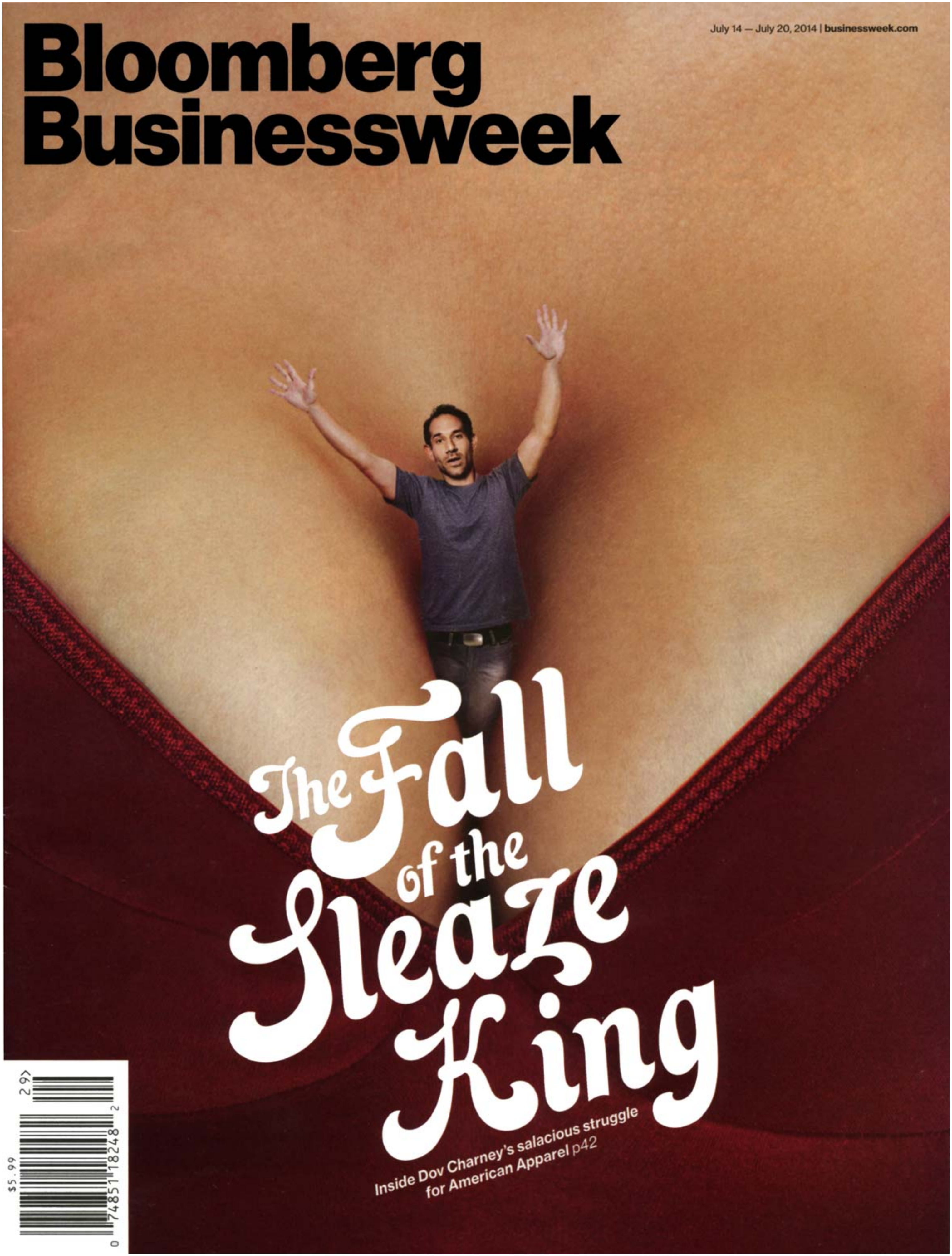

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The Fall of the Sleaze King
Inside Dov Charney's salacious struggle for American Apparel p42
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Don Charney's Sleazy Struggle for Control of American Apparel

By Susan Berfield

When I first reach Dov Charney on June 24, he's scrambling to raise money, find a partner, try anything to get his company back. His hand-picked board of directors had ousted him from American Apparel six days earlier following an investigation that turned up several instances of alleged misconduct. "They're concerned that an unconventional leader somehow damages the company's chances of success. But a contrarian, alternative-thinking CEO can bring creative ideas that advance the company, even the industry," he says. "Oh wait, got to take this." He hangs up. Two days later we talk again. He doesn't say it, but he's already worked out a deal with Standard General, a hedge fund in New York, which has been buying stock in American Apparel in hopes of influencing the fate of the troubled company.

The conversation continues over the next several days. He's outraged, crass, unapologetic, funny, disarming, constantly jumping between conversations, and mostly off-the-record. "It's my mother, let me take this, I apologize." "It's the finance guys, call me back in two minutes." At one point, there are four people on a call. He puts us all on hold. Later, it comes out that he's given Standard General control of his stake in the company he founded—and, along with it, control of his future at American Apparel. We speak again. "Just a second, you might be two minutes on hold, just wait. … Excuse me one second. … One second … oh s---, one second, please."

Just two weeks earlier, on June 17, the eve of the company's shareholder meeting, Charney, 45, was in a good mood for the first time in a while. For much of the past four years, he'd been in crisis as American Apparel lost $270 million and came close to bankruptcy twice. But the board had stuck by him, sales had increased this spring, and summer promised to be busier yet. Things were finally looking up.

Charney packed samples, ordered an Uber car to get to LAX, and boarded a red-eye for New York. After he landed, he put on a suit and tie and, wearing white American Apparel socks and Common Projects sneakers, sauntered into the office of the company's lawyers at 4 Times Square.

The shareholder meeting lasted about an hour. Close to noon, the five board members entered the conference room with Charney, their chairman, for their annual face-to-face meeting. Allan Mayer, a Hollywood public-relations man whom Charney had put on the board in 2007, gave Charney an ultimatum: Resign voluntarily, give up the voting rights to his 27 percent stake, and receive a multimillion-dollar severance and a four-year consulting contract. Otherwise, be fired for misconduct. Among the charges in the termination letter: Charney had the company pay for a few plane tickets for his family; misused company money in other ways; and violated the company's sexual-harassment policy. According to the letter, the board "recently learned that you presented significant severance packages to numerous former employees to ensure that your misconduct vis-à-vis these employees would not subject you to personal liability."

The board also cited a case that had received a lot of publicity and had been resolved confidentially. In 2011, Irene Morales, a sales associate, accused Charney of using her as a sex slave and sought damages of a quarter-billion dollars. An arbitrator dismissed those claims but found the company "vicariously liable" for the conduct of another employee who had created a fake blog in Morales's name. Then the employee posted erotic photos of Morales on it. Charney told some board members and his lawyers that he had photos of Morales and of others accusing him of harassment that showed the women weren't victims. The board members and lawyers didn't object to the idea of him using the photos as part of his defense. The photos were sent to several newspapers and websites. But no one imagined that someone would put together a phony blog and post the photos there.

At the June 18 meeting, Charney refused to accept either of the board's choices. He argued that the business was doing well now, that the supposedly new misconduct was really old misconduct, and in any case it didn't amount to enough to fire him. He noted that since he had renewed his employment contract in 2012, no new sexual-harassment cases had been filed against him. The board listened but was unmoved. An afternoon deadline was extended to early evening. Charney left the conference room several times to call his lawyer, his parents, some colleagues. Nine hours after the meeting began, he told the board he wouldn't resign. They had a press release ready. It said Charney had been ousted as chairman, suspended as chief executive, and would be officially fired after a 30-day waiting period, as his contract required. Mayer and David Danziger, a partner at MSCM, a To-

Charney at the company's lawyers' office in New York on June 18, soon after learning he was being dismissed.

ronto accounting firm, became co-chairmen.

After the board members left, a secretary escorted Charney out of the building. He walked to the company apartment on the southern edge of Hell's Kitchen. The next day, Charney's lawyer, Patricia Glaser, wrote to American Apparel's lawyer, calling the board's behavior "not merely unconscionable but illegal." She said the allegations were baseless and involved "activities that occurred long ago (if at all) and about which the Board and Company have had knowledge for years."

The board had defended Charney through years of negative publicity and even worse financial problems. Why now? "I know there's a lot of people who have criticized us very severely for not taking action earlier than we did," says Mayer. "I get it. But there's nothing I would do differently. You don't want to embark on a course of action that will bring down the whole house. That's destroying the village to save it." One theory on the timing is that the company had issued new shares in March to raise cash, reducing Charney's stake from 43 percent to 27 percent. There could be other reasons: concern about a possible bankruptcy that could force a sale, or additional lawsuits that could hold the company, and the board, liable. "All along they were thinking that anything goes in Charneyville," says Thomas White, a professor of business ethics at Loyola Marymount University in Los Angeles. "They only started to worry when they looked up and saw financial disaster."

After the meeting, the board authorized FTI Consulting to begin a second, more far-reaching investigation into Charney's behavior. Charney stayed in New York, desperately looking for a way to reclaim his position. At first it seemed as if he'd found someone to back him. Standard General began acquiring American Apparel shares, then lent Charney $20 million to buy them from the firm. He had to agree to pay 10 percent interest and use his stock as collateral. The board on June 28 belatedly adopted a poison-pill defense to prevent him from gaining control. By then, Charney owned 43 percent of the company. Really, though, Standard General controlled the shares, and the firm wasn't necessarily backing Charney. "This transaction is not about the founder, nor is it an endorsement of him," Standard General said in a letter to its investors on July 2. A week later, Standard General and American Apparel reached a deal to bring in new board members, sort out and shore up the company's finances, and keep the company's downtown Los Angeles factory open. Charney will serve as a "strategic consultant" while the FTI investigation is under way. His role beyond that, if he has one, will depend on the results.

"They control the shares. I'm a bystander," Charney says by phone in one of six conversations we have over two weeks. "My first issue is to save people's jobs, put the company into a stable financial situation. And then we'll evaluate whether or not I'll be the janitor or the CEO or the consultant. … I believe Standard General will treat me fairly."

From the beginning, Charney called himself a Yiddish hustler. He left Montreal for high school in Connecticut, left Tufts University to start a wholesale T-shirt business in South Carolina, and left the South for Los Angeles after his first company ran into financial trouble. There he connected with the Korean community that dominated the fast-fashion business. American Apparel got off the ground in 1998, and among its first tag lines was: "Two Koreans and a Jew making T-shirts." An ad features a black-and-white drawing of Charney with a full head of hair and protohipster glasses.

For five years, American Apparel was a wholesale business. It, and he, had already come to public attention, though. The *New Yorker* profiled Charney and his efforts to create perfect-fitting T-shirts; Charney took the reporter, Malcolm Gladwell, to a strip club where the dancers modeled new styles. In late 2003, Charney opened his first store, on Sunset Boulevard in the then-seedy neighborhood of Echo Park. The clothes would be logo-free and sweatshop-free; the advertising, sexually free, or at least that's how he thought of it. "He built an incredibly important brand," says Ilse Metchek, president of the California Fashion Association. “In terms of influence in the U.S., it’s as valuable as Gap.”

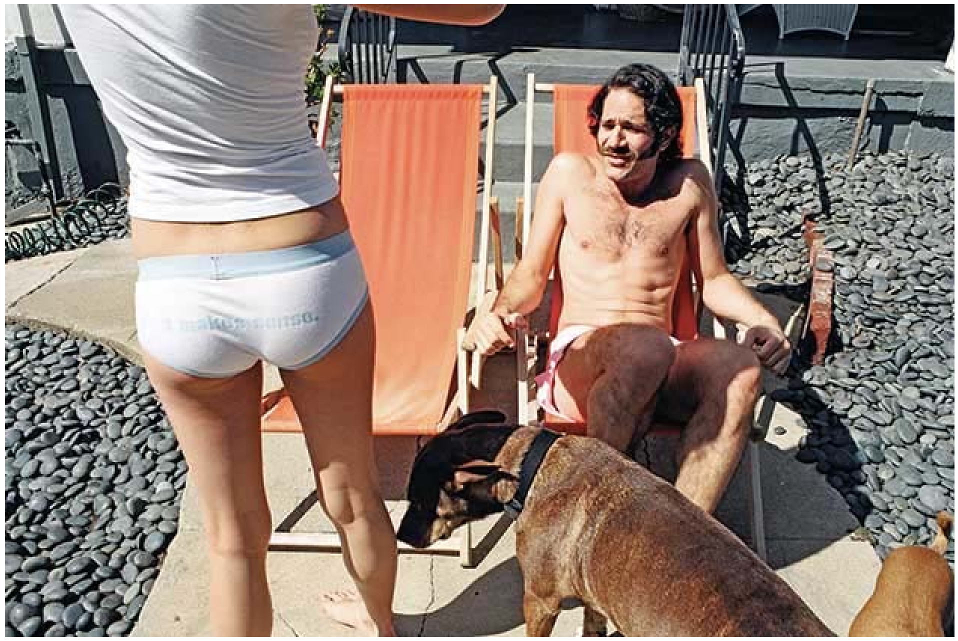
Today the American Apparel factory—the largest garment manufacturer in the country—is located in a seven-story, 800,000-square-foot, almost century-old, salmon-colored building. It has a banner proclaiming: “American Apparel is an Industrial Revolution.” Some 3,300 workers produce about a million pieces every week—T-shirts, leggings, dresses, shorts, socks, and underwear in 31,000 styles, sizes, and colors.

American Apparel has 249 stores in 20 countries; last year sales were $633 million, almost one-third of which came from wholesale. Its factory workers make an average of $12 an hour, generous by industry standards. A company slogan printed on the cafeteria wall says: “We may not be politically correct—but we have good ethics.”

Marty Bailey, a taciturn Southerner who worked for years at Fruit of the Loom, is the head of manufacturing. An office near his used to belong to Charney. Guards showed up the day after Charney was fired and stood by his door for the next 48 hours, according to four executives who were not authorized to speak on the record. The security code was changed, and a camera was installed nearby. John Luttrell, the chief financial officer, became the interim CEO. The first few days he walked around the floor with security guards of his own.

Bailey has been told by Mayer not to discuss any of this. “This is our corporate floor,” he says, giving a tour on June 30. “The, uh, CEO’s office is here. The general counsel. Everyone else.” Bailey keeps walking.

Mayer, the co-chairman, does the talking for everyone. His specialty is crisis management, and his clients have included the Los Angeles Dodgers and Universal Studios. He’s known Charney since 2004, when the first story about the chief executive who couldn’t keep his pants on was published. In his office at PR



Charney at home in Los Angeles in 2004.

firm 42 West in L.A., where he’s a principal partner, Mayer has a small sculpture of a man on a horse with a sword and a lance: a white knight.

He’s had time to think about why American Apparel has such an outsize reputation. “I think it’s the tension between the transgressive part of the brand and the idealistic part of the brand that gives it its special place in the culture,” Mayer says. “If you took out the sex, it would be kind of boring. And if you took out the idealistic component—our commitment to the sweatshop-free, made-in-USA philosophy—it would just be sleazy. But you put them together, and you have something that’s interesting. It’s edgy, but it’s also strangely wholesome at the same time.”

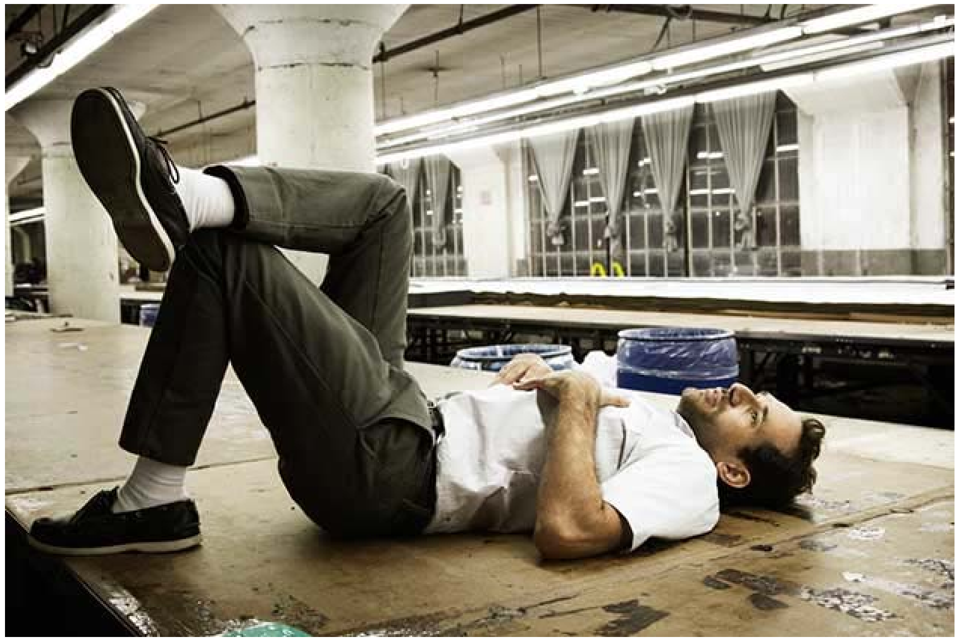
Several months after the Echo Park store opened, Charney gave a now infamous interview with Claudine Ko, a reporter for *Jane* magazine, during which he masturbated, with her consent, while carrying on a conversation about business. He engaged in oral sex with an employee with Ko nearby, too. “It all started there,” says Roy Sebag, a managing partner at Essentia Equity who later invested in American Apparel and still speaks with Charney. “Then he was the douche bag of the year. Everyone loved to hate American Apparel.”

By the middle of 2005, Charney, then 36, had opened 53 stores in five countries, which had sales of $250 million. He had 4,500 employees. He was also facing two sexual-harassment suits, which he said were bogus. One case was dismissed in arbitration. The other, brought by an ex-employee named Mary Nelson who accused Charney of creating a hostile work environment, made its way to court. Documents revealed that American Apparel had agreed to settle for $1.3 million without admitting liability. In exchange, the company could issue a press release saying an arbitration judge had dismissed the claims. The case eventually ended up in confidential arbitration.

By 2006 the company had begun requiring employees to sign a document acknowledging that American Apparel is a “sexually charged” workplace, hoping to protect itself from what Charney and his lawyers considered shakedowns. “One of the things you learn when you do crisis management is that where there is smoke, there isn’t always fire,” Mayer says.

If there's one thing that everyone agrees on when it comes to Charney, it's this: The guy works like crazy. One time, Charney took a deep interest in the lighting in the stores and studied bulb temperature and the Kelvin light scale. "The company is his whole life," says Eric Beder, an analyst at Brean Capital. "He's not into possessions or the money. I talk to CEOs who love their jobs but have a life. Not Dov."

American Apparel went public in 2007, and Charney's stake turned out to be worth $580 million. Afterward, Charney had to hire a real CFO, whom he later called "a complete loser" in a *Wall Street Journal* article. Charney apologized; the executive left. With the cash infusion, American Apparel opened more than 100 stores in 2007 and 2008.



Charney at the factory in 2010.

One of Charney's confidants on the board was Robert Greene, author of the best-selling *48 Laws of Power*, which is about the art of manipulation. Charney hired him as a personal consultant, but Greene says the CEO didn't follow all of his precepts. He was a volatile leader, says Greene. "There's nothing in my book really about that. It's not about being chaotic and yelling at people, which he would do."

Charney describes himself as unconventional, and some employees found the chaos and freedom in the workplace thrilling. Charney often invited new executives and visiting employees to stay with him for a few weeks, sometimes to get a feel for company culture. That included holding weekly videoconference calls with managers from home, sometimes in bed, occasionally shirtless. He put his mobile phone number on the company's website and would answer no matter who called. Young women regularly sent him nude photos. "Dov is very intense. He's very charismatic. And anybody who is so passionate and so totally devoted to what he's doing can be attractive. So he's always been subjected to a lot of temptation," says Mayer.

American Apparel, which boasted about its immigrant workforce, went through an immigration audit in 2009. It had to lay off more than half of its factory workers. Another thousand quit for fear of being swept up in immigration raids. The disruption led to delayed shipments and an expensive hiring and training program.

The company lurched from crisis to crisis. Sales slowed, the financial situation deteriorated, and each loan carried higher interest rates. At one point, Charney personally guaranteed the leases on some prime retail space for stores. Investors and their chosen executives came and went. Charney would welcome them enthusiastically, then quickly come to the conclusion they didn't fit in. He'd make it impossible for them to stay, according to five executives familiar with Charney's management style.

Then, in 2013, the company built an automated distribution center outside Los Angeles in La Mirada that was supposed to save $5 million a year. But delays, software problems, and insufficient training hampered operations; some orders were comically confused. One customer received a box with nothing but packing tape.

Charney moved into the facility in August. He had someone bring a mattress and a hot plate; a shower was installed. He slept with a walkie-talkie on his chest and, depending on who's telling, at least one young woman. Charney regarded his moving into the distribution center as a sign of his great commitment. The board saw it as a sign of Charney's insane management style.

The problems at La Mirada cost the company at least $15 million. A $13.5 million interest payment—money American Apparel didn't have—was due in April.

This February, Greene and Mayer took Charney out to dinner at a steakhouse in Los Angeles's Koreatown. They spoke to him about bringing in some senior executives. Charney was the CEO and the president. There was no chief operating officer, no chief technology officer. The company never had official designers. The two weren't trying to ease him out, only trying to free Dov to be Dov. Charney seemed to like that idea. There was another possibility: selling the company. People familiar with American Apparel say Luttrell, the CFO, favored that, though he said the opposite publicly.

Charney wouldn't even discuss it.

Once again, pressing financial matters arose. Charney agreed to let the company sell more shares, diluting his stake, in the belief the company would grant him additional shares later. It was difficult to sell the stock, says Beder, whose firm helped manage the offering. "Part of that is because of Dov." Charney now had a 27 percent stake, and for the first time since the company went public, he was vulnerable. But he didn't seem to know it.

All spring, Charney concerned himself with rooting out inefficiencies. For a while he was reviewing almost every check American Apparel issued. That wasn't making Luttrell too happy. In May, Charney forced out his general counsel, Glenn Weinman. Charney said it was because Weinman cost too much. Weinman declined to comment on the matter.

Soon the board received unpleasant news about two lawsuits—a potential payment of $700,000 to settle with Morales and new information in a suit accusing Charney of assault. In November 2012, Michael Bumblis, a store manager in Malibu, had accused Charney of rubbing dirt in his face because Charney was displeased with the store's condition and performance. Bumblis's lawyer, Ilan Heimanson, says he informed the company of evidence of the confrontation beyond the accounts of witnesses. The stores had security cameras, and Bumblis had access to the video. Among the details in the complaint was a phone call Charney had supposedly made to Bumblis about his store's poor sales. "Get your f---ing s--- together, fag. Where is your f---ing creativity? Get some f---ing girls in bikinis to stand on PCH [Pacific Coast Highway] and have them wave a f---ing American flag. Are you a fag? Do you not want to see girls in bikinis? Are you banging that girl you were with in Vegas? What's her name?" American Apparel's lawyer said in a filing that Bumblis was a poor-performing employee who was dismissed and that his story is "entirely contrived or wildly exaggerated."

That case could bring other complications. Heimanson asked a Los Angeles court to try the case rather than send it to confidential arbitration, as American Apparel requires in all such matters. The judge ruled that the documents all American Apparel employees have to sign are "unconscionable," according to legal filings. The agreements forbid workers from filing claims against the company, talking about the company, or sharing any information about the personal life of the CEO. If they do, they risk being sued for $1 million. The company is appealing the ruling. If it stands, "we'll be able to shine sunlight on the backroom dealings of American Apparel and Dov Charney," says Heimanson.

Charney's termination letter also faults him for alleged financial misconduct. "You authorized payments to induce employees to sign release agreements that were aimed at protecting you from personal liability for your misconduct," the letter says. Two former company executives say that was American Apparel's out-in-the-open, frequently used legal strategy. Employees had to re-sign their arbitration and confidentiality agreements when they got raises; if they left the company, they received severance in exchange for promising not to sue or disparage American Apparel. Everybody knew this, and everyone signed, they say (including these two executives).

The board also mentions some unauthorized expenses for employees and family members. Nickel-and-dime stuff, say three people with knowledge of Charney's spending. Charney behaved as if American Apparel was still his company and didn't always distinguish between the personal and the professional. The amounts they're aware of aren't enough to be fired over, they say.

FTI Consulting's probe into Charney's conduct began on June 19 and could conclude by early August. Standard General has said the board it wants to install will determine Charney's fate once it's seen the conclusions. "I'm reminded of that quote from Nietzsche," says Mayer. " 'The consequences of our actions take hold of us, quite indifferent to our claim that meanwhile we may have "improved." ' That may well be Dov's epitaph."

On July 9, Standard General announced its deal with American Apparel. It will provide as much as $25 million to the company and will create a seven-member board that will include experienced retailers and turnaround and corporate governance experts. Standard General will keep one seat for itself, says David Glazek, a partner at the firm. Mayer and Danziger will keep their seats, too. The new board, in turn, may bring in outside help to run the company. "We look for good businesses with bad balance sheets that can be fixed," says Glazek. "Chaos has a cost. We want to institutionalize things."

Glazek says Standard General wants to keep the company's business model, too. But it's made no commitment to the company's founder. "Dov found a lifeboat, but he's still surrounded by sharks," says Lloyd Greif, an investment banker in Los Angeles. Meanwhile, Charney can't help himself: In recent days, he was spotted at an American Apparel store in Manhattan.