

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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In re :
: C.C. MAGIC, INC., : Chapter 7
: : Case No. 96 B 42773 (CB)
Debtor. :
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JOHN S. PEREIRA, as Chapter 7 Trustee for :
C.C. Magic, Inc. :
Plaintiff, :
v. : Adversary Proceeding
: No. 99 / 8649A
STEVE STERN, TONI GARMENT a/k/a TONI :
GARMENT STERN a/k/a TONI STERN, HYMAN :
GARMENT a/k/a HY GARMENT, IRMA GARMENT, :
NICOLE STERN a/k/a NIKKI STERN, BRIAN :
STERN, THE STERN FAMILY TRUST and the TONI :
GARMENT FAMILY TRUST, :
Defendants. :
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FINDINGS OF FACT, CONCLUSIONS OF LAW AND JUDGMENT

John S. Pereira, as Chapter 7 trustee and the above-captioned plaintiff (the “Trustee” or “Plaintiff”), having filed and served a complaint dated October 5, 1999 (the “Complaint”), against each of the above-captioned defendants, as evidenced by the various affidavits of service thereof on file with the court; and an answer filed November 29, 1999, having been interposed by Steve Stern, Toni Garment a/k/a Toni Stern and Toni Garment Stern, Hyman Garment a/k/a Hy Garment, Irma Garment, Nicole Stern a/k/a Nikki Stern, Brian Stern, the Stern Family Trust and the Toni Garment Family Trust (collectively, the “Defendants”); and an amended answer (the “Answer”) having been filed (Doc. No. 4) November 29, 1999, on behalf of all Defendants; and a motion for partial summary judgment by the Plaintiff as to certain claims asserted in the Complaint against Defendant Steve Stern having been filed August 6, 2002; (Doc No. 9); and an order granting partial summary judgment and a judgment against Defendant Steve Stern in the amount of \$38,000 plus interest at the legal rate from October 5, 1999, each having been signed

by the Court and filed November 13, 2002; and a trial having been held before the Court on August 22, 2005, on the remaining claims asserted in the Complaint; and having heard the Trustee, by his attorneys, Schiff Hardin LLP, A. Peter Lubitz, of counsel, the Defendants, by their attorney, Ted Kramer, Esq.; and upon the testimony of Robert Troisio, on behalf of the Trustee, and upon all the pleadings and proceedings heretofore had herein, including the transcript of the trial held before me August 22, 2005, it is

FOUND:

I. THE DEFENDANTS

1. At all times relevant hereto, Toni Garment, a/k/a Toni Garment Stern (“Toni”) was an officer and employee of C.C. Magic, Inc., the above-captioned debtor (“C.C. Magic” or the “Debtor”), and was married to Steve Stern (“Steve”), the president and 100% shareholder of the Debtor. Both formerly resided at 279 Central Park West in New York City.

2. Nikki a/k/a Nicole Stern (“Nikki”) is their daughter. At times relevant hereto, Nikki resided at 179 East 79th Street, New York City.

3. Brian Stern (“Brian”) is their son. At times relevant hereto, Brian resided at 430 East 72nd Street, New York City.

4. Hyman (“Hy”) Garment is Toni’s now deceased father, who was reported in Steve and Toni’s 1995 tax return as their dependent son domiciled with them at 279 Central Park West. [Trial Exhibit A at Tab B [hereinafter, “Tr. Ex._____, Tab _____”].

5. Irma Garment (“Irma”) is Toni’s mother, who was reported in Steve and Toni’s 1995 tax return as their dependent daughter domiciled with them at 279 Central Park West. [Tr. Ex. A., Tab B].

6. S.B. Stern Family Trust (referred to in the Complaint as the Stern Family Trust) (“Stern Trust”) is, according to the Answer, a trust among Steve, Brian and Nanci Stern for the

benefit of certain members of Steve's family. The address of the Stern Trust was the same as Steve's former residence at 279 Central Park West.

7. Toni Garment Family Trust (referred to in the Answer as the T.G. Stern Family Trust) ("Garment Trust") is, according to the Answer, a trust among Toni, Brian and Nanci Stern for the benefit of certain members of Toni's family. The address of the Garment Trust was the same as Toni's former residence at 279 Central Park West.

II. THE DEBTOR AND ITS BANKRUPTCY CASE

8. The Debtor was in the business of designing, manufacturing, marketing and selling women's sportswear [Complaint ¶23; Admitted in Answer]. An involuntary petition was filed against it on May 21, 1996, and an order for relief was entered against it on June 12, 1996 [Complaint, ¶¶ 20 and 21; Admitted in Answer]. The Trustee thereafter was appointed, duly qualified and continues to act as such.

9. By order dated February 12, 1997, the Bankruptcy Court directed Steve and Toni to (a) assist in the preparation of the Debtor's bankruptcy schedules (b) turnover its books and records and (c) submit to examination pursuant to Bankruptcy Rule 2004.

10. Steve and Toni failed and refused (a) to cause the Debtor to prepare or assist in the preparation of the Debtor's schedules: (b) to turnover or disclose the location of the Debtor's books and records and (c) declined on the basis of their Fifth Amendment privilege to respond to questions at the 2004 examination held April 8, 1997, or at the prior §341 meetings of creditors conducted by the Trustee pursuant to the requirements of the Bankruptcy Code (the "Code").

11. The Trustee ultimately discovered certain of the books and records of the Debtor in a storage space located at a mini warehouse storage facility in Manhattan maintained in Steve's name. The books and records had previously been in another storage locker also maintained in Steve's name, but had been removed in September, 1996, well after the initial §341 creditors' meeting and the entry of the order for relief in this case. The Trustee also was required to

commence an adversary proceeding (97-8900A) and obtain relief from this Court to gain possession of the Debtor's books and records stored by Steve and other of the Debtor's books and records from the Debtor's accountant who also served in that capacity for both Steve and Toni.

12. Among other things, the Debtor's books and records and testimony at the trial demonstrated that the Debtor had been and continued to remain unable to pay its debts and they matured and was insolvent since at least 1993 when, inter alia, substantial obligations to union funds began and thereafter continued to accrue, and remained unpaid at the time when the order for relief was entered.

III. TRANSFERS TO OR FOR THE BENEFIT OF DEFENDANTS SUFFERED BY THE DEBTOR IN 1996

13. The Debtor's books and records discovered by the Trustee reflected no sales or shipments in February 1996. Nevertheless, during February, 1996, the Debtor purchased \$295,000 worth of piece goods, \$32,000 of trim, \$6,000 of buttons and \$256,000 worth of alleged contractor services. Based on these purchases aggregating \$589,000 (the "1996 Inventory Purchase Transfers"), the Debtor should have received at a minimum approximately 90,000 yards of fabric, 30,000 yards of trim, 300,000 buttons and 80,000 garments.

14. No inventory was turned over to the Trustee following entry of the order for relief including, but not limited to, any paid for by the 1996 Inventory Purchase Transfers. Nor were any of the Debtor's furniture, fixtures, equipment, cash on deposit or any other assets turned over to the Trustee.

15. Steve and Toni caused the Debtor to stop maintaining the Debtor's books and records after February, 1996.

16. On December 5, 1995, Toni incorporated an entity named S.Q.R. Inc. of which she was sole shareholder. SQR's address was the same as Toni's former residence located at 279 Central Park West. On March 14, 1996, SQR Inc. opened and started using an account at Chase Bank.

17. In January and February 1996, at a time when for all practical purposes no business was being conducted by or for the benefit of the Debtor, and they knew its demise was imminent, Steve and Toni caused the Debtor to pay \$24,000 in salary to Steve and \$30,000 in salary to Toni (the "1996 Excess Compensation"). During these same months, Steve and Toni also caused the Debtor to disburse \$36,000 for what they categorized as entertainment expenses but which in fact were their personal and lifestyle expenses, an additional \$7,000 which they categorized as travel expenses and \$2,000 in automobile maintenance expenses for which similarly no business purpose was evident (the "1996 Lifestyle Transfers").

18. The Court previously granted partial summary judgment on November 13, 2002, in the amount of \$38,000 to the Trustee against Steve arising from his causing the transfer (the "Porsche Transfer") of title in February, 1996, from the Debtor to himself of a Porsche convertible for which an invoice to Steve in the amount of \$995.00 was found in the Debtor's records, albeit without any evidence of payment therefor.

IV. THE DEFALCATIONS BY AND TRANSFERS TO OR FOR THE BENEFIT OF DEFENDANTS SUFFERED BY THE DEBTOR PRIOR TO 1996

19. The Lifestyle Transfers. During calendar year 1995, and while the Debtor was unable to pay its debts as they matured, Toni and Steve through various means and devices caused the Debtor to disburse monies to and on behalf of themselves on account of personal life style and living expenses, and other personal obligations. No evidence was offered by Steve or Toni or any of the Defendants to demonstrate such transfers and payments by the Debtor were on account of any obligation owed or incurred by or on its behalf. The cancelled checks located in the Debtor's books and records as well as testimony adduced at trial manifestly demonstrated that such disbursements were for Toni and Steve's personal obligations such as, by way of example, rent (approximately \$7,900 per month) on Steve and Toni's Central Park West residence, utility bills for their summer residence on Long Island, payments for their traffic

tickets on the east end of Long Island, restaurant, liquor, phone bills, their personal credit card charges and the like (collectively, the “Stern Personal Transfers”).

20. The Stern Personal Transfers aggregate no less than \$222,402.95 [Tr. Ex. A., Tabs C and D]

21. The Direct Payments by Steve and Toni to Themselves. During calendar year 1995, while the Debtor was unable to pay its debts as they matured, Steve and Toni through various means and devices caused the Debtor to disburse monies to themselves by means of (a) non-payroll hand-written checks drawn to the order of each of them [Tr. Ex. A., Tab E (approximately 21 checks to Toni) aggregating \$119,605.90] [Tr. Ex. A., Tab F (checks to Steve each in the amount of \$5,100) aggregating \$25,500]; (b) checks drawn to the order of petty cash deposited or cashed by Toni aggregating \$34,016 [Tr. Ex. A., Tab H] and (c) two checks payable to Dean Witter Reynolds aggregating \$308,648.20 credited to Steve and Toni’s brokerage account [Tr. Ex. A., Tab G]. (collectively, the “Stern Direct Payments”).

22. The Stern Direct Payments aggregate no less than \$487,770.10. No evidence was offered by Steve, Toni or any other Defendant to demonstrate that any of the Stern Direct payments by the Debtor were on account of any obligations owed or incurred by or on its behalf.

23. Transfers Effectuated by Steve and Toni to or for the Benefit of Family Members. During calendar year 1995 and thereafter, while the Debtor was unable to pay its debts as they matured, Toni and Steve caused the Debtor to make certain payments directly to or for the benefit of members of their families, including the following: (a) checks payable to Nikki aggregating \$12,285 [Tr. Ex. A., Tab K]; (b) checks payable to Brian aggregating \$2,110 [Tr. Ex. A., Tab M]; (c) checks written to Bettina Equities, the landlord of Nikki’s apartment, aggregating \$10,747.10 [Tr. Ex., A., Tab J]; (d) cash and petty cash checks cashed or deposited into Brian’s account aggregating \$15,950 [Tr. Ex. A., Tab M]; (e) cash and petty cash checks cashed or deposited by Nikki aggregating \$3,677 [Tr. Ex. A., Tab L].

24. Such transfers to or for Nikki's benefit total \$26,709.10 (the "Nikki Stern Payments") and those to or for Brian's benefit total \$18,060 (the "Brian Stern Payments"). No evidence was offered by any Defendants to demonstrate that any of the Nikki Stern Payments or the Brian Stern Payments by the Debtor were on account of any obligations owed or incurred by or on its behalf.

25. During calendar year 1995, Toni and Steve caused the Debtor to issue (i) two hand-written checks to the Steve B. Stern Family Trust in aggregate amount of \$6,950. [Tr. Ext. A., Tab O] and (ii) hand-written checks to the T.G. Stern Family Trust in the amount of \$2,360 and to the Toni Garment Stern Family Trust in the amount of \$2,225 aggregating \$4,585 [Tr. Ex A., Tab P]. (collectively, the "Family Trust Transfers" aggregating \$11,225.00). The Debtor had no obligations to these family trusts.

V. THE PAYMENTS TO ALLEGED CONTRACTORS

26. During calendar year 1995, Steve and Toni effectuated payments by the Debtor to contractors, some possibly real and some apparently fictitious, in various ways as a means and device and part of their scheme to defraud its creditors and convert monies of the Debtor.

27. The Trustee introduced documentary evidence and testimony more than sufficient to find the facts hereinafter enumerated while Steve and Toni neither provided nor offered any evidence to the contrary: (a) The Debtor used several contractors to cut and sew garments, at least certain of which contractors were caused by Steve and Toni to be overpaid through various devices by amounts in multiples of then prevailing rates for such services (the "Contractor Overpayments"); (b) the bulk of Contractor Overpayments which at trial were demonstrated to aggregate no less than \$1,282,616 were in turn paid over to Steve and Toni by those contractors, a few of which actually may have existed and participated in Steve and Toni's scheme and others of which were entities owned and/or created by Steve and Toni for such purpose; (c) each of the Debtor's checks used by Steve and Toni to transfer monies as part of the Contractor

Overpayments scheme was manually written as distinguished from the Debtor's standard practice which was to use computer-printed checks generated through the Debtor's accounting systems to pay its legitimate ordinary course expenses; (d) most, if not all, of the contractors involved in receiving Contractor Overpayments, to the extent they ever existed, were dissolved, defunct or not locatable shortly after the commencement of the Debtor's bankruptcy case; (e) certain of these "contractors" which received Contractor Overpayments were names which were apparent iterations of Toni's name, e.g., TEG II, TEG III and TGC, for which most invoices were missing; (f) the Debtor's records also demonstrated that invoices received by the Debtor from these contractors were paid in full despite the lack of verification of the number of garments or piece goods actually received, and such constituted another method by which Steve and Toni effectuated the Contractor Overpayments as part of their scheme to loot the Debtor's assets; (g) Steve and Toni also caused on numerous occasions several manually written checks bearing consecutive numbers to be issued simultaneously on the same dates to the participating contractors with each check, often with the exception of one in each group, being in even amounts, e.g., generally in round hundreds or thousands; (h) numerous of the checks which Toni and Steve caused to be issued as part of their Contractor Overpayment scheme after January 1, 2005, were manually endorsed, rather than stamped "for deposit" by the purported payee, and were cashed at check cashing services; (i) many of the "contractors" used the same check cashing services including, for example, one known as "Pioneer Ventures" which was located in or immediately adjacent to the building in which the Debtor operated; (j) a correlation existed between the activities at these check cashing services and deposits into Toni's and/or Steve's personal accounts – for example, on February 14, 1995, Pioneer Ventures issued its check in the amount of \$100,000 as payment of one it "cashed", and eight days later the Sterns deposited \$100,000 in their personal money market account at Chemical Bank; (k) Steve and Toni's scheme to loot and denude the Debtor of its assets further was advanced by their use of one fabric cutter known as Christina J at the beginning of 1995 rather than the five different cutters it used in accordance with prudent industry practices up to the end of 1994; (l) Steve and Toni

caused the Debtor to transfer approximately \$1.2 million from January to November, 1995, to Christina J. The testimony at trial as well as the Debtor's former accountants work papers obtained by the Trustee established that the cutting cost paid to Christina J. was \$2.95 per garment, rather than the then-prevailing industry cost of \$2-3 per dozen (the "Christina J Overpayments"); (m) although the Debtor's books and records included numerous files which contained invoices from its suppliers, the file labeled "Christina J" had apparently been purged and contained no documents at all; (n); the Christina J Overpayments made by Steve and Toni for their own benefit as part of their scheme to defraud the Debtor's creditors and convert its assets aggregated in 1995 no less than \$683,060.

VI. STEVE AND TONI'S EXCESSIVE COMPENSATION IN 1995

28. During calendar year 1995, when the Debtor was unable to pay its debts as they matured, its tax return showed that it paid Steve and Toni each \$557,000 in salary. The Debtor's records also reflected a transfer to Steve of \$411,617 made on December 27, 1995 and paydowns during that year of approximately \$650,000 (the "Sub-debt Paydown") to him of subordinated loans. Such distribution was made more than two months after the Debtor was unable to finance a large contract to supply K-Mart, a contract which Toni purported to have sold and assigned in or around October, 1995 for her personal benefit. The \$411,617 transfer to Steve occurred less than two months before Steve and Toni began meetings with the Debtor's unofficial creditors' committee, and approximately five months prior to the involuntary petition which commenced the Debtor's bankruptcy case.

29. Toni's personal tax return for 1995 reported her salary from the Debtor as \$344,700, while Steve's return for that year reported \$395,441.03 [Tr. Ex A, Tab B].

30. Under all of the circumstances, compensation paid to Steve and Toni is excessive by no less than \$300,000 for Steve, and no less than \$300,000 for Toni (the "Excessive Compensation"). The amounts reported as paid to each by the Debtor given, inter alia, its financial condition and its inability to finance the K-Mart Contract, represent another facet of

their breach of fiduciary obligations to, and their intention, scheme and design to enrich themselves at the expense of the Debtor and its creditors.

31. Steve and Toni acted with actual intent to hinder, delay and defraud the Debtor and its creditors by effectuating the Stern Transfers, as hereinafter defined.

32. Steve and Toni converted funds of the Debtor and defrauded its creditors by effectuating the Stern Transfers and were, by virtue thereof, inter alia, the transferees of fraudulent transfers which they caused the Debtor to suffer.

33. Based on the foregoing findings of fact, the Court makes the following Conclusions of Law:

1. Steve and Toni each neglected and failed properly to manage the business and assets of the Debtor as required pursuant to Section 720 of the New York Business Corporation Law by causing, effectuating and allowing (i) the Porsche Transfer; (ii) the 1996 Inventory Purchase Transfers; (iii) the 1996 Excess Compensation; (iv) the 1996 Lifestyle Transfers; (v) the Stern Personal Transfers; (vi) the Stern Direct Payments (vii) the Brian Stern Payments; (viii) the Nikki Stern Payments; (ix) the Family Trust Transfers; (x) the Contractor Overpayments; (xi) the Christina J Overpayments; (xii) the Sub-debt Paydown and (xiii) the Excessive Compensation (collectively, the “Stern Transfers”).

2. Steve and Toni effectuated the Stern Transfers which the Debtor suffered with actual intent to hinder, delay and defraud the Debtor and its creditors. Steve and Toni were variously the initial, immediate or mediate transferees and ultimate recipients of each and all of the Stern Transfers which were made to or for their benefit, without value given and in the absence of good faith and such constitute void fraudulent transfers under 11 U.S.C. § § 548(a)(1)(A), 544(b) and Sections 273-276 of the New York Debtor and Creditor Law for which each of Steve and Toni are jointly and severally liable therefor pursuant to, inter alia, 11 U.S.C. § 550.

3. Steve and Toni effectuated the Stern Transfers which the Debtor suffered when the Debtor was at all times insolvent and did not receive reasonably equivalent value in exchange therefor, and such constitute fraudulent transfers under 11 § § U.S.C. § 548 (a)(1)(B), 544(b) and Sections 273-276 of the New York Debtor and Creditor Law, of which transferees Steve and Toni were variously the initial, immediate or mediate transferees and each is jointly and severally liable therefor pursuant to, inter alia, 11 U.S.C. § 550.

4. Toni and Steve each breached their fiduciary obligations to creditors.

5. The Stern Transfers were effectuated through and constituted the common law fraud perpetuated by Steve and Toni .

6. The Stern Transfers constitute conversion by Steve and Toni; and, accordingly, it is

ORDERED, ADJUDGED AND DECREED:

The Trustee shall have judgment against Steve B. Stern and Toni Garment Stern jointly and severally in the amount of \$3,750,000, plus interest thereon at the legal rate from October 5, 1999, for the period through October 5, 2005, in the amount of \$2,025,000 for a total of \$5,725,000, plus interest from the date of judgment until satisfied; and

The following named defendants received fraudulent transfers under 11 U.S.C. §§ 548(a)(1)A and 548(a)(1)(B), 544(b) and Sections 273-276 of the New York Debtor and Creditor Law for which such defendant is liable as transferee under 11 U.S.C. § 550; and

The Trustee shall have judgment against each such defendant in the amount stated below plus interest thereon at the legal rate from October 5, 1999, jointly and severally with Steve and Toni with respect to the amounts set forth for each, below plus interest, until satisfied.

Defendant	Amount	Interest through October 5, 2005 at 9%	Total through October 5, 2005
Brian Stern	\$18,060.00	\$9,752.00	\$27,812.00
Nikki Stern	26,709.10	14,422.86	41,131.96
Steve Stern Family Trust	6,950.00	3,753.00	10,703.00
Toni Garment Stern Family Trust	4,585.00	2,475.90	7,060.90

Enter judgment accordingly.

Dated: New York, New York
October 17, 2005

/s/Burton R. Lifland
UNITED STATES BANKRUPTCY JUDGE