UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

SECURITIES AND EXCHANGE COMMISSION, **100 F Street, N.E.** **Washington, D.C. 20549** **Plaintiff,** **v.** **FRANKLYN A. CAINE,** **21 Dexter Street** **Dedham, MA 02026** **Defendant.**	)))))))))))))	**Civil Action No.** **COMPLAINT**

Plaintiff Securities and Exchange Commission (the "Commission" or "SEC") alleges that:

SUMMARY

1. Between 1997 and 2001, Raytheon Company and certain members of its senior management ("Raytheon" or the "company") made false and misleading disclosures and used improper accounting practices that operated as a fraud by masking the declining results and deteriorating business of Raytheon Aircraft Company ("RAC") and inaccurately reporting the company's operating results on both a segmented and consolidated basis. As set forth below, certain of these disclosures and accounting practices were undertaken by or with the knowledge of senior company officers, including Franklyn A. Caine ("Caine"), Raytheon's Chief Financial Officer from April 1999 to December 2002.

2. Between 1997 and 2001, Raytheon failed to fully and accurately disclose known risks, trends, uncertainties, and other information concerning the deteriorating state of RAC's commuter aircraft business and the negative impact this decline was having on asset values associated with RAC's line of nineteen-seat, turboprop aircraft (the "commuters" or the "1900s")

and, thus, on the company's (including RAC's) results of operations. Raytheon also engaged in several improper accounting practices that delayed and mischaracterized known losses associated with RAC's commuter line during this time period.

3. As Raytheon's CFO, Caine failed to make or ensure the timely, accurate, and full disclosure of these material trends and uncertainties in the company's public filings during 2000 and 2001 and failed to take sufficient steps to ensure that Raytheon properly accounted for the company's on- and off-balance sheet commuter assets during this time period. Caine also did not ensure that the company maintained an adequate system of internal accounting controls related to these assets.

4. Had Raytheon properly accounted for its commuter assets, the company would have reported material reductions in RAC's reported operating income of at least $34 million, $22 million, and $21 million at year-end 1998, 1999, and 2000, respectively, which represented 13 percent of the subsidiary's reported annual operating income in each of these periods.

5. RAC's operating results would have been further reduced by at least $67 million (41 percent) at year-end 2000 had Caine and others in senior Raytheon and RAC management timely and appropriately recognized losses inherent in a planned "soft landing" of the commuter aircraft line. Internal company documents and other information further indicate that, at this time, these senior executives expected commuter losses of $240 million given the cash sales prices that had been approved in the "soft landing," and a charge of $67 million to $240 million would have reduced Raytheon's 2000 profit before taxes by at least 8 to 27 percent. Caine and others, however, caused Raytheon to improperly take this charge in the third quarter of 2001, when the company wrote down its on-balance sheet commuter assets and increased reserves for its off-balance sheet commuter receivables by a total of $693 million after the terrorist attacks of

September 11th. Given the charge that the company should have taken at year-end 2000, Raytheon's third quarter 2001 commuter loss provision was materially overstated by at least 10 to 53 percent.

JURISDICTION

6. This Court has jurisdiction over this matter pursuant to Section 22 of the Securities Act of 1933 (the "Securities Act") [15 U.S.C. § 77v] and Sections 21(d)(3)(A) and 27 of the Securities Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. §§ 78u(d)(3)(A) and 78aa].

DEFENDANT

7. Caine, age 57, served as Raytheon's CFO from April 1999 to December 2002.

BACKGROUND

8. Raytheon is a Delaware corporation, headquartered in Waltham, Massachusetts. The company is an industry leader in defense, government electronics, space technology, and business and special mission aircraft. Between 1997 and 2001, Raytheon reported between $13 billion and $20 billion in net sales revenue annually and employed between 75,000 to 120,000 individuals. During this time period and continuing through today, Raytheon's securities have been registered with the Commission pursuant to Section 12(b) of the Exchange Act and listed on the New York, Chicago, and Pacific Exchanges.

9. In the early 1990s, Raytheon was a diversified, multi-national conglomerate, which operated in the defense, electronics, engineering and construction, major appliances and aircraft businesses. The company formed RAC in 1994 through the combination of Beech Aircraft and Raytheon Corporate Jets, and the wholly-owned Raytheon subsidiary has been reported as a separate segment in all of the company's public filings since that time.

10. RAC manufactures, markets, and services business jets, turboprops, and piston-powered aircraft for the world's commercial, fractional ownership, and military aircraft markets. Due to the cyclical nature of these markets, RAC often experienced fluctuating results. For example, between 1997 and 2001, RAC generated between $2.3 billion and $3.2 billion in net sales revenue for the company annually, accounting for 13 to 19 percent of Raytheon's consolidated annual sales revenues. In addition, while the revenues generated by the commuter aircraft product line represented approximately 1 percent of Raytheon's consolidated net sales revenue during this time period, the company's financing of those sales left Raytheon with substantial recourse obligations related to over $1 billion in commuter receivables that were off the balance sheet, which represented approximately 9 percent of Raytheon's reported stockholder's equity each year between 1997 and 2001.

11. In 1997, Raytheon completed two multi-billion dollar defense acquisitions in an effort to streamline its operations and solidify its position as one of the nation's largest military contractors. These acquisitions led to a doubling of Raytheon's long-term debt load (increasing it to over $8 billion) and a substantial lowering of Raytheon's credit rating. In an effort to reduce the burden of its debt expense on earnings and cash flows, Raytheon began to divest many of its "non-core" commercial units, using the cash generated by these sales to pay down debt it incurred as a result of its defense acquisitions. RAC was considered for divestiture as part of this plan.

RAYTHEON'S IMPROPER ACCOUNTING AND DISCLOSURES FOR ITS COMMUTER BUSINESS

12. Between 1997 and 2001, Raytheon deferred substantial losses related to RAC's line of commuter aircraft. These planes were typically used by small, thinly capitalized airlines to transport passengers along regional or local routes. These carriers were generally seen as

significant credit risks, were thus frequently unable to obtain independent financing for their aircraft purchases, and typically lacked sufficient cash on hand to make outright purchases of RAC's commuter aircraft.

13. As a result, RAC rarely sold its new or used 1900s for cash. Instead, RAC's sales were regularly financed by the subsidiary's captive finance company, Raytheon Aircraft Credit Corporation ("RACC"), which often offered below-market interest rates and other favorable terms to customers in order to increase demand for the 1900s. RAC also regularly took used commuter aircraft (model 1900Bs and 1900Cs) in trade for the purchase of newer planes (model 1900Ds), which left RAC with a supply of used 1900s in inventory that required reconditioning and refurbishment in order to be remarketed.

14. RACC sold most of its aircraft receivables, including commuter financing receivables, into a revolving credit facility funded by an outside bank syndicate, which removed the debt associated with these financed sales from the company's balance sheet. Under the terms of the credit facility agreement, Raytheon was obligated to re-purchase certain delinquent and defaulted receivables, and the level of recourse to Raytheon on the commuter receivables generally ranged between 75 to 100 percent depending upon the type of financing. RACC also renegotiated and restructured many of the payment arrangements it had with certain RAC customers in order to keep these customers from becoming overly delinquent or otherwise defaulting on their notes.

15. As Raytheon's CFO, Caine was aware that the company regularly substituted new or restructured commuter notes for delinquent receivables prior to their triggering any defaults under the credit facility. Thus, despite the financial stress accumulating in the portfolio's

commuter exposure, Caine was of the view that the portfolio as a whole was always "performing" from an accounting standpoint.

The Declining Commuter Market between 1997 and 1998

16. During the late 1990s, RAC began to experience softening demand for its commuter aircraft due to, among other things, shifting consumer preferences, increased government regulation of nineteen-seat aircraft, increased competition in the used aircraft market, and the introduction of regional jets. These and other factors combined to place downward pressure on the sales prices, lease rates, and asset values of these planes. Thus, in 1997, RAC began for the first time to place used 1900s with customers on operating leases and substantially ceased outright sales of used 1900s for cash.

17. In addition, many of the used commuters that RAC received as returns, repossessions, and trade-ins required significant refurbishment before RAC could re-market them. These refurbishment costs were capitalized as part of the aircraft's book value, which led to "[h]igher book values" that "can and do exceed fair market value." In response, during the mid 1990s, prior to Caine's arrival, RAC adopted a policy of depreciating the used commuter aircraft on an accelerated basis during the life of their leases to "bring down values" to amounts that were more likely to be recovered in later cash sales. By so doing, RAC improperly deferred and re-characterized impairment losses associated with high commuter book values as ordinary depreciation.

18. As Raytheon's CFO, Caine understood that the book value of all used commuters could not be recovered by cash sales into the then-current market. He was also repeatedly informed by Raytheon's outside auditors that "The most significant accounting issue for used commuters is the realizability of assets. Management's plan is to lease the aircraft, depreciate

them down to 50% of book value over 10 years and sell them to the freighter market at the end of the lease."

The Deferral of Significant Commuter Losses in 1999

19. Throughout 1999, certain senior Raytheon and RAC officers (including Caine) were made aware of potential negative and adverse trends, uncertainties, and risks related to RAC's commuter business.

20. In April 1999, Caine's first month as Raytheon's CFO, an outside consultant presented a report to senior management, which stated that the commuter market was "at a turning point," that other "[c]arriers have begun to flood the market with...used 19-seat airplanes," that "lease rates for used 19-seat aircraft [we]re declining," that the "[d]ownward pressure on lease rates w[ould] grow as the surplus of 19-seat aircraft expands," and that "[a]dditional lease rate pressures could impact the company's asset values and re-marketing efforts."

21. An April 1999 e-mail that previewed this report for Caine informed him that such "surplus" aircraft and "lower lease rates could drive declining asset values and represent a potential material write down" of the commuter assets. Caine subsequently received a copy of the report, and both he and other senior Raytheon officers were briefed on this situation and management's views of it. That same month, during their first meeting, Raytheon's lead auditor discussed issues related to the commuters with Caine.

22. In May 1999, an internal Raytheon study forecasted that RAC's portfolio of commuter receivables would generate an estimated $95 million in losses due to "[t]he lack of portfolio equity, poor customer credit and payment behavior, high loan-to-value ratios, and the modest level of reserves" established for these assets. That same study identified a "worst case

scenario" that could generate $200 million in additional losses depending upon the impact of the "upcoming introduction" of regional jets.

23. An e-mail that previewed the conclusions of this internal study further informed Caine that there was an "obvious" need for a "material write-down" of RAC's commuter assets, that these losses were "large and growing," that RAC was engaging in "misleading financial reporting," and that the situation was "as bad as [the author of the study had] seen." Caine subsequently received a copy of the internal study, and both he and other senior Raytheon officers were briefed on both its conclusions and management's views of them.

24. In June 1999, Raytheon's then-Controller advised Caine that there was an estimated exposure of $300 million to $500 million in marking the RACC portfolio to market.

25. Also in June 1999, Caine and other senior Raytheon officers received a "response" from RAC to the April and May 1999 external and internal studies. This response set forth the view of RAC management that there was greater demand for new commuter aircraft than forecast by the company's outside consultant. With respect to the internal study, RAC's response advised Caine and others that it was "a corporate decision" whether to adopt a proposed "equity model" as an alternative way to establish commuter reserves at RAC, but described the model as "[a] means to build reserves at the expense of current period profits." RAC's response instead proposed a series of "risk mitigation plans" for the commuter portfolio, such as addressing the $95 million commuter exposure identified in the May 1999 internal study through various means (including "third party, no recourse notes" that would provide an estimated $93 million "improvement"). These sales did not materialize, however. Yet, reserves were not adequately increased.

26. In July 1999, Raytheon's investment bankers informed company executives that "[p]ortfolio policies may be masking problems from being recognized," that "actual collateral values may be substantially lower than loan balances," and that, if the company attempted to securitize all of RAC's commuter receivables, the commuter portfolio would be valued "at a material discount to its current book value." Management subsequently decided not to pursue a securitization of these receivables.

27. In August 1999, as part of an initial consideration to divest RAC, Caine and other senior Raytheon executives were informed that there was "approximately $250 Million - $350 Million risk in [the] $2.4 Billion loan/lease portfolio," and the "risk is likely to approach the high end of this range over time" since "about 40% of loan/lease payments are delinquent" and "business cycle downturn may also drive up defaults [and] reduce residual values of used aircraft."

28. In the Fall of 1999, after the initial effort to divest RAC failed, Raytheon management attempted to sell RAC's portfolio of aircraft receivables (including its commuter receivables) to an outside finance company. The finance company, however, informed certain Raytheon executives that it would not purchase any of the commuter receivables due to, among other things, concerns over their high loan-to-value ratios and high concentrations in certain customers. The finance company also provided Raytheon personnel with an independent valuation analysis of the 1900s, which stated that the commuter industry was experiencing a "distinct reduction in sales activity" and a "downturn" in leasing activity over the past year. This report also listed estimated market values for the 1900s that were below their book values.

29. In October 1999, due to unrelated difficulties in its defense businesses and engineering and construction unit, Raytheon announced an unexpected $640 million charge,

which caused the price of the company's stock to fall 44 percent in one day. This charge also led to a downgrading of the company's bond and credit ratings, and Raytheon management continued with the strategy to pay down the company's debt by divesting certain "non-core" commercial units. As part of this strategy, senior Raytheon management undertook a new effort to divest RAC.

30. Contemporaneous documents further indicate that, during January 2000 presentations to Raytheon management and the audit committee, the company's outside auditors informed Caine and others that they had a "continued concern about commuter portfolio exposure," that "higher refurb[ishment] costs on used commuters" accounted for a $15 million decrease in RAC's operating profit that year, that the company "need[ed] to relook at FAS 125 calculations based on higher refurb costs," that the used commuter inventory was projected to be "higher than prior years" in 2000, that, if there is "any slip," the commuter inventory "balance will balloon."

31. In addition, following a number of production and accounting problems that arose at RAC as part of the year-end 1999 close, the subsidiary's CEO stepped down from his executive position, and Raytheon's CEO traveled to the subsidiary to make it clear that RAC personnel had to improve their processes to prevent similar issues from occurring in the future. Upon learning of the year-end closing issues at RAC, Caine immediately revoked the recent promotion and transfer of a senior RAC financial officer and directed him to return to RAC and help solve the problems there.

32. Thereafter, in early 2000, RAC's newly-installed CEO instructed his staff to critically examine the subsidiary's operations, and RAC's Deputy CFO took the lead role in identifying issues to be examined. As part of this review, RAC personnel identified a potential

$220 million exposure related to the commuter assets on and off the balance sheet. This estimate was calculated by comparing "[p]rices which could be readily obtainable in today's market" to commuter book values. The market values used in the analysis were supplied by the lead commuter sales officials at RAC and averaged from $500,000 to $1 million below the commuter book values.

33. During this time period, Caine commissioned a review of RAC's commuter program by a separate audit firm and requested that Raytheon's internal audit department also examine RAC's commuter accounting. In addition, as Caine was aware, Raytheon's outside auditors were conducting extended procedures at RAC as part of the year-end audit process given the issues that had previously arisen at the subsidiary, and the potential $220 million commuter exposure was reviewed as part of this process as well. However, based on overly optimistic internal analyses prepared by RAC executives, which indicated that no "event of impairment" had occurred, RAC's commuter assets were not written down nor were RAC's commuter reserves adequately increased at that time.

34. In January 2000, Raytheon had issued an earnings advisory for the fourth quarter of 1999 and the full year 2000 because of aircraft production delays at RAC, a restatement due to RAC's improper bill and hold accounting, higher interest expenses, a higher effective tax rate, and other unfavorable results in its defense and other businesses. Following this announcement, Raytheon's stock price fell approximately 17 percent in one day. By March 2000, it was reported that Raytheon's bond and credit ratings might be further downgraded "[i]f corrective actions do not lead to material long-term improvements in overall performance and its balance sheet, or if material new operating problems emerge...."

Raytheon's Improper Accounting and Disclosures in 1999

35. Raytheon's SEC filings for 1999 did not contain adequate disclosures of the negative and adverse trends, uncertainties, risks, and other information related to RAC's commuter aircraft or the subsidiary's commuter business.

36. Although certain forward-looking statements in Raytheon's third quarter 1999 Form 10-Q, which was signed by Caine as the company's CFO, did disclose that one of the fourteen "important factors that could cause actual results to differ" was "the impact of recourse obligations of Raytheon Aircraft [RAC] due to changes in the collateral value of financed aircraft," these statements did not reference commuter aircraft by name or describe how the collateral value of these aircraft were particularly susceptible to negative changes due to the current and anticipated market conditions for these planes. In addition, these and other statements in Raytheon's third quarter 1999 Form 10-Q did not disclose that there were tens to hundreds of millions of dollars of "risk" associated with the company's portfolio of commuter and general aviation receivables, as Caine and others at the company were aware at the time.

37. While Raytheon's 1999 Form 10-K did refer to "commuter valuation costs" as one of five factors affecting RAC's "decline in operating income as a percent of sales in 1999," this disclosure failed to provide adequate information concerning the known material and adverse risks, uncertainties, and trends posed by the commuters.

38. In addition, the forward-looking statements in Raytheon's 1999 Form 10-K stated that "the effect of market conditions, particularly as it affects the general aviation market, the impact of competing products and pricing, [and] the impact on recourse obligations of RAC due to changes in the collateral value of financed aircraft" were among the many "factors that could cause actual results to differ," but did not mention "commuter" aircraft by name or provide

adequate information about the negative trends, uncertainties, and risks concerning the commuters that were known to management at the time. Likewise, another set of forward-looking statements in Raytheon's 1999 Form 10-K stated that "continued market acceptance of, and government regulations affecting, 19-seat turboprop commuter aircraft" could affect RAC's future results of operations, but Raytheon did not disclose the significant information that it had about the declining commuter market and the exposures facing the company.

39. These forward-looking statements were also inconsistent with disclosures in the footnotes to the company's 1999 financial statements, which misleadingly stated that "the Company does not expect to incur any material losses against the net book value of the long-term receivables" because "it is the Company's policy to have the aircraft serve as collateral for the commuter airline receivables;" that "any liability arising from these transactions will not have a material effect on the Company's financial position, liquidity, or results of operations" given Raytheon's experience to date with resale activities and pricing and the Company's plan to continue production into the foreseeable future; and that "[t]hese financial instruments are recorded at estimated fair value. No material gain or loss resulted from the sales of receivables." As certain members of Raytheon management were aware, the fair value of the commuter aircraft serving as collateral for the corresponding receivables was declining given the deteriorating market conditions for these planes. Yet, the company was not adequately increasing its reserves for these anticipated short falls, causing significant potential future liability under its recourse provisions to the revolving credit facility. At the time, Caine considered the off-balance sheet portfolio of commuter receivables to be performing from an accounting standpoint since the ongoing substitutions of new or restructured notes for any troubled receivables avoided actual defaults under the facility.

40. In addition, contrary to the company's footnote disclosures, during 1999, RAC continued an incorrect practice of using FAS 125 gains on commuter receivables sold into the credit facility to set up equally off-setting commuter loss reserves. As a result, Raytheon's reported financial statements did not accurately reflect the accounting impact of declining commuter values.

41. For example, in the third quarter of 1999, RAC increased its "cushion" for commuter losses by roughly $11 million given the improper FAS 125 gains it recognized on the sale of commuter receivables into the credit facility. RAC, however, subsequently reduced that increase by roughly $7 million in the fourth quarter of 1999 that offset a significant FAS 125 loss caused by a reduction in Raytheon's credit rating. These adjustments represented approximately 17 and 19 percent of the subsidiary's reported operating income/loss in the third and fourth quarters of 1999, respectively.

42. Also, during 1999, RAC still had not properly applied FAS 125 to its off-balance sheet commuter receivables. As a result, RAC's reported annual operating income should have been reduced by at least $21 million (13 percent) at year-end.

In 2000, the Commuter Market Continued to Deteriorate

43. In 2000, a variety of internal and external sources continued to inform Raytheon and RAC executives that the market for 1900s was in substantial decline. These sources further indicated that there were actual material commuter losses at RAC and that the potential losses associated with the 1900 line were in the hundreds of millions of dollars.

44. In January 2000, Caine and other senior Raytheon and RAC officers were informed that the company's strategic planning department viewed RAC as having a substantial negative "economic value added," an internal business metric, due in large part to $240 million

in negative value and exposure associated with RAC's off-balance sheet commuter and general aviation receivables.

45. In February 2000, the same outside consultant that conducted the April 1999 external study reported to Raytheon executives that there would be "[c]ontinued downward pressure on turboprop lease rates due to falling demand for new units and a growing supply of used capacity" and that "demand for new [commuters] will average 7 to 12 sales annually," well below what RAC was planning to manufacture that year. RAC, however, had exceeded the consultant's sales predictions in the prior year due in part to its continued willingness to accept trade-ins of used commuters for the latest model (1900Ds).

46. In March 2000, auditors with a major public accounting firm that had been retained to perform a review of RAC's "used commuter program exposures" informed Caine and other members of senior Raytheon and RAC management that "the Company's largest exposure in the [commuter] portfolio is with potential returned aircraft" and that "the book values of certain aircraft in the portfolio exceed the current market values." In particular, these auditors identified a $115 million "shortfall" associated with RAC's 1900Cs that were on and off the balance sheet, assuming a strategy of selling the aircraft for cash at their fair market value. The auditors also noted that RAC personnel were "rejecting cash offers on commuter aircraft because of the income statement repercussions . . . [implying that] the carrying amounts of commuter airplanes exceed their fair market values." The auditors further noted that RAC only wrote down used commuter asset values "when the Company enters into a new finance/lease transaction." The auditors also reported that RAC lacked formal and documented policies and practices concerning the accounting for commuter aircraft, commuter loan restructurings, the creation of commuter valuation reserves, and the monitoring of customer accounts and collections.

47. In April 2000, in response to Caine's request, Raytheon's internal audit department prepared a report for Caine and other members of senior Raytheon and RAC management that examined the items identified as part of the year-end closing process, as set forth in Paragraph No. 32 above. Caine received a copy of the report's executive summary and certain attachments, which among other things stated that, although there was "[n]o event of impairment prior to 12/31/99" regarding the commuters, there was an "[u]ndetermined but likely to be significant" exposure related to these assets. The attachments to the executive summary also stated that there was another "undetermined" exposure associated with the subsidiary's commuter bad debt reserve, that the "[n]on-performing segment of [the] portfolio is increasing," and that there was "no formal collections process for non-performing customers" at RAC.

48. Between April and July 2000, in connection with the company's efforts to sell RAC and/or its portfolio of commuter financing receivables, Raytheon's outside investment bankers provided certain members of senior management with a series of valuation analyses for the commuter receivables. A July 2000 analysis indicated that a sale of RACC's portfolio of commuter receivables might generate losses of between \$63 million and \$622 million, depending on the underlying assumptions, and that the value of discounted cash flows on the portfolio was between \$200 million and \$273 million lower than the total loan balances, depending upon the underlying interest rate assumptions. Caine received a copy of this report.

49. Underlying the investment banker's analysis was a July 2000 report from the same major public accounting firm that had previously analyzed RAC's "used commuter program exposures." This report highlighted significant problems related to the commuters, including high levels of delinquencies and repossessions and "between \$10 million and \$200 million of collateral exposure" that was not reflected by RAC's accounting and restructuring

methodologies, such as the practice of recognizing losses only upon a new sale or lease of the aircraft instead of upon return or repossession. Caine received versions of this report and was aware of its contents.

50. Also, in the Summer of 2000, a senior RAC executive informed Caine and another senior Raytheon officer of his significant concern about a problem with the commuters in the "half a billion dollar" range based on his view of the number of idle aircraft that were then in inventory and the substantial number of commuter returns that were forecasted at year-end. Ultimately, this problem was addressed by transferring pension income to RAC to gradually build up commuter reserves.

The Undisclosed Surplus Pension Income

51. In the third quarter of 2000, Caine approved the quarterly use of $14 million in surplus pension income at RAC on a going forward basis to increase commuter reserves. This income was generated by an over-funded pension plan that had been retained by Raytheon after the divestiture of another business unit and merged with a RAC pension plan. As a result, RAC recognized $14 million in surplus pension income each quarter on a going forward basis, which was generated by the over-funded pension plan.

52. As Caine and others were aware, this surplus pension income was going to be used to fund "a general commuter reserve" at RAC, which would increase the company's "ability to absorb losses" and "allow us to continue to sell more 1900Cs versus continuing to lease them." In November 2000, a senior corporate financial officer told senior RAC executives to "[a]nticipate that the $14M per quarter coming from the 'over[-]funded pension income' is available indefinitely." Thereafter, RAC personnel projected that they would continue to receive

$14 million in pension-related income per quarter through at least 2004, which would enable the subsidiary to build up nearly $260 million in commuter reserves.

53. However, the surplus pension-related income was not separately identified and disclosed in any of the company's SEC filings because management viewed the amounts as immaterial. In fact, $14 million represented 24 to 353 percent of RAC's reported quarterly operating income/loss between the third quarter of 2000 and the second quarter of 2001 (which ranged from a $4 million operating loss to $59 million in reported operating income). This income also eliminated the comparability of the segment's current results with prior periods and represented 17 percent of RAC's reported annual operating income in 2000. In addition, Raytheon's 2000 Form 10-K failed to disclose that, had the surplus pension income from the discontinued operation not been reclassified to RAC's 2000 results, the RAC segment would have experienced a three-year decline in its reported annual operating income from $227 million in 1998, to $163 million in 1999, to $136 million in 2000.

The Improper "Pooling" of Commuter Aircraft

54. In the fourth quarter of 2000, at the direction of a senior corporate financial officer and others, RAC personnel instituted an improper "pooling" analysis when testing RAC's on-balance sheet commuter assets for impairment under FAS 121. This approach pooled aircraft on an aggregate basis, not on a plane-by-plane basis as required by GAAP. Although Raytheon's outside auditors were informed of the approach, they did not agree with its use. Pooling further enabled $45.7 million in "cushions" associated with low-book-value aircraft to be used to off-set losses associated with higher-book-value aircraft. These "benefits" were then used to lower the book values of its used 1900Bs and 1900Cs in small amounts at year-end 2000, and the company's public filings contained no disclosure of the aircraft's declining value.

55. In addition, even though the company's "pooling" analysis at year-end 2000 suggested that RAC did not need reserves on the 1900s that were held for sale, Caine and others at the company kept $26.4 million in commuter reserves on RAC's books and continued to use the $14 million in excess pension-related income at the subsidiary each quarter going forward to fund continued increases to a "general commuter reserve," which indicated that the anticipated losses associated with the 1900s were greater than the current level of reserves that had been established at RAC.

The "Soft Landing" for the Commuters

56. By late 2000, Caine and other senior Raytheon and RAC officers were aware that "[m]arket forces ha[d] created a non-performing asset problem" with the 1900s. Specifically, contemporaneous internal company documents show that, at December 31, 2000, RAC's inventory of used commuters had increased to over 100 airplanes due to an exceptionally high number of commuter returns and repossessions at year-end, and significant commuter returns were expected in the years ahead.

57. During January 2001, in response to a perceived "market shift" concerning the commuters, RAC prepared a "1900 Business Plan" intended to "steer[] to a 'soft landing' in 4 years" by (i) further reducing the build rate for new 1900Ds to one plane per month (the minimum production rate that the subsidiary could sustain without incurring an operating loss); (ii) moving away from RAC's historic commuter financing and leasing strategies to instead "sell 1900B[s and] 1900Cs for cash" at prices that were "well below" existing book values; and (iii) building up RAC's commuter reserves by at least an additional $240 million through the continued use of surplus pension-related income to facilitate commuter sales.

58. The "reduced cash sale prices" were approved by Caine and others in senior Raytheon management during January 2001, and the 1900 Business Plan projected that the revised "cash sale" values for the commuters would create at least $60 million in anticipated losses in 2001 alone. These losses, however, would be charged against the reserves that were being built up at RAC through the use of surplus pension-related income and, thus, would not be reflected in Raytheon's reported financial statements.

59. Caine and others at the company were aware of the strategy to move to "cash sales," including the effort to "maximiz[e] conversion of 1900Cs for cash" and use "gross margin generated by additional [commuter sales] to fund more sales." In January 2001, Caine further identified that one of his "goals" for the coming year was to sell "$180 million of 1900B and 1900C inventory, the proceeds of which will be used for debt reduction."

60. Consistent with the company's new commuter business plan, by February 2001, RAC's commuter sales force was instructed that "the operating lease program they had relied upon [in] the previous few years to place used commuters was gone.... In its place were new lower cash prices on 1900Cs and 1900Ds plus an emphasis on cargo sales."

Raytheon's Inadequate Disclosures in 2000

61. In his introductory remarks during the company's second quarter 2000 earnings call, which was held on July 20, 2000, Caine disclosed that Raytheon was "experiencing some pressure on pricing in the commuter line" and that "refurb[ishment] costs and remarketing costs on used commuters were also higher this year than they were in the same period a year ago." When subsequently asked about this issue during the earnings call, Caine explained that "one of the risk factors that we are trying to keep our eyes on is the commuter market and that would include pricing in the commuter market, so we're not trying to ring any alarm bells. On the other

hand, it...is one of the risk factors for Raytheon Aircraft." Caine, however, did not disclose relevant information that he possessed concerning the commuters during this call, including the plan to begin recording the reassigned pension income within the RAC segment for the purposes of building commuter reserves.

62. During the company's third quarter 2000 earnings call, which was held on October 19, 2000, Caine responded to certain questions concerning RAC's commuter aircraft by disclosing that "we have made some adjustments to our planning for the year with regard to used aircraft and that's part of what has hurt RAC cash flow this year to our plan, but those effects are baked into our outlook." Caine also disclosed that "[w]e admit that we've got a lot of work to do between now and the end of the year in order to place not only commuter but also some GA (general aviation) planes that would come back in to us on a trade-in basis, but we think we've captured that in our forecast." Caine, however, again did not disclose relevant information that he possessed concerning the commuters, including that, in the third quarter of 2000, he had approved the merger of the over-funded pension plan with a plan in the RAC segment in order to use the surplus pension income to establish a "general reserve" to "absorb losses" for the purposes of facilitating commuter sales at prices that were below book value.

63. Similarly, Raytheon's SEC filings for 2000 did not contain adequate disclosures of the negative, adverse, and material trends, uncertainties, risks, and other information described above related to RAC's commuter operations and the subsidiary's commuter line. Raytheon's SEC filings also did not disclose the $14 million in surplus pension income that was available to RAC each quarter on a going forward basis from the over-funded pension plan, or the improper testing of RAC's on-balance sheet commuter assets on a "pooled" basis. In addition, Raytheon's 2000 Form 10-K did not disclose the various elements of the "soft landing" plan for RAC's