

Evidentiary Analysis of the Button Defect on 60,000 Ladies Jacket Item [Redacted]

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Names have been changed, except for Costco, which is not a party to the lawsuit.

This matter involves an approximate half-million-dollar loss by a garment company (“JLI”) that sold 60,000 ladies jackets to Costco. The jackets were manufactured in China by a Chinese factory, and inspected in China by “XYZ,” an international quality control and testing conglomerate, according to test specifications prepared by Costco. After delivery of the jackets to hundreds of Costco stores in the U.S., the entire lot was found by Costco to be defective because of buttons falling off the jackets. XYZ had failed to report the button defect. Consequently, JLI is suing XYZ.

Initially, the owner of JLI provided about 25 pages of business documentation, including emails, to the attorney, who turned this evidence over to an expert in the field of quality control and testing procedures in the garment industry. That expert was supposed to testify that XYZ’S inspection of the jackets was beneath the standard of care. However, after examining the evidence (i.e. about 25 pages) he reported to the attorney that he would not be a good witness because his finding was that XYZ had done its job adequately, that there was no material problem with the buttons, and that the reason Costco refused to pay for the shipment was because the jacket was not selling well!

The attorney was in a pickle and asked me to look at the 25 pages of documents, together with the email from the expert stating there was no button problem. After reviewing these documents, I came to the same conclusion that the expert had! The 25 pages provided by the client did not contain enough business information to support the claims made by the client. I suggested to the attorney that she let me investigate. I then met

with the client and worked directly with his staff to dig out about 1,500 pages of relevant business documents. I then conducted an extensive analysis on all this information and produced this report, which has 79 exhibits, all of which I found in the client's files. (The exhibits are not included in this sample.) The attorney is thrilled with my report because it now forms the evidentiary basis of her case. She is currently presenting it to another quality control/testing expert.

1. Purpose of this Report

[Redacted], Inc. (hereinafter, "**JLI**") is an apparel company in [redacted], CA that designs garments, contracts with overseas factories for their manufacture, and sells them to stores primarily within the United States.

In or shortly before May 2006, JLI negotiated with Costco Wholesale, Inc. (hereinafter "**Costco**") and reached a deal (hereinafter "**Costco Deal One**") wherein Costco would purchase ladies jackets, JLI style No. [redacted], JLI Item No. [redacted] (hereinafter "**Jackets**") in the quantity of 60,000 Jackets. The finished Jackets would be packed in cartons (hereinafter "**Cartons**"), each containing 24 Jackets in an identical assortment of sizes and colors, folded and arranged in the particular manner they would be placed on Costco shelves. The 60,000 Jackets would thus be packed in 2,500 Cartons.

The 24 Jackets in a Carton would all be enclosed in a single plastic bag. When Costco places garments, such as the Jackets, on its shelves, it simply opens the Carton, lifts out the plastic bag, places the bag of garments on its shelf, and then pulls the plastic bag off, sliding it out from under the garments. Thus, in placing the garments on its shelves, Costco employees do not handle the individual garments much. Costco has no dressing rooms for apparel customers. Customers just rummage through the stacks of garments to find what they want.

Each Jacket had approximately seven buttons. The buttons were "jean buttons" that attach with a nail from the back, rather than with thread. Unfortunately, when the Jackets were manufactured, the process was somehow defective (perhaps because some of the nails were applied with excessive force), and, consequently, the fabric around some of the buttons was damaged to an extent that of the buttons came off easily (hereinafter

the “**Button Defect**”). The Button Defect was not uniform. In the worst cases, buttons readily fell off when a Jacket was picked up. In most cases, however, defective buttons would survive some amount of handling, and then fall off. When buttons fell off, they left a hole in the fabric.

The Button Defect was not concentrated on a subset of the Jackets, or on a subset of the Cartons, but rather was scattered among Jackets in all 2,500 Cartons. It appears from the data that a large portion of the 60,000 Jackets had at least one Button Defect, thus rendering the entire lot of 60,000 Jackets defective and unsuitable for sale. As discussed in detail below, it appears that, of the seven buttons on each Jacket, approximately 1.3 buttons per Jacket had the Button Defect.

The Button Defect was not discovered by Costco employees at the time of placing the Jackets on the shelves because those employees did not handle the Jackets much at all. Undoubtedly, some Costco customers noticed the Button Defect as they rummaged through the Jackets, but Costco has no convenient way for its customers to report problems with products on its shelves. Of the customers who noticed the Button Defect, some may have elected not to purchase a Jacket; but others might have selected a different Jacket whose buttons appeared to be intact (but might have later come off after being fastened and unfastened a few times); and still others may have been lucky enough to find a Jacket that did not have the Button Defect. Still other customers may have purchased the Jacket without inspecting it carefully enough to notice the Button Defect, only to be confronted with it when they got home, pulled the Jacket out of the bag and noticed one of the buttons had fallen off in the bag—or when they tried to put on the Jacket and had a button come off in their hands as they attempted to fasten it. Presumably, most of the customers who purchased defective Jackets eventually returned them to Costco for a refund, but they had an entire year to do so.

The purposes of this report are (a) to estimate the number of Jackets actually sold to Costco customers and not returned, (b) to estimate the extent of the Button Defect, and (c) to organize and present the evidence in support these estimates.

We do not have any actual sales data on the Jackets from Costco, so we must estimate sales from other data received from Costco. The Button Defect was not discovered until the 2,500 Cartons had been delivered to hundreds of Costco stores, an unknown number of those Cartons had been opened and their Jackets placed on Costco shelves, and many had been purchased by customers.

When Costco customers began returning the Jackets at a spectacular rate, Costco launched an investigation and determined that the Button Defect was pervasive and that the entire lot of 60,000 Jackets did not meet Costco's quality requirements. At that point, Costco (a) immediately pulled the remaining Jackets from its shelves and (b) refused to pay JLI for the unsold Jackets, including the Jackets in the Cartons that had not yet been opened. Costco also debited JLI's account for the returned Jackets.

2. History and Analysis

The story began when JLI and Costco negotiated Costco Deal One for the initial purchase of 60,000 Jackets.

In order to finance the manufacture of its products, JLI utilizes the financial "factoring" services of FFT Group/Commercial Services, Inc. in Danville, Virginia (hereinafter "FFT"). Consequently, JLI's receivables were assigned to FFT, and when JLI invoiced Costco, Costco paid those invoices to FFT. Hence, copies of Costco checks set forth in the Exhibits attached hereto are made payable to "FFT Group O/A [redacted]" Upon receipt of checks from Costco, FFT would credit the amount owed on JLI's account, and cut JLI a check for the difference.

2.1. Costco Deal One

Costco Deal One was primarily oral, but is presumably supported by Costco published guidelines, standards, etc., that we do not presently have. Costco Deal One is also evidenced by a large number of documents referenced herein. Costco Deal One

appears to have been reached on or shortly before May 18, 2006. Costco Deal One had the following pertinent terms, which have been gleaned from these many documents as well as discussions with Malcolm Bruno (hereinafter “**Bruno**”), the principal of JLI, and other people in the JLI offices:

- (a) JLI would cause 60,000 Jackets to be manufactured and packed in Cartons at a factory in China ([redacted] Products Co. Ltd., located in the city of Changzhou, in the province of Jiangsu, People’s Republic of China, hereinafter the “**Factory**”). JLI was responsible for paying the Factory for the Jackets.
- (b) The Jackets would be inspected at or near the Factory by [redacted] (hereinafter “**XYZ**”), an international quality control and testing conglomerate, according to specifications prepared by Costco. JLI was responsible for paying XYZ for the inspection.
- (c) The Jackets would be shipped via boat across the Pacific Ocean, and then via truck to a warehouse in Los Angeles operated by [redacted] (hereinafter “**RWW**”).
- (d) Costco would issue a first set of Costco purchase orders (hereinafter each a “**CPO**” and collectively the “**First CPO Set**”) to JLI for the Jackets, at the price of \$23.90 per Jacket, payable from Costco to JLI, with each CPO designating a specific number of jackets (in round Cartons) to be shipped to a specific Costco distribution center within the United States. Taken together, the First CPO Set would total the 60,000 Jackets. [As discussed below, a total of 16 CPOs were issued in this First CPO Set, for delivery of the 60,000 jackets to a total of 8 Costco distribution centers (some of the centers were designated in multiple CPOs).]

- (e) Costco would schedule the trucking of the Jackets from RWW in Los Angeles, CA according to a precise schedule. Different trucks, from various trucking companies, would pick up portions of the 2,500 Cartons for shipment to their destined Costco distribution centers. The cost of this shipping from Los Angeles to the various Costco centers was to be paid by Costco, and was thereby included in the \$23.90 price per Jacket.
- (f) Upon receipt of the Jackets in Los Angeles, CA from China, RWW would label the Cartons according to the CPOs for pickup by the various trucking companies, and, when the trucks arrived, would load the trucks. JLI was responsible for paying RWW for its warehousing, labeling and unloading/loading services.
- (g) JLI would invoice Costco for the Jackets, with a separate invoice for each CPO.
- (h) In the event of the return of Jackets by Costco customers, Costco would deduct the price of the returned Jackets from its payments on JLI's invoices via "RV" debit entries. In addition, in the event of returns, Costco would deduct one or more promotion-related charges from its payments on JLI's invoices via "DFP" debit entries. (This author has been unable to ascertain the details of the DFP deductions, which appear to be complex and widely variable in nature, but they are not relevant to estimating Jacket sales or the extent of the Button Defect.)

On May 18, 2006 JLI placed an order with the Factory for the 60,000 Jackets for a total price of \$756,000. This is evidenced by a letter of credit by [redacted] (hereinafter the "**Letter of Credit**"), which is attached hereto as **Exhibit 1**. On page 2 it specifies shipment no later than July 31, 2006, and that shipment terms are "FOB SHANGHAI."

This means that the Factory was responsible for loading the shipment onto a boat in the port of Shanghai, China, no later than July 31, 2006, at which point ownership of the Jackets would pass from the Factory to JLI. JLI was responsible for paying the freight charge (via boat) and for duties. The July 31, 2006 deadline was crucial for meeting Costco's tight scheduling requirements. If the Factory were to miss the deadline, it would be forced to ship the Jackets via air (rather than boat) and would be responsible for paying the VERY significant increase in shipping costs (the total weight of the 2,500 Cartons was about 117,453 pounds).

The Jackets were not actually shipped until sometime after August 12, 2006, and they were shipped by boat, evidently pursuant to some subsequent agreement not known to this author. However, JLI suspects that the Button Defect was known to the Factory, but that if the Factory had taken the time to fix it, they would have missed the new shipping deadline, and would have had to bear the cost of shipping by air.

On May 19, 2006 Costco issued a Textile Test & Inspection Request Form Confirmation (hereinafter the "**Inspection Request**"), which is attached hereto as **Exhibit 2**. The Inspection Request (as set forth in the Exhibit) includes various attached documents, and for convenient reference the entire set of pages is hand numbered by this author with circled numbers in the lower right corner of each page.

The Inspection Request specifies the factory production schedule on page 8, which indicates the Jackets were to exit the Factory on 7/31/2006. It specifies on page 2 that the inspection was to be done on a random sample taken from a minimum of 10,000 Jackets.

The Factory manufactured the Jackets.

On August 14, 2006, XYZ issued a Costco Apparel / Home Textiles Inspection Report (hereinafter the "**Inspection Report**"), which is attached hereto as **Exhibit 3**.

The Inspection Report is 20 pages long with its page numbers in the top right corner (except for page 1).

The Inspection Report states on page 1 that XYZ inspected the Jackets on August 11-12, 2006. It states on page 1 that the test sample was taken from 9,000 Jackets (which was 1,000 less than the 10,000 Jackets specified in the Inspection Request). It states on page 3 that the test sample consisted of 500 Jackets. It shows photographs of buttons on Jackets on pp. 8, 9 and 10. It indicates on p. 14 that, pursuant to Costco Inspection Protocol (PC-101-US), 14 specific checks were to be made on the buttons (section “E. Button holes & Buttons”), including “In-secure button.” Since (as discussed below) approximately 1.3 buttons per Jacket were defective, and the defective Jackets were randomly distributed among the 2,500 Cartons, the 500 Jackets in the test sample would likely have included approximately 650 Button Defects. But the Button Defect is nowhere mentioned in the Inspection Report.

On August 15, 16 and September 1, 2006, Costco issued the First CPO Set consisting of 16 CPOs, which are attached hereto as **Exhibit 4**, and are summarized in **Table 1** below. In Table 1, the first column contains the JLI Invoice number, which is discussed below and is included for indexing purposes. As shown on the 16 CPOs in the said Exhibit (but not shown in Table 1) each CPO indicates that the freight type is “COL” (see the right side of each CPO, half way down, where they each say “FRT TYPE COL”), which means “collect” and that Costco therefore pays the freight from Los Angeles, CA to the destination Costco distribution center.

JLI Invoice	CPO date	CPO #	Jackets	Amount	Costco Destination
8972	8/15/06	262-0815-326	360	\$8,604.00	College Park, GA
8973	8/15/06	175-0815-709	5,496	\$131,354.40	Monroe Tnsp, NJ
8974	8/15/06	175-0815-710	5,760	\$137,664.00	Monroe Tnsp, NJ
8975	8/15/06	175-0815-711	5,760	\$137,664.00	Monroe Tnsp, NJ
9028	8/15/06	171-0815-455	576	\$13,766.40	Sumner, WA
9029	8/15/06	171-0815-452	3,264	\$78,009.60	Sumner, WA

9030	8/15/06	171-0815-454	5,760	\$137,664.00	Sumner, WA
9031	8/15/06	288-0815-273	3,504	\$83,745.60	Dallas, TX
9032	8/15/06	267-0815-335	1,848	\$44,167.20	Morris, IL
9036	8/15/06	584-0815-397	2,400	\$57,360.00	Salt Lake City, UT
9083	8/15/06	960-0815-856	5,760	\$137,664.00	Mira Loma, CA
9084	8/15/06	960-0815-852	5,760	\$137,664.00	Mira Loma, CA
9088	8/16/06	960-0815-542	1,392	\$33,268.80	Mira Loma, CA
9089	9/1/06	960-0815-601	2,352	\$56,212.80	Mira Loma, CA
9090	8/15/06	179-0815-487	5,760	\$137,664.00	Tracy, CA
9091	8/15/06	179-0815-479	4,248	\$101,527.20	Tracy, CA
TOTALS			60,000	\$1,434,000.00	

Table 1
Costco Purchase Orders in the First CPO Set

The 2,500 Cartons were received in Los Angeles by RWW on or about August 24, 2006, and were picked up therefrom by Costco in sixteen shipments (one for each CPO) which departed from Los Angeles on various dates from August 24 to September 5, 2006. In reliance on XYZ's Inspection Report, JLI did not request that RWW open the Cartons or re-inspect the Jackets. The Jackets were presumed, on the basis of the Inspection Report, to meet quality requirements and to be properly packed in the 2,500 Cartons. RWW simply unloaded the Cartons from the incoming trucks, labeled them for Costco destinations, warehoused them, and loaded them into to the outgoing trucks. The Cartons were not opened by RWW (at least not at this point in the story).

RWW invoiced JLI for its unloading, labeling, warehousing and loading service on two invoices, #5732 and #5737, which are attached hereto, respectively, as **Exhibits 5 and 6**. Behind each RWW invoice are the bills of lading for the shipments listed. (RWW invoice #5732 additionally includes services in connection with two irrelevant shipments to Laredo, TX and two irrelevant shipments to Mira Loma, CA.) Also, JLI's check stubs in payment of the two RWW invoices are included at the back of Exhibits 5

and 6. These two RWW invoices are summarized in **Table 2**. Again the JLI invoice number is included for indexing purposes.

JLI Invoice	RWW Invoice	Jackets	CPO #	Costco Destination	Shipper	Actual Ship Date	Weight (pounds)
8972	5732	360	262-0815-326	College Park, GA	yellow	8/24/06	705
8973	5732	5,496	175-0815-709	Monroe Tnsp, NJ	alliance	8/28/06	10,763
8974	5732	5,760	175-0815-710	Monroe Tnsp, NJ	alliance	8/28/06	11,280
8975	5732	5,760	175-0815-711	Monroe Tnsp, NJ	alliance	8/28/06	11,280
9028	5732	576	171-0815-455	Sumner, WA	schneidr	8/29/06	1,128
9029	5732	3,264	171-0815-452	Sumner, WA	schneidr	8/29/06	6,392
9030	5732	5,760	171-0815-454	Sumner, WA	schneidr	8/30/06	11,280
9031	5732	3,504	288-0815-273	Dallas, TX	schneidr	8/30/06	6,862
9032	5732	1,848	267-0815-335	Morris, IL	yellow	8/30/06	3,619
9036	5737	2,400	584-0815-397	Salt Lake City, UT	integrity	8/31/06	4,700
9083	5737	5,760	960-0815-856	Mira Loma, CA	costco	9/1/06	11,280
9084	5737	5,760	960-0815-852	Mira Loma, CA	costco	9/1/06	11,280
9088	5737	1,392	960-0815-542	Mira Loma, CA	costco	9/6/06	2,679
9089	5737	2,352	960-0815-601	Mira Loma, CA	costco	9/6/06	4,606
9090	5737	5,760	179-0815-487	Tracy, CA	may trkg	9/5/06	11,280
9091	5737	4,248	179-0815-479	Tracy, CA	may trkg	9/5/06	8,319
TOTAL		60,000					117,453

Table 2
Initial Shipments from Los Angeles to Costco

As each shipment of Jackets departed from Los Angeles, JLI invoiced Costco on the applicable CPO. There were a total of 16 JLI invoices that corresponded to the 16 CPOs in the First CPO Set. These 16 JLI invoices were in a file at JLI, and each invoice was stapled to its corresponding CPO and to the bill of lading for the shipment from Los

Angeles to the Costco destination. The 16 JLI invoices for the First CPO Set are set forth in **Exhibits 7 through 22** and summarized in **Table 3** (where the “Actual Ship Date” column shows the date that the truck left Los Angeles, CA for a Costco distribution center):

JLI Invoice	Ex #	JLI Invoice Date	Jackets	Amount	CPO	Costco Destination	Actual Ship Date
8972	7	8/24/06	360	\$8,604.00	262-0815-326	College Park, GA	8/24/06
8973	8	8/24/06	5,496	\$131,354.40	175-0815-709	Monroe Tnsp, NJ	8/28/06
8974	9	8/24/06	5,760	\$137,664.00	175-0815-710	Monroe Tnsp, NJ	8/28/06
8975	10	8/24/06	5,760	\$137,664.00	175-0815-711	Monroe Tnsp, NJ	8/28/06
9028	11	8/29/06	576	\$13,766.40	171-0815-455	Sumner, WA	8/29/06
9029	12	8/29/06	3,264	\$78,009.60	171-0815-452	Sumner, WA	8/29/06
9030	13	8/29/06	5,760	\$137,664.00	171-0815-454	Sumner, WA	8/30/06
9031	14	8/30/06	3,504	\$83,745.60	288-0815-273	Dallas, TX	8/30/06
9032	15	8/30/06	1,848	\$44,167.20	267-0815-335	Morris, IL	8/30/06
9036	16	8/31/06	2,400	\$57,360.00	584-0815-397	Salt Lake City, UT	8/31/06
9083	17	9/1/06	5,760	\$137,664.00	960-0815-856	Mira Loma, CA	9/1/06
9084	18	9/1/06	5,760	\$137,664.00	960-0815-852	Mira Loma, CA	9/1/06
9088	19	9/1/06	1,392	\$33,268.80	960-0815-542	Mira Loma, CA	9/6/06
9089	20	9/4/06	2,352	\$56,212.80	960-0815-601	Mira Loma, CA	9/6/06
9090	21	9/3/06	5,760	\$137,664.00	179-0815-487	Tracy, CA	9/5/06
9091	22	9/3/06	4,248	\$101,527.20	179-0815-479	Tracy, CA	9/5/06
Totals			60,000	\$1,434,000			

Table 3
JLI’s Invoices on the First CPO Set

2.2. Discovery of the Button Defect

Over the next several weeks, the 60,000 Jackets were trucked from Los Angeles to 8 Costco distribution centers, and, from there, were shipped internally by Costco to

more than 300 Costco stores, and were ultimately placed on the Costco shelves. The timing of placement on shelves depended on the driving distance—store shelves in Southern California got the Jackets much sooner than those on the East Coast. As discussed below, it appears that the Jackets were first placed on the shelves in stores (presumably in Southern California) on or about August 31, 2006. Clearly, it was an attractive item at an attractive price because, notwithstanding that some customers must have noticed the Button Defect and passed on it, the Jacket sold quite well. As discussed below, as of November 14, 2006, there were 22,401 Jackets in the possession of Costco customers—*i.e.* 22,401 Jackets had been purchased and not returned.

However, on September 23, 2006, Costco computers flagged a problem—customers were returning the Jackets at spectacular rates at most or all Costco stores. In other words, the rate of returns was much higher than the normal rate of returns on this type of product. The computer system reported the problem to Costco management. The Buyer immediately telephoned Bruno and reported the spectacular return rate. At that point neither Costco nor Bruno knew why the Jackets were being returned—the Button Defect was not yet known to Costco or to JLI.

Two days after that, on September 25, 2006, the Costco Buyer telephoned Bruno and reported that several Costco managers had themselves purchased Jackets, taken them home, and then discovered the Button Defect. This was the first time either Costco or JLI became aware of the Button Defect, but they did not yet know its extent. The Buyer informed Bruno that Costco would launch an investigation.

Three days later, on September 28, 2006 the Costco Buyer telephoned Bruno and reported that Costco's investigation had revealed that the Button Defect was catastrophic. Costco investigators in many stores had examined Jackets on the store shelves and had also opened Cartons (Cartons that had not yet been placed onto the shelves) and found that an unacceptably high portion of the Jackets had one or more buttons with the Button Defect. The Buyer stated that Costco was pulling the remaining Jackets from its shelves, and was rejecting the unsold Jackets, including those in Cartons that had not yet been

placed on shelves. This meant that Costco would not pay the majority of the \$1,434,000 that JLI had invoiced, which would have been disastrous for JLI and could have forced it out of business.

2.3. Costco Deal Two

JLI immediately proposed another deal to Costco (hereinafter “**Costco Deal Two**”) wherein Costco would ship the unsold Jackets and the returned Jackets back to Los Angeles, JLI would repair and re-inspect the Jackets, and Costco would re-purchase them under new CPOs. The Buyer liked the idea because the Jacket had been selling well, and she told Bruno that Costco would immediately hold a meeting to consider it. 30 minutes later, still on September 28, 2006, the Buyer called Bruno back and announced that Costco was agreeing the Costco Deal Two. The terms of Costco Deal Two were:

- (a) Costco would ship the unsold Jackets and the returned Jackets back to JLI c/o RWW in Los Angeles, either in their original Cartons (holding Jackets never placed on shelves) or in other boxes (holding Jackets removed from the shelves or returned by customers). However, Jackets returned by customers after some date (which turned out to be October 30, 2006) would be not returned to JLI. This shipping would be done in whatever way was most convenient to Costco, and would involve a multiplicity of carriers, shipments and shipment sizes. The cost of this shipping would be deducted from payments on JLI invoices as “FD” (Freight Deduction) debit entries.

- (b) Costco would issue a second set of CPOs to JLI for the repaired Jackets (hereinafter the “**Second CPO Set**”), each designating a Costco distribution center for delivery. [As it turned out, there were 22 CPOs in the Second CPO Set, and some of the distribution centers Costco designated were different from those designated in the First CPO Set.]

- (c) Upon receipt of the Jackets back in Los Angeles from Costco, JLI (through its agent RWW) would open all the Cartons, repair, re-inspect and repack the Jackets into Cartons, label the re-packed Cartons according to the new CPOs in the Second CPO Set for pickup by the various trucking companies, and, when the trucks arrived, would load the trucks. JLI was also responsible for paying for the shipping from Los Angeles back to the various Costco distribution centers.
- (d) JLI would invoice Costco for the Jackets, with a separate invoice for each CPO in the second set.
- (e) In the event of the return of Jackets by Costco customers, Costco would deduct the price of the returned Jackets from its payments on JLI's invoices via "RV" debit entries. No further re-work would be done, and, if the Button Defect persisted, JLI would accept the "RV" debit entries as final.

Costco Deal Two is evidenced (albeit not in much detail) by an email sent from Bruno to Costco on September 28, 2006, a copy of which is attached as **Exhibit 23**.

That same day, and also the next day, September 29, 2006, Bruno contacted XYZ and inquired about the Button Defect. He received a reply from XYZ until October 3, 2006 that denied existence of the Button Defect in the samples tested. A copy of Bruno's second email and XYZ's reply is attached as **Exhibit 24**.

Pursuant to Costco Deal Two, Costco rounded up all the unsold Jackets and all the returned Jackets, charged back their price against JLI's account, and shipped them to Los Angeles. A total of 120 shipments were made from Costco stores, with the vast majority shipped on September 28, 29, 30, October 1, 2, 3, 4, 5, 6, 7, 9, 11, and 13, 2006, plus a few more small shipments on October 24, 27 and 30, 2006. The total number of

jackets shipped back cannot be determined precisely because Costco clerks did not follow consistent procedures in making the charge backs. Individual charge back transactions range from single Jackets to as many as 562 Jackets. The vast majority of the charge back transaction amounts are divisible by \$23.90, which means the clerk used the correct wholesale price of \$23.90 per Jacket. However a few of these charge back amounts are not divisible by \$23.90, which is presumed to indicate that an erroneous price was used. Indeed there are numerous single-Jacket charged backs wrongly entered at what seems to have been the retail price of \$29.45, and still others wrongly entered at various other clearly erroneous prices such as \$27.92, \$28.58 and \$28.66.

The charge back data appears on a 25-page, 1634-line-item statement (hereinafter the “**Long Statement**”) accompanying check #6989268 cut by Costco to FFT Group O/A [redacted] on November 15, 2006. A copy of that check and Long Statement are attached hereto as **Exhibit 25**. The Long Statement has been scanned into a spreadsheet and an analysis of the data has been done. The 1634-line-items in the Long Statement are categorized in **Table 4**:

Category	Orientation	Line items	Debit total	Credit total
DFP (promotion)	debit	12	\$142,424.99	
FD (return freight)	debit	120	\$24,492.32	
“RV” (Jacket returns)	debit	1,490	\$897,674.99	
JLI invoices	credit	11		\$1,070,525.40
“Vendor Account”	debit	1	\$400.00	
Costco Check	debit	1	\$5,533.10	
TOTALS		1,634	\$1,070,525.40	\$1,070,525.40

Table 4
Summary of the Long Statement (Exhibit 25)

Costco’s check #6989268 was for \$5,533.10, was drastically less than the total of the JLI invoices, which exceeded one million dollars.

The nature of the \$142,424.99 in DFP debit entries is not fully understood. These entries have something to do with a promotional program that is inadequately described in a printout obtained from Costco's website by JLI's bookkeeper, a copy of which is set forth in **Exhibit 26**. We believe the DFP charges are completely irrelevant to determining the numbers of jackets that were defective, but they might be relevant to calculating JLI's damages as a result of the Button Defect.

The \$24,492.32 FD charges are for the cost of freight paid by Costco to ship the Jackets back to Los Angeles, CA. There are a total of 120 FD debit entries on the Long Statement, all dated from September 28, 2006 to October 30, 2006, and these entries total \$24,492.32.

Of the 11 invoices entered as credits at the end of the Long Statement, only 9 are for the Jackets (JLI invoices 8972, 8973, 8974, 8975, 9030, 9036, 9083, 9084, and 9091). The two other invoices (JLI invoices 8917 and 8918, totaling \$83,790.00, and set forth in **Exhibit 27**) are for another product (JLI item #107967, style "HEN7") unrelated to the Jacket.

We do not know why Costco included JLI invoices 8917 and 8918 on the Long Statement. Bruno conjectured they were included to make the total come out positive so that a check could be cut. However, Costco could have included some of the other seven then-unpaid JLI Jackets invoices to accomplish that.

This author developed several spreadsheets, two of which are attached as exhibits. **Exhibit 28** sets forth a spreadsheet based on JLI invoice numbers for the purposes of analyzing the JLI invoices, CPOs, shipping, payment of shippers, and invoice payment. **Exhibit 29** sets forth a spreadsheet showing the "RV" entries from the Long Statement, sorted by date.

Since JLI invoices 8917 and 8918 are included on the Long Statement, a question arises as to whether any of the RV entries on the Long Statement are for returns of the unrelated product (JLI item #107967, style “HEN7”) on those two invoices. Evidently they are not, or not to more than a trifling extent. This is because that item had a price of \$12.25, as can be seen on invoices 8917 and 8918 (see Exhibit 27). But none of the RV entries on the Long Statement are for \$12.25, and none is divisible by \$12.25.

However, during the week of August 24-30, 2006, presumably before Costco had gotten the Jackets onto its shelves, there are 6 RV entries on the Long Statement, totaling \$136.50, none of which is divisible by \$23.90. These are all for odd prices that appear to be returns of another product. It would be usual for Costco to debit returns on another product on an unrelated invoice if that product’s invoices had already been paid. It is presumed that these entries are not for the Jackets.

The first RV entry that is divisible by \$23.90 was on August 31, 2006, and that appears to be the very first return of a Jacket, hence, this author believes that the Jackets were first placed on the shelves in stores on or about August 31, 2006.

Anyway, it is reasonable to conclude that the RV total of \$897,674.99 is almost entirely, for Jackets. And, while some Jackets were erroneously charged back at somewhat higher prices, such as the retail price of \$29.45, the vast majority of charge backs are divisible by the correct wholesale price of \$23.90. Using \$23.90 as the divisor and subtracting the 6 non-jackets, we obtain a total of 37,553 Jackets ($\$897,674.99 / \$23.90 - 6$) that, by November 14, 2006, were either (a) returned by customers who had bought them, (b) removed by Costco from its shelves, or (c) never made it out of their Cartons to the shelves.

Therefore, of the 60,000 Jackets, as of November 14, 2006 approximately 37,553 Jackets had been charged back and shipped back to JLI, and the other 22,441 Jackets were in the possession of customers who had purchased them.

Table 5 shows weekly totals of the RV entries in the Long Statement (see Exhibit 29), grouped according to size—the first group is for entries comprising 1-4 Jackets, the second for entries comprising 5-23 Jackets (i.e. less than a carton), and the third entries comprising one carton (24 Jackets) or more.

Week (2006)	amounts less than \$96 (1 to 4 jackets)	jackets returned in groups of 1 to 4	amounts \$96 to \$573 (5-23 jackets)	jackets returned in groups of 5 to 23	amounts over \$573 (1 carton or more jackets)	jackets returned in groups of 1 carton or more	TOTALS
8/23 to 8/30	136.50	not Jackets	-	-	-	-	
8/31 to 9/6	546.90	23	-	-	-	-	
9/7 to 9/13	2,857.10	120	454.10	19	-	-	
9/14 to 9/20	5,114.60	214	860.40	36	-	-	
9/21 to 9/27	6,422.01	269	1,362.30	57	-	-	
9/28 to 10/3	4,690.50	196	5,815.60	243	564,003.96	23,598	
10/4 to 10/10	1,927.77	81	1,724.76	72	269,922.04	11,294	
10/11 to 10/17	5,712.10	239	836.50	35	4,469.30	187	
10/18 to 10/24	4,923.40	206	1,362.30	57	-	-	
10/24 to 10/31	4,421.50	185	932.10	39	-	-	
Jacket Subtotal		1,533		558		35,079.00	37,170
11/1 to 11/7	4,182.50	175	669.20	28	-	-	
11/8 to 11/14	3,895.70	163	406.30	17	-	-	
Dollar totals	44,830.58		14,423.56		838,395.30		897,649.44
Jacket totals		1,877		603		35,079	37,553

Table 5
Summary by Week and Group Size of the RV Entries on the Long Statement

Returns at in the third group (1 Carton or more) commenced on September 28, 2006, the same day Costco Deal Two was made. It was at that point that Costco began making RV entries for Jackets that had not been sold. All RV entries prior to that date were for returns by customers.

The last shipment of Jackets from Costco to Los Angeles occurred on October 30, 2006. We know this because the only Costco check that includes any FD debit entries for the cost of shipping the Jackets back to Los Angeles, is the check issued on November 15, 2006 as detailed in the Long Statement. No other FD debit entries exist. And on the Long Statement, the last date of any FD entry is October 30, 2006 (see Exhibit 25, page 2, line 23—the other Costco checks are discussed below and appear in Exhibits 68 through 88).

Hence, we know that 100% of the shipments by Costco back to Los Angeles happened before the end of October, 2006. We can see from the “Jacket subtotal” line in Table 5 that, by October 31, 2006, a total of 37,170 Jackets had been charged back. Presumably all of those were shipped back to Los Angeles except for 14 charge backs on October 31, 2006, which total \$573.60 or exactly 24 Jackets (see Exhibit 29, pp. 29-30). Subtracting these 24 Jackets from the 37,170 Jackets, we get 37,146 Jackets. Thus, according to the RV entries on the Long Statement, it appears that Costco shipped back approximately 37,146 Jackets.

2.4. Estimating the Extent of the Button Defect

On or about October 6, 2006 RWW began receiving shipments of the Jackets from Costco back into its Los Angeles warehouse. According to this author’s discussion with [redacted] (hereinafter “**Flores**”), principal of RWW, the shipments arrived in great variety—via many different carriers, from small to large numbers of Jackets in a shipment, and with some Jackets in the original Cartons but other packed in other boxes of various sizes.

RWW began inspecting and repairing the Jackets and repacking them into Cartons of 24 Jackets with a plastic bag around all of the Jackets in each Carton. As this progressed, and as completed Cartons of repaired/reinspected Jackets became available, Costco issued the Second CPO Set for the repaired/reinspected Jackets. As the CPOs were issued, RWW labeled the Cartons and shipped them back to Costco at the destinations specified on the CPOs.

RWW invoiced JLI for these services in a set of six invoices, which are set forth in **Exhibits 30 through 35**, which include the JLI check stubs for payment thereon. RWW appears to be somewhat sloppy in its invoicing, given that two of the invoices are #5773, but are on different dates, for completely different line items, and both were paid in full by JLI. (Also, only the last of these six invoices has appropriate backup materials attached. According to JLI’s bookkeeper, at the time RWW presented those invoices he requested that RWW supply backup—however, because of the rush to get the jackets repaired and reshipped, Bruno instructed the bookkeeper just to pay those invoices without burdening RWW with supplying the backup.) According to Flores, the “quantity” in the “button repair” entries on the RWW invoices refer to buttons, not Jackets. Information from these six RWW invoices that is related to inspecting the returned jackets and repairing the defective buttons is summarized in **Table 6**:

RWW Invoice	Date	Returned Jackets	Buttons Repaired	JLI Check #
5759	10/06/06	10,000	2,000	
5763	10/13/06	10,000	5,000	
5773	10/31/06	16,402	17,248	7436
5773?	11/03/06	0	15,863	7488
5784	11/15/06	0	6,884	7492
5800	12/13/06	0	120	7679
TOTALS		36,402	47,115	

Table 6
RWW Button Repair Invoices

A total of 47,115 buttons were repaired.

Costco’s Second CPO Set was for a total of 35,064 Jackets on 22 CPOs, which are set forth in **Exhibit 36**, and are summarized in **Table 7** below. As shown on the 22 CPOs in the said Exhibit (but not shown in Table 7) each CPO indicates that the freight type is “PPD” (see the right side of each CPO, half way down, where they say “FRT TYPE PPD”), which means “prepaid” and that JLI therefore pays the freight from Los Angeles, CA to the destination Costco distribution center. It is crucial to note the distinction between the “PPD” freight type in the Second CPO Set and the “COL” freight type in the First CPO Set (where Costco paid the freight). However, Costco invoice 936-1010-265 (to Tolleson, AZ; JLI invoice 9435) appears to contain an erroneous entry here—the “FRT TYPE PPD” is shown as “COL” but in “TO SHIP” it states “ASAP PPD”—this author assumes the clerk made an error, because JLI did indeed pay the freight charge on that invoice, so it was not collect.

JLI Invoice	CPO date	CPO #	Jackets	Amount	Costco Destination
9424	10/10/06	960-1010-532	1,080	\$25,812.00	Mira Loma, CA
9425	10/10/06	171-1010-402	192	\$4,588.80	Sumner, WA
9426	10/10/06	171-1010-388	3,096	\$73,994.40	Sumner, WA
9427	10/10/06	584-1010-299	1,056	\$25,238.40	Salt Lake City, UT
9428	10/10/06	179-1010-498	2,112	\$50,476.80	Tracy, CA
9429	10/10/06	175-1010-503	5,352	\$127,912.80	Monroe Tnsp, NJ
9430	10/10/06	645-1010-221	408	\$9,751.20	Raleigh, NC
9431	10/10/06	288-1010-261	312	\$7,456.80	Dallas, TX
9435	10/10/06	936-1010-265	288	\$6,883.20	Tolleson, AZ
9436	10/10/06	584-1010-303	1,104	\$26,385.60	Salt Lake City, UT
9504	10/26/06	175-1026-399	5,688	\$135,943.20	Monroe Tnsp, NJ
9505	10/26/06	171-1026-397	2,352	\$56,212.80	Sumner, WA
9506	10/26/06	936-1010-285	2,496	\$59,654.40	Tolleson, AZ
9507	10/26/06	267-1026-274	1,200	\$28,680.00	Morris, IL

9508	10/26/06	584-1026-318	672	\$16,060.80	Salt Lake City, UT
9533	10/26/06	179-1026-460	2,616	\$62,522.40	Tracy, CA
9534	10/26/06	960-1026-574	4,080	\$97,512.00	Mira Loma, CA
9613	12/1/06	116-1201-220	240	\$5,736.00	Albuquerque, NM
9614	12/1/06	684-1201-226	96	\$2,294.40	Plano, TX
9615	12/1/06	304-1201-222	216	\$5,162.40	Brookfield, CT
9616	12/1/06	204-1201-229	168	\$4,015.20	Fairfax, VA
9617	12/1/06	213-1201-229	240	\$5,736.00	Gaithersburg, MD
TOTALS			35,064	\$838,030.00	

Table 7
Costco Purchase Orders in the Second CPO Set

Note: the original of JLI invoice #9613 is missing from the JLI files, but was available on its computer records, which indicate it was for the Jacket.

What we see here is a pattern of activity during the last days of September and all of October 2006 of (a) Costco charging back 37,146 Jackets and shipping them back to Los Angeles, (b) RWW receiving 36,402 Jackets from Costco and repairing 47,115 buttons, and (c) Costco then re-ordering a total of 35,064 Jackets. Why did these number decline slightly?

- 37,146 Jackets as gleaned from the Long Statement
- 36,402 Jackets as reported on the RWW invoices
- 35,064 Jackets on the Second CPO Set

The first discrepancy (between 37,146 and 36,402) can be explained because the 37,146 is known to be excessive in that (as discussed above) this author used \$23.90 as the divisor when some Jackets were charged back at higher prices. Also, Costco might not have shipped all the Jackets back. The second discrepancy (between 36,402 and 35,064) can be explained because, as reported to this author by Flores, many Jackets were

received back from Costco that were too badly damaged to repair and had to be discarded.

The above-stated estimate of 1.3 defective buttons per Jacket was calculated by dividing the 47,115 buttons repaired by the 35,064 Jackets, which comes to 1.344 repaired buttons per Jacket. According to Flores, the Button Defects were scattered, more or less randomly, among the hundreds of Cartons and other boxes received back from Costco.

Repair was done by hand-stitching the holes back together, and then nailing on new buttons. However, **approximately 1,338 of Jackets were defective beyond repair** (36,402 Jackets received back by RWW, minus 35,064 Jackets re-ordered by Costco). According to Flores, this was generally because buttons came off leaving holes too large, or with the fabric too damaged around the hole, for it to be stitched back together. That comprises 3.8% of the 36,402 Jackets returned by Costco, and it comprises 2.23% of the original 60,000 Jackets.

2.5. Reshipment of the Jackets to Costco

As each re-shipment of Jackets departed from Los Angeles, JLI invoiced Costco on the applicable CPO. There were a total of 22 JLI invoices that corresponded to the 22 CPOs in the Second CPO Set. We found 21 of these 22 JLI invoices in a file at JLI (invoice 9613 is missing in its original form, but was found on the JLI computer system), and each invoice was stapled to its corresponding CPO and to the bill of lading for the shipment from Los Angeles to the Costco destination. The 22 JLI invoices for the Second CPO Set are set forth in **Exhibits 37 through 58** and summarized in **Table 8**:

JLI Invoice	Ex #	JLI Invoice Date	Jackets	Amount	CPO	Costco Destination	Actual Ship Date
9424	37	10/11/06	1,080	\$25,812.00	960-1010-532	Mira Loma, CA	10/11/06
9425	38	10/11/06	192	\$4,588.80	171-1010-402	Sumner, WA	10/11/06
9426	39	10/11/06	3,096	\$73,994.40	171-1010-388	Sumner, WA	10/11/06

9427	40	10/11/06	1,056	\$25,238.40	584-1010-299	Salt Lake City	10/11/06
9428	41	10/11/06	2,112	\$50,476.80	179-1010-498	Tracy, CA	10/11/06
9429	42	10/12/06	5,352	\$127,912.80	175-1010-503	Monroe Tnsp, NJ	10/11/06
9430	43	10/13/06	408	\$9,751.20	645-1010-221	Raleigh, NC	10/13/06
9431	44	10/13/06	312	\$7,456.80	288-1010-261	Dallas, TX	10/13/06
9435	45	10/13/06	288	\$6,883.20	936-1010-265	Tolleson, AZ	10/13/06
9436	46	10/13/06	1,104	\$26,385.60	584-1010-303	Salt Lake City	10/13/06
9504	47	10/26/06	5,688	\$135,943.20	175-1026-399	Monroe Tnsp, NJ	10/26/06
9505	48	10/26/06	2,352	\$56,212.80	171-1026-397	Sumner, WA	10/27/06
9506	49	10/26/06	2,496	\$59,654.40	936-1010-285	Tolleson, AZ	10/27/06
9507	50	10/26/06	1,200	\$28,680.00	267-1026-274	Morris, IL	10/27/06
9508	51	10/26/06	672	\$16,060.80	584-1026-318	Salt Lake City	10/30/06
9533	52	11/1/06	2,616	\$62,522.40	179-1026-460	Tracy, CA	11/3/06
9534	53	11/1/06	4,080	\$97,512.00	960-1026-574	Mira Loma, CA	11/2/06
9613	54	12/4/06	240	\$5,736.00	1161201220	Albuquerque, NM	???
9614	55	12/4/06	96	\$2,294.40	684-1201-226	Plano, TX	12/4/06
9615	56	12/5/06	216	\$5,162.40	304-1201-222	Brookfield, CT	12/4/06
9616	57	12/5/06	168	\$4,015.20	204-1201-229	Fairfax, VA	12/4/06
9617	58	12/5/06	240	\$5,736.00	213-1201-229	Gaithersburg, MD	12/4/06
Totals			35,064	\$838,029.60			

Table 8
JLI's Invoices on the Second CPO Set

JLI had to pay the freight charges for the re-shipment of the Jackets from Los Angeles back to the Costco distribution centers. JLI's records of payment on these re-shipments are set forth in **Exhibits 59 through 62**. However, it appears Fedex never invoiced JLI on one re-shipment (JLI invoice 9504), and Yellow Transportation never invoiced JLI on four re-shipments (JLI invoices 9614, 9615, 9616, 9617). Also, this author was unable to identify the re-shipper for JLI invoice 9613. Nonetheless, Costco paid on all six of those invoices (9504, 9613, 9614, 9615, 9616, 9617) as indicated from

the Costco check records (discussed below). All the re-shipments are summarized in

Table 9, where the unknown items are shown as question marks:

JLI check	Ex #	JLI invoice	Destination	Shipper	Actual Ship Date	Freight Bill Number	Weight (lbs)	Fright Bill Charge
7408	59	9429	Monroe Tnsp, NJ	fedex	10/11/06	905345700	9143	\$5,100.00
7408	59	9436	Salt Lake City, UT	fedex	10/13/06	097014840-6	1886	\$1,031.20
7424	60	9424	Mira Loma, CA	yellow	10/11/06	572-263222-8	1845	\$1,749.17
7424	60	9425	Sumner, WA	yellow	10/11/06	572-263224-6	328	\$751.37
7424	60	9426	Sumner, WA	yellow	10/11/06	572-263220-x	5289	\$5,484.47
7424	60	9427	Salt Lake City, UT	yellow	10/11/06	572-263223-7	1804	\$1,703.27
7424	60	9428	Tracy, CA	yellow	10/11/06	572-263221-9	3608	\$3,119.45
7424	60	9431	Dallas, TX	yellow	10/13/06	572-287833-4	533	\$447.54
7515	61	9430	Raleigh, NC	yellow	10/13/06	572-287832-5	697	\$770.48
7515	61		Raleigh, NC		diverted	926-633219-7	697	\$866.43
7515	61	9435	Tolleson, AZ	yellow	10/13/06	572-287834-3	492	\$218.99
7515	61	9505	Sumner, WA	yellow	10/27/06	572-239776-2	3920	\$2,206.72
7515	61	9506	Tolleson, AZ	yellow	10/27/06	572-239849-6	4160	\$1,239.25
7515	61	9507	Morris, IL	yellow	10/27/06	572-239850-5	2000	\$1,477.18
7515	61	9508	Salt Lake City, UT	yellow	10/30/06	572-198352-0	1120	\$519.49
7550	62	9533	Tracy, CA	yellow	11/3/06	572-256248-8	4280	\$1,404.96
7550	62	9534	Mira Loma, CA	yellow	11/2/06	572-291959-3	6800	\$1,107.16
????	-	9504	Monroe Tnsp, NJ	fedex	10/26/06	905342939	1080	\$4,900.00
????	-	9613	Albuquerque, NM	????	????	????	????	????
????	-	9614	Plano, TX	yellow	12/4/06	572-285704-x	172	????
????	-	9615	Brookfield, CT	yellow	12/4/06	572-285707-7	387	????
????	-	9616	Fairfax, VA	yellow	12/4/06	572-285709-5	301	????
????	-	9617	Gaithersburg, MD	yellow	12/4/06	572-285708-6	430	????

Table 9

Re-Shipments from Veron to Costco

///

2.6. Estimating the Total Jackets Sold And Not Returned

For the purpose of estimating the total Jackets sold and not returned, we will count both Costco orders (Costco Deals One and Two), and let Jackets cycle around the loop of being returned and then re-sold.

Costco reported the Jacket charge backs on the statements accompanying its checks. As stated above, Costco's first check for the Jackets is set forth in Exhibit 25, and it includes both returns by customers and Jackets never sold. The remaining checks (with their much shorter accompanying statements) are set forth in **Exhibits 63 through 79**, but, unlike Exhibit 25, they do not contain any Jackets never sold (because they contain no FD entries and last shipment back to Los Angeles was on October 30, 2006). All the Costco checks, from both Exhibit 25 and Exhibits 63-79, are summarized in **Table 10**.

In Table 10, Costco checks crediting only one JLI invoice are shown in a single line, with that JLI invoice; and checks crediting multiple invoices are shown in multiple lines, with the JLI invoices totaled for that check. Returned jacket figures are estimated by dividing the RV amounts by \$23.90.

Costco Check #	Ex #	Costco Check Date	Costco Check amount	JLI invoice #	JLI invoice credit entries	Total misc. debit entries (DFP, FD, other)	Total RV debit entries	returned jackets
6989268	25	11/15/06	\$5,533.10	8975	\$137,664.00			
				8917	\$69,266.40			
				8918	\$14,523.60			
				8972	\$8,173.80			
				8973	\$131,354.40			
				8974	\$137,664.00			
				9030	\$137,664.00			
				9036	\$57,360.00			
				9083	\$137,664.00			

				9084	\$137,664.00				
				9091	\$101,527.20				
				<hr/>					
				11 inv	\$1,070,525.40	\$167,317.31	897,674.99	37,559	
							non-jackets	<hr/>	6
									37,553
7000013	63	11/22/06	\$137,090.40	9090	\$137,664.00		573.60	24	
7006952	64	11/28/06	\$29,376.80	9031	\$83,745.60	\$45,000.00	9,368.80	392	
7046846	65	12/26/06	\$161,262.73	9426	\$11,472.00				
				9427	\$25,238.40				
				9429	\$127,912.80				
				<hr/>					
				3 inv	\$164,623.20	\$220.50	3,139.97	131	
7048652	66	12/27/06	\$51,079.82	9424	\$25,812.00				
				9436	\$26,385.60				
				<hr/>					
				2 inv	\$52,197.60		1,117.78	47	
7083022	67	1/22/07	\$58,200.74	9533	\$61,375.20		3,174.46	133	
7095113	68	1/31/07	\$7,412.53	9428	\$573.60				
				9431	\$7,456.80				
				<hr/>					
				2 inv	\$8,030.40		617.87	26	
7092277	69	1/29/07	\$123,246.65	9426	\$62,522.40				
				9425	\$4,588.80				
				9428	\$49,903.20				
				9430	\$9,751.20				
				<hr/>					
				4 inv	\$126,765.60		3,518.95	147	
7096718	70	2/1/07	\$6,363.51	9435	\$6,883.20		519.69	22	
7108239	71	2/9/07	\$125,614.88	9504	\$135,943.20	\$6,728.00	3,600.32	151	

7116468	72	2/15/07	\$15,763.70	9508	\$16,060.80		297.10	12	
7114656	73	2/14/07	\$28,182.28	9507	\$28,680.00		497.72	21	
7111448	74	2/12/07	\$115,495.63	9505	\$56,212.80				
				9506	\$59,654.40				
				2 inv	\$115,867.20		371.57	16	
7121143	75	2/20/07	\$88,045.88	9534	\$97,512.00	\$8,000.00	1,466.12	61	
7162750	76	3/21/07	\$6,958.04	9614	\$2,294.40				
				9615	\$5,162.40				
				2 inv	\$7,456.80		498.76	21	
7166641	77	3/23/07	\$5,637.39	9613	\$5,736.00		98.61	4	
7175098	78	3/29/07	\$768.68	9616	\$4,015.20		3,246.52	136	
7351570	79	7/30/07	\$93,470.13	9533	\$1,147.20				
				9617	\$5,736.00				
				10627	\$11,634.84				
				10628	\$119,954.52				
				4 inv	\$138,472.56	\$34,348.43	10,654.00	446	
TOTAL								940,436.83	39,349

Table 10
Costco Checks

Thus, a total of 39,349 Jackets were charged back to JLI by July 31, 2006. These charge backs were against both Costco orders. It is reasonable to assume that any Jackets that were not charged back against JLI's account were sold by Costco to its customers and not returned by those customers (even if demand for the Jackets diminished, Costco

would just mark down the price until they were sold). **Table 11** sets forth the calculation of Jackets sold and not returned:

Jackets manufactured per the First CPO Set	60,000
Jackets refurbished per the Second CPO Set	<u>35,064</u>
Total Jackets purchased by Costco	95,064
Jackets charged back to JLI's account	<u>(39,349)</u>
Jackets sold to customers and not returned	55,715

Table 11
Jacket Sales

Thus, of the 60,000 Jackets manufactured, 55,715 were purchased by customers who did not return them.

3. Conclusions

Pursuant to Costco Deal One, JLI ordered 60,000 Jackets from the Factory, which were inspected in China on August 11-12, 2006 by XYZ according to Costco's Inspection Request. XYZ failed to report the Button Defect in its Inspection Report. The 60,000 Jackets were shipped, via Los Angeles CA, and then via eight Costco distribution centers, to over 300 Costco stores in the United States. On or about August 30, 2006, the Costco stores began putting the Jackets on shelves. They sold well, but customers started returning them when they discovered the Button Defect.

Costco discovered the Button Defect on September 28, 2006, and on that date agreed to Costco Deal Two. Approximately 36,402 Jackets were received back from Costco by RWW in Los Angeles. RWW repaired and re-inspected these Jackets, but discarded approximately 1,338 Jackets as irreparable (36,402 minus the 35,064 ordered in the Second CPO Set). Of the 35,064 non-discarded Jackets, a total of 47,115 buttons

were repaired, which is an average of about 1.3 buttons per Jacket. The repaired Jackets were shipped back to Costco.

The Jacket sold well. Of the 60,000 Jackets manufactured, 55,715 were purchased by Costco customers who did not return them.

The Button Defect should have been reported by XYZ. Flores observed that the Button Defect was randomly scattered through Jackets in virtually all of the 120 shipments RWW received back from Costco. Hence, it is reasonable to conclude that Jackets in most or all of the 2,500 Cartons had the Button Defect.

XYZ inspected 500 Jackets selected from 9,000 Jackets. Those 500 Jackets had a total of 3,500 buttons, each of which was supposed to be checked for “insecure button.” Of those 3,500 buttons, approximately 650 were defective buttons (500 times 1.3), but none is reported on the Inspection Report.

The Factory’s shipment deadline from Shanghai was July 31, 2006, but the inspection did not happen until August 11-12, 2003. This means the Factory was already late. Nonetheless, the Jackets were shipped by boat, presumably pursuant to a negotiated extension of the deadline. However, if the Factory had taken the time to repair the Button Defect, the additional delay might have forced it to incur the cost of shipping 117,453 pounds of Jackets by air.

4. Table of Exhibits

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