has been injured in his business or property by the conduct constituting the violation." See Sedima, S.P.R.L., 473 U.S. at 496; Holmes v. Sec. Investor Prot. Corp., 503 U.S. 258, 268 (1992) (noting that the defendant must have proximately caused the plaintiff's injury). A private party injured in his business or property as a result of a RICO violation may pursue a claim for treble damages and recoup attorney's fees and costs. 18 U.S.C. § 1964(c).

To recover under RICO, the plaintiff must first establish the existence of an interstate "enterprise." See Ahmed v. Rosenblatt, 118 F.3d 886, 889 (1st Cir. 1997). An enterprise "includes any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity." 18 U.S.C. § 1961(4). For jurisdictional purposes, only the activity of the enterprise, not the pattern of

racketeering underlying the civil RICO claim, must affect interstate commerce, see, e.g., United States v. Farmer, 924 F.2d 647 (7th Cir. 1991), and the nexus required between the activity of the enterprise and interstate or foreign commerce is minimal. See United States v. Doherty, 867 F.2d 47, 68 (1st Cir. 1989) ("RICO requires no more than a slight effect upon interstate commerce."). For example, an Alaskan gold mine engaged in interstate commerce when it purchased equipment and supplies out of state, its workers were solicited and hired from out of state, and its output was taken out of state. See United States v. Robertson, 514 U.S. 669, 671–72 (1995); see also United States v. Allen, 656 F.2d 964, 964 (4th Cir. 1981) (supplies used in bookmaking operation originated out of state); United States v. Altomare, 625 F.2d 5, 7–8 (4th Cir. 1980) (placement of interstate telephone calls is sufficient impact on commerce).

As a corporation, Gitto Global clearly falls within the definition of an enterprise under the civil RICO statute. See 18 U.S.C. § 1962(c). In addition, Gitto Global engaged in, and its activities affected, interstate commerce, as, among other things, it purchased equipment and supplies from out of state, sold its products to consumers throughout the United States and obtained financing from financial institutions throughout the country. See Robertson, 514 U.S. 671–72.

The "conduct" requirement under § 1962(c) authorizes recovery only against individuals, separate and distinct from the enterprise, who "participate in the operation or management of the enterprise." Reves v. Ernst & Young, 507 U.S. 170, 185 (1993); see also Doyle, 103 F.3d at 190–91 ("[T]he complaint must allege the existence of a 'person' distinct from the 'enterprise.'"); Miranda v. Ponce Fed. Bank, 948 F.2d 41, 44 (1st Cir. 1991) ("[T]he same entity cannot do double duty as both the RICO defendant and the RICO enterprise."). The Supreme Court has recently held, however, that a corporation and its employees are not legally identical

for purposes of RICO. Cedric Kushner Promotions, Ltd. v. King, 533 U.S. 158, 166 (2001) (holding that § 1962(c) applies "when a corporate employee unlawfully conducts the affairs of the corporation of which he is the sole owner—whether he conduct those affairs within the scope, or beyond the scope, of corporate authority"). Furthermore, it is not necessary that a RICO defendant wield control over the enterprise, but the plaintiff "must prove [that the defendant had] some part in the direction of the enterprise's affairs." United States v. Darden, 70 F.3d 1507, 1543 (8th Cir. 1995).

Charles Gitto, Gary Gitto, and Frank Miller, each legally distinct from Gitto Global as a corporate enterprise, see Cedric Kushner Promotions, Inc., 533 U.S. at 166, apparently all participated to a high degree in the operation and management of Gitto Global. Charles Gitto was the Chairman of Gitto Global and appears at least periodically to have had an active role in the day-to-day management of its production activities. The Examiner also has been provided with a number of letters authored by Charles Gitto (often on Gitto Global letterhead that referred to him as "Chairman of the Board") to customers or potential customers. He also appears to have been heavily involved in matters of high significance to Gitto Global, such as negotiations with Guaranty and VitroTech. Gary Gitto and Frank Miller were forty percent and fifty percent shareholders of Gitto Global, respectively (and Gary Gitto had voting control of an additional 10% of the company's stock), and have been active in its management since the company was formed in 1993. In addition, Frank Miller was primarily responsible for the financial affairs of Gitto Global. Thus, Charles Gitto, Gary Gitto and Frank Miller likely each satisfy the "conduct" element of a RICO claim.

After establishing that the defendants engaged in the conduct of an interstate enterprise, the plaintiff must establish a pattern of racketeering activity. See McEvoy Travel Bureau, Inc. v.

Heritage Travel, Inc., 904 F.2d 786, 788 (1st Cir. 1990). In alleging a pattern of racketeering activity, the plaintiff must first identify, in her complaint, the specific predicate acts of racketeering on which she relies. Offenses that can serve as RICO acts of racketeering are listed in the statute, see 18 U.S.C. § 1961(1), and include mail, wire, and bank fraud. See 18 U.S.C. §§ 1341, 1343, 1344. However, if the plaintiff relies on predicate acts containing fraud, the complaint will be subject to Federal Rule of Civil Procedure 9(b)'s heightened pleading requirement and therefore the plaintiff must state the time, place, and content of the alleged misrepresentation perpetuating the fraud. See Ahmed, 118 F.3d at 889; see also Bessette v. Avco Fin. Servs., Inc., 230 F.3d 439, 443 (1st Cir. 2000) (noting that a greater level of specificity is required in general in pleading a RICO claim); Feinstein v. Resolution Trust Corp., 942 F.2d 34, 42 (1st Cir. 1991) ("It is not enough for a plaintiff to file a RICO action, chant the statutory mantra, and leave the identification of predicate acts to the time of trial."); New England Data Servs., Inc. v. Becher, 829 F.2d 286, 288 (1st Cir. 1987) (Rule 9(b) has been strictly applied where fraud lies at the core of a RICO claim).

Based on the Examiner's findings, it is likely that the Gitto Principals perpetrated mail and bank frauds in carrying out their schemes, although further investigation is required to identify the precise time, place and content of the alleged misrepresentations underlying the frauds.[59] Bank fraud requires that the defendant engaged in or attempted to engage in a scheme

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[59]When the Examiner refers here and elsewhere in the Report to the involvement of the Gitto Principals in connection with the falsification of borrowing base certificates, overstatement of receivables, misrepresentation of inventory values and reporting of fictitious sales to real and fictitious customers, it should be understood that all three Gitto Principals were not equally involved in the planning and execution of these activities. It is clear to the Examiner that all three of the Gitto Principals must have known of the misconduct, but it is also fair to say that Frank Miller personally was much more involved than either Gary Gitto or Charles Gitto in the day-to-day reporting of fictitious inventory, accounts receivable and sales numbers. Mr. Slattery, in fact, believed that Charles Gitto was not directly involved in carrying out the fraud at all, but it must be noted that Mr. Slattery left the employ of Gitto Global in the late Summer or early Spring of 2002, and other interviewees report that Charles Gitto became much

to defraud a financial institution. 18 U.S.C. § 1344. Check kiting schemes, such as those perpetrated by the Gitto Principals, constitute a scheme to defraud a financial institution for purposes of the bank fraud statute. See United States v. Stone, 954 F.2d 1187 (6th Cir. 1992); United States v. Celesia, 945 F.2d 756 (4th Cir. 1991). In addition, the Gitto Principals (or those acting at their direction) falsified the company's Borrowing Base Certificates, required documentation under the LaSalle LSA, by overstating the company's accounts receivable, by reporting fictitious sales to real and fictitious customers and overstating and misrepresenting the value of the company's inventory. In doing so, the Gitto Principals fraudulently increased the company's borrowing level under the LaSalle LSA and thereby allowed the insiders to continue to loot the corporation.

Similarly, mail fraud requires that the alleged perpetrators had a scheme to defraud, had a specific intent to defraud, and made a mailing in furtherance of the scheme. 18 U.S.C. § 1341; see McEvoy Travel Bureau, Inc., 904 F.2d at 790. The Examiner believes that the Gitto Principals may have used the mails, in violation of RICO, perhaps through the delivery of deceptive Borrowing Base Certificates and financial statements, to further their schemes. At this time, however, further investigation may be required to plead mail or wire fraud with greater specificity.

Once the plaintiff identifies the predicate acts of racketeering, she must allege a pattern of racketeering activity. See McEvoy Travel Bureau, Inc., 904 F.2d at 788. A pattern of racketeering activity involves at least two predicate acts, the second of which must occur within

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more involved in the operations at Gitto Global subsequent to that time period. Mr. Slattery also states that while Gary Gitto was certainly aware of what was happening, he was not involved in the actual planning or execution of the fraudulent activities. Mr. Slattery identifies the masterminds of the fraud as Mr. Miller and Mr. Deakin. Mr. Deakin believes, as the Examiner does, that Charles Gitto must have known of the misconduct, at the very least

ten years of the first. See 18 U.S.C. § 1961(5); see also Apparel Art Int'l, Inc., v. Jacobson, 967 F.2d 720, 722 (1st Cir. 1992) (finding that a single criminal event does not constitute a pattern of racketeering activity). Indeed, even if a plaintiff adequately alleges *two* predicate acts, this is not necessarily sufficient to establish a "pattern of racketeering activity." See H.J. Inc. v. Northwestern Bell Tele. Co., 492 U.S. 229, 239 (1989) (finding "sporadic activity" does not form a pattern); Fleet Credit Corp. v. Sion, 893 F.2d 441, 444 (1st Cir. 1990) ("The use of the word 'requires' ... indicates that alleging two acts of mail fraud ... is necessary but not sufficient to establish a pattern of racketeering activity."); Roeder v. Alpha Indus., Inc., 814 F.2d 22, 31 (1st Cir. 1987) (holding that a single bribe paid in three installments, each constituting a mail fraud violation, did not constitute a "pattern").

In addition, a plaintiff seeking to establish a "pattern of racketeering activity" must show that the "predicate acts are related and that they amount to or pose the threat of continued criminal activity (the 'continuity' requirement)." Ahmed, 118 F.3d at 889; Fleet, 893 F.2d at 444; see also Roeder, 814 F.2d at 30 ("The constituent elements must be sufficiently related to one another and threaten to be more than an isolated occurrence."). To fulfill the relatedness requirement, the predicate acts must have the "same or similar purposes, results, participants, victims, or methods of commission, or otherwise are interrelated by distinguishing characteristics and are not isolated events." H.J., Inc., 492 U.S. at 241. In establishing continuity, the plaintiff must show "either that the related predicates 'amounted to' continued criminal activity or that there was, even though the predicate acts did not span a significant time, a 'threat' or realistic prospect of continued activity in time yet to come." Ahmed, 118 F.3d at 889; see also

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when he made the $1,500,000 deposit into the J&J Chemical Account at Clinton Savings Bank (if in fact such deposit was made, which Clinton disputes) and likely long before that.

Framingham Union Hosp., Inc. v. Travelers Ins. Co., 721 F.Supp. 1478, 1484 (D. Mass. 1989) (finding that the "flexible" factors to be looked at to determine whether defendants' activities are continuous include (1) the number of independent victims; (2) the number of participants; (3) the purpose of the activity; (4) the result of the activity; (5) the method of commission; (6) the number of transactions; (7) whether the scheme is ongoing and open-ended; and (8) the duration of the activity).

Over a period of years, the Gitto Principals appear to have methodically and systematically defrauded LaSalle and its other creditors and usurped corporate funds for their personal use. Beginning on July 25, 2002, the Gitto Principals routinely falsified the Borrowing Base Certificates they provided to LaSalle. In addition, beginning with the establishment of the J&J Checking Account in 2001, the Gitto Principals engaged in a check kiting scheme. In carrying out these schemes, the Principals may have engaged in hundreds of predicate acts of bank and mail or wire fraud. These acts were clearly not isolated events but were all conducted by the same participants, by similar methods, with the purpose of fraudulently inflating the company's assets to obtain financing and obtaining personal rewards.

d. Deepening Insolvency

Courts recognizing deepening insolvency as a distinct cause of action, rather than a theory of damages, describe it as "an injury to the [debtor's] corporate property from the fraudulent expansion of corporate debt and [the] prolongation of corporate life." See Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., Inc., 267 F.3d 340, 347 (3d Cir. 2001). As of yet, however, no court has definitively identified the elements of a deepening insolvency claim and many jurisdictions, including Massachusetts, have yet to determine whether they will acknowledge it as a viable cause of action. Nonetheless, the following factors appear essential to finding liability: (i) the fraudulent prolongation of an insolvent corporation's life by hiding its

true financial condition; (ii) causing the corporation to become more insolvent by incurring additional liabilities or the dissipation of assets; (iii) losing the value that could have been realized if the corporation's business activity had not been improperly prolonged; and (iv) the corporation suffers harm distinct from that suffered by its creditors.

Prolonging an insolvent corporation's life without more, however, will probably not result in liability. One Bankruptcy Court found a plaintiff seeking to recover for deepening insolvency "must show that the defendant prolonged the company's life in breach of a separate duty, or committed an actionable tort that contributed to the continued operation of a corporation and its increased debt." In re Global Serv. Group, LLC, 2004 WL 2480185, *5 (Bankr. S.D.N.Y. Nov. 4, 2004) (failing to resolve the question of whether deepening insolvency is a tort or damage theory under New York law) Other courts have recognized deepening insolvency claims against the debtor's directors and officers, outside professionals such as accountants, and financial institutions associated with the insolvent debtor. See R.F. Lafferty & Co., Inc., 267 F.3d 340. For example, deepening insolvency has been recognized as a cause of action against secured lenders that financed a troubled company's acquisitions in exchange for significant collateral and guarantees, forced the debtor to replace its chief financial officer, obtained liens on the assets and capital stock of the debtor's subsidiaries, and caused the debtor's bankruptcy filings to be delayed to prevent the liens from being voidable as preferences in a subsequent bankruptcy, all while the company became more insolvent. In re Exide Technologies, Inc., 299 B.R. 732, 752 (Bankr. D. Del. 2003).

This emerging area of law should be carefully considered as a potential claim against the Gitto Principals. The principal theme of this Report has been that the Gitto Principals abused their positions of authority at Gitto Global for the purpose of personal enrichment. There is

evidence that the diversion of corporate funds continued unabated even as Gitto Global's actual performance dramatically weakened and the company spiraled downward. As noted above, the Examiner is not in position to determine when Gitto Global became insolvent and to what extent the insolvency deepened over time. The discouraging results of the Debtor's Section 363 sale, however, makes clear beyond cavil that the company was very much insolvent when it filed bankruptcy. Further, nothing has been brought to the Examiner's attention that suggests the Gitto Principals acted to improve the company's (as opposed to their own) financial condition in the years prior to the Petition Date.

2. Other Employees of Gitto Global & Nancy Gitto-Panagiotes

The focus of this Report, of course, has been the Examiner's findings of misconduct by the Gitto Principals. As made clear above, however, it appears indisputable that a number of other current and former Gitto Global employees had knowledge of and/or actively participated in such misconduct. An estate representative could reasonably decide to pursue recovery actions against some or all of these employees and the Examiner is aware that many such employees were named as defendants in the LaSalle Complaint.

The Examiner does note a fundamental distinction between the employees discussed herein and the Gitto Principals themselves. In contrast to the significant evidence that the Gitto Principals personally profited from the misconduct described herein, the Examiner has not been provided with any evidence that suggests the employees (with certain possible exceptions noted below) received compensation specifically for their participation. The motivation of most of the employees appears to have been simply to stay in good standing as employees of Gitto Global. Further, it is doubtful that all of the employees fully grasped the scale of the fraudulent acts being carried out and the economic stakes of the Gitto Principals' misconduct. The Examiner

suggests that the roles of each employee should be considered very carefully before any recovery actions are commenced.

Some of the non-Gitto Principals do appear more culpable than others. Maria Miller was married to a Principal and it can be logically assumed that she shared in any misappropriated funds paid to him. It also appears that Ms. Miller personally played a central role in falsifying the company's inventory records. John Moritz, a former Gitto Global employee was the recipient of questionable "commission" payments that merit further investigation. The Examiner was also struck by the prominent role Helen Kozak seemed to play in various questionable activities and thinks it important that further investigation be conducted on her activities.

Ms. Gitto-Panagiotes merits separate discussion. As noted above, she is the daughter of Charles Gitto and sister of Gary Gitto and apparently has owned 10% of Gitto Global's capital stock for some period of time. Ms. Gitto-Panagiotes also ostensibly served as Gitto Global's marketing director from approximately 1992 until December, 2003. (Transcript of 2004 Examination of Nancy Gitto-Panagiotes, hereinafter "Gitto-Panagiotes Exam.," at 5-7). At some point during her tenure, it appears that Ms. Gitto-Panagiotes was given the title of vice president, but her duties never exceeded the coordination of Gitto Global's marketing efforts. (Gitto-Panagiotes Affidavit at ¶ 12.) Ms. Gitto-Panagiotes' role in the operations of Gitto Global seems to have been very limited. She testified that while serving as marketing director for Gitto Global, she typically worked at Gitto Global's office one day a week and at her home the remaining four days of the week. (Gitto-Panagiotes Exam. at 13). Despite having served as Gitto Global's marketing director for at several years, Ms. Gitto-Panagiotes was only able to recall the names of two of Gitto Global's customers. Indeed, during the 2004 examination of Ms. Gitto-Panagiotes

conducted by the Examiner, she was able to recall very little about Gitto Global's operations, customers, vendors and employees. (See, *e.g.*, Gitto-Panagiotes Exam. at 21, 44, 122-23).

Ms. Gitto-Panagiotes stated that she never served as an officer of Gitto Global and did not participate in management decisions made by Gitto Global. (See Gitto-Panagiotes Affidavit at ¶ 13). Moreover, although she owned 110 shares of Gitto Global, Ms. Gitto-Panagiotes did not have the right to vote her shares as a result of a Voting Trust Agreement entered into in 1994, through which she transferred legal title of her shares to Gary Gitto as Trustee. The Examiner has not been provided with any evidence that Ms. Gitto-Panagiotes was involved in, or even knew about, the fraudulent activities directed by the Gitto Principals.

While she was employed by Gitto Global, Ms. Gitto-Panagiotes received an annual salary ranging from $110,308 to $121,540. Ms. Gitto-Panagiotes testified that in December, 2003, Gary Gitto fired her after she demanded to see Gitto Global's financial records. (Gitto-Panagiotes Exam. at 32). Subsequent to her termination in December, 2003, Ms Gitto-Panagiotes continued to receive weekly paychecks from Gitto Global in the same amount as the paychecks she received in 2003, $2,480. (Gitto-Panagiotes Exam. at 96-97). Gitto-Panagiotes testified that she did not consider the checks she received from Gitto Global after she was fired to be "paychecks," but rather, looked at them as reimbursement for attorneys' fees she had incurred in collecting a loan she made to Frank and Maria Miller in June, 2002, and as dividend payments arising from her interest in Gitto Global. (Gitto-Panagiotes Exam. at 96-97).

In addition to her salary, Ms. Gitto-Panagiotes received additional payments, directly and indirectly, from Gitto Global. Between October 2, 2002 and June 2, 2004, Ms. Gitto-Panagiotes received from Gitto Global $64,966.68 in interest payments related to the loans she made to Gary Gitto and the Millers. Based upon the Elimination Reports (Exhibit 6), it appears that Ms.

Gitto-Panagiotes received reimbursement from Gitto Global for substantial expenses, including her vehicle lease, telephone charges and travel, meal and lodging expenses. Such charges attributable to Ms. Gitto-Panagiotes totaled $32,150.57 in 2000, $27,677.96 in 2001, and $21,762.93 in 2002. In light of such expenses, it is noteworthy that during her examination, Ms. Gitto-Panagiotes testified that she has not attended a trade show on behalf of Gitto Global since 1994. (Gitto-Panagiotes Exam. at 55-56).[60]

Based on the above information, some of the amounts paid to Ms. Gitto-Panagiotes may well be subject to recovery by an estate representative. The Examiner does not believe, however, that Ms. Gitto-Panagiotes was otherwise involved in the misconduct described in this Report.

B. Role of Third-Party Professionals and Theories of Liability Available to the Estate[61]

1. Theories of Potential Liability to the Estate and Potential Defenses

The far-reaching misconduct of the Gitto Principals implicated many persons and entities outside of Gitto Global. Below, the Examiner considers the participation of certain third-party professionals in the Debtor's transactions and measures their conduct and liability to the estate against two legal theories, professional liability and deepening insolvency (as discussed above). The Examiner considers each of these legal theories as they might be applied to the acts of Gitto

[60] Ms. Gitto-Panagiotes testified that although she had use of a Gitto Global corporate credit card at one point, it was taken away from her in or around 1994. (Gitto-Panagiotes Examination at 55-56). Based on certain of Gitto Global's credit card records reviewed by the Examiner, it does not appear that Ms. Gitto-Panagiotes had use of a corporate credit card in recent years.

[61] Any prosecution of recovery actions by an estate representative – whether against professionals or other third-parties – likely will implicate issues of standing that are not discussed herein. See, e.g., In re Rare Coin Galleries of America, Inc., 862 F.2d 896, 900 (1st Cir. 1988) (noting that bankruptcy trustee does not have standing to assert claim on behalf of creditors when it belongs solely to them).

Global's professionals, and the potential defenses that might be available to such professionals, in the sections below.[62]

a. Professional Malpractice

Where a third-party professional, such as an accountant or lawyer, provides deficient professional services to the debtor, the trustee may have a cause of action for fraud, malpractice, aiding and abetting a fraud, breach of contract, and breach of a fiduciary duty. See Hirsch v. Arthur Andersen Co., 72 F.3d 1085, 1092 (2d Cir. 1995); see also 11 U.S.C. § 541 (permitting the trustee to bring claims founded on the rights of the debtor). Generally, however, courts have traced each of these causes of action to a "single form of wrongdoing," professional malpractice. See Hirsch, 72 F.3d at 1092; In re Wedtech Corp., 81 B.R. 240, 241 (Bankr. S.D.N.Y. 1987); Cenco Inc. v. Seidman & Seidman, 686 F.2d 449, 553 (7th Cir. 1982). In Massachusetts, actions against accountants and attorneys for professional malpractice sound in negligence. See Am. Disc. Corp. v. Kaitz, 206 N.E.2d 156 (Mass. 1965) (action against accountant); DiPiero v. Goodman, 436 N.E.2d 998 (Mass. App. Ct. 1982) (action against attorney). Thus, the essential elements which must be established by the plaintiff in order to recover against an accountant or attorney for professional malpractice do not differ from those required in other negligence actions: (i) the duty owed to him by the defendant, (ii) breach of that duty, (iii) which was the proximate cause, (iv) of the plaintiff's damage. DiPiero, 436 N.E.2d at 999. Generally the duty which accountants and attorneys owe is "reasonable care" under the circumstances. Id.

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[62] The Examiner's discussion of Louis Pellegrine and Bowditch & Dewey below should not be considered limiting. Gitto Global employed other professionals, such as Mark Bodanza, Esq., who may have knowledge of the misconduct discussed in this Report. In the relatively short period of its investigation, however, the Examiner concluded that Mr. Pellegrine and Bowditch & Dewey were the primary accounting and legal service providers to Gitto Global during the relevant periods.

b. Potential Defenses

In assessing whether a fact-finder could determine that the third-party professionals have any liability under a professional malpractice or deepening insolvency theory, the Examiner has considered defenses available to the defendants. The Examiner has considered potential defenses by reference to the elements of the claims as well as additional defenses unrelated to knowledge or conduct. The elements most likely to present issues of material fact for consideration by the fact-finder are:

- Whether the Debtor's accountants or attorneys breached a duty they owed to the Debtor;
- Whether the damage suffered by the Debtor was the direct and foreseeable result of the breach of that duty; and
- Whether the accountants or attorneys committed an actionable tort that contributed to the continued operation of a Debtor and its increased debt.

Whether the accountants or attorneys of the Debtor will succeed on one or more defenses to any of these causes of action will depend upon the fact-finder's resolution of the facts. In addition, the Examiner also believes that the third-party professionals may be able to assert against claims brought by an estate representative the affirmative defense of *in pari delicto* if they can show that the misconduct of the Debtor's officers should be imputed to the Debtor. See supra Section VI(C)(4).

The *in pari delicto* doctrine provides that a claimant may not assert a cause of action against a defendant if the claimant bears the fault for the claim. Thus, the doctrine prevents the debtor-in-possession or the trustee from pursuing a claim in bankruptcy against a third party for

defrauding a corporation with the cooperation of management.[63] See generally Shearson Lehman Hutton v. Wagoner, 944 F.2d 114 (2d Cir. 1991); Official Comm. Of Unsecured Creditors v. R.F. Lafferty & Co., Inc., 267 F.3d 340 (3d Cir. 2001). The doctrine will not prevent the claim, however, if the "adverse interest exception" applies. Under the exception, management misconduct will not be imputed to the corporation if the officer acted entirely in his own interests and adversely to the interests of the corporation. See Munroe v. Harriman, 85 F.2d 493, 495 (2d Cir. 1936). The exception is narrow, however, and applies only when the officer has "totally abandoned" the corporation's interests. See In re Mediators, Inc., 105 F.3d 822 (2d Cir. 1997). Furthermore, the adverse interest exception does not apply, and the knowledge of the officer is imputed to the corporation, where the officer is the sole representative of the corporation. This is called the "sole actor" doctrine. See Wechsler v. Squadron, Ellenoff, Plesent & Sheinfeld, L.L.P., 212 B.R. 34, 36 (Bankr. S.D.N.Y. 1997) (applying the sole actor doctrine when "all relevant shareholders and/or decisionmakers" were involved in the wrongful conduct); Lippe v. Bairnco Corp., 218 B.R. 294, 302 (Bankr. S.D.N.Y. 1998) (applying the sole actor doctrine if there is sufficient "unity" between the corporation and the defendant to implicate the corporation itself, rather than just its agents, in the wrongdoing); PNC Bank v. Hous. Mortgage Corp., 899 F.Supp. 1399, 1405–06 (W.D. Pa. 1994) (dismissing corporation's claims against accountants because sole shareholders and officers of the corporation participated in alleged fraud); Official Comm. Of Unsecured Creditors v. R.F. Lafferty & Co., Inc., 267 F.3d 340 (3d Cir. 2001) (holding that the creditors' committee, pursuing "deepening insolvency"

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[63] The First Circuit has yet to consider in a published opinion whether the *in pari delicto* doctrine should bar suit by a trustee on behalf of a debtor that participated in the underlying fraud giving rise to the suit. Presently, however, the United States District Court for the District of Massachusetts is considering the issue. See In re Advanced RISC Corp. (C.A. No. 04-40123-NMG) (Oct. 27, 2004).

claim on behalf of debtor corporations, was *in pari delicto* with sole shareholders and thus did not have standing).

Under the *in pari delicto* doctrine, an estate representative will have standing to bring the aiding and abetting and deepening insolvency claims but misconduct by the Debtor's officers will create an affirmative defense to those claims if such conduct is imputed to the Debtor. Unless a sufficient adverse interest is shown, the misconduct of the Debtor's officers may be imputed. Even if a sufficient adverse interest is shown, however, the misconduct of the officers will be imputed if they were the sole representatives of the corporation.

2. Louis J. Pellegrine

The Examiner believes that persuasive evidence exists that Mr. Pellegrine's professional's services to Gitto Global were performed in a deficient manner. Based on the information presently available to the Examiner, potential claims exist with respect to at least three areas of Mr. Pellegrine's conduct:

- Preparation of grossly inaccurate audited financial statements for fiscal 2001 and 2002 and the "compilation" of equally inaccurate 2003 financial statements;
- Manipulation of accounts receivable verifications; and
- Establishment of Hemisphere Distribution and Direct Wood.

The Examiner's view that potential claims exist against Mr. Pellegrine is informed in part by the statements of William Deakin. Mr. Pellegrine became Gitto Global's independent auditor in 1998. Mr. Deakin advised that after the first couple of years of work for Gitto Global, during which Mr. Pellegrine was often on-site at the Gitto Plant, Mr. Pellegrine rarely was seen at the Gitto Plant even during times when he was preparing to audit the company's financial statements. Mr. Deakin stated that Mr. Pellegrine would appear at the plant for only one day

around the time of the company's annual audit and that Mr. Deakin could not understand how Mr. Pellegrine completed his audit based on the limited information provided to him. The Examiner also noted the substantial amounts of money that Gitto Global paid to Mr. Pellegrine. Finally, of course, the Examiner was struck simply by the gross inaccuracy of the financial statements that Mr. Pellegrine certified.

Mr. Pellegrine's involvement with the account receivable verifications and the establishment of Hemisphere Distribution and Direct Wood discussed above and in the Appendix clearly merits further investigation. Neither Hemisphere Distribution nor Direct Wood appears to have had a legitimate business purpose. While Mr. Pellegrine did meet with the Examiner for a limited period of time, his answers in respect of these activities were not informative and the Examiner found Mr. Pellegrine evasive. Mr. Pellegrine subsequently invoked his Fifth Amendment rights, which hampered the Examiner's further investigation of these matters.

In general, the Examiner was left with the clear impression that Mr. Pellegrine did not discharge his professional responsibilities to Gitto Global in an acceptable fashion. Further, the materials that Mr. Pellegrine prepared or participated in preparing seem to have helped prolong Gitto Global's existence.

3. Bowditch & Dewey, LLP

The Examiner does not have sufficient information to determine, even preliminarily, whether claims exist against Bowditch & Dewey or any of its partners. For a number of reasons, the Examiner's investigation into the relationship between Bowditch & Dewey and Gitto Global for the purposes of this section of the report has not been completed. Bowditch & Dewey appears to have represented Gitto Global since its inception. It also has a long history of representing the Gitto Principals individually on a variety of issues (Angelini Exam. at 1-13, 1-14). Sometimes the Gitto Principals would pay for the firm's services; sometimes Gitto Global

would pay for the services. (Angelini Exam. at 1-29, 1-30). Bowditch & Dewey also organized and, apparently, represented a number of corporations otherwise discussed in this report, including Kingsdale, Tradex and Direct Wood. Finally, Bowditch & Dewey has represented Gitto Global employees in addition to the three Gitto Principals.

As a result of these multiple representations, notwithstanding Gitto Global's waiver of the attorney-client privilege, the substantial Bowditch & Dewey document production had to be reviewed by counsel for Charles Gitto, Gary Gitto, Nancy Gitto-Panagiotes, Tradex, and Frank Miller prior to its delivery to the Examiner. As this Report is being prepared, the Examiner is still reviewing Bowditch & Dewey documents. In addition, the bulk of the Bowditch & Dewey documents had not been reviewed prior to the examination of Michael Angelini, the only Bowditch & Dewey lawyer whom the Examiner has interviewed. Further, the examination of Mr. Angelini was hampered by the fact that virtually all information that came to Mr. Angelini allegedly came through discussions with Gary Gitto, Charles Gitto and Frank Miller, who, as noted above, were all individual clients of Bowditch & Dewey. As a result, counsel for one or more of those parties would assert the attorney/client privilege with respect to such discussions and, accordingly, Mr. Angelini would decline to answer any questions. These issues concerning the scope of the attorney/client privilege will have to be pursued further by the Examiner or a subsequent investigator.

A brief discussion of Exhibit 24 to the Angelini Examination may serve to outline some of the problems the Examiner faced. Bowditch & Dewey withheld Exhibit 24 as privileged during its document production. The document was, however, among those delivered by Frank Miller's counsel to Hanify & King and subsequently turned over to the Examiner. Nonetheless, at Mr. Angelini's Rule 2004 Examination, Frank Miller's counsel requested that Mr. Angelini

not discuss the document and Mr. Angelini complied with that request. The Examiner is now holding under separate seal in his files copies of Exhibit 24 as well as the transcript pages on which Mr. Angelini, prior to the request of Frank Miller's counsel, read into the record certain parts of the document. Certainly, the Examiner or a subsequent investigator should pursue the issue of whether Mr. Miller can claim Exhibit 24 and any discussions related thereto as privileged.

Suggestive as to when Bowditch & Dewey may have known of the financial improperties at Gitto Global is Mr. Angelini's letter of May 10, 2002, to Frank Miller, a copy of which is attached hereto as Exhibit 37. In its entirety, that letter states as follows:

> Dear Frank:
>
> I am writing to confirm that we are not and cannot act as your counsel with respect to matters involving your banking relationships, and that we will not act as your counsel with respect to any matter involving any Gitto Global refinancing. We have obtained independent counsel with respect to this and have been advised that we may continue to represent Gitto Global Corporation with respect to other matters, not involving existing or future financial relationships.
>
> My best wishes.
>
> Very truly yours,
>
> Michael P. Angelini

In Bowditch & Dewey's file, this letter was attached to a Bowditch & Dewey inter-office memorandum of the same day to eighteen persons at Bowditch & Dewey who worked on Gitto Global matters. The text of the cover memorandum was as follows:

> The enclosed is for your information. If you have any issues or questions regarding this, please take them up with me.
>
> Thank you.

At the 2004 examination of Mr. Angelini, he stated that he learned the facts that precipitated the May 10, 2002 letter in conversations with Charles Gitto, Gary Gitto and/or Frank Miller (all of whom Bowditch & Dewey then represented on an individual basis) and that he was unable to recollect any conversations concerning this letter or the reasons that prompted the letter other than with Charles Gitto, Gary Gitto or Frank Miller and the referenced independent counsel to Bowditch & Dewey, Max Stern, Esq. (Angelini Exam. at 1-112, 1-113). Counsel for each of Charles Gitto, Gary Gitto and Frank Miller (including Max Stern, who is now representing Gary Gitto) claimed the attorney-client privilege with respect to Mr. Angelini's conversations with their clients and Mr. Angelini claimed the privilege with respect to his conversations with Max Stern in Mr. Stern's capacity as Bowditch & Dewey's then lawyer. The Examiner was thus unable to make inquiry as to the reasons why the letter was sent.

It is perhaps worthy of note that the document in Bowditch & Dewey's files immediately behind the May 10, 2002, letter and cover memorandum was Gitto Global Corporation's borrowing base certificate number 169 to Guaranty Business Credit for the time period ending April 16, 2002, a copy of which is attached hereto as Exhibit 38. The certificate reported, as of that date, Account Receivable Availability of $22,391,431.44 and Inventory Availability of $4,727,935.22. Mr. Angelini, however, did not recall having seen a Gitto Global borrowing base certificate.[64]

The best testimonial evidence (rather than as a result of reading documents) from Mr. Angelini that the Examiner was able to obtain concerning the level of Bowditch & Dewey's knowledge of the various frauds was Mr. Angelini's testimony with respect to Exhibit 21 from

[64] It also should not be overlooked it was during the very same time period, in late April and early May 2002, that Gitto Global and Guaranty were involved in discussions concerning the proposed First Amendment.

the examination of Mr. Angelini, a copy of which is attached hereto as Exhibit 39. Angelini Exhibit 21 consists of a fax cover page dated June 10, 2004, to Mr. Angelini from Frank Miller containing the message "Please review + call me with your thoughts." Attached to the cover page is the May 19, 2004 letter from Stonefield Josephson, to both the members of the Audit Committee and Board of Directors of VitroTech Corporation and the management of Gitto Global discussed in Section V.I.5. above. That letter, which is written to confirm Stonefield Josephson's understanding of the services they are to provide for Vitro Tech, states that "it has come to our attention that there have been certain material improprieties in historical reporting of the company's financial information, specifically in the company's audited financial statements for the years ended January 30, 2003 and 2002." While Mr. Angelini could recall no conversations with Stonefield Josephson on this point, he did indicate that this letter was the first time he could recall a reference to any such material improprieties other than in conversations with the Gitto Principals. (Angelini Exam. at 2-70). Of course, this letter was written over two years after Mr. Angelini wrote to Gitto Global that Bowditch & Dewey would no longer be able to represent Gitto Global with respect to the company's banking relationships.

The Examiner spent some of the time during the Angelini 2004 exam attempting to understand the nature of the relationship between the three Gitto Principals. Mr. Angelini made it clear that there was a substantial amount of disagreement between the three Gitto Principals on a number of issues, including compensation, withdrawals of funds from Gitto Global and travel and entertainment expenses (Angelini Exam. at 1-73, 1-74, 2-229, 2-230).

Further investigation is needed with respect to Bowditch & Dewey. To begin with, the breadth of the shield offered by the attorney-client privilege must be determined. One wonders whether all the conversations which were claimed as privileged by counsel for the Gitto

Principals did in fact involve consultations by individuals who were seeking legal advice on their own behalf. Even if the privilege provides a shield as wide as claimed, however, other attorneys at Bowditch & Dewey may have a recollection of conversations on relevant issues with persons at Gitto Global who were not also clients of Bowditch & Dewey.

Further, consideration must be given to the issues presented by Bowditch & Dewey's simultaneous representation of Gitto Global and its individual Principals after May 10, 2002, the date on or shortly before which Mr. Angelini received information from a Gitto Principal that caused him, on the firm's behalf, to decline to represent Gitto Global further in connection with any banking relationship. If Mr. Angelini learned of an ongoing fraud, and if he learned that the Gitto Principals were engaged in it, could Bowditch & Dewey satisfy it duties to the corporation thereafter, when it continued to represent both the corporation and the Gitto Principals? Moreover, Bowditch & Dewey appears to have formed and/or represented several business entities – including Kingsdale, Tradex Corp., Direct Wood and Hitachi Cable – that may have been utilized by the Gitto Principals to further their schemes and many of which had interests adverse to Gitto Global.

C. Role of Third-Party Institutions in the Gitto Principals' Misconduct and Theories of Liability[65]

1. Theories of Potential Liability

The Examiner reports on the participation of several third-party institutions in Gitto Global's transactions and measures their conduct against two legal theories: (1) aiding and abetting a breach of a fiduciary duty; and (2) deepening insolvency. The Examiner considers

[65] Again, the discussion of specific third-parties in this section should not be considered limiting. An estate representative should also consider recovery actions, where appropriate, against the persons and entities discussed in Section V.K.2. and the Appendix.

each of these legal theories as applied to the actions of various third-party institutions, including VitroTech, Clinton, LaSalle and Guaranty.[66]

a. Aiding and Abetting

If it is determined that one or more of the Debtor's officers breached their fiduciary duties to the Debtor, then one or more of the third-party institutions may be liable if they aided and abetted such breach. While Massachusetts courts have yet to adjudicate a claim for aiding and abetting the breach of a fiduciary duty against a financial institution, they do recognize the tort. See, e.g., Kurker v. Hill, 689 NE. 2d 833, 837 n.5 (Mass. App. Ct. 1998) (noting that the allegations of a complaint pertaining to civil conspiracy also state a claim for aiding and abetting the breach of a fiduciary duty); Spinner v. Nutt, 631 N.E.2d 542, 546 (Mass. 1994) (noting that the plaintiff beneficiaries were required to show that the defendant attorneys knew of the trustee's breach of its fiduciary duty and actively participated in the breach). Those jurisdictions that have applied the tort to financial institutions have found that an affirmative claim may exist if the evidence shows that (i) such third-party institution had *actual knowledge* of the wrongful conduct giving rise to the breach, (ii) such third-party institution gave *substantial assistance* to the wrongdoer, and (iii) the Debtor suffered an injury that was the proximate result of such conduct. See Sharp Int'l Corp. v. State Street Bank and Trust Co., 302 B.R. 760, 770 (E.D.N.Y. 2003) (applying New York law). Other jurisdictions do not require that the claimant plead damages as a result of the breach. See, e.g., Healthco Int'l, Inc., 208 B.R. 288, 309 (Bankr. D.

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[66] The theories discussed relate to affirmative recovery actions. An estate representative could also consider seeking the equitable subordination of any claim asserted by one or more of the third-parties if it can be established that: (i) such party engaged in inequitable conduct, (ii) that conduct resulted in harm to other creditors, and (iii) subordination is not inconsistent with the provisions of the Bankruptcy Code. See, e.g., United States v. Noland, 517 U.S. 535, 538-9 (1996); Mishkin v. Siclari (In re Adler, Coleman Clearing Corp.), 277 B.R. 520 (Bankr. S.D.N.Y. 2002) (finding that claimant's recklessness in allowing his brokerage account to be used for "wash"

Mass. 1997) (applying Delaware law); Neilson v. Union Bank of California, 290 F.Supp.2d 1101, 1118 (C.D. Cal. 2003) (applying California law). In evaluating the sufficiency of the pleadings, some courts have also held that the actual knowledge and substantial assistance requirements must be considered together, and thus a weak showing of substantial assistance may be overcome by a strong showing of actual knowledge. See Woodward v. Metro Bank, 522 F.2d 84, 95 (5th Cir. 1975); FDIC v. First Interstate Bank, 885 F.2d 423, 430 (8th Cir. 1989); Schneberger v. Wheeler, 859 F.2d 1477, 1480 (11th Cir. 1988).

A required element of aiding and abetting the breach of a fiduciary duty is actual knowledge of the underlying wrong. See Spinner, 631 N.E.2d at 546. As a general rule, an allegation of actual knowledge requires more than asserting that the "alleged aider and abettor harbored well-founded—but unconfirmed—suspicions of the primary violator's wrongdoing." Sharp Int'l Corp., 302 B.R. at 771. Thus, allegations that the defendant "must have" or "should have known" of the primary violator's breach will not suffice. See Neilson, 290 F.Supp.2d at 1118–19; Centennial Textiles, Inc., 227 B.R. 606, 613 (Bankr. S.D.N.Y. 1998); see also Kolbeck v. LIT America, Inc., 939 F.Supp. 240 (S.D.N.Y. 1996) (finding that "knowledge of accusations [of improper conduct], without more" did not give rise to a duty to investigate, and did not support an inference of actual knowledge). For example, mere proof that a borrower failed to comply with the reporting requirements in the loan agreement or that the borrower's conduct mimicked that of another fraudulent customer of the bank is not sufficient evidence of the financial institution's actual knowledge. See Sharp Int'l Corp., 302 B.R. at 771. However, it may be sufficient to plead such actual knowledge if a complaint alleges that a lender undertook

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transactions that allowed a separate brokerage company to misrepresent its financial condition amounted to inequitable conduct sufficient to subordinate his claim).

an investigation, or received reports on the borrower's activities from outside agencies, that ultimately confirmed its suspicions of the borrower's wrongful conduct. See Sharp Int'l Corp., 302 B.R. at 772–73.

Knowledge of the primary violation, however, need not be established by direct evidence but may be inferred from the circumstances of the case and the expectations of the parties. See Sharp Int'l Corp., 302 B.R. 760 at 772 ("determining the precise point at which evidence giving rise to suspicions of fraud reaches cumulative critical mass sufficient to support inference of actual knowledge is a fact-intensive inquiry not easily resolved on the face of the pleadings"). For example, less evidence of actual knowledge may be required if the parties are engaging in an atypical business transaction. See, e.g., Neilson, 290 F.Supp.2d at 1120–21 (finding that the banks utilized atypical banking procedures to service the accounts, which raised an inference that the banks knew of the Ponzi scheme and sought to accommodate it by altering their normal ways of doing business); Aetna Casualty and Surety Co. v. Leahey Construction Co., 219 F.3d 519, 536 (6th Cir. 2000) ("although short-term lending may be 'commonplace,' the details of this particular loan (e.g., its four-day duration straddling the July 1996 month end) were highly unusual"); Camp v. Dema, 948 F.2d 455, 459 (8th Cir. 1991) ("A party who engages in atypical business transactions or actions which lack business justification may be found liable as an aider and abettor with a minimal showing of knowledge," citing Woods v. Barnett Bank of Fort Lauderdale, 765 F.2d 1004, 1010 (11th Cir. 1985)). When the violation arises from an ordinary business transaction, however, such as the extension of credit on arm's-length terms and conditions, courts will require strong proof of actual knowledge. See Schneberger, 859 F.2d at 1480.

The second required element of aiding and abetting the breach of a fiduciary duty is substantial assistance of the underlying wrong. A proper allegation of substantial assistance generally requires that the plaintiff specifically allege an affirmative act of the defendant. For example, allegations that the lender made false or misleading statements about the borrower's creditworthiness to encourage secondary financing by another lender would meet the pleading requirements for substantial assistance. See Sharp Int'l Corp., 302 B.R. at 776 n. 8. Similarly, plaintiffs adequately alleged that an account administrator at a bank substantially assisted an investment advisor's fraud and breach of fiduciary duty when they alleged that she "vouched" for the advisor's investment club and "promoted" his skills as an investment advisor to account holders. See Neilson, 290 F.Supp.2d at 1132.

Almost invariably, allegations of inaction or silence on the part of the defendant, in the face of knowledge of a primary violation, are inadequate to sustain a claim for aiding and abetting unless the financial institution had a special duty to disclose information to the claimant.[67] See Sharp Int'l Corp., 302 B.R. at 774. Thus, claiming that the lender provided the borrower with continued access to a line of credit, which enabled the borrower's insiders to perpetrate the fraud, will not suffice. Id. at 775. Similarly, deliberately avoiding the inquiries of potential lenders into the borrower's credit history does not sufficiently allege substantial assistance. See id.

Even allegations of an affirmative act, however, may not suffice if the act does not proximately cause the harm suffered by the plaintiff. For example, a lender does not provide

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[67] Generally, however, banks have no duty to third parties to disclose information about a customer's account. See Eubanks v. FDIC, 977 F.2d 166, 170 n 3 (5th Cir. 1992) ("banks ordinarily owe no duty, fiduciary or otherwise, to third persons.")

substantial assistance when it merely provides the required written consent, as necessitated by the loan agreement, to the borrower's secondary financing. See id. at 776. As one court noted, "although the consent made it possible for the [insiders] to seek additional financing through fraud, there is no allegation that [the lender] did anything to induce [the secondary loan]." Id. at 777. It appears, therefore, that even if the alleged affirmative act of the defendant is the "but for" cause of the plaintiff's harm, courts will not find the defendant liable unless the injury is the "direct and reasonably foreseeable result of the conduct." Cromer Fin. Ltd., 137 F.Supp.2d at 470.

b. Deepening Insolvency

One or more of the third-party institutions may also be liable under a theory of deepening insolvency. See Section VI(A)(1)(d). The gating issue in any such inquiry likely will be whether any of the institutions engaged in inequitable conduct that contributed to Gitto Global's ongoing operations while it became more insolvent, to the detriment of other creditors. See Exide, 299 B.R. at 750-51.

2. VitroTech

The Examiner believes that persuasive evidence exists of the actual knowledge that VitroTech and the VitroTech Principals had of the Gitto Principals' misconduct and of their awareness that such misconduct was utilized to deceive Gitto Global's creditors, particularly LaSalle. The Examiner also believes that VitroTech gave substantial assistance to the Gitto Principals by a variety of means. It appears that VitroTech's actions contributed to Gitto Global's continued operations while it was insolvent, to the possible detriment of Gitto Global's creditors. Accordingly, the Examiner believes that an estate representative should consider pursuing an action against VitroTech, the VitroTech Principals and perhaps their affiliates if