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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN JOSE DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

WEST MARINE, INC.,

Defendant.

Case No. CV 09 3379

COMPLAINT

PVT

Plaintiff Securities and Exchange Commission (the "Commission") alleges:

SUMMARY OF THE ACTION

1. This case involves financial reporting violations by West Marine, Inc. ("West Marine" or the "Company"), a large boating supply retailer headquartered in Watsonville, California. Between 2004 and 2006, the Company filed numerous false and misleading financial statements with the Commission, after making unsubstantiated accounting adjustments.

2. In February 2004, West Marine issued a press release pre-announcing its earnings for fiscal year 2003. Soon thereafter, West Marine determined it needed to change its accounting for vendor allowances (payments West Marine received from product manufacturers), which would reduce its previously announced pre-tax income by approximately $13.2 million. To neutralize the

$13.2 million shortfall, West Marine set out to find an accounting offset and ultimately decided to capitalize 70 percent of its store occupancy costs, including expenses such as rent and utilities.

3. Capitalizing store occupancy costs had the effect of increasing West Marine's net income for the year and directly offset the change in accounting for vendor allowances. This allowed West Marine to avoid having to report in its annual report on Form 10-K, filed with the Commission on March 18, 2004, results inconsistent with those in the February 2004 press release.

4. By capitalizing store occupancy costs in this manner, West Marine violated Generally Accepted Accounting Principles ("GAAP"), and due to this improper offset, West Marine's Form 10-K materially misstated the Company's net income. West Marine also failed to disclose in the Form 10-K that it had changed its accounting for store occupancy costs, as well as its accounting for vendor allowances.

5. West Marine's subsequent registration statements (which offered company stock to employees) and annual and periodic reports continued to contain the materially false information until West Marine announced a restatement in 2007.

6. In making these significant accounting changes without disclosure, West Marine failed to take reasonable care to ensure that its accounting changes were appropriate. Accordingly, West Marine violated certain antifraud provisions of the Securities Act of 1933, as well as the reporting, books-and-records, and internal-controls provisions of the Securities Exchange Act of 1934.

JURISDICTION, VENUE, AND INTRADISTRICT ASSIGNMENT

7. This Court has jurisdiction over this action pursuant to Sections 20(b) and 22(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77t(b) and 77v(a)] and Sections 21(d), 21(e), and 27 of the Securities Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. §§ 78u(d), 78u(e), and 78aa].

8. Defendant, directly or indirectly, made use of the means and instrumentalities of interstate commerce or of the mails in connection with the acts, transactions, practices, and courses of business alleged in this Complaint.

9. Venue is proper in this District pursuant to Section 22 of the Securities Act [15 U.S.C. § 77v] and Section 27 of the Exchange Act [15 U.S.C. § 78aa] because acts, transactions, practices, and courses of business constituting violations occurred in the Northern District of California.

10. Assignment to the San Jose Division is appropriate pursuant to Local Civil Rules 3-2(c) and 3-2(e) because a substantial part of the events which give rise to the claim occurred in the county of Santa Cruz.

DEFENDANT

11. West Marine, a California corporation headquartered in Watsonville, California, is a large boating supply retailer, with 300 stores nationwide and annual net sales ranging from $661 to $680 million between 2003 and 2007. It was founded in 1976 and became a publicly traded company in 1993. During the relevant period, West Marine's common stock was registered under Section 12(g) of the Exchange Act and traded on the NASDAQ Global Market under the symbol WMAR.

FACTUAL ALLEGATIONS

12. Because of its size, West Marine successfully negotiates and receives vendor allowances worth millions of dollars annually. Generally vendor allowances reduce the cost of inventory purchased for resale because manufacturers provide cash or some other consideration to offset the cost of inventory to a retailer such as West Marine.

13. Before 2002, West Marine generally recognized vendor allowances as a reduction of cost of sales without regard to when the inventory on which the allowance was earned was actually sold. The practice at other retailers varied; unlike West Marine, some recognized vendor allowances only when they sold the inventory on which the allowance was earned.

14. In 2002, the Financial Accounting Standards Board issued new authoritative literature regarding the accounting for vendor allowances: Emerging Issues Task Force No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor" ("EITF 02-16").

15. EITF 02-16 requires an entity receiving vendor allowances to recognize them through the income statement upon sale of the inventory to better match the revenues with the cost of

inventory related to revenues. EITF 02-16 applies to vendor agreements entered into after November 21, 2002.

16. Throughout 2003, West Marine's management was focused on the adoption of EITF 02-16. In its 2003 quarterly reports on Form 10-Q, West Marine stated that, because most of its 2003 vendor arrangements were finalized before November 2002, it did not expect the adoption of EITF 02-16 to significantly affect its 2003 financial results. West Marine made similar representations to its external auditors.

17. On February 19, 2004, West Marine issued a press release announcing its financial results for 2003. Boasting that it surpassed 2003 earnings guidance, West Marine reported annual net income of $20.1 million, primarily due to favorable gross margins.

18. Shortly after the announcement, however, West Marine determined that it had not complied with EITF 02-16 and that, as a result, it needed to make a negative adjustment to its beginning inventory balance. Doing so materially reduced the book value of West Marine's inventory by approximately $13.2 million. That reduction in inventory book value would have required West Marine to reduce the already announced pre-tax income for the period by $13.2 million, or approximately 53 percent.

19. Faced with a $13.2 million reduction to West Marine's already announced earnings, the Company devised a solution by using an unrelated accounting adjustment that would offset the $13.2 million reduction. The solution was to add retail store occupancy costs as a component of inventory book value. Store occupancy costs are those costs incurred by West Marine to operate its retail stores and include such things as rent and utilities. Historically, and in accordance with GAAP, West Marine expensed store occupancy costs as incurred and included them as a component of cost of sales on the income statement (*i.e.*, West Marine did not capitalize them).

20. Under GAAP, a company may not capitalize store occupancy costs, unless those costs are specific to warehousing goods at the retail stores (by example, stores that sell items in bulk and structure their stores as warehouses may be able to capitalize some store occupancy costs).

21. In late February or early March 2004, as part of the audit of West Marine's fiscal year 2003 financial statements, West Marine prepared a spreadsheet showing the method by which it

determined certain inventory costs. The spreadsheet showed that vendor allowances and store occupancy costs were included in inventory costs for both 2003 and 2002. Accordingly, it was unclear from the analysis that significant accounting changes were being made and, in fact, suggested that West Marine was using a consistent method between 2003 and 2002 – *i.e.*, that West Marine in 2002 included both vendor allowances and store occupancy costs in inventory costs and made no change in its accounting in 2003. West Marine e-mailed the spreadsheet to its outside auditors, but provided no written explanation of these significant accounting changes.

22. When making significant accounting changes, the Company's historical and subsequent practice involved detailed discussions by Company management with its audit committee and with its outside auditors in formal quarterly meetings. Typically, the accounting changes were further supported by comprehensive research memoranda produced by Company management. Here, however, the Company deviated considerably from its usual conduct. West Marine prepared no written materials for the outside auditors or audit committee other than the spreadsheet described above.

23. West Marine filed its 2003 Form 10-K on March 18, 2004. Because West Marine improperly capitalized store occupancy costs, the report materially overstated West Marine's net income. In addition, the report failed to disclose the changes in accounting principles West Marine had made with respect to vendor allowances and store occupancy costs. West Marine also falsely stated that it had yet to determine the impact of adopting EITF 02-16 and that EITF 02-16 did not have a significant impact on its 2003 financial statements. In fact, as implemented by West Marine, EITF 02-16 had a significant impact on its 2003 financial statements and would have reduced the Company's pre-tax income by $13.2 million if not for the improper offset relating to store occupancy costs.

24. On May 27, 2005, West Marine filed a Form S-8 registering the offer of 375,000 shares and on May 11, 2006, West Marine filed a Form S-8 registering the offer of an additional 475,000 shares. Both registration statements incorporated by reference the false financial information contained in the Company's 2003 Form 10-K.

25. On February 27, 2007, West Marine announced that it would restate its financial statements for fiscal years ended December 28, 2002, through December 31, 2005, and its quarterly results for fiscal year 2005 and the first three quarters of fiscal year 2006. West Marine indicated that the restatement would correct the improper accounting for two inventory-related accounting changes made in their fiscal year 2003: (1) the inclusion of store operating costs in inventory value; and (2) the improper reporting of a cumulative change in accounting principle for vendor allowances included in inventory value.

26. In an annual report on Form 10-K filed March 27, 2007, West Marine reported its restated financial results for 2002 through 2005. Among other things, the Company reduced its previously reported 2003 net income from $20.1 million to $5.6 million – a 72 percent reduction. The following chart shows the yearly changes in net income:

Fiscal Year	Previously Reported Net Income/(Loss)	Restated Net Income/(Loss)	$ Reduction to Reported Net Income	% Reduction to Reported Net Income
2002	$18,908,000	$18,351,000	($ 557,000)	(3 %)
2003	$20,090,000	$ 5,634,000	($14,456,000)	(72%)
2004	$25,534,000	$22,178,000	($ 3,356,000)	(13%)
2005	($2,179,000)	($2,314,000)	($ 135,000)	(6%)

FIRST CLAIM FOR RELIEF

Violations of Section 17(a)(2) and (3) of the Securities Act

27. The Commission realleges and incorporates by reference Paragraphs 1 through 26.

28. By engaging in the conduct alleged above, West Marine, directly or indirectly, in the offer or sale of securities, by use of the means or instruments of transportation or communication in interstate commerce or by use of the mails obtained money or property by means of untrue statements of material fact or omissions to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and engaged in transactions, practices, or courses of business which operated or would operate as a fraud or deceit upon purchasers.

29. By reason of the foregoing, West Marine has violated and, unless restrained and enjoined, will continue to violate Section 17(a)(2) and (3) of the Securities Act [15 U.S.C. § 77q(a)(2) and (3)].

SECOND CLAIM FOR RELIEF

Violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13

30. The Commission realleges and incorporates by reference Paragraphs 1 through 26.

31. Based on the conduct alleged above, West Marine violated Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 12b-20, 13a-1, and 13a-13 thereunder [17 C.F.R. §§ 240.12b-20, 240.13a-1, and 240.13a-13], which obligate issuers of securities registered pursuant to Section 12 of the Exchange Act [15 U.S.C. § 78*l*] to file with the Commission accurate periodic reports, including annual and quarterly reports.

32. Unless restrained and enjoined, West Marine will continue to violate these provisions of the Exchange Act.

THIRD CLAIM FOR RELIEF

Violations of Section 13(b)(2)(A) of the Exchange Act

33. The Commission realleges and incorporates by reference Paragraphs 1 through 26.

34. West Marine, by engaging in the conduct described above, failed to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflected the transactions and dispositions of the assets of the Company, in violation of Section 13(b)(2)(A) of the Exchange Act [15 U.S.C. § 78m(b)(2)(A)].

35. Unless restrained and enjoined, West Marine will continue to violate Section 13(b)(2)(A) of the Exchange Act [15 U.S.C. § 78m(b)(2)(A)].

FOURTH CLAIM FOR RELIEF

Violations of Section 13(b)(2)(B) of the Exchange Act

36. The Commission realleges and incorporates by reference Paragraphs 1 through 26 above.

37. West Marine, by engaging in the conduct described above, failed to devise and maintain a sufficient system of internal controls

38. Unless restrained and enjoined, West Marine will continue to violate Section 13(b)(2)(B) of the Exchange Act [15 U.S.C. § 78m(b)(2)(B)].

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that this Court enter a final judgment:

A. Enjoining West Marine from violating, directly or indirectly, Section 17(a)(2) and (a)(3) of the Securities Act and Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1, and 13a-13 thereunder; and

B. Retaining jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered, or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court; and granting such other and further relief as this Court may determine to be just and necessary.

Respectfully submitted,

Dated: July 23, 2009

Robert Leach

Robert S. Leach
Attorney for Plaintiff
SECURITIES AND EXCHANGE COMMISSION