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Hennepin County, MN

STATE OF MINNESOTA | DISTRICT COURT

COUNTY OF HENNEPIN | FOURTH JUDICIAL DISTRICT
Case Type: Consumer Fraud

Ritchie Capital Management, Ltd. and
Ritchie Special Credit Investments, Ltd.,

Plaintiffs,

v.

Costco Wholesale Corporation,

Defendant.

Case No.

COMPLAINT

Introduction

1. Costco Wholesale Corporation ("Costco") draws customers into its membership warehouse stores to "hunt" for the "treasure" of luxury goods at significantly discounted prices. One week it might be designer handbags. The next, flat-screen televisions. To lure customers for each "treasure hunt," Costco must continually locate and stock new luxury goods. That, however, is easier said than done because manufacturers of luxury goods often won't sell to Costco for fear that doing so will tarnish and devalue the luxury image of their brands. To solve this problem, Costco has cultivated relationships with middlemen who obtain luxury goods from authorized dealers and divert those goods to Costco. To protect its middlemen and its access to diverted luxury goods, Costco routes the goods through "sanitation warehouses" and causes the packaging, shipping labels, SKUs, and paperwork associated with the goods to be removed, obscured, and even falsified so that the manufacturers, consumers, and lenders have no way of tracing the true origin of the goods. The lengths to which Costco

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has gone to protect its middlemen and their supply sources has increased the risk of damage to or, in some cases, counterfeiting of the treasure-hunt products. These practices, which are vital to Costco's treasure-hunt strategy, have harmed consumers by misleading them about the true origin of luxury goods being sold at Costco. Costco's practices have enabled the massive financial fraud of middleman diverter Tom Petters, and violated Minnesota consumer-protection laws. Plaintiffs, who financed the purchase of millions of dollars in luxury goods for Costco treasure hunts, were unable to obtain security interests in financed goods due to Costco's violations of Minnesota's consumer statutes and lost their investment in those goods. This lawsuit seeks to hold Costco accountable to the public, as well as to Plaintiffs, for Costco's violations of Minnesota law.

The Parties

2. Plaintiff Ritchie Capital Management, Ltd. ("RCM") is a Cayman Islands exempt company with an office in the Cayman Islands.

3. Plaintiff Ritchie Special Credit Investments, Ltd. ("RSCI") is a Cayman Islands limited partnership. RSCI's ownership includes one or more citizens of Washington State. RCM and RSCI are sometimes collectively referred to in this Complaint as "Plaintiffs."

4. Defendant Costco Wholesale Corporation is a Washington corporation with its headquarters located at 999 Lake Drive, Issaquah, Washington.

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Jurisdiction and Venue

5. This Court may exercise personal jurisdiction over Costco because Costco conducts substantial business in Minnesota; Costco has a designated registered agent for service of process in Minnesota; and actions giving rise to the Complaint took place in Minnesota.

6. Venue is proper in this Court because Costco resides in this judicial district; Plaintiffs' causes of action or some part thereof arose in this judicial district; Costco has transacted substantial business in this judicial district; and Costco has caused harm to Minnesota consumers residing in this district.

Factual Allegations Common to All Causes of Action

A. Costco's "Treasure Hunt" Operation

7. Costco operates an international chain of membership warehouses, primarily under the "Costco Wholesale" name.

8. Costco advertises that its membership warehouses are "dedicated to bringing . . . members the best possible prices on quality, brand-name merchandise." According to the profile on Costco's website investor-relations page, "Costco's warehouses present one of the largest and most exclusive product category selections to be found under a single roof. Categories include groceries, candy, appliances, television and media, automotive supplies, tires, toys, hardware, sporting goods, jewelry, watches, cameras, books, housewares, apparel, health and beauty aids, tobacco, furniture, office supplies and office equipment."

9. On its website, Costco represents itself as "carrying top quality national and regional brands," at prices that are "consistently below traditional wholesale or retail outlets."

10. The merchandise sold by Costco includes bulk items that it regularly stocks, as well as "exclusive" high-end luxury-brand items that may only be available for a short time. Shoppers are encouraged to visit Costco stores so they can discover special merchandise at deeply discounted prices. The selection of exclusive and special merchandise is purposefully unpredictable, inducing shoppers to return often to find new "treasures." Costco has branded its business model the "treasure hunt."

11. Costco has faced difficulty obtaining high-end luxury-brand treasure-hunt goods because many of the manufacturers of those items have refused to sell their goods to Costco for fear of tarnishing and devaluing the exclusive high-end luxury image of their brands. Indeed, the high-end luxury brands that Costco depended on for its treasure hunts—including Sony, Fendi, and Coach—tightly control their distribution networks to exclude discount warehouses like Costco. For example, some of those manufacturers required exclusivity agreements with their vendors that prohibited vendors from selling the goods to unauthorized merchants like Costco. If a vendor breached that agreement, the luxury manufacturer could cease selling goods to the vendor.

12. Costco circumvented the distribution restrictions of high-end luxury-brand manufacturers by cultivating a grey market of distribution channels, and then regularly using those channels to divert products from authorized-sale chains to Costco through unauthorized-sale chains.

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13. Costco navigated this grey market through partnerships with middlemen diverters. For example, once Costco identified a desired product, it would issue a purchase order to a middleman for the requested goods. The middleman would locate a supplier for the goods and seek financing for the product. Frequently, after a middleman obtained financing, Costco would cancel the original purchase order and reissue the order to the financier. Costco and the financier would then enter into other agreements that designated the financier as the "vendor" of the goods. Under these arrangements, the financier would pay the suppliers who would then ship the goods directly to Costco. Convicted Ponzi-schemer Tom Petters served both as a middleman diverter and financier for Costco.

14. On information and belief, manufacturers of high-end luxury brands were aware of the manner and extent to which Costco used the grey market and middleman diverters to circumvent their distribution restrictions. To protect their brands from Costco's practices, they labeled their products with shipping labels and SKU numbers that would enable them to trace products through the supply chains. Should one of their products appear on the shelves of an unauthorized retailer, like Costco, the manufacturers could reference the shipping label and SKU to easily identify the distribution network through which it passed (and cease conducting business with the vendor who sold products to a middleman diverter).

B. Costco's sanitizing procedures

15. Costco and its middleman diverters responded to the protective measures of high-end luxury-brand manufacturers by implementing an elaborate fraud—referred to

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by Costco as "sanitation"—to hide and misrepresent the true origin of the treasure-hunt goods in its warehouse stores ("the Sanitation Fraud").

16. Costco carried out the Sanitation Fraud by directing its middlemen diverters, including Tom Petters, to hide and misrepresent the true origin of treasure-hunt goods by shipping to sanitizing warehouses and putting them through an elaborate sanitation process before delivering them to Costco stores.

17. The sanitation process involved: (a) scraping off original shipping labels and SKUs or covering the original shipping labels and SKUs; (b) removing the goods from original packaging; and (c) creating false purchase orders, bills of sale, bills of lading, and other shipping documents, all in an effort to make sure that the origin of the goods could not be traced. By way of example, and without limitation, Costco sanitized the following high-end luxury-brand goods before delivery to its warehouse stores:

A. Costco caused one of its middleman diverters to purchase large quantities of "Precious Moments" figurines and, before delivery to Costco warehouse stores, sent the figurines to a sanitation warehouse where Costco caused each figurine to be removed from the original outer carton that was labeled with shipping and other identification information, and placed them in a clear, blister-pack package that did not identify the source of the figures or provide adequate protection from damage.

B. Costco caused one of its middleman diverters to purchase Sony Televisions and, before delivery to Costco warehouse stores, sent the Sony Televisions to a sanitation warehouse where the shipping labels were removed from the boxes or covered with stickers so that customers, and Sony, could not trace the source of the Sony Televisions.

C. Costco caused one of its middleman diverters to purchase large quantities of Nike shirts and, before delivery to Costco warehouse stores, sent the shirts to a sanitation warehouse where Costco caused all shipping labels and SKUs to be removed and created a false purchase order and shipping labels, all in an attempt to hide the true origin of the shirts. The falsified purchase order, which refers to the removal of shipping labels and SKUs as "SKU, pre-pack, sort & label work," required that "clean unsanitized copies of the original invoices from Nike" must be delivered to Nathan Fox for "approving" before delivery of the shirts to Costco.

D. Costco caused one of its middleman diverters to purchase large quantities of Nike "Toddler Boys L/S T-Shirt(s)" and, before delivery to Costco warehouse stores, sent the shirts to a sanitation warehouse where Costco caused all shipping labels and SKUs to be removed and created a false purchase order and shipping labels, all in an attempt to hide the true origin of the shirts. The falsified purchase order required that "clean totally unsanitized copies of the original invoices from Nike" must be sent to John Sullivan for "approving" before delivery of the shirts to Costco.

E. Costco participated in a "blind pickup" of high-end, Tumi luggage to be offered for sale in its stores. Communications relating to the purchase instructed that "[t]his will be a BLIND PICKUP for both trailers. No mention of COSTCO ro

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[sic] National Distribution is allowed on any document or this could result in TUMI cancelling our entire order. Please be careful." On information and belief, Costco sent the Tumi luggage to a sanitizing warehouse before offering the goods for sale in one of its warehouse stores.

18. While Costco perpetuates the Sanitation Fraud as a means of preventing the manufacturers of high-end luxury brands from tracing the grey-market channels through which Costco obtained their goods, it also prevents consumers from learning the origin of the treasure-hunt goods and whether they are genuine or counterfeit. The Sanitation Fraud has permitted Costco to sell counterfeit "treasure hunt" goods to consumers. By way of example, and without limitation: (a) Costco asked one of its middleman diverters to purchase $16 million of "Coach" handbags to sell to the consuming public, and the handbags were later identified as counterfeit by one of the middlemen diverters involved in the deal; (b) a jury found that Costco sold counterfeit flat hairstyling irons made by Farouk Systems, Inc.; and (c) brands including Calvin Klein Jeanswear and Tiffany have also accused Costco of selling counterfeit versions of their products.

C. Costco created a fraudulent lending market

19. Costco knew that the middlemen diverters upon whom it relied required very significant financing to purchase and sanitize high-end luxury goods before they were delivered to and purchased by Costco. By way of example, and without limitation, Costco knew that one of its middlemen diverters—Tom Petters and his associated entities Petters Capital, Inc. and others (hereinafter together referred to as "Petters")—obtained a variety of different financing to purchase and sanitize high-end luxury goods for Costco,

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including without limitation a $50 million line of revolving credit from General Electric Capital Corporation ("GECC"), which Costco knew Petters used, on a deal-by-deal basis, to finance the purchase of high-end consumer electronics that would be sanitized and then diverted to Costco warehouse stores.

20. Costco knew its middlemen diverters were obtaining financing by submitting to their lenders copies of falsified Costco purchase orders and written assurances from Costco that it would purchase the goods identified in those purchase orders. By way of example, on or about October 23, 2000, GECC sent a letter to Costco, requesting verification of 14 purchase orders that Petters, in support of a credit request to GECC, said had been issued by a Costco affiliate between June 1, 2000 and August 9, 2000, for more than $50 million worth of high-end luxury goods. Costco employees investigated and determined that the purchase orders were not real Costco purchase orders. Indeed, while the purchase orders contained actual Costco purchase-order numbers (specific numbers that had been used by a Costco affiliate on purchase orders that were actually issued to other vendors), all of the other information on the purchase orders was false.

21. By at least October 2000 Costco knew that Petters was using falsified Costco purchase orders to fraudulently induce lenders to loan money to Petters so that he could purchase and "sanitize" goods for Costco's benefit, and that—despite that knowledge—Costco encouraged and even facilitated the Petters fraud.

D. Plaintiffs' damages

22. On March 21, 2008, Plaintiffs loaned $31 million to Petters so that he could purchase 232,500 Sony PlayStation video-game consoles ("PS3s") for sale to Costco. In

connection with the loan transaction, Plaintiffs were to have received a perfected security interest in the PS3s.

23. On June 6, 2008, Petters represented to the Plaintiffs that the PS3s had been shipped to buyers, including Costco. But Plaintiffs were unable to receive the promised security interest in the PS3s. On information and belief, Petters could not deliver the promised security interest because Costco's practice of hiding the true origin of goods by altering packaging, shipping labels, SKUs, and purchase orders made it impossible to trace the goods, perfect a security interest, or even confirm that the goods existed.

24. On September 24, 2008, agents from the FBI, the IRS, and other federal agencies, executed search warrants on the headquarters of PCI and on Petters' personal residence. To obtain those search warrants, the FBI filed an affidavit detailing the information that their then on-going investigation of Petters and the Conspirators had revealed. The FBI affidavit represented the following information:

> **(a)** PCI is the venture capital arm of numerous PETTERS enterprises. The money raised by PETTERS through PCI is used by PETTERS for his other business ventures and to support his extravagant lifestyle;
>
> **(b)** PETTERS has solicited investors to invest substantial sums in PCI. To induce investors to invest, the investors were advised funds would be secured by transactions (which were fictitious). Investors were then provided with false documents relating to purchase and resale merchandise. The fraudulent documents purport to evidence PCI purchasing merchandise from vendors . . . . Additional purchase orders falsely detail PCI's sale of the same merchandise to [retail] stores . . . ."

25. In December 2010, Petters was tried and convicted. He was later sentenced to serve a 50-year prison sentence for 20 counts of fraud, conspiracy, and money

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laundering. That fraud included the PS3s that were to have been purchased (with the money Plaintiffs loaned to Petters) and resold to Costco.

26. But for Costco's Sanitation Fraud and business practice of removing product-tracking information and obfuscating product origins, Petters would not have been able to perpetuate this fraud on the Plaintiffs.

27. By reason of the foregoing, Plaintiffs lost $31 million.

E. Costco conceals Petters' relationship

28. After discovery of the Petters' fraud, Costco immediately undertook efforts to downplay and even hide its relationship to Petters. By way of example, and without limitation, a senior-management employee of Costco testified at the Petters trial that Costco did "very little" business with Petters in 2000, and that neither Costco nor its affiliates were doing any business with Petters in 2008.

29. Five years later, in 2014, Plaintiffs learned—for the first time—that Costco's testimony at the Petters' trial was false and misleading. Costco conducted substantial business with Petters—and continued to do so—even after Costco learned that Petters was creating false Costco purchase orders. By way of example, Costco conducted the following business with Petters:

A. On May 17, 2000, Costco and its affiliates used Petters as a middleman diverter to assist with purchasing, financing, sanitizing, and delivering to Costco $11 million worth of Razor-brand scooters.

B. In 2002, Costco used Petters as a middleman to assist with purchasing, financing, sanitizing, and delivering to Costco $3 million of Fendi and Prada handbags.

C. In 2003, Costco used Petters as a middleman diverter to assist with purchasing, financing, sanitizing, and delivering to Costco almost $1 million of handbags from Burberry, Christian Dior, and Prada.

D. In 2003, Costco used Petters as a middleman diverter to assist with purchasing, financing, sanitizing, and delivering to Costco approximately $16 million of Coach handbags.

30. Costco fraudulently concealed its relationship with Petters at the Petters trial. Plaintiffs therefore lacked knowledge sufficient to commence this cause of action until the later discovery of Costco's fraudulent concealment.

CAUSES OF ACTION

COUNT I
(Consumer Fraud)

31. The Plaintiffs incorporate Paragraphs 1 through 30 as if fully set forth herein.

32. By reason of the foregoing, Costco has and continues to act, use, or employ fraud, false pretense, false promises, misrepresentations, misleading statements, or deceptive practices, with the intent that others rely thereon in connection with the sale of merchandise, all violating Minn. Stat. § 325F.69.

33. The public has and continues to have been misled, deceived, or damaged by Costco's fraud, false pretense, false promises, misrepresentations, misleading statements, or deceptive practices.

34. Costco has and continues to undertake these practices with the intent that others rely upon its misrepresentations, misleading statements, and deceptive practices in connection with Costco's sale of merchandise.

35. Plaintiffs' action will benefit the public.

36. Plaintiffs have been misled, deceived, and damaged in an amount in excess of $50,000 by Costco's fraud, false pretense, false promises, misrepresentations, misleading statements, or deceptive practices.

COUNT II
(Deceptive Trade Practice)

37. The Plaintiffs incorporate Paragraphs 1 through 36 as if fully set forth herein.

38. Costco has and continues to: (a) pass off goods or services as those of another; (b) cause a likelihood of confusion or of misunderstanding as to the source, sponsorship, approval, or certification of goods or services; (c) cause a likelihood of confusion or of misunderstanding as to affiliation, connection, or association with, or certification by, another; (d) use deceptive representations or designations of geographic origin in connection with goods or services; (e) represent that goods or services have sponsorship, approval, characteristics, ingredients, uses, benefits, or quantities that they do not have or that a person has a sponsorship, approval, status, affiliation, or connection that the person does not have; (f) represent that goods are original or new that are really

deteriorated, altered, reconditioned, reclaimed, used, or secondhand; (g) represent that goods or services are of a particular standard, quality, or grade, or that goods are of a particular style or model, if they are of another; and/or (h) otherwise engage in conduct which similarly creates a likelihood of confusion or of misunderstanding, all violating Minn. Stat. § 325D.44.

39. Plaintiffs are persons likely to be damaged by the deceptive-trade practices of Costco, within the meaning of Minn. Stat. § 325D.45.

40. By reason of the above, Plaintiffs are entitled to an injunction, under the principles of equity and on terms that the court considers reasonable, which brings an end to Costco's deceptive-trade practices.

COUNT III
(Attorneys' Fees)

41. The Plaintiffs incorporate Paragraphs 1 through 40 as if fully set forth herein.

42. Costco has willfully engaged in a deceptive-trade practice knowing it to be deceptive.

43. Under Minn. Stat. § 325D.45 and Minn. Stat. § 8.31(3a), Plaintiffs are entitled to an award of all attorneys' fees.

Prayer for Relief

Plaintiffs pray for judgment in their favor, and against Costco, as follows:

A. For damages in excess of $50,000, together with interest and penalties, as provided by law;

B. An injunction against Costco, preventing Costco, and those acting in concert and participation with Costco, from continuing the deceptive-trade practices described in this Complaint;

C. Granting Plaintiffs an award equal to all of their costs, disbursements, and attorneys' fees in this action; and

D. For other relief as the Court may deem just and equitable.

Dated: April 19, 2017

GREENE ESPEL PLLP

/s/ Lawrence M. Shapiro
Lawrence M. Shapiro, P.A., Reg. No. 130886
Jenny Gassman-Pines, Reg. No. 386511
Sybil Dunlop, Reg. No. 390186
222 S. Ninth Street, Suite 2200
Minneapolis, MN 55402
(612) 373-0830

Attorneys for Plaintiffs

ACKNOWLEDGMENT

The undersigned hereby acknowledges that costs, disbursements and reasonable attorney and witness fees may be awarded pursuant to Minn. Stat. § 549.211, subdivision 2, to the party against whom the allegations in this pleading are asserted.

/s/ Lawrence M. Shapiro
Lawrence M. Shapiro