

SEP 21 2011

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

By *Jmw* JAMES N. HATTEN, Clerk  
Deputy Clerk

UNITED STATES OF AMERICA

v.

JOSEPH M. ELLES

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:  
:  
:

CRIMINAL INDICTMENT

NO. 1:11-CR-445

THE GRAND JURY CHARGES THAT:

COUNT ONE

**Securities Fraud**

(18 U.S.C. §§ 1348 and 2)

1. Beginning on a date unknown to the Grand Jury, but at least by in or about 2006, and continuing until in or about early 2009, in the Northern District of Georgia and elsewhere, the defendant, JOSEPH M. ELLES, aided, abetted, and assisted by others known and unknown to the Grand Jury, did knowingly and willfully execute and attempt to execute a scheme and artifice (1) to defraud other persons, in connection with stock securities of Carter's, Inc., and (2) to obtain, by means of false and fraudulent pretenses, representations, and promises, any money and property in connection with the purchase and sale of stock securities of Carter's, Inc., an issuer with a class of securities registered under Section 12 of the Securities Exchange Act of 1934 ("The Exchange Act") (Title 15, United States Code, Section 781), and that was required to file reports under Section 15(d) of The Exchange Act.

## BACKGROUND

2. At all times relevant to this Indictment:

a. Carter's, Inc. ("Carter's") was a public company registered in Delaware and headquartered in Atlanta, Georgia. Carter's common stock traded on the New York Stock Exchange under the stock ticker symbol, "CRI". Carter's securities were registered with the United States Securities and Exchange Commission ("SEC") pursuant to Section 12(b) of the Exchange Act, and the Company was required to file reports with the SEC pursuant to Section 15(d) of the Exchange Act.

b. As a public company, Carter's was required to comply with securities laws and rules and regulations issued by the SEC. Those laws, rules, and regulations generally were designed to protect members of the investing public and Carter's shareholders by ensuring the accuracy and integrity of the Carter's financial information that was disclosed to the public. Among other things, Carter's was required to and did periodically publish financial statements and other reports of its financial condition. Carter's was required to and did file an annual report (including audited financial statements) covering its entire fiscal year, which ran from January through December. Carter's was also required to and did file quarterly reports (including unaudited financial statements) every three months, for the quarters ending March 31 (1<sup>st</sup> quarter), June 30 (2<sup>nd</sup> quarter), September 30 (3<sup>rd</sup> quarter) and

December 31 (4<sup>th</sup> quarter).

c. Carter's marketed clothing and apparel for babies and young children, selling primarily to department stores and retailers such as Kohl's, Babies "R" Us, Macy's, Sears, Target, and Wal-Mart. The executive offices of Carter's were located in Atlanta, Georgia.

d. The defendant, JOSEPH M. ELLES, was employed as Executive Vice President of Sales for Carter's until in or about March 2009, working out of offices in Nevada, Carter's the corporate headquarters of Carter's in Atlanta, Georgia; and elsewhere. In this capacity, defendant JOSEPH M. ELLES served as the second-highest executive in the Carter's sales organization, supervising Carter's customer accounts through a team of vice presidents of sales ("sales VPs") and account executives assigned to manage each of those accounts, and reported directly to the President of the Carter's.

e. Kohl's Corporation ("Kohl's") was a public company headquartered in Menomonee Falls, Wisconsin. Kohl's was a department store chain which operated stores throughout the United States. Kohl's was Carter's most significant wholesale sales customer in terms of volume of sales, and wholesale sales constituted a significant portion of Carter's business.

## ACCOMMODATIONS AND ACCOUNTING FOR ACCOMMODATIONS

f. Carter's provided rebates in certain cases to wholesale customers (including Kohl's and other retail chains) generally referred to as "accommodations" or "margin support." These rebates were negotiated and paid at the end of particular selling seasons, in certain cases where the wholesale customer was not able to achieve an expected profit margin in selling Carter's goods. For example, Carter's might have sold and delivered \$100,000 worth of goods to a particular wholesale customer for a particular selling season, with the expectation that the wholesale customer might be able to make a certain profit in selling those goods in its retail stores (say, 35%). If at the end of that selling season the wholesale customer achieved a lower profit margin in selling those goods (say, 30%), the customer and Carter's might negotiate for Carter's to help make up all or part of the difference, in the form of "margin support" rebates. The decision as to whether to pay such rebates, and how much, is made in light of other discounts, promotions, market conditions, and other variables impacting the customer's sales of Carter's goods in that season.

g. By their nature, these rebates are negotiated and paid after-the-fact, that is, weeks or months after the goods to which the rebates relate have been sold and delivered by Carter's to the wholesale customer. For example, Carter's might sell and

deliver \$100,000 worth of goods to a wholesale customer in November of a particular year. After the selling season, in January of the following year, Carter's might agree to pay back a certain amount of that revenue to the customer in the form of margin support (for example, \$10,000).

h. The margin support payments are expenses that reduce Carter's profits. Using the above example, although Carter's initially received \$100,000 from selling the goods, it ultimately had to return \$10,000 in the form of a rebate, thereby reducing the net revenue for that sale to \$90,000.

i. To give an accurate picture of its financial results for any given period, it was important for Carter's to report not just the revenue from its sales during that period, but also the margin support expenses that Carter's later paid relating to those same sales. Using the above example, if Carter's received the \$100,000 from selling goods in November of 2008, but rebated back \$10,000 in January 2009, it would report a net sale of \$90,000 in its financial statements pertaining to the fourth quarter of 2008 (which consisted of October - December 2008). In other words, Carter's would record the expense as relating to the quarter and year in which the original sale occurred and the revenue was received, and not when the rebate happened to later be paid.

j. The defendant, JOSEPH M. ELLES, was the principal Carter's official who negotiated and agreed to accommodations

payments with wholesale customers, particularly to Kohl's.

DEFENDANT'S SCHEME TO DEFRAUD

3. The object of the scheme to defraud was for the defendant, JOSEPH M. ELLES, aided and abetted by others known and unknown to the grand jury, to use his position as Executive Vice President of Sales of Carter's, to hide and conceal millions of dollars in accommodations payments promised by defendant JOSEPH M. ELLES to Kohl's, Carter's largest wholesale customer, over a multi-year period, and to thereby report false sales profitability information to company auditors, directors, shareholders, and others, for purposes including to enrich himself through salary, bonuses, and Carter's stock and stock options.

4. The defendant's scheme included the following:

a. The defendant induced Kohl's to make substantial purchases of Carter's goods by assuring that if Kohl's did not achieve its desired profit margins, Carter's would make up the difference with margin support rebates.

b. The defendant's promises to Kohl's in this regard and consistent ability to actually deliver margin support in the amounts promised induced Kohl's to purchase more goods than it might have otherwise purchased. This had the effect of increasing Carter's wholesale sales.

c. The defendant effectively hid millions of dollars in accommodations expenses that he was agreeing to pay to Kohl's from

Carter's finance staff, audit committee, auditors, and others, for several periods. The defendant did this by regularly having Kohl's agree to defer taking the accommodations for 60 to 90 days, so that the expenses would falsely appear to relate to sales in future quarters. The defendant also caused falsified documents to be created and transmitted to Carter's finance staff, which misrepresented the timing of the sales to which accommodations related.

d. As part of the scheme, the defendant also personally executed false representation statements that were provided to and he knew would be relied on by Carter's management, board of directors, and auditors. The defendant on these forms falsely stated the amount of accommodations rebates that had been agreed to with Kohl's and other wholesale customers for particular periods.

e. As a result of the deferrals and the defendant's false statements relating to those deferred expenses, millions of dollars in accommodations expenses were regularly recorded by Carter's in the incorrect accounting period. For most of the years at issue and many of the quarters, the defendant's scheme resulted in a substantial understatement of Carter's accommodations expenses (and therefore an overstatement of Carter's profits). In other words, the scheme made Carter's reported results seem better than they actually had been. For example, the scheme caused Carter's to report income that was overstated by approximately 3% for 2005,

over 5% for 2006, and over 20% for 2007. During this three years Carter's financial statements failed to report over \$16 million in accommodations expenses, because those expenses had been hidden and disguised as a result of the fraud.

f. For one year, 2008, the scheme resulted in slight overstatement of accommodations expenses and therefore a slight understatement of Carter's profits. In other words, the scheme made Carter's reported results seem slightly worse than they actually had been. The scheme caused Carter's to report income for 2008 that was understated by approximately 3%.

g. On or about October 27, 2009, Carter's announced that it would delay its quarterly earnings release previously scheduled for that day in order to complete a review of its accounting for margin support to its wholesale customers. The company's stock price fell over 20% that day. On or about November 9, 2009, the company announced it had discovered the misconduct and that it would need to restate earnings. The company's stock price fell approximately 9% by the close of trading the next day. On or about January 15, 2010, Carter's issued its restated financial statements dating back to 2005. The company's stock price fell over 2% that day.

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

**COUNTS TWO THROUGH SIX**  
**Causing False SEC Filings**  
**(15 U.S.C. §§ 78m(a), 78ff; 18 U.S.C. § 2)**

5. Paragraphs One through Four of this Indictment are hereby realleged and incorporated by reference as if set forth in full herein.

6. On or about the dates identified in Column B of the chart set forth below, each date constituting a separate count as set forth in Column A, in the Northern District of Georgia and elsewhere, the defendant, JOSEPH M. ELLES, aided, abetted, and assisted by others known and unknown to the Grand Jury, unlawfully, willfully, and knowingly caused Carter's, Inc., an issuer with a class of securities registered under Section 12 of The Exchange Act (Title 15, United States Code, Section 781), and that was required to file reports under Section 15(d) of The Exchange Act, to make statements in such reports, as identified in Column C, that were false and misleading with respect to material facts:

| <b>A</b><br><b>COUNT</b> | <b>B</b><br><b>FILING DATE</b><br><b>(On or About)</b> | <b>C</b><br><b>SEC FILING</b>   |
|--------------------------|--|---|
| <b>TWO</b>               | 11-9-06  | Quarterly Report on Form 10-Q for the Third Quarter of 2006 (period ending 9-30-06) |
| <b>THREE</b>             | 2-28-07  | Annual Report on Form 10-K for the Fiscal Year Ended 12-30-06                       |
| <b>FOUR</b>              | 5-10-07  | Quarterly Report on Form 10-Q for the First Quarter of 2007 (period ending 3-31-07) |

| A<br>COUNT | B<br>FILING DATE<br>(On or About) | C<br>SEC FILING   |
|------------|-----------------------------------|---|
| FIVE       | 10-29-07                          | Quarterly Report on Form 10-Q for the Third Quarter of 2007 (period ending 9-29-07) |
| SIX        | 2-27-08                           | Annual Report on Form 10-K for the Fiscal Year Ended 12-29-07                       |

All in violation of Title 15, United States Code, Sections 78m(a) and 78ff; and Title 18, United States Code, Section 2.

**COUNTS SEVEN THROUGH SEVENTEEN**

**False Books and Records**

(15 U.S.C. §§ 78m(b) (2) (A), 78m(b) (5), 78ff; 18 U.S.C. § 2)

7. Paragraphs One through Four of this Indictment are hereby realleged and incorporated by reference as if set forth in full herein.

8. On or about the dates identified in Column B of the chart set forth below, each date constituting a separate count as set forth in Column A, in the Northern District of Georgia and elsewhere, the Defendant, JOSEPH M. ELLES, did knowingly and wilfully falsify and cause to be falsified, books, records and accounts, of Carter's, Inc., an issuer with a class of securities registered under Section 12 of The Exchange Act (Title 15, United States Code, Section 781), and that was required to file reports under Section 15(d) of The Exchange Act, as set forth in Column C:

| A<br><br>COUNT | B<br><br>DATE<br>(On or About) | C<br><br>BOOK, RECORD, ACCOUNT  |
|----------------|--------------------------------|---|
| SEVEN          | 2-19-07                        | Memorandum from Joseph Pacifico and Joseph Elles regarding customer accommodations commitments for 2006 |
| EIGHT          | 4-2-07                         | Internal Authorization Forms dated April 2, 2007  |
| NINE           | 4-29-07                        | Internal Authorization Forms dated April 29, 2007   |
| TEN            | 1-29-08                        | Memorandum from Joseph Pacifico and Joseph Elles regarding customer accommodations commitments for 2007 |
| ELEVEN         | 4-8-08                         | Internal Authorization Forms dated April 8, 2008  |
| TWELVE         | 4-28-08                        | Internal Authorization Forms dated April 28, 2008   |
| THIRTEEN       | 5-1-08                         | Internal Authorization Form dated May 1, 2008   |
| FOURTEEN       | 5-20-08                        | Internal Authorization Forms dated May 20, 2008   |
| FIFTEEN        | 1-21-09                        | Memorandum from Joseph Pacifico and Joseph Elles regarding customer accommodations commitments for 2008 |
| SIXTEEN        | 2-23-09                        | Internal Authorization Forms dated February 23, 2009  |
| SEVENTEEN      | 4-6-09                         | Internal Authorization Forms dated April 6, 2009  |

All in violation of Title 15, United States Code, Sections 78m(b) (2) (A), 78m(b) (5), and 78ff; and Title 18, United States Code, Section 2.

COUNTS EIGHTEEN THROUGH TWENTY-FOUR

Wire Fraud

(18 U.S.C. §§ 1343 and 2)

9. Paragraphs One through Four of this Indictment are hereby re-alleged and incorporated by reference as if set forth in full herein.

10. On or about the dates identified in Column B of the chart set forth below, each date constituting a separate count as set forth in Column A, in the Northern District of Georgia and elsewhere, the defendant, JOSEPH M. ELLES, for the purpose of executing the aforementioned scheme and artifice to defraud, and attempting to do so, and for obtaining money and property from Carter's by means of materially false and fraudulent pretenses, representations, and promises, and by omission of material facts, did knowingly and willfully cause to be transmitted by means of wire and radio communication in interstate commerce, certain writings, signs, signals, pictures, and sounds, that is, electronic communications, as described in Column C:

| A<br><br>COUNT | B<br><br>DATE<br>(On or<br>About) | C<br><br>TRANSMISSION   |
|----------------|-----------------------------------|---|
| EIGHTEEN       | 3-24-07                           | E-mail from Kohl's to Joseph Elles regarding timing of accommodations |
| NINETEEN       | 3-27-07                           | E-mail from Kohl's to Joseph Elles regarding timing of accommodations |
| TWENTY         | 5-3-07                            | Facsimile to Carter's Finance Department, Shelton, Connecticut,       |

| A<br><br>COUNT | B<br><br>DATE<br>(On or<br>About) | C<br><br>TRANSMISSION   |
|----------------|-----------------------------------|---|
|                |                                   | attaching April 19, 2007 and April 20, 2007 representation letters regarding Kohl's accommodations                          |
| TWENTY-ONE     | 4-18-08                           | E-mail from Patricia Wicks to Carter's Finance Department regarding Kohls' accommodations                                   |
| TWENTY-TWO     | 2-23-09                           | E-mail from Patricia Wicks to Kohl's regarding data entry relating to accommodations  |
| TWENTY-THREE   | 2-23-09                           | E-mail from Joseph Elles to Jon Ostenson and Patricia Wicks regarding data entry error by Kohl's relating to accommodations |
| TWENTY-FOUR    | 3-17-09                           | E-mail from Patricia Wicks to Kohl's regarding data entry for accommodations  |

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

**COUNTS TWENTY-FIVE THROUGH THIRTY-TWO**

**Mail Fraud**

**(18 U.S.C. § 1341 and 2)**

11. Paragraphs One through Four of this Indictment are hereby re-alleged and incorporated by reference as if set forth in full herein.

12. On or about the dates identified in Column B of the chart set forth below, each date constituting a separate count as set

forth in Column A, in the Northern District of Georgia and elsewhere, the defendant, JOSEPH M. ELLES, for the purpose of executing the aforementioned scheme and artifice to defraud, and attempting to do so, and for obtaining money and property from Carter's by means of materially false and fraudulent pretenses, representations, and promises, and by omission of material facts, did knowingly cause the document identified in Column C, to be sent and delivered by the United States Postal Service and other private and interstate carrier according to the directions thereon:

| A<br>COUNT   | B<br>DATE<br>(On or<br>About) | C<br>DOCUMENT  |
|--------------|-------------------------------|--|
| TWENTY-FIVE  | 4-12-07                       | Internal Authorization Forms dated April 2, 2007     |
| TWENTY-SIX   | 5-23-07                       | Internal Authorization Forms dated April 29, 2007    |
| TWENTY-SEVEN | 4-16-08                       | Internal Authorization Forms dated April 8, 2008     |
| TWENTY-EIGHT | 5-2-08                        | Internal Authorization Forms dated April 28, 2008    |
| TWENTY-NINE  | 5-14-08                       | Internal Authorization Form dated May 1, 2008        |
| THIRTY       | 7-10-08                       | Internal Authorization Forms dated May 20, 2008      |
| THIRTY-ONE   | 3-4-09                        | Internal Authorization Forms dated February 23, 2009 |
| THIRTY-TWO   | 4-27-09                       | Internal Authorization Forms dated April 6, 2009     |

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

FORFEITURE PROVISION

Upon conviction of one or more of the offenses alleged in Counts One through Thirty-Two of this Indictment, defendant JOSEPH M. ELLES shall forfeit to the United States pursuant to Title 18, United States Code, Section 981(a)(1)(C) and Title 28, United States Code, Section 2461(c), any property constituting or derived from proceeds obtained directly or indirectly as a result of the said violations.

If any of the above-described forfeitable property, as a result of any act or omission of the defendant(s):

- (a) cannot be located upon the exercise of due diligence;
- (b) has been transferred or sold to, or deposited with, a third party;
- (c) has been placed beyond the jurisdiction of the court;
- (d) has been substantially diminished in value; or
- (e) has been commingled with other property which cannot be divided without difficulty;

it is the intent of the United States, pursuant to Title 21, United States Code, Section 853(p) as incorporated by Title 18, United States Code, Section 982(b), to seek forfeiture of any other property of said defendant(s) up to the value of the forfeitable property described above.

A True BILL

[Signature]  
FOREPERSON

SALLY QUILLIAN YATES  
UNITED STATES ATTORNEY

[Signature]  
JUSTIN S. ANAND  
ASSISTANT UNITED STATES ATTORNEY  
Georgia Bar No. 016316

[Signature]  
DAVID M. CHAIKEN  
ASSISTANT UNITED STATES ATTORNEY  
Georgia Bar No. 118618

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