

BEFORE THE OFFICE OF TAX APPEALS

## STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF, )  
 )  
SWAT-FAME INC., ) OTA NO. 18010702  
 )  
 APPELLANT. )

IN THE MATTER OF THE APPEAL OF, )  
 )  
BRUCE STERN and JUDITH STERN, ) OTA NO. 18012114  
 )  
 APPELLANT. )

IN THE MATTER OF THE APPEAL OF, )  
 )  
MITCHELL QUARANTA and ) OTA NO. 18012115  
NINA QUARANTA, )  
 )  
APPELLANT. )

## TRANSCRIPT OF PROCEEDINGS

Van Nuys, California

Wednesday, December 12, 2018

Reported by:  
ERNALYN M. ALONZO  
HEARING REPORTER

ORIGINAL

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Transcript of Proceedings, taken at  
6150 Van Nuys Blvd., Van Nuys, California, 91401,  
commencing at 8:47 a.m. and concluding  
at 4:45 p.m. on Wednesday, December 12, 2018,  
reported by Ernalyn M. Alonzo, Hearing Reporter,  
in and for the State of California.

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APPEARANCES:

Panel Lead: Hon. JUDGE VASSIGH

Panel Members: Hon. GRANT THOMPSON  
Hon. MICHAEL GEARY

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I N D E X

OPENING STATEMENT

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DEPARTMENT'S <u>WITNESSES:</u>	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>
(None offered)				

APPELLANTS' <u>WITNESSES:</u>	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>
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(FTB's Exhibits A-E were received at page 10.)

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1 Van Nuys, California; Wednesday, December 12, 2018

2 8:47 a.m.

3  
4 ADMINISTRATIVE LAW JUDGE VASSIGH: Let's go on  
5 the record.

6 We're opening the record in the consolidated  
7 appeal of Swat-Fame et al, before the Office of Tax  
8 Appeals in OTA Case No. 18010702. The other cases are  
9 appeal of Quaranta, OTA Case No. 18012115, and appeal of  
10 Stearn, OTA Case No. 18012114. We're taking in all the  
11 evidence in Case No. 18010702, which is the Appeal of  
12 Swat-Fame.

13 Today is December 12th, 2018, and the time is  
14 8:47. This hearing is being conveyed in Van Nuys,  
15 California. Today's case is being heard by a panel of  
16 three judges. My name is Amanda Vassigh, and I'll be  
17 acting as the lead judge for the purpose of conducting  
18 this hearing. Judges Grant Thompson and Michael Geary  
19 will also be participating in this hearing.

20 We've read the briefs and examined the exhibits  
21 produced. All three judges will be tasked with making a  
22 decision in this matter as equal participants.

23 Although, the lead judge will conduct the  
24 hearing, any judge on this panel may ask questions and  
25 otherwise participate to ensure that we all have the

1 information needed to make a fair decision.

2 So let's have the parties state their appearances  
3 for the record.

4 MR. DIES: I'm John Dies on behalf of Swat-Fame.

5 ADMINISTRATIVE LAW JUDGE VASSIGH: Can you please  
6 state and spell your name as well.

7 MR. DIES: Yes, ma'am. John Dies, D-i-e-s.

8 MR. SUGGS: Wilber Suggs, S-u-g-g-s, on behalf of  
9 the Appellants.

10 MR. HUNZIKER: Scott Hunziker, H-u-n-z-i-k-e-r  
11 for Appellants.

12 ADMINISTRATIVE LAW JUDGE VASSIGH: And I'd like  
13 to confirm the representatives for Appellants represent  
14 all three of the taxpayers?

15 MR. DIES: Yes, Your Honors.

16 ADMINISTRATIVE LAW JUDGE VASSIGH: And for the  
17 agency?

18 MS. KUDUK: Carolyn Kuduk representing FTB. My  
19 last name is K-u-d-u-k.

20 MR. ROUSE: Ray Rouse representing FTB. Last is  
21 name is R-o-u-s-e.

22 MR. RILEY: Jason Riley representing FTB,  
23 R-i-l-e-y.

24 MS. WIGNALL: And Terry Wignall representing FTB,  
25 W-i-g-n-a, double l.

1 ADMINISTRATIVE LAW JUDGE VASSIGH: Since we all  
2 know the record is voluminous in this case, the parties  
3 have agreed to resolve the appeal based on our  
4 determination with respect to the four sample projects.

5 The parties have agreed to the following samples:  
6 I have UB636, which is Bermuda shorts; Z1743, which is a  
7 skirt and leggings; D11072, which is a slip dress; M93771,  
8 which is a sun dress; is that correct?

9 MR. DIES: It is correct, Your Honor.

10 MR. ROUSE: Yes.

11 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. Thank  
12 you. As I'll remind the parties throughout the appeal, we  
13 need you to please focus on these four sample projects.  
14 The parties have not agreed on how any credit would be  
15 calculated, if the panel finds for some but not all of the  
16 samples are qualified research.

17 You've submitted your proposals to the panel for  
18 consideration on this. You may wish to address it again  
19 in your closings and we will consider accepting some  
20 post-hearing briefing on the matter if the parties would  
21 like that.

22 My understanding of the issues on appeal, are  
23 with respect to four sample projects, one, whether  
24 Appellants' have demonstrated that activities of Swat-Fame  
25 constituted qualified research pursuant to Revenue and

1 Taxation Code Section 23609. And two, whether Appellants  
2 have substantiated Swat-Fame's qualified research  
3 expenses. The parties are free to address such issues as  
4 they see fit in their presentation.

5 We'll go into the exhibits now. It's my  
6 understanding, based on our prehearing conferences, that  
7 there are no objections to exhibits submitted; is that  
8 correct.

9 MR. DIES: That was our understanding, Your  
10 Honor.

11 MS. KUDUK: Yes. No objection.

12 ADMINISTRATIVE LAW JUDGE VASSIGH: And other  
13 testimony you have no new evidence to present?

14 MR. DIES: That is correct; Your Honor.

15 ADMINISTRATIVE LAW JUDGE VASSIGH: FTB, you have  
16 no new evidence?

17 MR. ROUSE: No.

18 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay.

19 MR. DIES: And just for clarification, are those  
20 admitted so that we can refer to them, or do we need to  
21 individually try to offer each one?

22 ADMINISTRATIVE LAW JUDGE VASSIGH: They will be  
23 admitted.

24 MR. DIES: Okay.

25 ADMINISTRATIVE LAW JUDGE VASSIGH: We'll do that



1 right now.

2 MR. DIES: Okay. Perfect.

3 ADMINISTRATIVE LAW JUDGE VASSIGH: So I have here  
4 and you have each before you this little packet,  
5 Swat-Fame's list of trial exhibits, Appellant's Exhibits 1  
6 through 17 listed in the exhibit log. I'm sorry. Some of  
7 these copies might only copied on one side. So you might  
8 look at Appellant's actual exhibit log that they sent you.

9 Appellants, is that what you expect to see in the  
10 record?

11 MR. DIES: Yes, Your Honor.

12 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay.  
13 Respondents, can you confirm for the record that there are  
14 no objections to these exhibits?

15 MS. KUDUK: We have no objections.

16 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay.  
17 Exhibits 1 through 17 are now admitted in evidence.

18 (Appellant's Exhibits 1-17 were received  
19 in evidence by the Administrative Law Judge.)

20 We have also respondent's Exhibits A through E  
21 listed in the exhibit log before you.

22 Respondents, does this reflect what you expect to  
23 see in the record?

24 MS. KUDUK: Yes.

25 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. And

1 Appellants, can you confirm for the record that there are  
2 no objections to these exhibits?

3 MR. DIES: That is correct.

4 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. So  
5 Exhibits A through E are now admitted into the record.

6 (Respondent's Exhibit A-E were received  
7 in evidence by the Administrative Law Judge.)

8 The parties have provided stipulations in this  
9 appeal. I have a printout of appeals from Appellants  
10 dated December 7th and agreed to by Respondents on the  
11 same date, listing the facts parties agreed to. You each  
12 have a copy before you.

13 Does this document accurately represent the  
14 stipulations of the parties?

15 MR. DIES: Your Honor, is that in the blue  
16 binder? I just want to confirm that.

17 ADMINISTRATIVE LAW JUDGE VASSIGH: It should be  
18 in that little package I gave you this morning, the last  
19 page. There's an e-mail from Mr. Hunziker and Ms. Kuduk's  
20 agreement. Is that accurate?

21 MR. DIES: Yes, that is correct.

22 MS. KUDUK: Yes.

23 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. So we  
24 will begin with opening statements. As discussed  
25 previously, each party will have 15 minutes for opening.

1 Please keep your opening statements to an explanation of  
2 what you intend to provide during the evidentiary portion  
3 of this hearing.

4 Appellants, when you are ready, please begin.

5  
6 OPENING STATEMENT

7 MR. DIES: Your Honors, opposing counsel, may it  
8 please the panel. My name is John Dies, and on behalf of  
9 my team, Scott Hunziker, Wilbur Suggs, we are very  
10 grateful to have the opportunity to represent Bruce Stern,  
11 Mitchell Quaranta, and Jonathan Greenberg, as well as the  
12 folks at Swat-Fame, a local business that started many  
13 years ago in the 70's and has continued to create  
14 incredible products for its customers for a very long  
15 time.

16 If I were to speak to you about a product that I  
17 had to make that had to be built with incredibly exacting  
18 specific detail, in some cases within and eighth of an  
19 inch. And then if I were to say, "That product may have  
20 to be duplicated 10,000 times in total correctness with  
21 folks that I have communication challenges with, very  
22 little opportunity to expose myself to, and very little  
23 opportunity to better understand the thought behind the  
24 process," you would expect an incredible level of  
25 engineering.

1           If I were to tell you that Boeing was ordered by  
2     the United States Government to change the kind of metal  
3     that they used in a machine, like an engine block, you  
4     would expect that one would have to learn the  
5     characteristics of that metal. You would expect that  
6     Boeing would have to experiment.

7           I would submit to you that my manufacturer  
8     changes its metal on virtually every product they create.  
9     They have different properties. They have different  
10    structures. They have different characteristics. I  
11    submit to you that this is something that we all take for  
12    granted when we get dressed in the morning.

13          There is this perspective that for the longest  
14    time since Adam found a fig leaf, we've used clothing to  
15    cover our bodies, and, therefore, it must be simple to  
16    make such clothing. This chart behind you belies that  
17    fact, ladies and gentlemen. As it turns out, there is an  
18    incredibly systematic process that must be followed with  
19    multiple iterations to make a blouse, to make a shirt, to  
20    make a pair of pants.

21          And today we're going to talk to you about that  
22    process and the context of the research and development  
23    and credit. In the 1980s when the United States created  
24    the research and development credit, they really did it  
25    for two purposes. The first was to inspire innovation.

1 That is, to get companies to make new and different  
2 products and to take risks.

3 The second was to create technical jobs. That is  
4 we wanted the skilled laborer to be able to make an honest  
5 living and earn a wage. States quickly realized that this  
6 was not only good economic business for them, it was very  
7 good economic business for the states.

8 That is, if we created incentive for our  
9 businesses in our state and places like California to  
10 encourage innovation, to do new and different things, and  
11 to hire technical professionals, we create a stable  
12 citizenry. We create a stable tax base, and we advance  
13 the interest of our state economically. And that's  
14 precisely why California adopted the research and  
15 developing credit, as first espoused under Section 41 of  
16 the Internal Revenue Code.

17 There were some minor differences with  
18 California's adoption. So for example, the research has  
19 to occur in California. So we can't claim research in  
20 Louisiana, or some other part of the country, like on the  
21 federal side. But for purposes of our discussion today,  
22 there are a ton of very, very similar approaches that have  
23 been taken by the State of California who has actually  
24 adopted the United States Section 41 approach.

25 I want to focus on the key arguments that you

1 guys are going to see today with respect to the R&D  
2 credit, and there aren't a ton of them, right. The first  
3 thing you're gonna hear us talk about is the products we  
4 are creating and the process for creating them.

5 Now, the hope is that we can go through this  
6 process in detail quickly, so that when we apply to each  
7 of the products, we're mindful of everyone's time. We  
8 could work through what the challenges were, and it's a  
9 much better, quicker understanding.

10 But for prospective, there are numerous arguments  
11 that have been made by California that we think the  
12 evidence will show don't apply. So let's start with a  
13 couple of them. The first one is that Swat-Fame and the  
14 folks who make these products don't have uncertainty at  
15 the outset when they make their products. There are  
16 really three kinds of uncertainty that we're looking at.

17 Capability, can I do it. You'd be surprised to  
18 note that there's a garment on here that was an utter  
19 failure. We thought we could do it, and we couldn't,  
20 right. At the onset we didn't know.

21 The second uncertainty is uncertainty as to  
22 methodology. You guys will hear in testimony today that  
23 there are times when there are multiple potential  
24 methodologies that might be used to solve a problem. And  
25 we have a theory about what will work, but we don't know

1       until we follow a process that we're about to discuss.  
2       The third kind of uncertainty is uncertainty as to  
3       ultimate design.

4               Ladies and gentlemen, I submit to you that each  
5       and every product we make for the first time has that  
6       uncertainty. And you'll see why here in just a moment.  
7       The second key argument that we're going to be dealing  
8       with is the process of experimentation. As the State of  
9       California has said, Swat-Fame has no process of  
10      experimentation. There are a couple of key phrases that I  
11      want you to focus for purposes of this.

12             And I will tell you when I first began to study  
13      the R&D credit, if you had told me that clothing  
14      manufactures engage in experimentation, I would have said  
15      that sounds silly to me. I understand now, and that's why  
16      we're going to talk about it. This is not about Bunsen  
17      burners or white lab coats.

18             The process of experimentation, as defined in the  
19      Internal Revenue Code, has a totally different meaning  
20      than human beings walking around in the street use, right?  
21      I'm not surprised by that. Our tax code loves to change  
22      words of what they mean. But what you need to understand  
23      is this. The two key things we're focusing on, on are  
24      modeling.

25             Modeling is an activity which is specifically

1 called out as an example of the process of experimentation  
2 within the Internal Revenue Code Regulations that have  
3 been adopted by California.

4 The second kind of process of experimentation  
5 that I want to focus on is systematic trial and error.  
6 That is, we have a hypothesis just like when we were in  
7 grade school learning life science, and we have a theory  
8 about what will work. We try that. It either works, in  
9 which case we've confirmed it, or it doesn't, in which  
10 case we refine our approach and we try it again.

11 Ladies and gentlemen, you will see in every  
12 single garment Swat-Fame make, they have to follow this  
13 process, right. The best evidence that we have is not  
14 going to be the testimony of John Greenberg who is going  
15 to talk to you in great detail in a moment about this  
16 process. The best you have is our action.

17 You see, if we had no uncertainty at the outset,  
18 we make the garment we want to make the first time every  
19 time. If we had no uncertainty at the outset, we would  
20 not need to have a 12-step process to prove we have a  
21 viable product. We're not undergoing all this effort, all  
22 of the labor, all of the hassle and problems that are  
23 associated with the approach we're about to discuss  
24 because we have some academic curiosity of how all that  
25 works.



1           In fact, to the contrary. We are doing so  
2 because we must, to have a viable product. If we make a  
3 single dress that works well in our presence and aren't  
4 careful about our process and order 12,000 of that for one  
5 of our key clients, like Nordstrom's or Sears or  
6 JC Penney's or Walmart, and that product fails, we can  
7 have a catastrophic loss on our hands.

8           So these are clothes that you have seen that some  
9 of you may have bought at stores that you may frequent all  
10 the time. Places like Macy's and so on. But let's talk  
11 for a moment about the process itself. So if you will  
12 excuse me and bear with me, I need to come here for a  
13 moment.

14           We're going to start with the creative concept.  
15 We have a thing called a creative designer, and you guys  
16 are going to see a video of this process that we've put  
17 together if you haven't already. The creative designer is  
18 literally putting together a vision of a garment they want  
19 to create. This is something that is in two dimensions  
20 that is very stylized. That it is hopefully something a  
21 consumer might buy.

22           You're going to hear that one of the arguments  
23 about our work and why it doesn't qualify is that it's  
24 because it is aesthetic, or it involves style factors.  
25 And there's no denying that apparel involves elements of

1 style. So what I will tell you guys, ladies and  
2 gentlemen, is after this initial concept, after the  
3 creative design, no one else in the process gets a vote.

4 If I'm the pattern maker and I think this design  
5 is grotesque, I don't get a vote. My job is to make tools  
6 which can be used to create a three dimensional product  
7 that reflects the two-dimensional design that I have  
8 stated. Does that make sense?

9 So we're going to start with almost a  
10 cartoon-character type drawing, and you guys will have  
11 seen these. We're going to have a small two-by-two swatch  
12 of fabric. That's what we get to start this process. And  
13 then our technical professionals have to create a real  
14 product that is viable that can be scaled to mass produce.

15 Now, you'll hear in evidence that when we get  
16 this swatch we have to test it because we don't know what  
17 the fabric does. We don't know if a young lady wearing  
18 gray pants made out of this fabric walks in the rain and  
19 sits on a white couch, if she's going to change the color  
20 of that couch. We've got to test it.

21 We don't know if this fabric is subjected to a  
22 certain wear that it's going to leave color from an  
23 abrasion standpoint. We don't know if this fabric looks  
24 great the first time you wear it, and you wash it, and  
25 it's two sizes smaller. That's a problem for us. We've

1 got to test shrinkage, right. We have to learn the  
2 properties of this fabric.

3 At this point we're dealing with a two-inch  
4 square. And now somebody has to say okay, if I want to  
5 make this jacket, this pocket, there are sleeves, there  
6 might be a collar, maybe lapels. I've got to draw out  
7 what I think the dimensions are for a slightly heavysset  
8 guy who is six-foot two with whatever my frame is, right.  
9 And I'm going to guess. I mean, I know a little bit about  
10 what I'm doing.

11 These folks are professionals. They've been  
12 doing this for a long time. But I have to guess about  
13 what the proportions of that fabric will be. Now, keep in  
14 mind I haven't seen this fabric in max, right. So I'm  
15 going through the process. Someone is going to make a  
16 pattern based on those dimensions.

17 So if I say make a sleeve that's two inches long  
18 and four inches wide and has the following  
19 characteristics, they are going to try to make pieces of  
20 paper, tooling if you will, that will help us create a  
21 product. I will tell you guys that tooling and the  
22 creation of tooling has been routinely blessed as research  
23 and development.

24 In fact, there are a number of cases where the  
25 creating of tooling dyes have been allowed. Now, our

1 tooling isn't made of metal. Our tooling doesn't bend  
2 steel. But I submit to you that you can't accurately make  
3 a garment without tooling, and that's what our pattern  
4 makers do.

5 Then we have a person who is going to try to make  
6 the first prototype. They're going to cut the fabric  
7 according to the pattern and sew it together. Now, we  
8 hope this will work. And this is a place where modeling  
9 comes in as we're making the pattern. First off we're  
10 going to have digital modeling. So you guys are going to  
11 see this, and we have it on video.

12 We have cad operators who are literally moving  
13 things around in digital space to try create this pattern,  
14 right. The same kind of cad that you would use for a  
15 building or other applications that are routinely accepted  
16 as research activities. So that's the first place where  
17 we're modeling, and it's very clear from the record that  
18 you can move things around in digital space and that be  
19 treated as a process of experimentation.

20 Then we make this thing, and you guys may have  
21 seen a dress formed. It looks like the mannequin who has  
22 be decapitated and had the arms and legs removed, just a  
23 body, right, of a certain size. We're going to put this  
24 garment on there. This is what I would call static  
25 modeling.

1           At this point we don't know how this fabric is  
2 going to lay. We'll see some examples of unpredictable  
3 outcomes today. We don't know how this garment is going  
4 to interact with the body that we've used to simulate a  
5 real size 8 or 10 or 12 or whatever we're making. If that  
6 fails, you guys are going to hear we have to go back to  
7 pattern making. We have to make a new sleeve. We have to  
8 have a new collar. We have to make a new hemline,  
9 whatever it is, right.

10           If it works, now we're going to get to a dynamic  
11 modeling. This is a human being. As it turns out people  
12 in skirts have to get out of cars. They have to climb  
13 steps, right. They have to sit down in a chair. We have  
14 to lift kids and be able to move our arms up. We have to  
15 be able to drive a car. We have to be able to move around  
16 in our clothing.

17           So we do dynamic modeling where we put this  
18 garment that we have made, which has so far passed all of  
19 our tests, on a model and we get feedback. Does it pinch?  
20 Does it pull? Does it sit weird? Does one shoulder rise  
21 higher than the other? Does it look off? Is it different  
22 than what we set out to create?

23           If the answer is yes, we go all the way back to  
24 the drawing board using systematic trial and error to try  
25 to figure out why. Okay. Then and only then, when we've

1 created a product, make a new pattern, make another cut  
2 and sew another example. Then we have to drape it again  
3 over the model, and we have to put it on a fit model and  
4 go through this exact same process again. Then and only  
5 then, we begin to do some other tests.

6 Now we're trying to look at other things like you  
7 see this here. We've completed a sample, looked at  
8 finished goods. How about make a product that someone who  
9 doesn't spend a lot of time that can manufacture on a mass  
10 scale, right. What finishes am I putting on a product?  
11 Am I going to subject that product to a stone wash?

12 People don't realize this. When you get stone  
13 washed jeans, there's actually stones. They're actually  
14 tearing up the fabric. Well, what if I stone wash these  
15 jeans because I've been told by a customer that's what  
16 they want, and it comes apart because I didn't understand  
17 stitching. I didn't understand construction. I didn't  
18 understand how this fabric would behave.

19 Now I have a challenge on my hands. Now I've got  
20 a problem. Now I have to go all the way back here, right,  
21 to cutting and sewing. I've got to change the strength of  
22 the thread. I've got to change the stitch count. I've  
23 got to change the stitch structure. I've got to try and  
24 figure out why this thing failed here, and then I have to  
25 go through this process again. All over again until I get

1 all of this done.

2 And you will see some examples here where we were  
3 not successful, ladies and gentlemen. What I will tell  
4 you is the clothing that we wear we take for granted in  
5 terms of the challenge that's associated with  
6 manufacturing here.

7 The last thing I would point out to you is this.  
8 We heard from an argument from the FTB that there is  
9 adaptation involved. Adaptation has a very specific  
10 meaning with respect to Internal Revenue Code and with  
11 respect to California's adopted version of the R&D credit.  
12 It goes like this.

13 You have taken a business component where you  
14 overcame uncertainty with process of experimentation, and  
15 then you have done something to that business component,  
16 which did not involve the process of experimentation to  
17 change it. The notion is like this.

18 You made a shirt before. This is just another  
19 shirt. The first thing I would tell you, ladies and  
20 gentlemen, is you will see what we go through in the  
21 creation of every garment. If we were just saying that we  
22 made a shirt before, we wouldn't go through all of this.  
23 We would do it the same way we did it before and move on  
24 down the line.

25 The second thing I'll tell you is having been

1 involved in this case for almost five years, the FTB has  
2 never not one time pointed to a single product that was  
3 adapted. That is they have never one time said Swat-Fame  
4 made this, and this is an adaptation of that. They've  
5 never once played evidence of it. They didn't argue in  
6 the underlying exempt. If they show up in this hearing  
7 today and say there are examples of where we have adapted  
8 the four projects you're here to hear about, it'll be the  
9 first time we've seen or learned about it, right.

10 There is no evidence of adaptation. The other  
11 thing is there's a little bit of a disconnect. There is a  
12 kind of talking out of both sides of your neck when you  
13 accuse a manufacturer about adaptation with respect to  
14 R&D. Because on the one hand they've told you we don't  
15 have uncertainty. They've told you we don't have a  
16 process of experimentation.

17 But then they've told you the garments we make  
18 are an adaptation of other things we've made that add  
19 uncertainty in the process of experimentation. The  
20 argument belies the evidence. These are inconsistent  
21 positions that have been taken by the State.

22 We believe the evidence will show that we have a  
23 process which uses modeling, systematic trial and error to  
24 create a product. The methodology that was employed here  
25 has been blessed by several courts who have heard the



1 matter and any other methodology out there. We'll talk  
2 about that as well.

3 The approach taken here is not different or new  
4 or strange. There was nothing radical about this. Seven  
5 courts have heard and seen the use of estimates for wages.  
6 They've seen how we get a supply cost. They've seen how  
7 we calculate the credit.

8 You're going to hear from Mrs. Speice who is a  
9 very experienced project manager with an expertise in  
10 apparel who put together this study. You're going to  
11 learn about the methodology she employed and why she  
12 employed it.

13 Ladies and gentlemen, I submit to you that the  
14 clothing we don't assume has R&D has more R&D than most  
15 things that we deal with on a very technical basis every  
16 day of our life. Thank you very much.

17 ADMINISTRATIVE LAW JUDGE VASSIGH: Thank you.

18 Respondents please begin when you're ready.

19

20 OPENING STATEMENT

21 MS. KUDUK: Okay. My name is Carolyn Kuduk. To  
22 my left are my co-counsels, Ray Rouse, Jason Riley, and  
23 Terry Wignall. For the last 40 years Swat-Fame has made  
24 clothes. For only five of those 40 years, 2008, 2009,  
25 2010, 2011, and 2012 and not in recent years has Swat-Fame

1 claimed California research credit.

2 They claimed it based on a credit study compiled  
3 in 2013 by alliantgroup, Appellant's representatives. In  
4 this study Swat-Fame claimed 36,189 projects, 7,237  
5 projects per year, 603 projects per month, or 20 projects  
6 per day as qualified research. Swat-Fame attempts to  
7 claim credit for its production cost and not for  
8 qualifying research.

9 There are multiple steps to claim the California  
10 research credit. First, the taxpayer must prove there's  
11 qualified research with research documentation. Second,  
12 the taxpayer must prove its qualified research expenses  
13 with accounting records showing nexus to the proven  
14 qualified research.

15 If a taxpayer can prove step one, the analysis  
16 then moves to step two. So this appeal has two issues,  
17 whether Appellants have substantiated Swat-Fame performed  
18 qualified research, and whether Appellants have  
19 substantiated Swat-Fame's claimed qualified research  
20 expenses.

21 Specifically, did Appellants prove that  
22 Swat-Fame's activity is for a permitted purpose, such as a  
23 purpose relating to a new or improved function,  
24 performance, reliability, or quality, and that the  
25 activity is not for disqualified purpose. Activity

1 related to style, taste, consumer preference, cosmetic, or  
2 seasonal design factors are not for permitted purpose.

3 Did Appellants prove that Swat-Fame's activity  
4 met each of the four part test of Section 41(d)(1)?

5 Third, if the activity was qualified research, did  
6 Appellants prove that Swat-Fame's activity was -- was not  
7 adaptation or duplication of an existing business  
8 component.

9 Fourth, did Swat-Fame meet their burden to show a  
10 nexus between the qualified research expenses and  
11 qualified research? And I would just like to state that  
12 it's clearly briefed the question of whether Swat-Fame's  
13 activity was adaptation or duplication in our opening  
14 brief.

15 Five, if any of Appellants' projects are  
16 qualified research, are the estimates of the qualified  
17 research expenses reasonable under the Cohan Rule? To  
18 determine if Appellants are eligible for the credit, your  
19 office will evaluate four sample projects, which I believe  
20 Judge Vassigh has already enumerated. But to review their  
21 project: UB636 are Bermuda shorts; Project Z1743D01  
22 leggings with a ruffle skirt; project D1107 a dress with  
23 an adjustable spaghetti straps; and project M93771 a  
24 cotton sundress in shrug.

25 The evidence will show that respondent properly

1 disallowed Appellants claimed research credit. The  
2 evidence will show that the Swat-Fame's activities were  
3 related to style, taste, consumer preference, cosmetic,  
4 and seasonal design, which was disqualified for the  
5 credit.

6 Today respondent will discuss how Swat-Fame  
7 failed each of the four tests found in Section 41(d)(1).  
8 In each of the four projects, Swat-Fame identified its  
9 business component as a garment and not part of a garment.  
10 Swat-Fame did not apply the shrinking back rule. By law  
11 substantially all of Swat-Fame's activities with respect  
12 to each sample project must be qualified research to get  
13 the credit.

14 Appellants have not demonstrated this. The  
15 evidence will show that Swat-Fame's activities failed the  
16 Section 174 test because at the beginning of each project,  
17 Swat-Fame had a method to develop the garment based on its  
18 40 years of experience creating similar garments. The  
19 evidence will show that Swat-Fame failed the process of  
20 experimentation test because its general design procedures  
21 were not experimentation.

22 The evidence will show that Appellants did not  
23 prove 80 percent of Swat-Fame's activity was a process of  
24 experimentation because Appellants did not show which  
25 activities were done to meet fashion trends, and which, if

1 any, activities were experimentation. The evidence will  
2 show the documentation did not show experimentation.

3 The evidence will show that Swat-Fame failed the  
4 process of experimentation test because its activities was  
5 not for a permitted purpose. The evidence will show that  
6 Swat-Fame failed the technological and nature test because  
7 Swat-Fame's activity was not for the purpose of  
8 discovering information which fundamentally relied on the  
9 principals of physical or biological sciences, engineering  
10 or computer sciences.

11 And the key phrase here is fundamentally rely.  
12 Moreover, even if your office finds qualified research,  
13 evidence will show that Swat-Fame's activity is excluded  
14 from the credit because Swat-Fame's garments were already  
15 made or were a common industry style so that they were  
16 adapted or duplicated.

17 In regards to Swat-Fame's qualified research  
18 expenses, executive wages are presumed ineligible for the  
19 credit. The evidence will show that Appellants have not  
20 overcome that presumption. Therefore, the executive wages  
21 are disqualified.

22 Further evidence will show Appellants did not  
23 provide a nexus between the qualified research expenses  
24 and the alleged qualified research. Swat-Fame did not tie  
25 its expenses to a project. Therefore, Swat-Fame failed to

1       substantiate the right to the credit. As evidence will  
2       show, Appellants failed to prove Swat-Fame engaged in  
3       qualified research. Therefore, Appellants cannot use the  
4       Cohan rule to estimate the qualified research expenses.

5               The evidence will show Appellants failed to prove  
6       entitlement to the California research credit. Therefore,  
7       respondent's determination must be upheld. Thank you.

8               ADMINISTRATIVE LAW JUDGE VASSIGH: Thank you.  
9       We'll now move on to the evidentiary portion of today's  
10      hearing.

11              Appellants, please call your first witness.

12              MR. DIES: Thank you, Judge. We would call  
13      John --

14              ADMINISTRATIVE LAW JUDGE GEARY: Ms. Kuduk,  
15      please state for me again -- I was jotting down -- I think  
16      you mentioned five perspectives that were at issue.

17              MS. KUDUK: Right.

18              ADMINISTRATIVE LAW JUDGE THOMPSON: Can you  
19      briefly hit those for me?

20              MS. KUDUK: First the --

21              ADMINISTRATIVE LAW JUDGE THOMPSON: Yeah. The  
22      first is did Swat-Fame -- did Appellants prove that  
23      Swat-Fame's activities were for a permitted purpose and  
24      was not for a disqualified purpose, such just style.

25              Second, did Appellants activities meet the

1 four-part tests of Section 41(d)(1). And then was the  
2 activity qualified research? If the activity was  
3 qualified research, was it adaptation or duplication? And  
4 then fourth, did the Appellants meet the burden to show  
5 nexus between qualified research expenses and qualified  
6 research.

7 And then the fifth one, if there is qualified  
8 research, are the estimates of the qualified research  
9 expenses reasonable under Cohan?

10 ADMINISTRATIVE LAW JUDGE THOMPSON: Just so I  
11 understand, I understand that to be as contesting overall  
12 amount of expenses claimed, certainly so that it's not  
13 reasonable method; right?

14 MS. KUDUK: Right.

15 ADMINISTRATIVE LAW JUDGE THOMPSON: I heard you  
16 mention executive wages. So you're contesting that. So  
17 in your view the panel might say we find the overall  
18 method is unreasonable, or we find that it needs to be  
19 carved back somehow, but that's the overall pie.

20 Is FTB also arguing that Appellants haven't  
21 adequately substantiated the expenses with respect to each  
22 project on a project level basis?

23 MS. KUDUK: Yes. Yes. And we have found no  
24 nexus between the expenses and the projects.

25 ADMINISTRATIVE LAW JUDGE THOMPSON: Thank you.

1 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. Let's  
2 move on to Appellants' first witness.

3 MR. HUNZIKER: We would call Jonathan Greenberg.

4 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay.

5 MR. HUNZIKER: And, Judge Vassigh, just as a sort  
6 of forecast of where we're going with this. There will  
7 be, with this witness in particular, interplay between not  
8 only what's on the screen but also with the blowups and  
9 what we have on the rack.

10 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay.

11 MR. HUNZIKER: I would like to ask, for the  
12 purpose of preserving time, sort of a running request, if  
13 I may, to approach just the board, the witness, and these  
14 other elements?

15 ADMINISTRATIVE LAW JUDGE VASSIGH: That will be  
16 fine.

17 MR. HUNZIKER: Thank you very much.

18 ADMINISTRATIVE LAW JUDGE THOMPSON: If I may ask  
19 one more question? I apologize. So I think it sounds to  
20 me, like Judge Vassigh say, there's not an agreement on  
21 the calculation that there's a decision -- it's in favor  
22 on some projects and against others. That may be just  
23 something we have to live with. I want to make sure I  
24 understood FTB's position.

25 So -- and also I don't want parties reading into



1       this. I just don't want to walk out of this hearing two  
2       weeks later without something, you know, I need to  
3       understand. But in terms of the proven methodology, let's  
4       just take an example. Let's say the panel found, okay,  
5       you don't get the whole 100 bucks you claim. We think  
6       overall you've got to carve back some aspect -- 80 bucks.

7               And, again, don't read anything into this. I'm  
8       just thinking it through. And then let's say the panel  
9       finds in favor of the Appellants on three of the projects.  
10       Would FTB say then or would 60, you know, would 60 bucks  
11       of credit or three quarters with regard to the overall  
12       pie? Or in other words, is FTB -- I feel like I've heard  
13       different things about where FTB is on the Appellants'  
14       provided methodology.

15              MR. RILEY: If I could just kind of handle that.  
16       So I think you said it best, Mr. Thompson, when you said  
17       there's an additional carve out. So if -- if we say,  
18       well, you know. If -- yeah. If all the projects qualify,  
19       right, then on the step two, with respect to the expenses,  
20       we're asking you to determine whether there should be an  
21       additional carve out based on -- and we're not, you know,  
22       we're not necessarily targeting the individual employees  
23       that worked on, you know, each of these projects.  
24       Because, you know, we're talking about then and, you know,  
25       about ten people.

1           What we're talking about the, you know, the  
2 taxpayers used a cost center methodology, you know. So  
3 they're looking at each cost center. They're looking at  
4 the pattern makers as a block. They're looking at sewers  
5 as a block. They're looking at the, you know, the -- the  
6 designers and the directors as a certain block.

7           So if you were to decide that those cost centers  
8 should be carved at some percentage, then that's what  
9 we're asking you to do based on Cohan.

10           ADMINISTRATIVE LAW JUDGE THOMPSON: But if we  
11 come back and we said -- my example -- we're gonna allow,  
12 let's say, 60 percent. So we allow three quarters  
13 undisputed. Think about our question. Let's just think  
14 about it for a second. Are we going to get a petition  
15 from today's hearing from FTB saying that, you know, that  
16 was unreasonable?

17           MR. RILEY: So -- so you're saying -- so three  
18 projects qualify?

19           ADMINISTRATIVE LAW JUDGE THOMPSON: Yeah.

20           MR. RILEY: So we -- our starting universe is  
21 then 75 percent of what they claimed?

22           ADMINISTRATIVE LAW JUDGE THOMPSON: Yeah, yeah.

23           MR. RILEY: And then you're taking the 60 percent  
24 carve out of that?

25           ADMINISTRATIVE LAW JUDGE THOMPSON: I'm just

1     imagining 8.  You're saying 8.  You start -- they ask for  
2     a 100.  We say, you know, there's a piece of that that we  
3     don't think you should own.  So the overall pot there's  
4     80.  And then, you know, we think you've shown three  
5     quarters.  That was the example I was thinking about.

6             MR. RILEY:  Right.  So I think, you know.  I  
7     think the -- the -- the way it should apply is first we  
8     take -- we, you know, we determine what is the universe of  
9     projects that qualify.  And then based on what that  
10    universe of projects that qualify, then you apply whatever  
11    carve out for wages.  So step one, qualified research.  
12    Step two, qualified research expenses.

13            MR. ROUSE:  So the difficulty is that we don't  
14    have the information -- and it sounds like maybe the  
15    taxpayer doesn't either -- to come up with a more specific  
16    method.  We don't have the numbers by project to where we  
17    can kind of hash this out.  So that's the difficulty.

18            So this is the method we've come up with and to a  
19    certain extent, kind of put it in your hands with the  
20    understanding that we're challenging their methodology.  
21    And then as far as what the -- what the result is, we  
22    could come up with a better way.  We just didn't have the  
23    numbers to be able to come up with a more specific method.

24            ADMINISTRATIVE LAW JUDGE THOMPSON:  And the  
25    Appellants, do you have any comments?

1           MR. DIES: Well, my concern, Your Honor, would be  
2 let's just -- I don't want to add to the hypothetical. If  
3 you -- let's -- we've talked about executive wages. I'm  
4 sure that's going to come up.

5           Let's say you bless three of the four projects  
6 that we talk about today, and you don't bless the fourth  
7 one. If you start at 75 percent and an executive never  
8 touched that project, you're adding a double haircut.  
9 There's a reason why Suiter, McFerren, right, these other  
10 cases that have handled these issues all looked at these  
11 in buckets of wages.

12           Are the wages reasonable? Are these appliances  
13 reasonable? Are the contract cost reasonable? And I  
14 think we should fairly have to show you which wages we  
15 took and didn't take and so on. But to say on a given  
16 product, starting with the sample of four when you have  
17 thousands of products, you should extrapolate this to the  
18 universe of things, we think creates all sorts of  
19 craziness.

20           So the reason why all of these -- and frankly, I  
21 think the reason why the last panel said we're going to  
22 break this into equal parts. It's because we know it  
23 could work affirmatively in someone's favor, but it's just  
24 as likely to work against them. That is, if I have a  
25 small project that qualifies, maybe I don't have a ton of

1 qualified research expenses associated with it, and maybe  
2 I get a boon.

3 What if have a huge project that qualifies? I'm  
4 only going to get 15 percent but that may be 30 percent of  
5 my work. It works both ways. It's equally fair to both  
6 sides, and you don't have a double haircut. You don't  
7 have a situation in where in theory you've acknowledged  
8 which projects qualify, and then you're still carving out  
9 for other activities for a second pass, right.

10 Mechanically -- and we'll get into some detail on  
11 this. What we did was we took a statistical sample, which  
12 is a just a random sample of this large body, and we  
13 qualified all of those projects or disqualified them,  
14 depending on the outcome, right.

15 And then we applied wages, supply cost, and  
16 contracting cost to our findings there. We think that is  
17 a viable methodology. No court has said it's not, and we  
18 will talk about that. But that is what we would propose  
19 you do because we can't look at a larger group. Because  
20 we can't extrapolate for 2000s if there is qualified  
21 activity pro or con, you make the call, right.

22 And briefing, the notion of post-hearing briefing  
23 may make a lot of sense here to be honest with you guys,  
24 where we can lay out the law, where we're coming from,  
25 where we get the calculation on it being, and you got

1 something physically in front of you that you're not  
2 trying to read a record.

3 ADMINISTRATIVE LAW JUDGE THOMPSON: I appreciate  
4 that. And I appreciate, Judge Vassigh, your indulgence on  
5 my questions.

6 We know where to find you if we have questions  
7 after the hearing today.

8 ADMINISTRATIVE LAW JUDGE VASSIGH: And can I just  
9 clarify FTB's position about the Suiter wage allocation  
10 method does not apply here because there's not enough  
11 information?

12 MR. RILEY: Well, I think in, you know, when  
13 we're talking about some of these other cases, the -- the  
14 parties may have stipulated things. I don't necessarily  
15 think that Mr. Dies and I are talking past each other. I  
16 think we are -- we are -- our position is that these  
17 things can be qualified or disqualified based on  
18 activities.

19 And even if they're qualified or disqualified on  
20 activities, they must also qualify or be disqualified  
21 based on expenses. And so even if everything qualified,  
22 there is a potential that the -- the expenses are not  
23 reasonable, and therefore, none of -- there would be no  
24 credit in the end. Okay.

25 So -- and so we're -- what we're saying is we're

1 not -- we are not foreclosing our -- our ability to argue  
2 both step one, activities, and step two, expenses. And  
3 we're gonna try and keep it, you know, on a forest level  
4 rather than a tree level to make it as easy as possible  
5 for everyone. But we're still going to -- it's still our  
6 position that even if it doesn't qualify under activities,  
7 I, you know, even if it does qualify under activities, it  
8 doesn't qualify under expenses.

9 ADMINISTRATIVE LAW JUDGE VASSIGH: Thank you.  
10 Mr. Greenberg has been sitting here patiently. Before I  
11 swear you in, I just want to check in with our  
12 stenographer.

13 (A discussion was held off the record.)

14 ADMINISTRATIVE LAW JUDGE VASSIGH: Mr. Greenberg,  
15 I'm going to swear you in, and you will remain under oath  
16 until this hearing is over.

17  
18 JONATHAN GREENBERG,  
19 produced as a witness by and on behalf of the Appellant,  
20 and having been first duly sworn by the Hearing Officer,  
21 was examined and testified as follows:

22  
23 THE WITNESS: I do.

24 ADMINISTRATIVE LAW JUDGE VASSIGH: Thank you.

25 MR. HUNZIKER: If I may proceed?

1 ADMINISTRATIVE LAW JUDGE VASSIGH: Please.

2

3

DIRECT EXAMINATION

4

BY MR. HUNZIKER:

5

Q Yes, thank you for your patience and good  
6 morning, sir.

7

A Good morning.

8

Q Would you please introduce yourself fully to the  
9 members of our panel today?

10

A I'm Jonathan Greenberg, and I am the president of  
11 Swat-Fame.

12

Q And as the president of Swat-Fame testifying here  
13 today on behalf of that company, can you give the panelist  
14 an indication of your day-to-day responsibilities at that  
15 business?

16

A Yes. I'm responsible for all the operations of  
17 the company, design, production, warehousing, all the  
18 management part of the company, marketing, sales. And I'm  
19 heavily involved with each of those areas and how they all  
20 coordinate together.

21

Q I'm going to return to what you do at the present  
22 time, and I want to go back and talk about your  
23 experiences at Swat-Fame.

24

A Yes.

25

Q Did you actually as a youngster begin working at



1       this company?

2           A     I did.  I worked -- I worked at Swat-Fame during  
3       summers and holiday breaks.  Growing up I started probably  
4       around 12 years old and here 45 -- 40 years later.

5           Q     And during that time when you were, you know, in  
6       those early years, what type of things did you do to give  
7       you an early exposure to the company?

8           A     I did everything pretty much from working in the  
9       warehouses to working a lot of different entry-level  
10      positions.  I just basically learned the business from the  
11      ground up.

12          Q     Now today we're going to be talking about the  
13      development of the business; correct?

14          A     Yes.

15          Q     Even back in those early years --

16          A     Yes.

17          Q     -- did you still have exposure to the warehouse  
18      floor, the design elements, the things we're going to be  
19      talking about here today?

20          A     Yes, I do.  Yeah.

21          Q     Now, when you got through the teens, was it  
22      originally your intent when you continued your education  
23      to come back to Swat-Fame?

24          A     No.  No.  I planned to go to medical school and  
25      decided after college to take a year off and decided to

1 give business a try and came to work for Swat-Fame, which  
2 I thought would be temporary and ended up being 30 years  
3 later.

4 Q Okay. In talking about that time period, did you  
5 grow up -- have you been a member of this community for --  
6 for those years?

7 A Yes.

8 Q So did you grow up in this Los Angeles area?

9 A I did.

10 Q When you first came back, after you were going to  
11 college, what level did you enter the company at that  
12 point.

13 A I started at an entry-level position. I started  
14 in the data-processing department, which was basically the  
15 sort of the bottom level of information being put into the  
16 main system of the company.

17 Q And roughly how old were you when you took on  
18 that position?

19 A 22.

20 Q How long were you at that position?

21 A That position I was probably at four or five  
22 months.

23 Q Okay. And besides what you've already described  
24 for the panel, were there any other activities that you  
25 were involved with within any other divisions during that

1 first five month time period?

2 A Well, I interacted with all the departments in  
3 the company because you were basically putting in all the  
4 information related to a product. So you were working  
5 with -- I was working with the design department. I was  
6 working with the production department. You were  
7 basically taking a sku, a product, and putting in all the  
8 information for that product and then follow along the  
9 preproduction to production process.

10 Q You understand today that we're going to be  
11 talking about a lot of different stations in the life of a  
12 product?

13 A Yes.

14 Q And as you -- before you went to college and had  
15 exposure to those areas, did you have continued exposure  
16 when you had gone back?

17 A Yes. I started in the data-processing  
18 department, and then I moved into the warehousing and  
19 worked in two different departments in the warehouse. And  
20 then I came back into production. I worked in production,  
21 preproduction, and then stayed there for a while.

22 Q Did you ultimately become the head of production?

23 A Yes.

24 Q And just to put this in context, roughly how old  
25 were you when you were promoted to the head of production

1 for this company?

2 A I was 23 or 24.

3 Q It seems like a very quick time period in which  
4 to advance?

5 A Yeah.

6 Q Congratulations on that.

7 A Thank you.

8 Q When we talk about Swat-Fame, where is it  
9 currently located?

10 A City of Industry, which is 20 miles east of  
11 downtown.

12 Q And that actual physical location, before we go  
13 inside and talk about the people where they work, what  
14 they do, what their divisions are and responsibilities,  
15 could you describe the general building itself, the  
16 structure that houses this and size and what not?

17 A Yeah. It's about 250,000 square feet. We have  
18 all of our corporate offices there. We have all our  
19 design department there, which is housed in a building  
20 within our building. We have a sample sewing room there  
21 that produces all of our samples. And then we have all of  
22 our production there. And then we have our very large  
23 distribution facility there that distributes all the  
24 finished product.

25 Q You heard Mr. Dies at the beginning when we were

1 talking about California's credit, and those things taking  
2 place in California?

3 A Yes.

4 Q When we're talking about these items here, unless  
5 we talk about specific elements otherwise, are these  
6 things that take place at the manufacturing plant?

7 A Yes.

8 Q Okay. And when you say yes, is this all within  
9 the plant that's in California?

10 A Yes.

11 Q Okay. Now do you recall when Swat-Fame actually  
12 opened its doors and began its business?

13 A I -- I -- yes. It started in 1977 -- end of '76  
14 into '77 then we were incorporated in '78.

15 Q And I believe mathematically you would have begun  
16 there around the mid to late 80s; is that right?

17 A I started full time in '88.

18 Q Okay. Now, during that time have you seen a lot  
19 of changes within this apparel world in the universe of  
20 Swat-Fame?

21 A Yes. Tremendous change.

22 Q Could you just -- to provide that background for  
23 the panel -- could you explain how it's changed within the  
24 three decades that you've been working there?

25 A Yeah. It's changed in its size when I came to

1 the company. It was a much smaller company. And the  
2 company has gone through a lot of evolutions. So when I  
3 started it was predominantly a junior company. It then  
4 evolved to a mostly kids product company. In the 90's we  
5 started making denim. So we became primarily a denim  
6 company.

7 And the industry has changed, you know, the way  
8 product is sold at retails, trade, as you know,  
9 tremendously in the last, you know, five years with  
10 e-commerce, subscription services, and all the different  
11 ways product gets sold to customers.

12 And it's -- the demands have changed. We used to  
13 manufacturer everything locally in Los Angeles. And then  
14 NAFTA passed and we manufacture almost everything in  
15 Mexico and then now primarily in Asia.

16 Q I want to draw a distinction here. When we're  
17 talking about the R&D, the actual designing elements,  
18 those things are all happening in California; is that  
19 correct?

20 A Correct.

21 Q Okay. So when we talk about -- let's really set  
22 this out for the panel. What we're talking about in this  
23 case here today for this company, what you're claiming is  
24 what occurred, the activities and the accompanying cost  
25 and expenses for California only; correct?

1           A    Correct.

2           Q    Okay.  Now, within the 30 years you've been  
3           there, have you kept your thumb on the pulse, so to speak,  
4           of the apparel world?

5           A    Yes.

6           Q    And just as there have been changes within  
7           Swat-Fame, have you seen other businesses that have not  
8           evolved and have gone out of business?

9           A    Yes.  I think that's one of the -- one of the  
10          unique things about Swat-Fame and one of the things that  
11          got me hooked on the business is it's constantly changing.  
12          And so I think one of the things we always feel is our  
13          strength is that we are constantly changing to market  
14          needs, to just whatever is happening in the business.

15                Like I said, one minute we're making all kids  
16          clothing.  The next minute we're making all denim.  I  
17          think we're really good at adapting to change and -- and  
18          following the market.

19          Q    When you talk about we, do you consider Swat-Fame  
20          to be a bigger business but still a close-knit family?

21          A    Yes.  Yes.  We're unique in that we're run like a  
22          family business, very hands on, but we're a large company.

23          Q    In the spirit of that large company, roughly how  
24          many employees -- feel free to estimate -- work at  
25          Swat-Fame present day?

1           A    We have about 285 employees.

2           Q    And this is at the location, I believe, that you  
3 already described in --

4           A    Yes.

5           Q    -- City of Industry?

6           A    Yes. Yeah. Yeah. About 280.

7           Q    So now with that amount of people, are there  
8 different divisions that are located -- and we're going to  
9 see a video. We're going to talk about what's up on the  
10 easel. But are there divisions within the company  
11 existing within that building?

12          A    Yes. Yes. We have a kids division, which is  
13 broken down into two division of sportswear and dresses.  
14 We have a junior division, which is broken down into  
15 dresses and social dresses. We have a branded division,  
16 which are denim brands that have a denim component and a  
17 sportswear component, and we have a few of those. So we  
18 have about five divisions.

19          Q    And I'm going to be talking specifically about  
20 the different divisions here a bit just to understand it.  
21 Now that you're the president, do you still, over the  
22 years that you've been at that position, have direct  
23 communication and direct involvement in the different  
24 stations?

25          A    Absolutely.



1 Q Let's talk about those people. Do you actually  
2 interact with them and be with them regularly?

3 A Regularly.

4 Q What is regularly as president of Swat-Fame?

5 A Every day.

6 Q Every single day?

7 A Every day.

8 Q And what's the reason that you have every day  
9 meetings with all these people in these divisions?

10 A It's -- it's the basis of the company. It's the  
11 way the company operates. It's my involvement is critical  
12 from all those aspects to bring it all together. So if  
13 I'm standing in front of a customer, I need to be able to  
14 translate that to a design department or a preproduction  
15 department and make sure that all the pieces are working  
16 together.

17 Q All organs within one body of operations?

18 A Yes.

19 Q Now, are you the only executive at Swat-Fame?

20 A No.

21 Q When we talk about the other executives, these  
22 other positions, do they have also have interaction?

23 A Yes.

24 Q So would it be fair for anyone, including anyone  
25 on this side of the room over there, just say that just

1 because someone had a different title or executive  
2 position, they're not dialed into the different elements  
3 within the business?

4 A That is correct.

5 Q Would that be an incorrect statement?

6 A That they wouldn't be dialed in?

7 Q That's right.

8 A Yes. I mean, you have to be -- you have to be  
9 involved with all the aspects, otherwise it would be a  
10 disaster.

11 Q Why would it be a disaster?

12 A Because all the parts are interconnected. And if  
13 there's not somebody that's bringing it all together, it  
14 would be very difficult for one hand to know what the  
15 other hand is doing.

16 Q In just a bit we're going to be seeing a video  
17 that's going to talk about or actually it's going to  
18 demonstrate eye-to-eye these different divisions on the  
19 floor. Have you actually visited those?

20 A Every day.

21 Q So it wouldn't be -- it wouldn't be unusual to  
22 see you working right by a sewer or cutter and may be  
23 involved in their work? Is that what you're saying?

24 A Absolutely.

25 Q So I want to turn to the products that you

1 manufacture and who your customers are.

2 A Yes.

3 Q Okay. Now, first of all, are there seasons of  
4 different designs and different products at Swat-Fame?

5 A There are. There's four seasons. There's fall,  
6 spring, which are larger seasons. And then we have spring  
7 and hole -- I'm sorry -- holiday and summer, which are  
8 smaller seasons.

9 Some of our divisions work on a seasonal basis in  
10 terms of release of product. But most of the divisions  
11 work on a monthly basis. We have a market week every  
12 month that we see customers, and we're showing new lines  
13 every month.

14 Q Okay. And is that unusual that you actually have  
15 to have new lines, new ideas, every single month?

16 A Not for the type of company we are.

17 Q And what do you mean by that?

18 A Well, you have some large brands like a Hanes or,  
19 you know, sort of big brands that, you know, are known for  
20 certain items, make the same things over and over, you  
21 know. They're -- they have a very different model than we  
22 do. We're in the fashion business. We sort of cater to  
23 customers and what their needs are.

24 And so we're a little bit unique in that that  
25 we -- our customers don't come in. We don't put product

1 on the wall and the customer says I want this and this and  
2 this. It's more of, "I like that dress but can you put  
3 that sleeve on it, and can you put that skirt on it?"

4 So we're a little -- we're very -- we act like a  
5 smaller company, but we're a large company so it presents  
6 a lot of challenges for us because we're very customized.  
7 And we're very flexible in terms of what we'll do for our  
8 customers. So it makes it challenging.

9 Q Do you have to be able to come up with new ideas  
10 and concepts regularly?

11 A Every month.

12 Q Okay. And within your -- and just to put a fine  
13 point on it, if there's allegations that hey, they've been  
14 in business 40 years, and it's not a compliment. It's an  
15 insertion that they've got to be just doing the same thing  
16 over and over again. Would that be fair at all?

17 A No.

18 Q And why wouldn't it be fair?

19 A Because we're not in the widget business. We're  
20 not in the Hanes Underwear business. We are in the  
21 fashion business, and we're constantly responding to  
22 fashion and changing and doing what the new trends are,  
23 new silhouettes and the new fabrications. We're in the  
24 fashion business. We're not in the basics business.

25 Q Who are some of the clients or customers that

1 wears Swat-Fame?

2 A We sell to Nordstrom's, Macy's, Kohl's, Penney's,  
3 Walmart. We have a thousand-plus small mom and pop  
4 boutiques.

5 Q When you have boutiques versus large operations,  
6 both of these are your clients?

7 A Yeah.

8 Q Do they present different types of constraints  
9 with what they expect from you?

10 A Yes.

11 Q Let's start with the mom and pops, the boutiques.

12 A Yes.

13 Q What are the differences between the constraints  
14 you face, those obstacles, speed bumps within that group  
15 versus a larger group like a Walmart?

16 A Well, with a boutique they are basically looking  
17 for product that they can sell. And they are assuming  
18 you're gonna do all the right things to give them a  
19 quality product that retails. When you're dealing with  
20 people like Walmart and some of the mass big retailers,  
21 there's a lot of emphasis on standards.

22 So it could be, you know, standards that they  
23 impose in terms of what factories you can use, what  
24 testing standards they require, conforming standards to  
25 color and, you know, governmental standards. So you're --

1       you're doing a lot more technical, I'd say, stuff for the  
2       bigger retailers.

3             Q    We're going to be talking to the panel about  
4       these processes you see behind you.  You're familiar with  
5       those?

6             A    Yes.

7             Q    And does that ever pose to the way things look or  
8       cosmetic appeal, does this relate to -- to the actual  
9       function and the performance?

10            A    Yes.

11            Q    And frankly is that the basis for that entire  
12       system?

13            A    Yes.

14            Q    I want to talk about the expectations by these  
15       clients in regard to deadlines.  Are there many of these  
16       that require a relatively quick turnaround time?

17            A    Yeah.  Deadlines are really the basis for our  
18       business because it's a fashion business.  And if they  
19       don't have merchandise on the floor, in retail they'll  
20       miss those sales.  So everything is driven by deadlines.  
21       We are in a -- one of our competitive advantages, has  
22       always been since I've been at the company, has been being  
23       able to respond fast and have very reduced lead times  
24       compared to the market.

25            Q    If you're going through these processes that

1       involve everything from labor, hardware, you're involved  
2       in fabric, sewing, all those hours, and then ultimately it  
3       didn't get done by a deadline, do you eat that cost?

4           A     Yes, we do. Either we receive a cancellation  
5       from the customer or a price concession. Yes, deadlines  
6       are critical.

7           Q     And let's round it out. In that -- in that  
8       hypothetical that you're explaining to this panel, would  
9       you lose that customer at that moment when you fail to  
10      make that deadline?

11          A     We could.

12          Q     And let's talk about the big picture. When you  
13      do this by season --

14          A     Yes.

15          Q     And I think you said it was spring, summer, fall,  
16      and holidays; is that right?

17          A     Yes.

18          Q     If you can't meet a deadline, can you lose an  
19      entire season?

20          A     Yes.

21          Q     Is that, frankly, pretty stiff financial  
22      ramification to a company?

23          A     It could put a company out of business.

24          Q     I want to talk -- when you're given an  
25      expectation from the beginning, many times these come from

1 living people, companies that are wanting to buy from you,  
2 can they truncate -- can they shorten those deadlines they  
3 give you?

4 A They often do.

5 Q What are some of the reasons -- just so we have a  
6 full understanding -- that they can actually narrow in or  
7 reel in those deadlines?

8 A Our customers?

9 Q Yes.

10 A You know, they -- it's not -- we're competing  
11 with other companies. So it's not like we say to them,  
12 okay, to hit this delivery we need your order by here. We  
13 can say that, and they can say, okay, we'll do our best,  
14 but a lot of times that doesn't happen. And they're doing  
15 the best they can on their end.

16 They have a lot of constraints on their end with  
17 meeting with their management trying to decide what  
18 product they're going to have on the floor. And so while  
19 we shoot for those dates, it's often we're sort of  
20 crunched to get things done.

21 Q You hear businesses sometimes describe as a  
22 business of sharp elbows and competition. Is that what  
23 we're looking at here in the apparel world?

24 A Very competitive.

25 Q I want to come over here real quick, and I draw



1 your attention to the screen. I know it seems distant.

2 A Yeah.

3 Q I want to talk about the different lines. And  
4 I'm going to -- for the benefit of the panel and  
5 yourself -- I'd like to see if this can -- can you see  
6 that?

7 A Yes.

8 Q Okay. I want to talk about Kut from the  
9 Kloth/Kut Collection, SeeThruSoul, Underground Soul, and  
10 Speechless. Are you familiar with those lines?

11 A I am.

12 Q First of all, are those in fact lines versus a  
13 single product?

14 A Those are -- those are lines.

15 Q What as opposed to a product -- and you've heard  
16 this. Panel mentioned and us confirm, we're going to be  
17 talking about some actual products today. When we talk  
18 about a line, what constitutes a line of apparel?

19 A A line is a collection of product. And in our  
20 case we refer to it by the brand label. So all those are  
21 our brands so -- and they happen to correspond to  
22 divisions within our company.

23 Q Now were these developed by Swat-Fame?

24 A Yes.

25 Q And I want to -- and just for the benefit of the

1 panel and for opposing counsel. What I'm reviewing is a  
2 previously provided and today pre-admitted document, which  
3 is page 1 of Exhibit 3. Which I believe everybody has  
4 been supplied with a notebook if you care to reference it.

5 It says in here that they maintain several  
6 specialized brands and also had been developing these for  
7 women and girls. How long, if you recall, has the Clothe  
8 Cut Collection been in existence with that clientele?

9 A We started Kut from the Kloth in 2006, I believe.

10 Q Is it still around today?

11 A Yes.

12 Q Are all your lines necessarily still around  
13 today?

14 A Some of them on there we're no longer using,  
15 Underground Soul, and Common Genes, and Corey P. have been  
16 sort of put on the shelf. We haven't been making those  
17 anymore.

18 Q And just so we have an understanding when we're  
19 talking about lines, what are some of the reasons that you  
20 may have a line that's discontinued?

21 A Customer doesn't want to buy it. We've moved on  
22 to another brand that sort of takes over that category.

23 Q Do these go through the process that we're going  
24 to be talking about today?

25 A Yes.

1           Q   And just to put a fine point on it, here we have  
2   four different lines you talked about. And I just want to  
3   make sure with SeeThruSoul, how is that different from the  
4   Kut/Kloth?

5           A   Kut from the Kloth is a denim-based brand that  
6   also has sportswear, and that's for women sizes and  
7   SeeThruSoul, which is really -- we have two versions of  
8   it. There's SeeThruSoul and STS Blue. That's more for --  
9   more for young contemporary junior-type customer.

10          Q   And then moving down to Underground Soul, Common  
11   Genes and Corey P.?

12          A   Underground Soul was a junior denim brand that  
13   was at a lower price point. Common Genes was a missy  
14   denim brand. And then Corey P. was a missy dress brand we  
15   had. And then Speechless we do -- and Speechless,  
16   Accidentally Love, Lots of Love, and Xtraordinary all sort  
17   of support the junior girls and kids-girls market.

18          Q   We talked about different types of products. I  
19   want to talk about the delineation of the individuals  
20   making them consumer based. Can you distinguish between  
21   women's, juniors, kids, missies? Kind of explain what  
22   comprises those categories as to age or client?

23          A   In most of our kids brands we ship anywhere from  
24   4 size -- size 4 to 16. So it's really servicing the 5 --  
25   4 or 5 years old all the way up to 14, 16. And then

1 juniors would take off from that point. So it would be  
2 the teenager, you know, and then there's some of the  
3 junior sizes go into the early 20s.

4 Young contemporary kind of picks up from there,  
5 which is like early 20, maybe into the late 20s. And  
6 women's kind of picks up mid 20s and can go all the way up  
7 to 50.

8 Q We talked about and you confirmed these lines.  
9 The products within them you said they all go through this  
10 process of experimentation, this system; correct?

11 A Hm-hm.

12 Q My question is this. Are there different  
13 considerations, limitations, obstacles, whether you're  
14 dealing with little girls versus the juniors, missies, or  
15 women's clothes?

16 A Very different.

17 Q Can you explain based on the age group, that  
18 population, that type of folks, what those differences  
19 are?

20 A With kids there's much more regulation around  
21 kids clothing. So there's flammability issues. There's  
22 drawstring issues. There's pull-test issues, you know.  
23 All the products have to conform to governmental  
24 standards. And then in women's you know, there's  
25 different fit consideration for a woman than a kid. So

1 each one is sort of unique.

2 Q I want to talk about, just very briefly, the  
3 obstacles that can exist across the lines and components.  
4 And I draw your attention to -- which coming from the  
5 bottom of page 3 of Exhibit 3, okay.

6 A The bottom of that slide?

7 Q Actually I've blown up the part we're going to  
8 talk about.

9 A Okay.

10 Q So my understanding is each of the new and  
11 improved apparel products designed have specific  
12 requirements, including certain factors; is that correct?

13 A Yes.

14 Q What I want to do is for the panel just get an  
15 understanding of what the different factors are when it  
16 comes to the new and improved products. Okay. How is a  
17 fact or obstacles associated with fabric and material or  
18 composition?

19 A Well, material fabric and material makes up the  
20 garment, makes up the product. So it's really defining  
21 what the structure of the garment is. It could be a soft  
22 fabric. It's a little bit more drapey. It could be more  
23 stiff, which means it has a little bit more structure. It  
24 really defines the nature of the garment.

25 Q And then on the dimensional requirements?

1           A    That would be the measurements of the product.  
2   You know, it's got to fit a -- fit a body.  So it has to  
3   have detailed specifications in terms of different points  
4   of measure throughout the product.

5           Q    And just to be clear, regardless of which bullet  
6   point we're discussing, do they all present their own  
7   individual complication and uncertainty?

8           A    Yes.

9           Q    We move to material consumption requires, first  
10  of all, what are we talking about?  Material consumption?

11          A    That's how much material is required to make that  
12  product.

13          Q    And then product, clasps, linings, and other  
14  components?

15          A    There's other materials on a garment besides  
16  fabric.  So there could be zippers, buttons, clasps.

17          Q    Different elements?

18          A    Different.  Yeah, those types of things.

19          Q    Now, when we're talking about the kids products  
20  having regulatory requirements, specifically what's are  
21  those requirements?

22          A    I mean flammability requirements.  We have  
23  California prop 65 requirement, which is related to  
24  chemical components and lead.  We have, depending on the  
25  size of the kid's garment, we have drawstring

1 requirements, pull test requirements so that a kid can't  
2 pull off a button and eat it, choke on it.

3 Q What is meant by fit parameters?

4 A The parameters of the process we go through to  
5 make and take a garment and make it fit not only one body  
6 but multiple size bodies.

7 Q And we'll talk about these later when we get to  
8 silhouette, get to the wash and dries, and we go through  
9 the different projects. But when we talk about the  
10 difference between making one product, and as Mr. Dies  
11 talked about in the opening, having to make 20,000 of  
12 them.

13 A Yes.

14 Q What is the level of precision -- the difference  
15 of level in the level of precision required to complete  
16 that type of task?

17 A It has to be very precise because you're  
18 basically taking one model, one piece, and saying now we  
19 need to make 10,000 of them. So we -- a big part of this  
20 process is coming up with the sort of the guidelines on  
21 how to make it. This is this measurement. This, you  
22 know, if we have an elastic waist on something, the  
23 elastic has to be cut to a certain measurement, otherwise  
24 it may be falling off the body. So we're very detailed in  
25 our specifications and guidelines.

1           Q    If I may attend the board?

2                   ADMINISTRATIVE LAW JUDGE VASSIGH:  Mr. Hunziker,  
3   I just want to let you know we're approaching 10:00  
4   o'clock.  So when you find a natural stopping point, it  
5   would be a good time to take our morning break.

6                   MR. HUNZIKER:  This would be it.

7                   ADMINISTRATIVE LAW JUDGE VASSIGH:  Then let's  
8   have a five-minute break, and we'll come back.

9                   (There was a pause in the proceeding.)

10                  ADMINISTRATIVE LAW JUDGE VASSIGH:  Let's go back  
11   on the record.

12                  We are back to Mr. Hunziker.

13   BY MR. HUNZIKER:

14           Q    Sir, we're back on the record.  Are you ready to  
15   continue?

16           A    Yes, I am.

17           Q    If I could approach the board if that's okay?  
18   First of all, I'm assuming you all can hear me properly  
19   okay.  When we're back here, we're talking about the  
20   cycle.  Is this the cycle that all products go through?

21           A    Yes.

22           Q    When we called development cycle, why is it  
23   entitled "development cycle?"

24           A    Because you're developing the product from a  
25   concept.



1           Q    Okay.  And when that concept comes in, what are  
2   the different ways that that can arrive as a vision to  
3   your door to analyze functions of this process?

4           A    It could be a trend that we know, you know, we do  
5   some research on trends.  So it could be a trend.  It  
6   could be something that is -- a celebrity wears that we're  
7   going to, you know, do our own version of that.  It could  
8   be anything that's happening in fashion.

9           Q    Now, just to be very candid.  Whenever someone  
10  presents a vision, are they more concerned how it looks?

11          A    It's all about the look at that point.

12          Q    But for you, once we get past the concept, once  
13  we get to this, is it about the appearance?  Or is it  
14  about functions and performance?

15          A    It's about function.  It's about how is this  
16  product going to perform on the body.  Is it going to  
17  function?  Can we make it?  It's all those things.

18          Q    So when can we start here at conceptualization,  
19  and we're gonna have a video that actually shows this in  
20  real-time at work.  What comprises material selection and  
21  testing?

22          A    So what happens is a design team comes up with a  
23  concept.  So they may say I want this silhouette, you  
24  know, this basic shape, say, this jacket, and I want to  
25  use this fabric in that jacket.  So they're basically

1 putting elements together that they want to use to create  
2 that product.

3 Q Now, in that very moment, could it be that it's  
4 completely unknown if that will even work for that type of  
5 project?

6 A It usually is.

7 Q So can you have -- I want to make sure when we  
8 talk about this theory of uncertainty -- is that prevalent  
9 within the world of apparel?

10 A Very much so.

11 Q So tell me what are the things -- and this is so  
12 I understand it. When we're talking about material  
13 selection, can you have someone who wants to have a  
14 product from a certain material but because of things  
15 later on, frankly, it ultimately can't even work?

16 A That's right.

17 Q What are some of the reasons for --

18 A Well, you're -- you're combine -- you're assuming  
19 that the fabric that I selected is going to be able to be  
20 transformed into a product. So that assumption is not  
21 always the case, you know. If you take, let's say, best  
22 example is I have a thicker fabric and I want to make it  
23 into a dress that's kind of flowy and soft and has a skirt  
24 that kind of moves around. Well, if that fabric is too  
25 thick, it's not going to do that. So, you know, the

1 fabric is such an integral part of it, that that fabric  
2 combined with the pattern or the silhouette is really one  
3 of the key considerations.

4 The other thing you have to do is you have to  
5 figure out how to then sew that. So there may be issues  
6 with sewing along the line. For example, fabric is thick.  
7 It may not -- maybe if you're creating a seam that has  
8 three or four plies of the fabric put together, it may not  
9 fit under a sewing machine.

10 Q When we're talking about material selection,  
11 you've just described situations where the fabric itself  
12 on a product -- let's just say that fabric may not work;  
13 is that right?

14 A Yes.

15 Q And at that stage or --

16 A Or combination of fabrics.

17 Q That's what I was going to ask you. Are there  
18 times, though, where even if the fabric works, you have to  
19 make consideration for its combination with something  
20 else?

21 A Yes. So we may have a fabric that the design  
22 team wants to use, and we get it into a product and it  
23 turns out that you can see through the product.

24 Q Okay.

25 A And the fabric is see through; so we may have to

1       add a lining to alleviate that. So now we're sewing two  
2       fabrics together. The design, you know, may require  
3       certain things that we have to alter how it's constructed  
4       to achieve it.

5           Q     Now, when we move from material side down to  
6       pattern making, at Swat-Fame what computers or computer  
7       science do they use in their pattern-making exercises?

8           A     We use a software that allows us to create a  
9       pattern through a computer. You know, in olden days they  
10      used to do them -- done by hand. Pattern makers would  
11      actually cut out the different pattern pieces. Now it's  
12      done by computers because it makes it easier down the road  
13      when you have to alter that pattern and change it. It  
14      makes it easy to go into the system or pull up those  
15      pieces and change it.

16          Q     You talked about what can take us from here back  
17      to concept. But when you have pattern making, is that a  
18      station that can see a lot of iterations come through and  
19      changes?

20          A     Yes. Because that's really where sort of you're  
21      starting to see how can I translate this material into  
22      a -- you know, it's really -- it's really still a 2-D  
23      process, but you're starting to see at that point how this  
24      thing is going to get constructed and put together.

25          Q     And we're going to talk in specifics about the

1       uncertainties using these --

2           A     Yes.

3           Q     So just I understand.  If you look behind you --  
4       and I just want to -- so the panel can understand this.  
5       We're talking pattern making here.  The video is going to  
6       bear it out.  But when you actually see the different  
7       pieces of these items that are actually laid out on  
8       AutoCAD to be cut out --

9           A     Yes.

10          Q     And whenever you need to make alterations, is  
11       that something that's done on AutoCAD?

12          A     Yes.

13          Q     Then how does it go from there, to get from  
14       pattern making down to cutting and sewing?

15          A     So those pattern pieces are then printed out on a  
16       large printer.  They are then used as templates to cut the  
17       fabric into the different parts.

18          Q     All right.  And if something has to go back  
19       through concept or through these different stages, can it  
20       just jump forward to the end, or does it still have to go  
21       through the systematic process?

22          A     Well, it has to continue through the rest of the  
23       process, which is making sure it fits, making sure it  
24       functions, and so the rest of the process.  At any one of  
25       those places, it could stop and go back through the cycle

1 if a change needs to be made.

2 Q And if a change is made -- let's just say we're  
3 talking about finding a different material. Do you just  
4 take it for granted then, after you make that change, it  
5 will work for every other station involved?

6 A No. It still has to go through the same process.

7 Q In fact, do you have situations where something  
8 will be changed and then have issues at different areas  
9 down the line and continue to go through the process?

10 A Often.

11 Q Is it unusual?

12 A No.

13 Q Is that part of the process of experimentation in  
14 going from concept to product?

15 A Yes.

16 Q Now, when we go to finish washing and specs and  
17 it says denim, is this something that can be specific to  
18 this type of garment?

19 A Yes. When you're talking about dresses, most  
20 dresses, you're going through a -- you're making a pattern  
21 then sewing it. Then you can look at that product on a  
22 mannequin or a fit model to determine the fit and  
23 function. With denim, you have that added step of, you  
24 need to process that denim to the way it's going to be  
25 processed for the final product.

1           Q   Remember earlier we talked about considerations  
2   for juniors, misses, juniors, girls, women. Do you recall  
3   that?

4           A   Yes.

5           Q   Are there specific considerations based on  
6   whether it's denim, polyester, cotton, rayon, silk?

7           A   Yes.

8           Q   And does that have to go the full interim process  
9   itself?

10          A   Yes.

11          Q   What is the stage of development sample washing?

12          A   That's when you actually get the finished sample  
13   after you've cut and sewn it. After you've made the  
14   pattern and you've cut and sewn it, you've washed it if it  
15   takes a wash. And now you have a sample.

16          Q   Okay. And then functional testing?

17          A   That's the stage -- so we take that sample and  
18   the first thing we'll do is we'll put it on a mannequin  
19   just to make sure that -- because everything has been  
20   either in somebody's mind as a concept or on a 2-D  
21   computer. So now we actually have a sample that we can  
22   then take, put on mannequin, adjust it, tweak it, make it  
23   bigger, make it smaller. That's what happens from there.

24          Q   Now, I want to be clear. Because when we talked  
25   about the functional testing, is there a part down the

1 line where you actually have real people that can  
2 communicate a problem to you and tell you if something  
3 isn't working?

4 A Well, what happens is after we do that  
5 mannequin -- which there's almost always a change -- we  
6 start the process again, and we make those changes based  
7 on the mannequin. Once that comes down back to that  
8 stage, now we put it on a live model so that she can give  
9 feedback, raising her arms.

10 You know, they bend down to make sure it  
11 functions in the waist and seat. So we get all that live  
12 feedback. And then we make those changes and then it goes  
13 back through the cycle again.

14 Q So just to be clear, can you have some changes  
15 that are specific to the inanimate object, the mannequin,  
16 where you already know just by it being on there, it's got  
17 to go back through the process?

18 A Yes.

19 Q And then how are those a little different than  
20 the ones that actually have communication from a live  
21 model?

22 A Well, those are general data. You know, the  
23 mannequin doesn't move. The mannequin can't give  
24 feedback. So you're just getting the basic shape, and  
25 you're just -- you're kind of honing the product into a



1 more accurate product as you go along and tweaking it.

2 So with a mannequin, you know, you're constrained  
3 to just this object, right? And when you're doing it on a  
4 live model, they're telling you it's a little tight, you  
5 know. In the armhole I can't really move my arms very  
6 far. And so you're getting all that feedback to make your  
7 changes.

8 Q I want to put real-world terms on this just using  
9 that example. When you talk about, "I can't move my  
10 arms," could that ultimately involve repatterning the item  
11 using AutoCAD to have bigger allowances for movement?

12 A Yeah. They would -- they would pin the garment  
13 while it's on the fit model. They will release, you know,  
14 as you'll see in the video, they could release a seam to  
15 give it more room. And the model may say, "Oh, yeah.  
16 That feels much better." And then they translate those  
17 changes into the pattern making system.

18 They go in and adjust the pattern. And when you  
19 reprint the pattern, it goes through and cuts several and  
20 cycles. Sometimes things happen at this stage that even  
21 require it to go further up. Maybe the fabric isn't  
22 reacting the way we thought it was going to react, the way  
23 the design intended to react.

24 Like I said earlier, it may not be draping  
25 because the fabric is too stiff, or we had to add a

1 lining. And by adding that lining, it didn't give the  
2 same effect of what they wanted. So then it'll go back to  
3 design, and they'll have to reinterpret and start over.

4 Q And not to focus on the frustrations of your  
5 business, but have you had an occasion where you thought  
6 you made an improvement and it gave rise to more gosh darn  
7 problems than it had before?

8 A Well, that's the thing about pattern making and  
9 fit, is you change one thing and it effects another. So  
10 if the fit model says it's a little tight in the  
11 shoulders, and they open up the shoulder, it may drop the  
12 front. And, you know, her chest may be hanging out. So  
13 it's a balancing act with all the measurements on that  
14 product.

15 Q We've been talking about a specific stage in the  
16 functional testing. Okay. Can you actually have  
17 modifications made at that stage where it actually stays  
18 at that stage, slight alterations?

19 A No. We still always go back and produce a new  
20 sample. You can't take the chance that those changes we  
21 made result in the right product that we're going to go  
22 then and mass produce.

23 Q And are there things that can actually take it  
24 all the way back and basically be a deal killer?

25 A Yes.

1           Q   And what are some of the things that even in  
2           your -- rather than just talking about the first or second  
3           stage, what are things that down the line can cause it to  
4           have to go back where the product is a complete failure  
5           and you can't go to production?

6           A   We can't get it to fit right. We can't  
7           manufacture it based on the way the designers want that  
8           product to end up. We may not be able to manufacture it  
9           that way.

10          Q   So when we go from functional testing to fit  
11          sample complete, we just talked about this.

12          A   Yes.

13          Q   What is involved with the fit sample complete  
14          station?

15          A   So that would be we've gone through this process  
16          two or three times with the static model on a mannequin  
17          and then a live model. We've gone through that, and we've  
18          gotten a product that we say, this is exactly what we  
19          want. This is the final garment that matches what the  
20          product is going to be.

21          Q   Okay. Where does it go from there?

22          A   It then gets -- goes to the technical team that  
23          puts together all the documents that goes out to the  
24          factories. So we create construction documents. We  
25          actually duplicate that sample that then gets forwarded to

1 the factory. We keep ours, so that we know this is what  
2 we want. A duplicate gets made. It goes with all the  
3 construction guidelines, documents, and all the  
4 measurement specifications.

5 Q So in the world of apparel when something comes  
6 back, even if they've made a single item made by  
7 Swat-Fame, and have all the specifics and particulars that  
8 gave rise to it, do you just assume, "I must have gotten  
9 it right?" Or do you have to do more testing?

10 A Now, we do a whole new process, which we call  
11 preproduction, which is basically a similar process. So  
12 what we're doing is we're saying to the factories that's  
13 going to make it, here's the sew by sample, we call it.  
14 This is what you're supposed to go by. Here's all the  
15 documents of construction details, measurements, you make  
16 a sample in your factory with your machinery and your  
17 environment and your sewers and send that back to us.

18 We then take that, and we go through a fitting  
19 process. And that will be fit on a live model, and we  
20 will do the same thing where the model gives feedback.  
21 And we then go in and adjust our pattern to make those  
22 changes, and we forward that pattern back to the factory  
23 and they do a new round of samples that --

24 Q That's -- I'm sorry. Go ahead, Jon.

25 A That they send to us, and we did do a new

1 fitting. And we do that process until we do a fitting and  
2 we say, this fits the fit model perfectly.

3 Q Cut, sew, wash.

4 A Yes.

5 Q That can happen after you get it back from the  
6 factory?

7 A That's at the factory.

8 Q Okay. This is at the factory. And then when it  
9 comes back, you look at it again. And does it undergo  
10 more performance testing?

11 A Yes.

12 Q Talk to me about that in relation to the previous  
13 performance functional testing that we went through  
14 previously.

15 A Well, it's a -- it's a similar process in that  
16 you're fitting it on the live model, but you're comparing  
17 it to what we had given the factory. You're putting it on  
18 that live model and you're saying, okay. If the live  
19 model is saying it doesn't fit here, it doesn't fit there;  
20 then you're comparing it to what we gave to the factory,  
21 and you're kind of tweaking so that the factory -- the  
22 sample they produce matches what we want.

23 John Dies looks like you're doing an opening,  
24 talked about an apparel situation where you might end  
25 up -- if you don't do this, you might end up having tens

1 of thousands of items produced that don't actually have  
2 the input of fit models.

3 A Yes.

4 Q Could that be a disaster to a company?

5 A Yes. It's the success or failure of a product.

6 Q I want to go ahead. Let me -- if I could direct  
7 the panel and thank you for your consideration to the --  
8 to the screen. This is going to be in the actual video.

9 MR. HUNZIKER: Judge Vassigh, this is what we had  
10 referred to and supplied earlier as a visual aid.

11 (A discussion was held off the record.)

12 BY MR. HUNZIKER:

13 Q First of all, just to supply a little context,  
14 the opening screen, as I actually said, before it went to  
15 prototype, Swat-Fame Inc., was this taken at Swat-Fame  
16 Inc.?

17 A Yes.

18 Q And can you just in general tell us, before we  
19 get into it, kind of what we're going to be seeing as far  
20 as what's inside that building?

21 A We're basically going to see this cycle happening  
22 from the time that the creative team has a concept, all  
23 the way to the live model fitting, and then some testing  
24 that we do once the product has been approved.

25 Q Okay.

1           A    And it doesn't involve the stage past this --  
2           this panel right here.  It doesn't -- well, actually it  
3           does.  Actually, there's one part which is the samples  
4           coming back from the factory and we can fit them on the  
5           live model.

6           Q    Okay.

7           MR. ROUSE:  So just for clarification, this video  
8           is starting where on the flow chart?

9           THE WITNESS:  It starts at the concept stage.

10          MR. ROUSE:  Okay.

11                   (A digital file was played.)

12          BY MR. HUNZIKER:

13          Q    And just as we go through here, I'm going to be  
14           stopping at different parts just to ask you as we break  
15           into a new frame, what we're going to be seeing.  Can you  
16           describe what stage this is at?

17          A    This is the design team taking a concept, and  
18           she's sketching out the silhouette.

19          Q    And is this done by folks actually at the  
20           Swat-Fame facility?

21          A    Yes.  These are our designers.

22          Q    When we talk about style creation, beginning with  
23           concept images, what are those?

24          A    I'm sorry.  Can you repeat the question?

25          Q    The conceptual images at the very beginning of

1 the product.

2 A This is really first stage of what the product  
3 is. So this is the designer basically taking an image out  
4 of her head and saying I want to create a dress. I want  
5 to have a dress that has a ruffle around the neck. And so  
6 she's just sketching that idea onto paper.

7 Q Okay.

8 A And then she's adding details to the sketch of  
9 what she would like on it.

10 Q It says it's added for first pattern maker to  
11 create a pattern. Is that for their benefit down the  
12 line?

13 A Yes.

14 Q Okay. One thing I want to do as we talk about  
15 these patterns. If we're looking at a blowup of that,  
16 without getting into every single marking on there, what  
17 are the different pieces of information supplied by that  
18 concept artist?

19 A Basically, she's giving them a rough sketch of  
20 the silhouette. She's telling them what details she would  
21 like on the garment. And then she's pairing it with a  
22 fabric that she'd like to use for that.

23 Q Is this at the pattern maker stage?

24 A Yes. This is a pattern maker that's then now  
25 taking that sketch and creating the pattern pieces.



1           Q   Now, when we look up on the board, and I want to  
2   be very clear on this. For the benefit of the panel, it  
3   starts with conceptualization, goes before pattern making  
4   to material selection and testing. At this stage how they  
5   know what material has been selected? Did that come from  
6   the first artist?

7           A   Yes.

8           Q   And was that one of the items that was on the  
9   document itself?

10          A   Yes. They usually put a small little --

11          Q   Swatch?

12          A   -- square -- swatch of what the material is.

13          Q   Now, before we get into the actual end product --  
14   but when we talk about that I'm going to call it a swatch,  
15   okay? Can that actually undergo testing from the very  
16   beginning to determine if it will adequately need to  
17   proceed to next stage?

18          A   No.

19          Q   So there's no stage -- there's no -- none at that  
20   point?

21          A   No. It's this big, and you won't feel the drape  
22   of fabric and how the fabric reacts to a pattern. It's  
23   just a reference.

24          Q   Down the line --

25               ADMINISTRATIVE LAW JUDGE VASSIGH: I'm sorry. I

1       didn't hear what you said. Can you say the size again?

2               THE WITNESS: The size of a four by four swatch.

3       BY MR. HUNZIKER:

4               Q    Going back.

5                       (A digital file was played.)

6               A    Those are all the different pattern pieces.  
7       They're measurements, and that's sort of the building of  
8       the construction details and specifications.

9               Q    Where do the pieces of information -- and I'm  
10      going to see if I can possibly -- if I can blow that up.  
11      This information that's being put in here, who supplies  
12      that and what is it?

13              A    The pattern maker creates this. So each one of  
14      those lines is pattern piece. So if I'm looking at my  
15      shirt --

16              Q    Yes.

17              A    -- this front panel would be one pattern piece.  
18      This other panel, this right side panel would be a second  
19      pattern piece. And it's just all pieces that are used to  
20      assemble the garment.

21              Q    And does this actually all fall under the third  
22      stage on the first blowup?

23              A    Yes.

24              Q    Okay. Can you describe what this individual is  
25      doing at this stage?

1           A    So he's taking those pattern pieces that were  
2           printed out from the computer, and he's laying them on top  
3           of fabric that he will use as a template to cut the fabric  
4           into the pattern pieces.

5           Q    And in this example, is he cutting those from the  
6           same piece?

7           A    From the same --

8           Q    Piece of fabric?

9           A    Yes. And then those pieces are then given to the  
10          sewer to assemble together.

11          Q    Yes. I wanted to confirm if we have now  
12          proceeded from pattern making down to the cut and sew  
13          stage?

14          A    Yes.

15          Q    Now, when you're actually -- we were talking in  
16          the beginning about your interaction with the folks at  
17          Swat-Fame.

18          A    Yes.

19          Q    Have you been to these individual stations?

20          A    Yes.

21          Q    Are they all on the floor?

22          A    They are.

23          Q    And how often do you interact with the folks and  
24          have input and interaction with those divisions and those  
25          personnel people?

1           A    Frequently. I mean it's -- you know, problems  
2           come up. They need approvals, questions, help. So it's  
3           frequently. Because my background was in production, I'm  
4           able to do that for them.

5                       (A digital file was played.)

6           BY MR. HUNZIKER:

7           Q    I want to stop right here because we've talked  
8           about static and dynamic modeling. Do you recall that?

9           A    Yes.

10          Q    When we're talking about this stage, prototype  
11          draping and fitting with a first pattern making, would  
12          that be under the static modeling section?

13          A    Yes.

14          Q    Where do we find that within our process of  
15          experimentation for it on the board?

16          A    That's here.

17          Q    And right here --

18                       ADMINISTRATIVE LAW JUDGE VASSIGH: For the  
19          record, Mr. Greenberg pointed at the board.

20                       THE WITNESS: It's around functional testing  
21          section.

22                       MR. DIES: It would be helpful if you would  
23          narrate because we're saying the second board, the third  
24          board; if you will say it's the arrow below or whatever.

25                       THE WITNESS: Okay. It's out -- it's basically

1       that we got a development sample, which you can see. And  
2       then we take that and we put it on a mannequin first as a  
3       functional test. So it's the functional testing. There's  
4       just two different functional testing.

5       BY MR. HUNZIKER:

6             Q     Okay. Now, we don't have a person wearing their  
7       garment here giving back input to you?

8             A     No.

9             Q     But can you still see, through visual  
10      observation, problems at this stage?

11            A     Yes, because they -- the mannequin gives you the  
12      general proportions of the body. So in this case it's a  
13      dress. They know where the general place of the waistband  
14      should lay in general. So she's pinning it at -- it looks  
15      like the waist fell a little lower. So she's pinning it  
16      up and making those changes.

17            Q     Can this cause -- well, and frankly, would it  
18      necessarily cause you to revisit a previous station to  
19      address this?

20            A     It could.

21            Q     Using your example, where would it have to return  
22      to in our process?

23            A     It could either return back to the pattern  
24      making, or it could return back to design.

25            Q     Which is at the very beginning?

1           A    Right.  For example, this dress is -- it's very  
2   blousy, very slinky, very drapey.  If during this process  
3   they were seeing that it wasn't laying on the mannequin  
4   properly because the fabric really didn't fit to the  
5   pattern, it would go back to design.  If they -- if it was  
6   just a function of making slight adjustments to the  
7   pattern, it would go back to the pattern.

8           Q    And I want to make sure just so the panel can  
9   understand the interaction between the video and the  
10  chart.  If it didn't have to go to, let's just say, back  
11  to pattern making, okay; does that mean that it can just  
12  skip back to where it was, or does it go through the whole  
13  process again?

14          A    It goes through the whole process again.

15          Q    And can you see additional issues at stations  
16  that didn't pop up at the beginning?

17          A    Um --

18          Q    Meaning, can you have continuing problems even  
19  after it goes back to the beginning?

20          A    Well, you would -- you would see those problems.  
21  Yeah, because you could make a change on a pattern.  And  
22  when you get that sample sewn, that change, like I was  
23  saying earlier, may have caused another issue.  So, again,  
24  it's a balancing act.  In the pattern world they call it  
25  balancing a pattern.

1 Q Okay.

2 A And that's what it is. You're kind of balancing  
3 it to create a whole.

4 (A digital file was played.)

5 Q What's being done here with this cutting?

6 A So she's opening up the armhole. So the armhole  
7 because of the way the fabric was reacting, a little  
8 small, so she's opening it up.

9 Q And while we can see this item with our eyes,  
10 does that change have anything to do with how it looks  
11 versus the function?

12 A No. It's function. The armhole is a function.

13 Q Why are we returning to pattern making?

14 A She's going to make those changes now that she  
15 just did on the mannequin on the pattern itself.

16 Q And here, what are we seeing here?

17 A They're now printing out a new pattern.

18 Q To be cut again?

19 A To be cut again and sewn again.

20 Q We're not going to -- just before we show the  
21 model -- we're not gonna go back through the video again.  
22 But with what the panel just saw, going back to the  
23 drawing, would that go back to the gentleman putting it  
24 down again and re-cutting it?

25 A Yes.

1 Q And round and round we go?

2 A Yes.

3 Q What are we seeing here?

4 A This is the prototype that's being fit on the  
5 live model. So that's the pattern maker working with her.

6 Q Why are they cutting this?

7 A So she's saying it's too tight in the back. So  
8 he's releasing that, opening it up.

9 Q Now, we can see that distinction, but is this  
10 being done for purposes of cosmetics or appearance or now,  
11 for function and performance?

12 A Fully about fit and function. So you could see  
13 she's stretching her arms to see if it fits. And by doing  
14 that, you could see here that it caused an issue in the  
15 front where the -- now, the piece is hanging down and not  
16 covering her chest.

17 Q I just want to ask you something very quickly.  
18 Was that something -- there was an issue before they made  
19 the change on the back?

20 A You know to be honest, I'm not sure.

21 Q Can you have something that's changed -- and this  
22 is just for the benefit of the panels that are standing.  
23 Can you change something functionally, just like this  
24 entire process, and then something new come up that didn't  
25 exist before?



1           A   Likely. Yeah. If you're opening up the back,  
2           you're changing the whole front of the garment as well.  
3           So likely.

4           Q   All right. If you can guide us into what's  
5           happening?

6           A   So they're trying to come up with changes that  
7           they can make, reinjuring the front of that garment. See  
8           how it's flapping open. It's not covering her chest. So  
9           they're talking about adding elastic, adding different  
10          details to make it more functional in front.

11          Q   At this stage do you know what obstacles they'd  
12          be encountering?

13          A   It's the same thing. It's they're trying to  
14          figure out to make it lay like a normal garment and not  
15          expose her breast.

16               MR. ROUSE: Judge, just for the record, I want to  
17          make sure that I clarify that this dress that we're  
18          looking at on this video is not one of our four sample  
19          projects; correct?

20               MR. HUNZIKER: That is correct. This is a  
21          demonstrative.

22               ADMINISTRATIVE LAW JUDGE VASSIGH: On that note,  
23          everything we're hearing and seeing so far is not on the  
24          four sample projects, but you will get to that?

25               MR. HUNZIKER: Yes.

1 ADMINISTRATIVE LAW JUDGE VASSIGH: I want to make  
2 sure you have time.

3 MR. HUNZIKER: Certainly. Certainly.

4 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay.

5 MR. HUNZIKER: Sure.

6 BY MR. HUNZIKER:

7 Q And one of the things that opposing counsel  
8 brought up is whether that's the actual item that's one of  
9 the four. I want to be clear. Is that representative,  
10 though, and that representative of the process that all of  
11 these items, including our four, go through?

12 A Yes.

13 ADMINISTRATIVE LAW JUDGE VASSIGH: And by this  
14 and that, Mr. Hunziker, is?

15 MR. HUNZIKER: You know what, let me put shoe  
16 leather on it.

17 BY MR. HUNZIKER:

18 Q What we're seeing in the video, that process, and  
19 what we're seeing on our flow chart that has a dozen  
20 stages, are those -- even if it's not the exact item in  
21 the video -- representative of the exact process of  
22 experimentation that all these four projects go through?

23 A Yes.

24 (A digital file was played.)

25 A So there she's talking about a fit in the inseam

1 and the rise that she's saying it's too tight. It's  
2 cutting into her. So they're trying to come up with  
3 changes to that. She's talking about the elastic waist.

4 MR. HUNZIKER: And just for the panel, opposing  
5 counsel, certainly the witness, in the interest of time,  
6 I'm going to move forward. I want to talk about, if I  
7 can -- actually, I want to talk about real world issues  
8 with these uncertainties that are going to relate to the  
9 products we have.

10 BY MR. HUNZIKER:

11 Q If I may again, for the record for demonstrative  
12 purposes, are these two dresses right here -- I want to  
13 show the uncertainties in regard to material. Okay.

14 First of all, could you tell the panel what this  
15 demonstrative is? And by the way, what we're talking  
16 about here is the dress that has vertical stripes with  
17 white --

18 A Horizontal.

19 Q Oh, I'm sorry. Not vertical stripes but  
20 horizontal stripes, and it's white and black?

21 A White and navy.

22 Q White and navy. My eyes are not as good as they  
23 used to be. And what is this item?

24 A This is an item we sold in our junior dress  
25 division.

1           Q    Okay.  And to compare it to something nearby,  
2           what is this item that has the black, what looks like  
3           mustard and aqua horizontal stripes as well.  What is this  
4           item?

5           A    This is the same item in a different stripe.

6           Q    Okay.  Are they different materials?

7           A    They're the same classification of materials, but  
8           actually a different material.

9           Q    Okay.  And does that come into play later with  
10          how this reacted to the same --

11          A    Yes.

12          Q    First of all, what were you asked to do in regard  
13          to this dress and with this pattern?

14          A    So we had shipped this dress and our customer  
15          said that they wanted this same dress but in this stripe.

16          Q    How did you go about -- just so we understand the  
17          system.  When we see a dress like this, at what point -- I  
18          want to make sure we're clear.  At what point in the  
19          process would this dress be?

20          A    All the way through.

21          Q    So this thing is clear down to the final level;  
22          correct?

23          A    Yeah.  Yes.

24          Q    Okay.  I just want to put an asterisk.  Now --  
25          MR. DIES:  A blue asterisk.

1                   MR. HUNZIKER: I'm sorry?

2                   MR. DIES: A blue asterisk.

3                   MR. HUNZIKER: A navy blue asterisk. I

4 apologize.

5 BY MR. HUNZIKER:

6           Q With this dress, what was done in attempt to

7 duplicate the dress with the navy and the white horizontal

8 stripes?

9           A So what we do is the process would start with the

10 material selection, which is really saying that this

11 stripe now is going to be joined with that style. And it

12 would continue onto the pattern making, really which

13 wouldn't happen because we have a pattern already. So we

14 sort of skip that.

15          Q Okay. Would you go to cut sew?

16          A We'd go straight to cut sew.

17          Q And what I'm doing, just for the record, when he

18 had the first item, I had an asterisk with a "1". And

19 then what we're showing is the process encounter by

20 asterisk 2, which is the mustard, aqua, black and white

21 horizontal striped dress. So what happens at cut sew?

22          A We'll cut and sew that style. We already have a

23 pattern. So we'll cut and sew from that new fabric.

24          Q Okay.

25          A And we'll end up with a development sample.

1           Q    Okay.  Now, when you get to development sample,  
2           at what point do we run into problems?

3           A    So when the fit sample was finished, it was  
4           determined that it was two or three inches too long.

5           Q    Okay.

6           A    And so an adjustment was made to the pattern to  
7           make it shorter.  So we go back to the pattern making.

8           Q    So when you got to here, this represented for 2,  
9           this is where a trouble was identified?

10          A    Yes.

11          Q    And then where did it go from there?

12          A    It went back to pattern making.

13          Q    Okay.  So it's going to come over here, back  
14          through here, and come back to pattern making?

15          A    Correct.

16          Q    Okay.  And why was it -- and I want to talk in  
17          terms of theory hypothesis and testing.  Okay.  When it  
18          got back to pattern making, were you attempting to address  
19          the problem with the extra length?

20          A    Yes.

21          Q    And I want to be real clear.  How does this extra  
22          length relate to a material issue?

23          A    Well, each fabric reacts differently when you're  
24          working.  You're sewing it, and you're cutting it.  And so  
25          you're accommodating those differences in fabrication.

1       You're accommodating that to the final fit by changing the  
2       pattern.

3               So if something is very stretchy and it hangs or  
4       it's -- or, you know, you're adjusting for all that; same  
5       with shrinkage. Something shrinks more than something  
6       else, you're increasing allowances on a pattern to allow  
7       for more shrinkage.

8               Q     Now, when we talk about uncertainties, do  
9       material issues, such as this material, represent many of  
10      those uncertainties?

11              A     Yes.

12              Q     Okay. In this situation, did you realize that  
13      when you got to the development sample stage, we would  
14      have to go back to the pattern making stage?

15              A     You know, it's just a matter of how much -- the  
16      degree to going back. You know, you kind of assume you're  
17      gonna go back at some point. Because one, fabric doesn't  
18      react the same as another.

19              Q     Now do you know exactly what reactions are going  
20      to be different?

21              A     No.

22              Q     Is there any way to tell if they're going to be  
23      different?

24              A     No.

25              Q     And I want to put a fine point on this as we get

1 through these. If you knew -- and this was pointed out in  
2 the very beginning. If you knew exactly how this was  
3 going to happen, would you even need this entire process?

4 A No. We would just make one pattern and use it  
5 for everything that is made in that silhouette. We  
6 wouldn't need anything else.

7 Q In doing that approach, if you didn't have any of  
8 this uncertainty, would you save a heck of a lot of time  
9 in time, labor, and money and materials?

10 A And people.

11 Q And people.

12 A Yes.

13 Q So what happens when we get back to pattern  
14 making? Did you have a hypothesis --

15 A No.

16 Q -- on how this could be changed?

17 A So what a pattern maker would do is, obviously,  
18 two or three inches long, they would adjust the pattern up  
19 two or three inches.

20 Q Okay.

21 A And then we'd go cut and sew a new sample.

22 Q Was that change made based on the theory that,  
23 hey, shortening it may solve our problem?

24 A Yes.

25 Q But even though that change was made back here,



1 did it, nevertheless, continue the process?

2 A Yes.

3 Q When you got back to development, what did you  
4 find?

5 A It was still long.

6 Q Why was that?

7 A We realized that the nature of the fabric, it was  
8 growing. So by hanging on the hanger, the fabric was so  
9 unstable that it just kept growing and growing. Similar  
10 to like when you wear -- when you hang a sweater and it's  
11 got that construction that kind of adds weight. This was  
12 so unstable that it just kept growing. So we couldn't do  
13 anything about it.

14 Q At that stage --

15 A We abandon the style.

16 Q So in other words, we had a vision and there was  
17 nothing after that that could have been done to bring it  
18 to reality?

19 A No.

20 Q Now, let's talk about some other issues that  
21 relate to material. What are some of the things that you  
22 deal with in regard to shrinkage?

23 A So fabric shrinks -- fabric shrinks even when  
24 you're working with it. Fabric shrinks when you wash it.  
25 So you're constantly trying to accommodate that. It

1 shrinks when you're doing productions. You're  
2 accommodating all that shrinkage in the pattern.

3 Q I want to talk about colorfasts as it relates to  
4 material.

5 A Yes.

6 Q What is the uncertainty in your world in relation  
7 to colorfasts?

8 A So an example would be on that same dress. So in  
9 this case we would buy this fabric expecting it to be  
10 colorfast bleeding that wouldn't bleed onto that fabric.  
11 We purchase it that way. It doesn't always happen, and  
12 sometimes you go and we make this and we see transfer of  
13 color on the dress.

14 So any time we're working with, you know, white  
15 or browns or light-colored browns and we're pairing it  
16 with a dark color, there's chance of color transfer.

17 Q Okay.

18 A So we have to test for that.

19 Q Now, just so we can keep with that example. If  
20 we were up here on the board, where might the issue of  
21 colorfasts present itself?

22 A Well, we do some testing of the samples. You may  
23 see it in the sewing. Sometimes it's just the sewer  
24 sewing it. We see some color transfer. Sometimes, you  
25 know, we see it in the testing when we do product testing.

1 We put it through a laundering for a home-wash simulation.

2 We may see it that way.

3 Q I'm going to go ahead and move this to the back,  
4 because I think you said the same exact attempt was  
5 ultimately abandoned; is that correct?

6 A Yes.

7 Q So what I'm doing is this actually went back and  
8 technically it couldn't get past conceptual stage. Would  
9 that be fair?

10 A No. That fabric just couldn't be used.

11 Q Okay. Using -- and I want to talk a little bit  
12 about the materials themselves and issues with the  
13 horizontal and the vertical stripes. Okay. When we have  
14 an item like this, can you -- can someone tell you within  
15 your business, "Listen I want to keep this type of  
16 garment, but I want to have vertical stripes instead of  
17 horizontal stripes." Have you heard those requests  
18 before?

19 A Yes.

20 Q Okay. Can you explain to the panel -- can you  
21 explain to them why, based on the characteristics of the  
22 material, that doesn't automatically translate.

23 A So fabrics have a stretch, usually in one  
24 direction. Most knits stretch in one direction. So if  
25 the stripe is going horizontally on the stretch, as in

1       this direction, which is what we need to fit on a person;  
2       and now they ask for it to be vertical, and it doesn't  
3       stretch in that direction, the person wouldn't be able to  
4       get it over their body. They wouldn't be able to get it  
5       over their head, chest. It wouldn't function.

6           Q    I want to talk, if I could --

7           MR. HUNZIKER:  If I may just have one moment.

8           ADMINISTRATIVE LAW JUDGE THOMPSON:  Go ahead.

9       BY MR. HUNZIKER:

10          Q    What is meant by silhouette within this industry?

11          A    Silhouette is the basic shape of the garment.

12          Q    Now, I want direct your attention -- and I'm  
13       going to move this to the back -- to this item.

14          A    Yes.

15          MR. ROUSE:  Judge, again, just for the record, I  
16       just want to make the record clear that -- my  
17       understanding is that these clothes are not any of the  
18       four sample projects that are at issue.

19          ADMINISTRATIVE LAW JUDGE VASSIGH:  Appellants,  
20       will you confirm that these are not any of the sample  
21       projects.

22          MR. HUNZIKER:  Confirmed.

23          MR. ROUSE:  Okay.

24       BY MR. HUNZIKER:

25          Q    I want to make sure, and before we move on to

1       this. You and I talked about the four projects that are  
2       at issue in this case.

3           A    Yes.

4           Q    When we talk about the situation that deals with  
5       the issues we saw before, which related to materials, did  
6       we have a similar --

7           MR. HUNZIKER:  If I can get the witness binder  
8       real quick if that would be okay?

9           ADMINISTRATIVE LAW JUDGE THOMPSON:  Yes.

10       BY MR. HUNZIKER:

11           Q    Do you recall the different items that were at  
12       issue in this case?

13           A    Yes.

14           Q    Did any of them have material issues?

15           A    Yes.

16           Q    Okay.  First of all, I want to make sure for  
17       opposing counsel and to the panel that we identify them.  
18       What's an example of one of these four items that had  
19       material issues?

20           A    D11072.

21           Q    Okay.

22           MR. DIES:  I'm on Exhibit 8 page 2, which is  
23       marked for the record SFI0437.  We've blown out that upper  
24       right-hand corner.

25       ///

1 BY MR. HUNZIKER:

2 Q Okay. Real quickly, and I'm going to operate  
3 from here because I'm going to have to change a few things  
4 around. You can feel free to have a seat while we discuss  
5 this part, Jonathan.

6 First of all --

7 A Can I take a 30 second break to use the restroom?

8 MR. HUNZIKER: Is that okay with the panel?

9 THE WITNESS: It'll be 30 seconds.

10 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. Why  
11 don't we make it a five-minute break.

12 (A break was taken.)

13 ADMINISTRATIVE LAW JUDGE VASSIGH: We're back on  
14 the record.

15 BY MR. HUNZIKER:

16 Q Mr. Greenberg, are you ready to continue?

17 A Yes.

18 Q Let's talk about Exhibit 8. And just real  
19 quickly to remind us, we're going to move real quickly  
20 through these. What are we seeing? What product is that  
21 in Exhibit 8?

22 A This is a party slip dress.

23 Q Okay.

24 A It's from our junior division.

25 Q And just to bring us full circle, is this one of

1 the items that we discussed as part of the four projects  
2 at issue?

3 A Yes, it is.

4 Q Now, if we want to talk about a product, and  
5 we're talking about one of the sheets that we're seeing  
6 here, what are these sheets called?

7 A These are face cards.

8 Q And what is a face card?

9 A It's a generic document related to the garment.  
10 So it basically gives you more generic information about  
11 the garment. And it gets more refined as it goes through.

12 Q Okay. You had said, I believe, this was one that  
13 related to material issues; is that right?

14 A Yes.

15 Q Now, first of all, I want to talk real quickly.  
16 When we go down here to the bottom left-hand side -- I'll  
17 blow this up for us. When we talk about pattern  
18 sections --

19 A Yes.

20 Q -- on the bottom left-hand side of the face  
21 card --

22 A Yes.

23 Q -- does that let us know what is actually  
24 involved in the creation of the document as far as  
25 material?

1           A    Yes.  Those are all the pattern pieces.

2           Q    Okay.  So can those specifications change over  
3 time in different versions as you go back through and  
4 change parts of it?

5           A    Oh, yeah.  Yeah.

6           Q    Would this particular item, what were -- and this  
7 is one of the four, just for the record, that we're  
8 talking about.  We have been using illustrations through  
9 the -- in the form of demonstratives.  Okay.  And what  
10 would happen if you actually kept decades of garments --  
11 one of each and samples, I'm sorry -- over the years  
12 without letting them go?

13          A    It would not be possible.

14          Q    Why is that?

15          A    We would need ten football fields of warehouses  
16 to store all them.  We're making 600 styles a month.  
17 Impossible.

18          Q    Going back to this item, could you tell us what  
19 were the uncertainties that you faced in creating  
20 Exhibit 8?

21          A    So one of the big ones in this one was the  
22 fabrication used.  This was a dress that would normally be  
23 made in a Poplin fabric, which is more of a lightweight --  
24 I have samples here if you want to see them.

25          Q    Okay.



1           A    It's more of a lightweight fabrication, kind of  
2 thin and sort of more drapey. And our customer wanted it  
3 in what's called a jacquard fabric which is this. It's  
4 almost like an upholstery-type fabric. And that just  
5 presented a lot of problems switching this style into  
6 that.

7                   If you look at the style, in the middle of the  
8 style, you have that darker part. It's a cummerbund  
9 detail. They wanted that to be a charmeuse fabric, which  
10 is a more satiny fabric.

11           Q    Is this what we're talking about?

12           A    Yes.

13           Q    Okay.

14           A    And that just took -- to be able to do that  
15 product in the charmeuse they wanted would not give the  
16 appearance of the way it looks in the concept. It would  
17 look almost bubbly. It doesn't lay flat because the  
18 charmeuse fabric is so soft and shiny.

19           Q    When we're up here, we're talking about our  
20 chart. Where would we find the point on the chart where  
21 you actually realize that obstacle, that issue?

22           A    It could happen in the sewing. You know,  
23 sometimes we get feedback from the sewers -- down over  
24 here -- where they say I can't sew this, or I'm having  
25 problems sewing this. It can happen when the sample is

1 done, and we take a look at the sample and we can't get it  
2 to lay flat.

3 And sometimes we'll make some changes to the  
4 construction, and it goes back to the sewers and she tries  
5 to do it again to see if she can get it to lay flat with  
6 those changes. So it's kind of like it keeps going round  
7 and round, to try to solve the issue.

8 Q In this situation, was the issue ultimately  
9 solved?

10 A No. No. They tried to also solve it by  
11 adding -- because the fabric is so stiff, so when you --  
12 if you hold up this fabric it kind of lays flat. When you  
13 hold up this kind of fabric, you know, kind of like it's  
14 more stiff. So to get something lying flat and flowing  
15 nice, it's a little more difficult. So they added an  
16 under netting part to this dress, and it just didn't --  
17 didn't help.

18 Q Ultimately was the project abandoned?

19 A Yes.

20 Q Putting a fine point on this as far as  
21 percentages, what percentage of all the garments that go  
22 through this process actually have to be abandoned because  
23 of issues just like you described?

24 A If I had to estimate, 10 percent, 20 percent.

25 Q How many ultimately get through to production?

1           A    Well, we sell about 25 percent of what we show.

2           Q    Is everything else cost you have to eat?

3           A    Yes.

4           Q    If I can turn your attention back here for a  
5 moment. We've talked about silhouette -- and actually,  
6 first of all before I do that -- in regard to that item,  
7 which was D11072. You talked -- I think you prefaced it  
8 with the big issues you had with the material?

9           A    Yes.

10          Q    But were there other uncertainties you had to  
11 deal with that caused complications?

12          A    There's always construction, uncertainties. How  
13 is this fabric going to sew? Can we -- do we need to  
14 construct it a different way based on the way the end  
15 sample comes out and how the fabric laid. So there's  
16 construction details. There's stitch details that will  
17 determine.

18          Q    In regard to all of those issues, would you have  
19 to go through this process of experimentation we're seeing  
20 on the board, for that project in its entirety?

21          A    Yes.

22          Q    And for all your project that are --

23          A    We go through this process for everything.

24          Q    Okay. I want to talk for a second about  
25 silhouette. And I believe --

1           MR. DIES: You have to speak because you're away  
2       from the mic.

3           MR. HUNZIKER: No problem.

4       BY MR. HUNZIKER:

5           Q    Could you describe for us what actually -- what  
6       is silhouette?

7           A    Silhouette is the general shape of the style. So  
8       it defines -- if you took a black and white sketch of  
9       that, that would be the silhouette.

10          Q    And now in regard to this document -- I'm sorry.  
11       In regard to this sample, what was the change that was  
12       sought with this sample?

13          A    So this style existed. And when it existed  
14       originally it had -- the top part of the dress was built  
15       up all the way to the neckline and went around the  
16       shoulders and continued from the back of the neck all the  
17       way down. Our buyer wanted it constructed in a way that  
18       it stopped right above the chest. And so we had to  
19       reengineer this whole piece of the dress.

20          Q    Did that basically make it something brand new?

21          A    Yes.

22          Q    Was it anything like based on these elements even  
23       like the previous product?

24          A    No.

25          Q    So explain, if you would, in regard to

1 silhouette. What were the considerations that had to be  
2 made for these different changes that were made from one  
3 form to the other?

4 A So she wanted the similar look in terms of the  
5 body part and the fabric being used up here. So we just  
6 had to reengineer this piece to just fall here, which  
7 meant we didn't really have the support of the top part of  
8 the dress holding up the dress on the shoulders.

9 So we had to add these bra cups. We had to add  
10 these adjustable straps. Because when you do a bra cup  
11 and something is fitted on the chest, we have to allow for  
12 different body shapes. So this all had to be redone. We  
13 had to add a lining to the chest part to accommodate the  
14 bra cup. So this was all reengineered.

15 Q In regard to the projects that we're here talking  
16 about today, in regard to silhouette, is M93771 an  
17 example one of these issues?

18 A Yeah. That would be a similar issue. And  
19 then --

20 Q Just if you would allow me to identify very  
21 quickly in regard to Exhibit 9. What is -- what is this  
22 sample that we're looking at?

23 A This is a Poplin sun dress.

24 Q Okay.

25 A And then it's got an accompanied shrug cardigan

1       that goes over it. So it's sold as a two-piece set.

2           Q    Okay. Now, from the very outset, we're talking  
3       here this is one of our four projects; correct?

4           A    Yes.

5           Q    This is a two-piece set with two independent  
6       items; is that right?

7           A    That's correct.

8           Q    To be clear for the panel, whenever we are going  
9       through and you're doing the process with each of these  
10      items, do you have to go through them for both parts of  
11      that set?

12          A    Yes, separately.

13          Q    Okay. And by process, are we talking about  
14      behind you, the dozen-part process that shows the stations  
15      of your development cycle?

16          A    Yes.

17          Q    I want to ask you real quickly, if we go over to  
18      what's called the related styles, do you see that?

19          A    Yes.

20          Q    Is that relating -- is that talking about other  
21      documents similar -- or I'm sorry -- other items that are  
22      similar? Or are those the actual two items that comprise  
23      this set?

24          A    On this style, those are the two items that  
25      comprise the set. So set -- M93771 is the SKU number for

1 both parts. And then these two numbers are the individual  
2 piece -- product pieces.

3 Q Okay. Now, we had begun this conversation when  
4 we were talking about silhouette issues. So can you  
5 explain to the panel, with this item, what the issues were  
6 within that realm of silhouette problem?

7 A So similar to the dress I just showed you, the  
8 top part of this -- if you're looking at the top part just  
9 below the straps, that's like a panel piece. That was  
10 done in a solid fabric, whereas the rest -- and the back  
11 tie was done in a solid fabric, whereas the rest of the  
12 dress was done in a printed fabric.

13 So when you're combining solid fabric with  
14 printed fabric, the characteristics of those are  
15 different. Solids are usually softer because they go  
16 through a dye process. Prints are a little bit stiffer.  
17 So you're combining those together. So when we were  
18 constructing this solid piece around the neck, it was very  
19 flimsy because it was a solid piece.

20 We had done a lot of these dresses where it was  
21 all print. So then when we went to do the dress with the  
22 solid piece, that piece wasn't lying flat. It kept kind  
23 of falling forward because it was so flimsy and soft. So  
24 we had to add a fusible Pellon in there, which is a lining  
25 that gets heat sealed to the back of the fabric and gets

1 sandwiched in between the fabric to give it structure.

2 Q Now, well that's something we can see. Can you  
3 explain how that also relates completely to function of  
4 the garment?

5 A Well, you can't have a dress that's pulling down.

6 Q Is it wearable? Does it work without making that  
7 change?

8 A Nobody would wear it.

9 Q Okay.

10 A We also had to -- there's a back zipper. And  
11 because the zipper is extending into that solid piece at  
12 the top, and that solid piece is soft and flimsy, we had  
13 to add a hook and eye, which is a little metal, like,  
14 clasp that goes into another clasp that holds the -- at  
15 the top of the zipper, it holds that part together. Yeah,  
16 you can see it at the top of that picture.

17 Q And what is that showing us, just for the  
18 panelist?

19 A It shows that we added that functional piece to  
20 keep that. So if you just sewed the two parts together  
21 and you didn't have anything to close it at the top, it  
22 would be separating and the zipper can release down. So  
23 what this does is it keeps the top part of that closed.

24 Q And just to be clear, does that have anything to  
25 do with the appearance of it versus how it actually



1 performs or functions?

2 A No. Actually that cost us more money. It's very  
3 expensive to put a hook and eye in. So we do it when it's  
4 absolutely necessary for function. And it's hidden. It's  
5 inside the garments. You don't see it.

6 Q In regard to this particular product, which is  
7 M93771, this sample. What were other uncertainties you  
8 faced, and what was the manner in which those were  
9 resolved?

10 A Well, the cardigan -- shrug cardigan has a  
11 smocking that goes around the neck and around the waist,  
12 which is a process where they take fabric and sew multiple  
13 rows of elastic thread in it to give it a real stretch.

14 So there's always challenges of getting the fit  
15 right when you're working with smocking. And when we go  
16 through this process, and we're cutting and sewing  
17 samples, we're also having to make that smocking. So you  
18 make that smocking. You fit it.

19 Now, you have changes you have to then go back  
20 and not only cut this other sample, you need to reprocess  
21 that smocking to get the fit right. So this is a  
22 difficult garment.

23 Q I've pulled up one portion of that face card.

24 A Yes.

25 Q And could you kind of explain for the panel and

1 everyone's iteration, what is contained within those  
2 columns and rows? What information is needed there?

3 A So those are the pattern pieces. The number on  
4 the left says how many of that pattern piece there are.  
5 And the number on the right is just an identifying number  
6 for the pattern piece in the computer system.

7 So the first -- the first section is what we call  
8 self. Self refers to the predominant fabric of the dress.  
9 So in this case it was a predominantly print dress solid  
10 and then there was solid, which we call contrast fabric,  
11 which is the detailing around the top of the chest.

12 Q Just before you finish that, would the self-piece  
13 on this item be the bottom piece?

14 A Yes. The self would be this, and this would  
15 be -- the contrast one would be the lace. The lining  
16 would be contrast two.

17 Q And is that purely a function of the amount of  
18 material needed?

19 A Consumption.

20 Q Go ahead.

21 A And so each of these pieces -- and so the first  
22 item is center front. So that's the pattern piece used  
23 for the center front of the dress. The next one down is  
24 side front. And you have two of those because you have a  
25 right and you have a left, and they are identical.

1           Then you have two back pieces. And then you have  
2 a front skirt. You have a back skirt. And these are just  
3 listing of all the pattern pieces. Then we move on to the  
4 shrug. We have a front. We have a back. We have a  
5 sleeve, and we have neck binding that is sent out for  
6 smocking.

7           Q In the interest of time, I want to go all the way  
8 to right.

9           A Yes.

10          Q When it says maintain and you see initials and  
11 then you see a date?

12          A Yes.

13          Q First of all, those initials, what do those  
14 signify?

15          A That's the pattern maker.

16          Q Okay. And do you know who that is?

17          A Yes. That's one of our pattern makers, Elizabeth  
18 Gallardo.

19          Q Let's talk about the date as well, 8/16 of 2010.

20          A That would be the last time this style got  
21 maintained.

22          Q Do you maintain all the documentation, or even  
23 can you, that relate to every single one of these samples  
24 over 40 years?

25          A No. We just go with our most current revision.

1           Q    Could you have a situation where it could be  
2   disastrous if you kept a previous iteration of a face  
3   card?

4           A    It would just open us up to producing the wrong  
5   thing.  Somebody grabbed the wrong version or -- so we  
6   always go -- we always have the most current information  
7   in our system.

8                   ADMINISTRATIVE LAW JUDGE GEARY:  Just a quick  
9   question because I see it on the overhead, the words.  Is  
10  this 9?

11                  MR. HUNZIKER:  Yes, this is Exhibit 9.  This is  
12  the lower left-hand page.  It's an excerpt from Exhibit 9.  
13  BY MR. HUNZIKER:

14           Q    Turning your attention back over here.  What is  
15  meant by the term draping within the industry?

16           A    So draping is a function that we do to get an  
17  overall shape of a style we want to produce, and that's  
18  done on a mannequin.  So for example on this dress,  
19  they'll take some fabric that's --

20           Q    When you say this dress I want to make sure we're  
21  specific.  What are we talking about?

22           A    We're talking this is all one style.  This is one  
23  item between these three.  So if the design team wants to  
24  make a dress of this particular product, what they'll do  
25  is they will make a pattern, cut and sew a generic shape

1 of what they want, and they will fit it on a mannequin.

2 And a lot of times what they do is they use a  
3 similar fabric to what they're going to want to use  
4 because the other fabric may not be available, or it may  
5 be too expensive to use on all these different  
6 re-fittings. So what they do is they take a similar  
7 fabric, which is what they did here.

8 Q The similar fabric mean --

9 A This.

10 Q All right.

11 A And they just put it on a mannequin like you see  
12 that's on the video. And they'll just get the general  
13 shape of the pattern.

14 Q All right.

15 A Once they do that, then they go back when they  
16 have the fabric and they -- because if you're doing this  
17 process two or three times, you don't want to be wasting  
18 this premium fabric. So they'll do this as a precursor to  
19 doing the actual fabric.

20 Once they get the general shape, they'll then  
21 take the actual fabric, cut sew using that same pattern,  
22 and then they'll put it on the form to see if the shape is  
23 right. So in this case you can see that by following the  
24 same pattern, it came out just very boxy, very wide. It  
25 didn't react the same.

1           So then what they'll do is they'll go through and  
2       they will start pinning, like you saw on the video.  
3       They'll start pinning the style. They'll take out the  
4       sleeve, make it smaller. They take out a side seam. So  
5       it's making it more look like this.

6           Q     And that's the green dress?

7           A     Yes. And so that's draping. Draping is really  
8       getting the overall shape down before we try it on a fit  
9       model.

10          Q     And just so we know -- and I'm not going to mark  
11       it up -- but where would be the point in the process where  
12       you would encounter the problem with the draping where you  
13       would notice it?

14          A     It happens here.

15          Q     Is this a functional testing?

16          A     Yes.

17          Q     Okay. And where do we go back to make the change  
18       to get to where you want it to?

19          A     Pattern making.

20          Q     And then it goes through the process again?

21          A     Correct.

22          Q     Is this, again, based on the function of the  
23       item?

24          A     Yes.

25          Q     Were any of those, just to be clear, I think we

1 had -- I think we were actually down to the final one  
2 before we go to nine. I want to talk real quickly about  
3 the stitching issue. Could you describe this sweater?

4 A So this was a jacket that we were producing, and  
5 when we went through the cut sew wash process for this  
6 garment, we noticed that there were holes being generated.  
7 This goes through a stone wash.

8 So these pockets in the corner were tearing from  
9 the stone wash. The stones were ripping the corners of  
10 these pockets. And so this frequently happens where we  
11 see result of problems in the washing. So what we had to  
12 do was reinforce all these pockets with extra bar tack  
13 stitching. We'll do that. We'll go back.

14 So technically it goes back to pattern making  
15 'cause they make an adjustment in the construction  
16 guidelines, but really it's a cut sew and rewash thing.  
17 We redo it, and we make sure that the change we made  
18 resulted with no ripped holes in the corner of the  
19 pockets.

20 Q I'm going to draw your attention to -- yes -- to  
21 Exhibit 7 within your binder.

22 MR. HUNZIKER: And for the panel and for the  
23 benefit of opposing counsel, this is one of four items,  
24 which is Z1743D01.

25 ///

1 BY MR. HUNZIKER:

2 Q Do you see that?

3 A Yes.

4 Q Okay. Now, just to be clear, is this an adult or  
5 kids garment?

6 A This is a kid's garment.

7 Q So before we actually get into the issues that  
8 you face with this particular sample, could you explain  
9 some of the issues in general that we face when we're  
10 dealing with garments for children and not adults?

11 A Well, you have to take into the consideration  
12 that the kids are more active. They -- you have to take  
13 into consideration the vanity part of it, that you can't  
14 have items that are going to expose parts of the body, you  
15 know, maybe an older woman would want. You have  
16 regulations that you have in kids that you don't have in  
17 women's. So we can take all that into consideration.

18 Q Okay. And then in regard to this --

19 A Oh, I'm sorry. One more thing. You have to take  
20 into consideration that a kid may not be able to put on a  
21 garment like a woman can. They may not be able to button  
22 it. They may not be able to pull up a zipper, button a  
23 waist. So we have to take all of that into consideration.

24 Q Now, stepping away from the general and moving  
25 onto the specific with this actual sample. Once again,



1 are we dealing with two individual garments here?

2 A Yes, we are.

3 Q Do those both have to go through the same process  
4 of iteration that's behind you that every other item has  
5 gone through that?

6 A They do, but they go through separately.

7 Q Okay. And when you say "go through separately,"  
8 what do you mean?

9 A Each product, the skirt and the pant, goes  
10 through that whole cycle on its own.

11 Q Okay. With this particular garment, drilling  
12 down to issues with this particular project, what were  
13 some of the uncertainties you faced in difficulties within  
14 our flow chart?

15 A You know, the biggest problem we had with this  
16 was this product had -- if you look at the sketch, each  
17 one of those are rows, they're rows of stitched fabric. I  
18 don't know if you could see it on the sketch. But there's  
19 like 13. They're basically ruffles of fabric that are  
20 strung together, and they create layers to the garment.

21 So the challenge here was when we do construction  
22 on certain garments, we have to allow for stretch. So  
23 certain stitching is used to allow for stretch. We also  
24 have to allow for stability and especially to kids'  
25 garments. We don't want seams opening up when the kid is

1       being active.

2               So the challenge we had on this one was being  
3       able to allow for stretch in that garment for activity.  
4       But because those ruffles -- if you can imagine fabric  
5       that's all bunched together. You have this much fabric  
6       and now you bunch it together. It's much more condense  
7       and thick.

8               So it's heavier. So it causes seams to easily  
9       open up. So we had to figure out a way to reinforce that  
10      seam so that the seams wouldn't open up, yet also provide  
11      for the stretch. And trying to do that on 13 different  
12      rows and keep the proportions right and keep the ruffles  
13      consistent was very, very difficult.

14              Q     Do we within these two particular -- even though  
15      they're a part of the same set, do we see different issues  
16      presented with stitching when you have that type of a  
17      skirt in relation to the legging?

18              A     Yes.

19              Q     How?

20              A     So on the skirt, we would use a stitch called  
21      five thread overlock. So an overlock is a stitch that's  
22      used to join two pieces together. And you're probably  
23      familiar with it if you look inside your clothing. You'll  
24      see it's that general stitch that goes where two seams  
25      comes together -- or a seam comes together.

1           And so what a five thread overlock is it's --  
2       overlock is three threads. This is one extra -- two extra  
3       stitches that go above the overlock, and it just provides  
4       reinforcement. We can't do that on the legging. Because  
5       imagine if you guys ever had a top where you put it over  
6       your neck and you hear something pop. Those are the --  
7       that's that extra safety stitch popping.

8           So we had to figure out a way to be able to  
9       provide that safety stitch, but allow for the stretch to  
10      where it wasn't going to pop that extra safety stitch. So  
11      on the legging we wouldn't use that safety stitch. We  
12      would use just a regular four thread overlock.

13           MR. HUNZIKER: Could we have one second to  
14      confer?

15           ADMINISTRATIVE LAW JUDGE VASSIGH: Sure.

16      BY MR. HUNZIKER:

17           Q     Just a couple of final things, Mr. Greenberg.  
18       The ever present boards that we've used a lot over the  
19       last couple of hours. All the things we've talked about  
20       on those board, those were preproduction; correct?

21           A     Yes.

22           Q     Okay. Then also, lastly, you have, for yourself  
23       in this case, a 20 percent allocation of the time that you  
24       put in doing your job. Do you think that's fair based  
25       upon the amount of time in the day, week, month, year that

1       you spend in the trenches directly involved in the  
2       projects or in direct supervision of those folks?

3           A     It's probably low.

4           Q     Where do you -- you think the 20 percent is  
5       actually conservative?

6           A     Yes.

7           Q     What do you say to the notion that if you've seen  
8       one product, you've seen it all? That can't be that  
9       different in what it takes to make them?

10          A     I think you don't know what goes into  
11       manufacturing a garment.

12          Q     And then if they said that from the other side --  
13       if you heard the other side stand up and say, after  
14       everything you've showed us, that this is all style over  
15       function; how would you respond?

16          A     I would say that past that conceptual stage, it's  
17       all about function and fit and the ability to manufacture  
18       a garment.

19          Q     With everything we've talked about, especially in  
20       regard to our four projects, how many of these did you  
21       take from somebody else versus having them as an original  
22       thought and concept that Swat-Fame created?

23          A     It's a mixture. I mean, you're taking elements  
24       from fashion and trend and -- but it's the way you  
25       interpret it is original.

1           Q    But each one of them is unique, and you're  
2   creating from scratch?

3           A    Correct.

4           MR. HUNZIKER:  At this time we would pass the  
5   witness, Judge.

6           ADMINISTRATIVE LAW JUDGE VASSIGH:  Question for  
7   Appellants.  Did you want to refer at all to the Bermuda  
8   shorts?

9           MR. DIES:  We have another witness that's going  
10   to talk about that one.

11          ADMINISTRATIVE LAW JUDGE VASSIGH:  Okay.  Thank  
12   you.

13          MR. HUNZIKER:  And by the way before we do, we  
14   would like you to know Mr. Suggs may very well use those  
15   panels, those board, I move those be preserved in the  
16   manner that we have them, unless Mr. Suggs modifies them.

17          ADMINISTRATIVE LAW JUDGE VASSIGH:  Okay.  That's  
18   fine.

19          Let's take care of a little timekeeping.  Judge  
20   Thompson, how much time do you have?

21          ADMINISTRATIVE LAW JUDGE VASSIGH:  My math is  
22   100 -- approximately 100 -- we're almost 8 minutes over.

23          Mr. Remmington, what number do you have?

24          MR. REMMINGTON:  I did it individually kind of  
25   based on our time line.  I'll add it up, and we are --

1 well, let me put it this way. We have -- we went over by  
2 a minute 30 on our opening. California went under by 5.  
3 We planned an hour 45 for Mr. Greenberg, and we hit it on  
4 the dot. I've taken out time for administrative matters  
5 and bathroom break.

6 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay.

7 MS. WIGNALL: That's consistent with what we have  
8 too.

9 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. I'd  
10 like to ask respondents. We can take lunch break here.  
11 It's 11:30, or you can begin your cross now.

12 MR. ROUSE: I think we would like to take the  
13 lunch break to avoid the crowds.

14 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. We'll  
15 take a little break, and we'll take one hour for lunch.  
16 Then we'll be back and be ready to start at 12:30.

17 (A lunch recess was taken.)

18 ADMINISTRATIVE LAW JUDGE VASSIGH: We'll back on  
19 the record.

20 We're ready for respondents' questions for this  
21 witness whenever you're ready.

22 MR. ROUSE: Thank you.

23 ///

24 ///

25 ///

1 CROSS-EXAMINATION

2 BY MR. ROUSE:

3 Q Good afternoon, Mr. Greenberg.

4 A Good afternoon.

5 Q I'm going to stand back here so I can spread some  
6 stuff out. If at any point you can't hear me, let me  
7 know.

8 A Okay.

9 Q I'm going to reference the development cycle flow  
10 chart that's currently behind you and ask you some  
11 questions about that.

12 A Yes.

13 Q Is that a flow chart that actually existed in  
14 that form at Swat-Fame, or is that something that was  
15 created for this hearing?

16 A This exact flow chart was created for this  
17 hearing.

18 Q Okay. Did you have anything similar within  
19 Swat-Fame that use the same words that are on that flow  
20 chart?

21 A Well, it's our everyday business. So --

22 Q Okay. Do you have anything within Swat-Fame that  
23 talks about functional testing; in those words?

24 A We would probably have some manuals that have  
25 that language.

1           Q    Okay.  Is that anything you provided during the  
2           audit, or do you know?

3           A    I don't know.

4           Q    Okay.  I think you talked about this during  
5           direct examination, but I'm going to ask it again because  
6           I don't think I quite got it.  Is there any part of that  
7           development cycle process that is performed outside of  
8           California?

9           A    No.

10          Q    Okay.  So the finishing is done in California?

11          A    Yes.

12          Q    And the washing is done in California?

13          A    You're talking about from the top first card to  
14          the bottom of the second?

15          Q    No.  I'm talking about the whole process.  So my  
16          understanding of the development cycle is it goes from  
17          conceptualization all the way through production; is that  
18          accurate?

19          A    Yes.  So the cut sew and wash on the third panel  
20          is done at the factory.

21          Q    Okay.  And that's the only one that's done  
22          outside of California?

23          A    Yes.

24          Q    Okay.  And where is that factory at?

25          A    That can be in Los Angeles.  It can be overseas.



1           Q    Okay.  Do you guys -- and let me back up.  So I  
2 might refer to you or the company or Swat-Fame, but when I  
3 say "you," I'm referring to Swat-Fame.

4           A    Yes, got it.

5           Q    I'll use those interchangeably.  Okay.  Does  
6 Swat-Fame have an organization chart?

7           A    Yes.

8           Q    And where do you fall on that organization chart?

9           A    I would be -- you mean relative to everybody?

10          Q    Well, yeah.  Let me ask it this way.  So who is  
11 above you in the chain of command?

12          A    Mitchell Quaranta, CEO, Chairman Bruce Stern.

13          Q    Okay.  So you have two people above you?

14          A    Yes.

15          Q    And who is directly below you?

16          A    All the managers and then everybody that reports  
17 to them; salespeople, design.

18          Q    Right, but directly below you are the managers;  
19 right?

20          A    Yes.

21          Q    Okay.  And how many of those are there?

22          A    Probably about 10.

23          Q    Okay.  And you mentioned on direct examination  
24 that you had interaction with some part of this process,  
25 essentially, every day.  So the pattern making, the

1 cutters and sewers; is that correct?

2 A In some form, yeah.

3 Q And what does that interaction on a daily basis  
4 look like?

5 A It could be a decision to make. It could be  
6 information to communicate to a customer. It could be  
7 just information that I need to know so that when I'm with  
8 the customer I have the background. It could be for an  
9 opinion, or it could be just my knowledge.

10 Q Okay. Are you communicating with the cutters and  
11 sewers --

12 A Yes.

13 Q -- with respect to that?

14 A Yes.

15 Q So you might have an issue come up with the  
16 client or the customer, and then you'll actually call or  
17 go and see a cutter or sewer to find out what you need to  
18 find out?

19 A Well, it would be more I would hear an issue, and  
20 get involved with either the pattern making, the cutting,  
21 the sewing, the design team. And then communicate that to  
22 a customer if we couldn't achieve something.

23 Q Right. And I guess what I'm more asking -- so  
24 what I understand you to have said in direct examination  
25 is that you would bypass your managers and go straight to

1       their employees?

2           A     Well, I would I would be involved with them.

3           Q     Who is them?

4           A     The managers.

5           Q     Okay.  So at any point you would bypass your  
6 managers and go directly to a cutter or sewer?

7           A     Yeah, occasionally.  I guess a pattern maker  
8 could ask me for an opinion on something.

9           Q     Okay.  So they can go directly to you --

10          A     Yes.

11          Q     -- without going to the manager first?

12          A     Yes.

13          Q     Okay.

14          A     We don't -- we're not a corporate-type set up.

15          Q     Would you say mostly you would go directly to  
16 your managers?

17          A     I would say mostly we collaborate all together.

18          Q     All right.  So on direct examination we heard a  
19 lot of about -- you used the word "function."  There were  
20 times you used the word "trends."  There were time you  
21 used the word "look."  What is your definition of a  
22 function as it relates to the fashion industry?

23          A     Function would be can the garment stay up on a  
24 body?  Does it fit?  Does it perform when a person moves  
25 their arms?  When they sit down?  When they go to reach

1 for something? I would call all that function. Does the  
2 zipper work? Does it achieve what the function of a  
3 zipper is supposed to be, or is it falling down?

4 Q So when you -- everything you described seemed to  
5 be based on the wearer's movement. So would you say the  
6 level of comfort ability that a wearer has is a function?

7 A Yes.

8 Q Okay. And in one of the examples you used on  
9 direct examination you said, "For example, if the wearer  
10 couldn't move their arms, then obviously the item would  
11 not be functional."

12 A Right.

13 Q But that's a common issue; right? There's  
14 usually a situation where they could move their arms, but  
15 it might not be comfortable for them; right?

16 A Well, there's degrees. I mean, if you put on a  
17 blouse that's too tight, and you can't extend your arms,  
18 that's a problem.

19 Q Okay. And you would consider that function?

20 A Yes.

21 Q All right. And at the same time while you're  
22 dealing with these functional issues, you have to make  
23 sure the look is what your customer or what the  
24 conceptualization team wants; right?

25 A Yes.

1           Q   And you mentioned the fit also with respect to  
2 function.  What do you mean by the fit?

3           A   How that product sits on the human body and  
4 reacts to a movement of a human body.

5           Q   All right.  Let me give you an example, just  
6 something I face when I buy dress shirts.  Now, there's  
7 dress shirts that are slim fit?

8           A   Yes.

9           Q   And there's -- I can't remember what they call  
10 it -- but regular size dress shirts.

11          A   Yes.

12          Q   If I bought a dress shirt that was supposed to be  
13 slim fit but maybe a little baggy on me, would you  
14 consider that a functional issue or --

15          A   No.

16          Q   Okay.  Even though it didn't meet the goal of  
17 being a slim fit?

18          A   Well, I guess it's in the context of the way  
19 you're describing it where you have more than one fit.  
20 You have a slim fit.  You have a regular fit.  If you  
21 chose the regular fit and it wasn't slim, then I would say  
22 that's not a functional issue.  If the intended use was  
23 supposed to be slim fit, and you put it on and it was  
24 oversize, then that's a fit issue.

25          Q   Are you equating fit with function?

1           A    I'm saying the second case --

2           Q    Yeah.

3           A    -- that would be fit and function would be --

4   that would be a problem.

5           Q    Okay.

6           A    Whereas in the first case it's just what you've

7   selected.

8           Q    Even though regardless of the shirt, I can still

9   reach up and grab things. I can still write. I can still

10  flip pages?

11          A    Yeah.

12          Q    Okay.

13          A    If I can't button the waist, that's a problem.

14          Q    Right. And then I probably have to get into the

15   gym.

16                Going back to the flow chart behind you, it's

17   labeled the development cycle. Is that entire -- well,

18   let me say it. The first 12 steps excluding production

19   begins, so all the way to conceptualization to product

20   performance testing; is that what your describing as the,

21   quote, end quote, "preproduction process."

22          A    Yes.

23          Q    Okay. And if you look on the third board over

24   there, three lines up it says "Preproduction/Technical

25   Design Review."

1           A    Yes.

2           Q    Why is that labeled "preproduction?"

3           A    That's just what we call it when a factory sends  
4 in samples for a preproduction review.

5           Q    Okay. But that whole process before production  
6 begins is preproduction?

7           A    Yeah. I mean, people call it development,  
8 preproduction, prototype, development. It's sort of inter  
9 changeable.

10          Q    Okay. So the way I understood your direct  
11 examination testimony is that everything after  
12 conceptualization is performed to essentially bring that  
13 concept to life, to a product; right?

14          A    That's correct.

15          Q    Also in your direct examination, I think as  
16 Mr. Hunziker was taking you through the video. And at one  
17 point you mentioned that the garment that's on the video  
18 was not laying on the mannequin properly. What does that  
19 mean "properly?"

20          A    I think I was referring to that dress. The  
21 proportions needed to be adjusted, and so she was pinning  
22 it to match the correct proportions on the mannequin.

23          Q    Okay.

24          A    And it had detail of, like, ruffling right here,  
25 and she was adjusting that to fit the proportions.

1 Q And would you consider that a functional issue?

2 A Yes.

3 Q And you would agree also, affects how the dress  
4 looks on the wearer; right?

5 A Yeah. But if I have a waist that is right here,  
6 that wouldn't be very functional for a pair of pants  
7 because the waist is up here. The same with a dress.  
8 There's a waist line on a dress. It has to be in the  
9 right proportions.

10 Q Okay.

11 A The woman might not be able to sit properly if  
12 the proportions are off.

13 Q May not be able to what?

14 A Sit properly.

15 Q Okay. One thinks it would be uncomfortable?

16 MR. DIES: If you nod your head, it's not on the  
17 record.

18 THE WITNESS: I think it's more than  
19 uncomfortable.

20 BY MR. ROUSE:

21 Q I want to ask you about the second part of the  
22 flow chart, "Material Selection and Testing." Can you  
23 explain what that is?

24 A That's when the design team decides what fabric  
25 and what materials will be used to match up to the



1 silhouette.

2 Q Where does Swat-Fame get the fabric?

3 A We source it. We -- sometimes it's just an  
4 inspirational fabric we find, and we want to take a  
5 version of that. Or it just comes out of a concept of a  
6 designer.

7 Q Well --

8 A We -- we have, for example, in this yellow dress  
9 we create prints of our own, and then we have those prints  
10 produced into fabric.

11 Q So I guess physically where do you get the fabric  
12 from? Do you --

13 A From suppliers.

14 Q Okay. So you don't actually manufacture the  
15 fabric?

16 A No, we don't. Well, we use other companies to  
17 manufacture the fabric.

18 Q Okay. And then the testing process, what does  
19 that entail?

20 A If it's a new fabric that we don't have any  
21 experience working with, we'll put it through some  
22 testing -- initial testing. But most of that happens  
23 after we do the fittings. But we sometimes will do, you  
24 know, initial testing; stretch, you know, shrinkage just  
25 to make sure as we get down, that we're trying to avoid

1 any issues down the line.

2 Q Can you describe in a little bit more detail of  
3 what the testing is?

4 A Yes. And this could happen either in that stage  
5 or after the sample is complete or later on in the  
6 development cycle. Once we get the samples from the  
7 factory, it could happen at any of those stages.

8 That's basically we're testing for wear-ability.  
9 So we're testing did the garment shrink? Did the fabric  
10 shrink? Did it -- did the color rub off? Did it crock?  
11 Did it -- did it have any color transfer? Did it torque,  
12 which means when you sew it or wash it the fabric kind of  
13 twists. There's lots of different things that we're  
14 trying to avoid.

15 Q How do you test it? So you've told me what  
16 you're testing it for, but how do you test it?

17 A Some tests we can do in-house. Some tests we  
18 have to send out to a third-party lab. So --

19 Q Is there one lab you use, or do you --

20 A There's multiple.

21 Q Okay. Some in California?

22 A I believe -- yes. I believe one of them has a  
23 branch in California that we use.

24 Q Okay. And some are outside of California?

25 A Yes.

1 Q Now, you said some of the testing is done  
2 in-house?

3 A Yes.

4 Q So what -- let me ask you. Which employees do  
5 that testing? Is it the pattern makers? The cutters?  
6 The sewers?

7 A It depends on what the test is. So sometimes the  
8 pattern maker will request from the warehouse to do a  
9 steam test. Sometimes we take fabric and we put steam on  
10 it to see if grows or if it shrinks. Sometimes we put it  
11 in a washing machine. We have personnel in the warehouse  
12 that do that.

13 Sometimes we us a crocking test, which is a  
14 machine that kind of rubs the fabric a certain amount of  
15 times to tell if there's a color transfer. So things we  
16 can do in-house we do. But some of the technical things  
17 we don't have the machinery for, we send out; like  
18 chemical analysis, things like that.

19 Q You said you do that with respect to materials  
20 that you don't have experience with; right?

21 A Or just at the end of the development cycle.

22 Q For all of your products?

23 A For many of them.

24 Q Okay. Do you know, specifically for the four  
25 we're talking about today, were those fabrics tested?

1           A    I don't know. Likely, but I don't know for sure.

2           Q    Okay.

3           A    Especially one of them had a -- with the solid  
4 piece with the white print, that almost I'm certain, went  
5 through testing because we're testing to make sure there's  
6 no bleeding.

7           Q    So that probably would have gone through the  
8 washing machine?

9           A    Yes.

10          Q    Okay.

11          A    Like for example, where it's up here, we may take  
12 just a swatch of that black fabric against white fabric  
13 and sew one piece together and throw it in the machine to  
14 see if it's okay, and then move forward. In other cases  
15 we'll just test the whole dress and make sure that's okay.  
16 It just depends on the situation.

17          Q    And in-house you said at times the pattern makers  
18 do that?

19          A    No. It would either be before pattern making.  
20 If from the design end, if they're worried about  
21 something, they may request a test. So if they foresee  
22 something they want to make sure is okay, they may put a  
23 test in there. And then we can do it again on a full  
24 garment because some things you can't see in swatches,  
25 materials without sewing a full garment.

1 Q Do you have a specific department that performs  
2 those test?

3 A In-house part of our warehouse team does some of  
4 the testing.

5 Q And what are the titles of the employees that  
6 would do that test?

7 A It would be -- it's just our fabric warehouse. I  
8 don't think he has a specific title.

9 Q Okay. So the second board of the flow chart  
10 behind you at the top "Finishing" -

11 A Yes.

12 Q Can you explain again what that is?

13 A That's when we do denim. We sometimes do  
14 finishing to the garment so we could wash it -- stone wash  
15 it. In some cases we garment dye styles. So we cut and  
16 sew it and then send it out to be garment dyed -- the  
17 color.

18 Q So finishing is referencing garment dye?

19 A It could be garment dye. It could be stone  
20 washed. Any finishing process that gets done to the  
21 garment after it's sewn.

22 Q So an example of finishing is dyeing the garment  
23 and what else would be an example of finishing?

24 A Stone washing, sanding down the fabric to get,  
25 you know, a sandblast effect.. It could be a silk screen

1 put on a garment after it's sewn. It could be an  
2 embroidery. Any of those things are finishing processes  
3 we put on a garment.

4 Q What about whiskering? Is that a finishing?

5 A Yes.

6 Q But that's only done with respect to denim?

7 A Whiskering?

8 Q Well, just the finishing process in general?

9 A No. No. We do embroidery on dresses. We do  
10 silk screen on sportswear tops. We've done washing on  
11 sportswear tops.

12 Q Is there a reason you specifically mentioned  
13 denim --

14 A Because all of our denim goes through that.  
15 Whereas in the other case, not everything goes through  
16 that, but all denim goes through that.

17 Q With respect to the four projects that we're  
18 dealing with today, do you know -- although, I think one  
19 of them is denim, I believe that's the Bermuda shorts.  
20 But with respect to the other three, do you know if those  
21 went through a finishing process?

22 A The denim did. The two dresses didn't. The  
23 skirt and legging set has a send out process, which I  
24 described earlier where that -- those strips of fabric  
25 were sent out for a ruffling process. Oh, and the

1 cardigan, that shrug on the dress, that ruffle around the  
2 edge got sent out to a third party service that did the  
3 finishing detail around the edge.

4 Q Is that third party service inside California or  
5 outside of California?

6 A Inside California in Los Angeles.

7 Q So ruffling would also be a part of the finishing  
8 process?

9 A It can or may not be. Some ruffling we can do  
10 in-house, some we can't.

11 Q Okay. The mannequin -- if I remember your direct  
12 examination testimony -- the mannequin comes into play in  
13 the functional testing section; right?

14 A Yes.

15 Q Why do you start with a mannequin?

16 A Because it gives us the general shape without  
17 having a fit model. It's sort of like the precursor to  
18 the fit model. It's your sort of first of honing the fit.

19 Q Why not just go straight to the fit model?

20 A It's expensive.

21 Q All right. That's what I thought, but I wasn't  
22 sure.

23 A Also time constraints, and you're reliant on a  
24 fit model's time. They're an outside service that comes  
25 to our place. You sort of have these set times, and if

1 you can get a jump on things using mannequins to cut out  
2 some of that time.

3 Q And then the technical design review, can you  
4 explain that process?

5 A We're on the third?

6 Q Yes.

7 A Yeah. So when the factory sends us their version  
8 of our sample, we put it through technical design, which  
9 means they analyze the sample. They compare it against  
10 our standard. They measure every point of measurements.  
11 They check every seam. They basically make sure that  
12 garment is exactly what we want before goes it goes on a  
13 fit model to be fitted.

14 They also measure every single point of  
15 measurement. So when we go make a change, we know what we  
16 changed, and we can communicate that back to the factory.

17 Q And also do you guys keep a copy, for example, so  
18 you can compare?

19 A Well --

20 Q Or you said a duplicate copy of the --

21 A Yeah, we have our original -- the sample that's  
22 complete. There's two copies of it. One we keep and one  
23 we give to the factory.

24 Q I put a blue binder over in front of you, and I'd  
25 like you to refer to Respondent's Exhibit C, please. It



1       should be a letter from alliantgroup dated,  
2       November 17, 2015.

3           A    Yes.  With Marcy Hunt?

4           Q    Yes.  And then if you could turn to page 3,  
5       please.  Did you see this letter during the audit?

6           A    No.

7           Q    Okay.  So the changes that you see there, for  
8       example, on page 3 the third paragraph down.  It starts  
9       with, "All aspects," and it looks like the word all is  
10      crossed out and somebody put in aspects in changes form.  
11      Do you see that?

12          A    Yes.

13          Q    That would have been you that did that?

14          A    No.

15          Q    Okay.  Do you know why somebody would change the  
16      sentence, "All of the preproduction processes is  
17      considered qualified research activity," to say, "Aspects  
18      of the preproduction process would be considered or be  
19      considered qualified research activity?"

20          A    I don't know.  I don't know.  Maybe the design,  
21      the conceptualized part is not.  I don't know.

22          Q    Okay.  Would you agree that only specific aspects  
23      of the flow chart are research activity?

24          A    Well, I would say once the concept is -- once we  
25      have the concept, pretty much everything down forward

1 until production is you're trying to figure out how and  
2 can we make it? What's going to be needed to make it?

3 Q All right. Are you involved at the  
4 conceptualization stage?

5 A At times, yes.

6 Q And what does that process look like? I can tell  
7 you what I'm envisioning, and then you tell me if I'm  
8 wrong. I'm envisioning a lot of people getting into a  
9 room and talking about current trend and styles and what  
10 you want to design for the upcoming season. Is that about  
11 right?

12 A That's one part of it.

13 Q Okay. What are the other parts?

14 A The other part is then putting together boards  
15 and styles of mixing silhouettes with fabrics and deciding  
16 what the products are going to actually be.

17 Q When you say "boards," what do you mean?

18 A Inspiration boards of what, you know, that sort  
19 of drive the design concepts.

20 Q Do you ever bring in other clothing  
21 manufacturer's products to these conceptualization  
22 meeting?

23 A I don't understand what you mean. We'll use  
24 pictures as inspiration sometimes for just, you know, we  
25 may like a color from this or a neckline from that, but

1 it's just more for inspiration.

2 Q So you don't bring in the actual garment? So you  
3 won't go to some store -- I don't know who your  
4 competitors might be, but you won't go to another clothing  
5 manufacturer's store and get that and bring it to  
6 conceptualization?

7 A We may, but we try to be original. We try to be  
8 not -- I mean, they don't need it from us if they're  
9 already buying it from our competitors.

10 Q Who are your competitors?

11 A Who are our competitors? Topson Downs that's a  
12 competitor of ours. There's a company called City  
13 Triangle that makes dresses. They are a competitor of  
14 ours.

15 Q What were they called?

16 A City Triangle.

17 Q City Triangle.

18 A You know, there's denim brands that are  
19 competitors of ours. Lucky Brand is probably a competitor  
20 of ours. Not Your Daughters Jeans is a competitor. But  
21 they are competitors in different ways. So --

22 Q Okay. I'm going to drop into the four projects  
23 that we're talking about here today.

24 A Okay.

25 Q And I know -- I can't remember who said it. But

1 before lunch somebody said that the other witness will be  
2 talking about the Bermuda shorts. I have questions for  
3 you on that, but if you tell me you don't know anything  
4 about the Bermuda shorts then we'll save those questions,  
5 or I can give it a shot?

6 A I -- I guess.

7 Q I'll give it a shot. If you don't know, just say  
8 I don't know.

9 A We can try.

10 Q That's fine.

11 A Yeah.

12 Q All right. Swat-Fame's Appellant binder -- the  
13 other one.

14 A This one or the blue one?

15 Q The other one.

16 A Okay.

17 Q If you can turn to Exhibit 10, please. And I'm  
18 referring to Appellants' exhibit binder, Exhibit 10. Do  
19 you see what I'm referring to?

20 A Yes.

21 Q Okay. And I think you explained this on direct,  
22 but I want to make sure I understood it. So throughout  
23 this document -- I'm looking at the one that's page 1.  
24 And throughout this document the date of May 27, 2008,  
25 appears numerous times on that document. Can you tell me

1 again what that date represents?

2 A That should be the last time that item or the  
3 whole style was maintained.

4 Q And when you say "maintained," what does that  
5 mean?

6 A Any change. If we made a change, let's say  
7 today, that date would be updated to today's date.

8 Q So this document does not reflect any changes  
9 that were made to that product; correct?

10 A No. You're talking about during the development  
11 process?

12 Q Yes.

13 A No.

14 Q Okay. But those documents did exist; correct?

15 A This document?

16 Q No. Documents that represented changes?

17 A Well, it's this document that gets updated.

18 Q And so -- okay. So let me ask it this way. So  
19 let's say you have a document that represents your first  
20 run through the process.

21 A Yes.

22 Q So if it needs to go back through that process  
23 for whatever changes, tell me what happens to that  
24 document?

25 A So this document is actually from our system. So

1 the system is getting updated. Depending on when I  
2 printout whatever is coming out of that system at that  
3 moment is the most recent information for that style.

4 Q So you do not keep a copy of that original form?

5 A No. It just updates in the system as we go  
6 along.

7 Q Okay. Now, if you can keep your finger in  
8 Exhibit 10 and then go to -- excuse me -- Appellants'  
9 Exhibit 3, please?

10 A 3? .

11 Q 3. And then on that exhibit if you can go to --  
12 give me one second here -- page 11, please. On the last  
13 box there, you see the project No. UV636N?

14 A I do.

15 Q Okay. About midway down in that paragraph that's  
16 next to it, I'm going to read this into the record. It  
17 says, "A specific issue faced with the Bermuda shorts  
18 related to the fit for the garment, specifically the fit  
19 of the shorts was challenging because the wash process  
20 caused the material to be susceptible to a higher rate of  
21 shrinkage." Do you see that section?

22 A Yes.

23 Q Can you go onto more detail about that problem?

24 A Yes. So when you're dealing with fabric matching  
25 to a silhouette to create a style, you know, a lot of

1 challenge with how that fabric is going to react; how it's  
2 going to -- as I mentioned before. It shrinks when you're  
3 sewing it. It may grow when you're sewing it. So there's  
4 plenty of challenges with that.

5 When you now add washing that fabric into the  
6 mix, it becomes exponentially more difficult because  
7 you're dealing with a new -- another factor that effects  
8 the stability of that fabric, which then lends to, you  
9 know, the overall fit of the garment and function of the  
10 garment. You may do something to it in a wash that may  
11 break down the fabric and not make the fabric stable  
12 anymore.

13 Q Now, if you could keep your finger there --

14 A Yup.

15 Q -- and go back to Exhibit 10?

16 A I'm running out of fingers. Yup.

17 Q We're back on the face card for the Bermuda  
18 shorts.

19 A Yes.

20 Q And at the top of the page there's a section  
21 called "Fabric Type." Do you see that on the top right?

22 A Yes.

23 Q And the fabric type is TY6166-2B.

24 A Yes.

25 Q Do you see that?

1           A    Yes.

2           Q    What is that?

3           A    That's the code for that specific fabric that  
4 would be the intended use for that style.

5           Q    Is there a name for that fabric?

6           A    If there is I don't know what it is.

7           Q    Do you know if you've ever dealt with that fabric  
8 before this project?

9           A    I don't.

10          Q    Okay. Do you know when you first realized that  
11 there was a problem with the fit of these shorts?

12          A    It would have been after we received it back  
13 after wash. So it would have been in this stage right  
14 here between development and testing. We would get the  
15 sample after wash.

16                We would spec it out. We would put it on a  
17 mannequin or a live model and see. Or just through the  
18 inspection if the fabric is broken down or if there's  
19 something wrong with it.

20          Q    Okay. Now, there's also a wash process -- maybe  
21 I'm getting confused. But there's a wash process before  
22 that; right? So the second part of that flow chart up  
23 there where it says "Finishing and Washing" --

24          A    No. That's what I'm talking about.

25          Q    Oh, that is what you're talking about.



1           A    Yeah.

2           Q    Okay.

3           A    Wash is just another part for certain items.  You  
4   have cut sew in some items.  You have cut, sew, wash on  
5   some items.  You have cut, sew, silkscreen on some items.  
6   You have cut, sew, embroidery on some items.  Some items  
7   you have cut, sew, embroidery and wash.  So it's just  
8   another part of the process.

9           Q    Okay.  I want to talk to you a little bit about  
10   the fit test.  We talked a little bit about that in direct  
11   examination.  And so the way I understand it and correct  
12   me if I am wrong.  Fit test involves either -- well,  
13   sometimes both -- but it would involve a mannequin; right?

14          A    Yes.

15          Q    And that's when you put a product on the  
16   mannequin and somebody from Swat-Fame steps back, takes a  
17   look at it to see how it's fitting; right?

18          A    We're basically building the shape.

19          Q    Okay.  So you may take things, and widen things  
20   or bring things --

21          A    Exactly.

22          Q    Okay.  And then --

23          A    And that's based on how that fabric reacted when  
24   you sewed it 'cause we don't know that ahead of time.

25          Q    And then with a live fit model you hire someone

1 to come in, and essentially do the same thing as  
2 mannequin; right? You put the product on the live fit  
3 model. Someone from Swat-Fame takes a step back, looks at  
4 it, and then gives their opinion but also receives input  
5 from the live model; right?

6 A Yes. It's both together.

7 Q All right. When you perform the fit test, is  
8 there any documentation of the result of the fit test?

9 A At this stage there are.

10 Q And who does the documentation?

11 A The technical design team.

12 Q All right. Do you keep those documents?

13 A Yes.

14 Q All right. And do you know if you provided those  
15 documents at all?

16 A I have no idea.

17 Q Okay.

18 A I thought I saw something in here, but I'm not  
19 sure.

20 MR. DIES: For the record, "in here" is what?  
21 What were you referring to?

22 THE WITNESS: The blue -- the blue -- I'm not  
23 sure. I just happen to glance through it.

24 BY MR. ROUSE:

25 Q Oh, feel free to look through. If you see

1 something in there, let us know please.

2 A I do see. I do see something that has a document  
3 that refers to reviewing a factory sample.

4 Q Okay. What exhibit is it?

5 A It's Exhibit D, page 219.

6 Q Okay. Can you explain what this document is?

7 A So it's showing the sample that came in from the  
8 factory, and it's saying -- if you look under notes, it's  
9 saying it was fit on 5 /10. And it's saying what some of  
10 the issues were. Binding is inconsistent. Hanger  
11 tape should be -- it's basically noting all the  
12 inconsistencies.

13 Q Okay. It's from a fit test?

14 A Yes.

15 Q Okay. Do you know what the garment was on this?  
16 Was it one of our four or was it something separate?

17 A Oh, no. This is separate.

18 Q Okay.

19 A We would only do this if we went into production  
20 with styling.

21 Q You only do this when you do production with it?

22 A Correct.

23 Q Okay. Out of our four sample projects, do you  
24 know how many of those went to production, if any?

25 A I believe one.

1 Q Which one?

2 A I don't remember.

3 Q Okay. Mr. Greenberg, when the Franchise Tax  
4 Board auditors came out to conduct a field audit and site  
5 tour, were you involved in that at all? This was back in  
6 October of 2015.

7 A Was that when the woman did the -- met with the  
8 woman from Franchise Tax Board that did the report? Is  
9 that what you're talking about?

10 Q Well, let me ask you about that. Can you tell me  
11 what happened at that meeting? Maybe it is.

12 A I don't remember. We just walked through the --  
13 it was similar to this. Walking through the process of  
14 what we do and how we do it.

15 Q Okay. Did you -- do you know if the auditor took  
16 a site tour?

17 A I believe she did.

18 Q Okay. And were you on that site tour?

19 A I believe so.

20 Q Okay. So those documents obviously exist. The  
21 document we just looked at, which is on --

22 A Well, they existed for this style. You know, I'm  
23 noticing too. We went up on a new system, which is  
24 product life cycle management system, which basically  
25 tracks electronically all this. Previous to that it was

1 all a manual process. So I don't know if, of the four  
2 styles, if that was in our new system or old system  
3 because we had to transition.

4 Q When you transitioned to your new system, what  
5 happened to the documents in the old system?

6 A They would be just hand docs. They would just be  
7 hand papers that would have been thrown in files --  
8 containers that are saved for a certain amount of time.

9 Q Okay. Do you know if you -- did you look in  
10 those containers at all when you --

11 A I didn't.

12 Q Okay. If you can refer back to Exhibit 10. So  
13 the section of that document that says "Related Styles."  
14 There's nothing here for this particular product. But can  
15 you explain again what related style would be with respect  
16 to a face card?

17 A A related style is just something that could be  
18 similar, or we also use that for when there's multiple  
19 parts to a set that identifies individual pieces of the  
20 set.

21 We could have a related style based on, you know,  
22 shape of a waistband or -- its any detail that if we  
23 wanted to see what it could be similar to, it would be  
24 similar to that.

25 ADMINISTRATIVE LAW JUDGE VASSIGH: Which exhibit

1 is that?

2 MR. ROUSE: Appellants' Exhibit 10.

3 BY MR. ROUSE:

4 Q It should be style --

5 A It could refer to a design print. A print of a  
6 pattern. It could refer to that. It's just a reference  
7 for if we ever had to look back.

8 Q Okay. And it's something you've done before and  
9 that if it's something similar, you've done it before?

10 A Well, it could be -- it could be used -- use that  
11 color thread for this item and refer back to that thread.

12 MR. ROUSE: And then Judge Thompson, did you find  
13 it?

14 ADMINISTRATIVE LAW JUDGE THOMPSON: Yeah. I'm  
15 not -- it's the way it's listed; correct?

16 MR. ROUSE: Correct.

17 BY MR. ROUSE:

18 Q And then on the section that says -- I assume  
19 it's referral or refral (sic).

20 A Where are you looking?

21 Q So the pattern section on Respondent's -- oh,  
22 excuse me -- Appellants' Exhibit 10. And then five  
23 columns over it says -- I think it's referral.

24 A Yeah. Sometimes a single pattern piece could  
25 refer back to something, but we rarely use that.

1 Q Okay. Is the wash process documented at all?

2 A In what way?

3 Q If you test wash a product, and it comes out and

4 you say hey, it shrunk quite a bit more than what we're

5 expecting; does anyone document that?

6 A No. If we were documenting all that, we'd be

7 documenting the whole time and not making garments.

8 Q I understand. Can you refer to Appellants'

9 Exhibit 8?

10 A Yes.

11 Q And that's related to one of our sample projects

12 style D11072.

13 A Yes.

14 Q And then on this face card you do have a related

15 style that's numbered D10521?

16 A Yes.

17 Q And is that because -- is that referencing a

18 separate product like you meant or is that referencing

19 something similar that you've done before?

20 A A separate product.

21 Q Okay. What's the separate product?

22 A D10521.

23 Q Right. But what is that?

24 A I don't know.

25 Q Okay. And how could you tell that that's a

1 separate product as opposed to just something similar  
2 you've done before?

3 A Well, because I can tell by the style number that  
4 it's a different product. It's not a version of this one.  
5 It's a totally separate product?

6 Q What tells you that?

7 A The style number.

8 Q How does it tell you that?

9 A It's a completely different style number. It  
10 wouldn't be -- it's D10521. It wouldn't be D110721234,  
11 you know, just -- we don't do a lot of, you know -- most  
12 of our styles are pretty unique. So --

13 Q So let me back up and make sure I understand. So  
14 if it's a related style in the sense that --

15 A Relate style just -- can I interrupt you?

16 Q Yes.

17 A Related style is just a very loose field. We  
18 just use it that if the design team needs to know what was  
19 that color of that trim I used on that? They can go back  
20 and look. It's -- it can be used for many different  
21 things. It's not really -- it's not a great field for us  
22 because it can mean so many different things.

23 As I told you, it meant the individual styles of  
24 a set, it can also mean in this case what color was used  
25 on the, you know, trim of another style that refers to



1 this. So it's not a great --

2 Q That's just an example?

3 A -- tool for us. Yeah. It could be anything.

4 Q Okay. Now, staying on this page under the  
5 referral column, you have D11071. What is that?

6 A That is a -- it could be another style or it  
7 could be another pattern piece in that style. Oh, it  
8 looks like it could be another pattern piece in that  
9 style.

10 Q Okay. So another pattern piece that you've done  
11 on a previous garment?

12 A Could be, yeah.

13 Q Okay. In your direct examination testimony you  
14 mentioned the challenge you had with this particular  
15 product was with the material. I think the charmeuse was  
16 a problem; right?

17 A Yes. One of them, yeah.

18 Q Okay.

19 A I also talked about the main fabric too.

20 Q All right. Can you refer to Appellants'  
21 Exhibit 3 again and then page 16, please.

22 A Yes.

23 Q So I'm going to read our reference project  
24 No. D11072, the one we're just talking about. And I'm  
25 going to read into the record what the project summary

1 says about the challenges that you faced.

2 "Swat-Fame undertook this project to design and a  
3 dress with adjustable straps. The company faced  
4 uncertainty as to the optimal design for the dress. In  
5 addition, the company faced challenges in implementing  
6 certain elements of the design. For example, straps,  
7 commonly known as spaghetti straps were thin. Therefore,  
8 the company evaluated the straps' location and ability to  
9 support the dress during several fit tests.

10 That particular description doesn't mention the  
11 fabric. Do you know why?

12 A No.

13 Q No. Did you have a challenge with the spaghetti  
14 straps?

15 A We always have an issue with spaghetti straps  
16 because it's holding up in this -- in many cases, it's  
17 holding up the dress. So if it's -- there's a lot of  
18 construction detail in terms of how they get set so they  
19 don't pull out of the dress.

20 Q And you've done spaghetti straps on garments  
21 before this dress; right?

22 A We have. A lot of it depends on what the upper  
23 piece is.

24 Q Right.

25 A So in this case it had the bra foam. That

1 presents an extra problem.

2 Q Okay.

3 A This fabric is also very heavy.

4 Q Have you dealt with spaghetti straps relating to  
5 heavy clothing in the past?

6 A Yes. Varying degrees. It's dependent on how  
7 that fabric is used.

8 Q Okay. If you can go to Appellants' Exhibit 7,  
9 please?

10 A Yes.

11 Q And that is style Z1743D01?

12 A Yes.

13 ADMINISTRATIVE LAW JUDGE GEARY: I'm sorry. I  
14 missed the first part of that question. Where are we for  
15 the record?

16 MR. ROUSE: Oh, Appellants' Exhibit 7.

17 ADMINISTRATIVE LAW JUDGE GEARY: Okay.

18 BY MR. ROUSE:

19 Q Appellants' Exhibit 7, style Z1743D01 -- by the  
20 way, do the project numbers have any significance? I  
21 notice some of them start with different letters; Z, D, M.

22 A They do.

23 Q What's the significance?

24 A The first digit, and it's not the same throughout  
25 the company. It's different by division. But the first

1 digit usually refers to a combination of the division and  
2 the product type. So the Z in this case refers to sets in  
3 the kids division.

4 Q You said sets?

5 A Set.

6 Q Okay.

7 A Yeah. And then the 1743 is just a random number  
8 associated with that to create the SKU. And then the D  
9 represents the size range. So 7 to 16 we use the  
10 letter D.

11 Q Okay. Now, in this face card they have two  
12 related styles.

13 A Yes.

14 Q The first one is Z1679D01, and the second one is  
15 Z1693D01.

16 A Yes.

17 Q I think you addressed this on direct examination.  
18 You said that each one of those represents a piece of this  
19 garment; right?

20 A Correct.

21 Q And then the style number that we see that I  
22 mentioned earlier, the Z1743D01 is the two garments  
23 together?

24 A Correct.

25 Q Okay. Do you have any documents that

1 specifically relate to one of those related styles?

2 A Do I have them with me now?

3 Q Well, does Swat-Fame have documents that relate  
4 to one of those related styles?

5 A It depends. Because in some cases we'll produce  
6 a set together, even though they're two items. In some  
7 cases, based on being two separate products that can't be  
8 manufactured together, they're produced separately and  
9 then they would have two documents. I don't remember if  
10 these were produced together or not.

11 Q Why do you give them a separate, I guess, project  
12 number when they all come together as one?

13 A Because the manufacture -- the whole process,  
14 development and manufacturing, is all done individually on  
15 each one.

16 Q If you go back to Appellants' Exhibit 3, please,  
17 and I'm going to refer you to page -- page 20.

18 MR. DIES: Which exhibit is this?

19 MR. ROUSE: It's Appellants' Exhibit 3.

20 THE WITNESS: Yes.

21 BY MR. ROUSE:

22 Q At the bottom of that page it references this  
23 project. So I'm going to read from the description of the  
24 challenges that the company claims it had?

25 A Yes.

1           Q    It says, "The company faced uncertainty as to the  
2           optimal design for both the leggings and the ruffle skirt  
3           with most challenges arising from the skirt design. For  
4           example, the company was required to determine the ruffle  
5           skirts' fabric management to achieve the desired fit and  
6           ensure the skirt fell on the wearer correctly."

7                   What do you mean by correctly?

8           A    Where it falls on the body. Where it ends on the  
9           legs. It can't be too short or you could see the  
10          underneath of it.

11          Q    And what is the purpose of ruffles?

12          A    It's part of the garment.

13          Q    Do they serve a functional purpose?

14          A    The actual ruffles themselves?

15          Q    Yes.

16          A    No.

17          Q    And you've created garments prior to this. So  
18          this was created in 2010, but you've created garments  
19          prior to this that had ruffles right?

20          A    I'm not sure about this specific ruffle. This  
21          was kind of a unique way this was done. This was done on  
22          the fabric. It was kind of unique.

23          Q    Okay. So you don't know if you've done this  
24          specific type of ruffle?

25          A    Prior to this?

1 Q Yes.

2 A I'm not sure. I would venture to say no.

3 Q And why would you venture to say that?

4 A Because it was kind of a unique product. And

5 just thinking back to when we were using that, it was kind

6 of like a new thing.

7 Q Okay. Almost done. I'm going to refer you to

8 Appellants' Exhibit 9. And this is relating to style

9 M93771?

10 A Yes.

11 Q So again on the related styles section you have

12 two project numbers there. One is M64201, and then

13 another one is S10171. Do you know if those are there

14 because they're referencing something similar from the

15 past, or is it just related to two separate pieces of this

16 garment?

17 A Those are related to -- the M is related to the

18 dress and the S is related to the shrug.

19 Q Okay. And then in the referral section, the

20 first one is M64201. So that's the dress again; right?

21 A Yes.

22 Q And then the next one is S10171. That's the

23 shrug?

24 A Yes.

25 Q So why are those in the referral column and the

1 related styles?

2 A I think it's just repetitive. It's just pointing  
3 out the style number for each.

4 Q Okay.

5 A I think it's just telling the pattern maker that  
6 the self components go to the dress. The shrug components  
7 go to that.

8 Q Can you go back to Appellants' Exhibit 9?

9 A I'm on 9.

10 Q Oh, I'm sorry, 8. I'm sorry, 11, which is style  
11 D11072?

12 A Yes.

13 Q Do you know why the related style number on that  
14 face card, which is D10521, is not mentioned in the  
15 referral column?

16 A No. There would be no reason to put it in the  
17 referral column. You have only one item here. I think  
18 they just put it in the referral column when there was two  
19 items to distinguish for the pattern maker which item --  
20 which pattern pieces went to which.

21 Q Okay. That's all I have, Mr. Greenberg.

22 A Thank you. Stay up or sit down?

23 MR. HUNZIKER: In that regard we have no  
24 redirect.

25 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. Thank



1       you, Mr. Greenberg.

2               THE WITNESS: Thank you.

3               MR. DIES: Judge Vassigh, if we'd be allowed a

4       brief restroom break at the hour point?

5               ADMINISTRATIVE LAW JUDGE VASSIGH: What time do

6       we have? It's 1:30.

7               MR. DIES: 1:30.

8               ADMINISTRATIVE LAW JUDGE VASSIGH: It's 1:30

9       right now. You're asking for 2:00 o'clock?

10              MR. HUNZIKER: No, no. Just a couple of minutes.

11       A five-minute restroom break?

12              ADMINISTRATIVE LAW JUDGE VASSIGH: That's fine.

13       Okay. That's okay.

14                       (A break was taken.)

15              ADMINISTRATIVE LAW JUDGE VASSIGH: We'll go back

16       on the record.

17              Appellants, when you're ready please call your

18       second witness.

19              MR. SUGGS: Appellants call Connie Nevarez.

20              ADMINISTRATIVE LAW JUDGE VASSIGH: Ms. Nevarez,

21       please spell your name first -- state and spell your name.

22              THE WITNESS: Connie Nevarez. It's

23       N-E-V-A-R-E-Z.

24              ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. I'm

25       going to swear you in, and you will remain under oath

1 until the end of this hearing. Please raise your right  
2 hand.

3 ///

4 ///

5 CONNIE NEVAREZ,

6 produced as a witness by and on behalf of the Appellant,  
7 and having been first duly sworn by the Hearing Officer,  
8 was examined and testified as follows:

9

10 THE WITNESS: I do.

11 ADMINISTRATIVE LAW JUDGE VASSIGH: Whenever  
12 you're ready.

13 MR. SUGGS: Thank you.

14

15 DIRECT EXAMINATION

16 BY MR. SUGGS:

17 Q Good afternoon, Ms. Nevarez. How are you?

18 A Good. How are you?

19 Q Good. Will you please introduce yourself for the  
20 record?

21 A I am the design coordinator -- well, not  
22 coordinator. Operations. And I -- do you want me to say  
23 what I do?

24 Q Sure. What company do you work for?

25 A Swat-Fame.

1 Q What is your current job title?

2 A Design operations.

3 Q Okay. How long have you been at Swat-Fame?

4 A 15 years.

5 Q So you didn't start at 12 like Mr. Greenberg?

6 A No, I did not.

7 Q Okay. Have you been in the same role the entire

8 time?

9 A Yes, I have.

10 Q Can you give us an idea of what you do in your

11 current role?

12 A I actually take care of executing from the

13 beginning of that stage, when they start --

14 Q I'm sorry. When you say "that stage," what are

15 you pointing to on the board?

16 A The concept.

17 Q Conceptualization?

18 A Yes.

19 Q Okay?

20 A So it's from the minute they start sketching all

21 the way through. I make sure execution is running as we

22 are supposed to be running.

23 Q Okay. And what point does your involvement stop

24 in the development process?

25 A As soon as we go into product performance

1 testing.

2 Q Okay. Who all do you work with during the  
3 process?

4 A So many people.

5 MR. DIES: Can you move that microphone over  
6 closer to your mouth just to make it easier.

7 THE WITNESS: Okay.

8 MR. DIES: Thanks.

9 BY MR. SUGGS:

10 Q So in terms of job titles, do you work with the  
11 designers?

12 A I do.

13 Q Do you work with pattern makers?

14 A I do.

15 Q Cutters?

16 A Yes.

17 Q Sewers?

18 A Yes.

19 Q Design assistant?

20 A Yes.

21 Q Executives?

22 A Yes.

23 Q Do you work with Mr. Greenberg?

24 A Yes, on a daily basis.

25 Q So Mr. Greenberg testified earlier about the

1 entire development process that's on the boards there  
2 behind you. In your 15 years of being at Swat-Fame, has  
3 that development process remain somewhat consistent?

4 A Absolutely.

5 Q Okay. So from your perspective, do all new  
6 products start with conceptualization?

7 A Yes.

8 Q Go into material selection, testing --

9 A Yes.

10 Q -- pattern making, cut, sew. If there were  
11 issues or challenges throughout the process, do you all go  
12 back either a step or two or return to conceptualization  
13 to revisit and find ways to solve that --

14 A Yes, we do.

15 Q Okay. Which division do you work in yourself?

16 A The branding division, which is a denim division.

17 Q Okay.

18 A We do sportswear as well, like that jacket that  
19 was there.

20 Q Okay. So can you give us a little bit of  
21 understanding of what all is involved in the denim  
22 division?

23 A Okay. So based on the concept, we start with  
24 making boards. Then the designer, our creative director,  
25 who really are mind readers. Sometimes they put it on

1 board and they choose the fabrics that they want on that  
2 exact silhouette. And my job is to make it, to execute  
3 from beginning to end to try and make it work.

4 Q Okay. Let me take it sort of step-by-step here.  
5 So at conceptualization you work with the creative  
6 director?

7 A Yes.

8 Q And they will identify a particular fabric.

9 A Yes.

10 Q Will they identify the silhouette?

11 A At that time, yes.

12 Q Okay. Anything else that's identified in terms  
13 of components for a new product?

14 A No. That's it at that time.

15 Q Okay.

16 A Just the fabric and sketch.

17 Q At that point in time, do you know if this idea  
18 at conceptualization is actually going to work?

19 A No. I wish. No.

20 Q So what is one of the first things that you look  
21 at on the execution side to make the determination?

22 A Well, we go into pattern making, number one. We  
23 can't really decide at that point. So we don't know if  
24 it's going to work.

25 Q Okay.

1 A So we'll start executing with the pattern maker.

2 Q Let me ask you this. I know you're in the denim  
3 division. Is all denim created equal?

4 A No.

5 Q Why not?

6 A There's so many variations.

7 Q Can you give me an example?

8 A First of all, all the fabrics have different  
9 contents. There are some that have poly. There's some  
10 that don't have poly. There's some that is cotton.  
11 Spandex, some have more spandex. It's completely  
12 different. They're completely different.

13 Q So how would that impact things?

14 A It can impact shrinkage as Jonathan talked about.  
15 The fit -- but what I base it more is on the shrinkage or  
16 the components of -- making sure that the garment is going  
17 to be accomplished at the end without the shrinkage,  
18 without making sure that it doesn't -- like in this  
19 particular one, it was more about the banding.

20 Q When you say "this particular one," what are you  
21 referring to for the record?

22 A The style, the denim style. The only denim style  
23 that we're talking about.

24 Q Oh, style of UB636 and --

25 A Yes.

1 Q Okay. We'll get to that in one movement.

2 A Oh, sorry.

3 Q Regarding shrinkage though, does that really only

4 come into play when you're dealing with washing?

5 A Yes. Yes.

6 Q Okay. And is there a unique or different washing

7 process for denim than it is for, say, misses?

8 A Can you repeat? I'm sorry.

9 Q The wash process for denim, can you elaborate on

10 what that entails?

11 A It's completely different. We are very unique in

12 our washes. That's the reason we've grown so much. We

13 just do so many variations of washes.

14 Q So what -- when you say about the wash, are we

15 talking about just putting the jeans into a washing

16 machine?

17 A No.

18 Q What all -- what all is involved?

19 A There's so much involved. There's a lot of

20 chemicals that you have to take in place.

21 Q Such as what?

22 A We do potassium. We do stones. We -- there's

23 this chemical called resin that sometimes can make, you

24 know, it can create a rash. We have to test that to make

25 sure it's okay.



1           Q    When you say "we have to test it," do you guys  
2   test that in-house?

3           A    Yes.  We do actually.

4           Q    Okay.

5           A    Sometimes based on our fit model, but I don't  
6   know if you want to go there.

7           Q    We'll get that in a moment.  So you all test the  
8   garment for resin.  What else do you test for in denim?

9           A    The chemicals to make sure that everything is  
10   okay.

11          Q    What happens if a test fails?

12          A    At the end of the process?

13          Q    But after you test it?

14          A    Well, we don't really say if it fails or not  
15   fails.  That's how we're going to be able to say do we  
16   continue with this wash, or do we go back to step one?

17          Q    Let me ask you another question.  What would  
18   require you to go back to step one?

19          A    So many reasons; shrinkage, the wash tore, and  
20   whenever they do all this.  When they're doing washes,  
21   we're not dealing with only a washing machine.  We're  
22   dealing with actual -- four people washing this garment,  
23   doing every detail on the garment.

24          Q    Okay.

25          A    So it could be anything.  It could be from

1 tearing from the washes from the stones. It could be from  
2 the potassium. They sprayed it too much so it tore the  
3 fabric. It could be so many variations.

4 Q So the application, these chemicals can actually  
5 destroy the denim itself?

6 A Absolutely.

7 Q Okay. And then for the record that's a bad  
8 thing?

9 A Absolutely.

10 Q Okay. So let's look at this particular project  
11 that you referenced a few moments ago, UB636. And for the  
12 record we're referring to Appellants' Exhibit No. 10.  
13 First, Ms. Nevarez, this style number in the upper  
14 right-hand corner. Can you help us understand the numbers  
15 and letters and the style number and what they all mean?

16 A Yes. So the U, the first one, is the brand.  
17 It's a division within Swat-Fame.

18 Q What does the U stand for?

19 A For the division, for the brand.

20 Q And what's that division?

21 A That's our junior denim at that time.

22 Q Okay. Why the letter U?

23 A For Underground Soul.

24 Q Got it. Okay.

25 A And the B is for Bermuda, which is a long short.

1 And the 636N3 is our pattern number.

2 Q Got it.

3 A We have to identify the pattern. As the pattern  
4 maker is making it, she has to have her own style number.

5 Q Okay. And then I see the fabric type here in the  
6 middle of the page towards the top, TY616-2V. What's that  
7 mean?

8 A That's a stretched denim. That's indigo stretch  
9 denim.

10 Q Okay. So -- so during this time frame from the  
11 document itself, it looks like the last maintain date is  
12 May of 2018; correct?

13 A Yes.

14 Q In May of 2018 had you all worked with that  
15 particular type of fabrication before?

16 A No, we had not.

17 Q This is a brand -- brand spanking new  
18 fabrication?

19 A That fabric was actually a brand new one at that  
20 time.

21 Q So what were some of the challenges that you  
22 faced with that new fabrication?

23 A Shrinkage.

24 Q Okay.

25 A It was shrinking too much. So we had to make

1 sure that we balance that pattern based on the shrinkage  
2 of that fabric.

3 Q So do you know the material composition of this  
4 fabric? Was it 100 percent cotton? Was it --

5 A No. This was 98/2 cotton to spandex.

6 Q Two percent Spandex?

7 A Yes.

8 Q Okay. Had you dealt with fabrics that had 98/2  
9 before?

10 A No, we had not. At this time we had not.

11 Q Okay. So tell me what did you learn about  
12 dealing with this particular fabric on this particular  
13 garment?

14 A In this case for the fabric it was at --  
15 obviously, having 2 percent spandex was actually good for  
16 the fit of the garment.

17 Q How so?

18 A It actually was able to fit better. After we  
19 washed it, it fit -- it was able to be a little bit more  
20 spongier to the body.

21 Q Okay.

22 A If that makes any sense.

23 Q Would stretch be another way of saying it?

24 A Yes, yes.

25 Q Okay.

1           A    It has a little bit more stretch to it.  And  
2   because of the banding, we needed that stretch for it.

3           Q    Let me ask you this.  When you get in broad  
4   denim, brand new fabrication, what does that feel like?

5           A    Sandpaper.  I have some here if you want to touch  
6   it.

7           MR. SUGGS:  Okay.  Permission to approach to feel  
8   it?

9           ADMINISTRATIVE LAW JUDGE VASSIGH:  Sure.

10          THE WITNESS:  It'll bleed in your hands.

11          MR. SUGGS:  Would Your Honors like to feel the  
12   denim itself?

13          ADMINISTRATIVE LAW JUDGE VASSIGH:  Sure.

14          MR. SUGGS:  Be careful.

15   BY MR. SUGGS

16          Q    So I've just handed the panel raw denim.  When  
17   you guys purchase denim, does it come in the leg and have  
18   the cuts and divots already in there?

19          A    No.  It literally comes like that.

20          Q    Okay.  So -- so why do you have to treat or do  
21   anything to it at all?

22          A    Because dealing with denim all day, my hands are  
23   blue by the end of the day.  It bleeds if you don't wash  
24   it or do anything to it.

25          Q    Okay.

1           A    And it's extremely rough on the skin.  I don't  
2           think anyone wants to wear raw denim.

3           Q    Okay.  So is one of your objectives with denim  
4           make it -- lack of a better phrase -- softer?

5           A    Yes, much softer.

6           Q    Okay.  What about the stretch?  You mentioned the  
7           stretch earlier?

8           A    Yes.  Well, every type of denim has a different  
9           content to it.  Some have more stretch than others.

10          Q    When you have denim in the raw form, does it all  
11          shrink exactly the same?

12          A    No.  It --

13          Q    Okay.  How do you -- go ahead.  I'm sorry.

14          A    It does not.

15          Q    Okay.  So what do you -- so help me understand  
16          how the washing effects the shrinkage of the denim?

17          A    It's depending on all the chemicals that they  
18          use.  Based on all the chemicals that they use there.  The  
19          temperature that they put it in the machine, it'll effect  
20          the denim.

21          Q    So some of the chemicals used could be potassium?  
22          You mentioned that?

23          A    We do potassium.

24          Q    You mentioned resin?

25          A    We do resin.

1 Q You mentioned stone washing?

2 A Stone washing, yes.

3 Q The duration of the wash?

4 A Yes.

5 Q What else could affect the wash itself?

6 A If we do laser, it shrinks.

7 Q You guys utilize actual lasers to the denim  
8 itself?

9 A Yes, we do. On -- it's an actual machine that  
10 lasers it -- that lasers the garments for the denim, and  
11 it actually shrinks it.

12 Q Okay. And what is the purpose of the laser? To  
13 burn the denim?

14 A Actually it all depends on look, because we want  
15 to accomplish the first concept.

16 Q Okay.

17 A And that's why it comes back to us to make sure  
18 that we are accomplishing the concept.

19 Q What about the temperature of the water?

20 A It all depends.

21 Q Is that -- is that part of the wash itself?

22 A Yes.

23 Q Okay.

24 A And that actually -- it all depends on how --  
25 what the washhouse wants to use. We don't -- we don't

1 tell them what temperature to use.

2 Q So coming back to Exhibit 10 here in this  
3 particular project. For this specific fabric TY6162B, you  
4 said you had shrinkage issues?

5 A We did.

6 Q How did you address those?

7 A We had to actually fit it on the garment -- on  
8 the model, looked at the shrinkage. We had to go back to  
9 the pattern maker, and she had to adjust the pattern and  
10 balance it out and add the shrinkage to it now that we  
11 knew what the shrinkage is going to be.

12 Q Okay. So just for purposes of reference to the  
13 board behind you there. When you're actually putting it  
14 back on -- putting it onto a model, you are at the  
15 functional --

16 A Fit and.

17 Q -- and testing stage?

18 A -- sample complete.

19 THE COURT REPORTER: Please, I need you both to  
20 speak one at a time. You're both stepping on each other.

21 MR. SUGGS: Okay. Thank you.

22 BY MR. SUGGS:

23 Q A little louder, please, for the record.

24 A The fit sample complete, that's where we're at.

25 Q Okay. So once you're at the fit sample, you test



1 it on the model, determined it was --

2 A It didn't fit well or shrunk too much. So we  
3 sent it back to pattern maker.

4 Q Okay. And what was the next step in that  
5 process?

6 A We either see if that fabric was the proper  
7 fabric for that body, or we go back to materials again and  
8 start choosing other materials for that garment.

9 Q So you have one of two options?

10 A We do.

11 Q Change the fabric or change the material?

12 A Yes.

13 Q Do you all know what you did in this particular  
14 instance?

15 A This one was actually very particular because we  
16 didn't go into production because we had such challenges.

17 Q Okay. Would you consider this project then --  
18 for a lack of a better phrase -- a failure?

19 A Yes, it was.

20 Q Okay. What other challenges did you have on this  
21 project?

22 A The waistband. So because it's a contour,  
23 waistband, it has to fit properly on the body around the  
24 waist. And it's a lower waist -- waistband. So for us to  
25 be able to reinforce it, we had to put fusing on it, which

1 is something else I brought. And we had to put that in  
2 between the denim, and that has been tested as well.

3 Q So let's back it up a little bit. When you say  
4 "fusing on it," what type of fusing are you referring to?

5 A We only use one type of fusing.

6 Q Okay. Are there more than one type of fusing?

7 A Yes, but for denim we only use one type.

8 Q Okay. And -- and what is the purpose of fusing?

9 A To be able to make it stable on the body.

10 Q Okay. So more stretchable?

11 A Stretchable. And so when the girl bends down,  
12 because it's such a wide waist, it won't -- you won't have  
13 to see her behind.

14 Q And how do you all apply that fusing?

15 A In sewing. In the sewing process. We have --

16 Q And is it just -- I'm sorry. Go ahead.

17 A We have to do a pattern piece for it. Then we  
18 have to apply it in the cutter and then sew it.

19 Q Is it sewn within two pieces of denim itself?

20 A Yes.

21 Q Okay. So a customer like myself would never know  
22 I had fusing?

23 A Never.

24 Q Okay. And were you able to ultimately accomplish  
25 that issue with the fusing?

1           A    No, we are not in this case.

2           Q    Okay. Any other challenges on this particular  
3 project?

4           A    In this case the fusion was even shrinking. So  
5 we couldn't accomplish this because of that. Those are  
6 the challenges we -- we've actually are -- we impact  
7 ourselves with a lot.

8           Q    Okay. Understood. Any other notable challenge  
9 on this project?

10          A    The back pocket was tearing. That was it at that  
11 time. I don't remember it very well to be honest with  
12 you, other than the pockets. That's all I remember. It  
13 was more the contour waist on it.

14          Q    And you mentioned this project never went into  
15 production?

16          A    It did not.

17          Q    Had you ever produced -- have you ever duplicated  
18 this garment previously to this?

19          A    No.

20               MR. SUGGS: One moment. No further questions,  
21 Your Honors.

22               Thank you, Ms. Nevarez.

23               THE WITNESS: Thank you.

24               ADMINISTRATIVE LAW JUDGE VASSIGH: Thank you.

25               Please stay.

1 THE WITNESS: Sorry. I thought I was done. I  
2 execute everything behind the wheel not in front of the  
3 wheel.

4 ADMINISTRATIVE LAW JUDGE VASSIGH: Does  
5 respondent have any questions?

6 MR. RILEY: Yes.

7  
8 CROSS-EXAMINATION

9 BY MR. RILEY:

10 Q Okay good afternoon, Ms. Nevarez. My name is  
11 Jason Riley?

12 A Good afternoon.

13 Q We heard about your -- some of your competitors  
14 from Mr. Greenberg; and Topson Down and City Triangle. Is  
15 H&M a clothing man -- as a clothing manufacturer, are they  
16 a competitor of Swat-Fame?

17 A No, they're not.

18 Q We heard -- so we heard Mr. Greenberg talk a  
19 little bit about related styles. And he said that was  
20 something that could be similar to another garment;  
21 correct?

22 A Hm-hm.

23 Q Could a related style be a proto sample?

24 A It can be.

25 Q What is a proto sample?

1           A    A proto sample is the first sample that we  
2 actually assemble.

3           Q    Okay. Do you get proto samples from competitors?

4           A    No, we don't.

5           Q    For example, could you -- do you guys have -- I  
6 know you submitted some paragraphs to us of the garments.  
7 And I'm going to refer to these photographs here because  
8 we didn't see it in the video.

9           MR. DIES: Which documents are you referring to?

10          MR. RILEY: These would be photos that you  
11 submitted on December 3rd of the sample garments.

12          MR. DIES: Of the demonstratives. All right.

13          MR. RILEY: Of the demonstratives.

14 BY MR. RILEY:

15          Q    So could you look at those two?

16          A    Absolutely.

17          Q    Does one of those depict a proto sample and is  
18 one of those a Kut from the Kloth?

19          A    They're both Kut from the Kloth.

20          Q    They're both Kut from the Kloth?

21          A    Yes. And this one, actually, we had to change  
22 this. This is one of the challenges that we go through.  
23 This one here was -- had -- it was opening. So we tried  
24 it on the fit model. It was opening too much.

25          ADMINISTRATIVE LAW JUDGE VASSIGH: Pardon me, can

1       you be clear. It's unclear to us.

2               THE WITNESS: Sorry. The one on the left.

3               MR. DIES: What page number are you on as well?

4               MR. RILEY: There are no page numbers, but it is  
5       the third from the last.

6               MR. DIES: This is not an exhibit.

7               ADMINISTRATIVE LAW JUDGE VASSIGH: Which --  
8       which -- this is a sample?

9               MR. RILEY: This is not an exhibit, but this  
10       was -- we would have seen it in the video had we watched  
11       the entire video. The videography was putting a spin  
12       here.

13              THE WITNESS: It's not here today, but it is part  
14       of the video.

15              MR. HUNZIKER: Can we take a quick look at that,  
16       if you don't mind. I just want to make sure we're looking  
17       at the same thing.

18              ADMINISTRATIVE LAW JUDGE VASSIGH: No objections  
19       to it?

20              MR. DIES: No objections to it.

21              MR. HUNZIKER: Keep in mind the purpose of the  
22       photos was just to give a sense of the demonstratives we  
23       would bring with us. And in the interest of time, we just  
24       didn't end up bringing this particular one. But I don't  
25       have any problem with asking any questions about it.

1 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. Then  
2 we'll allow it.

3 BY MR. RILEY:

4 Q Okay. So in -- if you wouldn't mind passing it  
5 back this way. But, so you stated that those are both --

6 A Kut from the Kloth.

7 Q -- Kut from the Kloth?

8 A Yes.

9 Q And these are the same two bottoms that are  
10 depicted in the video?

11 A Yes.

12 Q Now, in the video isn't the -- isn't one of those  
13 documents -- I'm sorry. Isn't one of those bottoms a  
14 sample garment? Isn't that sample garment an H&M garment?

15 A No. That's our garments. That photo you just  
16 showed me is our Kut from the Kloth garments.

17 Q I believe -- I believe if we were to look at the  
18 video at about minute 9:30, the sample document -- sorry.  
19 The sample garment -- we've got a blowup of it here --  
20 is -- I mean, the tag on the document -- I mean, garment  
21 is an H&M -- yeah. It's an H&M garment?

22 A So maybe that is where they got the concept for  
23 that bottom. When I executed that bottom that you just  
24 showed me, that is actually both our prototypes.

25 Q So you're examining that proto sample there and

1 I -- I mean, that tag is stitched on. So do you sew that?  
2 Do you stitch then the H&M tag onto the proto sample?

3 A No, no, no. Sorry. Can I see that?

4 ADMINISTRATIVE LAW JUDGE VASSIGH: Sure.

5 THE WITNESS: That could maybe be used for  
6 concept only. The two that you showed me on your paper,  
7 those are both our protos.

8 BY MR. RILEY:

9 Q These are both your protos?

10 A Correct.

11 ADMINISTRATIVE LAW JUDGE VASSIGH: Let's take a  
12 moment for Appellants to show that to the witness, and the  
13 panel would like to look at that too.

14 ADMINISTRATIVE LAW JUDGE GEARY: You realize this  
15 transcript is going to make very little sense since --

16 MR. RILEY: I'm -- yeah. Yes, Your Honor.

17 ADMINISTRATIVE LAW JUDGE GEARY: Okay.

18 MR. DIES: And again, it's not offered as  
19 evidence or any part of the record.

20 ADMINISTRATIVE LAW JUDGE VASSIGH: Right.

21 MR. RILEY: That's fine.

22 MR. DIES: We're just trying to help.

23 THE WITNESS: I don't -- I've never seen it.

24 Sorry. I don't know what that is.

25 ADMINISTRATIVE LAW JUDGE VASSIGH: Mr. Riley,



1       you're saying that this is a blowup of an image --

2               MR. RILEY: I'm saying --

3               ADMINISTRATIVE LAW JUDGE VASSIGH: -- from the  
4       video --

5               MR. RILEY: -- It's a blow up of the tag.

6               ADMINISTRATIVE LAW JUDGE VASSIGH: -- of the tag?

7               MR. RILEY: Yes. Sorry for talking over you.  
8       It's at about 9:30 in the video.

9               ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. So, for  
10      the record, what we're looking at is an H&M logo on -- it  
11      looks like two different items with sizes listed.

12              MR. RILEY: Correct.

13              ADMINISTRATIVE LAW JUDGE VASSIGH: Okay.

14              MR. RILEY: And it sounded like the gentleman in  
15      the video is referring to this proto sample, and that he  
16      said -- that he stated that the -- the purpose of looking  
17      at the two is that Swat-Fame bottoms needed to be altered  
18      from a pleat to a dart to -- what I think -- what he  
19      exactly -- what he said was that the H&M bottom had,  
20      quote, "More of a dart sewn all the way down as compared  
21      to ours. Meaning we made it into a pleat."

22              So I mean is it possible to play the video at  
23      about 9:30?

24              ADMINISTRATIVE LAW JUDGE VASSIGH: I think the  
25      panel will take a few minutes to discuss.

1 ADMINISTRATIVE LAW JUDGE GEARY: I have a  
2 question. May I ask a question?

3 ADMINISTRATIVE LAW JUDGE VASSIGH: Go ahead.  
4 Yes, of course.

5 ADMINISTRATIVE LAW JUDGE GEARY: Mr. Hunziker,  
6 you've seen this video. You're familiar with its content.  
7 Do you disagree that -- that those statements were made on  
8 the video? Is there a dispute about that? Is there a  
9 dispute about what this photograph depicts?

10 MR. HUNZIKER: So we want to confer with our  
11 client to clarify, but I believe, Your Honor, the item in  
12 the video is not exactly the same items that are on the  
13 photograph they showed. So I think there is a  
14 miscommunication between what's in the photograph with the  
15 two pants, and what's actually on the video.

16 MR. RILEY: The left image is a screen grab from  
17 the video. And the right image is an H&M tag showing same  
18 size -- set of sizes.

19 ADMINISTRATIVE LAW JUDGE VASSIGH: Where did the  
20 right image come from?

21 MR. RILEY: A Google search of an H&M tag.

22 ADMINISTRATIVE LAW JUDGE VASSIGH: Oh, I see.  
23 Okay. I think the panel -- we'll take a few minutes for  
24 panel to discuss this privately.

25 ADMINISTRATIVE LAW JUDGE GEARY: Is there a

1 pending request about -- do you still request that we view  
2 a particular part of the video?

3 MR. RILEY: I think it would be beneficial if you  
4 watch the video at about minute 9:30 to probably about  
5 minute 10:00.

6 ADMINISTRATIVE LAW JUDGE VASSIGH: Would  
7 Appellants have any objection to watching some part of the  
8 video?

9 MR. HUNZIKER: We don't have any objection to the  
10 watching of the video. I think the challenge is none of  
11 this is evidence; right? I mean, we've agreed that the  
12 video is to illustrate the process. None of this has  
13 anything to do beyond that. We won't get in your all's  
14 way. If you want to look at it, we encourage you to look  
15 at it. It's just -- it can't be a part of the record or  
16 the basis for any opinion. So I just think we should be  
17 mindful of how much time we spend chasing that. But I'm  
18 wide open to you guys looking at it.

19 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. So if  
20 you'll please excuse us we will exit for a few moments,  
21 and we will be back.

22 We'll go off the record.

23 (There is a pause in the proceedings.)

24 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. We're  
25 ready to go back on the record.

1           Thank you for waiting for us. The three of us  
2           are equal decision makers. So we have to kind of work  
3           together. So we discussed the visual aids prior to this  
4           hearing, and Appellants did not present them as evidence.  
5           They actually objected to them being used as evidence, or  
6           at least some of them.

7           Mr. Riley, this document seems like new evidence.  
8           We're not using the visual aids to base our decision on.  
9           So we won't be looking at that. We'll just -- if you  
10          please just move forward onto your next question.

11          MR. RILEY: Okay.

12          BY MR RILEY:

13          Q   Ms. Nevarez, did you participate in the  
14          October 29, 2015 audit field -- audit site tour with the  
15          auditor?

16          MR. DIES: Let the man finish his questions  
17          because she can't take two folks at one time.

18          THE WITNESS: Sorry.

19          BY MR. RILEY:

20          Q   So you did not personally select any of the  
21          projects that were selected for either alliantgroup to  
22          review or that were part of the 68-project sample in this  
23          appeal?

24          A   Correct, I did not.

25          Q   Okay. Yeah, do you know who did?

1           A    I don't. I'm sorry. I don't.

2           Q    What is a minor design change?

3           A    Minor design? It could be a stitching, something

4           very minor. It could be the stitching. It could be

5           just -- it could be stitching on waistband. It could be a

6           stitching on the back pocket. It could be a thread color.

7           Those are changes. Those are minor changes.

8           Q    Do you make a prototype of the minor design

9           changes?

10          A    Yes, we do.

11          Q    How often?

12          A    Pretty often.

13          Q    Okay. Who among your employees would work on a

14          minor design change on the prototypes?

15          A    The designer --

16          Q    Okay.

17          A    -- design assistant, cutting and sewing, and then

18          I would have a wash.

19          Q    With the pattern makers?

20          A    No, because it's a minor design. Well, actually,

21          she would just have to change the pat -- the face card.

22          Q    Okay.

23          A    So, yes.

24          Q    Who makes the decision as to whether a design

25          change is a minor design change?

1           A    The creative director.

2           Q    Okay. All right. I'm going to move on to .  
3   Exhibit 10 of the Appellants' Exhibit 10, which is the  
4   Bermuda shorts. Okay. Let's see here. The fabric that  
5   was used in this design is -- we know it's denim  
6   TY6166-2B; correct?

7           A    Correct.

8           Q    And you stated that was a new fabric for  
9   Swat-Fame?

10          A    At that time, yes.

11          Q    Great. And did Swat-Fame manufacture that  
12   fabric?

13          A    No.

14          Q    Okay. Do you know who does manufacture that  
15   fabric?

16          A    Second party.

17          Q    Okay. And you stated that Swat-Fame hadn't used  
18   that before project UB636N?

19          A    Correct. Mostly for Bermuda.

20          Q    Right. Okay. You stated in your testimony  
21   earlier on direct that it was actually brand new in May of  
22   2007 -- sorry -- May 27, 2008; correct?

23          A    For Bermuda, yes.

24          Q    Right. For Bermuda or for Swat-Fame?

25          A    For our Bermuda.

1 Q Okay. So you had used -- so I guess let's --  
2 let's sort this out. So Swat-Fame had used fabric  
3 TY61662B in its products before?

4 A Yes.

5 Q Okay. So have you -- and it is a denim  
6 project -- product. So you used it on what? Full-length  
7 jeans? Did you use it on other --

8 MR. DIES: I'm sorry. You have to speak in  
9 words. So the question was: Did you use it on  
10 full-length denim jeans?

11 THE WITNESS: Yes.

12 BY MR. RILEY:

13 Q And you used it -- did you use it on other  
14 shorts?

15 A No.

16 Q So this is the first time you used it on shorts?

17 A Yes.

18 Q Okay. And does a -- does denim shrink at a  
19 different rate when it's used in shorts versus in a pant?

20 A No.

21 Q Okay.

22 A It all depends on the wash.

23 Q Okay. So with respect to denim, what are  
24 sisters?

25 A I'm not quite sure.

1 Q Is it with the respect to denim -- denim  
2 inside -- it's denim in a different wash but the same cut?

3 A I've never used the term "sisters."

4 Q Okay.

5 A Sorry.

6 Q Do you consider using a different wash on a denim  
7 as a minor design change?

8 A No. That's a big design change.

9 Q Okay. In her interview, Ms. Ober stated that she  
10 brought, like, ten samples of shorts for the UVN636  
11 project to JC Penney; two washes in five styles. Was that  
12 five different styles of Bermuda shorts?

13 A That's correct.

14 Q Okay. Are those five styles indicated on the  
15 document the -- the 406, Exhibit 10?

16 A No, they're not.

17 Q Okay. But using a different wash, that is not a  
18 minor design change?

19 A No.

20 Q Okay. So in her interview -- I'm sorry. Was  
21 this -- in her interview, Ms. Ober stated that this  
22 project was developed in SeeThruSoul with respect to the  
23 Bermuda shorts; correct?

24 A I wasn't there. So if you're telling me that,  
25 yes.



1           Q    Okay.  And she stated that it was just maybe  
2   modified a little for Underground Soul in her interview?

3           ADMINISTRATIVE LAW JUDGE GEARY:  Can I ask you,  
4   Counsel, are you asking this witness if she agrees with  
5   the statement attributed to this person?  Is that what  
6   you're asking?

7           MR. RILEY:  Yes.

8           ADMINISTRATIVE LAW JUDGE GEARY:  Okay.

9           THE WITNESS:  You're asking if I agree to it?

10          MR. DIES:  Your Honor, if I may.  This witness  
11   wasn't present for those statements or in that interview  
12   process.  I'm not sure she can attest to any sort of  
13   knowledge to the accuracy of those statements.

14          ADMINISTRATIVE LAW JUDGE GEARY:  Well, to the  
15   extent the statement is a statement of fact, she can  
16   either agree or disagree with that fact, though, couldn't  
17   she?

18          MR. DIES:  If she thinks she knows the answer.

19          ADMINISTRATIVE LAW JUDGE GEARY:  Yeah.

20   BY MR. RILEY:

21          Q    Okay.  If this project -- if this -- if UBN636  
22   was initially developed in SeeThruSoul, which is a  
23   different brand of Swat-Fame's denim; correct?

24          A    Correct.

25          Q    If it was developed in SeeThruSoul and then it

1 was maybe -- just maybe modified a little for Underground  
2 Soul, would you consider that a minor design change?

3 A No, I don't. I'll explain why I don't agree with  
4 that. SeeThruSoul was a higher-end junior denim. This  
5 one is a lower-end. So we had to still start from the  
6 beginning, testing new fabrics. So SeeThruSoul I don't  
7 think was done in this fabric.

8 Q So in her interview Ms. Ober stated that all of  
9 the development money had been spent in the better  
10 divisions. Is that a typical -- with respect to this  
11 Bermuda short, is that a typical practice for Swat-Fame?

12 A Repeat that one more time. Sorry.

13 Q All of the development money had been spent in  
14 the better divisions. And she's speaking about the -- in  
15 her interview about the Bermuda shorts specifically. Is  
16 that a typical practice for Swat-Fame?

17 A I look at overall. So I'm going to agree to  
18 disagree. I look at overall importance to me. So we test  
19 everything exactly the same exact way. I don't look at it  
20 as spending money somewhere else more than we do  
21 elsewhere, because we truly spend the same amount of money  
22 for the development stages. Nothing changes in the  
23 development stages. It still cost us the same amount of  
24 money.

25 Q So even though this -- this short was developed

1 in SeeThruSoul and -- well, let me phrase it this way. In  
2 her interview -- do you know Ms. Ober to -- to take best  
3 sellers from another division and put them into -- from a  
4 high-end like the See Though Soul and put them in a middle  
5 brand like Underground Soul?

6 A Yes. And, again, it goes back to what I just  
7 finished saying. We still have to test everything because  
8 we're going to change the fabrication. So to us,  
9 personally, it becomes a brand new style. We have to go  
10 through the same process all over again. So it becomes a  
11 brand new style from the higher-end to the lower-end.

12 Q So are you saying that you take the same design  
13 with the same fabric?

14 MR. DIES: Now you may answer him.

15 THE WITNESS: Sorry. I was waiting for him to  
16 finish.

17 MR. DIES: Okay.

18 MR. HUNZIKER: As she should.

19 THE WITNESS: I just keep it in my head. Sorry.  
20 She takes the design -- the same silhouette, the same  
21 product style, but we change the fabric. So it becomes to  
22 us a different style number.

23 BY MR. RILEY:

24 Q So SeeThruSoul does not use TY61662B?

25 A No, we don't.

1 Q Okay. What is the function of the maple wash?

2 A It was a dark wash, and it had potassium on it  
3 and sanding. I don't have the information here.

4 Q So what is -- what does it do to the denim?

5 A What do you mean "what does it do to the denim?"

6 Q I mean, so how is the functionality of the maple  
7 wash, how is that different from a dark-stone wash?

8 A The dark-stone wash does not have potassium. It  
9 doesn't have those chemicals that this one did.

10 Q And so do the jeans in the maple wash function  
11 differently than the jeans in a dark-stone wash?

12 A Absolutely.

13 Q Can you explain how?

14 A Because it has different chemicals to it, so it  
15 makes it shrink. It makes it shrink more.

16 Q I'm saying the jeans themselves. Do the jeans  
17 themselves function differently?

18 A I'm so sorry. I don't understand your question.

19 Q What is the purpose of using a maple wash versus  
20 using a dark-stone wash? Is it consumer preference? Like  
21 the end-buyer likes a darker jean than a lighter jean?

22 A Well, it's just a different wash. You're  
23 describing two totally different washes. A dark-washed  
24 jean has no chemicals. Not -- it has, but not as intense  
25 as the one -- the maple wash. Maple wash has more intense

1 chemicals in it that'll make it shrink more. The fabric  
2 will react differently.

3 Q On the end user, the consumer, does a  
4 stone-washed jean look different than a maple-washed jean?

5 A Yes.

6 Q How?

7 A I just -- the dark-washed jean is going to be  
8 very light on the -- called sanding. A maple-washed jean  
9 has more potassium. You'll see it much lighter on the  
10 front.

11 Q So the appearance of the jeans look different?

12 A Absolutely.

13 Q What is the function of the Bermuda shorts?

14 A The function? The waistband.

15 Q The function of the Bermuda. What is -- I'm  
16 saying what -- what is the function of the Bermuda short?

17 A It's just a longer short. It's not as short as a  
18 short. It's between a jean and a very short short.

19 Q Why would someone choose a Bermuda short as  
20 opposed to a, you know, a fringy short?

21 A It's a preference.

22 Q Okay. Was this Bermuda short -- I'm going to ask  
23 you to look at Exhibit 10 again. Was -- I guess, first of  
24 all, it states here that Evelyn Ober is the designer;  
25 correct?

1           A    She's a creative director.

2           Q    Okay. But it says on here, "Designer: Evelyn  
3   Ober."

4           A    She is -- yes. She designs everything.

5           Q    Okay. And it also states here, "Created -- I  
6   guess that's the face card -- "Created 5/27/2008 by  
7   L.J.E.W.S.?

8           A    That's the pattern maker.

9           Q    Do you know who L.J.E.W.S. is?

10          A    Yeah. She was there for a very short time.

11          Q    So can you look at Exhibit 8, which is D11072,  
12   party dress. Did you work on this project?

13          A    I did not.

14          Q    Okay. Can you look at exhibit -- which is it  
15   here -- Exhibit 9, which is project M3 -- sorry -- M93771.  
16   Did you work on this project?

17          A    I did not.

18          Q    So --

19          A    Sorry to interrupt you. To make it easy, the  
20   only project I worked on is Exhibit 10.

21          Q    The only one you worked on is Exhibit 10?

22          A    Yes.

23          Q    Okay. Thank you. Does Swat-Fame employ any  
24   engineers?

25          A    We are the engineers.

1 Q You are the engineers?

2 A Yes, we are. We engineer that garment from  
3 beginning to end.

4 Q Do you have an engineering degree?

5 A No, I don't.

6 Q Do you know --

7 A I don't think --

8 Q -- of anyone at Swat-Fame?

9 A -- for denim. We are the engineers to me. This  
10 is our engineers.

11 Q So do you know if anyone at Swat-Fame is a  
12 California structural engineer?

13 A No. I don't think there is any.

14 Q Licensed civil engineer?

15 A No.

16 Q How about a chemist? Is anyone at Swat-Fame a  
17 chemist?

18 A No.

19 Q Are you a chemist?

20 A No.

21 Q Okay. With respect to the -- I'll go back to the  
22 Bermuda shorts. Where on this -- where on the face card  
23 is the -- where are the chemical experiments referred to?

24 A We don't have it on here.

25 Q You don't have them on there?

1           A    No. This was an old system. So we did not  
2 actually provide that in the system?

3           Q    Okay. So on the -- I'm sorry -- Exhibit 8 the  
4 party dress.

5           A    Yes.

6           Q    Can you tell me where on this sheet the  
7 structural engineering calculations are?

8           A    You're asking about the specs and measurements?

9           Q    I'm asking you where the structural engineering  
10 calculations are related to the spaghetti straps of this  
11 dress?

12          A    Oh, it's here. It's on the market section.

13          Q    The market section?

14          A    Yes.

15          Q    So these are which are -- which of these relates  
16 to the weight of the dress?

17          A    The weight of the dress?

18          Q    Yeah?

19          A    No. None of them. It does not give you the  
20 weight of the dress.

21          Q    Which of these refers to the critical load of the  
22 spaghetti straps?

23          A    Contrast one. Yes, contrast one is your  
24 spaghetti strap.

25          Q    So contrast one relates to -- and this estimate,



1 is this E.S.T. is that?

2 A Estimate. The estimate yardage of how much  
3 they're going to use.

4 Q Okay. Are you familiar with principals of  
5 structural engineering?

6 A I am.

7 Q Yes?

8 A By looking at this face card, I can tell you what  
9 it is. But I don't work on this product, but I can tell  
10 you just by looking at this face card what goes where.  
11 What pieces belong to what.

12 Q Do you know -- let me ask this a different way?  
13 Do you know what structural engineering involves?

14 A Well, the instructional -- are you talking about  
15 assembling the dress.

16 Q I'm asking about the engineering field of -- like  
17 a licensed civil engineer. Do you know what that field --

18 A No. No, I don't. I just said I don't know.

19 Q Okay. Thank you.

20 MR. RILEY: I have no further questions.

21 ADMINISTRATIVE LAW JUDGE VASSIGH: Appellants, do  
22 you have any more questions for Ms. Nevarez?

23 MR. HUNZIKER: No further questions.

24 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay... Thank  
25 you so much, Ms. Nevarez.

1 THE WITNESS: Thank you.

2 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay.

3 Appellants we're ready for your third witness.

4 MR. DIES: Yes. Appellants call Ms. Ashley

5 Speice.

6 ADMINISTRATIVE LAW JUDGE VASSIGH: Good

7 afternoon.

8 THE WITNESS: Hi.

9 ADMINISTRATIVE LAW JUDGE VASSIGH: Thank you for

10 waiting all day.

11 THE WITNESS: Of course.

12 ADMINISTRATIVE LAW JUDGE VASSIGH: Please state

13 and spell you name.

14 THE WITNESS: Ashley Speice,

15 A-s-h-l-e-y-s-p-e-i-c-e.

16 ADMINISTRATIVE LAW JUDGE VASSIGH: Thank you.

17 I'm going to swear you in, and you will remain under oath

18 until the end of this hearing. Please raise your right

19 hand.

20 ASHLEY SPIECE,

21 produced as a witness by and on behalf of the Appellant,

22 and having been first duly sworn by the Hearing Officer,

23 was examined and testified as follows:

24

25 THE WITNESS: Yes.

1 ADMINISTRATIVE LAW JUDGE VASSIGH: Thank you.  
2 Appellants when you are ready.  
3

4 DIRECT EXAMINATION

5 BY MR. SUGGS:

6 Q Good afternoon, Ms. Speice, how are you?

7 A Good. How are you?

8 Q Good. Are you currently employed?

9 A Yes.

10 Q Where do you work?

11 A Alliantgroup.

12 Q What kind of company is alliantgroup?

13 A Alliantgroup is an international specialty tax  
14 consulting firm.

15 Q How many years have you been there?

16 A It'll be seven years in January.

17 Q What's your current job title at alliantgroup?

18 A I'm a director in our quality control group.

19 Q Quality control, what does that maintain?

20 A It is made up of a different -- a group of  
21 individuals who have different backgrounds from attorneys,  
22 to data analytics, statisticians, mathematics, chemist.  
23 We have a whole different wide variety of individuals who  
24 are involved in our three process of all of our files.

25 Q Have you always been in the quality control

1 department?

2 A No. I -- about seven years ago, I originally  
3 started alliantgroup in our implementation group. So I  
4 started in our project management group where I was  
5 involved in the front end of the studies building on the  
6 credit calculations, building out the clients' reports,  
7 and then grew to become a team director.

8 So I oversaw up to about 20, 25 people who are  
9 also project managers on different files. I did stay in  
10 implementation group for about five years. Then about two  
11 years ago moved over into our quality control group  
12 because I wanted to have a different, you know, side of  
13 things from that perspective of what I was seeing from the  
14 studies and being able have more of an impact in our  
15 practice.

16 MR. DIES: Ms. Speice, can you speak a little  
17 slower so the court reporter doesn't kill you?

18 THE WITNESS: Sure. Sorry. Yes.

19 BY MR. SUGGS:

20 Q And when you say studied, what types of studies  
21 are you referring to?

22 A R&D tax credit studies.

23 Q How many of those R&D tax credit studies have you  
24 either personally worked on or oversaw as the manager?

25 A Personally, over 300 I would say. Oversaw

1       probably close to 1,000 based on the different studies  
2       that my teams have worked on. So I would be part of the  
3       overseeing those different studies with them.

4           Q     Have you received any awards, recognition,  
5       certifications based on your experience?

6           A     Yes. So I am the industry practice leader in  
7       manufacturing at alliantgroup.

8           Q     How many of those studies that you worked on are  
9       for apparel companies?

10          A     Probably about 150, I would say...

11          Q     Okay. Were you involved in the R&D study for  
12       Swat-Fame?

13          A     Yes. I was the project manager.

14          Q     Okay. Was your name Ms. Speice at the same time?

15          A     No. I was Ashley Ward previously before I got  
16       married. It's my maiden name.

17          Q     Congratulations.

18          A     Thank you.

19          Q     So I want to focus in a little bit on this  
20       particular taxpayer and that study process. But before we  
21       get into the specifics on what was done, can you help me  
22       understand what the process is to implement an R&D study  
23       at alliantgroup?

24          A     So we have a three-tier or we have a three-phrase  
25       process. This process has been built out with the help

1 off our former R.S. commissioners and our two R.S.  
2 commissioners that we have involved in our studies and in  
3 our process. So through our guidance, we've come up with  
4 our three-phase process.

5 It starts out with our initial phase one. So  
6 this is our value assessment phase. This would begin with  
7 the kickoff call with the client, where we would have  
8 teleconference with them; talking through their business  
9 and getting familiar with how they're tracking different  
10 information and their overall process.

11 At the end of this call we would send them a  
12 document request requesting different information, such as  
13 tax returns, wages, company organizational charts,  
14 contracts, general ledgers; anything that might come up as  
15 relevant.

16 And then when -- once we have received that  
17 initial document request, then we would be going through  
18 and setting up different teleconferences with them, or  
19 going and visiting them in person where we would talk to  
20 individuals at the company and get an understanding of the  
21 activities that are happening at the company.

22 So understanding their process. Understanding  
23 different roles and responsibilities at the company. Once  
24 we have that information, we would prepare a credit  
25 estimate for that client; where we would then have another

1       teleconference with them, talk through what we're seeing  
2       and what we're finding.

3               There may -- there are cases where we don't have  
4       an actual credit for them. Then we would move into our  
5       phase two. This is going to be focused on building out  
6       the project. So we would request what we would call a  
7       project list; so figuring out what the client's business  
8       component is, how they're tracking it, and -- and  
9       ultimately getting a listing of that information from the  
10      client.

11              Once we have the project listing, we'll talk  
12      through that information with the client and then go  
13      through our process to figure out how we're going to  
14      handle project qualification.

15              Q     Mrs. Speice, let me interrupt you just for a  
16      moment. You talked through phase one, and a little bit of  
17      phase two. And before we get too far ahead of ourselves  
18      in phase three, I'd like to break them up a little bit,  
19      more specifically regarding what your role and involvement  
20      was and the methodology for this particular taxpayer.

21              A     Sure.

22              Q     So from phase one you mentioned the first thing  
23      you all do is do a kickoff call?

24              A     Yes.

25              Q     And that was done in this instance?

1           A    Yes.

2           Q    Okay.

3           A    I believe December 2012.

4           Q    Okay.  And during that kickoff call, what was  
5 your purpose of having that kickoff call with the  
6 taxpayer?

7           A    To gather information regarding their overall  
8 process, their company history, who is doing what at the  
9 company, and how they're tracking information.

10          Q    Okay.  You mention typically afterwards you send  
11 out a request for information.  What type of information  
12 did you request from Swat-Fame?

13          A    W-2's, job titles, tax returns, organizational  
14 chart, I believe, were some of the things that we  
15 requested.

16          Q    Okay.  And then what was the next thing you all  
17 did from a project team perspective?

18          A    We ended up going on-site and visiting the  
19 company within about two weeks or so, I believe, after  
20 having done an initial kickoff call with them.

21          Q    Let me interject one moment.  Referring to  
22 Exhibit 6 --

23               MR. SUGGS:  May I approach?

24               ADMINISTRATIVE LAW JUDGE VASSIGH:  Yes.

25        ///



1 BY MR. SUGGS:

2 Q Mrs. Speice, I'm handing you four pages of  
3 Appellants' Exhibit 6. Can you talk to me about what  
4 those documents are?

5 A So these would be our site visit agendas.  
6 There's two different ones here. So if you look at the  
7 one that's dated December 18th through the 21st, that  
8 would be the one I'm referring to. It's the initial visit  
9 that we had.

10 Q Okay. And then Ms. Ward -- that's you?

11 A That's me.

12 Q That's your maiden name?

13 A Yes.

14 Q Okay. And then you were with a colleague, it  
15 appears?

16 A Yes. That was my team director at the time,  
17 Allison Mullins.

18 Q Can you walk us through the, like, the agenda  
19 proposed, the purposes of -- I'd like for you to read into  
20 the record regarding what you got accomplished during that  
21 visit?

22 A Sure. So we had laid out the first day getting  
23 an overview of the employees' activities. So in there we  
24 had listed people, such as creative directors, associates,  
25 designers. And then there's also an asterisk in there --

1 in that section that references a listing of the  
2 additional employees that we had requested to interview  
3 while we were on-site.

4 Q Okay.

5 A And it's about 20 to 30 employees, it looks like,  
6 that we requested to interview in addition to that list.

7 Q And that would have been all supposed to be  
8 conducted on the first day, Tuesday, December 18th;  
9 correct?

10 A Yes.

11 Q And what about further down, the agenda for the  
12 following day?

13 A We have listed here our base analysis, and then  
14 getting interviews with the executives. And then also  
15 getting a listing of -- of their project list and their  
16 documentation.

17 Q Okay. And all this was done in those two days?

18 A Yes.

19 Q Once you all concluded that site visit, what was  
20 the next step in the process?

21 A We returned to Houston and cataloged the  
22 information and put it into the credit calculations.

23 Q And it appears to be it was right around the  
24 holiday time?

25 A Yeah.

1 Q So Christmas, New Year's, all of that. Turning  
2 back a couple of pages in that same exhibit, No. 6.

3 A Okay.

4 Q Can you walk me through what this second agenda  
5 is?

6 A The one dated January 24th, this would be the  
7 start of our phase two. So we had received the project  
8 list and then completed our fiscal sample. So these were  
9 the projects that were selected from the first fiscal  
10 sample that we completed.

11 We went on-site to gather -- or to conduct the  
12 technical interviews with the design team. So people that  
13 were associated with the development of these styles, and  
14 had already received the project documentation from  
15 Swat-Fame.

16 Q Let me take a couple of steps back. You referred  
17 to a few names. I want to make sure that everyone  
18 understands what we're talking about? You said you  
19 received a project list. What do you mean by that?

20 A So this was a listing of all the styles that are  
21 designed by individual by Swat-Fame for this specific time  
22 period. It looks like tax years 2009 through 2011.

23 Q Okay. When you say "all styles," does that  
24 include duplicate styles?

25 A Yes.

1 Q Does that include new styles?

2 A Yes.

3 Q And then what's the purpose of gathering that  
4 project list information?

5 A To be able to substantiate the R&D tax credit.  
6 The -- we've got the employees and their activities  
7 determined, but then we use the projects to substantiate  
8 and tie them to the ultimate credit.

9 Q How many projects did you gather during that  
10 process, total project?

11 A Total projects in the R&D setting was about 60, I  
12 believe.

13 Q 60 total that you gathered from the taxpayer  
14 originally?

15 A Oh, from the original. Originally, I believe it  
16 was over 30,000.

17 Q Okay. It seems like a lot of project?

18 A Yes. They're busy people.

19 Q Is that typical in the apparel industry?

20 A Yes.

21 Q Why?

22 A So like Mitchell -- or excuse me. Like Jonathan  
23 mentioned, they are constantly designing and presenting  
24 hundreds of styles in a given month, you know, trying to  
25 get buyers to buy them. They're only -- they're only

1 selling a smaller percentage.

2 So they are, you know, constantly trying to keep  
3 up with -- with the industry and the market. So to stay  
4 on top of, you know, their competitors, they've got to be,  
5 you know, developing that much.

6 Q So help me understand. How do you vet through  
7 thousands of projects in determining qualification?

8 A So we need to have conversations with the client.  
9 We need to understand how are they tracking their  
10 information. What is their style name and style numbers?  
11 What do those style numbers mean? Are there any -- how  
12 their tracking system works, having those conversations  
13 and then using that to figure out how do we determine  
14 duplicates. How do we determine, you know, data errors in  
15 the lines?

16 Q What do you mean by data errors?

17 A So they may have put test numbers in there.  
18 Like, Swat-Fame discussed they -- they made a new system.  
19 They made us put -- have a test number in there as they're  
20 transitioning that can accidentally get pulled when they  
21 check all the data at once.

22 Q Okay. So how did you all and your team go about  
23 determining qualification? Did you review all 30,000 of  
24 those projects?

25 A No.

1 Q What did you do?

2 A We completed a fiscal sample. We have an outside  
3 third party. Her name -- she's Dr. Gold -- Deborah  
4 Goldwasser. We work with her to determine the appropriate  
5 statistical sampling methodology, and then she provides us  
6 with information. Or she provides us with a statistical  
7 analysis to be able figure out which projects to review.

8 Q So let me -- if I can get you to return to tab 4  
9 of Appellants' exhibits. What's this document?

10 A This is the statistical sampling report from  
11 Dr. Goldwasser.

12 Q Okay. Is Ms. Goldwasser a Ph.D. on the --

13 A Yes.

14 Q Are you a statistician, Mrs. Speice?

15 A No.

16 Q Okay. Is Ms. Goldwasser a statistician?

17 A Yes. Yes.

18 Q What authority do you -- does alliantgroup rely  
19 on in order to do a statistical sampling methodology to  
20 these projects as opposed to doing all 30,000 projects?

21 A Revenue Procedure 2011-42.

22 Q Okay. Is that an Internal Revenue Code  
23 procedure?

24 A Yes.

25 Q Okay. Can you maybe help us understand how you

1 employed the statistical sampling? How did you break up  
2 the projects, and did you get to the number of projects  
3 that you actually looked at and reviewed?

4 A So we had two different year -- two different  
5 time frames that we looked at for Swat-Fame. So there's  
6 two different statistical samples that were completed. So  
7 based on the time period, the samples were broken apart.  
8 And her report talks through how it doubled up the  
9 projects in each of the sampling frame. So we submit the  
10 sampling frame to her. She then had --

11 Q When you say "sampling frame," what do you mean?

12 A That is after we've received the original list  
13 from Swat-Fame, we reviewed it, tried to remove  
14 duplicates -- duplicate styles and then narrow down, you  
15 know, too ideally have a potential -- a list that's  
16 potentially qualified projects.

17 Q Okay. And you take that list -- that number,  
18 which is the 36,189 that's referenced on page SFI0384 of  
19 Exhibit 4?

20 A Yes.

21 Q When you submit that list to Dr. Goldwasser, do  
22 you dictate which projects you want to specifically  
23 review?

24 A No, not at all. We just -- we sent her -- in  
25 this case we sent her two different lists. One was made

1 up of 22,856 projects. The other one was made up of  
2 13,333 projects -- new products. And she then provides us  
3 with the completely random sample that we will then  
4 individually review with the client for each of those  
5 list.

6 Q And then how many projects were within that  
7 randomized sample that you received?

8 A 30 for each list, so a total of 60.

9 Q Okay. And then just to put it in perspective, we  
10 are in phase two at this point of the process?

11 A Yes.

12 Q Okay. So you now you have a list of 60 projects  
13 for multiple years that were given to you by a  
14 statistician?

15 A Hm-hm.

16 Q What is the next thing you all did in the study  
17 process?

18 A We would -- we e-mailed the list to the client  
19 letting them know these were the -- the projects that were  
20 randomly selected and that's what we want to -- we  
21 requested project documentation associated with them, and  
22 then figure out, you know, whether we -- for this case we  
23 came on-site to conduct individual interviews on each of  
24 the projects.

25 Q Can I get you to refer back to Exhibit 6?



1           A    Yes.

2           Q    What are those first two pages there?  The first  
3           page, I should say.

4           A    The first page with the date, January 24, 2013?

5           Q    Yes, ma'am.

6           A    So that's the site visited agenda for the first  
7           set of interviews that we went out after our first  
8           statistical sample was completed.  So we wanted to conduct  
9           the project interviews.

10          Q    And just for the record, this is the second time  
11          you went out to Swat-Fame?

12          A    Yes.

13          Q    Okay.  Did you go out to Swat-Fame on any  
14          additional occasions?

15          A    Yes.  We went a third time, I believe, in  
16          March 2013 to conduct the second round of project  
17          interviews on the additional fiscal sample.

18          Q    Okay.  And based on your interviews and those  
19          subsequent site visits, were there any of the projects you  
20          deemed not qualified?

21          A    Yes.  There was one from each sample that were  
22          not qualified.

23          Q    Can you tell us why they were not qualified?

24          A    Based on the information provided from the  
25          company, they were duplicate files.

1 Q For both of those?

2 A Yes.

3 Q So what happens, for us non-statistically savvy  
4 folks, when you have a project within your sample that is  
5 deemed non-qualified?

6 A So for this statistical sample methodology, we  
7 would calculate the total qualified research expenses. So  
8 after our interviews and -- on the expenses there would be  
9 a rescaling factor that gets applied to the total  
10 qualified research expenses.

11 And then every time -- which would be the  
12 rescaling factor we would receive from Dr. Goldwasser --  
13 and then every time you determine a product does not  
14 qualify, it would be a reduction in the total qualified  
15 research expenses based on the rescaling factor provided  
16 from Dr. Goldwasser.

17 Q Is that rescaling factor within her sampling  
18 report?

19 A Let me check.

20 Q It would be Exhibit 4 for your reference.

21 A I believe it is. Yes, the rescaling factor would  
22 be -- both of them are provided. I'm on SFI0390.

23 Q And so this instance, there was one error you  
24 claim out of each cluster; correct?

25 A Yes.

1           Q    So re-scale factors of .85151 and .85157 were  
2 applied to those applicable tax years respectively?

3           A    Yes.

4           Q    Okay. I want to talk a little bit about the  
5 cost, and we'll come back to the re-scale factor. So what  
6 types of costs do you consider when you're doing an R&D  
7 tax credit?

8           A    Anything that's allowed under Section 41. So it  
9 would be wages, supplies, contractors.

10          Q    Okay. So in this instance, you're looking at  
11 wages, meaning employees of Swat-Fame?

12          A    Yes.

13          Q    So did you allocate 100 percent of everyone's  
14 time?

15          A    No.

16          Q    Why not?

17          A    Because they're not -- everyone in the company is  
18 not 100 percent of time doing qualified activities.

19          Q    When you say "qualified activities," what do you  
20 mean?

21          A    They, under Section 41, they're not -- they're  
22 not conducting qualified research. They're not involved  
23 in the product development process.

24          Q    You heard the question earlier of whether or not  
25 taxpayer was able to shrink back in this instance. Were

1       you able to do that in your analysis?

2           A     Yes.

3           Q     How so?

4           A     So in our initial interviews that I mentioned --  
5       that first phase site visit -- we conducted interviews  
6       with about 20 or so employees and talked through their  
7       different job titles, their responsibilities, their  
8       day-to-day activities and the time that they're spending  
9       on those different activities.

10                Then through those interviews, talking through  
11       what time they're spending on qualified research, then  
12       determining percentages of time that's qualified. And  
13       then from there, there would be that shrink back where,  
14       you know, out of our 10-hour day or 8-hour day that they  
15       have, you know, 6 hours or 4 hours, you know, an average  
16       is what we find qualified time.

17           Q     So for an individual you determined a percentage  
18       of their time dedicated to R&D?

19           A     Yes.

20           Q     Okay. And in your conversations with employees  
21       in determining qualified activities, did you talk to any  
22       executives?

23           A     Yes.

24           Q     What was the reason for talking to executives?

25           A     We had several reasons. So we were able to speak

1 with, I believe, all of the executive team. So Bruce,  
2 Mitchell, Jonathan, and J.P. So with the conversations --  
3 and I believe it's Exhibit 6 -- shows that -- the site  
4 visit agenda, that initial visit. But our intent,  
5 understanding their day-to-day activities, their roles,  
6 responsibilities in the company, and then also building  
7 out our base period analysis that's also listed there in  
8 our site visited agenda.

9 Q Are all the executives allocated towards the  
10 research credit?

11 A No. Only Jonathan is allocated in credit.

12 Q What about supply cost? Did you consider any  
13 supply cost?

14 A Yes.

15 Q What types of supply cost did you consider?

16 A There were fabrics, I believe, trims, and then  
17 the marker grading expenses.

18 Q Okay. What types of fabrics would you have  
19 considered R&D supply cost?

20 A So if we're -- I use a chart for fabrics, the  
21 sample making. So any of the fabrics that are going into  
22 making the actual sample garments throughout the  
23 development process.

24 Q Okay. Do you know if you allocated all supply  
25 cost that they tracked in their system or for specific

1 accounts for supply costs?

2 A It would have been specific accounts. So we had  
3 an interview with Swat-Fame CFO, J.P. Wolk. And so with  
4 him we talked through what were -- how they tracked the  
5 expenses; what were the -- what were the overall general  
6 ledger accounts and determine the appropriate ones that  
7 would be dedicated to sample making. And then also talk  
8 through what -- what was tracked into those accounts.

9 So I believe the fabric account did not -- we did  
10 not take the entire account because it had shipment cost.  
11 So for Swat-Fame to receive the fabric from the mills  
12 and -- and the people that manufacture the fabrics for  
13 them, they had to pay a shipping cost. That cost is  
14 rolled into one account. So we determined, you know,  
15 approximately how much of that account would be shipping  
16 versus actual fabric material.

17 Q Okay. What about contractor cost?

18 A Yes. We took contractor cost.

19 Q What would those have been for?

20 A I believe it was fit model expenses.

21 Q Per the functional fit sample --

22 A Yes. Yes. So Swat-Fame, they do not have  
23 internal fit models. So they use third parties to bring  
24 in individual who have standard -- standards for them.

25 Q And of those contractor costs, do you -- are you

1 allowed to take 100 percent of those costs that are  
2 incurred by Swat-Fame?

3 A No. We have to determine what makes sense for --  
4 for the client. I believe for Swat-Fame for the fit  
5 models in particularly, I believe we did take all those  
6 cost up.

7 Q Are there any statutory limitations on how much  
8 you can take in terms of cost per contractors?

9 A They are going to be from -- from -- 65 percent  
10 reduction.

11 Q What's that 65 percent reduction?

12 A So under Section 41, contractors will be reduced  
13 by 35 percent. The code only allows you to take  
14 65 percent of contractor cost.

15 Q Okay. So once you range that sample, once you've  
16 done two or three site visits at the time, once you've  
17 spoken to the employees about projects and their role and  
18 responsibilities, and the cost, what do you do with all  
19 that information?

20 A We have a calculation model that we would then  
21 compile it into and -- to determine the overall credit  
22 calculation.

23 Q Okay. Going back for just a moment to the  
24 statistical sampling. You mentioned the re-scale factor,  
25 the .85 percent.

1           A    Yes.

2           Q    And that's applied to the bottom line total  
3 qualified wage expenses; correct?

4           A    Yes. Yes. So after -- after the interviews,  
5 after the percentages, you know, that come about out of  
6 that, and the total qualified research expenses that are  
7 determined, that rescaling factor is taken on top of how  
8 we've already shrunk back the overall of expenses.

9           Q    You also, by that same re-scale factor, that 15  
10 percent reduction to supply and contractor calls as well?

11          A    Yes.

12          Q    Okay. And that information ultimately -- what do  
13 you do with it? How does it make it to the tax return?

14          A    So from this instance, I was a project manager.  
15 So I would complete the credit calculations. At  
16 alliantgroup we have a three-tier review process. So any  
17 file is gonna go through a project manager review. And  
18 then it would go through a team director interview who is  
19 going to analyze the credit calculation, the projects, the  
20 methodology behind it.

21               And then once the team director has signed off on  
22 it, then it would go through our quality control review  
23 who is going to look at it from the -- from the legal  
24 standard. Is it going to, you know, meet our requirements  
25 and then, you know, calculation model and our



1       substantiation behind it.

2               We would then go through our quality control  
3   review and get the final sign off from that team. At that  
4   point it can then go through and be delivered to the  
5   client via e-mail, and it's ready for the tax return. So  
6   we would deliver the Form 3523 in this case.

7           Q   And any credits on that -- that return for the  
8   entity would flow through to respective shareholders?

9           A   Yes.

10          Q   Okay. What -- have there been many courts that  
11   have looked at the methodology approach employed here and  
12   sanctioned that approach for tax payers?

13          A   Yes, numerous. I believe McFerren allow, you  
14   know -- talks through estimates and allocations. She, I  
15   mean, further reiterates McFerren. And then also, you  
16   know, she talks about the methodology. And then Suiter as  
17   well has -- talks through not only allowing reasonable  
18   estimates, you know, with substantiating employee  
19   activities.

20               It also talks through how executives can be  
21   involved in research and development activities and using  
22   testimony and other information to support their time.

23          Q   So once you complete that credit calculation you  
24   provide that to the taxpayer, to their CPA? What do you  
25   do with that information?

1           A    We provide the Form 3523 to the taxpayer and the  
2           CPA.

3           Q    Okay. And does that conclude your process?

4           A    No. At that point we move into our phase three,  
5           which is our reporting and final deliverable phase. So  
6           that begins. And in this case we did this for Swat-Fame,  
7           drafting the project summary report.

8                        So that is going to detail our analysis; the  
9           company's activities; how they're meeting the four-part  
10          test under Section 41; the projects that we individually  
11          reviewed; the people and the expenses that we capture  
12          towards the credit.

13                       That's going to be reviewed and submitted to the  
14          taxpayer for their review verification on the terminology  
15          and information. Then if they have anything to add we can  
16          incorporate that. And then if -- once we have the review  
17          and approval on it, we will compile our final report,  
18          which is a hardbound deliverable for them, applying the  
19          legal analysis behind it, as well as the projects specific  
20          information from the project summary report.

21          Q    You mentioned that you draft that report and  
22          submit it to the taxpayer for their review. If there were  
23          any changes, what would happen?

24          A    It would be incorporated. Well, we would have a  
25          discussion in talking through why -- why they would make

1 it if we -- if we, you know, honestly don't understand why  
2 they're making it, but then incorporate it into the final  
3 report for them.

4 Q What about the employee allocation? You  
5 mentioned relying on estimation of the folks that you  
6 spoke with. Do you -- do you put those allocations also  
7 back in front of the taxpayer for them to redetermine  
8 their estimates?

9 A Yes. So any expense that we're taking towards  
10 the credit will then -- will be confirmed with the client  
11 before -- before ultimately putting it in their tax  
12 return. So in this case, we did all the employee  
13 interviews, compiled that information, and the appropriate  
14 percentages of time for the employees. And then send that  
15 via e-mail to them and get their confirmation on it.

16 Q What types of activities would you qualify for  
17 Swat-Fame?

18 A Can I use the chart?

19 Q Absolutely.

20 A So it's been discussed, you know, I believe with  
21 the other two witnesses. But from the concept phase,  
22 that's where a lot of aesthetic, where the market  
23 research, where the overall, you know, coming up with the  
24 initial idea of what the client -- or what the taxpayer is  
25 going to put together happens. At that point that's what

1 we try to carve out.

2 And then talking through once they're going  
3 through on the execution side, they decide, okay. They  
4 got the sketch ready to go. They're going to then figure  
5 out how do they execute it. So talking through, you know,  
6 the different phases of the sampling, talking through the  
7 different revisions that are going to be made; from that  
8 perspective of the execution side, that's what we would be  
9 capturing from the R&D credit.

10 So every time it's going through the revisions,  
11 it's going through the process of experimentation, the  
12 conceptualization side, we do need to shrink back and  
13 figure out how much time is spent on non-qualified  
14 activities. But for the actual execution of making the  
15 samples, determining the revisions, figuring out the  
16 overall right materials, right washes, the specifications,  
17 dimensional requirements, points of measurement, stitching  
18 types, reviewing the testing; those are going to be  
19 samples of the way we're capturing.

20 And then once the client is approved for  
21 production, then we would cut off, you know, those  
22 activities as well as people's time.

23 Q So you mentioned "shrinking back and  
24 conceptualization." How do you that in terms of  
25 allocations?

1           A    So talking through different people's roles and  
2   responsibilities for Swat-Fame, their company is broken  
3   down by division or by brand. So, you know, there's  
4   brands such as Speechless. Then there's other brands  
5   underneath that. People that are working in those  
6   divisions have different levels of activity.

7                    So we could talk through when you're working with  
8   a branded product, you know, what's your process. What --  
9   what are the activities, and we're talking through, you  
10   know, Speechless.

11                   So determining, you know, based on that type of  
12   analysis, where does it fit into, you know, their  
13   day-to-day activities on concept, on sample review,  
14   testing, revisions, figuring out how much of their time on  
15   a per-person basis if it's going to be made up of.

16           Q    You mentioned removing duplicates earlier on in  
17   the sampling process. What about anything after  
18   production? Did you take any cost after production?

19           A    No.

20           Q    How do you know you're not -- after cost -- it  
21   could be an adaptation of existing business components?

22           A    So that was part of the conversations with  
23   talking through the different roles and responsibilities  
24   of the individuals. So with the allocations, people who  
25   are not at 90 percent but also not designers were likely,

1 you know, that time we're carving back for accounting, for  
2 repeat work they're going to be touching, adaptations, you  
3 know.

4 I believe Connie mentioned, you know, there is  
5 sometimes that they're just going to have be updating the  
6 face cards and the specs for, you know, making minor  
7 tweaks. We talked how much of that time it was taking for  
8 them.

9 Q And the current allocation that they were  
10 following, took that into account?

11 A Yes.

12 Q Does Swat-Fame utilize credits for subsequent  
13 years after your study?

14 A From my understanding, no.

15 Q Okay.

16 A Based on where their business was, it did not  
17 make sense from a tax position for them to take additional  
18 California credits.

19 Q And once you complete that final summary report  
20 that you mentioned earlier, does that conclude your phase  
21 three?

22 A Yes.

23 Q Okay.

24 MR. SUGGS: One moment. No further questions of  
25 this witness.

1 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. Thank  
2 you.

3 FTB, do you have any questions for this witness?

4 MR. RILEY: Yes, we do as soon as I fix this mic.  
5

6 CROSS-EXAMINATION

7 BY MR. RILEY:

8 Q Good afternoon.

9 A Hello.

10 Q Again, I'm Jason Riley. And you are?

11 A Ashley Speice.

12 Q And the former Ms. Ashley Ward; correct?

13 A Yes.

14 Q Okay. Do you have a technical background?

15 A My background, I have a business degree. My  
16 bachelor's degree is a business degree, and I have a law  
17 degree and an MBA.

18 Q Okay. What did alliantgroup base its  
19 determination of qualification on? Was it solely  
20 documents? Was it documents and technical interviews?

21 A Documents and technical interviews.

22 Q Okay. The credit study states at page -- and the  
23 credit study is -- sorry -- so at SFI316.

24 ADMINISTRATIVE LAW JUDGE VASSIGH: Mr. Riley, is  
25 there and exhibit number?

1 MR. RILEY: 3. I'm sorry, Exhibit 3. I heard  
2 Ray say it.

3 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. Thank  
4 you.

5 BY MR. RILEY:

6 Q Okay. So the first page that 36,191 projects  
7 were identified; correct?

8 A Yes.

9 Q Did you provide any guide -- and who identified  
10 those?

11 A The taxpayer provided the listing of all the  
12 styles developed in those years.

13 Q Of the 36,191?

14 A Yes.

15 Q Okay. Did you provide any guidance to Swat-Fame  
16 regarding their submission of the 36,000 of these project?

17 A During our tele -- our initial kick-off call, we  
18 talk through the need to have a project list. In this  
19 case the client talked through that style numbers would be  
20 the best case for them to demonstrate their overall  
21 projects. So we talked through them being able to extract  
22 an Excel file to provide us with that list.

23 Q So would you say they had a general idea of the  
24 legal requirements for what would qualify?

25 A Yes. We talked through the need to substantiate



1 the activities and using the overall project list and then  
2 complete a statistical sample. I don't believe I  
3 necessarily told them Revenue Procedure 2011-42.

4 Q And do you know about the date that you -- that  
5 they gave you -- I'm sorry. Was this at the  
6 December 18th, 2012, interviews?

7 A Yes, as well as it would have been discussed on  
8 the kickoff call.

9 Q So on what date did you -- do you recall what  
10 date you received the project list from Swat-Fame?

11 A I would say early January.

12 Q Early January?

13 ADMINISTRATIVE LAW JUDGE THOMPSON: Of what year?

14 THE WITNESS: Of 2013.

15 ADMINISTRATIVE LAW JUDGE THOMPSON: Okay.

16 BY MR. RILEY:

17 Q So how early are we talking? The first week?

18 A I -- I don't know.

19 Q Okay. Did you review any of those 36,000  
20 projects prior to the statistical sample?

21 A We talked through the listing with them on how  
22 the information was maintained in the Excel file, and then  
23 what we could do in next steps on after a statistical  
24 sample was completed; what documentation we'll be able to  
25 gather and tie to that list.

1           Q    So you didn't do any qualified activity analysis  
2 of any of the 36,000 projects prior to the statistical  
3 sample?

4           A    I don't think so.

5           Q    Okay. And that statistical sample occurred on --  
6 well, it's dated January 7th, 2013; correct?

7           A    Yes.

8           Q    So you received the list sometime in that first  
9 week of January?

10          A    I believe so. It might actually be the end of  
11 December, based on that being January 7th, that being ran.

12          Q    Okay. Thank you. The credit study continues on  
13 page SFI0316, that projects that were duplicate styles or  
14 styles that had minor design changes were eliminated from  
15 the sample population. Does this mean that the minor  
16 design changes were eliminated from the 36,191?

17          A    To the best of our ability. I mean, it's 36,000  
18 lines in an Excel file. We would look at the style names.  
19 You could see that there could be, you know, similar style  
20 names that can come up, you know, in relation to the style  
21 numbers. It doesn't necessarily mean that it's a  
22 duplicate, but talking through what makes sense, based on  
23 that they're tracking of the information.

24          Q    Did the credit study take into account all  
25 114,000 Swat-Fame projects performed from 2017 -- sorry --

1 2007 to 2011?

2 A You said 114,000?

3 Q Yes.

4 A It would be the 36,000. Where is the 114,000  
5 number?

6 Q So if you could refer to -- and here in Exhibit C  
7 in the blue binder -- first at the bottom of page 2. So  
8 here in Exhibit C, for the record, this is a  
9 Swat-Fame Inc.'s response to audit issue section letter  
10 dated, November 2nd, 2015, from Mr. Suggs to FTB's  
11 auditor.

12 And so we're referring to -- sorry -- page 2 of 7  
13 here, where it states at the bottom, "All 36,189 new  
14 products were considered potentially qualified research  
15 activity. Duplicate projects were eliminated. Projects  
16 that were the same design but under different labels were  
17 eliminated."

18 And if you flip to page 3, it states that, "For  
19 2007 and 2008, 22,792 duplicate project entries were  
20 removed and 33,977 removed due to minor design changes.  
21 And regarding 2009 to 2011 study period, 5,407 duplicate  
22 projects were removed, and 16,000 projects were removed  
23 due to minor design changes."

24 And you'll have to trust me, but if you add up at  
25 78,214, which is the numbers here, with 36,189, it equals

1 114,403, which seems to correspond to page 5 of 7, where  
2 we got 336,189 and the approximately 78,000 design changes  
3 that were removed from the list before being sent to  
4 alliantgroup.

5 So I guess I'll ask the question again. Did the  
6 credit study take into account all 114,000 Swat-Fame  
7 projects performed from 2007 to 2011?

8 A No. So in here the way that the list would have  
9 been sent over in Excel, there could have just been  
10 duplicate information as the reports were being exported  
11 over.

12 So you would have to look at style numbers that  
13 would not be individual projects in there, as well, you  
14 know, styles with similar style names or the same style  
15 name within there would likely be removed because of not  
16 having, you know, much qualified activity.

17 Q Did you provide them with any guidance as to the  
18 exclusion of the 78,000 projects?

19 A We talked through the methodology of how to  
20 remove the projects to figure out where the potential  
21 qualified projects were.

22 Q Okay. The credit -- also then states on  
23 page 316, "Then each individual project included in the  
24 random samples was analyzed by alliantgroup via the  
25 technical interviews conducted during visits to

1 Swat-Fame's office in Los Angeles."

2 Did the technical interviews take place on  
3 July -- January 24th, 2013?

4 A One set of them did.

5 Q Okay. And the other took place --

6 A Mid-March.

7 Q -- mid-March. Okay. Sorry for talking over you.  
8 And what tax years did the first set of interviews relate  
9 to?

10 A The first set was the tax years '09 through '11.

11 Q Okay. Did you conduct those interviews?

12 A Yes.

13 Q Okay. And who from Swat-Fame participated in  
14 those technical interviews?

15 A A number of individuals.

16 Q Do you recall Ms. Forge?

17 A Yes.

18 Q Ms. Ober?

19 A Yes.

20 Q And Ms. Coy?

21 A Yes.

22 Q Okay. Which hearing exhibit relates to these  
23 technical interviews? Is it Exhibit 5? I guess refer to  
24 Appellants' Exhibit 5, which -- sorry. Appellants' are  
25 numbers and respondents' are lettered. If we haven't made

1       that distinction, apologies. So could you look at  
2       Exhibit 5?

3             A    Yes.

4             Q    And are these the technical interviews here?

5             A    It look like it, yes.

6             Q    Okay. Did these technical interviews result in  
7       alliantgroup removing any projects as not qualified from  
8       the sample?

9             A    I believe with the stat sample we had one project  
10       that was determined to be a duplicate.

11            Q    Okay. When did alliantgroup determine the number  
12       of erroneous claims in each sample?

13            A    The final determination we made at our quality  
14       control review. So the project team would have their  
15       initially take on it. And the team director could also  
16       come, you know, would review the information, give their  
17       feedback on it. And then through our quality control  
18       review, that would be where the final determination would  
19       be made of what, you know, of what we want to approve.

20            Q    Do you recall a date of that final?

21            A    No, I don't. Sorry.

22            Q    Okay. The credit study states on page 316 that  
23       two projects were removed because they were, quote,  
24       "duplicate styles;" correct?

25            A    Yes.

1 Q Who determined these styles were duplicates?

2 A From information provided from the client -- or  
3 from the taxpayer -- excuse me -- of development  
4 activities. Their feedback on it gave us guidance that it  
5 would not meet the requirements of Section 41.

6 Q Were these projects duplicates of other projects  
7 within the sample?

8 A No. In the overall statistical sample or the  
9 sampling frame?

10 Q Within -- so the 60 projects you selected -- the  
11 60 projects that Ms. Gold --

12 A Goldwasser.

13 Q -- that she selected with her sample. Were  
14 these -- I mean, the reason that you removed them from  
15 qualification was because they were duplicates of those  
16 other projects within that 60?

17 A No. They were duplicates of projects Swat-Fame  
18 had previously made outside of the 60.

19 Q Okay. So based on the -- so it was a statistical  
20 sample used to substantiate the claimed credit?

21 A Yes.

22 Q Is it your position that the 36,000 projects  
23 qualified for the California Research Credit?

24 A No, because there's 2 out of the 60 that did not  
25 qualify.

1           Q    So is it your position then about 85 percent of  
2   the 36,000 projects qualified for the California Research  
3   Credit?

4           A    Yes.

5           Q    So 30,654 projects qualified --

6           A    Sure.

7           Q    -- for the California Research Credit?

8           A    Sure.

9           Q    Okay. Do you recall which duplicate project --  
10   which was the duplicate project for 2007 and 2008?

11          A    I do not know offhand.

12          Q    Okay. Do you recall which was the one for the  
13   2009 to 2011 tax years?

14          A    No. I'm sorry.

15          Q    You stated earlier that you conducted interviews  
16   for the tax years at issue on -- for the 2009 to 2011 tax  
17   years at issue on January 24th, 2013; correct?

18          A    Yes.

19          Q    Is that interview part of the record?

20          A    I believe it's Exhibit 5 is where we we're  
21   looking. Yes.

22          Q    Don't these interviews relate solely to the 2007  
23   to 2008 projects?

24          A    It looks like the notes from this list are for  
25   the other statistical sample from March. The notes are



1 from the March interviews, but I can't confirm that right  
2 now.

3 Q Are the 2009 to 2011 technical interviews part of  
4 the record in this appeal in Appellants' binders or in  
5 Respondent's binders?

6 A I don't see them.

7 Q Do you recall taking notes on those interviews?

8 A I would have, yes.

9 Q Do you know who wrote the descriptions of the  
10 projects in the credit study?

11 A I don't know offhand. There are different  
12 people. I believe I was involved in it, but I couldn't  
13 tell you what ones I drafted personally. I would have  
14 been involved in reviewing the overall document, though.

15 Q Okay. Let's get back to the interviews that  
16 we've got. So after examining the interviews in the  
17 documents for 2007 to 2008, you determined that just one  
18 project was disqualified; correct?

19 A Yes.

20 Q Did you read Ms. Ober's technical interview with  
21 respect to the Bermuda shorts?

22 A Did I read the notes that were taken on it?

23 Q Yeah. Did you read the notes that you took with  
24 respect to her interview?

25 A I don't know if these are my notes, but these are

1 the notes for the record. Do you know which page it's on?

2 Q It is Exhibit 5, and it is page 0711?

3 A Okay. I see it.

4 Q Do you remember when Ms. Ober stated in the  
5 interview that, "This project was developed in  
6 SeeThruSoul?"

7 A It says in the notes here, yes.

8 Q And that was maybe just modified a little for  
9 Underground Soul; do you remember that?

10 A If it says in the notes. I don't remember the  
11 personal interview at this point.

12 Q And does it not also say that Ms. Ober stated  
13 with respect to the Bermuda shorts that, "All development  
14 money had been spent in the better divisions,"  
15 specifically with reference to SeeThruSoul?

16 A Looks like it.

17 Q Does Ms. Ober mention chemistry in her UV636N  
18 interview?

19 A In this specific style, no.

20 Q Does --

21 A She talks through the two different washes, which  
22 would allude to what Connie was talking about of the wash  
23 process that they would go to. This was based on where it  
24 is in the overall interview process. This would be one of  
25 the final styles that we discuss, and the second time I've

1 spoken with Evelyn.

2 So we would already have a good understanding on  
3 the overall process that they would go through. So when  
4 she tells me she's made about five styles and two washes  
5 to go through those, I would have an understanding that  
6 she has gone through this full process of experimentation  
7 that's shown behind me. And she doesn't need to repeat it  
8 to me every single time that we talk about a new style.

9 Q So does Exhibit 10, which is page SFI0406. Does  
10 that page mention chemistry?

11 A No. It has -- I believe this one don't have the  
12 wash listed. So it would still allude to the overall wash  
13 process that they -- that they've mentioned, that Connie  
14 mentioned before.

15 Q But it doesn't include any chemical testing or  
16 what chemicals would have been involved specifically?

17 A Not in this.

18 Q Okay. Let's move on to QRE's.

19 A Okay.

20 Q Were you present today when Ms. Nevarez stated  
21 that the pattern makers, cutters, sewers all worked on  
22 minor design changes?

23 A Yes.

24 Q Did you interview any pattern makers in  
25 December of 2012?

1           A    I believe so.

2           Q    Are any of them listed on Exhibit 6, SFI0727?

3           A    They are not. However, what happened after we  
4 sent this list was the client -- or excuse me. The  
5 taxpayer had to make adjustments based on who was still at  
6 the company, and gave us -- guided us to other people who  
7 could provide us additional information. This was our  
8 initial listing. But I don't know that this was the final  
9 list of the people that ultimately were interviewed.

10          Q    Do you know if that document was ever provided to  
11 the Franchise Tax Board?

12          A    I don't know. I would assume so.

13          Q    So could you remind me of the -- so of the  
14 114,403 projects for the 2007 to 2011 credit study years,  
15 how many did Swat-Fame exclude as duplicate or minor  
16 design changes? Do you recall that?

17          A    Whatever that math is.

18          Q    About 78,214 to be correct?

19          A    Okay.

20          Q    To be exact, sorry.

21          A    Okay.

22          Q    So these minor design changes amounted to  
23 two-thirds of Appellants' projects; correct?

24          A    But like I mentioned, the way the data came over,  
25 there would be duplicate style numbers listed in there

1 from the way that they are extracting it out of the  
2 system. So it's not saying that a 114,000 line items  
3 would represent qualified activities.

4 Q So despite excluding two-thirds of these projects  
5 that the taxpayer Swat-Fame selected -- so I'm sorry.

6 So if these people only worked on a universe of  
7 one-third of this -- only worked on about one-third of  
8 this universe of projects, okay. Can you explain why  
9 alliantgroup included the pattern makers', cutters', and  
10 sewers' wages at 100 percent?

11 A So for how we give them 114,000 to 36,000 is  
12 figuring out how the client is tracking the information,  
13 their different style number. So 114,000 line items came  
14 through to us from the way they extracted the data within  
15 the style numbers, but they could be just duplicate line  
16 items within that that need to be removed.

17 We get to the 36,000 projects, and I know Connie  
18 mentioned briefly that there were some -- where they're  
19 working on some minor revisions. However, it's not a  
20 substantial part of their time. It's -- it's a pattern  
21 maker isn't going to be spending significant time or any,  
22 you know, really making minor adjustment to a computer  
23 system.

24 Q But I think -- well -- but if Ms. Nevarez stated  
25 that the pattern makers, cutters, and sewers all worked on

1 minor changes, and these minor design changes were  
2 excluded prior to alliantgroup, you know, performing its  
3 statistical analyses on the 36,000 remaining projects,  
4 wouldn't that mean that you decided that all day, every  
5 day, the pattern makers, cutters, and sewers were  
6 performing qualified services if you've claimed their  
7 wages at 100 percent?

8 A Yes.

9 Q But if we already know that they are -- well,  
10 let's move on here. Could you tell me the percent you  
11 claimed for the spec writer employees?

12 A Let me reference Exhibit 3. That would have the  
13 percentages in there. On page SFI0375 in Exhibit 3, it's  
14 about -- it looks like 95 percent.

15 Q 95 percent?

16 A Yes.

17 Q Okay. So do you know -- I'm sorry. Referring to  
18 that same page, could you tell me the percent you claimed  
19 qualified for marking and grading employees? Is it about  
20 90 percent?

21 A Yes.

22 Q Okay. And could you tell me the percentage of  
23 claimed -- the percent you claimed qualified for the  
24 associate designers and preproduction employees? Is that  
25 about 80 percent?

1 A Associate designers.

2 Q Associate designers and preproduction employees.

3 A No. The associate designers varied. They range  
4 from -- it looks like 60 to 80 percent. So that would be  
5 analyzing their different brands and what their focus was  
6 from the different products that they developed and  
7 talking through their roles and responsibilities.

8 Q Are you referring to the -- the -- sorry --  
9 associate designers as opposed to the --

10 A Oh, excuse me.

11 Q -- designers. Sorry. I think the --

12 A Associate designers are 60 to 80. Designers also  
13 60 to 80. So page 0361 shows that all but one of the  
14 designers were taken at 60 percent for these years.

15 Q So again if two-thirds of the 114,000 projects  
16 related to activity that the taxpayers themselves  
17 eliminated as not qualified before alliantgroup even got  
18 involved, how do we justify anything more than one-third  
19 of those wages, even in the most favorable light to the  
20 taxpayer?

21 A The listing, that is the potential list of  
22 qualified research activities by the company is the  
23 36,000. That's how we narrowed it down through  
24 conversations with them, talking through the overall  
25 tracking system and the line items. It's not the 114,000

1 that were potentially qualified activities.

2 Q Okay. We'll move on. So you stated on direct  
3 that the -- you applied the shrinking back with respect to  
4 employees' time on a per-person basis; correct?

5 A Yes.

6 Q But you didn't apply -- so does that mean that  
7 you did not apply the shrinking back rule to specific  
8 research activity?

9 A So what do you mean?

10 Q I mean, with respect to the 60 projects that are  
11 the sample size, did you apply the shrinking back rule to  
12 the activities that are described in those 60 sample  
13 projects?

14 A So we used the rescaling factor from the  
15 statistical sample to determine -- to shrink back the  
16 cost.

17 Q Could you define the shrinking back rule?

18 A So shrinking back is looking at -- from a  
19 business component. You're looking at the business  
20 component qualify overall. And then as you shrink back  
21 the cost -- if it does not, then you need to shrink back  
22 to where -- where the actual cost of experimentation,  
23 where you can meet the four-part test within that business  
24 component.

25 Q So would you agree that the shrinking back rule



1 applies to research activity under Section 41(d)?

2 A Yes.

3 Q Okay. But you stated on direct that you didn't  
4 apply the shrinking back rule to the 60 projects on the  
5 sample. You applied it to employees' time. Isn't  
6 employees under -- taken under IRC41(b)?

7 A So it would be -- you would be double hitting the  
8 client or the taxpayer from a methodology because the  
9 percentages are accounting for what their work is  
10 happening on the projects. .

11 Q Which you've already stated that the percentages  
12 were developed prior to even analyzing anything for  
13 qualified research?

14 A Correct. But then the statistical sampling is --  
15 is used and allowed to substantiate the activities under  
16 Revenue Procedure 201142, which then has the rescaling  
17 factor to account for -- account for projects that do not  
18 qualify.

19 Q Okay. Almost out of time here. You stated that  
20 only Mr. Greenberg as an executive. Was -- only  
21 Mr. Greenberg's wages of the executives were allocated?

22 A Yes.

23 Q Is Mr. Quaranta allocated in the credit?

24 A No.

25 Q No?

1           A    I don't -- am I wrong? I do not believe so.  
2       Where is --  
3           Q    Like in 2000 -- so page 17 perhaps.  
4           A    17?  
5           Q    SFI17, which is that.  
6           ADMINISTRATIVE LAW JUDGE THOMPSON: I see  
7       Exhibit 11.  
8           THE WITNESS: Yeah. That's what I have.  
9           MR. RILEY: So page 3 -- I'm sorry. Exhibit 3 at  
10       page 03074.  
11          MR. DIES: It's page 59 of 66 of the credit  
12       study.  
13          THE WITNESS: Okay. Sorry. I apologize. Yes,  
14       he was at five percent.  
15       BY MR. RILEY:  
16          Q    What about the vice president of sales?  
17          A    Yes, they were included.  
18          Q    Okay. And Mr. -- okay. I think that's all.  
19       Thank you.  
20          ADMINISTRATIVE LAW JUDGE VASSIGH: Thank you.  
21       Quick question for Appellants' representatives. Will you  
22       have any further questions for this witness?  
23          MR DIES: Just a couple.  
24          ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. It is  
25       3:35. Why don't we take a ten-minute break. And then

1 we'll have time.

2 (There was a pause in the proceeding.)

3 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. We're  
4 back on the record in the Swat-Fame case.

5 Mr. Dies you indicated you had some questions  
6 for this witness.

7 MR. DIES: I'm not going to redirect. I think  
8 Mr. Suggs is going to, but yes, ma'am. We just had a few  
9 more.

10 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. Go  
11 ahead.

12 ADMINISTRATIVE LAW JUDGE THOMPSON: I have a  
13 couple of questions for the witness. I thought I would  
14 ask them before redirect.

15 Could you talk a little more about the initial  
16 cut of the duplicate projects, and what was going on and  
17 why? I mean, were these actual projects that were similar  
18 to the projects that you thought were so similar,  
19 shouldn't be included? Or were literally duplicate spread  
20 sheet entries for the same project that you were removing  
21 or is it some mix? Can you just explain that a little so  
22 I understand what came out?

23 THE WITNESS: It would be a mix of both. So the  
24 way the client had extracted the data would have this  
25 duplicate lines items in it, which would look like

1 duplicate projects because you're gonna have the same  
2 exact style number, the same exact style name in there.

3 And then, additionally, you would have similar  
4 style names, which would, like, be indicative of a similar  
5 project or duplicate project. I don't remember the makeup  
6 of percentage wise what would have been an error in the  
7 information or were just duplicate information based on  
8 how they provided the report, versus what would be  
9 duplicate styles.

10 ADMINISTRATIVE LAW JUDGE THOMPSON: Okay. Then  
11 how did alliantgroup determine or make sure that cost  
12 associated were actual duplicate projects? I suppose  
13 duplicate style entries were not included when the scale  
14 back calculation were performed?

15 THE WITNESS: So it would be a couple of  
16 different ways using the employee interviews. So talking  
17 through their overall roles and responsibilities of the  
18 people and their different job titles. So having  
19 percentages of time associated with that as well as the  
20 rescaling factor from the statistical sample then as the  
21 additional haircut on top of the total qualified research  
22 expenses. So we talk about the 85 -- 85 percent after  
23 we've already done the initial interviews.

24 ADMINISTRATIVE LAW JUDGE THOMPSON: And where  
25 85 percent applies to the whole universe, including

1       duplicates?

2               THE WITNESS:   So if you -- Exhibit 14, page 17 of  
3       that is a good way to show you how it works.   So you'll  
4       see it lists employee name, job title, department, state,  
5       percentage, total gross salary by tax year, and then the  
6       QRE's by tax year.   And we've got -- this one shows tax  
7       year 2010 and tax year 2011.

8               So in this -- it looks like this page or this  
9       exhibit only shows the qualified employees.   And it  
10      doesn't give you the entire total population of all the  
11      employees at the company.   But you would see at the bottom  
12      of that page 17, you've got the \$5,176,555.   That would be  
13      the total qualified research expenses before any  
14      statistical sampling adjustment is made there.

15              And then you see the 85.16 percent.   That's your  
16      sample, the re-scale factor that we'd get from  
17      Dr. Goldwasser.   So based on the total number of projects  
18      that qualify from the statistical sample, that then is  
19      utilized after the project qualification phase and  
20      multiplied by the \$5 million number there to result in  
21      \$4,427,617.

22              ADMINISTRATIVE LAW JUDGE THOMPSON:   Okay.   So for  
23      example, looking at this, the pattern maker and a sample  
24      sewer say --

25              MR. DIES:   Real quick, and I don't mean to cut

1       you off, but if we're going to talk about wages we might  
2       need to speak with the client about who can hear what  
3       about wages if we're going to talk about specific numbers.  
4       If we need to, that's okay. I just don't want any  
5       embarrassing situation.

6               ADMINISTRATIVE LAW JUDGE THOMPSON: Yeah, I'm not  
7       going to talk about specifics.

8               MR. DIES: Oh, okay. Well --

9               THE WITNESS: With job titles too.

10              MR. DIES: Names, job titles, or salaries could  
11       be a challenge to share.

12                       (Multiple crosstalk.)

13              MR. DIES: Okay. I'm sorry. I don't want an  
14       awkward moment.

15              ADMINISTRATIVE LAW JUDGE THOMPSON: So if we look  
16       at this column of percentage, anywhere we see 100 percent,  
17       is it right that the alliantgroup said none of those  
18       100 percents is included in the duplicate project --  
19       expenses, I believe -- duplicate projects that were thrown  
20       out?

21              THE WITNESS: Yes. And the way the calculation  
22       overall works, so anyone with 80 percent or more  
23       allocation on either of these pages, would be capturing  
24       100 percent of their wages under rule Section 41.

25              ADMINISTRATIVE LAW JUDGE THOMPSON: But you're

1 saying -- but -- so if we have a person -- I'm going to  
2 take a person. I'm not going to say the name, but third  
3 up from the bottom. So looking at this chart, the  
4 implication is that that person, alliantgroup felt  
5 confident, did not work on any of the duplicate projects?

6 THE WITNESS: Yes, correct.

7 ADMINISTRATIVE LAW JUDGE THOMPSON: And that was  
8 determined by the interviews?

9 THE WITNESS: Correct.

10 ADMINISTRATIVE LAW JUDGE THOMPSON: Okay. And  
11 then look at Exhibit 15.

12 THE WITNESS: Okay.

13 ADMINISTRATIVE LAW JUDGE THOMPSON: So I guess  
14 the same question about marking and grading supplies are  
15 at 100 percent and display trim is 100 percent?

16 THE WITNESS: Yes.

17 ADMINISTRATIVE LAW JUDGE THOMPSON: So how did  
18 alliantgroup ensure that those 100 percent figures did not  
19 include duplicate projects that were thrown out?

20 THE WITNESS: So through conversations with the  
21 client determining what the overall materials were, what  
22 the overall cost were, they identified that these would be  
23 the cost that would be used for the new products.

24 ADMINISTRATIVE LAW JUDGE THOMPSON: That's all I  
25 have. I appreciate it.

1 MR. ROUSE: Judge, may I clarify based on your  
2 questioning?

3 ADMINISTRATIVE LAW JUDGE THOMPSON: Sure.

4 BY MR. ROUSE:

5 Q So you said based on the interviews, you  
6 determined that the employees that were claiming a  
7 100 percent did not work on any of duplicate projects?

8 A Yes.

9 Q And they also did not work on any of the minor  
10 design change projects that were excluded?

11 A Yes.

12 Q And what was said in those interviews or asked in  
13 those interviews that gave you that comfort level?

14 A Talking through roles and responsibilities of --  
15 of what those individuals were doing.

16 Q So they were able to remember specific  
17 projects -- duplicate projects they didn't work on?

18 MR. SUGGS: So, Your Honor, is this a new line of  
19 questioning for the witness?

20 MR. ROUSE: It's not a new line. I'm just  
21 following -- I had pertinent understanding based on a  
22 previous testimony, but I think different now that  
23 Judge Thompson clarified it.

24 ADMINISTRATIVE LAW JUDGE VASSIGH: I'll allow it.

25 THE WITNESS: So can you say -- repeat the



1 question?

2 BY MR. ROUSE:

3 Q What you're saying is the employees that were  
4 taken at 100 percent, based on the interviews, you were  
5 able to tell that those employees did not work on any of  
6 the duplicate projects; right?

7 A Yes.

8 Q And also did not work on any of the, quote,  
9 unquote, "minor design change projects that were also  
10 excluded;" right?

11 A Yes. So for example, a pattern maker, if there's  
12 going to be a revision it's likely they're going to be  
13 dealing with the major design changes. If the pattern has  
14 to be revised, it's going to take significant work and  
15 have a significant impact. And that's why they would get  
16 back involved into it.

17 Q And what was it that gave you your comfort  
18 level -- what were these employees able to say to you to  
19 give you a comfort level that they had not worked on  
20 duplicate projects? Did they remember? Did you give them  
21 a project number and say, hey, project TY342. Oh, I  
22 remember that. How did it happen?

23 A Through discussing roles and responsibilities.  
24 If they had -- if they were involved in projects where  
25 there would be minor design revisions, I believe, would be

1 part of the question that we would go through.

2 Q I mean, I'm talking about the duplicates.

3 A Oh, the dupe -- well, the duplicates. So we  
4 would talk through the roles and responsibilities of who  
5 would be handling the duplicates.

6 MR. DIES: Can I ask a question since we're doing  
7 this a little bit differently. May I ask the context?

8 Assume I'm a pattern maker --

9 THE WITNESS: Okay.

10

11 REDIRECT EXAMINATION

12 BY MR. DIES:

13 Q And I have a duplicate issue. He was the pattern  
14 maker who made the first one and duplicate. If I'm a  
15 pattern maker, do I need to make another pattern for the  
16 duplicate?

17 A No. They're gonna go and pull the old pattern.

18 MR. ROUSE: But he would need to remember that  
19 project; right?

20 BY MR. DIES:

21 Q Well, if we know, then the pattern maker cannot  
22 work on a duplicate project because they already have the  
23 pattern. By definition, every pattern maker's duplicate  
24 project wouldn't involve any of their time because it's a  
25 duplicate?

1           A     Correct. With how much Swat-Fame needs to  
2     produce on a given annual basis, they're not going to want  
3     to waste anybody's time by recreating the wheel on  
4     something they've already got or already have in-house.  
5     They're just going to take -- they're going to that  
6     pattern from a previous design and create an initial  
7     sample with it.

8           It then may -- they take that initial pattern  
9     from a previous design but then use a different material.  
10    But they'll use that first pattern to test it and see how  
11    does that material perform and react and function relative  
12    to the first product that was made.

13           That can then trigger additional revisions to the  
14    pattern -- the original pattern they started with. But  
15    then it's going to be improvements that's being made on  
16    the way to achieve the functionality and performance  
17    requirements that they have because the fabric is behaving  
18    and performing differently than the first one.

19           So now they need to go to the iterative process  
20    that's behind me to -- to then determine what the overall  
21    pattern and dimensions and specifications needs to be for  
22    that given product.

23           Q     Really quick on some of these 100 percents. You  
24    mentioned that they call this the Substantially All Rule?

25           A     Yes.

1 Q Tell me what that means?

2 A So when an employee is spending 80 percent or  
3 more of their activity, the Section 41 allows you take 100  
4 percent of their wages.

5 Q So if hypothetically a pattern maker spend  
6 15 percent of their time making minor changes -- minor  
7 design changes and 85 percent of their time creating new  
8 patterns and retooling a product, what would the number  
9 for that person be?

10 A 100 percent of their wages.

11 Q Why?

12 A Because the Substantially All Rule would take --  
13 would allow you to say, okay. 85 percent of their work is  
14 qualified. So you still capture 100 percent of their  
15 wages for them.

16 ADMINISTRATIVE LAW JUDGE THOMPSON: Could you use  
17 two Substantially All test?

18 MR. DIES: Yes.

19 THE WITNESS: Yes.

20 ADMINISTRATIVE LAW JUDGE THOMPSON: So you're  
21 talking about the Wages Substantially Test?

22 THE WITNESS: Yes.

23 MR. RILEY: If you will allow me one question.

24 ADMINISTRATIVE LAW JUDGE VASSIGH: I will allow  
25 you one question.

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1 THE WITNESS: That's before. So we would be  
2 talking through the employees' roles, responsibilities,  
3 day-to-day activities, talking through do you touch  
4 duplicate projects. And duplicate projects, these groups  
5 would not be touching those. So we would have the  
6 100 percent there. The way the calculation model would  
7 have formulas built into this the Substantially All Rule  
8 mathematically applied, and not at that total qualified  
9 research expenses column.

10 ADMINISTRATIVE LAW JUDGE THOMPSON: Thank you.

11 ADMINISTRATIVE LAW JUDGE VASSIGH: Do Appellants'  
12 representatives have any more questions for this witness?

13 MR. SUGGS: I think we covered it. Thank you.

14 MR. DIES: We were going to ask real quick. As a  
15 courtesy, Mrs. Speice has a brand new baby. Can we  
16 release her to go try and catch a flight?

17 ADMINISTRATIVE LAW JUDGE VASSIGH: Yes.

18 THE WITNESS: Thank you. I appreciate it.

19 ADMINISTRATIVE LAW JUDGE VASSIGH: And thank you  
20 so much for your participation. Congratulations.

21 THE WITNESS: Thank you.

22 ADMINISTRATIVE LAW JUDGE VASSIGH: I want to see  
23 if my co-panels have any questions for the parties or any  
24 other business?

25 ADMINISTRATIVE LAW JUDGE THOMPSON: No.

1 ADMINISTRATIVE LAW JUDGE VASSIGH: Judge Geary?  
2 ADMINISTRATIVE LAW JUDGE GEARY: No.  
3 ADMINISTRATIVE LAW JUDGE VASSIGH: No. Thank  
4 you. Okay. We're at 4:00 o'clock. Congratulations.  
5 We've done a good job. So thank you, everyone. We really  
6 hit those time allotments really well.  
7 So parties may now provide closing statements.  
8 Please tell us why you should prevail based on the  
9 evidence provided in this hearing. Each party will have  
10 15 minutes to do so. And Appellants' will then have 5  
11 minutes to respond to anything raised by Respondents in  
12 their closing.  
13 Do parties have any questions before we move onto  
14 closing?  
15 MR. DIES: I just have one, Your Honors.  
16 ADMINISTRATIVE LAW JUDGE VASSIGH: Yes.  
17 MR DIES: You had mentioned post-trial briefing,  
18 particularly on calculations and what to do with this  
19 thing. I'm happy to close if it helps summarize that  
20 information. I'm also happy to put that position in  
21 writing or/and do both. I would ask though that we be  
22 given the opportunity to do a post-hearing brief to lay  
23 some of these complex calculation issues out. Flying  
24 through in that 15 minutes is probably not going to get us  
25 there.

1 ADMINISTRATIVE LAW JUDGE VASSIGH: What do  
2 Respondents think about that?

3 MS. KUDUK: Well, my thought is that we had that  
4 opportunity when you asked both parties to clarify what  
5 percentages and why, and that was in your response order  
6 that we submitted and worked very hard on. I think it was  
7 dated November 30th, 2018. So I feel like we've had that  
8 opportunity.

9 We're open to have it -- we're open to  
10 Appellants' thoughts, but we've already, you know, worked  
11 very hard make sure we made a deadline.

12 ADMINISTRATIVE LAW JUDGE VASSIGH: So the panel  
13 discussed this, and we're inclined to close the record  
14 today subject to further briefing. We would like to take  
15 a chance to get the transcript from our stenographer, look  
16 at the record, look at the evidence again, and we  
17 anticipate that we might have questions.

18 MR. DIES. Sure. So you'll tell us if you need  
19 briefing?

20 ADMINISTRATIVE LAW JUDGE VASSIGH: Yes, we will.

21 MR. DIES: If and then we'll do it, and we're  
22 happy to do that.

23 ADMINISTRATIVE LAW JUDGE VASSIGH: And it will  
24 not be over the holidays.

25 MR. DIES: Okay. Thank you very, very much for



1 that. The only thing that I would say on this issue is we  
2 did walk in here with the belief that we had a method for  
3 adjustment. And so to the extent you've receive some  
4 briefing from us, I was operating from that understanding.

5 I don't know that you yet have a rubric for what  
6 to do if you qualify a percentage of these projects, and  
7 then want to do a deeper dive into, you know, a duplicate  
8 issue or a wage issue from a particular class of employee  
9 or and adjustment that was made from the stat sampling.

10 No one has provided you that metric. And the  
11 reason we didn't provide it was because we didn't believe  
12 it necessary. We thought we already had a methodology.  
13 It was sort of agreed. So that's -- just to be clear  
14 that's why we would like to brief this and say what should  
15 be done, but we'll defer to you guys. You tell us what  
16 you want and we'll follow the lead.

17 ADMINISTRATIVE LAW JUDGE VASSIGH: Great.  
18 Appellants, whenever you're ready.

19

20 CLOSING STATEMENT

21 MR. DIES: Your Honors, thank you for your time  
22 today. You have listened to us. You've been attentive.  
23 You've asked questions, and you've let us know that you  
24 care to give this taxpayer a voice, which is very  
25 important to us, not just as their representatives, but to

1       them as a company.

2               It's been many years since we first claimed this  
3       benefit. It's been many years since we've seen any  
4       benefit going through this process, and we look forward to  
5       finding a complete and final outcome for these folks.

6               This morning when I started with you, we talked  
7       about the idea that manufacturing is a difficult thing.  
8       Manufacturing, precisely, is even more difficult.  
9       Manufacturing when you're changing the building blocks is  
10      even more difficult. And then scaling that manufacturing  
11      to make 10,000 or 20,000 or 30,000 of a unit is incredibly  
12      difficult. When you add to that short time frames, which  
13      become shorter when a client says, "But I'd like it this  
14      way." You really put an incredible demand on  
15      manufacturing.

16              So what I'd like to do over the next few minutes  
17      is walk you through some of the testimony, walk you  
18      through some of the arguments you've seen, and walk you  
19      through some of the approach so that you have a better  
20      understanding of kind of how we attacked this and what we  
21      think the right answer is for this taxpayer.

22              I guess the first thing I would say is no one  
23      would go to Boeing and say, "Boeing, you've been making  
24      planes for 40 years. Your planes have wings on them.  
25      Your planes have cockpits on them. Your planes have tails

1 and rudders. Your planes have engines, therefore, you  
2 know how to make a plane."

3 And yet that's precisely what the State of  
4 California has done to a clothing manufacturer. They said  
5 because you haven't done something different in the past,  
6 you must not have needed a process of experimentation.  
7 You must not have encountered uncertainty. You already  
8 know how to do this. You're really good at it.

9 Ladies and gentlemen, if the test is that Boeing  
10 has to make a toaster to qualify for this credit, no one  
11 in California will ever get it. Business is intentionally  
12 focused on that which they are good at because that's how  
13 they gain the competitive advantage.

14 But I submit to you that what I told you this  
15 morning is still absolutely true, right. If we didn't  
16 have uncertainty, why wouldn't we just draw this, make  
17 this, and sell this? Why would my chart only have three  
18 areas? Why would I employ pattern makers? Why would I  
19 buy computer technology? Why would I buy dress forms?

20 Which by the way, I have a bonus daughter who  
21 just graduated. Her gift was a dress form. That thing  
22 cost me 600 bucks for one little size 8 dress form. These  
23 are incredibly expensive pieces of equipment, right.

24 And so no one would go through those processes.  
25 No one would hire a lady who takes the trouble to maintain

1 a perfect size 10, a perfect size 12, or the perfect size  
2 8 to show up every day, to give you nothing but the  
3 critical feedback about why your clothing is not working  
4 if they already knew all these outcomes.

5 The answer is we have uncertainty when we start.  
6 We have uncertainty about whether this material will work.  
7 We have an uncertainty about whether something we do in  
8 this material will fundamentally change it. You've heard  
9 about denim. I mean, I like the denim. Maybe it's  
10 imperative to start with. I want my jeans to feel like  
11 Ralph Lauren wore them for 20 years before I put them on  
12 my body. So how do I go about that?

13 I have to wash them with stones. Well, stones  
14 tear up stitches. So I have to go back and fix the  
15 stitches, right? Put acid on them. Well, I'm a pretty  
16 high allergy dude. If I have acid on my jeans, I'm  
17 probably going to catch on fire, right?

18 So I've got to make that consumer safe, and I've  
19 got to test all of these things. And if I make minor  
20 changes in that wash, or minor changes in that stitching,  
21 or minor changes in that structure, I could have  
22 unexpected outcome.

23 So what I would like to do very briefly is walk  
24 through some of the projects that we talked about today  
25 and the methodology that was used to get us there. I

1     guess the first thing I would say is you have seen now all  
2     the different ways that a minor change in fabric can  
3     affect whether a garment is functional.

4             I submit to you, ladies and gentlemen, that a  
5     garment that doesn't fit isn't functional. If I'm wearing  
6     an incredibly tight miniskirt, and I try to get out of  
7     taxicab, we're gonna have a problem. That garment is not  
8     going to function because in theory, when I put on that  
9     miniskirt, I was doing so to cover up some part of my  
10    body. If that miniskirt does not cover up that part of my  
11    body for so long as I need that part of my body to be  
12    covered up, it's not functional.

13            If I'm wearing a coat that prevents me from  
14    raising my arms, I didn't buy a coat so that I can go  
15    outside in the cold with a limited range of motion. I  
16    bought a coat so that I could go outside in the cold and  
17    be as active as I need to be.

18            Let me tell you. If I buy a coat for my kid, I  
19    need my kid to climb monkey bars. I need my kid to play a  
20    sport. I need my kid to do all things that a kid does.  
21    If that clothing limits the range of motion, it's a  
22    problem. Many little girls don't yet have hips. If I'm  
23    making a waist in a skirt that falls straight down my  
24    daughter's very straight body because she's not yet  
25    developed curves, she's going to be very embarrassed in

1 recess.

2 So a manufacturer has to take these things into  
3 consideration -- little things. Maybe a little boy can't  
4 handle a zipper, right? We have to make a product that  
5 meets all the functional requirements of our audience,  
6 taking into consideration how they're going to use it.

7 Now, let's apply some of the other principals  
8 that we talked about today to the projects that we've  
9 seen. Very often, we aren't just working with one garment  
10 or one materials. We're working with two materials.  
11 We're merging them together. They have different  
12 properties. One of them is stiff. One of them is not.

13 If we wash them and they shrink differently, we  
14 have a problem. We have an unexpected outcome. You heard  
15 that the stitches in our project that involved the ruffled  
16 skirt were very different than the Lycra pants that went  
17 with it. And if they weren't different, neither of those  
18 would perform. You would bust the stitches on the Lycra  
19 pants and the skirt wouldn't work, right?

20 This is not a function of do I think the ruffle  
21 skirt is pretty. And you've heard this over and over  
22 again; because apparel is pretty; because we buy clothes  
23 that are attractive, therefore, everything that's  
24 associated with the creation of those clothes must be a  
25 seasonal or style factor.

1           As I suggested to you earlier, once we get the  
2       concept no one else in the scheme gets a vote. The  
3       pattern makers don't get to say, "I think this is pretty."  
4       The pattern makers don't get to say, "Let's change the  
5       ruffle." The pattern makers don't get to say, "Lets make  
6       it longer or shorter," or do this or do that.

7           They have to create a vision, right. Everything  
8       that we have focused on here is the time that is spent by  
9       those who are creating a product from a two-dimensional  
10      sample. There's a very interesting question today that  
11      was asked. Are you an engineer? That was the question  
12      that was asked, you know, and I like the answer very much.

13           "Yes, we're engineering jeans on a constant  
14      basis. Jeans have a structure."

15           A very good friend of mine just finished an  
16      engineering under grad, and his final was the boning for a  
17      strapless dress. Why? Because garments have to have  
18      structure. There is engineering involved. I can't  
19      imagine the State of California is going to come before  
20      you and say, "You must have an engineering degree to  
21      qualify for this."

22           I will tell you about Eric Suiter, who I was very  
23      proud to represent. He had a math degree. He had a sales  
24      background, and he also was a self-taught inventor who had  
25      11 patents. And no one said, "Mr. Suiter, your patents

1 don't count because I don't like your degree or your  
2 background."

3 Farouk Shami was a hairdresser. Turns out he's  
4 allergic to ammonia. I don't know how many of you ladies  
5 have played with the color of your hair once or twice, but  
6 ammonia is incredibly common in hair dyes. So if I'm a  
7 hairdresser who is allergic to ammonia, when I go to apply  
8 my trade, my hands catch fire.

9 So his choices were to leave and stop applying  
10 his trade, or to come up with a solution. He was a  
11 self-taught chemist. Absolutely no academic background.  
12 But what he understood was there are probably ladies out  
13 there who also have allergies to ammonia. If I can create  
14 a product that helps those who can't work with traditional  
15 products, I may have an angle. And he built a  
16 multi-million business as a self-taught chemist.

17 These folks have the specialty to create a  
18 three-dimensional garment that moves with the wearer in  
19 predictable ways that helps them to build their brand by  
20 meeting exacting quality standard. That is R&D. There's  
21 no degree required to do it.

22 You've heard some stuff about the qualification,  
23 and there was some very interesting questions asked about  
24 how we went about gathering this information. I will tell  
25 you that in the in McFerren case, we gathered documents.



1 When I say "we," we're talking about the same provider.  
2 We're talking about the same methodology. We're talking  
3 about interviews.

4 The exact same methodology, it was blessed by the  
5 courts. In the Farouk Shami case, they interviewed  
6 witnesses. They talked to the folks who created the  
7 chemistry, and everyone but two of their witness was  
8 blessed. All of their activities were blessed at 100  
9 percent except for two witnesses.

10 And Eric Suiter's case, a young man named Harvey  
11 Winnie was on the stand for three days talking about how  
12 each person spent this percentage of time do this or that,  
13 and how this qualified and why. And the court blessed  
14 that methodology three times.

15 No court that I know of -- and I've dedicated my  
16 life to this, sad as that may be. No court has ever dealt  
17 with this methodology more than the alliantgroup  
18 methodology that's at issue in this case. And no court  
19 has ever said that that methodology is inappropriate or  
20 unsupportable. No one has ever said that there's a better  
21 one. This methodology has been vetted by two IRS  
22 commissioners and three courts. I think the numbers stand  
23 for themselves.

24 Now, let's talk for a moment about the  
25 calculation. There has been some assertions that there

1 was no shrink back. And I think you may recall Mr. Riley  
2 asked a number of questions of Mrs. Speice very near the  
3 end of this where they said, "You're not taking into  
4 account shrink back for activities."

5           Shouldn't we be shrinking back for activities?  
6 To be clear, there's a ton of shrink back on activities.  
7 How do we know that? If you look at a person's interview  
8 for wages, we're asking them what they do. The reason we  
9 have a 40 percent allocation for a particular employee is  
10 because we had vetted that 40 percent of their time is  
11 spent creating, testing, or evaluating new prototypes that  
12 have not yet been made.

13           We have shrunk back 60 percent of their time.  
14 And then on top of that, we've taken an extra haircut.  
15 One of the things that didn't come out about 2011-42 --  
16 but it's very easy to Google if you're -- if you have a  
17 question about it -- is you take a disproportionate hit if  
18 you use a statistical sample.

19           It may have occurred to you guys that we had two  
20 sampling frames where 1 in 30 projects didn't qualify.  
21 And yet, if you look at the math, there was a 15 percent  
22 adjustment. One out of 30 should have yielded a three to  
23 a third percent adjustment. But because statistical  
24 sampling already builds in a margin of error, we took an  
25 even more substantial margin of error.

1           And if you had looked at this, or if you dive  
2     into the sampling frame, which we'll see in Dr.  
3     Goldwasser's report, which is a tax review, each new error  
4     has a disproportionately high impact on the amount of  
5     dollars that can be taken.

6           So we've already shrunk back these activities.  
7     We've already dove down with these folks about how they're  
8     spending their time, and then apply a statistical sample  
9     haircut on top of that. That by definition, makes us be  
10    more conservative than we would have otherwise had to be.

11           I can't imagine the State of California is going  
12    to take the position that the better course would have  
13    been for us to have 30,000 projects. I can't imagine any  
14    manufacturer who produces that many items would have to go  
15    through that, because the cost of doing so would greatly  
16    exceed any benefit they might hope to achieve.

17           The next thing I want to talk about is this  
18    discussion of what the wages did; this 100 percent, the  
19    duplicate projects. You heard from Mrs. Speice, and I  
20    will tell you, having handled and represented many  
21    hundreds of clients over these years, I have never had a  
22    client who showed up to me and said, "I know about the R&D  
23    credit. Here are my business records, which have been  
24    created in the course of further advancing my interest in  
25    this credit. They say I keep records so I could keep the

1 door opens. Do with them what you can, and do with them  
2 what you will."

3 Swat-Fame didn't know about the R&D credit before  
4 they started claiming it. It's not that they weren't  
5 entitled to it. The reality is that in December of 2015,  
6 the Wall Street Journal said less than 90 percent of --  
7 more than 90 percent of companies who qualify for this  
8 benefit don't know about it.

9 They found out about it. They started claiming  
10 the benefit. And then we asked them for a list of  
11 projects. We said, "What are the projects that you worked  
12 on during these years?"

13 Now, they didn't have a 179 -- or a Section 41  
14 list of projects that perfectly allocates each and every  
15 new individual item. So what we had to do was we had to  
16 sort them. So it has a cool function that allows you to  
17 do that. Every time we had duplicate projects, we removed  
18 them.

19 This is not, by the way, the same thing as  
20 Mr. Riley's cross-examination which says, "You deleted a  
21 third of these, but you didn't account for it in time."

22 It's not a third new project. We had a massive  
23 number of duplicates. As to the question how could I have  
24 a pattern maker at 100 percent if duplicates were  
25 involved? I would say you looked at the work that a

1 person is doing. If I'm a pattern maker and I'm dealing  
2 with I duplicate, my job is to go get the pattern someone  
3 else made.

4 I'm not making a new pattern. There's no time  
5 involved in that, right? Now, if I am cutting or sewing  
6 something, right, and I have to make a duplicate, guess  
7 what? I'm making a new product. I am -- I am diving into  
8 that product. If you look at these allocations, something  
9 very interesting happens. You'll notice that as gross,  
10 that is of all the wages we claimed, about 23 percent of  
11 our wages were allocated toward R&D credits.

12 So despite all the work that we do, if there are  
13 some illusion that we have overreached or grabbed more  
14 than we should have, or qualified people at a higher  
15 level, I think that is a mistake. We focused on a very  
16 particular group of folks. We focused on that group of  
17 folks who creates a new product, sees it through the final  
18 vision, and gets it to a place where it can be made again.

19 I want to talk briefly about adaptation because  
20 I'm nearing the end of my time, ladies and gentlemen, to  
21 the best of my efforts.

22 The notion that I told you what happened this  
23 morning did happen. I said they won't show you a product  
24 we've made before where one of these four products is an  
25 adaptation of that. I told you they wouldn't do it, and

1 they didn't do it. There's no evidence that we took a  
2 product all the way through this process and then stole  
3 from that knowledge, claimed another product as R&D.

4 It doesn't exist now. It didn't exist five years  
5 ago when we first claimed the benefit. Throughout audit,  
6 throughout settlement bureau, throughout the illustrious  
7 journey we've spent, that has never come up not one time.

8 I will also tell you this. You have it easy out  
9 here when it comes to adaptation. So when the R&D credit  
10 was first created, there was apparent contradiction. You  
11 may notice that to qualify for this benefit, you have to  
12 have new or improved business component.

13 By definition, an improved business component is  
14 improvement on something that you already make. There  
15 were also two exclusions that were kind of confusing. One  
16 was research after commercial production. Well, if I'm  
17 improving a business component, by definition I'm doing  
18 research after commercial production. Adaptation, if I'm  
19 adapting a business component, by definition I'm adjusting  
20 something that is already made and has already followed  
21 this process.

22 And so practitioners around the world went crazy  
23 and said, "You're asking us to apply a standard which is  
24 internally contradictory." The thing called TB8930 came  
25 out, which said this, if you follow the four-part test on

1 the new business component, adaptation, research after  
2 commercial production, modification, and duplication,  
3 don't apply. Otherwise, we are being internally  
4 contradictory.

5 So we beat the junk out of these three boards  
6 today, ladies and gentlemen. The 12 parts, which area are  
7 we on? Scott drew this illustrious roadmap of a  
8 particular project to show you how many times we went back  
9 to the drawing board. And what you heard is every time we  
10 make a new style, we follow this process.

11 So if for a moment, in the wee hours of this  
12 evening, you might be thinking for a second, we might have  
13 adapted a project. The adaptation exclusion would still  
14 not apply because we followed this process for every  
15 single new style. That testimony has been uncontroverted.

16 There's been no evidence that we don't follow  
17 this process. There's been no evidence that we don't  
18 encounter uncertainty. There's been no evidence that when  
19 we start our work, we don't know how we're going to do it.  
20 In fact, you saw several examples of failures. We don't  
21 know the methods we're going to use, and we don't know the  
22 ultimate design.

23 You heard about the three kinds of modeling I  
24 told you about, which were computer modeling, systematic  
25 trial and error to manipulate the patterns, static

1 modeling on the dress forms. We're seeing if this thing  
2 sits right and fits the body, and finally dynamic  
3 modeling.

4 We have a process of experimentation where we're  
5 testing these garments as we make them, forming them over  
6 time. And that's how we overcome the State's allegation  
7 that we didn't have uncertainty, that we didn't have a  
8 process of experimentation.

9 In terms of documentation in evidence, there are  
10 hundreds of pages in the records before you, the records  
11 that we introduced and underlined in the exam. There are  
12 tax years. They trace this, right. These are the records  
13 that companies like this keep. There is no specific  
14 documentation requirement in California or in the fed.

15 It is merely that you keep reasonable records.  
16 So we took these records. We gathered the information.  
17 We asked questions. We calculated this credit to the best  
18 of our ability. We think it's reasonable. We think in  
19 the four projects that you've heard about, there have been  
20 examples of each of the kind of challenges that we're  
21 facing in doing so.

22 And so for that reason, we would ask that you  
23 honor this claim for credit and award them the research  
24 benefit that they've requested. Thank you for your  
25 attention, ladies and gentlemen, and I look forward to



1 hearing what the State has to say.

2 ADMINISTRATIVE LAW JUDGE VASSIGH: Respondents,  
3 please begin when you're ready.

4

5 CLOSING STATEMENT

6 MS. KUDUK: Okay. Appellants spent a lot of time  
7 describing a development cycle, but what they did not  
8 discuss was a scientific process. The key question in  
9 this appeal is where is the science? Taxpayers do not  
10 qualify for the California Research Credit for any  
11 activity. Taxpayers only qualify for the credit for  
12 qualified research, a term defined by Internal Revenue  
13 Code Section 41.

14 To be qualified research the activity must be for  
15 permitted purpose. Certain purposes are not qualified.  
16 That is purposes related to style, taste, cosmetics, or  
17 seasonal design factors. The activity must pass a  
18 four-part test; the business component test, the Section  
19 174 test, which analyzes uncertainty, and most importantly  
20 here, the technological and nature test, and the process  
21 of experimentation test.

22 However, even if the activity passes the  
23 four-part test, the same activity is excluded from the  
24 credit if the taxpayer adapts or duplicates an existing  
25 business component. Congress added the process of

1 experimentation test to Section 41 because it was  
2 concerned that taxpayers were claiming the credit for  
3 virtually any expense related to product development.

4 Congress intended to exclude activities in which  
5 a taxpayer has not undertaken experimentation in the  
6 scientific or laboratory sense. Further, Congress didn't  
7 want certain activities, those relating to style, to get  
8 the credits. So Congress excluded them right in the  
9 statute.

10 The documents and testimony today show that  
11 Swat-Fame's activity is not for permitted purpose because  
12 it relates to style, such as the number of ruffles on a  
13 skirt that have no function but style, cosmetic, or  
14 seasonal factors. In fact, Mr. Greenberg said, "Meeting a  
15 deadline for season designs is so crucial that it could  
16 put a company out of business."

17 Swat-Fame's activity is like example one in  
18 Treasury Regulation Section 1.414(a)(8), changing a color  
19 of a product was not qualified research. Because that  
20 change relate to style, taste, cosmetic or seasonal design  
21 factors. Like the company in the example, Swat-Fame's  
22 activity was not for permitted purpose making Swat-Fame  
23 ineligible for the credit.

24 We can look to case law where a similar case held  
25 that changing the look and the feel of the product through

1 color, shape, or size does not change the function and was  
2 not a permitted purpose. Adjusting color, shape, or size  
3 is not qualified research. That's what Swat-Fame did in  
4 these project. They adjusted color, shape, and size of  
5 the garment.

6 For example, Mr. Greenberg said that in project  
7 D11072, the spaghetti strap dress, Appellants reengineered  
8 the top of the dress, but kept the bottom of dress that  
9 was made from a previous project. Based on documentation,  
10 Swat-Fame's activity relates to style, taste, cosmetic, or  
11 seasonal design and is not qualified research.

12 Under the law, Appellants do not get the credit  
13 just from that observation, but that's not all.  
14 Appellants have not substantiated that Swat-Fame met any  
15 of the test found in Section 41(d)(1). In fact  
16 Swat-Fame's activity failed each test. That is the second  
17 reason that Appellants are not eligible for the credit.

18 Under the law, a taxpayer must identify exactly  
19 what business component is associated with qualified  
20 research. Appellants have not identified a business  
21 component for each of the four projects. According to  
22 bear, Appellants are not entitled to the claimed credit.

23 Mrs. Speice had talked about the shrinking back  
24 rule, but there's no documentation that Appellants shrank  
25 back the projects. Appellants have identified their

1 business component as each garment, rather than a  
2 particular part of the garment. Appellants have not  
3 applied the shrinking back rule.

4 And Appellants' documentation is so inadequate,  
5 we cannot apply the shrinking back rule. Appellants bear  
6 the burden of showing that their activity, with respect to  
7 each garment as a whole, satisfies Section 41(d)(1) under  
8 the all-or-nothing rule Trinity decision, credit must be  
9 denied.

10 And Mr. Greenberg has also stated that aspects of  
11 the design are credit research, but the conceptualization  
12 of the products is not research. We do not know what part  
13 the activity was spent on the conceptualization of the  
14 garment and what was spent afterwards. Swat-Fame's  
15 activities failed the business component because Swat-Fame  
16 did not develop a new or improved business component.

17 In fact, Ms. Nevarez said that a related project  
18 could be a first sample in the development process, or  
19 Mr. Greenberg stated a related style refers to a previous  
20 style with one or more details that is similar to this  
21 project.

22 It is Appellants' burden to tell us what their  
23 business component is, and they haven't done it. And we  
24 don't know if it's a related style, or if it's a  
25 competitor's style. With respect to the Bermuda shorts,

1 Swat-Fame took a best seller from the SeeThruSoul line and  
2 used it in the Underground Soul line, adapting,  
3 duplicating a previous garment.

4 Two projects were similar to the leggings ruffle  
5 skirt project Z1679 and Z1693. The previously  
6 acknowledged spaghetti strap dress, project D1107, has a  
7 related style. And Mr. Greenberg said this is a dress  
8 where they reengineered the top but kept the bottom from a  
9 previous style. Further, the spaghetti straps on the  
10 dress were send outs, which means Swat-Fame did not make  
11 the straps. They just attached them.

12 Mr. Greenberg said the company had worked on the  
13 spaghetti straps -- these types of spaghetti straps in  
14 previous projects with a heavier cloth before. Project  
15 M93771, the cotton sundress shrug, is similar to projects  
16 M64201 and S10171. Appellants have never testified as how  
17 the projects differed from these related styles.

18 Since Appellants have not identified their  
19 discrete business component, Appellants have not proven  
20 that these projects were not adaptations or duplications  
21 of other projects, and they were excluded from the credit.

22 Under the Section 174 Test, the law requires  
23 uncertainty in the experimental or laboratory sense.  
24 Swat-Fame's activity did pass the Section 174 Test because  
25 Swat-Fame did not have the type of uncertainty needed to

1 pass the test.

2 Treasury Regulation said uncertainty exist only  
3 if the information available to the taxpayer does  
4 establish the capability or method for developing or  
5 improving the business component or the appropriate design  
6 of the business component.

7 Appellants know the appropriate design at the  
8 outset, because as we have heard today they took the  
9 design either from a previous project, sometimes from a  
10 competitor, and other times took half of the project from  
11 one previous design and then modified it for this design.

12 What Swat-Fame said is it had uncertainty about  
13 the optimal design of the four garments. The use of the  
14 word "optimal" indicates not if the garment can be  
15 produced, but what is the best manner in which it can be  
16 produced.

17 Swat-Fame's own experience in producing similar  
18 garments provided the method to develop the garments. As  
19 I've said before in relationship to the spaghetti strap  
20 dress, the company has worked with spaghetti straps with  
21 heavier cloth before. Swat-Fame did not have uncertainty  
22 in the experimental laboratory sense.

23 The evidence demonstrates that Swat-Fame was  
24 uncertain as to whether they could make a garment.

25 Swat-Fame failed the Section 174 Test because this type of

1       uncertainty did not meet the test. Appellants have used  
2       the words like "the principals of chemistry," "structural  
3       engineering," and "material science." But it is clear  
4       from documents and testimony that Swat-Fame did not  
5       employee these principals.

6               For example, Ms. Nevarez stated about the  
7       washhouses who performed the wash testing, "We don't tell  
8       them what to do." Swat-Fame employs no chemist and no  
9       engineers. They make no chemical experiments. They've  
10      made no engineering calculations. And choosing the  
11      particular fabric to use in a dress does not seem to be a  
12      material science.

13             The law requires the taxpayer to fundamentally  
14      rely on the principles of physical or biological science,  
15      engineering, or computer science. The word fundamentally  
16      means at its core, the activity must rely on hard science.  
17      Using chemicals to wash clothes does not equal a  
18      fundamental reliance on science.

19             Swat-Fame failed the technological and nature  
20      test because the information Swat-Fame thought to discover  
21      was not technological in nature. It did not fundamentally  
22      rely on chemistry. Using computers does not fundamentally  
23      rely on computer science.

24             Figuring out the amount of material needed to  
25      construct Bermuda shorts or adding or subtracting ruffles

1 on a dress, the location of a spaghetti strap on a dress,  
2 and how much pleating is needed in a shirt to make it lay  
3 flat does not rely on the principles of biological  
4 sciences, engineering, or computer sciences.

5 They do not fundamentally rely on those  
6 principals, therefore, Swat-Fame is not eligible for the  
7 credit. Again, what Appellant showed us in the video was  
8 a developmental cycle not a process of experimentation.  
9 To pass the process of experimentation test, Appellants  
10 must show that 80 percent of the activity must constitute  
11 elements of a process of experimentation for permitted  
12 purpose; meaning related to a new or improved function,  
13 performance, reliability, or quality.

14 Appellants have not proven substantially all of  
15 their activities was a process of experimentation.  
16 Mr. Greenberg said that the past, the conceptual  
17 initial -- that past conceptualization phase, everything  
18 else is function.

19 However, we don't know the amount of time spent  
20 on the conceptualization phase. We don't know the amount  
21 of time that was spent on the other phases. Mr. Greenberg  
22 said that some products were produced in a factory  
23 overseas. We don't know what percentage of that activity  
24 that is, and there is no indication that the conceptual  
25 phase was carved out in the credit study.



1 Further, Appellants have not provided no  
2 documentation to show Swat-Fame met the elements of the  
3 process of experimentation as I have said. Appellants  
4 have not shown that substantially, all of their activities  
5 were process of experimentation.

6 Appellants have no documentation proving --  
7 showing they performed scientific experiments. CAD  
8 drawing is not experimentation. Modeling, per se, is not  
9 experimentation. CAD is using a computer to make a  
10 drawing. The use of a computer in itself does not  
11 establish that research has been undertaken.

12 Shami tells us that Appellants must provide  
13 documentation that demonstrates qualified research to  
14 claim the credit. The documentation Appellants provided  
15 did not show qualified research. Again, we don't know  
16 what percentage is preproduction, production,  
17 conceptualization, performance testing.

18 And Appellants have said that they sent out  
19 multiple parts of these projects to third parties. We  
20 don't know what percentage of this activity was done by a  
21 third party. Appellants have not given us the type of  
22 research documentation that Fudim gave us. Taxpayers  
23 provide scientific letters, journals, publication, and  
24 patents.

25 And Union Carbide, there were e-mail

1 communications, lab data, notes, monthly reports in which  
2 the taxpayer actually recorded and listing the problems be  
3 solved. Swat-Fame supplied face sheets and photographs  
4 for four garments. These documents did not show  
5 experimentation. No structural engineering calculations  
6 were shown. No chemical formulas were noted. The  
7 documentation Appellants provided was not research  
8 documentations like provided in Fudim or Union Carbide.

9 The documents do not evidence a process of  
10 experimentation. What Appellants showed us in their  
11 documentation, in their video, was a developmental cycle.  
12 Mr. Greenberg developed -- described a development  
13 process, but that process did not reflect the scientific  
14 process as required by law.

15 Appellants' documents do not show an evaluated  
16 process involving a systematic testing of alternatives as  
17 required by Union Carbide. The documents Swat-Fame  
18 provided did not show a hypothesis, the testing of a  
19 hypothesis, analyzing the test, refining the hypothesis,  
20 discarding the hypothesis as in Union Carbide.

21 It's Appellants' burden to prove Swat-Fame  
22 performed a process of experimentation, and they haven't  
23 done it. Here Appellants failed all four tests of  
24 Section 41(d)(1). However, if your office finds there was  
25 qualified research, there's a third reason that Appellants

1 do not qualify for the credit. That activity is excluded  
2 as adaptation and duplication.

3 You heard Mr. Greenberg say sometimes they use  
4 competitors' projects as prototypes. And you heard  
5 Ms. Nevarez say that sometimes they use competitors'  
6 projects for conceptualization. Documentation indicates  
7 that Swat-Fame copied some styles for the sample projects  
8 from other previous styles.

9 The Bermuda shorts were duplicate of the  
10 SeeThruSoul design developed for another line of clothing.  
11 And the spaghetti strap dress, again, was a dress whose  
12 top was reengineered from another -- from a project, and  
13 whose bottoms were used from another project. Not only  
14 did Appellants fail to prove qualified research,  
15 Appellants failed to substantiate Swat-Fame's qualified  
16 research expenses, a fourth reason that Appellants are not  
17 eligible for the credit.

18 For the 2008 to 2012 years, Respondent has  
19 identified six employees were executives. Their wages  
20 totaled \$2.4 million. Higher-level managers, such as top  
21 executives, are presumed excluded from the credit.  
22 Appellants have not overcome the presumption that  
23 executive wages are disqualified, therefore, no executive  
24 wages should be allowed.

25 There was no nexus between qualified research and

1 qualified research expenses. Swat-Fame did not track  
2 alleged research cost on a per-project basis. Swat-Fame  
3 tracked on a cost-center basis. Employees provided time  
4 allocations to calculate qualified employee wages.

5 Appellants did not provide analyses upon which  
6 the time allocations were based, nor documentation showing  
7 how the estimates were made. In fact, we don't even have  
8 the interviews which were conducted for 2010, '11, and  
9 '12. They were never given to FTB. Swat-Fame did not tie  
10 its qualified research expenses to its claimed research  
11 activity. Therefore, Appellants did not meet their burden  
12 to substantiate qualified research expenses.

13 Additionally, Appellants cannot estimate their  
14 expenses under the Cohan Rule. In Fudim the tax court  
15 applied the Cohan Rule to research a credit case following  
16 a two-step analysis. Did the taxpayer engage in qualified  
17 research? And is there a basis to estimate qualified  
18 research expenses?

19 Respondents have already shown that Swat-Fame's  
20 activity was not qualified research. Therefore, none of  
21 the claimed qualified research expenses are eligible. But  
22 if your office does find there is qualified research,  
23 Appellants still have not proven that their estimate is  
24 reasonable.

25 You heard Ms. Nevarez's testimony that pattern

1 makers, cutters, sewers, and creative designers all worked  
2 on minor design changes. Those duplications and minor  
3 design changes amounted to about 23 percent of Swat-Fame's  
4 projects, and were not included in their claim. They also  
5 claimed 100 percent of those employees' wages.

6 Is the burden of proof on Appellant to ensure  
7 that their qualified research expenses are reasonable  
8 based on the testimony today? These qualified research  
9 expenses are not reasonable, and Appellants have not met  
10 their burden to prove it. Unsupported assertions cannot  
11 satisfy a taxpayer's burden of proof.

12 Appellants have not proven that they met the  
13 statutory requirements to claim the credit, nor have  
14 Appellants' proven up their qualified research expenses.  
15 As a result, Respondent properly propose a tax adjustment  
16 to disallow the California Research Credit for the taxable  
17 years at issue. Respondent urges you to uphold the  
18 Notices of Action and the denial of refund.

19 Thank you.

20 ADMINISTRATIVE LAW JUDGE VASSIGH: Thank you.

21 Appellants, if you want, you have five minutes.

22 MR. DIES: Okay. I wanted to be respectful. I  
23 went slightly more than 15. I'll do my very best to knock  
24 this out in 5. Is that fair?

25 ADMINISTRATIVE LAW JUDGE VASSIGH: Okay. We'll

1 keep this to 5.

2 MR. DIES: Okay. Okay. Are you ready?

3 ADMINISTRATIVE LAW JUDGE VASSIGH: Go ahead.

4

5 CLOSING STATEMENT (continued)

6 MR. DIES: Where is the science? It's physics.

7 This fabric with this weave, composed of this material,  
8 will behave differently than that fabric with that weave,  
9 composed of that material. This denim, which we know  
10 shrinks at this rate when exposed to hot water, shrinks  
11 differently than that denim when exposed to the same hot  
12 water.

13 This cloth when exposed to potassium or chemical  
14 or resin shrinks at a particular rate that is unexpected.  
15 And guess what? When my denim shrinks, it doesn't shrink  
16 in both planes, so it doesn't shrink in a proportionate  
17 way.

18 These are all effects of the physical sciences.  
19 The way heat, thermodynamics, water, chemicals, and other  
20 additives interact with a garment absolutely impact the  
21 physics of that garment. There is a reason we don't make  
22 bras out of chiffon. Chiffon does not have the ability to  
23 bear a load. Period. It's a small very delicate fabric  
24 that can't possibly fit that purpose. That's physics.

25 I could really want my chiffon to make a bra. I

1       could really, really want to make a bra out of something  
2       that's so airy as a Kleenex because it would probably be a  
3       lot more comfortable, but it can't do the job. It can't  
4       be functional and won't work. This is physics, right.

5               We did have a hypothesis when we tried to make  
6       that second striped dress. The hypothesis was we could  
7       use a pattern that we had tried before with a similar  
8       fabric. We tested that hypothesis by making a dress with  
9       that same pattern. That dress grew two inches. We formed  
10      another hypothesis despite the assertion that we are not  
11      systematically engaged in trial and error.

12             The hypothesis was let's take two inches off of  
13      this skirt. In doing so, if it grows two inches we'll end  
14      up in the same place. We went back and changed the  
15      pattern. We went back and made a new product. We hung  
16      that product up. We draped that product. We modeled that  
17      product statically and on a model and guess what? It grew  
18      again. And guess what? We had to abandon it.

19             That wasn't because the fabric didn't want to  
20      work with us. That wasn't because we were incompetent.  
21      That was because the physics of that fabric proved  
22      incapable of creating a garment.

23             Now, I suggest to you that that belies the  
24      assertion of the State that we don't have uncertainty  
25      about whether we're capable of creating a product at the

1       outset. If we knew we couldn't make that dress, we would  
2       say, hey, we can't make that dress; right?

3               The assertion is that our Bermuda shorts are not  
4       an adaptation, that the style is something we already seen  
5       in a higher brand. You heard the actual testimony from  
6       Connie that it was different denim, different fabric,  
7       shrunk a different way. And we abandoned the project as a  
8       failure.

9               If this was so easy, why would we fail so  
10       regularly? Why would 80 percent of the things that we  
11       undertake never get made if we don't have a process of  
12       experimentation; if we don't have systematic trial and  
13       error? If we don't have to go through this process for  
14       everyone, why would we fail the creation of new product 80  
15       times out of a 100?

16              The government's arguments don't make sense.  
17       They say we didn't offer a business component that they  
18       site there. You guys saw our business component. It is a  
19       specific style number. Business components may be a  
20       product. You could stop there. It could also be a  
21       process, a technique, software, invention, right?

22              But we have a product. Each one of our products  
23       is a new garment. We've identified the product, and we  
24       claimed the benefits for it. In Bayer, the IRS asked,  
25       "Can you name your business components?"



1           Their response was, "We have tens of thousands of  
2 business components. We can't possibly name them all."

3           The courts said, "If you want to claim the  
4 benefit, you've got to tell me what your business  
5 component is."

6           That is not this case. The assertion is that  
7 we're globally lacking in documentation, that we don't  
8 have nearly the documentation they had in Fudim and  
9 Trinity. Trinity's documentation was destroyed in  
10 Katrina. There was not a lick of it. Trinity was  
11 presented by a bankruptcy trustee who found a few old  
12 employees and took pictures of the boats that existed.

13           Fudim was an absentminded scientist who is known  
14 to be brilliant, but kept no records. All of the  
15 testimony came from him, his wife, and his daughter. We  
16 are well in advance of any of the evidentiary burdens for  
17 both of these folks who got credits and benefits.

18           They say we didn't shrink back, and there's no  
19 evidence that we did. You guys see our wages. You guys  
20 see how we took 40 percent of this employee and 60 percent  
21 of that employee. That's evidence of shrinkage.

22           They say we didn't break down our 12 product-step  
23 process into what percentage is conceptualization and what  
24 percentage of these other things. I submit to you that we  
25 did because 77 percent of the wages at Swat-Fame never

1 showed up on a credit claim. We shrunk back in a massive  
2 way. There are tons of employees that we've never  
3 claimed, who we aren't talking about today because we  
4 don't want to waste your time.

5 Finally, they say that we don't -- that they  
6 can't breakout -- excuse me -- the cost we might have  
7 spent overseas or with contractors who are in these other  
8 places. False. Swat-Fame has no employees overseas. All  
9 of our wages came from employees, therefore, none of our  
10 wages come from overseas.

11 They say we can't break up contractor costs.  
12 False. We actually did break down contractor cost. We  
13 told you precisely where they came from. Those are third  
14 parties. We took 65 percent of them, and they're on  
15 schedule. We've broken down all of these things in ways  
16 that have been blessed by every court who has ever looked  
17 at that methodology.

18 There may be similar details in our work, but if  
19 you say we've made a sleeve before, therefore, we can't  
20 qualify, you got to get rid of Boeing 'cause they make  
21 wings. The standard that the FTB has applied to an  
22 apparel company would literally wipe out the R&D credit as  
23 applied to any discipline, much less that of apparel.

24 As far as style and cosmetic factors, style  
25 starts the journey, but all of the work that's done here

1 has nothing do with any of that. We've applied the  
2 sciences. We've shown you our hypothesis. We've shown  
3 you systematic trial and error. We have shown you how we  
4 test with a computer. We test in a static frame. We test  
5 for dynamic.

6 If I was a human factor's engineer, and I was  
7 trying to make a car that would be safer for a child, you  
8 wouldn't doubt me. But, frankly, every apparel company in  
9 the world is a human factor's engineer because they have  
10 to make a dynamic product that will move with someone who  
11 is living.

12 Steering wheels have qualified for this credit in  
13 TG Missouri. A sharp cheese blade is qualified for the  
14 credits in the Internal Revenue Code. In Farouk there  
15 were hair dyes that were qualified for the R&D credit.

16 We don't have to cure cancer or solve, you know,  
17 space exploration to qualify for this benefit. I mean,  
18 the assertion that the act of systematically going through  
19 this process isn't trial and error; it isn't a hypothesis;  
20 it isn't a process of experimentation belies the intent of  
21 Congress first and California second. We re-urge these  
22 guys get their credit.

23 ADMINISTRATIVE LAW JUDGE VASSIGH: Thank you. As  
24 I mentioned earlier, we're now going to close the record  
25 subject to further briefing. If after reviewing the

1       briefs and the record and judges determine that further  
2       briefing or evidence is required, we may reopen the record  
3       to ask you for that. I promise it won't be until 2019.

4               Thank you to the parties and witnesses for  
5       providing information and argument today. And I would  
6       also like to thank the stenographer, and other folks for  
7       their contributions to this hearing.

8               This hearing is now concluded. Thank you.

9               (Proceedings adjourned at 4:45 p.m.)

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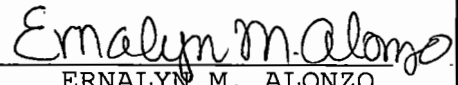
HEARING REPORTER'S CERTIFICATE

I, Ernalyn M. Alonzo, Hearing Reporter in and for the State of California, do hereby certify:

That the foregoing transcript of proceedings was taken before me at the time and place set forth, that the testimony and proceedings were reported stenographically by me and later transcribed by computer-aided transcription under my direction and supervision, that the foregoing is a true record of the testimony and proceedings taken at that time.

I further certify that I am in no way interested in the outcome of said action.

I have hereunto subscribed my name this 2nd day of January, 2019.

  
ERNALYN M. ALONZO  
HEARING REPORTER

1 SWAT-FAME DIGITAL VIDEO: PRODUCT DEVELOPMENT WITH MUSIC

2  
3  
4 (FIT MODEL NO. 1)

5 FEMALE ONE: Okay so this is first fit?

6 THE MODEL: Yes. This is the --

7 FEMALE ONE: Okay.

8 THE MODEL: -- this is sin that's quality she gave me for  
9 fitting.

10 FEMALE ONE: Okay.

11 MALE: 14 and a half at the shoulder.

12 FEMALE TWO: Is that normal for woven dressing?

13 FEMALE ONE: I think we can do 15 if it feels small.

14 FEMALE TWO: Can you do a [UNINTELLIGIBLE].

15 THE MODEL: -- it's back across [UNINTELLIGIBLE]  
16 definitely.

17 MALE: Maybe here we can add it four-inch by side but not  
18 too much.

19 THE MODEL: Yeah.

20 MALE: Only here in the -- in the --

21 FEMALE TWO: The back.

22 THE MODEL: Yes. Yeah.

23 FEMALE ONE: Probably the neck. Probably the neck too  
24 then a little. I don't know.

25 THE MODEL: I think you might -- you can pin it. But I  
26 think you might want a little bit. So much better.

27 MALE: Okay. So --

28 FEMALE ONE: So let's add two inches to the overlap. And

1 then how much -- we have to lengthen that, like, it's barely  
2 covering her bra right here.

3 THE MODEL: Yeah.

4 FEMALE ONE: So I mean it needs like --

5 MALE: You -- you have 16.

6 FEMALE ONE: 16.

7 MALE: Maybe -- maybe we can make it one inch longer.

8 FEMALE ONE: I would --

9 MALE: I need -- put the elastic here. Elastic to pull  
10 it.

11 FEMALE ONE: Add elastic?

12 MALE: Yeah, elastic.

13 FEMALE ONE: Okay. All right. Let's add --

14 MALE: It hold it here --

15 FEMALE ONE: I think that's a good idea.

16 MALE: In the top maybe we can -- we can play with the  
17 tie.

18 FEMALE ONE: Okay.

19 MALE: But bottom I need something to hold it.

20 FEMALE ONE: And then we just don't want it to weigh  
21 it --

22 THE MODEL: -- it's just got like --

23 FEMALE ONE: -- from her body like this.

24 THE MODEL: -- this. It's gonna look weird.

25 FEMALE TWO: Should take some out.

26 FEMALE ONE: So I don't know. If we need to add a dart,  
27 I'd rather -- I'd like to add it -- I'd rather add it now.

28 MALE: Add elastic here. Maybe we can put a dart and put

1 elastic in here --

2 FEMALE ONE: Okay.

3 MALE: -- to come in better.

4 FEMALE ONE: Okay.

5 MALE: Better fit.

6 THE MODEL: This guy is definitely too tight. So I can  
7 pull it past there.

8 FEMALE TWO: [UNINTELLIGIBLE] start from top to bottom.  
9 Let's talk about the armhole.

10 THE MODEL: I think it might be able to go up an armhole  
11 more if this was cut. Right now it can't 'cause it's too  
12 tight. So um --

13 FEMALE TWO: Okay.

14 MALE: Are you --

15 MODEL: I can't tell exactly how high. Actually, it's  
16 definitely too high for sure. Yeah, now that it -- you can  
17 do that it's definitely high. Because yeah --

18 Male: [UNINTELLIGIBLE] over here shave it here. Go in  
19 and lower.

20 THE MODEL: Yeah. So if we cut that I'd want to pull  
21 this down a little bit, I think, because this -- it's way too  
22 open there.

23 MALE: Yeah.

24 FEMALE: Okay. So how's the -- so we're going to raise  
25 the waste one inch. And then how's the measurement of the  
26 elastic?

27 THE MODEL: I think it's too tight.

28 FEMALE ONE: It's hard to tell but -- too tight. So



1 we're gonna be adding to elastic. So I would just try to  
2 do --

3 FEMALE THREE: An arm whole length measurement.

4 FEMALE ONE: Try to do it a --

5 MALE: Yeah. I normally -- I put 26 and a half.

6 FEMALE ONE: Okay. So let's start with 26 and a half and  
7 see where that gets us. And then the rise is too short?

8 THE MODEL: Yeah.

9 FEMALE ONE: And what about the through? Like this one?

10 THE MODEL: I think I agree. Like I think it's  
11 cutting --

12 FEMALE ONE: Cutting in okay.

13 FEMALE TWO: And this --

14

15 (FIT MODEL NO. 2)

16 THE MODEL: This back is huge.

17 FEMALE ONE: Okay. So how much do you think I should  
18 take out?

19 THE MODEL: You can do about an inch and a half in the  
20 waste.

21 FEMALE ONE: Inch and a half, okay. And how about the  
22 hip?

23 THE MODEL: I would do like two inches on the hip, easy.

24 FEMALE ONE: Okay.

25 THE MODEL: And two inches on the leg opening.

26 FEMALE ONE: Two inches at the leg opening. Okay. I'm  
27 going to take out -- I'm gonna put out an inch and a half.  
28 Two at the bottom, right?

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(FIT MODEL NO. 3)

FEMALE ONE: Okay. So she's supposed to be about nine and a quarter, nine and a half?

FEMALE TWO: She's supposed to be ten.

FEMALE ONE: She's supposed to be ten. She had yeah. She's at ten.

FEMALE TWO: She's at ten. Okay right now it's a little bit [UNINTELLIGIBLE] it's quite long.

THE MODEL: Okay. It feels like maybe in here it's a little bit straight.

FEMALE ONE: Okay.

FEMALE TWO: The fly is super-super low. It looks like all the way down.

THE MODEL: Yeah. It looks really long.

FEMALE TWO: Rise right now is happening too long.

THE MODEL: Okay.

FEMALE TWO: So you want me to take out the back hook?

THE MODEL: I think so.

FEMALE ONE: Okay.

THE MODEL: It feels like it needs to come closer to the body.

FEMALE ONE: Okay.

THE MODEL: Make it shorter.

FEMALE TWO: Yeah.

THE MODEL: It's gonna come up to about here.

FEMALE ONE: Okay.

FEMALE TWO: So if I make it shorter, what is the --

1 how's the leg opening?

2 THE MODEL: I feel like I have plenty of room Izzy  
3 (SOUNDS LIKE). I mean it kind of feels like it's caving in.

4 FEMALE TWO: Okay.

5 FEMALE ONE: Make it out.

6 THE MODEL: Yeah like it needs -- I don't know if it  
7 needs the pick up or it just looks like [UNINTELLIGIBLE].

8 FEMALE TWO: Okay. I see on this side more than that  
9 side. Yeah.

10 FEMALE ONE: This side is uh, this side is that ways.  
11 Can you pull down this side just a little bit here. Okay.  
12 So this is rest relax. You can step -- yeah.

13 FEMALE TWO: And you need it.

14 FEMALE ONE: I think I need one inch. This is one inch.

15 THE MODEL: Okay. But it is going to grow. So that  
16 is --

17 FEMALE TWO: Yeah. Yeah.

18 THE MODEL: Okay.

19 FEMALE TWO: How is it now?

20 THE MODEL: It feels better, and you're gonna bring this  
21 closer.

22 FEMALE TWO: Uh-huh.

23 THE MODEL: Okay. Yeah.

24 FEMALE TWO: Yeah.

25 THE MODEL: I think so.

26 FEMALE TWO: Okay.

27

28 (BERMUDA SHORTS)

1           MALE: So we need to change the -- the pleat out of this.  
2 When a model is wearing it, it's opening up. And what I'm  
3 finding is this should not actually be a pleat. This should  
4 be a dart. So we need to continue the sewing all the way  
5 down here. This will close it up, so when the model is  
6 wearing it, it won't open, and it'll look too baggy on her.

7           And that's just how our proto sample was. Found out the  
8 construction was different. They are more of a dart sewn all  
9 the way down as compared to ours. We made it into a pleat,  
10 which is not looking so well on her. So we're gonna make  
11 this change on the next sample. ....

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