

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

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CLERK US DISTRICT COURT
WESTERN DISTRICT OF TEXAS

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SEALED

UNITED STATES OF AMERICA,)
)
Plaintiff,)
)
v.)
)
(1) JOHN RAFFLE, and)
(2) DAVID APPLGATE)
)
Defendants.)

CRIMINAL NO. 1:12 CR 314-SS

INDICTMENT

[Violation: 18 U.S.C. § 371 - Conspiracy to
Commit Wire, Mail and Securities Fraud;
18 U.S.C. §§ 1343 and 2 - Wire Fraud;
18 U.S.C. §§ 1341 and 2 - Mail Fraud; and
18 U.S.C. §§ 1348 and 2 - Securities Fraud]

THE GRAND JURY CHARGES:

General Allegations

At all relevant times to this Indictment:

Relevant Entities

1. ArthroCare Corporation ("ArthroCare") was a Delaware corporation headquartered in Austin, Texas.
2. Among other products, ArthroCare sold medical devices that used its patented technology, called Coblation, to physicians and surgery centers. Coblation technology was designed to be used by physicians in surgical procedures to remove soft tissue in a way that was minimally invasive.
3. ArthroCare sold medical devices directly to physicians, surgery centers and other end-users through its sales representatives and sales agents. In addition, ArthroCare sold

medical devices to distributors, who would then resell ArthroCare's products to physicians, surgery centers, and other end-users.

4. ArthroCare's stock was traded publicly on NASDAQ, a national securities exchange, and its stock was registered with the United States Securities and Exchange Commission ("SEC") pursuant to Section 12(b) of the Securities Exchange Act of 1934.

5. Distributor 1 was a privately owned Oklahoma corporation, which was incorporated in 1988. Distributor 1 was located at 44550 Deason Drive, Edmond, Oklahoma. Distributor 1 primarily sold ArthroCare's ENT products, and acted at various times as a sales agent and distributor for ArthroCare. Distributor 1 consisted of two individuals: the owner and one employee, and was operated out of the personal residence of the owner.

6. DiscoCare, Inc. ("DiscoCare") was a privately owned Delaware corporation, which was incorporated in 2005. DiscoCare was located at 2047 Palm Beach Lakes, Suite 200, West Palm Beach, Florida. ArthroCare was DiscoCare's only supplier. At various times, DiscoCare was ArthroCare's largest single distributor of medical devices. On December 31, 2007, ArthroCare acquired DiscoCare.

7. Distributor 2 was a privately owned California corporation, which was incorporated in 1982. Distributor 2 acted as a distributor of ArthroCare's medical devices.

8. Distributor 3 was a privately owned Pennsylvania corporation, which was incorporated in 1981. Distributor 3 acted as a distributor of ArthroCare's medical devices.

The Defendants

9. From 1997 until December 2008, Defendant **JOHN RAFFLE** was employed by ArthroCare. From approximately June 2001 until approximately May 2006, **RAFFLE** was Vice

President of Corporate Development and Legal Affairs. From approximately May 2006 until December 2008, **RAFFLE** was the Senior Vice President of Strategic Business Units. As Senior Vice President of Strategic Business Units, all marketing and sales staff in the United States reported to **RAFFLE**.

10. From 2001 until December 2008, Defendant **DAVID APLEGATE** was employed by ArthroCare. In approximately February 2004, **APLEGATE** became the Vice President in charge of ArthroCare's Spine division. As the Vice President in charge of the Spine division, all sales and marketing staff in the Spine division reported to **APLEGATE**. In April 2008, **APLEGATE** was promoted to Senior Vice President.

11. As ArthroCare employees, **RAFFLE** and **APLEGATE** received salary, bonuses, stock options and other benefits that were directly tied to the financial performance of ArthroCare.

The Federal Securities Laws and SEC Rules and Regulations

12. The SEC was an independent agency of the United States government that was charged by law with preserving honest and efficient markets in securities. The federal securities laws, regulations, and rules were designed to ensure that the financial information of publicly traded companies was accurately recorded and disclosed to the investing public. As a publicly traded company, ArthroCare and its directors, officers, and employees were required to comply with the federal securities laws, regulations and rules. Under the federal securities laws and regulations, ArthroCare was required, among other things, to file with the SEC annual reports (known as SEC Forms 10-K), quarterly reports (known as SEC Forms 10-Q), and other periodic reports that included accurate and reliable financial statements.

The Scheme to Defraud

A. Overview of the Scheme

13. Between in or about December 2005 through in or about December 2008, **RAFFLE, APLEGATE** and others, known and unknown, devised, intended to devise, and executed a scheme to defraud ArthroCare's shareholders and members of the investing public by (a) inflating falsely ArthroCare's earnings by tens of millions of dollars, (b) failing to disclose the terms of purported sales between ArthroCare and some of its largest distributors, and (c) concealing millions of dollars in commission payments that ArthroCare paid to its distributors.

14. **RAFFLE, APLEGATE** and other co-conspirators inflated falsely ArthroCare's sales and revenue through a series of end-of-quarter transactions involving several of ArthroCare's distributors. After **RAFFLE** and **APLEGATE** determined the type and amount of product to be shipped to distributors based on ArthroCare's need to meet sales forecasts, rather than the distributors' actual orders, **RAFFLE, APLEGATE** and others caused ArthroCare to ship millions of dollars worth of ArthroCare's medical devices to its distributors at the end of each relevant quarter. ArthroCare would then report these shipments as sales in its quarterly and annual filings at the time of the shipment, enabling the company to meet or exceed internal and external earnings forecasts.

15. In fact, as **RAFFLE** and **APLEGATE** knew, ArthroCare's distributors agreed to accept shipment of millions of dollars of product because ArthroCare had agreed to: (a) provide the distributors extended payment terms, (b) pay the distributors substantial, upfront cash commissions, (c) allow the distributors to return the product, (d) in some cases, allow the distributors to make payments to ArthroCare only after the distributor actually sold the product to end-users, and (e) in some cases, acquire the distributor and the excess inventory so that the

distributor would not have to ultimately pay ArthroCare for the products at all. This caused ArthroCare to inflate falsely its revenue by tens of millions of dollars, as ArthroCare was prohibited from counting such shipments as sales under Generally Accepted Accounting Principles (“GAAP”). In addition, ArthroCare failed to disclose the conditions related to the shipment of the product in its quarterly and annual filings. In essence, **RAFFLE** and **APPLEGATE** caused ArthroCare to park tens of millions of dollars of its inventory with its distributors, while causing ArthroCare to inform investors that it had actually sold the product.

16. At the beginning of each month, ArthroCare was obligated to pay commissions to distributors on ArthroCare’s purported sales to the distributor from the prior month. The commission payments were calculated either as a flat percentage of the purported sales to the distributors or as a lump sum, depending on the distributor. Under GAAP, ArthroCare was required to offset revenue by the amount of these commission payments, thereby reducing ArthroCare’s earnings. To avoid that earnings reduction, **RAFFLE** mischaracterized, and caused others to mischaracterize, the payments due to distributors as marketing fees and expenses. Through this fraudulent representation, **RAFFLE** concealed approximately \$4 million in commissions from being disclosed by ArthroCare, thereby inflating ArthroCare’s revenue by the same amount.

B. Purpose of the Scheme

17. The purpose of the scheme was to (a) conceal from ArthroCare’s shareholders, the investing public and ArthroCare’s internal accountants and external auditors the true nature of the purported sales and commissions to ArthroCare’s distributors, (b) cause ArthroCare to make materially false and fraudulent representations to its shareholders and the investing public about ArthroCare’s financial condition in order to maintain and increase the market price of

ArthroCare's stock, and (c) enrich **RAFFLE, APLEGATE** and others through compensation related to the artificially inflated sales figures.

C. False Inflation of ArthroCare's Earnings

18. Shareholders of ArthroCare stock, stock market analysts and members of the investing public tracked ArthroCare's earnings per share or "EPS." EPS was considered a key determinant of a company's share price because it reflected a company's profitability. ArthroCare reported its EPS each quarter in Forms 10-Q, and each year in Forms 10-K, which were filed with the SEC.

19. Prior to ArthroCare's financial reporting for each quarter and for each year, stock market analysts issued forecasts for the company's EPS. The average of the analysts' predictions about ArthroCare's EPS was referred to as the "consensus EPS."

20. **RAFFLE, APLEGATE** and other senior executives at ArthroCare closely tracked the consensus EPS for each quarter and each year.

21. For each financial reporting period from December 2005 through December 2007, ArthroCare purportedly met or exceeded the stock market analysts' consensus EPS. For 2005, the consensus EPS for ArthroCare was \$0.89; ArthroCare reported an EPS of \$0.89. For 2006, the consensus EPS for ArthroCare was \$1.16; ArthroCare reported an EPS of \$1.18. For 2007, the consensus EPS for ArthroCare was \$1.50; ArthroCare reported an EPS of \$1.50.

22. As described in Paragraphs 14 and 15 above, **RAFFLE, APLEGATE** and others directed the end-of-quarter shipments to ArthroCare's distributors in order to overcome quarterly revenue shortfalls and to meet the consensus EPS. **RAFFLE, APLEGATE** and others concealed the true nature of the purported sales on the end-of-quarter shipments from

ArthroCare's internal accountants and external auditors so that ArthroCare could recognize as revenue the purported sales in ArthroCare's publicly filed financial statements and so that ArthroCare would meet the consensus EPS.

(i) Distributor 1

23. From the Third Quarter 2006 through the Second Quarter 2008, **RAFFLE** caused ArthroCare to ship its products to Distributor 1, the vast majority of which occurred at or near quarter-end, based on the volume of business ArthroCare needed to meet its company-wide revenue numbers.

24. At **RAFFLE**'s direction, ArthroCare shipped product to Distributor 1 that far exceeded Distributor 1's needs, and shipped product that Distributor 1 did not need and, in one case, even order. Between the Third Quarter of 2006 and the Second Quarter of 2008, ArthroCare shipped Distributor 1 a total of approximately \$4 million worth of ArthroCare products at **RAFFLE**'s direction. Distributor 1's excess inventory over this period grew to over \$2 million worth of product, which represented over a year's worth of its inventory.

25. In return, **RAFFLE** provided Distributor 1 with: (a) extended payment terms, (b) up-front sales commissions, which were paid by ArthroCare to Distributor 1 months before Distributor 1 had to make payments to ArthroCare, and (c) an agreement that Distributor 1 did not have to pay for any product until it sold the product to end users.

26. **RAFFLE** and others allowed ArthroCare to file public financial statements that did not disclose to the investing public that it was offering these terms to Distributor 1.

27. In 2008, in order to conceal the excess inventory being held by Distributor 1 and the fact that Distributor 1 had not paid ArthroCare for the excess inventory, **RAFFLE** attempted to have ArthroCare acquire Distributor 1 and purchase Distributor 1's excess inventory.

(ii) DiscoCare

28. DiscoCare was another distributor that **RAFFLE**, **APPLEGATE** and others used to cover shortfalls in ArthroCare's revenue and to meet the consensus EPS.

29. DiscoCare purported to specialize in obtaining reimbursement for medical devices from ArthroCare's Spine division from insurance companies, after the device was used to perform a surgical procedure on a patient.

30. At **RAFFLE** and **APPLEGATE**'s direction, ArthroCare shipped product to DiscoCare that far exceeded DiscoCare's needs. Between the Fourth Quarter of 2005 and the Fourth Quarter of 2007, ArthroCare shipped DiscoCare a total of approximately \$37 million worth of ArthroCare product.

31. In return, **RAFFLE** and **APPLEGATE** agreed that DiscoCare would: (a) receive extended payment terms of up to 360 days (as compared to ArthroCare's standard 30 days payment term), (b) receive over \$11 million in up-front sales commissions, which were termed a "service fee", and which ArthroCare paid to DiscoCare up to a year before DiscoCare had to pay ArthroCare anything, (c) be able to return product it did not want, and (d) not be required to pay for any product until it sold the product to end users.

32. **RAFFLE**, **APPLEGATE** and others allowed ArthroCare to file public financial statements that did not disclose to the investing public that it was offering these terms to DiscoCare.

33. To allow shipments to DiscoCare to count as additional revenue, **RAFFLE**, **APPLEGATE** and others caused ArthroCare to frequently change its internal and external revenue recognition policies that dictated when it could recognize sales as revenue, and then violated those policies without informing ArthroCare's internal accountants or external auditors.

34. While DiscoCare began as a separate entity from ArthroCare, **RAFFLE**, **APPLEGATE** and others at ArthroCare gradually assumed control of almost every aspect of DiscoCare's operation. As a result, **RAFFLE**, **APPLEGATE** and others at ArthroCare were able to dictate the terms and conditions for purported sales to ArthroCare, and to use DiscoCare's purported purchases of ArthroCare's products as a way to falsely inflate ArthroCare's earnings.

35. Throughout the relationship, DiscoCare purchased product from ArthroCare like a distributor, but DiscoCare itself had no sales staff. DiscoCare relied on ArthroCare sales staff to actually market and sell ArthroCare's products.

36. In June 2007, at ArthroCare's suggestion, ArthroCare set up a warehouse located in Sanford, Florida that purportedly belonged to DiscoCare. In reality, ArthroCare employees under the direction of **RAFFLE** and **APPLEGATE** managed and controlled the warehouse, which contained DiscoCare's purported inventory. **RAFFLE** and **APPLEGATE** used the warehouse as a place to ship and store large amounts of product so that the shipments could be recorded as sales to DiscoCare. ArthroCare deducted part of the cost of the warehouse from the service fee it paid DiscoCare, meaning that DiscoCare did not have any out-of-pocket expenses related to the warehouse.

37. By October 2007, ArthroCare had hired all of DiscoCare's employees, who purportedly continued to work for DiscoCare. The former DiscoCare employees received their paychecks and benefits directly from ArthroCare. ArthroCare deducted the cost of the

employees from the service fee it paid to DiscoCare, meaning that DiscoCare did not have any out-of-pocket expenses related to its former employees.

38. At **RAFFLE** and **APPLEGATE**'s direction, an ArthroCare employee would also draft purchase orders that purported to come from DiscoCare, but which were based on the amount of sales ArthroCare needed to hit revenue forecasts. DiscoCare staff would then sign the purchase orders without making any changes.

39. Because ArthroCare continued to ship to DiscoCare more product than there were patients who were actually undergoing surgery with the product, and because DiscoCare could not receive reimbursement for product that was not used during surgery, DiscoCare's account receivable with ArthroCare began to grow dramatically. From June 2007 to December 2007, DiscoCare's account receivable to ArthroCare more than doubled, to over \$26 million.

40. To conceal the fact that DiscoCare owed ArthroCare a substantial amount of money on the unused inventory, **RAFFLE** and **APPLEGATE** caused ArthroCare to acquire DiscoCare on December 31, 2007. During the period leading up to the acquisition, **RAFFLE** and **APPLEGATE** caused ArthroCare to ship DiscoCare more product than ever before. All of ArthroCare's shipments of product to DiscoCare in the Fourth Quarter of 2007 came with extended payment terms, which meant that DiscoCare was not obligated to make any payments on those sales until after ArthroCare acquired DiscoCare.

41. Between December 2005 and December 2007, ArthroCare reported over \$37 million in revenue in its publicly-filed financial statements based on purported sales to DiscoCare. During the same period, DiscoCare's actual net cash payments to ArthroCare were less than \$50,000.

(iii) Son of DRS

42. In an attempt to increase revenue in the Third Quarter of 2007, **RAFFLE** and **APPLEGATE** began a new program at ArthroCare, called "Son of DRS." Under the Son of DRS program, ArthroCare shipped medical devices from its Sports division to its customers for free, and then invoiced DiscoCare. ArthroCare recorded revenue once the product was shipped free of charge and DiscoCare had been invoiced for the product. Instead of parking inventory at the DiscoCare warehouse, **RAFFLE** and **APPLEGATE** caused the inventory to be parked at end-users, while simultaneously invoicing DiscoCare.

43. To maximize inflated revenue from this scheme, **RAFFLE** and **APPLEGATE** caused ArthroCare to invoice DiscoCare at prices of more than twice the normal list price, which made it virtually impossible for DiscoCare to benefit financially from the purported sales. In addition, when **APPLEGATE** and **RAFFLE** launched the Son of DRS program, they did not disclose to DiscoCare that it was purportedly purchasing the Sports division's medical products, let alone at twice the normal list price.

44. Under the Son of DRS program, ArthroCare's sales representatives, not DiscoCare employees, interacted with the customers. ArthroCare shipped the product directly to customers free of charge. DiscoCare never received the physical product. ArthroCare provided DiscoCare with payment terms of 210 days, which meant that (a) all of the invoices came due after ArthroCare acquired DiscoCare, and (b) DiscoCare was never actually required to make any payments under the program.

45. **RAFFLE**, **APPLEGATE** and others allowed ArthroCare to file public financial statements that did not disclose to the investing public the substance of the Son of DRS program.

46. Between August and November 2007, **RAFFLE** and **APLEGATE** caused ArthroCare to falsely report over \$7 million in revenue in its publicly filed financial statements based on purported sales to DiscoCare under this program.

D. Concealing Commissions

47. **RAFFLE** and others also fraudulently inflated ArthroCare's revenue by mischaracterizing commission payments to distributors as fees for purported marketing services. This enabled ArthroCare to record the gross amount of the purported sales to distributors as revenue, rather than only recognizing the net revenue of the sale, which would not have included the commission.

48. In 2006 and 2007, **RAFFLE** caused ArthroCare to restructure its contracts with three distributors – Distributor 1, Distributor 2 and Distributor 3 – to disguise commissions as marketing fees. However, in reality the “fees” ArthroCare owed to Distributor 1, Distributor 2 and Distributor 3 were all commissions, calculated as either a flat percentage of the amount of the purported sales to the distributor in the applicable quarter or as an agreed upon lump sum.

49. **RAFFLE** instructed other ArthroCare employees to mislead ArthroCare's internal accountants about the fact that the “marketing fees” were really disguised commission payments.

50. **RAFFLE** caused ArthroCare to file false quarterly and annual reports with the SEC that reported over \$4 million in fake revenue based on these misrepresentations, including:

- (a) \$881,146 based on sales to Distributor 1, which was reported in ArthroCare's SEC filings from Third Quarter 2006 to First Quarter 2008;

(b) \$2,071,850 based on sales to Distributor 2, which was reported in ArthroCare's SEC filings from the Third Quarter 2006 to First Quarter 2008; and

(c) \$1,482,700 based on sales to Distributor 3, which was reported in ArthroCare's SEC filings from the First Quarter 2007 to First Quarter 2008.

E. The Victims

51. Between December 2005 and December 2008, ArthroCare's shareholders held more than 25 million shares of ArthroCare stock.

52. On July 21, 2008, after ArthroCare announced publicly that it would be restating its previously reported financial results from the Third Quarter 2006 through the First Quarter 2008, the price of ArthroCare shares dropped from \$40.03 to \$23.21 per share. The drop in ArthroCare's share price caused an immediate loss in shareholder value of over \$400 million.

THE CHARGES

COUNT ONE

**Conspiracy to Commit Wire, Mail and Securities Fraud
(18 U.S.C. § 371)**

53. Paragraphs 1 through 52 of this Indictment are realleged and incorporated by reference as though fully set forth herein.

54. Between approximately December 2005, the exact date being unknown to the Grand Jury, through at least December 2008, in the Western District of Texas and elsewhere, the defendants **JOHN RAFFLE** and **DAVID APPLGATE**, and others known and unknown to the Grand Jury, did knowingly and willfully conspire and agree with each other and others to commit certain offenses against the United States, namely:

- (a) wire fraud, that is, to knowingly and with intent to defraud, devise and intend to devise a scheme and artifice to defraud, and to obtain money and property by means of materially false and fraudulent pretenses, representations, and promises, knowing that they were false and fraudulent when made, and transmitting and causing certain wire communications to be transmitted in interstate and foreign commerce, for the purpose of executing the scheme and artifice, in violation of Title 18, United States Code, Section 1343;
- (b) mail fraud, that is, having devised and intending to devise a scheme and artifice to defraud, and for obtaining money and property by means of false and fraudulent pretenses, representations, and promises, for the purpose of executing such scheme and artifice to defraud and attempting to do so, did knowingly: (i) place in any post office and authorized depository for mail matter, any matter and thing whatever to be sent and delivered by the Postal Service; (ii) deposit and cause to be deposited any matter and thing whatever to be sent and delivered by any private and commercial interstate carrier; and (iii) cause to be delivered by mail and private and commercial interstate carrier, according to the direction thereon, any such manner and thing, in violation of Title 18, United States Code, Section 1341, and;
- (c) securities fraud, that is, to knowingly and intentionally execute a scheme and artifice (i) to defraud any person in connection with any security of ArthroCare, an issuer with a class of securities registered under § 12 of the Securities Exchange Act of 1934 (Title 15, United States Code, § 781), and (ii) to obtain, by means of materially false and fraudulent pretenses, representations, and promises, any money and property in connection with the purchase and sale of any security of ArthroCare, an issuer with a

class of securities registered under § 12 of the Securities Exchange Act of 1934 (Title 15, United States Code, § 781), in violation of Title 18, United States Code, Section 1348.

Purpose of the Conspiracy

55. The Grand Jury realleges and incorporates by reference Paragraph 17 of this Indictment as a description of the purpose of the conspiracy.

MANNER AND MEANS

56. The Grand Jury realleges and incorporates by reference Paragraphs 13 through 16 and 18 through 50 of this Indictment as a description of the manner and means of the conspiracy.

OVERT ACTS

In furtherance of the conspiracy and to achieve its objects and purposes, at least one of the conspirators committed and caused to be committed, in the Western District of Texas and elsewhere, at least one of the following overt acts, among others:

57. On or about February 27, 2007, **RAFFLE** and **APPLEGATE** caused ArthroCare to file a Form 10-K for 2006 that materially misrepresented ArthroCare's quarterly and annual sales, revenues, expenses and earnings.

58. On or about March 18, 2007, **RAFFLE** sent an email to an ArthroCare employee in which he suggested that the employee draft a misleading contract, which did not reflect the agreement of the parties to the contract, in order to conceal the true nature of commissions paid to Distributor 3.

59. On or about June 25, 2007, **RAFFLE** sent an email to **APPLEGATE** in which he suggested that ArthroCare would be required to purchase DiscoCare in order to cover up DiscoCare's rapidly expanding accounts receivable balance to ArthroCare.

60. On July 23, 2007, **RAFFLE** emailed several ArthroCare employees directing them not to discuss with ArthroCare finance staff the true nature of the commission payments to Distributor 1.

61. On or about August 15, 2007, **RAFFLE** sent an email to **APPLEGATE** in which he explained that he would use what became the Son of DRS program to make the revenue number for that quarter.

62. On or about September 27, 2007, **RAFFLE** and **APPLEGATE** caused ArthroCare to ship 200 MD Spine Wands to the DiscoCare warehouse.

63. On or about September 28, 2007, **RAFFLE** and **APPLEGATE** caused ArthroCare to ship 100 MD Spine Wands to the DiscoCare warehouse.

64. On or about November 27, 2007, **RAFFLE** sent an email to **APPLEGATE** in which he told **APPLEGATE** that ArthroCare should sell as much product as possible to DiscoCare just before the acquisition.

65. On or about December 19, 2007, **APPLEGATE** sent an email to ArthroCare sales managers in the Spine Division to inform them that they would be receiving shipment of ArthroCare product at their personal residences.

66. On or about December 20, 2007, **RAFFLE** sent an email to ArthroCare's general counsel in which he stated that the acquisition of DiscoCare was "not a typical acquisition; not even close. We basically have an agency agreement with [DiscoCare] now, and everything that

they have done, has been done either in cooperation with us, or at our direction.... This is really a termination of the agreement dressed up as an acquisition for accounting purposes.”

67. On or about December 26, 2007, **APLEGATE** sent an email to the DiscoCare staff in which he directed them not to reject potential cases for reimbursement that they would otherwise reject.

68. On or about December 27, 2007, **RAFFLE** and **APLEGATE** caused ArthroCare to ship over 200 MD Spine Wands from the DiscoCare warehouse to the personal residences of ArthroCare sales managers.

69. On or about December 31, 2007, **RAFFLE** and **APLEGATE** caused ArthroCare to acquire DiscoCare.

70. On or about February 29, 2008, **RAFFLE** and **APLEGATE** caused ArthroCare to file a Form 10-K for 2007 that materially misrepresented ArthroCare’s quarterly and annual sales, revenues, expenses and earnings.

71. On or about May 12, 2008, **RAFFLE** and **APLEGATE** caused ArthroCare to file a Form 10-Q for the First Quarter 2008 that materially misrepresented ArthroCare’s quarterly and annual sales, revenues, expenses and earnings.

72. On or about May 30, 2008, **RAFFLE** caused ArthroCare to ship Distributor 1 approximately \$600,000 in ArthroCare products.

73. In July 2008, while ArthroCare was conducting an internal investigation, **RAFFLE** directed an ArthroCare executive and a third-party to draft misleading emails describing the purported work done by the distributors to earn the marketing fees, which he then

forwarded to ArthroCare's internal accountants in an attempt to maintain favorable accounting treatment for the marketing fees.

All in violation of Title 18, United States Code, Section 371.

COUNTS TWO THROUGH FIVE

**Wire Fraud
(18 U.S.C. §§ 1343 and 2)**

74. Paragraphs 1 through 52 and 57 through 73 of this Indictment are realleged and incorporated by reference as though fully set forth herein.

75. Between approximately December 2005, the exact date being unknown to the Grand Jury, through December 2008, in the Western District of Texas and elsewhere, the defendants, **JOHN RAFFLE** and **DAVID APPLGATE**, aided and abetted by each other and others known and unknown to the Grand Jury, did knowingly and with intent to defraud devise a scheme and artifice to defraud, and to obtain money and property by means of materially false and fraudulent pretenses, representations and promises, knowing that the pretenses, representations, and promises were false and fraudulent when made.

PURPOSE OF THE SCHEME AND ARTIFICE

76. The Grand Jury realleges and incorporates by reference Paragraph 17 of this Indictment as a description of the purpose of the scheme and artifice.

THE SCHEME AND ARTIFICE

77. The Grand Jury realleges and incorporates by reference Paragraphs 13 through 16 and 18 through 50 of this Indictment as a description of the scheme and artifice.

USE OF THE WIRES

78. On or about the dates specified as to each count below, the defendants, for the purpose of executing the aforesaid scheme and artifice to defraud, and attempting to do so, did knowingly transmit and cause to be transmitted, by means of wire communications in interstate and foreign commerce, certain writings, signs, signals, pictures and sounds, as more particularly described below:

Count	Defendant(s)	Approximate Date	Description of Wire Communication
2	RAFFLE	November 15, 2007	Email from RAFFLE in Texas to ArthroCare employee in Ohio
3	RAFFLE APPLEGATE	December 19, 2007	Email from APPLEGATE in Texas to ArthroCare employees in Florida
4	RAFFLE APPLEGATE	December 22, 2007	Email from APPLEGATE in Texas to ArthroCare employees, including in Florida
5	RAFFLE	June 5, 2008	Email from RAFFLE in Texas to ArthroCare employees, including an employee in Ohio

In violation of Title 18, United States Code, Sections 1343 and 2.

COUNTS SIX THROUGH THIRTEEN**Mail Fraud
(18 U.S.C. §§ 1341 and 2)**

79. Paragraphs 1 through 52 and 57 through 73 of this Indictment are realleged and incorporated by reference as though fully set forth herein.

80. On or about the dates set forth below, each such date constituting a separate count of this Indictment, within the Western District of Texas and elsewhere, defendants **JOHN RAFFLE** and **DAVID APPLEGATE** and others, having devised and intending to devise a scheme and artifice to defraud, and for obtaining money and property by means of false and fraudulent pretenses, representations, and promises, for the purpose of executing such scheme and artifice to defraud and attempting to do so, did knowingly, on or about the dates listed

below: (i) place in any post office and authorized depository for mail matter, any matter or thing whatever to be sent and delivered by the Postal Service; (ii) deposit and cause to be deposited any matter an thing whatever to be sent and delivered by any private and commercial interstate carrier; and (iii) cause to be delivered by mail and private and commercial interstate carrier.

PURPOSE OF THE SCHEME AND ARTIFICE

81. The Grand Jury realleges and incorporates by reference Paragraph 17 of this Indictment as a description of the purpose of the scheme and artifice.

THE SCHEME AND ARTIFICE

82. The Grand Jury realleges and incorporates by reference Paragraphs 13 through 16 and 18 through 50 of this Indictment as a description of the scheme and artifice.

USE OF THE MAILS

Count	Defendant(s)	Approximate Date	Mailing
6	RAFFLE APPLEGATE	September 27, 2007	Shipment of product via DHL Ground Service from ArthroCare, 680 Vaqueros Ave., Sunnyvale, CA 94085 to DiscoCare, 651 Progress Way, Sanford, FL 32771
7	RAFFLE APPLEGATE	September 28, 2007	Shipment of product via DHL Ground Service from ArthroCare, 680 Vaqueros Ave., Sunnyvale, CA 94085 to DiscoCare, 651 Progress Way, Sanford, FL 32771
8	RAFFLE APPLEGATE	December 27, 2007	Shipment of product via FedEx Ground Service from DiscoCare, 651 Progress Way, Sanford, FL 32771 to 7859 SE River Lane, Stuart, FL 34997
9	RAFFLE APPLEGATE	December 27, 2007	Shipment of product via FedEx Ground Service from DiscoCare, 651 Progress Way, Sanford, FL 32771 to 400 Hunt Club Road, Nashville, TN 37221
10	RAFFLE APPLEGATE	December 27, 2007	Shipment of product via DHL Ground Service from ArthroCare, 4900 Creekside Pkwy, Lockbourne, OH 43194 to DiscoCare, 651

			Progress Way, Sanford, FL 32771
11	RAFFLE APPLEGATE	December 28, 2007	Shipment of product via DHL Ground Service from ArthroCare, 4900 Creekside Pkwy, Lockbourne, OH 43194 to DiscoCare, 651 Progress Way, Sanford, FL 32771
12	RAFFLE	March 24, 2008	Shipment of product via DHL Ground Service from ArthroCare, 4900 Creekside Pkwy, Lockbourne, OH 43194 to Distributor 1, 44550 Deason Drive, Edmond, OK 73013
13	RAFFLE	May 29, 2008	Shipment of product via DHL Ground Service from ArthroCare, 4900 Creekside Pkwy, Lockbourne, OH 43194 to Distributor 1, 44550 Deason Drive, Edmond, OK 73013

In violation of Title 18, United States Code, Sections 1341 and 2.

COUNTS FOURTEEN THROUGH SIXTEEN

**Securities Fraud
(18 U.S.C. §§ 1348 and 2)**

83. Paragraphs 1 through 52 and 57 through 73 of this Indictment are realleged and incorporated by reference as though fully set forth herein.

84. On or about the dates set forth below, each such date constituting a separate count of this Indictment, within the Western District of Texas and elsewhere, defendants **JOHN RAFFLE** and **DAVID APPLEGATE** did knowingly and intentionally execute a scheme and artifice (i) to defraud any person in connection with any security of ArthroCare, an issuer with a class of securities registered under § 12 of the Securities Exchange Act of 1934 (Title 15, United States Code, § 781), and (ii) to obtain, by means of materially false and fraudulent pretenses, representations, and promises, any money and property in connection with the purchase and sale of any security of ArthroCare, an issuer with a class of securities registered under § 12 of the Securities Exchange Act of 1934 (Title 15, United States Code, § 781), to wit, **RAFFLE** and **APPLEGATE** made, and caused to be made, false and misleading representations to

ArthroCare's shareholders and members of the investing public about ArthroCare's quarterly and annual sales, revenues, expenses and earnings.

Count	Defendant(s)	Approximate Date	SEC Filing
14	RAFFLE APPLEGATE	October 29, 2007	SEC Form 10-Q for Third Quarter 2007
15	RAFFLE APPLEGATE	February 29, 2008	SEC Form 10-K for 2007
16	RAFFLE	May 30, 2008	SEC Form 10-Q for First Quarter 2008

In violation of Title 18, United States Code, Sections 1348 and 2.

FORFEITURE ALLEGATION

85. As the result of committing wire, mail and securities fraud offenses, in violation of Title 18, United States Code, Sections 1341, 1343, 1348 and 2, and, as alleged in Counts One through Fourteen of this Indictment, **JOHN RAFFLE** and **DAVID APPLEGATE**, the defendants, shall forfeit to the United States pursuant to 18 U.S.C. § 981(a)(1)(c) and 28 U.S.C. § 2461, all property, real and personal, that constitutes or is derived from proceeds traceable to the commission of the offenses alleged in Counts One through Fourteen of this Indictment.

Substitute Asset Provision

86. If any of the above described forfeitable property, as a result of any act or omission of the defendants:

- (a) cannot be located upon the exercise of due diligence;
- (b) has been transferred or sold to, or deposited with, a third person;
- (c) has been placed beyond the jurisdiction of the Court;
- (d) has been substantially diminished in value;

(e) or has been commingled with other property which cannot be subdivided without difficulty;

it is the intent of the United States, pursuant to 21 U.S.C. § 853(p), to seek forfeiture of any other property of said defendant up to the value of the above forfeitable property.

Title 18, United States Code, Sections 981 and 1343; Title 28, United States Code, Section 2461.

A TRUE BILL:

SIGNATURE REDACTED PURSUANT
TO E-GOVERNMENT ACT OF 2002

FOREPERSON

DENIS J. MCINERNEY
Chief
Fraud Section, Criminal Division
U.S. Department of Justice

By:



Benjamin D. Singer
Assistant Chief
Fraud Section, Criminal Division
U.S. Department of Justice

By:



Henry P. Van Dyck
Trial Attorney
Fraud Section, Criminal Division
U.S. Department of Justice

Sealed X

Unsealed _____

Personal Data Sheet USAO# [REDACTED]
UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF TEXAS
RELATED CASE X YES _____ NO
CASE NO. A-08-CV-00574

County: TRAVIS AUSTIN Division Judge: SPARKS

Date: 8/21/2012 Mag Ct.# _____ SSN: [REDACTED] FBI #: [REDACTED]

Case No.: _____ Assistant U. S. Attorney: BENJAMIN D. SINGER & HENRY P. VAN DYCK

Defendant: JOHN RAFFLE Date of Birth: [REDACTED]

Address: [REDACTED]

Citizenship: United States X Mexican _____ Other _____

Interpreter Needed: Yes _____ No X Language _____

Defense Attorney: _____ Employed _____

Address of Attorney: _____ Appointed _____

Defendant is: In Jail _____ Where: _____

On Bond _____ Amt. of Bond _____ Where: _____

Date of Arrest: 08/22/2012 Bench Warrant Needed YES

Prosecution By: _____ Information _____ Indictment X

Offense (Code & Description): Count 1 -- 18 U.S.C. § 371 - Conspiracy to Commit Wire, Mail and Securities Fraud; Counts 2-5 - 18 U.S.C. § 1343 and 2 - Wire Fraud; Counts 6-13 - 18 U.S.C. § 1341 and 2 -Mail Fraud; Counts 14-16 18 U.S.C. § 1348 and 2 - Securities Fraud

Offense Is: Felony X Misdemeanor _____

Maximum Sentence: Count 1 -- Up to 5 yrs imprisonment; up to \$250,000 fine; Counts 2-5 - Up to 20 yrs imprisonment; up to \$200,000 fine;Counts 6-13 - Up to 20 yrs imprisonment; up to \$200,000 fine; Counts 14-16 - Up to 25 yrs imprisonment; up to \$200,000 fine

Penalty is Mandatory: Yes _____ No X

Remarks: [REDACTED]

