

United States Courts
Southern District of Texas
FILED

NOV 09 2005

Michael N. Milby, Clerk

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

UNITED STATES OF AMERICA

v.

KEVIN HOWARD
and MICHAEL KRAUTZ

§
§
§
§
§
§
§
§
§

Cr. No. H-03-93-06

Violations: 18 U.S.C. § 371 (Conspiracy);
18 U.S.C. §§ 1343, 1346 (Wire Fraud); 15
U.S.C. §§ 78m(b)(2)(A) & (B), 78m(B)(5)
and 78ff (False Books and Records); 18
U.S.C. § 2 (Aiding § and Abetting).

SIXTH SUPERSEDING INDICTMENT

The Grand Jury charges:

INTRODUCTION

1. At all times relevant to this Sixth Superseding Indictment, Enron Corp. (“Enron”) was a publicly traded Oregon corporation with its headquarters in Houston, Texas. Among other businesses, Enron was engaged in the purchase and sale of natural gas, construction and ownership of pipelines and power facilities, provision of telecommunication services, and trading in contracts to buy and sell various commodities. At all times relevant to the indictment, Enron’s telecommunications business unit was known as Enron Broadband Services (“EBS”).

2. Enron was a publicly traded company whose shares were listed on the New York Stock Exchange. As a public company, Enron was required to comply with regulations of the United States Securities and Exchange Commission (“SEC”). Those regulations protect members of the investing public by, among other things, ensuring that a company’s financial information is accurately recorded and disclosed to the public. Enron’s outside accountants during the relevant time period were Arthur Andersen (“Andersen”).

3. Enron's management provided guidance to the investing public regarding anticipated revenue and earnings for upcoming reporting periods for Enron Corporation and its business units, including EBS. The price of Enron's stock was influenced by factors such as the financial performance of its business units, the company's growth potential, and the consistent ability to meet its publicly stated revenue and earnings targets. Internally, EBS had been identified as Enron's mechanism for incorporating "dot com luster" into its stock price.

4. Under SEC regulations, Enron and its officers had a duty to make and keep books, records, and accounts that fairly and accurately reflected Enron's business transactions; to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that the company's transactions were recorded as necessary to permit preparation of financial statements in conformity with Generally Accepted Accounting Principles ("GAAP"); and to file with the SEC reliable quarterly and annual reports.

Principal Conspirators

5. Defendant KEVIN HOWARD is a resident of Houston, Texas. HOWARD is a Certified Public Accountant and was Vice President of Finance at EBS from approximately August 1, 1999, to September 2001. As the senior finance executive at EBS, HOWARD was responsible for supervising all aspects of structured finance transactions. In the year 2000, as well as in the year 2001, HOWARD received total compensation in excess of \$650,000 including an annual bonus of \$350,000.

6. Defendant MICHAEL KRAUTZ is a resident of Houston, Texas. KRAUTZ is a Certified Public Accountant and was Senior Director of Transactional Accounting at EBS from approximately August 16, 1999, to October 3, 2001. KRAUTZ's responsibilities included being

the primary liaison between EBS and Enron's outside auditors, Arthur Andersen, regarding accounting treatment for structured finance transactions. For the year 2000, KRAUTZ received total compensation in excess of \$300,000, including an annual bonus of \$80,000. For the year 2001, KRAUTZ received total compensation in excess of \$175,000, including an annual bonus of \$80,000.

7. Defendants HOWARD and KRAUTZ, and their co-conspirators, sought to enrich themselves as a result of the scheme through salary, bonuses, grants of stock and stock options, other profits, and increasing their prestige within their professions and communities. The defendants' ability to close deals and to generate earnings and revenue for the company was a factor in their annual performance evaluations, advancement within the company and compensation through annual bonuses.

8. As Enron employees, HOWARD and KRAUTZ each owed a fiduciary duty to Enron and its shareholders to provide the company with their honest services.

Summary

9. As part of a scheme to manufacture reported earnings and to reach publicly declared financial targets for EBS for the fourth quarter of 2000 and the first quarter of 2001, EBS executives engaged in the creation of a "sham" joint venture and the subsequent "sale" of a portion of that venture to a third party. The "sale" enabled EBS executives falsely to record revenue and earnings on Enron's books and to enhance fraudulently EBS's and Enron's financial position for the year 2000 that Enron portrayed to the public. The "sale" and fraudulent recognition of revenues and earnings also caused Enron to pay EBS executives, including HOWARD and KRAUTZ, unwarranted bonuses.

EBS's Bleak Financial Picture

10. At its annual Analyst Conference in January 2000, Enron projected that its EBS division would achieve a certain earnings target for the year 2000. By the fourth quarter of 2000, EBS had failed to generate any significant recurring revenue from its business and was in danger of missing its publicly declared earnings target. HOWARD, together with EBS's Chief Executive Officer ("CEO") Ken Rice and Chief Operating Officer ("COO") Kevin Hannon knew that absent a large revenue-generating transaction before the end of the year, EBS would miss its previously announced target by a wide margin. In the first quarter of 2001, as HOWARD and others knew, EBS repeated its lackluster earnings performance and would have missed its targets once again but for a significant revenue-generating transaction.

11. In order to generate the revenue necessary to help EBS achieve its previously stated earnings target for 2000, HOWARD, KRAUTZ, and their co-conspirators designed and executed a transaction known as Project Braveheart. Project Braveheart involved the immediate recognition, or "monetization," of modeled future revenue from a start-up video-on-demand ("VOD") business. In order to accomplish the monetization, defendants HOWARD and KRAUTZ intentionally deceived Andersen accountants working on Project Braveheart by failing to disclose, among other things, that Project Braveheart deliberately had been structured in a way that failed to comply with the accounting requirements imposed by Andersen.

Origins of Project Braveheart

12. In the fall of 2000, EBS was significantly short of its publicly declared earnings projections for the year. At the same time that EBS was facing dismal financial performance, it was attempting to launch a VOD business. The core of that VOD business was a 20-year

agreement between EBS and Blockbuster Inc. (“Blockbuster”), the nation’s largest video rental company, to stream movies to customers’ homes. Under the agreement, Blockbuster was responsible for obtaining digital rights to film content from studios and other sources. EBS was responsible for encoding the movies and streaming them over its telecommunications network to customers’ homes. The VOD service never got beyond the testing stage, as EBS never developed a cost-effective way to stream movies to customers’ homes, and Blockbuster and EBS never obtained sufficient quantities of premium content to distribute over the system. As a result, the EBS/Blockbuster relationship never generated any actual recurring revenue for EBS, and the EBS/Blockbuster agreement was terminated in March 2001.

13. As defendant HOWARD knew, the performance of EBS’s normal business operations was insufficient to meet the earnings targets set by Enron senior management. Accordingly, in order to generate revenue and earnings sufficient to meet earnings targets, HOWARD ordered Enron employees who reported to him to examine the Blockbuster agreement to see if Enron could recognize accelerated earnings from it for the fourth quarter of 2000. The structured finance transaction that resulted was known at EBS by the code name “Project Braveheart” and was designed to allow EBS to “monetize” – or book earnings and cash flow from – the Blockbuster agreement. As EBS’s earnings shortfall continued to grow, Kevin Hannon, the number two executive of EBS, ordered that the amount of earnings taken from the transaction be increased during the fourth quarter of 2000.

Structure of Project Braveheart

14. In order to complete Project Braveheart, the conspirators created a joint venture with EBS and two other investors: nCube, a small VOD technology company based in Beaverton,

Oregon; and “Thunderbird,” an investment vehicle owned by an Enron-controlled investment fund called “Whitewing.” This joint venture was named EBS Content Systems. In order to recognize revenue from Project Braveheart the joint venture had to be off balance sheet or “deconsolidated” from Enron’s books. As HOWARD, KRAUTZ, and their co-conspirators also knew, in order for the joint venture to be properly “deconsolidated,” the joint venture had to be funded with a minimum contribution of 3% outside, “at-risk” equity. Accordingly, the conspirators arranged for nCube and Thunderbird purportedly to contribute 3% of the outside equity in EBS Content Systems. The conspirators subsequently assigned the Blockbuster agreement to EBS Content Systems. EBS then “sold” a portion of its interest in EBS Content Systems for approximately \$115 million to yet another of Enron’s off-balance-sheet structures, called “Hawaii 125-0,” which previously had been funded by the Canadian Imperial Bank of Commerce (“CIBC”). Enron recognized as revenue approximately \$111 million of the \$115 million it received from CIBC in the fourth quarter of 2000 and the first quarter of 2001.

15. Under relevant accounting rules, as applied by Andersen, defendants HOWARD and KRAUTZ knew that Enron could recognize revenue from Project Braveheart only if, among other things, three requirements were met: (i) EBS did not control the joint venture; (ii) nCube and Thunderbird made at-risk equity investments in the joint venture, which investments had to remain at risk for the duration of the joint venture; and (iii) the joint venture was a true operating business. If any of these requirements were not met, the proceeds Enron received from CIBC should have been reported as debt, not revenue.

16. HOWARD and KRAUTZ knew that these requirements were not met, and Enron should not have reported the proceeds it received from Project Braveheart as revenue.

Specifically, HOWARD and KRAUTZ knew that nCube agreed to participate as EBS's partner in the joint venture and to contribute 3% in purported "outside equity" only because they had been verbally assured that they would be "made whole" and would not suffer financially as a result of their participation. nCube's participation in the joint venture was secured after HOWARD and conspirators orally promised nCube that it could sell its interest in the joint venture to EBS or an EBS designee in early 2001 and that nCube would receive, at that time, its investment plus a fixed return. KRAUTZ and others were made aware that nCube would be taken out of the joint venture for a fixed return in early 2001. Because of the assurances from HOWARD and others, nCube's equity investment in the joint venture was not truly "at risk," and Enron should not have treated the transaction as a sale from which earnings and cash flow could be recorded.

17. Through their participation in the scheme, defendants HOWARD, KRAUTZ and their co-conspirators intentionally violated applicable accounting requirements. HOWARD, KRAUTZ, and their co-conspirators misled representatives of Andersen by failing to disclose the existence of the oral side agreement with nCube whereby EBS promised nCube that it could sell its interest in the joint venture to EBS or an EBS designee in early 2001 and would receive at that time its investment plus a fixed return. As HOWARD and KRAUTZ knew, the oral side agreement was critical to closing Project Braveheart and allowing EBS and Enron to record \$111 million in revenue for EBS and Enron over two quarters. As HOWARD and KRAUTZ also knew, had Andersen been advised of the oral side agreement, Andersen would not have permitted EBS to record the transaction as a sale.

18. Defendants HOWARD, KRAUTZ, and others intentionally deceived Andersen accountants working on the transaction by failing to disclose, among other things, that Project

Braveheart deliberately had been structured in a way that violated the requirements imposed by Andersen. Specifically, HOWARD, KRAUTZ, and others, told Andersen that nCube would be a long-term strategic partner that would exercise shared control over the joint venture. In fact, HOWARD, KRAUTZ, and others, selected nCube as a joint venture partner because they knew that nCube, an EBS vendor, would allow EBS to control the joint venture.

19. Project Braveheart closed on or about December 31, 2000. The understanding between nCube and EBS that nCube would not be in the venture past early 2001 and would receive its money back plus a fixed amount was not part of the written agreement documenting the deal entered into at year's end. In order to conceal the full agreement from regulators, auditors and the investing public, the written agreement between EBS and nCube gave the outward appearance that nCube would be a full participating partner, and would exercise shared control over the VOD business. Further, there was no mention in the written agreement about nCube exiting the deal in early 2001 with a fixed return.

20. In the first quarter of 2001, with no third-party buyer having been found for nCube's interest and nCube strapped for cash, a conspirator caused EBS to make a "prepayment" to nCube in order to meet nCube's urgent cash needs and in partial fulfillment of the promise made by HOWARD, and reiterated by conspirators that nCube would be "made whole" in the deal.

Impact of the Braveheart Transaction

21. In the fourth quarter of 2000, as HOWARD and KRAUTZ knew, \$53 million of EBS's reported \$63 million in revenue came from Project Braveheart, while in the first quarter of 2001, \$58 million of EBS's \$85 million in reported revenue was from the transaction. As

HOWARD and KRAUTZ also knew, absent the fraudulent Braveheart revenues, EBS would have missed its publicly stated target for the year 2000 by more than \$50 million. Similarly, in the first quarter of 2001, EBS would have missed its quarterly target but for the revenues from the fraudulent Braveheart transaction.

COUNT ONE

(Conspiracy to Commit Wire Fraud and Falsify Books and Records)

22. The allegations of paragraphs 1 through 21 are realleged as if fully set forth here.

23. On or about and between at least August 2000 and May 14, 2001, both dates being approximate and inclusive, within the Southern District of Texas and elsewhere, the defendants KEVIN HOWARD and MICHAEL KRAUTZ, together with their co-conspirators, did knowingly and intentionally conspire to (a) devise a scheme and artifice to defraud Enron and its shareholders, including to deprive them of the intangible right of honest services of its employees, and to obtain money and property by means of materially false and fraudulent pretenses, representations, and promises, and for the purpose of executing such scheme and artifice to transmit and cause to be transmitted by means of wire communication in interstate and foreign commerce writings, signs, signals, pictures and sounds, all in violation of Title 18, United States Code, Sections 1343, 1346; and (b) knowingly and willfully falsify books, records and accounts of Enron in violation of Title 15, United States Code, Sections 78m(b)(2) (A) & (B), 78m(b)(5) and 78ff and Title 17, Code of Federal Regulations, Section 240.13b2-1.

OVERT ACTS

24. In furtherance of the conspiracy and to effect the objects thereof, within the Southern District of Texas and elsewhere, the defendants KEVIN HOWARD and MICHAEL

KRAUTZ, together with their co-conspirators, did commit and cause to be committed the following overt acts, among others:

- a. In or about early fall 2000, HOWARD ordered EBS employees to examine the Blockbuster agreement to see if EBS could use it to generate revenue in the fourth quarter of 2000.
- b. On or about November 7, 2000, a conspirator sent an e-mail message to a representative of nCube, which attached a presentation proposing formation of the joint venture.
- c. On or about November 8, 2000, HOWARD met with an nCube executive to propose formation of the joint venture.
- d. On or about November 22, 2000, HOWARD and KRAUTZ either participated in or caused subordinates to participate in a telephone conversation with nCube executives to discuss the proposed joint venture.
- e. On or about November 22, 2000, KRAUTZ caused an EBS employee to send to nCube a document that set forth proposed accounting journal entries.
- f. In or about January 2001, HOWARD met with a co-conspirator to discuss a prepayment to be made to nCube.

(Title 18, United States Code, Sections 371 and 3551 et seq.)

COUNTS TWO THROUGH FOUR

(Wire Fraud)

25. The allegations of paragraphs 1 through 21 and 24(a - f) are realleged as if fully set forth here.

26. On or about the dates specified below, within the Southern District of Texas and elsewhere, the defendants KEVIN HOWARD and MICHAEL KRAUTZ, together with others, having devised a scheme and artifice to defraud Enron and its shareholders, including to deprive them of the intangible right of honest services of its employees, and to obtain money and property by means of materially false and fraudulent pretenses, representations and promises, and for the purpose of executing such scheme and artifice to defraud did transmit and cause to be transmitted by means of wire communication in interstate commerce writings, signs, signals, pictures and sounds, as follows:

Count	Date	From	To	Description
2	11/17/00	Houston, TX	Oregon	e-mail
3	11/22/00	Houston, TX	Oregon	e-mail
4	1/26/01	Houston, TX	Oregon	e-mail

(Title 18, United States Code, Sections 1343, 2 and 3551 et seq.)

COUNT FIVE

(False Books and Records)

27. The allegations of paragraphs 1 through 21 and 24 (a-f) are realleged as if fully set forth here.

28. On or about and between at least August 2000 and May 14, 2001, both dates being approximate and inclusive, within the Southern District of Texas and elsewhere, the defendants KEVIN HOWARD and MICHAEL KRAUTZ, together with conspirators and others, unlawfully, willfully, and knowingly did, directly and indirectly, falsify and cause to be falsified books, records and accounts which were subject to Section 13(b)(2) of the Securities and Exchange Act

of 1934 which Enron was required to make and keep, accurately and fairly reflecting, in reasonable detail, the transactions and dispositions of the assets of Enron. Specifically, defendants HOWARD and KRAUTZ caused to be falsely recorded as revenue EBS and Enron's earnings from Project Braveheart on Enron's books, records and accounts in violation of Title 15 United States Code, Sections 78m(b)(2) (A) &(B), 78m(b)(5) and 78ff, and Title 17, Code of Federal Regulations, Section 240.13b2-1.

Dated: Houston, Texas

November 9 2005

A TRUE BILL


FOREPERSON

PAUL PELLETIER
Acting U. S. Attorney

SEAN BERKOWITZ
Director, ENRON TASK FORCE

By: *Lisa O. Monaco*
BENTON J. CAMPBELL
LISA O. MONACO
Assistant United States Attorneys
ENRON TASK FORCE