

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

UNITED STATES SECURITIES	§	
AND EXCHANGE COMMISSION,	§	
Plaintiff,	§	
	§	Civil Action No. H-04-1994 (Harmon)
v.	§	
	§	COMPLAINT
PAULA H. RIEKER,	§	
	§	
	§	
Defendant.	§	

Plaintiff Securities and Exchange Commission for its Complaint alleges as follows:

SUMMARY

1. Paula H. Rieker engaged in insider trading in violation of the federal securities laws in July 2001 when she traded on material inside information about significant losses in a business unit of Enron. Rieker also violated the federal securities laws by providing substantial assistance to Enron executives and senior managers in the dissemination of false and misleading information to the public about Enron business units in analyst calls and earnings releases.

2. The Commission requests that this Court order Rieker to pay disgorgement, prejudgment interest, and a civil penalty, enjoin Rieker from violating Section 10(b) of the Securities Exchange Act of 1934 (“Exchange Act”), and prohibit her from acting as an officer or director of any public company.

JURISDICTION AND VENUE

3. The Court has jurisdiction over this action pursuant to Sections 21(d), 21(e), and 27 of the Exchange Act [15 U.S.C. §§ 78u(d) and (e) and 78aa].

4. Venue lies in this District pursuant to Section 27 of the Exchange Act [15 U.S.C. § 78aa] because certain acts or transactions constituting the violations occurred in this District.

5. In connection with the acts, practices, and courses of business alleged herein, Rieker, directly or indirectly, made use of the means and instruments of transportation and communication in interstate commerce, and of the mails and of the facilities of a national securities exchange.

DEFENDANT

6. Paula H. Rieker, age 49, resides in Spring Branch, Texas. During the relevant time period, Rieker was employed as a managing director for investor relations at Enron Corp. Rieker has been employed at Enron or Enron-related entities in various positions since 1990.

ENTITIES INVOLVED

7. Enron Corp. is an Oregon corporation with its principal place of business in Houston, Texas. During the relevant time period, Enron's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange. Among other operations, Enron was the nation's largest natural gas and electric marketer. Enron rose to number seven on the *Fortune 500* list of companies. By December 2, 2001, when it filed for bankruptcy, Enron's stock price had dropped in less than a year from more than \$80 per share to less than \$1.

8. Enron Energy Services (EES) was formed by Enron in late 1996 to provide energy

products and services to industrial, commercial, and residential customers in both regulated and deregulated markets. In Enron's segment disclosures, EES' results were reported separately as Retail Energy Services.

9. Enron Wholesale Services (Wholesale) was Enron's largest and fastest growing business segment in 2000 and 2001. Wholesale consisted of several business units, including Enron North America (ENA). ENA was the largest and most profitable business unit within Wholesale and included Enron's wholesale merchant energy business related to natural gas and power across North America, including trading, marketing and new asset development activities in that region. In its segment disclosures, ENA's results were reported within the Wholesale Services segment.

10. Enron Broadband Services, Inc. ("EBS") was a wholly- owned subsidiary of Enron engaged in the telecommunications business.

FACTUAL ALLEGATIONS

Enron's Manipulation Of Reserves

11. During 2000 and 2001, the profitability of Enron's wholesale energy trading business, primarily based in its Enron Wholesale business unit, dramatically increased for various reasons including rapidly rising energy prices in the western United States, especially in California. This sudden and large increase in trading profits, which exceeded \$1 billion, threatened to undermine Enron's description and presentation of itself as the dominant "intermediator" in the energy markets, rather than as a speculative (and therefore risky) trading company whose stock would trade at a much lower price-to-earnings ratio.

12. From the third quarter of 2000 through the third quarter of 2001, Enron used

energy trading profits generated in excess of internal budget targets to create a “cookie jar” of unreported earnings for use in future periods. Using reserve accounts within Enron Wholesale to mask the extent and volatility of Enron Wholesale’s windfall trading profits, particularly its profits from the California energy markets, Enron preserved the earnings for use in later quarters in which Enron could use them to meet analysts’ expectations and avoided reporting large losses in other areas of Enron’s business. By early 2001, undisclosed reserve accounts within Enron Wholesale, which prior to mid-2000 had held only tens of millions of dollars of Enron’s energy trading earnings, contained over \$1 billion in unreported earnings. Enron planned to and did use hundreds of millions of dollars from the undisclosed reserve accounts to, among other things, ensure that budget targets were met and to conceal hundreds of millions of dollars in losses within Enron’s EES business unit from the investing public.

Concealing EES Failures

13. In presentations to the investing public, Enron heavily emphasized the performance and potential of EBS and EES as major reasons for past and projected increases in the value of Enron’s stock, attributing as much as half of Enron’s total stock value to those two business units. To support what Enron had already said about EES, Enron concealed massive losses in EES’s business through fraudulently manipulating Enron’s “business segment reporting.”

14. Enron accomplished this at the close of the first quarter of 2001 through a reorganization designed to conceal the magnitude of EES’s business failure. Enron hid that failure from the investing public by moving large portions of EES’s business – which Enron knew at the time otherwise would have to report hundreds of millions of dollars in losses – into

Enron Wholesale, which was the Enron business segment housing most of the company's wholesale energy trading operations and income. As Enron knew, Enron Wholesale would have ample earnings, including in the reserve accounts described above, to ensure that Enron Wholesale could absorb the losses that, in fact, were attributable to EES while at the same time continuing to meet Enron's budget targets. Enron explained the change in segment reporting solely as a means to improve efficiency. It omitted to disclose that the alleged "efficiency" maneuver in fact concealed from the public and others the poor performance of the heavily touted EES business unit. Instead, Enron stated publicly that EES was continuing to perform profitably and as expected.

15. In addition, Enron transferred from EES to ENA uncollectible receivables owed to EES by California utilities, avoiding the entry of a reserve on EES' books of hundreds of millions of dollars and allowing that reserve to be, in effect, funded by ENA earnings.

Concealment of EBS Failure

16. Enron executives and senior managers well knew that EBS was a struggling business that was hemorrhaging money. However, they took steps to ensure that EBS's problems were not publicly revealed. For example, during 2000, Enron structured a series of misleading, one-time financial transactions in EBS that were designed to manufacture earnings that Enron used to present the false impression that EBS was progressing towards generating operating profits. Even with these transactions, EBS still was facing much larger than expected losses during the first quarter of 2001. In order to ensure that EBS did not record in the first quarter of 2001 losses that exceeded Enron's annual budgeted loss target for EBS, and in order to ensure that the quarterly budgeted loss target dictated by management for the first quarter 2001 was met,

Enron fraudulently reduced EBS's expenses for the first quarter of 2001. Even with these measures, by March 2001 Enron senior executives knew that EBS' annual losses would be significantly greater than what Enron publicly projected just two months earlier.

False And Misleading Representations To The Investing Public

March 23, 2001 Analyst Call

17. Enron held a special conference call with Wall Street analysts on March 23, 2001 in an effort to dispel growing public concerns about Enron's stock, which had fallen from over \$80 per share to under \$60 per share in less than two months. An Enron executive knowingly made false and misleading statements, and omitted to disclose facts necessary to make his statements not misleading, in an effort to prop up Enron's stock. Among other things, he stated that "Enron's business is in great shape" and "I know this is a bad stock market but Enron's in good shape," even though both of Enron's showpiece new businesses, EBS and EES, were failing. He stated that Enron was "highly confident" of its income target of \$225 million for the year for EES, and that EES was seeing the "positive effect" of "the chaos that's going on out in California." In reality, even EES's existing contracts were overvalued by hundreds of millions of dollars. EES was also owed hundreds of millions of dollars by the California utilities that it could not collect and Enron had concealed within Enron Wholesale reserves it was forced to book for those receivables.

18. The Enron executive further stated that EBS "is coming along just fine" and that the company was "very comfortable with the volumes and targets and the benchmarks that we set for EBS." He said that EBS's two profit-and-loss centers, intermediation and content services, were "growing fast" and that EBS was not laying off employees but rather "moving people

around inside EBS” and that this was “very good news.” In reality, EBS was continuing to fail. Senior personnel at EBS had reported internally that the unit had an unsupportable cost structure and unproven revenue model. Enron and EBS executives also knew that EBS’ annual losses would significantly exceed the targeted losses that it had publicly announced at its January 2001 annual conference.

First Quarter 2001 Earnings Release And Analyst Call

19. Enron issued an earnings release and held its conference call with Wall Street analysts to discuss its first quarter 2001 results on April 17, 2001. An Enron executive made false and misleading statements in the call and omitted to disclose facts necessary to make his statements not misleading. He talked about continued “big, big numbers” in EES’s energy contracting business. He falsely explained Enron’s movement of EES’s energy contract portfolio into Enron Wholesale, omitting any reference to EES’s large losses or their transfer to Enron Wholesale and stated, “[W]e have such capability in our wholesale business that we were -- we just weren’t taking advantage of that in managing our portfolio at the retail side. And this retail portfolio has gotten so big so fast that we needed to get the best -- the best hands working risk management there.” While Enron reported modest first quarter earnings for EES of \$40 million, in reality, EES was facing losses approaching one billion dollars, including overvalued contracts and uncollectible receivables with the California utilities. Enron had moved EES’s energy trading portfolio into Enron Wholesale to conceal those losses.

20. The Enron executive made further knowingly false and misleading statements about Enron’s wholesale energy trading business, and omitted to disclose facts necessary to make his statements not misleading, including that “we remain confident that the situation in California

will have no material impact on our financial condition and no adverse impact on 2001 earnings.” He refused, when pressed by analysts, to provide any detail or specific numbers regarding Enron’s reserves and to explain how Enron’s reserves were allotted between EES and Enron Wholesale, stating only that “we have adequate reserves and other credit offsets in place” to cover any exposure in California. In reality, Enron had concealed for later use hundreds of millions of dollars of year 2000 energy trading profits in reserve accounts within Enron Wholesale and had used those reserves to conceal hundreds of millions of dollars of probable losses to EES.

21. The Enron executive also made knowingly false and misleading statements, and omitted to disclose facts necessary to make his statements not misleading, about the success of EBS. The Enron executive stressed that the reported losses in the unit were on target. In reality, EBS was continuing to fail and was incurring much larger than expected losses that could not be offset with projected future revenues.

22. A senior Enron manager made further false and misleading statements about EBS in the call, and omitted to disclose facts necessary to make his statements not misleading, including that revenues from a monetization of its content business, as opposed to recurring earnings from operations, were only “about a third” of EBS’s overall earnings and that EBS had only done “a little bit” of such sales in the past two quarters. In reality, the sale of a portion of EBS’s content business was the principal mechanism by which the unit had generated quarterly revenues in 2001. Only a very small percentage of the unit’s revenues was due to operations that could be expected to recur. Moreover, EBS had only been able to meet its target of \$35 million in losses for the first quarter of 2001 through the combined efforts of the sale of portions of its

content services business and the shifting of some EBS expenses to another Enron division.

Second Quarter 2001 Earnings Release And Analyst Call

23. Enron held its conference call with Wall Street analysts to discuss its second quarter 2001 results on July 12, 2001. An Enron executive made knowingly false and misleading statements about the condition of Enron, and omitted to disclose facts necessary to make his statements not misleading, including that Enron had a “great quarter.” He further stated that EES “had an outstanding second quarter” and was “firmly on track to achieve our 2001 target of \$225 million” in earnings; that losses in EBS were due to “industry conditions” and “dried up” revenue opportunities; and that Enron’s “new businesses are expanding and adding to our earnings power and valuation, and we are well positioned for future growth.” A senior Enron manager also misled analysts about the movement of EES’s losses into Enron Wholesale, stating, “We just took the risk management functions and combined them because we just -- we were trying to get some more efficiency out of management of the overall risk management function.”

24. In reality, by the close of the second quarter of 2001, EBS had failed. As for EES, it was facing hundreds of millions of dollars in concealed losses and was a year or more away from any prospect of success. As a whole, Enron was less than five months from bankruptcy.

Rieker’s Participation In And Knowledge Of The Scheme

25. Rieker was actively involved in the compilation and drafting of the First and Second Quarter 2001 earnings releases, and scripts for the March 23, 2001 Analyst Call and the First and Second Quarter 2001 Analyst Calls.

26. During her efforts, Rieker learned that Enron had moved large portions of EES’s business into Enron Wholesale, Enron’s most profitable business unit. Rieker knew Enron did

this to hide losses related to EES contracts that should have been reported.

27. Rieker also learned in advance of the analyst calls that EBS' losses for 2001 would be significantly greater than what Enron had publicly targeted in January 2001. Enron failed to disclose this fact in the analyst calls or earnings release. Rieker also knew that over 70% of EBS's revenues for the first quarter 2001 were derived from a monetization of its content business, a one-time transaction.

28. Rieker was aware prior to the analyst calls that EES and EBS were not the successful units described in the earnings release and scripts she compiled and as described by Enron in the analyst calls. Nevertheless, Rieker did not correct the false and misleading information provided to analysts and investors by Enron executives and senior managers.

Insider Trading

29. Enron's code of ethics prohibited Rieker from trading in Enron securities based on material, nonpublic information. The code stated in part: "No director, officer, or employee of Enron Corp. . . . shall, directly or indirectly, trade in the securities of Enron Corp. . . . while in possession of material non-public information relating to or affecting any such company, disclose such information to others who may trade, or recommend the purchase or sale of securities of a company to which such information relates."

30. During Enron's second fiscal quarter of 2001 (the quarter ending June 30, 2001), Rieker became aware that EBS was experiencing significant financial problems and was experiencing losses greater than had been previously disclosed to analysts and investors. In addition, on or about July 2, 2001, Rieker learned that during the second quarter of 2001 EBS had suffered losses in the first six months of 2001 that exceeded the (\$65) million guidance

figure for the entire year that had previously been given by the company. Enron's second quarter earnings announcement was scheduled to be released on July 12, 2001. On or about July 5, 2001, Rieker learned that Enron would report in its earnings release that EBS had lost \$102 million during the second quarter, an amount significantly greater than the total amount of EBS losses that had been forecast for the entire year.

31. On July 5, 2001, shortly after learning that Enron intended to announce these EBS losses, Rieker traded in Enron stock while in possession of material non-public information about Enron's actual financial position and the performance of its business units as described in ¶ 30. Rieker exercised 18,380 options of Enron stock at \$49.77 per share for net proceeds of \$629,805. One week later, on July 12, 2001, Enron issued its earnings release and reported a \$102 million loss for EBS for the quarter. Enron's stock price decreased on the news to \$48.78 on July 13, 2001. As a result of her trade, Rieker avoided losses in the amount of \$18,196.

32. In aiding and abetting material misrepresentations and omissions in furtherance of a scheme to defraud undertaken by others at Enron, and engaging in insider trading in July 2001, Rieker violated Section 10(b) of the Exchange Act and Rule 10b-5.

CLAIM FOR RELIEF

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

33. Paragraphs 1 through 32 are realleged and incorporated by reference herein.

34. As set forth more fully in ¶¶ 25-32, Rieker, directly or indirectly, by use of the means or instrumentalities of interstate commerce, or by the use of the mails and of the facilities of a national securities exchange, in connection with the purchase or sale of securities: has

employed devices, schemes, or artifices to defraud, has made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or has engaged in acts, practices, or courses of business which operate or would operate as a fraud or deceit upon any person.

35. By reason of the foregoing, Rieker violated and aided and abetted violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)], and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

PRAYER FOR RELIEF

The Commission respectfully requests that this Court:

- (A) Grant a Permanent Injunction restraining and enjoining Rieker from violating the statutory provisions set forth here; prohibiting her from acting as an officer or director of any public company; and ordering her to pay disgorgement and civil penalties;
- (B) Under Section 308 of the Sarbanes-Oxley Act of 2002, enter an order providing that the amount of civil penalties ordered against Rieker be added to and become part of a disgorgement fund for the benefit of the victims of the violations alleged here; and

C) Grant such other and additional relief as this Court may deem just and proper.

Dated: May ___, 2004

Respectfully submitted,

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