

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8931 / June 17, 2008

SECURITIES EXCHANGE ACT OF 1934
Release No. 57979 / June 17, 2008

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2841 / June 17, 2008

Administrative Proceeding
File No. 3-13073

In the Matter of

Tamela Pallas,

Respondent.

ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS AND IMPOSING A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (the “Securities Act”) and Section 21C of the Securities Exchange Act of 1934 (the “Exchange Act”) against Tamela Pallas (“Pallas” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (“Offer”), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings contained herein, except that Respondent admits the Commission’s jurisdiction over her and over the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings and Imposing a Cease-and-Desist Order.

III. FINDINGS

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

A. RESPONDENT

Tamela Pallas, 50, resides in Texas and, during the relevant period, was Chief Operating Officer and later Chief Executive Officer of CMS Marketing Services & Trading ("MS&T"), a subsidiary of CMS Energy Corp. ("CMS"). CMS is a Michigan corporation with its principal place of business in Jackson, Michigan. CMS's shares are registered with the Commission under Section 12(b) of the Exchange Act and trade on the New York Stock Exchange under the symbol "CMS." During the relevant period, MS&T was active in retail marketing of gas and wholesale trading of electricity and natural gas. Pallas is no longer employed at MS&T.

Prior to joining MS&T on November 1, 1999, Pallas served as an officer of Reliant Energy Services, Inc. ("RES"), a subsidiary of Reliant Energy, Inc., that was a part of Reliant's Wholesale Group and that, among other things, traded in and marketed power, natural gas, and other energy-related commodities. Until August 31, 2002, Reliant was an electric and gas public utility holding company exempt from registration under Section 3(a)(2) of the Public Utility Holding Company Act of 1935 (the "1935 Act"). Reliant's common stock was registered with the Commission under Section 12(b) of the Exchange Act, and traded on the New York Stock Exchange under the symbol REI until October 1, 2002.

B. FACTS

1. Overview of Round Trip Trades.

The round trip trades² were transactions conducted by Reliant and CMS (among others) whereby Reliant and CMS essentially agreed with one another (or with other counterparties) to simultaneously both purchase and sell electric power or natural gas for the same volume and at the same price, with no delivery contemplated and with neither party making any profit.³ At both Reliant and CMS, the transactions were intended solely to improve each company's standing in industry publications that ranked energy marketing companies based on volumes reported to the Federal Energy Regulatory Commission ("FERC"). However, in both cases, the trades also had the effect of causing the companies to overstate the revenues and expenses reported in each company's respective Commission filings as the transactions were reported on a gross basis in each company's financial statements.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

² Round trip trades at CMS and Reliant were referred to variously as "Brag-a-Watts," "volumetric" deals, "back-to-back" trades, "net-zero" trades, "no margin" trades and "zero-margin" trades. The press coined the term "round trip" to describe the trades in articles reporting on the practice first published in May 2002 and will be used in this Order.

³ Typically, the round trip trades had no impact on CMS's net earnings. However, in at least one instance, RES paid a counterparty a nominal accommodation fee as part of the transaction.

2. Round Trip Trades at Reliant.

In late 1998 or early 1999 a series of informal strategy meetings were held within the Wholesale Group of Reliant to find ways to increase trading volume. One option considered was to do frequent day trades in and out of power or gas positions. The Wholesale Group rejected this sort of transactional churning, however, after receiving an estimate of the transaction costs associated with each trade. Ultimately, Reliant officials decided to arrange a smaller number of offsetting large volume trades with willing counterparties.

Reliant officials initially considered booking the round trip trades at a price of zero, but rejected the idea because it would skew the market prices reported to FERC. Instead, the company booked the round trip trades at market prices. Based on Reliant's practice at the time of recording all trades on a gross basis, the revenues and expenses associated with the round trip trades were recorded in Reliant's books and records. Recording all trades on a gross basis meant that Reliant's reported revenue figures were not netted against offsetting expenses. As a result, the round trip transactions conveyed an inaccurate picture of the company's revenues and expenses.

In 1999 Reliant entered into five power round trip trades totaling 29.75 million megawatt hours with three counterparties: PanCanadian Energy Services, Inc. ("PanCanadian"), Merchant Energy Group of the Americas, Inc. ("MEGA"), and Public Service Company of Colorado. MEGA requested and Reliant paid an accommodation fee of \$50,000 for its trade. Reliant also entered into a series of round trip gas trades that year for 182 billion cubic feet, valued at \$364 million, with Cokin Energy. In total, the 1999 power and gas round trip trades added over \$1.4 billion in offsetting gross revenue and expenses to Reliant's books.

Reliant's first series of round trip trades was with Cokin Energy for an aggregate \$364 million in natural gas to be delivered from April to June 1999. The trades were not initially entered into Reliant's computerized trading system or its accounting and general ledger system. In July 1999, the RES Senior Vice President of Gas Trading, who reported to Respondent, brought the trades to the attention of Reliant's Chief Risk Officer. As a result of discussions involving, at various times, Reliant's Chief Risk Officer, Manager of SEC Reporting, Director of Financial Reporting, and Controller, the trades were brought to the attention of Reliant's Chief Accounting Officer. These discussions involved, among other things, the structure of the trades, their purpose, and whether and how to account for the trades. Thereafter, Reliant entered the round trip trades into its books after the close of the second quarter of 1999 using a post-closing adjustment.⁴ Respondent did not participate in these or any other discussions or decisions at Reliant regarding how to account for the round trip trades.

In the fourth quarter of 1999 an individual in Reliant's credit group brought to the attention of the RES Vice President of Risk Control a round trip trade that exceeded the counterparty's credit limit. The RES Vice President of Risk Control brought the trade to the

⁴ Reliant also provided documentation concerning the \$364 million post-closing adjustment to its outside auditor as part of the SEC reporting binders for the second quarter of 1999. In February 2000, Reliant's outside auditor reviewed and approved the post-closing adjustment as part of their annual audit.

attention of Reliant's Chief Risk Officer later that same afternoon. Reliant's Chief Risk Officer told this individual that the trade was approvable so long as it did not create a margin or credit risk to Reliant. Because round trip trades had exactly offsetting buy and sell positions, they did not give rise to margin or credit risk to the company. Following this discussion, Reliant's credit department did not generate exception reports for subsequent round trip trades.

These round trip trades continued at Reliant in 2000 and through the third quarter of 2001 when they were discontinued. However, Reliant did not restate its financial statements for the affected years until May 2002, after press reports of round trip trading at Dynegy and CMS led to the disclosure that Reliant had also done the trades.

On May 12, 2003, the Commission issued a settled cease-and-desist order against Reliant Resources, Inc. and Reliant Energy, Inc. finding that each had violated Section 17(a) of the Securities Act and Sections 10(b), 13(a), and 13(b)(2) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1 and 13a-13 thereunder. *In the Matter of Reliant Resources, Inc. and Reliant Energy, Inc.*, Administrative Proceeding File No. 3-11110 (May 12, 2003).

3. Round Trip Trades at CMS.

As with Reliant, CMS materially overstated its revenues and expenses in 2000 and 2001 as a result of round trip energy transactions conducted by its Houston-based energy-trading subsidiary, MS&T. These overstatements appeared in certain 10-Qs and 10-Ks filed with the Commission. During the relevant period, CMS also filed with the Commission several registration statements in connection with offerings of its securities.⁵ The registration statements incorporated by reference the materially misleading Forms 10-Q and the 2000 Form 10-K, including the financial statements incorporated in the filings.

CMS's sole purpose for engaging in the round trip trades was to elevate MS&T's standing in certain industry publications that ranked energy marketing companies based on total FERC-reported volumes. Specifically, CMS sought to be among the top 20 tier ("Top 20") in such industry publications in order to attract requests for proposals from municipalities that considered such industry rankings as a useful means of identifying which companies should receive requests for proposals.

Although the purpose of the round trip trades was to boost CMS's rankings, the trades also had the effect of artificially inflating CMS's revenues and expenses. CMS reported all trades on a gross basis, which meant that its reported revenue figures were not netted against offsetting expenses. As a result, the round trip transactions conveyed an inaccurate picture of the company's revenues and expenses.

On July 12, 2000, MS&T and RES entered into a round trip trade with a September 2000 term involving 10,000,000 MWH of power and \$380 million in revenue and expense. As at Reliant, Respondent and her staff at MS&T communicated the structure, magnitude and purpose of the transactions to CMS. Before its execution, this transaction was reviewed by MS&T's

⁵ CMS filed the following registration statements during the relevant period: a Form S-3 on December 15, 2000, December 22, 2000, and December 12, 2001, and a Form S-8 on April 11, 2001.

Director of Credit Management, CMS's Chief Risk Officer, and CMS's Chief Financial Officer who approved the practice.⁶ On or before October 20, 2000, CMS's outside auditor learned about the transaction from its audit team in Houston responsible for MS&T. During this same period, CMS's Chief Accounting Officer and CMS's Audit Committee Chairman discussed the accounting for the \$380-million dollar round trip trade in a conference call on October 25, 2000 with CMS's outside auditor who advised that accounting for the trade on a gross basis was appropriate. Respondent did not participate in such discussions or decisions on how to account for the trades. The \$380-million dollar round trip trade also came to the attention of the CMS Director of Financial Reporting in connection with the preparation of the MS&T Results of Operations for the CMS 2000 third quarter 10-Q.⁷

Separately, Respondent's staff informed CMS's accounting department that the \$380-million dollar round trip trade was the source of a substantial increase in current assets and liabilities for CMS for the month ended September 30, 2000. CMS's accounting staff, in turn, prepared an internal variance report for that same month that was distributed to CMS's executive officers (including CMS's Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, General Counsel, and Vice President in Charge of Investor Relations) and the entire CMS Board of Directors that attributed CMS's increase in receivables and payables to MS&T's "electric wholesale activities with Reliant Energy." Thereafter, through July 2001, every time MS&T did round trip trades, Respondent's staff would identify the round trip trades by dollar amounts as the source of the corresponding increases in current assets and liabilities and CMS's accounting staff would then attribute those increases to "buy/sale" "deals" with Reliant in the monthly variance reports given to the CMS executive officers and Board.

During its audit of the 2001 first quarter financial statements, MS&T disclosed to CMS's outside auditor three "no-margin" transactions with RES with revenues and corresponding expenses of \$1.2 billion. CMS's outside auditor, in turn, brought the round trip trades to the attention of CMS's Audit Committee Chairman who discussed the trades first with Respondent and CMS's Chief Executive Officer⁸ and then with CMS's outside auditor and Chief Accounting

⁶ Respondent also discussed the proposed marketing strategy with MS&T's Vice President of Power Trading & Marketing and MS&T's Vice President of Wholesale Power Trading, both of whom supported the strategy.

⁷ The initial draft of the MS&T Results of Operations for the CMS 2000 third quarter 10Q prepared by Respondent's staff did not include references to gross revenues or volumes. CMS's financial reporting staff subsequently revised the proposed draft to include references to total volumes and volume percentage increases. In response, Respondent's staff specifically disclosed to the CMS Director of Financial Reporting that the trades generating the increased volumes did not contemplate physical delivery, made no margin, and were being done only for the purpose of "puffing up the volumes" and specifically suggested that he delete the volume references. Nevertheless, CMS included volume references in the MS&T Results of Operations for the CMS 2000 third quarter 10Q and every 10Q thereafter during the relevant time period. Respondent did not participate in drafting CMS's third quarter earnings release or any subsequent earnings release or Commission filing. Later, after reading a published press release or Commission filing, Respondent asked CMS's Chief Financial Officer why CMS used the phrase "lower margin" to explain certain revenue increases when the transactions contributing significantly to the revenue increases were "zero margin." CMS's Chief Financial Officer dismissed Respondent's concern.

⁸ CMS's Audit Committee Chairman asked CMS's Chief Executive Officer and Respondent about the "zero-margin" trades. CMS's Chief Executive Officer responded that the trades were: (i) commonly done in the industry, (ii) done to establish MS&T on league tables as a means of showing MS&T as a viable commodities trader, and (iii) that such trading did not affect earnings, cash flow or the balance sheet/shareholders' equity. Respondent told the

Officer. At the request of the CMS Audit Committee Chairman, Respondent explained to the CMS Board of Directors what MS&T's round trip trades were, their purpose, and how they worked and answered the questions asked by the Board.

The outside auditor's review of the round trip trades continued into the second quarter of 2001.⁹ At that time, a member of the MS&T audit team concluded that revenues and expenses from the round trip trades should be recorded on a net basis – contrary to MS&T's (and CMS's) practice and the audit team's prior guidance. Neither Respondent, others at CMS, nor the CMS audit team, however, were apprised of this conclusion.

A few days prior to October 2001 (prior to the filing of CMS's third quarter Form 10-Q), CMS's outside auditor recommended to CMS that it record the revenues and expenses from round trip trades only if:

- ◆ The parties to the trade bear both credit and performance risk;
- ◆ Title to the related commodity transfers to the buyer; and
- ◆ Settlement is for the gross proceeds (checks must be exchanged and cashed for the gross amount of the transaction).

The round trip trades – which involved no risk, no net transfer of title and no exchange of cash – could not satisfy these criteria. Respondent first learned of this guidance on or about October 2, 2001 when CMS's Chief Accounting Officer informed Respondent and MS&T's Controller that CMS had decided to change the way it accounted for the round-trip trades in the financial statements it filed with the SEC. Thereafter, Respondent was advised on several occasions both before and after the filing of the CMS third quarter earnings release and Form 10-Q that revenues and expenses for the round trip trades were not included “in the numbers being reported for the financial/SEC reporting purposes.” Nevertheless, CMS reported in the third quarter of 2001 the revenues and expenses from MS&T's third quarter round trip trades, resulting in material financial misstatements.

By recording revenues and expenses from the round trip trades, CMS overstated its revenues and expenses by a total of \$5.2 billion over a one-year period: \$1.0 billion (10%) in 2000, and \$4.2 billion (36%) for the first three quarters of 2001. On March 24, 2002, CMS's auditors advised CMS that the financial results of the round trip trades conducted in 2001 would have to be reclassified to record them all on a net basis, which CMS did in its annual report for 2001.¹⁰ However, CMS did not reclassify the financial results of the round trip trades conducted in 2000 until May 29, 2002.

On March 17, 2004, the Commission issued a settled cease-and-desist order against CMS Energy Corp. and MS&T's Controller, finding that each had violated Section 17(a) of the

CMS Audit Committee Chairman that the trades were ongoing, arranged transactions with RES that represented “more than half” of MS&T's volume.

⁹ This review included round trip trades that MS&T had done for that quarter that were disclosed by MS&T to the outside auditors.

¹⁰ MS&T conducted additional round trip trades in November and December of 2001. However, the revenues and expenses from those trades were not included in Commission filings.

Securities Act and Sections 10(b), 13(a) and 13(b)(2) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1 and 13a-13 thereunder. *In the Matter of CMS Energy Corp. and Terry Woolley*, Administrative Proceeding File No. 3-11436.

Respondent's Conduct

Respondent participated in and approved of the decision to do the round trip trades while she was Senior Vice President of Reliant's Wholesale Group and as the Chief Operating Officer and later Chief Executive Officer of MS&T. Before her resignation in October 1999, Reliant completed a total of six round trip trades. After Respondent joined CMS, she agreed at the request of Reliant's Senior Vice President of Power Trading to do round trip trades with Reliant. Thereafter, traders at MS&T under Respondent's supervision executed round trip trades beginning with the third quarter of 2000 and ending with the fourth quarter of 2001, the sole purpose of which was at all times to raise MS&T's profile in industry league tables by improving MS&T's FERC-reported volumes.¹¹ Although Respondent neither participated in discussions or decisions regarding how to account for the transactions nor participated in drafting earnings releases or Commission filings at either Reliant or CMS,¹² Respondent should have known that the revenues and expenses associated with the round trip trades would be included in each company's financial statements, including filings made with the Commission.

Respondent's conduct with respect to the round trip trades was negligent and, as such, was a cause of the filing of reports, including offering materials, which included revenues and expenses related to round trip trades. Respondent's negligent conduct was also therefore a cause of the related misstatement of the transactions in each company's books, records and accounts.

C.

As a result of the conduct described above, Respondent Pallas was a cause of Reliant's and CMS's violations of Sections 17(a)(2) and (3) of the Securities Act, Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.¹³

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions specified in the Respondent's Offer.

Accordingly, IT IS HEREBY ORDERED, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, that

¹¹ Respondent and others at CMS believed that MS&T remained relatively unknown outside Michigan and that some of CMS's municipal customers considered industry rankings of FERC-reported volume as a useful means of identifying which companies should receive requests for proposals and, therefore, round trip trades could improve MS&T's industry profile.

¹² Respondent and her respective staffs did communicate the structure, magnitude and purpose of the transactions to their respective parent companies and to the persons responsible for financial reporting at those companies, as early as the first round trip trades conducted at each company.

¹³ *KPMG, LLP. v. SEC*, 289 F.3d 109, 120 (D.C. Cir. 2002) (negligence alone is sufficient to establish causing liability for non-scienter violations under Section 21C of the Exchange Act).

Respondent Pallas cease and desist from committing or causing any violation and any future violation of Section 17(a)(2) and (3) of the Securities Act, and cease and desist from causing any violation and any future violation of Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder.

By the Commission.

Florence E. Harmon
Acting Secretary