UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

UNITED STATES SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. JERRY K. CASTLEMAN, CHERYL I. LIPSHUTZ, and KATHLEEN M. LYNN Defendants.	§	Civil Action No. 06-3226 **COMPLAINT** JURY DEMANDED

Plaintiff Securities and Exchange Commission (the "Commission") for its Complaint alleges as follows:

SUMMARY

1. The defendants, Jerry K. Castleman, the former Vice President and Chief Accounting Officer ("CAO") of Enron South America, Cheryl I. Lipshutz, the former Vice President of Enron's Corporate Finance Division Special Projects Group, and Kathleen M. Lynn, the former Senior Vice President of Enron International and Managing Director and Chief Operating Officer ("COO") of the LJM private equity funds (collectively "defendants"), participated in a transaction that defrauded Enron's security holders to enrich themselves and others. Defendants' fraudulent conduct involved either or both the closing of a sham sale pursuant to which Enron Corp. ("Enron") manufactured earnings, and the later unwinding of this

sham sale by repurchasing the asset without reversing the previously (and improperly) recognized earnings.

2. The Commission requests that this Court permanently enjoin the defendants from violating the federal securities laws cited herein, order them to disgorge all ill-gotten gains, pay civil penalties, have the amount of such penalties added to and become part of a disgorgement fund for the benefit of the victims of their unlawful conduct, and prohibit Castleman permanently and unconditionally from acting as an officer or director of any issuer of securities that has a class of securities registered pursuant to Section 12 of the Securities Exchange Act of 1934 ("Exchange Act") or that is required to file reports pursuant to Section 15(d) of such Act, and order such other and further relief as the Court may deem appropriate.

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] and Sections 20(b), 20(d)(1) and 22(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77t(b), 77t(d)(1) and 77v(a)].

4. Venue lies in this District pursuant to Section 27 of the Exchange Act [15 U.S.C. § 78aa] and Section 22 of the Securities Act [15 U.S.C. § 77v(a)] 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, Castleman, Lipshutz and Lynn, 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.

6. The defendants, unless restrained and enjoined by this Court, will continue to engage in transactions, acts, practices, and courses of conduct as set forth in this Complaint, or in similar illegal acts and practices.

DEFENDANTS

7. Jerry K. Castleman, CPA, 42, is a resident of Humble, Texas. A former Arthur Andersen auditor, Castleman joined Enron in March 1997. He worked in the Corporate Accounting Unit and eventually became a Vice President and the CAO of Enron South America ("ESA"). Castleman is a licensed CPA in the state of Texas. Castleman was responsible for negotiating and documenting the transaction described below and did so knowing that the transactions: 1) violated the relevant accounting principles and 2) would be used to materially and fraudulently inflate Enron's earnings.

8. Cheryl I. Lipshutz, 50, is a resident of Houston, Texas. She received a Masters in Business Administration in 1977, and joined Enron in July 1998, as a Vice President in the Enron Global Finance Special Projects Group. She later became Chief Financial Officer ("CFO") of Enron Energy Services. Lipshutz was responsible for negotiating on behalf of LJM1 on the 1999 transaction described below. Lipshutz knew, or was reckless in not knowing, that the transaction: 1) violated the relevant accounting principles; and 2) would be used to materially and fraudulently inflate Enron's earnings.

9. Kathleen M. Lynn, 49, is a resident of Houston, Texas. She joined Enron in 1994 as a Vice President of Enron Capital and Trade, and in 1998 became Senior Vice President of Enron International for the South America region. In March 2000, she became Managing Director and COO of the LJM private equity funds controlled by Andrew Fastow ("Fastow"), the then-CFO of Enron. During this time, however, she remained a full-time Enron employee (LJM

reimbursed Enron for Lynn's salary, but not benefits or certain other compensation). Lynn was responsible for representing LJM1 and negotiating on behalf of LJM1 on the 2001 transaction described below and did so knowing that the transaction: 1) violated the relevant accounting principles; and 2) had been used to materially and fraudulently inflate Enron's earnings.

RELATED ENTITIES AND INDIVIDUALS

10. Enron is an Oregon corporation with its principal place of business in Houston, Texas. During the relevant time period, the common stock of Enron 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 with reported annual revenue of more than $150 billion. 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.

11. Andrew S. Fastow, age 44, was Enron's Chief Financial Officer from March 1998 to October 24, 2001. Fastow oversaw many of Enron's financial activities and reported directly to Enron's Chief Executive Officer. Fastow was also the owner of the general partner of the LJM private equity funds that served as the counterparty to Enron for the transactions described below. On January 14, 2004, Fastow pleaded guilty to, among other items, conspiracy to commit wire and securities fraud. He was sentenced to six years in prison for his role in this and other fraudulent Enron transactions.

12. Richard A. Causey, age 44, was Enron's Chief Accounting Officer from 1998 to 2002. He was responsible for approving the transactions described below on behalf of Enron. On December 28, 2005, Causey pleaded guilty to conspiring with members of Enron's senior

management in efforts to mislead the investing public by making false and misleading statements or omissions in violation of the securities laws, rules and regulations.

13. In June 1999, Andrew Fastow formed a private equity fund called LJM Cayman, L.P. ("LJM1"). Enron granted Fastow a limited waiver of Enron's conflict of interest rules so he could run LJM1 as its general partner. LJM1 served as the counterparty for the transactions discussed below.

FACTUAL ALLEGATIONS

The Fraudulent Sale of Enron's Cuiaba Interest

14. Enron, through a wholly-owned subsidiary, held an approximate 65% interest in a power plant and related pipelines under construction in Cuiaba, Brazil (the pipeline project is hereafter referred to as "Cuiaba"). Enron was developing the project to generate and sell electricity. However, the Cuiaba project was troubled from its inception and caused Enron to incur significant costs. Enron's problems with the Cuiaba project were known by the defendants.

15. In the second and third quarters of 1999, ESA and Enron were falling short of reaching earnings estimates. In order to generate earnings, ESA attempted to find a short term buyer for a percentage of ESA's Cuiaba interest so that ESA could deconsolidate its Cuiaba interest. This, in turn, would allow Enron to recognize earnings on related gas supply contracts by allowing an Enron-owned entity to mark those gas supply contracts to market and reflect any changes in market fluctuations relating to those contracts in Enron's income statement.

16. Unable to find an independent third party to buy ESA's Cuiaba interest, Castleman contacted a former colleague of Castleman's at Arthur Andersen who was now working for Enron's Global Finance division. The colleague proposed using LJM1 as a short-

term warehouse of the Cuiaba interest until a long-term buyer could be found, and discussed with Castleman options for structuring the transaction to achieve the desired accounting treatment.

17. Castleman and others on behalf of ESA and Enron, and Lipshutz and others on behalf of LJM1, negotiated the transaction pursuant to which Enron would sell down its interest in Cuiaba in order to be able relinquish control of, and consequently deconsolidate, the Cuiaba asset (the "selldown"). Both Castleman and Lipshutz knew, or were reckless in not knowing, that the purpose of the transaction was to allow Enron to recognize earnings from certain related gas supply contracts.

18. As initially proposed, Castleman and Lipshutz structured the transaction so that LJM1 had the right to "put" its interest to Enron, or force Enron to repurchase its interest, in the event that a long-term purchaser could not be found within a specified period of months. Because this did not reflect a sale of the Cuiaba interest that transferred risk to LJM, Enron's auditor, Arthur Andersen, when made aware of this provision by Castleman, rejected the "put" provision.

19. Next, Castleman and Lipshutz structured the transaction so that LJM1 would enjoy certain express rights and assurances that: 1) Enron would find a long-term buyer for the interest within a period of months that would provide a return of and on LJM1's investment; or 2) if a long term buyer could not be found to provide this return of and on LJM1's investment, LJM1 would enjoy certain supermajority rights in ESA's Cuiaba holding company, and preferred access to income from the Cuiaba project, so that LJM1 was guaranteed that it would receive its investment back and a return on its investment.

20. Because the proposed transaction did not transfer risk from Enron to LJM1, Arthur Andersen advised Enron, including Castleman, that the sale must include a provision ensuring that LJM1's investment be "at risk."

21. In light of the substantial uncertainty that Enron would be able to find a long-term buyer for LJM1's interest given the troubled economics of the Cuiaba project, Fastow refused to purchase Enron's Cuiaba interest without further assurances. To deal with this problem, Enron's CEO, Jeffrey Skilling, orally promised Fastow that LJM1 would be made whole on his investment in Cuiaba.

22. Castleman and Lipshutz knew, or were reckless in not knowing, that this oral agreement ("the side agreement") between Skilling, on behalf of Enron, and Fastow, on behalf of LJM1, existed, and that it violated the accounting requirement that the seller (Enron) transfer to the buyer (LJM1) the usual risks and rewards of ownership in a sale. Because the side agreement would have destroyed the desired accounting treatment, the side agreement was never included in the written deal documents; nevertheless, it continued in fact as part of an oral understanding between Enron and LJM1.

23. Castleman, as the CAO for ESA and the senior Enron accountant working on Enron's behalf on the Cuiaba transaction, was the official responsible for interfacing with Enron's auditor.

24. Castleman and others did not tell Arthur Andersen about the existence of the side agreement. This omission was material because, had Arthur Andersen known about this side agreement that promised to make LJM1 whole, it would not have treated the transaction as a sale to LJM1, which was a necessary step to allow the deconsolidation of Enron's Cuiaba interest and the recognition of earnings.

25. Castleman knew, or was reckless in not knowing, that the side agreement was material, and that Arthur Andersen relied upon his omissions.

26. On September 30, 1999, Enron sold to LJM1 a 13% interest in the project for $11,300,000. This amount constituted a $10,800,000 payment for the Cuiaba interest, and a $500,000 payment for the "preferred shares" in Enron's Cuiaba holding company. The sale of this interest (and the board seat that went with it) was purportedly sufficient for Enron to conclude that it did not control the Cuiaba project and, consequently, allowed Enron to deconsolidate its interest in Cuiaba.

27. This deconsolidation, in turn, enabled Enron to recognize a total of approximately $34,000,000 of income in the third quarter of 1999, and $31,000,000 of income in the fourth quarter of 1999, when it was struggling to meet its projected earnings estimates. The Cuiaba-related earnings were material to Enron's publicly-filed financial statements. It also allowed Enron to recognize $14,000,000 in 2000 earnings, and $5,000,000 in 2001 earnings.

The Cuiaba Extensions

28. Pursuant to the written terms of the selldown documents, LJM1 was entitled to achieve a 13% return on its investment if its interest was sold to a long-term buyer by May 2000, and a 25% return if such a buyer was not found until after May 2000 (the return would be reduced by a percentage that LJM1 was required to maintain at-risk if the sales price to the long-term buyer was insufficient to cover LJM1's initial investment and its return).

29. When a long-term buyer was not found by May 2000, LJM1 and Enron executed a written agreement extending the date by which Enron was required to find a long-term buyer to August 2000. Enron paid LJM $240,000 for this three month extension. When the August 2000 deadline passed, Causey, on behalf of Enron, and Fastow, on behalf of LJM1, orally agreed to

extend the date by which Enron was required to find a long-term buyer to the end of 2001. The effect of each of these extensions was to keep LJM1's return amount at 13%. Castleman and Kathleen Lynn were aware of these two extension agreements.

30. The oral extension agreement was consistent with the oral side agreement between the parties that LJM1 would be made whole by Enron at some point in the future and would not lose money on this troubled asset.

The Cuiaba Buyback

31. By January of 2001, Enron was still unable to find a long-term buyer for the LJM1 interest in Cuiaba. The project continued to require cash infusions, and was still over budget, unfinished, and not producing income.

32. In order to satisfy the oral promise to make LJM1 whole, Enron agreed to buy back the interest that LJM1 held in the project (the "buyback"). Lynn and others represented LJM1 in the buyback transaction, and Castleman and others represented Enron. Like Castleman, Lynn was aware of the unwritten side agreement that Enron would make LJM1 whole.

33. In light of their knowledge of the oral side agreements made by Enron to Fastow and LJM1, the poor economics of the Cuiaba projects, and other information, Castleman and Lynn knew, or were reckless in not knowing, that the buyback was in furtherance of that fraudulent, unwritten side agreement.

34. Castleman calculated the purchase price for the buyback. Initially, Lynn and Castleman negotiated whether a 13% or 25% return was due LJM1. In the end, they agreed that, by virtue of the written and unwritten extensions described above, a 13% return applied, and Castleman, Lynn and others determined that Enron would pay LJM1 $13,200,000 to repurchase LJM1's interest in Cuiaba.

35. The purchase price reflected LJM1's initial $10,800,000 investment plus a return of $2,400,000. In addition, the parties agreed that LJM1 would be paid $4,000 each day until closing.

36. Enron agreed to pay LJM1 a profit despite the fact that LJM1's "investment" had actually decreased in value over the time it held the interest by virtue of the massive cost overruns and delayed schedule experienced in the Cuiaba project.

37. The preferred shares LJM1 had purchased for $500,000 were "redeemed" by Enron in April 2000, for $750,000.

38. A "share purchase agreement" was executed between Enron and LJM1 on March 28, 2001, reflecting Enron's agreement to repurchase LJM1's interest in Cuiaba pending satisfaction of certain conditions precedent. Those conditions were satisfied and, after several delays undertaken for disclosure purposes, the buyback closed on August 15, 2001. Enron paid LJM1 $13,752,000. This buyback completed the fraud that began in the fall of 1999 with the selldown of the Cuiaba interest to LJM1.

39. Castleman and Lynn knew, or were reckless in not knowing, that their efforts in negotiating and documenting the Cuiaba buyback were in furtherance of the fraudulent transaction that manipulated Enron's earnings.

40. Castleman also knew, or was reckless in not knowing, that despite Enron's repurchase of the LJM1 interest in Cuiaba, Enron did not intend to, and did not, unwind the earnings that were fraudulently reflected on its income statement by the purported sale and deconsolidation of Enron's Cuiaba interest.

CLAIMS FOR RELIEF

FIRST CLAIM

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]

41. Paragraphs 1 through 40 are realleged and incorporated by reference herein.

42. As set forth more fully above, Castleman, Lipshutz and Lynn, 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: employed devices, schemes, or artifices to defraud, 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 engaged in acts, practices, or courses of business which operate or would operate as a fraud or deceit upon any person.

43. By reason of the foregoing, Castleman, Lipshutz and Lynn violated 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].

SECOND CLAIM

Violations of Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)]

44. Paragraphs 1 through 43 are realleged and incorporated by reference herein.

45. Castleman, Lipshutz and Lynn, by engaging in the conduct described above, directly or indirectly, by the use of the means or instruments of transportation or communication in interstate commerce or by the use of the mails: employed devices, schemes, or artifices to defraud, obtained money or property by means of untrue statements of material facts or omissions 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 engaged in acts, practices, or courses of business which operate or would operate as a fraud or deceit upon the purchasers of such securities.

46. By reason of the foregoing, Castleman, Lipshutz and Lynn violated Section 17(a) of the Securities Act.

THIRD CLAIM

Aiding and Abetting Violations of Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 12b-20, 13a-1, & 13a-13 thereunder [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-13]

47. Paragraphs 1 through 46 are realleged and incorporated by reference herein.

48. By engaging in the conduct described above, Castleman, Lipshutz and Lynn knowingly or recklessly and substantially caused Enron to file materially false and misleading quarterly reports on Form 10-Q with the Commission during the period 1999 through at least September 2001, and/or also knowingly or recklessly and substantially caused Enron to file materially false and misleading fiscal reports with the Commission for the years 1999 and 2000.

49. By reason of the foregoing, Castleman, Lipshutz and Lynn aided and abetted violations by Enron of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

FOURTH CLAIM

Aiding and Abetting Violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§ 78m(b)(2)(A), 78m(b)(2)(B)] and Violations of Rule 13b2-1 thereunder [17 C.F.R. § 240.13b2-1]

50. Paragraphs 1 through 49 are realleged and incorporated by reference herein.

51. By engaging in the conduct described above, Castleman, Lipshutz and Lynn aided and abetted Enron's failures to make and keep books, records and accounts which, in reasonable detail, accurately and fairly reflected Enron's transactions and dispositions of its assets, in violation of Section 13(b)(2)(A) of the Exchange Act, and further aided and abetted failures to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that Enron's corporate transactions were executed in accordance with management's authorization and in a manner to permit the preparation of financial statements in conformity with generally accepted accounting principles in violation of Section 13(b)(2)(B) of the Exchange Act.

52. By engaging in the conduct described above, Castleman, Lipshutz and Lynn, directly or indirectly, falsified and caused to be falsified Enron's books, records, and accounts subject to Section 13(b)(2)(A) of the Exchange Act in violation of Rule 13b2-1 thereunder.

53. By reason of the foregoing, Castleman, Lipshutz and Lynn aided and abetted violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and violated Rule 13b2-1 thereunder.

FIFTH CLAIM

Violations of Section 13(b)(5) of the Exchange Act [15 U.S.C. § 78m(b)(5)]

54. Paragraphs 1 through 53 are realleged and incorporated by reference herein.

55. By engaging in the conduct described above, Castleman, Lipshutz and Lynn knowingly or recklessly circumvented or knowingly failed to implement a system of internal financial controls at Enron.

56. By reason of the foregoing, Castleman, Lipshutz and Lynn violated Section 13(b)(5) of the Exchange Act.

SIXTH CLAIM

Violations of the Exchange Act Rule 13b2-2 thereunder [17 C.F.R. § 240.13b2-2]

57. Paragraphs 1 through 56 are realleged and incorporated by reference herein.

58. By engaging in the conduct described above, Castleman directly or indirectly, made or caused to be made false and misleading statements or omitted or caused others to omit to state material facts necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading to Enron's independent accountants and Enron's auditors in connection with audits and examinations of Enron's required financial statements and in connection with the preparation and filing of documents and reports required to be filed with the Commission, in violation of Exchange Act Rule 13b2-2.

59. By reason of the foregoing, defendant Castleman violated Exchange Act Rule 13b2-2.

JURY DEMAND

60. The Commission demands a jury in this matter.

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that this Court enter an Order:

A. Permanently enjoining and restraining Castleman, Lipshutz and Lynn from violating the statutory provisions set forth herein; requiring Castleman, Lipshutz and Lynn to pay

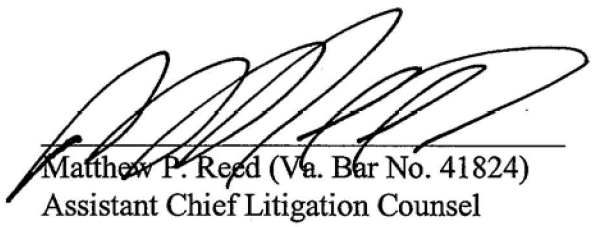
disgorgement of illegal gains, and civil penalties; and prohibiting Castleman permanently and unconditionally from acting as an officer or director of any issuer of securities that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of such Act;

B. Providing, pursuant to Section 308 of the Sarbanes-Oxley Act of 2002, that the amount of civil penalties ordered against Castleman, Lipshutz and Lynn be added to and become part of a disgorgement fund for the benefit of the victims of the violations alleged herein; and

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

Dated: October 12, 2006

Respectfully submitted,



Matthew P. Reed (Va. Bar No. 41824)
Assistant Chief Litigation Counsel
Attorney-in-Charge, Plaintiff
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549
Phone: (202) 551-4511 (Reed)
Fax: (202) 772-9245 (Reed)

Of Counsel:
Gregory G. Faragasso
Kurt Gresenz
Michele R. Vollmer
Lauren B. Poper
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549