IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

SECURITIES AND EXCHANGE COMMISSION,	:	
Plaintiff,	:	**Civil Action No.**
v.	:	
JOSEPH PACIFICO,	:	
Defendant.	:	

COMPLAINT FOR INJUNCTIVE RELIEF

Plaintiff, Securities and Exchange Commission (the "Commission"), files its complaint and alleges that:

OVERVIEW

1. This case involves financial fraud by Defendant Joseph Pacifico ("Pacifico"). From 2004 through 2009, Pacifico was the President of Carter's, Inc. ("Carter's or the "Company") (NYSE: CRI), an Atlanta-based manufacturer of children's clothing.

2. From at least 2004 through March 2009, Joseph Elles, the Executive Vice President of Sales at Carter's who reported to Pacifico, fraudulently manipulated

the amount of discounts Carter's granted Kohl's Corporation ("Kohl's"), Carter's largest wholesale customer, in order to induce Kohl's to purchase greater quantities of Carter's products.

3. These discounts—typically known in the clothing industry as "accommodations"—were intended to help Kohl's defray costs related to inventory clearance and sales promotions, and to allow Kohl's to achieve a desired profit margin.

4. At the same time, to conceal these additional accommodations from Carter's senior management, Elles obtained from Kohl's an agreement to defer taking those accommodations, i.e., deducting them from invoice payments, until later quarters. To further conceal his actions, Elles directed his assistant to create false accommodation tracking sheets for Carter's accounting department which misrepresented the timing of accommodations granted.

6. Elles' misconduct caused Carter's accommodation expense in many quarters to be understated and its income for that quarter to be overstated. In some other quarters, Elles's scheme caused Carter's to materially understate its net income.

7. Pacifico learned of Elles' scheme at least as early as March 2009, when, after Elles' employment was terminated and he entered into a consulting arrangement with Carter's, his replacement discovered the deferred

accommodations owed to Kohl's and brought this information to Pacifico's attention.

8. On April 28, 2009, despite his awareness of the deferred accommodations, Pacifico signed a representation letter stating that $22 million was the budget for 2009 accommodations to be given to Kohl's for the year. Pacifico knew the letter was relied on by Carter's accounting personnel in preparing the company's financial statements. Pacifico also knew that this representation letter did not identify or include the more than $18 million in accommodations to Kohl's that had been carried over from the prior year.

9. Moreover, in May and July 2009, Pacifico approved individual accommodation payments to Kohl's and falsely represented to Carter's accounting personnel that these payments related to accommodations accrued in the current quarter when Pacifico knew that the payments actually related to accommodations earned in earlier periods.

VIOLATIONS

10. Pacifico has engaged and, unless restrained and enjoined by this Court, will continue to engage in acts and practices that constitute and will constitute violations of Section 17(a)(2) of the Securities Act of 1933 ("Securities Act") [15

U.S.C. § 77 q(a)] and Sections 10(b) and 13(b)(5) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §§ 78j(b) and 78m(b)(5)] and Rules 10b-5(b) and 13b2-1 thereunder [17 C.F.R. §§ 240.10b-5(b) and 240.13b2-1].

11. Additionally, Pacifico has engaged, and unless restrained and enjoined by the Court, will continue to engage in acts and practices in violation of Section 20(e) of the Exchange act by aiding and abetting violations of Sections 10(b), 13(a) and 13(b)(2)(A) of the Exchange Act [15 U.S.C. §§ 78j(b), 78m(a) and 78m(b)(2)(A)] and Rules 10b-5(b), 12b-20, 13a-1, 13a-11 and 13a-13 thereunder [17 C.F.R. §§ 240.10b-5(b), 240.12b-20, 240.13a-1, 240.13a-11 and 240.13a-13].

Jurisdiction and Venue

12. The Commission brings this action pursuant to Sections 20(e) and 20(d) of the Securities Act [15 U.S.C. §§ 77t and 77v] and Sections 21(d) and 21(e) of the Exchange Act [15 U.S.C. §§ 78u(d) and 78u(e)] to enjoin Defendant from engaging in the transactions, acts, practices, and courses of business alleged in this complaint, and transactions, acts, practices, and courses of business of similar purport and object, for civil penalties, for an officer and director bar and for other equitable relief.

13. This Court has jurisdiction over this action pursuant to Section 22 of the Securities Act [15 U.S.C. § 77v] and Sections 21(d), 21(e), and 27 of the Exchange Act [15 U.S.C. §§ 78u(d), 78u(e), and 78aa].

14. Defendant, unless restrained and enjoined by this Court, will continue to engage in the transactions, acts, practices, and courses of business alleged in this complaint, and in transactions, acts, practices, and courses of business of similar purport and object.

The Defendant

15. Joseph Pacifico, 67 years of age, resides in Atlanta, Georgia. Pacifico joined Carter's in 1992 and served as the Company's President of Marketing before being promoted to President in 2004, the position he held until his termination in late December 2009.

Relevant Entities

16. Carter's, Inc., is an Atlanta-based company that manufactures and markets in the U.S. apparel exclusively for babies and young children. The company sells clothing under the Carter's and OshKosh brand names as well as private label apparel through its own stores and other retailers. Since October 2003, Carter's common stock has been registered with the Commission under Section 12(b) of the Exchange Act and listed on the NYSE.

17. Kohl's Corporation is a retailer based in Wisconsin. Kohl's operates over a thousand department stores in 49 states. At the time of the misconduct discussed herein, Kohl's was Carter's largest wholesale customer by volume of purchases.

THE FRAUDULENT SCHEME

A. Background

18. As a standard business practice, Carter's gives customers discounts off invoices to help customers defray costs related to inventory clearance and sales promotions and to allow customers to achieve a desired profit margin on their subsequent resales of Carter's products.

19. The granting of such accommodations has been a common arrangement in the clothing industry. Between 2004 and 2009, accommodations worked as follows. Once an accommodation was agreed upon—typically at or near the end of a period—the customer then deducted the accommodation amount from its subsequent payments to Carter's.

20. From an accounting standpoint, an accommodation is technically a contra-revenue account on the books of Carter's, but essentially it functioned as an expense that reduced the revenue otherwise realized by Carter's from the sale to which it related.

21. From at least 2004 until March 2009, Carter's accommodations to Kohl's were negotiated on behalf of Carter's by Elles. Elles was the primary Carter's employee involved in negotiating Kohl's purchases and corresponding

accommodation amounts on a quarterly basis and knew the amount of accommodations Carter's owed to Kohl's at any given time.

B. Carter's Accounting for Accommodations

22. Under the matching principle of accounting, an expense should be recognized when incurred and in the same period as the revenue associated with that expense.

23. Unlike sales, which can typically be verified by purchase orders and shipping confirmations, accommodations were oftentimes negotiated amounts that were not finalized until just before or even after the last day of a fiscal period. This timing is a result of the fact that the appropriate amount of accommodations frequently cannot be known until the product is sold through to the end consumer.

24. At Carter's, the total accommodations extended to Kohl's for any given period was never finalized until negotiations were completed for that period during something called "market week," which typically occurred a couple of weeks after the last day of the relevant period but before Carter's closed its books for that period.

25. Although accommodations are taken by customers in the form of deductions against subsequent payments, Generally Accepted Accounting Standards require

that the accommodation be recognized in the same period as the sales to which it related.

26. Carter's accounting department monitored and booked accommodations primarily by using information and documents obtained from Carter's sales department.

27. Specifically, when an accommodation was negotiated and granted to Kohl's, Elles' assistant filled out an Internal Authorization Form (or "IAF") which set forth the details of each accommodation, including the customer, the amount, the date the form was processed, and the apparel category, budget year and selling season to which it related.

28. This form was then forwarded to Carter's Manager of Strategic Planning ("Manager"), who was responsible for managing the company-wide budget for accommodations and tracking any changes therein. After being prepared by his assistant, Elles signed each IAF for Kohl's and caused them to be sent to Carter's accounting department.

29. When a customer actually took an accommodation by deducting it from payment to Carter's, Carter's accounting personnel would check to see if they had a matching IAF on file. If so, they then cleared the residual charge from the customer's account receivable.

30. In doing so, accounting also reviewed information from the customer accompanying the payment as it pertained to the details of the accommodation and checked to see whether it agreed with the IAF. If there were no matching IAFs on file, accounting personnel would contact the Manager or Elles' assistant to ask whether the accommodation was authorized and, if so, the accounting department would request the corresponding IAF. Whenever these individuals received such an inquiry, they would go directly to Elles and relay Elles' response back to accounting.

31. Since at least 2004 through his departure from Carter's in 2009, Elles secretly granted excess accommodations to Kohl's and affirmatively concealed those excess accommodations from Carter's accounting personnel. Specifically, Elles extended accommodations to Kohl's above and beyond what he was budgeted to give, and arranged for Kohl's to delay taking those excess discounts via deductions from its payments to Carter's for a sufficient amount of time such that each accommodation could be mischaracterized to Carter's accounting department as an expense of the period in which it was taken, rather than an expense of the period in which the sale to which it related was recognized by Carter's.

32. Elles' actions produced a net understatement of Carter's accommodations and material overstatement of its net income in the following periods: Q1 2006 (19.1%); Q3 2006 (9.6%); Full FY 2006 (6.7%); Q1 2007 (6.5%); Q3 2007 (5.3%); Q4 2007 (6.7%); Full FY 2007 (5.0%); and Q3 2008 (8.0%). In Q2 2009, Carter's materially understated its net income by approximately 47% as a result of the deferred accommodations.

C. <u>Pacifico Conceals the Fraud from Carter's Management</u>

33. In or around March 2009, Elles' employment with Carter's was terminated and he entered into a consulting arrangement with the company. Thereafter, Pacifico assigned a sales vice president to handle the Kohl's account. In order to get up to speed on the account, the vice president began discussing the Kohl's account with Elles' former assistant who managed the direct day to day relationships with Kohl's.

34. The assistant was well-aware of the agreements for Kohl's to defer taking accommodations and, at Elles' direction, had assisted him in concealing the truth from Carter's senior management.

35. During her first conversation with the sales vice president, the assistant told him about the deferrals and provided him with a spreadsheet she had prepared which tracked them. The assistant's spreadsheet specified the period and category

of goods to which each margin support agreement related, the amount of the margin support and the date to which Kohl's had agreed to defer claiming it for both Carter's and Oshkosh goods. At the time the sales vice president learned of the deferrals, the spreadsheet showed that approximately $18 million of margin support had been incurred in 2008 but deferred into 2009.

36. In March or April 2009, shortly after learning of the deferrals, the sales vice president prepared a memorandum recapping his understanding of the deferrals shown on the spreadsheet for both Carter's and Oshkosh products, and set forth his recommendation on how to resolve the problem over the next two years.

37. The memorandum plainly referred to the "carryover" into 2009 for both Carter's and Oshkosh products sold in 2008 totaling approximately $18 million.

38. The sales vice president personally delivered the memorandum to Pacifico and discussed it with him.

39. During this discussion, the sales vice president also expressed his concern that senior management did not know about the issue. Pacifico assured the sales vice president that Pacifico would discuss the issue with them.

40. Prior to April 28, 2009, the sales vice president had at least three additional discussions with Pacifico regarding the deferrals, and showed Pacifico an e-mail

from Kohl's in which Kohl's made the point that the deferrals had to be cut down to no more than thirty days.

41. Pacifico knew that accommodations could not be deferred in this manner. In a March 13, 2003 memo from Pacifico to Elles, Pacifico instructed that accommodations could not be deferred to later fiscal years. The memo stated that charging accommodations for one year in the following year could not be done because "[i]t is illegal." During his conversations with the sales vice president, Pacifico noted that the deferred accommodations would likely necessitate a restatement of Carter's financial statements

42. Although Pacifico knew that it was improper to defer accommodations, during one of his discussions of the deferrals with the sale vice president in 2009, Pacifico stated that he did not want to know anything about Fall 2008 margin support paid in 2009.

43. On April 28th, Pacifico signed a representation letter addressed to Carter's CFO, falsely asserting, among other things, that Carter's planned to pay Kohl's $22 million in margin support in 2009.

44. Pacifico knew this representation was false because it did not include the $18 million in margin support that the sales vice president had told him was carried over from 2008 in addition to the $22 million budgeted for 2009.

45. Pacifico knew that that this information would be relied upon by Carter's accounting personnel in preparing Carter's financial statements that would be filed with the Commission and made available to the public.

46. On April 29, 2009, Pacifico discussed the company's first quarter financial results in its wholesale business on the company's quarterly earnings conference call. In his comments, Pacifico intentionally overstated Carter's first quarter earnings because he knew they did not reflect the 2008 accommodations that Kohl's had deferred until 2009.

47. Pacifico subsequently approved an IAF for $6.5 million in accommodations to Kohl's on May 12, 2009, Carter's second quarter. The IAF falsely claimed that the accommodations related to second quarter sales when Pacifico knew that they were agreed to in January 2009 and related to fourth quarter 2008 business.

48. On August 3, 2009, Carter's third quarter, Pacifico approved an IAF for $2.1 million in accommodations to Kohl's. That IAF falsely represented that the accommodation related to third quarter sales when Pacifico knew that they actually related to first quarter 2009 business.

49. Based on the information that the sales vice president had given him regarding the deferrals, Pacifico knew or was reckless in not knowing that these two IAF's related to an earlier period.

50. Pacifico knew or was reckless in not knowing that Carter's accounting personnel would rely on these IAFs to record the accommodations as second and third quarter 2009 expenses, respectively, in Carter's accounting records.

51. Despite his knowledge of the deferrals and his understanding that the deferrals would necessitate a restatement of Carter's financial statements, Pacifico concealed the deferrals from Carter's senior management until at least September 2009.

52. Moreover, in August 2009, Elles' eventual replacement as Executive Vice President of Sales showed Pacifico a copy of the spreadsheet prepared by Elles' assistant. That spreadsheet clearly identified the deferred accommodations due Kohl's. Pacifico again failed to report the problem to Carter's senior management.

53. This Executive Vice President of Sales eventually informed Carter's CFO of the deferred accommodations and the full scope of the problem was soon addressed and resolved. Carter's terminated Pacifico in late December 2009 after it reviewed the preliminary results of the internal investigation.

D. Impact of the Fraud

54. On October 27, 2009, following discovery of Elles' scheme, Carter's announced that it was delaying the issuance of its third quarter financial results in order to complete a review of its accounting for margin support provided to its

wholesale customers. On the same day, the Company's stock price dropped 23.8% to a closing price of $21.66 from the previous day's closing price of $28.44.

55. Shortly thereafter, on November 10, 2009, Carter's announced in a Form 8-K that management's review had "identified issues with respect to the timing of recognizing such margin support payments and the associated historical accounting treatment as a result of margin support commitments that were not disclosed to the Company's finance group."

56. Carter's also announced that its Audit Committee, with the assistance of outside counsel, had begun a review of margin support payments more broadly and an investigation into undisclosed margin support commitments and related matters.

57. In the same Form 8-K, the Company also announced that as a result of the review, its previously issued financial statements for the fiscal years 2004 through 2008 included in the Company's Forms 10-K, and for the fiscal quarters from September 29, 2007 through July 4, 2009 included in the Company's Forms 10-Q, should no longer be relied upon and would be restated. On November 10, 2009, the Company's stock price dropped 9.1% to a closing price of $21.86 from the previous day's closing price of $24.04.

E. Carter's Sells Shares in 2009 While its Share Price is Inflated from the Fraud

58. During 2009, Carter's regularly issued stock options, with the strike price based on the current market price, and allowed employees to exercise stock options and issued restricted stock to certain employees. These options were issued pursuant to a Form S-8 that was filed and effective in May 2005 and registered an offering of up to 5.1 million shares of common stock pursuant to the company's 2003 Equity Incentive Plan.

59. The S-8 incorporates by reference all subsequently-filed Exchange Act reports until such time as a post-effective amendment (PEA) was filed indicating that all of the securities have been sold or terminating the offering and deregistering any unsold securities. According to EDGAR, no PEA has been filed so the offering is ongoing and the first quarter 2009 Form 10-Q would have been automatically incorporated by reference into the S-8 upon filing of that Form 10-Q.

60. Carter's 2009 Form 10-K indicated (in Note 6 to the financial statements) that securities were issued pursuant to the 2003 Plan in 2008 and 2009. While Pacifico did not sign the Form S-8 or Carter's quarterly reports, he was well aware that his representation letter would be relied upon in preparing Carter's public filings.

Moreover, Pacifico was issued options pursuant to the Form S-8 in 2008 and 2009.

COUNT I —FAUD

Violations of Section 17(a)(2) of the Securities Act
[15 U.S.C. §§ 77q(a)(2)]

61. Paragraphs 1 through 60 are hereby re-alleged and are incorporated herein by reference.

62. Defendant, in the offer and sale of the securities described herein, by use of means and instruments of transportation and communication in interstate commerce and by use of the mails, directly and indirectly obtained money and or property by means of untrue statements of material fact and omissions to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

63. By reason of the foregoing, Pacifico, directly and indirectly, has violated and, unless enjoined, will continue to violate Section 17(a)(2) of the Securities Act [15 U.S.C. §§ 77q(a)(2)].

COUNT II—FRAUD

Violations of Section 10(b) of the Exchange Act
[15 U.S.C. § 78j(b)]and Rule 10b-5(b) thereunder [17 C.F.R. §§ 240.10b-5(b)]

64. Paragraphs 1 through 60 are hereby re-alleged and are incorporated herein by reference.

65. Defendant, in connection with the purchase and sale of securities described herein, by the use of the means and instrumentalities of interstate commerce and by use of the mails, directly and indirectly, made untrue statements of material facts and omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

66. In engaging in such conduct, Defendant acted with scienter, that is, with an intent to deceive, manipulate or defraud or with a severely reckless disregard for the truth.

67. By reason of the foregoing, Defendant, directly and indirectly, has violated and, unless enjoined, will continue to violate Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5(b) thereunder [17 C.F.R. § 240.10b-5(b)].

COUNT III- INTERNAL CONTROLS

Violations of Section 13(b)(5) of the Exchange Act [15 U.S.C. § 78m(b)(5)] and Rule 13b2-1 thereunder [17 C.F.R. § 240.13b2-1]

68. Paragraphs 1 through 60 are hereby re-alleged and are incorporated herein by reference.

69. By his conduct, Pacifico knowingly circumvented Carter's system of internal controls, knowingly falsified the books, records and/or accounts of Carter's, and knowingly caused to be falsified Carter's books, records and/or accounts.

70. By reason of the foregoing, Pacifico, directly and indirectly, has violated and, unless enjoined, will continue to violate Section 13(b)(5) of the Exchange Act [15 U.S.C. § 78m(b)(5)] and Rule 13b2-1 thereunder [17 C.F.R. § 240.13b2-1].

COUNT IV- AIDING AND ABETTING FRAUD

Aiding and Abetting Violations of Section 10(b) of the Exchange Act
[15 U.S.C. § 78j(b)]and Rule 10b-5(b) thereunder [17 C.F.R. §§ 240.10b-5(b)

71. Paragraphs 1 through 60 are hereby re-alleged and are incorporated herein by reference.

72. Carter's , in connection with the purchase and sale of securities described herein, by the use of the means and instrumentalities of interstate commerce and by use of the mails, directly and indirectly, made untrue statements of material facts and omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

73. In engaging in such conduct, Carter's acted with scienter, that is, with an intent to deceive, manipulate or defraud or with a severely reckless disregard for the truth.

74. Pacifico knowingly or recklessly substantially assisted Carter's violations of Section 10(b) of the Exchange Act and Rule 10b-5(b) thereunder.

75. By reason of the foregoing, Pacifico aided and abetted violations of and, unless enjoined, will continue to aid and abet violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5(b)thereunder [17 C.F.R. §240.10b-5(b)].

COUNT V-AIDING AND ABETTING REPORTING PROVISIONS

Aiding and Abetting Carter's Violations of Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-13 and 240.13a-13]

76. Paragraphs 1 through 60 are hereby re-alleged and are incorporated herein by reference.

77. Through the action described above, Carter's' violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder.

78. The underlying violations occurred when Carter's filed periodic reports that contained financial statements that were not prepared in conformity with GAAP and contained material misstatements.

79. Pacifico knowingly or recklessly substantially assisted Carter's violations of these provisions.

80. By reason of the foregoing, Pacifico aided and abetted violations of and, unless enjoined, will continue to aid and abet violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder.

COUNT VI-AIDING AND ABETTING BOOKS

AND RECORDS PROVISIONS

Aiding and Abetting Carter's Violations of
Section 13(b)(2)(A) of the Exchange Act [15 U.S.C. § 78m(b)(2)(A)]

81. Paragraphs 1 through 60 are hereby realleged and are incorporated herein by reference.

82. Carter's violated Section 13(b)(2)(A) of the Exchange Act, when, as an issuer of securities, it failed to make and keep accounting books, records and accounts which accurately and fairly reflected its transactions and the dispositions of its assets.

83. Through the conduct described above, Pacifico knowingly or recklessly substantially assisted Carter's violations of these provisions.

84. By reason of the foregoing, Pacifico aided and abetted violations of and, unless enjoined, will continue to aid and abet violations of Section 13(b)(2)(A) of the Exchange Act.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff Commission respectfully prays for:

I.

Findings of fact and conclusions of law pursuant to Rule 52 of the Federal Rules of Civil Procedure, finding that Pacifico committed the violations alleged herein.

II.

A permanent injunction enjoining Pacifico, his agents, servants, employees, and attorneys from violating, directly or indirectly, Section 17(a)(2) of the Securities Act [15 U.S.C. § 77 q(a)] and Sections 10(b) and 13(b)(5) of the Exchange Act [15 U.S.C. §§ 78j(b) and 78m(b)(5)] and Rules 10b-5(b) and 13b2-1 thereunder [17 C.F.R. §§ 240.10b-5 and 240.13b2-1], and enjoining Pacifico, his agents, servants, employees, and attorneys, pursuant to Section 20(e) of the Exchange Act, from aiding and abetting violations of Sections 10(b), 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 10b-5(b), 12b-20, 13a-1, 13a-11 and 13a-13 thereunder.

III.

An order pursuant to Section 20(d) of the Securities Act [15 U.S.C. §77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. §78u(d)(3)] imposing civil penalties against Pacifico.

IV.

An order pursuant to Section 20(e) of the Securities Act [15 U.S.C. §77t(e)]and Section 21(d)(2) of the Exchange Act [15 U.S.C. §78u(d)(2)] barring Pacifico from acting as an officer or director of any issuer whose securities are registered with the Commission pursuant to Section 12 of the Exchange Act or which is required to file reports with the Commission pursuant to Section 15(d) of the Exchange Act.

V.

Such other and further relief as this Court may deem just, equitable, and appropriate in connection with the enforcement of the federal securities laws and for the protection of investors.

Dated: October 18, 2012

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