UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

SECURITIES AND EXCHANGE COMMISSION,	:	
Plaintiff,	:	Civil Action No.
v.	:	**COMPLAINT**
DAVID B. DUNCAN,	:	
Defendant.	:	

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

SUMMARY

1. Enron Corp.'s ("Enron") senior executives engaged in and presided over a wide-ranging scheme to defraud the investing public by materially overstating the company's earnings and cash flows, and concealing debt in periodic reports filed with the Commission. The fraudulent scheme was carried out through a variety of complex structured transactions, off-balance sheet financings, related party transactions, misleading disclosures, and a widespread abuse of generally accepted accounting principles ("GAAP").

2. Arthur Andersen LLP ("Andersen") served as Enron's auditor, and for each year during the relevant time period, issued an auditor's report stating the opinion that Enron's financial statements were presented fairly, in all material respects, in conformity with GAAP, and that Andersen had conducted its audit of those financial statements in accordance with generally accepted auditing standards ("GAAS"). David B. Duncan ("Duncan") served as the global

engagement partner responsible for the Enron audits. As the global engagement partner for the Enron audits, Duncan was ultimately responsible for determining whether an unqualified opinion should be issued within the auditor's report. For years ended December 31,1998 through 2000, Duncan was reckless in not knowing that the unqualified auditor's reports he signed on behalf of Andersen were materially false and misleading. These auditor's reports were part of Enron's annual reports on Forms 10-K filed with the Commission for years 1998, 1999 and 2000. Based on this, the Commission alleges that Duncan violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 promulgated thereunder. Accordingly, the Commission requests that this Court permanently enjoin Duncan from any future violation of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

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.

DEFENDANT

5. David B. Duncan, age 48, resides in Houston, Texas. Duncan served as the global engagement partner for Andersen's audits of Enron from 1997 until December 2001. During the relevant time period, Duncan was a certified public accountant licensed in the state of Texas. As the global engagement partner, Duncan was the senior member of the Andersen engagement team responsible for the Enron audits during each of the relevant periods.

OTHER ENTITIES

6. Enron was 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, with reported annual revenue of more than $100 billion. In 2000, Enron rose to number seven on the *Fortune 500* list of public companies. By December 2, 2001, when it filed for bankruptcy, Enron's stock price had dropped over the course of a year from more than $80 per share to less than $1.

7. Andersen once was one of the so-called "Big Five" accounting firms in the United States and had its headquarters in Chicago, Illinois. Andersen personnel performed work for Enron during the relevant time period in several cities, including Chicago, Houston, and London.

FACTUAL ALLEGATIONS

Enron Identified as a Maximum Risk Client

8. Duncan was aware that the risk of fraudulent financial reporting at Enron was high. In accordance with applicable professional standards, Andersen assessed the risk of fraud at Enron (AU §316, *Consideration of Fraud in a Financial Statement Audit)*, and the engagement team documented that Enron possessed many of the risk factors that should be considered in making that assessment. For example, Fraud Risk Assessment questionnaires prepared by the engagement team and reviewed by Duncan documented that Enron placed an "undue emphasis on meeting earnings targets;" used "highly aggressive accounting . . . practices;" utilized "unusual" year-end transactions that posed difficult "substance over form" questions; possessed a

"philosophy of significantly managing (maximizing or minimizing) earnings;" and had a "high dependence on debt, difficulty in meeting debt payments or vulnerability to interest rate changes." In addition, an internal Andersen document prepared each year by Duncan and others on the engagement team consistently classified the Enron engagement as involving "maximum risk" and noted that Enron's use of complex "form over substance" and related party transactions created an "extreme" or "very significant" financial reporting risk.

9. Because of the recognized risk and his position as global engagement partner, Duncan was required by GAAS to design and implement auditing procedures adequate to address the risks inherent in the Enron engagement, to perform substantive tests or other procedures to obtain sufficient, competent evidential matter, and to properly supervise the audits (AU §312, *Audit Risk and Materiality in Conducting an Audit,* AU §326, *Evidential Matter*, and AU §311, *Planning and Supervision*). Instead, in performing and supervising the Enron audits, Duncan failed to exercise due professional care and the necessary skepticism (AU §230, *Due Professional Care in the Performance of Work*) to ensure that Enron's financial statements were presented in conformity with GAAP (AU §410, *Adherence to Generally Accepted Accounting Principles*) and that the audits were conducted in accordance with GAAS (AU §508, *Reports on Audited Financial Statements*).

Enron's Prepay Transactions

10. Enron improperly reported structured financing proceeds as operating cash flows by means of "prepay" transactions with various financial institutions. Enron used prepay transactions to improperly report the cash it received from prepay transactions as cash flow from operating activities, rather than cash flow from financing activities. This allowed Enron to hide the true extent of its borrowing from investors and the national credit rating agencies because

sums borrowed in prepay transactions appeared as "price risk management liabilities" rather than additional debt on Enron's balance sheet.

11. Enron's prepay transactions were in substance financings because Enron used a three party structure involving a bank and a bank sponsored SPE that were not independent of each other to remove all commodity price risk from the transaction. The circular nature of delivery and payments with respect to the commodities and the lack of independence between the bank counterparties had the effect of eliminating any material risk or any potential gain with respect to changes in the price of the underlying commodity. In effect, Enron's prepay transactions involved an investment bank making a large payment to Enron in exchange for Enron's promise to pay the bank sponsored entity an amount in excess of what Enron received in the initial prepayment.

12. Amounts borrowed by Enron using the prepay structure were finely tuned each quarter for maximum reporting benefit. Enron simply determined the amount of operating cash flows it wanted to report, projected any "shortfall" as the end of a reporting period approached, and then used prepay transactions to fill the gap. From 1997 through September 30, 2001, Enron, using prepay transactions, received over $5 billion in funds in this manner.

13. Enron never separately disclosed in its public filings that it was entering into prepay transactions. Such disclosure was necessary because of the large dollar amounts and volume of prepay transactions entered into by Enron and the significant future obligated cash commitments associated with the transactions. Rather, the prepay transactions were aggregated into Enron's "price risk management liabilities." Enron provided a generic and inadequate description of its price risk management activities in the notes to the financial statements and in

the management's discussion and analysis section of its annual reports on Form 10-K and its quarterly reports on Form 10-Q.

14. GAAS provides that "the presentation of financial statements in conformity with [GAAP] includes adequate disclosure of material matters. These matters relate to the form, arrangement, and content of the financial statements and their appended notes . . ." (AU §431, *Adequacy of Disclosure in Financial Statements*). GAAS also states that "[GAAP] recognize[s] the importance of reporting transactions and events in accordance with their substance" and that the "auditor should consider whether the substance of the transactions or events differs materially from their form." (AU §411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles in the Independent Auditor's Report*). Enron's financial statement presentation and disclosure of the prepay transactions was not in conformity with GAAP because it mischaracterized the nature of the cash flows associated with the transactions, obscured the true economic substance of these financing transactions, and did not address the material impact they had on Enron's financial statements.

15. Duncan failed to ensure that the engagement team audited Enron's prepay transactions in accordance with GAAS and failed to ensure that Enron properly presented and disclosed the prepay transactions in its financial statements. For example, Andersen advised Enron of certain basic criteria they believed were required for the prepay transactions to be treated as price risk management liabilities rather than debt, as well as the requirements they believed were necessary to account for the related cash infusion as cash flow from operations rather than cash flow from financing. However, the testing work done and evidential matter obtained and considered by the engagement team was not sufficient to establish whether Enron followed those criteria. One of Andersen's key criteria required that the three parties to the

prepay transactions be independent from one another. Duncan and the engagement team placed an undue reliance on unsupported and unverified representations from Enron's management that the third-party special purpose entities ("SPEs") involved in the prepay transactions were credit worthy independent businesses (AU §333, *Management's Representations*). Andersen's limited and untimely attempts to seek confirmations from these SPEs were insufficient to conclude that each was an independent business. Accordingly, in violation of applicable professional standards, Duncan failed to ensure that the engagement team designed and implemented adequate audit procedures (AU §312, *Audit Risk and Materiality in Conducting an Audit*) and obtained sufficient, competent evidential matter regarding this vital aspect of the prepay transactions (AU § 326, *Evidential Matter*). In doing so, Duncan failed to properly supervise the audit (AU §311, *Planning and Supervision*) and to exercise due professional care to ensure that adequate audit procedures were performed to confirm that Andersen's prepay advice was followed by Enron, and that the unqualified audit reports he signed were not misleading (AU §230, *Due Professional Care in the Performance of Work*).

16. In exercising the appropriate level of due professional care, Duncan should have recognized that Enron's disclosures regarding prepay transactions were materially inadequate. Duncan did, on several occasions, recommend improved disclosures to certain senior management of Enron. In conjunction with the 2000 audit, Duncan proposed to certain of Enron's senior management specific language used by another Andersen audit client that would have disclosed the fact that Enron used "prepaid commodity contracts" and also the dollar amount of liabilities associated with the prepay transactions. Duncan's recommendations to enhance the disclosure for prepay transactions were rejected. However, Duncan failed to inform Enron's Audit Committee of his recommendations or that they had been rejected by

management. GAAS requires that any disagreements with management regarding financial statement disclosures should be discussed with the audit committee (AU §380, *Communication With Audit Committees*). "If management omits from the financial statements, including the accompanying notes, information that is required by generally accepted accounting principles, the auditor should express a qualified or an adverse opinion and should provide the information in his report. . ." (AU §431, *Adequacy of Disclosure in Financial Statements*). Accordingly, under these circumstances, Duncan should have insisted that Enron enhance its prepay transaction disclosure, and, if Enron refused, raised the matter with Enron's Audit Committee. If the disclosure was not fixed after that, Duncan should have issued qualified audit opinions. He failed to undertake any of these actions.

Enron's Project Nahanni

17. After completing an $800 million dollar prepay transaction in November 1999, Enron was still approximately $500 million short of the funds flow target Enron had told the credit rating agencies it intended to achieve for the year. To make up for this shortfall, Enron entered into a transaction code-named Project Nahanni that, in its entirety, had no material economic benefit to Enron. This transaction was in substance a year-end, one month, $500 million financing that Enron used to manipulate its financial statements by: (i) inflating reported cash flow from operating activities; (ii) under-reporting cash flow from financing activities; and (iii) under-reporting debt -- in each instance by $500 million.

18. Project Nahanni was structured as a minority interest transaction in which Citigroup, through an SPE called Nahanni, provided capital in return for a minority interest in a consolidated subsidiary of Enron called Marengo. Marengo was a partnership between Enron and Nahanni created specifically to effectuate the subject transaction. As a result, cash flow

associated with the activities of Marengo appeared as cash flow from operating activities on Enron's financial statements, and Nahanni's financial contribution to Marengo appeared as a minority interest on Enron's balance sheet, rather than debt.

19. On or about December 17, 1999, Citigroup funded Nahanni with $485 million in debt and $15 million in outside equity. Nahanni immediately purchased $500 million of short-term U.S. Treasury bills ("T-bills") and then contributed the T-bills to acquire a minority interest in Marengo. On or about December 29, 1999, two days before Enron's annual reporting period ended, Enron directed Marengo to sell the $500 million in T-bills. The sale of the T-bills appeared as cash flow from operating activities on Enron's consolidated statement of cash flow. Enron then borrowed from Marengo the cash proceeds from the sale of the T-bills to pay down its reported debt by $500 million just before year-end 1999. Since Enron treated the transaction with Marengo as an inter-company loan, it did not increase Enron's reported debt. By replacing $500 million of debt with a minority interest in a consolidated subsidiary, Enron improved its reported debt-to-equity ratio by 16 percent at year-end, December 31, 1999. In addition, the $500 million in operating cash flow from Project Nahanni accounted for 41 percent of Enron's total cash flow reported for the year.

20. On or about January 14, 2000, Enron repaid the $500 million loan from Marengo with interest. Marengo then paid Nahanni approximately $487.1 million, representing $485 million in principal, plus $2.1 million in interest. While the initiation of the transaction was reported as an increase in cash flow from operating activities, its wind-down just weeks later was reported by Enron as a reduction in cash flow from investing activities.

21. In order for the Nahanni transaction to achieve Enron's goal of increasing its cash flow from operating activities, it was necessary for Enron to take the position that holding

Treasury securities was part of its "merchant activities," so that it could then claim that the sale of those securities generated cash flow from operating activities. Accordingly, Enron changed the merchant activities footnote in its financial statements to include government securities in the definition of merchant investments. Duncan and others on the engagement team were reckless in not knowing that such a change was materially misleading because T-bill investing was not a part of Enron's merchant business, and because, contrary to the definition of a merchant investment, Enron never had any intent to hold the securities for the purpose of making a profit.

22. Enron's overall disclosure of the Nahanni transaction in its 1999 Form 10-K was materially misleading because Enron did not disclose: (i) that the partnership was created in December to fund a transaction that lasted just long enough to achieve a year-end financial reporting objective; and (ii) that the Nahanni transaction was a one-time boost to cash flow, not a continuous, sustainable cash flow from operations. Thus, Enron's disclosure created the false impression that the transaction related to Enron's regular-course-of-business investments in energy and technology companies. Duncan reviewed Enron's Project Nahanni disclosure and was reckless in not knowing that it was materially misleading. Although various aspects of the Nahanni transaction were technically reported in accordance with GAAP, Duncan and the engagement team failed to exercise due professional care and skepticism when approving Enron's accounting for the transaction (AU §230, *Due Professional Care in the Performance of Work*), and failed to ensure Enron's financial statement presentation was not materially misleading (AU §431, *Adequacy of Disclosure in Financial Statements*, AU §411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles in the Independent Auditor's Report*, and AU §508, *Reports on Audited Financial Statements*).

Enron's Raptor Transactions

23. Beginning in the spring of 2000, Enron and LJM2, a partnership formed and managed by Enron's then-Chief Financial Officer Andrew Fastow, engaged in a series of complex financial transactions with four SPE structures called Raptor I, Raptor II, Raptor III, and Raptor IV (collectively referred to as the "Raptors"). Enron's senior management used the Raptors, in part, to manipulate Enron's financial statements.

24. By 1999, a large percentage of Enron's quarterly earnings were attributed to unrealized gains in its merchant energy portfolio and in various technology investments. Many of these assets were extremely volatile. The Raptors were used by Enron to "hedge" the value of those investments with a purported independent third party SPE, so that Enron could offset declines in the value of these assets with the Raptor hedges. Enron capitalized Raptors I, II, and IV with Enron stock. Raptor III was capitalized with warrants of an Enron spin-off company. Enron received an economic interest in the Raptors and $1.2 billion in notes receivable from the Raptors in return for the Enron shares and warrants.

25. LJM2 contributed $30 million of equity to each Raptor. However, through undisclosed side agreements between Fastow and others, the structures were designed so that amounts equal to LJM2's equity was returned to LJM2 for each Raptor prior to any hedges being put in place. As a result of the oral side agreements and related effective return of capital, LJM2 had no equity at risk and Enron should have consolidated the Raptors into its financial statements. LJM2's equity was effectively returned to it through three separate $41 million put options in Enron stock in Raptors I, II, and IV, and through a distribution in Raptor III. These put options provided a return equal to LJM2's initial $30 million capital contribution in each Raptor, along with an agreed upon rate of return on such capital, before the Raptor SPEs entered

into the hedging transactions. Effectively, Enron was entering into hedging contracts with entities backed solely with its own stock.

26. Since the Enron engagement was classified as maximum risk, and related party transactions created an "extreme" or "very significant" financial reporting risk, the existence of the put options in the Raptor structures should have triggered increased professional skepticism. The puts were priced at a premium that matched exactly LJM2's targeted return and were included as part of aggressive and complex related party transactions that had a material effect on Enron's reported earnings. Additionally, LJM2 received its $41 million payout in each Raptor shortly after signing the contracts - resulting in a short term return on investment in excess of 130% in each case. Moreover, the payout occurred in each Raptor after Enron settled the put option early and before any hedges were put in place. The timing of settlement by Enron of these out-of-the-money put options should have been an additional red flag and prompted Duncan and the engagement team to increase their professional skepticism and question why Enron would repeatedly make such economically irrational payments. These payments actually eliminated the supposed protection from a drop in its stock price that the company purportedly had purchased at a premium. GAAS requires that more extensive or effective audit tests should be designed for related party transactions when the auditor assessed risk at a higher level (AU §334, *Related Parties*). Despite the need for greater scrutiny, Duncan did not exercise due professional care or professional skepticism with regard to this aspect of the Raptor transactions (AU §230, *Due Professional Care in the Performance of Work*).

27. Enron's footnote disclosure in its Form 10-K for year 2000 contains a paragraph describing some aspects of the Raptor transactions. However, the disclosure was not in accordance with GAAP (FAS 57, *Related Party Disclosures*) since it did not include an adequate

description of the Raptor transactions and information necessary to understand the effects these transactions had on Enron's financial statements. Furthermore, in the footnote, Enron asserted, without any reasonable basis or substantiation, that "the terms of the transactions with the Related Party were reasonable compared to those which could have been negotiated with unrelated third parties." FAS 57 states that financial statement representations "shall not imply that the related party transactions were consummated on terms equivalent to those that prevail in arm's-length transactions unless such representations can be substantiated." Duncan reviewed Enron's related party disclosure and was reckless in not knowing that the terms of the Raptor transactions were not equivalent to an arm's-length transaction and that the disclosure was materially misleading.

Audit Reports

28. On March 5, 1999, Duncan, on behalf of Andersen, signed an unqualified auditors' report in which he stated that Andersen audited Enron's 1998 consolidated financial statements "in accordance with generally accepted auditing standards" and expressed the opinion that the financial statements "present fairly, in all material respects, the financial position of Enron Corp. and subsidiaries . . . and the results of their operations, cash flows and changes in shareholders' equity . . . in conformity with accounting principles generally accepted in the United States." This auditors' report was included in Enron's Form 10-K filed with the Commission on March 31, 1999.

29. On March 13, 2000, Duncan, on behalf of Andersen, signed an unqualified auditors' report in which he stated that Andersen audited Enron's 1999 consolidated financial statements "in accordance with auditing standards generally accepted in the United States" and expressed the opinion that the financial statements "present fairly, in all material respects, the

financial position of Enron Corp. and subsidiaries . . . and the results of their operations, cash flows and changes in shareholders' equity . . . in conformity with accounting principles generally accepted in the United States." This auditors' report was included in Enron's Form 10-K filed with the Commission on March 30, 2000.

30. On February 23, 2001, Duncan, on behalf of Andersen, signed an unqualified auditors' report in which he stated that Andersen audited Enron's 2000 consolidated financial statements "in accordance with auditing standards generally accepted in the United States" and expressed the opinion that the financial statements "present fairly, in all material respects, the financial position of Enron Corp. and subsidiaries . . . and the results of their operations, cash flows and changes in shareholders' equity . . . in conformity with accounting principles generally accepted in the United States." This auditors' report was included in Enron's Form 10-K filed with the Commission on April 2, 2001.

31. For the reasons outlined above, Duncan was reckless in not knowing that Andersen's audits of Enron's financial statements were not performed in accordance with GAAS and that Enron's financial statements did not present Enron's financial position, the results of their operations, cash flows, and changes in shareholders' equity in conformity with GAAP. Duncan, as the global engagement partner for the Enron audits, was ultimately responsible for determining whether an unqualified opinion should be issued within the auditors' report. As such, when he certified that Andersen audited Enron's financial statements in accordance with GAAS, and that Enron's financial statements were prepared in accordance with GAAP, he made material misstatements or omissions in Andersen's auditors' reports filed with Enron's 1998, 1999, and 2000 Forms 10-K.

CLAIM FOR RELIEF

Violations of Section 10(b) of the Exchange Act and Rule 10b-5 Thereunder

32. Paragraphs 1 through 31 are realleged and incorporated by reference herein.

33. Duncan, as Andersen's global engagement partner for the Enron audits, directly or indirectly, by use of the means or instrumentalities of interstate commerce, or by the use of the mails or of a facility of a national securities exchange, in connection with the purchase or sale of securities: (a) employed devices, schemes, or artifices to defraud; (b) made untrue statements of material fact 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 (c) engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon other persons.

36. In connection with the above discussed acts or omissions, Duncan acted recklessly.

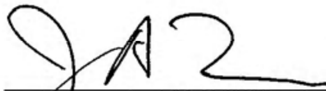
37. By reason of the foregoing, Duncan violated Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)], and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

PRAYER FOR RELIEF

Wherefore, the Commission respectfully requests that this Court grant a permanent injunction restraining and enjoining Defendant Duncan from any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Dated: January 9, 2008

Respectfully submitted,



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