UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
Criminal No.: 11-121(RHK)

UNITED STATES OF AMERICA,	)	
	)	
Plaintiff,	)	
	)	
v.	)	PLEA AGREEMENT AND
	)	SENTENCING STIPULATIONS
MICHELLE WEBSTER PALM,	)	
	)	
Defendant.	)	

The United States of America, by and through its attorneys, B. Todd Jones, United States Attorney for the District of Minnesota, and Assistant United States Attorneys Timothy C. Rank and John F. Docherty, and Michelle Webster Palm (hereinafter referred to as the "defendant") agree to resolve this case on the terms and conditions that follow.

1. **Charges**. The defendant agrees to plead guilty to Count 1 of the Information, which charges her with securities fraud, in violation of Title 15, United States Code, Sections 77q(a) and 77(x), and to Count 2 of the Information, which charges her with providing false statements to a government agent, namely lawyers for the United States Securities and Exchange Commission, in violation of Title 18, United States Code, Section 1001.

(7)

2. **Factual Basis**.

Defendant makes the following admission to support her plea and as relevant conduct.

The defendant worked at Arrowhead Capital Management, LLC ("Arrowhead Management"), a company owned and run by "Individual A." Individual A is also the principal of Blue Point Management Ltd., an exempt Bermuda company incorporated with limited liability under the laws of Bermuda, which acted as the Investment Manager to the hedge fund Arrowhead Capital Finance, Ltd., a mutual fund company incorporated under the laws of Bermuda. Individual A, as principal of Arrowhead Management, acted as General Partner for Arrowhead Capital Partners II, L.P., a Delaware Limited Partnership; and acted as Master Servicer to the Investment Manager, Integrated Alternative Investments Limited, a private limited liability company incorporated in England and Wales, that acted as the investment manager to a hedge fund, the Elistone Fund, an investment company incorporated under the laws of the Cayman Islands.

The Petters Fraud

Arrowhead Capital Finance, Arrowhead Capital Partners II and the Elistone Fund were invested almost exclusively in short-term, trade finance, promissory notes issued by Petters Company, Inc. (hereinafter referred to as "PCI"). PCI was owned and operated by

Thomas J. Petters. Petters represented to investors that funds invested in PCI Notes would be used to finance the purchase of vast amounts of consumer electronics and other consumer merchandise from certain vendors. PCI would then purportedly resell the merchandise at a profit to certain "Big Box" retailers, including such well-known chains as Sam's Club and Costco. Over the years, Petters raised billions of dollars through the sale of the notes. But in reality, the transactions underlying the PCI Notes were fictitious. Documents evidencing the purported transactions were fabricated by Petters' criminal associates and the purported vendors acted in concert with Petters to launder the funds back to PCI. No retailers participated in the transactions underlying the PCI Notes and there were no purchases and resales of consumer electronics or other consumer merchandise. Instead, Petters diverted hundreds of millions of dollars to his own purposes and paid purported profits to investors with money raised from the sale of new notes. Petters' inventory finance operation was nothing but a Ponzi scheme. The scheme was brought to light after federal agents executed search warrants at Petters' business offices and other locations on September 24, 2008.

Petters raised much of his money by selling PCI Notes to several large hedge funds. Among the hedge funds that bought PCI Notes from PCI were funds managed or serviced by entities

controlled by Individual A, including Arrowhead Capital Finance, Arrowhead Capital Partners II and the Elistone Fund.

Individual A first purchased PCI notes on behalf of funds he managed in 1999 and had investors' funds invested with PCI through at least September 24, 2008.

Securities Fraud

From in or about September 2007 through on or about September 24, 2008, the defendant, aiding and abetting "Individual A" and other individuals, and being aided and abetted by such individuals, did knowingly, willfully, and unlawfully, by the use of means and instrumentalities of interstate commerce, directly and indirectly, use and employ manipulative and deceptive devices in connection with the purchase and sale of securities, and did make untrue statements of material facts and omit to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading in connection with the purchase and sale of said securities, in violation of Title 15, United States Code, Sections 77q(a) and 77(x).

At all relevant times, defendant was a salaried employee of Arrowhead Management. In or about September 2007, the defendant was hired with the title of Vice President of Special Operations for Arrowhead Management. The defendant contends she was never

licensed as, registered as, or acted as a securities broker, investment advisor, insurance agent, financial planner or financial advisor.

In or about February of 2008, the defendant was given the role of Managing Director, Finance as a result of staff attrition. As part of her duties with Arrowhead Management, at the direction of Individual A and others, the defendant communicated with investors in Arrowhead Capital Finance, Arrowhead Capital Partners II and the Elistone Fund. At all times during defendant's employment, Arrowhead Management employed sales and/or investor relations personnel who were primarily responsible for investor communications on a day-to-day basis.

The defendant, Individual A, and others acting at the direction of Individual A, both verbally and in written materials provided to investors and potential investors, made material misrepresentations and concealed material information about the investments with PCI to induce investors and potential investors in Arrowhead Capital Finance, Arrowhead Capital Partners II and the Elistone Fund (collectively "the Funds") to purchase securities.

The Flow of Funds/Collateral Account Misrepresentations

Shortly after joining Arrowhead Management, defendant identified and reported to Individual A and others several material inconsistencies between both the written materials and verbal

communications provided to investors and potential investors and the actual workings of the PCI Notes. Specifically, Individual A, the defendant, and others acting at the direction of Individual A, both verbally and in written materials, made false representations to investors in the Arrowhead Capital Finance, Arrowhead Capital Partners II and the Elistone Fund regarding the safeguards purportedly provided by certain bank accounts (the "Collateral Accounts") held by the Funds. Individual A, the defendant, and others acting at the direction of Individual A, falsely represented to investors that when a retailer purchased consumer electronics or other goods from PCI, in a deal that was financed by one or more of the Funds, those goods were paid for by the retailer's transfer of funds directly to a bank account that was under the control of the Funds. This representation was material to investors in the Funds because it gave the Funds the ability to ensure that the deals were in fact taking place and to prevent PCI from simply converting the investors' money for its own use. Individual A, the defendant, and others acting at the direction of Individual A knew that this representation was false. Individual A, the defendant, and others acting at the direction of Individual A, knew the Funds received payments from PCI, not directly from the retailers. At least as of the time her employment began, no money was transferred by the retailers into bank accounts controlled by the Funds; nevertheless,

Individual A, the defendant, and others acting at the direction of Individual A, continued to represent to investors that retailers were depositing money directly into bank accounts controlled by the Funds.

After the defendant learned that payment for the PCI Notes came from PCI, and not the retailers, the defendant raised this issue with Individual A, and noted that it was inconsistent with what the Funds' investors were being told. Individual A acknowledged that the information was false, but explicitly directed the defendant not to disclose to investors the true method of payment for the PCI Notes.

By concealing the fact that the funds in payment for the mature PCI Notes came from PCI rather than the retailers, investors were prevented from seeing that Petters was able to recycle his own funds and falsely make it appear that payments were being received from retailers. The misrepresentations and omissions regarding the true flow of funds in the PCI note transactions were material.

PCI Investment Performance Misrepresentations

In addition, investors in the Funds were told both orally and in written materials that the PCI Notes were due within 90 days after the dates they were funded and that the notes defaulted if not paid in full within 182 days. In the fall of 2007, payments from PCI started to become delayed beyond 90 days. By February of

2008, millions of dollars of PCI Notes were on the verge of going into default. This information was material to investors, but was not communicated to investors by Individual A, the defendant, and others acting at the direction of Individual A. Instead of advising investors about the late payments and the approaching defaults, beginning in or about February 2008, Individual A, or entities controlled by Individual A, arranged for or extended the payment due date for PCI Notes to avoid default without advising investors of the extensions. Moreover, the defendant knew that, even though Individual A had entered into these "note extensions" on PCI Notes, Individual A, or others acting at the direction of Individual A, were continuing to falsely report, in monthly communications to investors, that the notes were being paid within the 90-day time-period. The misrepresentations to investors that PCI was paying its notes when due, when in fact the Funds were simply extending out the payment maturity dates of the notes, were material.

During this same time period, the defendant and Individual A were actively seeking new investors, as well as additional money from existing investors, for investment into PCI Notes. From February 2008, after Individual A began to enter into the PCI "note extensions," until on or about September 24, 2008, the Funds raised

more than $20 million, but less than $50 million in new investor money.

Management Fees Obtained By Fraud

Over the life of the Arrowhead Capital Finance fund, from 1999 to September 2008, investors contributed a total of $387,227,064.00 to the fund; during that same period, Arrowhead Management, and other entities controlled by Individual A, took a total of $35,066,992.00 in performance and management fees from Arrowhead Capital Finance. During the life of the Arrowhead Capital Partners II fund, from 2001 to September 2008, investors contributed a total of $133,480,000.00 to the fund; during that same period, Arrowhead Management and/or other entities controlled by Individual A took a total of $6,963,573.00 in performance and management fees from Arrowhead Capital Partners II. During the life of the Elistone Fund, from March 2008 through September 2008, investors contributed a total of $37,949,499.00 to the fund.

False Statement Offense

On December 14, 2010, the defendant gave sworn testimony to lawyers for the United States Securities and Exchange Commission (the "SEC") regarding the PCI investment. The defendant knowingly and willfully testified falsely that she believed that the payments were coming from the retailers directly to a bank account that was under the control of the Funds. The entire matter and the

testimony was within the jurisdiction of the SEC and the false testimony was material to investors and the SEC.

On January 26, 2011, after consulting with an attorney, the defendant again gave sworn testimony to lawyers for the SEC, during which she voluntarily corrected her testimony and admitted to providing false testimony concerning her knowledge that the payments on the PCI Notes came from PCI and not the retailers.

3. **Waiver of Indictment**. The defendant agrees to waive indictment by a grand jury on these charges and to consent to the filing of a criminal information. The defendant further agrees to execute a written waiver of her right to be indicted by a grand jury on these offenses.

4. **Waiver of Pretrial Motions**. The defendant understands and agrees that she has certain rights to file pre-trial motions in this case. As part of this plea agreement, and based upon the concessions of the United States within this plea agreement, the defendant knowingly, willingly, and voluntarily gives up the right to file pre-trial motions in this case.

5. **Statutory Penalties**.

The parties agree that Count 1 of the Information carries statutory penalties of:

a. a term of imprisonment of up to 5 years;

b. a criminal fine of up to the greater of $250,000.00 or twice the amount of gain or loss;

c. a term of supervised release of up to three years;

d. a special assessment of $100.00, which is payable to the Clerk of Court prior to sentencing; and

e. the costs of prosecution (as defined in 28 U.S.C. §§ 1918(b) and 1920).

The parties agree that Count 2 of the Information carries statutory penalties of:

a. a term of imprisonment of up to 5 years;

b. a criminal fine of up to $10,000.00;

c. a term of supervised release of up to three years;

d. a special assessment of $100.00, which is payable to the Clerk of Court prior to sentencing; and

e. the costs of prosecution (as defined in 28 U.S.C. §§ 1918(b) and 1920).

6. **Revocation of Supervised Release**. The defendant understands that, if she were to violate any condition of supervised release, she could be sentenced to an additional term of imprisonment up to the length of the original supervised release term, subject to the statutory maximums set forth in 18 U.S.C. § 3583.

7. **Guideline Calculations**. The parties acknowledge that the defendant will be sentenced in accordance with 18 U.S.C. § 3551, et seq. The parties also acknowledge that the defendant will be sentenced in accordance with federal sentencing law which includes consideration of the Sentencing Guidelines promulgated pursuant to the Sentencing Reform Act of 1984. The parties recognize that although the Court must give considerable weight to the guidelines, the guidelines are no longer binding but simply advisory. The parties stipulate to the following guideline calculations:

a. Base Offense Level. The parties agree that the base offense level for these offenses is 6. (U.S.S.G. § 2B1.1).

b. Specific Offense Characteristics. The government contends that the offense level should be increased by 22 levels, because the loss that resulted from the fraud during the defendant's participation in the fraud is in excess of $20 million but less than $50 million. (U.S.S.G. § 2B1.1(b)(1)(L)). The defendant reserves the right to contest the loss amount. The government contends that the offense level should be increased by 4 levels because at the time of the offense the defendant was a person associated with an investment adviser. (U.S.S.G. §2B1.1(b)(17)(iii)). The defendant reserves the right to contest this enhancement. The parties agree that no other specific offense characteristics apply.

c. Chapter Three Adjustments. The parties agree that the offense level should be reduced by two (2) levels because she played a minor role in the offense. U.S.S.G. § 3B1.2(b).

d. Acceptance of Responsibility. The government agrees to recommend that the defendant receive a 3-

level reduction for acceptance of responsibility and to make any appropriate motions with the Court. However, the defendant understands and agrees that this recommendation is conditioned upon the following: (i) the defendant testifies truthfully during the change of plea hearing, (ii) the defendant cooperates with the Probation Office in the pre-sentence investigation, (iii) the defendant commits no further acts inconsistent with acceptance of responsibility, and (iv) the defendant complies with this agreement, fully identifies all assets and makes good faith efforts to make restitution. (U.S.S.G. §3E1.1). The parties agree that other than as provided for herein no other Chapter 3 adjustments apply.

e. Criminal History Category. Based on information available at this time, the parties believe that the defendant's criminal history category is I. This does not constitute a stipulation, but a belief based on an assessment of the information currently known. Defendant's actual criminal history and related status will be determined by the Court based on the information presented in the Presentence Report and by the parties at the time of sentencing.

f. Guideline Range. If the adjusted offense level is 27, and the criminal history category is I, the advisory guideline is 70-87 months. (U.S.S.G. § 5G1.1(a)).

g. Fine Range. If the adjusted offense level is 27, the fine range is $12,500.00 to $125,000.00. (U.S.S.G. § 5E1.2(c)(3)).

h. Supervised Release. The Sentencing Guidelines require a term of supervised release of between two and three years. (U.S.S.G. § 5D1.2).

i. Departures and Sentencing Recommendations. The parties reserve the right to make motions for departures or variances from the applicable guideline.

8. **Discretion of the Court**. The foregoing stipulations are binding on the parties, but do not bind the Court. The parties understand that the Sentencing Guidelines are advisory and their application is a matter that falls solely within the Court's discretion. The Court may make its own determination regarding the applicable guideline factors and the applicable criminal history category. The Court may also depart from the applicable guidelines. If the Court determines that the applicable guideline calculations or the defendant's criminal history category is different from that stated above, neither party may withdraw from this agreement, and the defendant will be sentenced pursuant to the Court's determinations.

9. **Special Assessments**. The Guidelines require payment of a special assessment in the amount of $100.00 for each felony count of which the defendant is convicted. U.S.S.G. § 5E1.3. The defendant agrees to pay the special assessment of $100.00 before sentencing.

10. **Restitution**. The defendant understands and agrees that the Mandatory Victim Restitution Act, 18 U.S.C. §3663A may apply and that the Court may be required to order the defendant to make restitution to the victims of her crime. If so, the parties agree to request that the Court enter the restitution order with respect to the defendant after the Court has entered orders with respect to

any codefendants and/or coconspirators, such that her restitution may be considered in light of 18 U.S.C. §3664(h).

The defendant will fully and completely disclose to the United States Attorney's Office the existence and location of any assets in which she has any right, title, or interest. The defendant agrees to assist the United States in identifying, locating, returning, and transferring assets for use in payment of restitution and fines ordered by the Court. The financial statement to be provided to the United States Attorney's Office will be accurate, truthful and complete.

If requested by the United States, the defendant agrees to submit to a financial deposition and to a polygraph examination to determine whether she has truthfully disclosed the existence of all of her assets.

11. **Forfeiture**. The government reserves its right to proceed against any of the defendant's assets if those assets represent real or personal property involved in violations of the laws of the United States or are proceeds traceable to such property.

12. **Cooperation**. The defendant has agreed to cooperate with law enforcement authorities in the investigation and prosecution of other suspects. This cooperation includes, but is not limited to, being interviewed by law enforcement agents, submitting to a polygraph examination if the government deems it appropriate, and

testifying truthfully at any trial or other proceeding involving other suspects. If the defendant cooperates fully and truthfully as required by this agreement and thereby renders substantial assistance to the government, the government will, at the time of sentencing, move for a downward departure under Guideline Section 5K1.1. The government also agrees to make the full extent of the defendant's cooperation known to the Court. The defendant understands that the government, not the Court, will decide whether the defendant has rendered substantial assistance. The government will exercise its discretion in good faith. The defendant also understands that there is no guarantee the Court will grant any such motion for a downward departure, and the defendant understands that the amount of any downward departure is within the Court's discretion. In the event the government does not make or the Court does not grant such a motion, the defendant may not withdraw this plea based upon that ground.

13. **Other Criminal Conduct**. The United States Attorney's Office for the District of Minnesota agrees that it will not prosecute this defendant for conduct known, as of the date of the defendant's guilty plea, to the Federal Bureau of Investigation and IRS - Criminal Investigation Division case agents assigned to the case other than as set forth herein.

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14. **Complete Agreement**. This is the entire agreement and understanding between the United States and the defendant. There are no other agreements, promises, representations, or understandings.

Date: April 7, 2011

B. TODD JONES
United States Attorney

for BY: _____
TIMOTHY C. RANK
JOHN F. DOCHERTY
Assistant U.S. Attorneys

Date: April 7, 2011

_____
MICHELLE WEBSTER PALM
Defendant

Date: 4/7/11

_____
WILLIAM J. MAUZY
Counsel for Defendant