

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW HAMPSHIRE

Civil Action No.

SECURITIES AND EXCHANGE COMMISSION,
Central Regional Office
1801 California Street, Suite 1500
Denver, CO 80202

Plaintiff,

v.

ENRIQUE (HENRY) FIALLO
4909 SW 74th Court
Miami, FL 33155

Defendant.

COMPLAINT

Plaintiff Securities and Exchange Commission (“SEC”), for its complaint, alleges:

- 1) From March 2000 through December, 2001 (the “relevant period”), Enrique (Henry) Fiallo (“Fiallo”), a former executive vice president of Cabletron Systems, Inc. (“Cabletron”) and the president of its former subsidiary Enterasys Networks, Inc. (“Enterasys”) and later the chief executive officer of the combined companies, participated in a scheme to inflate revenues of Enterasys and Cabletron (which are jointly referred to herein as “Enterasys”) and thereby convince investors that Enterasys was a viable independent company with consistently strong revenue growth.
- 2) During the relevant period, Fiallo knowingly reviewed, approved, or otherwise participated in transactions for which revenue was improperly recognized in

- Enterasys's financial statements and reported in periodic and other filings with the SEC and in press releases while the company's stock was publicly trading.
- 3) In carrying out the scheme to improperly inflate Enterasys's revenues, Fiallo also participated in misrepresenting information to, or concealing information from, Enterasys's outside auditor concerning the true nature of some of the transactions for which the company improperly recognized revenue.
 - 4) Fiallo participated in Enterasys's financial fraud by reviewing, approving, and otherwise participating in sales transactions that lacked one or more necessary elements for revenue recognition under generally accepted accounting principles ("GAAP"). In some of these transactions, Fiallo was aware that sales staff had entered into undisclosed "side agreements" with purchasers, in which payment for the product was contingent upon the purchaser's resale of the product, or the purchaser was granted full return, exchange, or cancellation rights. Fiallo knew, or was reckless in not knowing, that it was improper to recognize revenue on these transactions that were subject to material contingencies.
 - 5) In addition, many of the problematic sales were linked to investments that Enterasys made in unaffiliated, privately-held companies in return for the investee company's agreement to use Enterasys's investment to buy products from Enterasys and its former subsidiary, Aprisma Management Technologies, Inc. ("Aprisma"). Fiallo knew, or was reckless in not knowing, that Enterasys was not interested in the investment aspect of these transactions, but rather used investments to improperly manage its revenues at quarter end.

- 6) Moreover, Fiallo was aware that Enterasys, after failing to perform a reasonable valuation for its investment interests, frequently overpaid for investment interests in companies that could not otherwise afford Enterasys's and Aprisma's products and, in some cases, did not need the products. Accordingly, Fiallo knew, or was reckless in not knowing, that Enterasys's investment transactions lacked economic substance.
- 7) Knowing that the foregoing circumstances would raise auditor concerns and impair Enterasys's ability to recognize revenue, Fiallo and others on the investment team frequently structured Enterasys's investments as "three-corner" deals by inserting a third-party reseller between Enterasys and the investee company, and requiring the investee company to purchase Enterasys product from the third-party reseller. In this manner, Fiallo and others concealed from Enterasys's outside auditor critical revenue information and the fact that several of Enterasys's large sales were linked to reciprocal investments by Enterasys.
- 8) In addition to lacking economic substance, some of the investment deals in which Fiallo participated were not consummated until the quarter after Enterasys recognized revenue for the related sale. Fiallo knew, or was reckless in not knowing, that it was improper to recognize revenue from sales that were contingent on the finalization of investments in future quarters.
- 9) During the relevant period, Fiallo and others caused Enterasys to improperly recognize approximately \$47 million in revenue from sales transactions flawed by one or more of the foregoing deficiencies.

- 10) The improper revenue was material information because it enabled Enterasys to meet or exceed analysts' consensus pro forma earnings per share estimates. Moreover, Fiallo and others caused Enterasys to overstate by 50% to 600% its announced pro forma earnings per share for five quarters during the relevant period. Further, Fiallo and others caused Enterasys to understate its operating losses by 6% to 33% for five quarters during the relevant period, and to overstate its net revenues by 8% and 25% for the final two quarters of the relevant period.
- 11) By participating in Enterasys's improper accounting practices, Fiallo and others caused Enterasys to make various materially false statements in several SEC filings and other documents, including: Enterasys SEC Form 10-K - for the fiscal year March 1, 2000 to March 3, 2001 ("Fiscal Year 2001"); Enterasys SEC Forms 10-Q - for the quarters March 1, 2000 to June 3, 2000 ("Q1 Fiscal Year 2001"), June 4, 2000 to September 2, 2000 ("Q2 Fiscal Year 2001"), September 3, 2000 to December 2, 2000 ("Q3 Fiscal Year 2001"), March 4, 2001 to June 2, 2001 ("Q1 Transition Year 2001"), June 3, 2001 to September 1, 2001 ("Q2 Transition Year 2001"), and July 1, 2001 to September 29, 2001 ("Q3 Transition Year 2001"); and all SEC filings/statements incorporating the above documents. Fiallo also reviewed and signed Enterasys's false Forms 10-Q that were filed with the SEC for Q2 and Q3 Transition Year 2001.
- 12) Largely as a result of the materially overstated revenue reported by Enterasys, Enterasys was successfully launched as an independent public company on August 6, 2001.

- 13) During or shortly following the relevant period, a period in which Enterasys's stock price was artificially inflated due to its material overstatement of revenues, Fiallo realized substantial monetary gains that related to his improper conduct, including, but not limited to, profits from Enterasys stock sales ranging from approximately \$700,000 to \$1,111,000, loan forgiveness benefits of approximately \$208,000, bonuses of approximately \$462,500, and severance payments of approximately \$346,000.
- 14) When Enterasys announced on February 1, 2002 that its accounting and revenue recognition practices were being investigated by the SEC, Enterasys's stock price dropped from \$10.80 to \$4.20 per share, a loss of approximately 61%.

I. JURISDICTION AND VENUE

- 15) The SEC brings this action for injunctive relief under Sections 21(d) and (e) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §§ 78u(d) and (e)].
- 16) This Court has jurisdiction over this action pursuant to Sections 21(e) and 27 of the Exchange Act [15 U.S.C. §§ 78u(e) and 78aa].
- 17) In connection with the transactions, acts, practices, and courses of business described in this Complaint, Fiallo, directly and indirectly, has made use of the means or instrumentalities of interstate commerce or the mails, or the means and instruments of transportation or communication in interstate commerce or the mails.
- 18) Venue is proper in this district because certain of the transactions, acts, practices, and courses of business constituting the violations of law alleged herein occurred within this district. During the relevant time period, Fiallo resided and worked in New Hampshire.

II. DEFENDANT AND RELATED THIRD PARTIES

- 19) Defendant Enrique P. (Henry) Fiallo, age 53, was the executive vice president and chief information officer of Cabletron from November 1998 to February 2000. Fiallo served as president of Enterasys from February 2000 to August 2001, when Enterasys was a subsidiary of Cabletron. He served as president, chairman and chief executive officer of Enterasys from August 2001 until his resignation in April 2002. Fiallo as the president of the Enterasys subsidiary and later the combined companies, was involved in the day to day operations of the company, and participated in the preparation of the company's periodic reports filed with the SEC.
- 20) Cabletron was a public corporation with securities registered under Section 12(b) of the Exchange Act. During the relevant period and until August 6, 2001, its securities were traded on the New York Stock Exchange. On May 5, 2000, the company reported 184,535,909 shares held by approximately 2,821 shareholders of record valued at approximately \$5 billion. On May 16, 2001, the company reported 188,815,621 shares held by approximately 2,730 shareholders of record and valued at approximately \$3.4 billion. As a public company, Cabletron was required to file annual and quarterly reports with the SEC which contained financial statements prepared in accordance with GAAP.
- 21) Enterasys became an independent publicly traded company by merging with and into Cabletron on August 6, 2001. Following the merger, Enterasys's stock traded on the New York Stock Exchange, and it was required to file annual and

quarterly reports with the SEC which contained financial statements prepared in accordance with GAAP.

**III. FIALLO KNOWINGLY PARTICIPATED IN SALES
TRANSACTIONS FOR WHICH ENTERASYS IMPROPERLY
RECOGNIZED REVENUE**

A. The SG Cowen Transaction

- 22) During 1999, Societe General Cowen (“SG Cowen”), an international investment bank, provided financial services to Cabletron in return for a cash payment and approximately \$7 million in product credits. Fiallo and other members of Enterasys senior management met with SG Cowen on or about March 31, 2000 to clarify the terms for use of the product credits.
- 23) On April 18, 2000, Enterasys’s CFO prepared a memorandum for SG Cowen that he also sent to Fiallo and other members of senior management, which set forth the terms governing the use of product credits by SG Cowen. The memorandum noted the fact that Enterasys granted SG Cowen full exchange rights for a period of 60 days following delivery of products to a SG Cowen facility.
- 24) In November 2000, less than 60 days prior to the end of Enterasys’s quarter, Fiallo and other members of Enterasys senior management learned that SG Cowen planned to submit purchase orders for that and the following quarter. On November 29 and 30, 2000, Aprisma shipped \$1.8 million in software products and Enterasys shipped approximately \$117,000 of hardware to SG Cowen, for which Enterasys immediately recognized revenue. However, SG Cowen never accepted the Aprisma software, and it was stored at Enterasys’s office in New York.

- 25) Enterasys improperly recognized revenues of approximately \$1.917 million on the transaction with SG Cowen. Revenue for both shipments was barred until the 60 day right to exchange expired. Additionally, revenue for the Aprisma software was barred due to SG Cowen's refusal to accept the shipment.
- 26) On or about January 18, 2001, Enterasys agreed to take possession of the software products, store them, and assume all responsibility for them. On or about June 18, 2001, SG Cowen requested credit for the software. Neither Enterasys nor Aprisma processed the return or reversed the associated revenue until January 2002.
- 27) Although Fiallo knew SG Cowen had 60 day exchange rights and those exchange rights precluded recognizing revenue until the 60-day exercise period had expired, he took no steps to ensure that (1) Enterasys properly accounted for SG Cowen's purchase order, or (2) the company's outside auditor was made aware of the exchange rights.
- 28) Although he knew about the side agreement with SG Cowen, Fiallo signed representation letters dated September 24, and October 29, 2001 to Enterasys's outside auditor falsely representing that "there were no side agreements with customers, or other terms in effect, which allow for the return of merchandise, except for defectiveness or other conditions covered by the unusual and customary warranties or for stock rotation rights pursuant to distributor agreements."
- 29) As a result of the acts of Fiallo and others, Enterasys improperly recognized revenue in the December 2000 Form 10-Q.

B. The GovStreet Transaction

- 30) At the beginning of the fourth quarter of Fiscal Year 2001, members of senior management of Enterasys gave Fiallo revenue goals for the quarter ending on March 3, 2001.
- 31) In an effort to meet the revenue goals, Fiallo and others met in late January 2001 with corporate officers of ICS Consolidated Inc., a Florida-based reseller of information technology products that operated under the name GovStreetUSA, LLC (“GovStreet”), to discuss an investment by Enterasys in GovStreet. At this meeting, Enterasys proposed that the investment include both product credits and cash.
- 32) After GovStreet expressed concerns that the purchase commitment associated with Enterasys’s proposed investment represented an entire year’s worth of inventory and that it would need Enterasys to find customers for the product, Enterasys employees, with Fiallo’s knowledge, entered into a verbal side agreement in which Enterasys agreed, among other things, (1) to resell the product that GovStreet purchased as part of the investment deal; (2) to unlimited rotation rights for the product; and (3) to guarantee GovStreet a five percent profit on sales of product in state contracts.
- 33) With these additional concessions and pressure from Enterasys to complete the transaction before the end of its quarter, GovStreet agreed to the investment and submitted purchase orders for approximately \$2.6 million to Enterasys during the final days of Fiscal Year 2001.

- 34) GovStreet submitted its purchase orders contingent upon Enterasys signing a promissory note, and subject to the terms of the side agreement.
- 35) At the time Enterasys consummated the GovStreet transaction, Fiallo knew, or was reckless in not knowing, that Enterasys intended to recognize revenue from the sale notwithstanding that the material undisclosed contingencies in the verbal side agreement of which he was aware precluded revenue recognition.
- 36) Notwithstanding his awareness that the undisclosed side agreement with GovStreet precluded revenue recognition, Fiallo participated in the activities that resulted in Enterasys improperly recognizing approximately \$2.6 million in revenue from sales to GovStreet over the course of three quarters, including approximately \$1.7 million in the fourth quarter of Fiscal Year 2001, approximately \$674,000 in the first quarter of Transition Year 2001, and approximately \$266,000 in the second quarter of Transition Year 2001.
- 37) Fiallo also knew, or was reckless in not knowing, that improperly recognized revenue from the GovStreet transaction was included in the financial statements contained in the Form 10-K Enterasys filed with the SEC for Fiscal Year 2001 and the Forms 10-Q Enterasys filed with the SEC for the first, second and third quarters of Transition Year 2001.
- 38) Moreover, while aware of the material undisclosed contingencies with GovStreet, Fiallo signed management representation letters to Enterasys's outside auditor dated June 27, 2001, September 24, 2001, and October 29, 2001 in which he affirmatively represented that the financial information provided to the outside auditor for the first, second and third quarters of Transition Year 2001 conformed

- with GAAP and that all financial records and related data had been provided to the outside auditor. In the September 24 and October 29, 2001 letters, Fiallo also misrepresented that there were no side agreements with customers providing for return rights.
- 39) On June 4, 2001, Cabletron filed an annual report on Form 10-K for the year ended March 3, 2001 (“March 2001 Form 10-K”) that reported net revenues for the entire year of \$1,071,453,000, which included net revenues by the Enterasys subsidiary of \$793,243,000. Cabletron also reported a loss from operations for the year of \$198,184,000 and net loss to shareholders of \$628,901,000.
 - 40) The net revenue in the March 2001 Form 10-K included net revenues for the fourth quarter of \$286,016,000, which included revenues from the Enterasys subsidiary of \$221,054,000. Cabletron reported a loss from operations for the fourth quarter of \$45,039,000 and net loss to shareholders of \$428,028,000.
 - 41) The net revenue for the fourth quarter was overstated by at least \$6,967,000. This overstatement caused the loss from operations for the quarter to be understated by \$4,000,000 and the net loss to shareholders for the quarter to be understated by \$4,000,000.
 - 42) As a result of the acts of Fiallo and others, Enterasys improperly recognized revenue in the March 2001 Form 10-K.

C. The Cellit Transaction

- 43) During the first quarter of Transition Year 2001, Enterasys entered into a financing arrangement with Cellit, Inc., a software developer based in Miami, Florida. Under the terms of the agreement, Enterasys agreed to invest \$2,000,000

- in Cellit in return for two \$1,000,000 promissory notes, an equity interest in Cellit, and Cellit's agreement to purchase \$1,000,000 of Aprisma product. In addition, Enterasys agreed that one of the promissory notes would be forgiven based on Enterasys's future purchase of Cellit's software.
- 44) On or about June 1, 2001, Cellit issued a purchase order for approximately \$1,000,000 of Aprisma product.
 - 45) Enterasys improperly recognized and reported approximately \$1,000,000 in revenue in the Form 10-Q it filed with the SEC for this quarter because the transaction had no economic substance.
 - 46) At the time Enterasys entered into its agreement with Cellit, Fiallo and others at Enterasys knew that Cellit was not a reseller of Aprisma software, that one million dollars of software far exceeded Cellit's internal needs, and that Enterasys did not need Cellit product.
 - 47) In addition, Fiallo and others at Enterasys were aware that the only reason for Enterasys to enter into the transaction with Cellit was to recognize revenue and that the transaction lacked economic substance.
 - 48) Accordingly, Fiallo knew, or was reckless in not knowing, that it was improper for Enterasys to recognize revenue for the sale of Aprisma product to Cellit in the first quarter of Transition Year 2001.
 - 49) On December 26, 2001, Enterasys cancelled the \$1 million promissory note in exchange for Cellit's agreement to cancel Enterasys's purchase order to buy software from Cellit, because the software was of no value to Enterasys.

- 50) On July 10, 2001, Cabletron filed a quarterly report on Form 10-Q for the quarter ended June 2, 2001 (“June 2001 Form 10-Q”) that reported net revenues for the quarter of \$306,898,000, which included net revenues from the Enterasys subsidiary of \$232,185,000. Cabletron also reported a loss from operations for the year of \$12,868,000 and net loss to shareholders of \$9,801,000.
- 51) The June 2001 Form 10-Q contained materially false and misleading statements because the amount of revenue recognized was overstated by at least \$10,869,000. This overstatement caused the loss from operations to be understated by approximately \$6,000,000 and the net loss to shareholders to be understated by approximately \$3,000,000.
- 52) As a result of the acts of Fiallo and others, Enterasys improperly recognized revenue in the June 2001 Form 10-Q.

**IV. FIALLO COLLABORATED WITH OTHERS TO PROVIDE
FALSE, MISLEADING, AND INCOMPLETE INFORMATION
REGARDING INVESTMENT DEALS TO
ENTERASYS’S OUTSIDE AUDITOR**

- 53) By the first quarter of Transition Year 2001, the volume of Enterasys’s investment deals increased and the quality and financial viability of the companies in which Enterasys considered investing declined. Aware that Enterasys’s outside auditor had identified an investee company’s independent ability to pay for product as an important prerequisite to recognizing revenue for an investment deal, Fiallo and others carried out a scheme to structure investment transactions so as to conceal investment related revenue from the company’s outside auditor.

- 54) In approximately March of 2001, Enterasys senior management presented the concept of a “three-corner” deal during a conference call with Enterasys’s investment team, which included Fiallo. During this call, senior management detailed an investment structure in which the investee company would purchase Enterasys product from a distributor or “channel partner” rather than directly from Enterasys to conceal from Enterasys’s outside auditor the link between Enterasys’s investment and the purchase, for which Enterasys would record revenue.
- 55) During this conference call, and during numerous subsequent weekly conference calls involving Enterasys’s investment team, which included Fiallo, the participants openly discussed the purpose of three-corner deals: to conceal from Enterasys’s outside auditor the connection between investments and purchases, given that the poor financial condition of investee companies could lead the outside auditor to conclude that the related revenues did not comport with GAAP.
- 56) After Enterasys structured some of its investments as three-corner deals during the first quarter of Transition Year 2001, its outside auditor became aware of two of these deals and advised Enterasys that the exchange of equity connected to the purchase of product through a third party reseller needed to be “collapsed” and viewed as a single transaction to perform the appropriate analysis for revenue recognition.
- 57) Notwithstanding the outside auditor’s admonition, Fiallo and the Enterasys investment team accelerated the use of three-corner deals and continued to

- conceal the relevant facts from Enterasys's outside auditor during the second quarter of Transition Year 2001.
- 58) In fact, Fiallo and the investment team worked together to close more than \$17.7 million in transactions during the final week of the second quarter of Transition Year 2001, many of which were structured as three-corner deals to conceal the precarious financial condition of the investee company from Enterasys's outside auditor.
- 59) For example, in the final days of the second quarter of Transition Year 2001, Enterasys, with Fiallo's knowledge and approval, completed a three-corner deal with a reseller called Gateway Electronics Medical Management Systems, LLC ("GEMMS"), in which Enterasys agreed to invest \$1 million in return for an equity interest in GEMMS and GEMMS's agreement to purchase \$1 million of Enterasys product through a third-party distributor.
- 60) At the time of the investment, Fiallo knew that the purpose of the investment was to bridge Enterasys's revenue shortfall at quarter end.
- 61) Although Enterasys' outside auditor had advised Enterasys the previous quarter that three-corner deals needed to be collapsed and viewed as one transaction for revenue recognition purposes, Fiallo knew that the GEMMS investment was being structured as a three-corner deal in order to conceal from the outside auditor GEMMS's precarious financial state and the connection between the investment and the related revenue.
- 62) By allowing Enterasys to recognize revenue from the GEMMS investment deal and several additional three-corner deals during the second quarter of Transition

- Year 2001, Fiallo knowingly, or recklessly, participated in Enterasys's improper recognition of approximately \$17.7 million in revenue, all of which was reported in the Form 10-Q.
- 63) On October 16, 2001, Fiallo signed and caused Enterasys to file a quarterly report on Form 10-Q for the quarter ended September 1, 2001 ("September 2001 Form 10-Q") that reported net revenues for the quarter of \$240,181,000. Enterasys also reported a loss from operations for the year of \$81,496,000 and net loss to shareholders of \$151,278,000.
 - 64) The September 2001 Form 10-Q contained materially false and misleading statements because the amount of revenue recognized was overstated by at least \$17,786,000. This overstatement caused the loss from operations to be understated by approximately \$12,000,000 and the net loss to shareholders to be understated by approximately \$11,000,000.
 - 65) In the September 2001 Form 10-Q, Fiallo represented that Enterasys's investment-related revenue for the second quarter was only \$5.2 million. In fact, he knew that Enterasys had recognized at least an additional \$6.6 million in undisclosed revenue from three-corner deals during the quarter.
 - 66) In addition, Fiallo signed Enterasys's September 24, 2001 representation letter to its Outside Auditor in which he represented that there were no undisclosed related party transactions or related amounts receivable for the quarter when in fact he knew of several such transactions including GEMMS described above.
 - 67) In a September 26, 2001 press release, Fiallo and Enterasys announced that the company had again achieved its quarterly revenue target as a result of \$240

- million of revenue. Fiallo knew this statement was misleading, because the company only met its revenue target as a result of misrepresenting its revenue.
- 68) On September 28, 2001, Enterasys changed its fiscal year to the Saturday closest to the last day in December, which resulted in Enterasys's third quarter of Transition Year 2001 ending on September 29, 2001 and including the final two months of the second quarter and the month of September.
- 69) On November 14, 2001, Fiallo signed and caused Enterasys to file a quarterly report on Form 10-Q for the quarter ended September 29, 2001 ("September 29, 2001 Form 10-Q") that reported net revenues for the quarter of \$105,535,000. Enterasys also reported a loss from operations for the year of \$204,625,000 and net loss to shareholders of \$274,079,000.
- 70) The September 29, 2001 Form 10-Q contained materially false and misleading statements because the amount of revenue recognized was overstated by at least \$20,162,000. This overstatement also caused the loss from operations to be understated by approximately \$12,000,000 and the net loss to shareholders to be understated by approximately \$12,000,000.
- 71) Enterasys improperly recognized revenues from many of the same transactions from the second quarter, which were also included in the financial statements filed in the company's Form 10-Q for the quarter ending September 29, 2001.
- 72) Fiallo knew or was reckless in not knowing that the revenues were overstated in the September 29, 2001 Form 10-Q because Enterasys recognized revenues of approximately \$20.162 million in transactions that were not recorded in accordance with GAAP. The overstatement also resulted in the loss from

operations of approximately \$205 million to be understated by approximately \$12 million, and the loss to shareholders of approximately \$274 million to be understated by approximately \$12 million.

- 73) In an October 29, 2001 press release, Fiallo and Enterasys announced that the company had pro forma earnings of \$0.05 per share. Fiallo knew this statement was misleading, because the earnings per share were based on overstated revenues of approximately \$20 million, which he and others improperly recognized.

V. FIALLO AIDED ENTERASYS'S FILING OF FALSE FORMS 10-K AND 10-Q

- 74) As a public company, Enterasys and its directors, officers and employees were required to comply with the federal securities laws and regulations. Those laws and regulations require public companies to file annual and quarterly reports that contain financial statements that are prepared in conformity with GAAP and which contain accurate information about the financial condition of the company.
- 75) Between March 1, 2000 and December 2001, Enterasys filed one annual and six quarterly reports with the SEC.
- 76) These annual and quarterly reports were materially false and misleading because they contained financial statements that were not prepared in conformity with GAAP. In each report, Enterasys improperly recognized revenue on transactions, misrepresented the income or loss from operations, and misrepresented the net income or loss to common shareholders.
- 77) As a result of the conduct alleged above, Enterasys violated the reporting provisions of Section 13(a) of the Exchange Act and Rules 13a-1, 13a-13 and 12b-20.

- 78) With respect to the annual report filed by Enterasys for Fiscal Year 2001, the December 2000 Form 10-Q, and each of the three quarterly reports filed by Enterasys during the Transition Year 2001, Fiallo aided and abetted Enterasys's violations of Section 13(a) of the Exchange Act and Rules 13a-1, 13a-13 and 12b-20 by knowingly providing substantial assistance of the violations by reviewing or otherwise participating in transactions for which revenue was improperly recognized in the financial statements and reported in the filings with the SEC.

VI. FIALLO AIDED ENTERASYS'S VIOLATION OF THE BOOKS AND RECORDS PROVISIONS

- 79) Enterasys was required to keep books, records, and accounts that accurately and fairly reflected the company's business transactions.
- 80) As a result of Fiallo's conduct alleged above, Enterasys failed to make and keep books, records, and accounts that accurately and fairly reflected the company's business transactions and thereby violated Section 13(b)(2)(A) of the Exchange Act.
- 81) These inaccurate books, records and accounts include, but are not limited to, journal entries, postings to the general ledger, reports generated from the general ledger, financial statements, purchase orders, sales transactions files that did not contain side agreements or other documents defining the material terms of the agreement, and investment files that did not contain adequate documentation of due diligence performed to establish whether the transaction had economic substance.

- 82) Fiallo was aware that his activities which caused Enterasys to improperly recognize revenue also caused the company to keep books, records and accounts that did not accurately record the transactions with its customers.
- 83) As a result of his conduct, Fiallo knowingly provided substantial assistance that caused Enterasys to keep inaccurate books, records, and accounts, and thereby aided and abetted Enterasys's violations of Section 13(B)(2)(A) of the Exchange Act.

VII. FIALLO AIDED ENTERASYS'S VIOLATIONS OF THE INTERNAL CONTROLS PROVISIONS

- 84) Under the federal securities laws and regulations, Enterasys was required to create and maintain a system of internal controls sufficient to provide reasonable assurances that its transactions were recorded in a manner that would permit it to prepare financial statements in conformity with GAAP.
- 85) Enterasys did not create and maintain a system of internal controls sufficient to assure that its financial statements were prepared in conformity with GAAP during the seven quarters starting on March 1, 2000 and continuing through September 29, 2001.
- 86) During the five quarters in which he was involved in the improper conduct described above (i.e., from September 3, 2000 through September 29, 2001) and continuing through November 14, 2001, the date on which Enterasys filed its Form 10-Q for the third quarter of Transition Year 2001, Fiallo aided and abetted Enterasys's violations of the internal control provisions.
- 87) As the chief executive officer and/or president of Enterasys during the time of his misconduct, Fiallo was aware from his participation in various transactions

discussed above that Enterasys's internal controls were not sufficient to assure that its financial statements were being prepared in conformity with GAAP.

- 88) Fiallo provided knowing and substantial assistance to Enterasys's violation of the internal control provisions by failing to implement a system to record transactions in a manner to permit the preparation of financial statements in conformity with GAAP.

VIII. FIALLO CREATED FALSE BOOKS AND RECORDS OR CIRCUMVENTED ENTERASYS'S INTERNAL CONTROLS

- 89) As a result of the conduct alleged above, between September 3, 2000 and November 14, 2001, Fiallo knowingly circumvented or knowingly failed to implement a system of internal accounting controls, or knowingly falsified or caused to be falsified a book, record or account which Enterasys was required to keep reflecting transactions and dispositions of its assets.

IX. FIALLO DECEIVED ENTERASYS'S AUDITOR

- 90) At all times material to this Complaint, Fiallo was an officer of Enterasys.
- 91) Between September 3, 2000 and November 14, 2001, Fiallo made or caused to be made materially false or misleading statements to an accountant, or omitted or caused to be omitted material facts in connection with the audit, review or examination of the financial statements of Enterasys or in the preparation of filings of any document or report required to be filed with the SEC.
- 92) Between September 3, 2000 and November 14, 2001, Fiallo directly or indirectly took actions to manipulate, mislead or fraudulently influence the independent public or certified public accountant engaged in the performance of an audit or

- review of the financial statements of Enterasys that were required to be filed with the SEC.
- 93) Fiallo created false books, records and accounts in order to mislead Enterasys's certified public accountants.
- 94) Fiallo knew or should have known that his actions, if successful, would result in creating financial statements that were materially misleading.

FIRST CLAIM FOR RELIEF

**Fraud – Violations of Exchange Act Section 10(b) and Rule 10b-5
[15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5]**

- 95) The SEC realleges paragraphs 1 through 94 above.
- 96) Fiallo directly or indirectly, with scienter, in connection with the purchase or sale of securities, by the use of means or instrumentalities of interstate commerce, the mails, or any facility of a national securities exchange, employed devices, schemes, or artifices to defraud; made untrue statements of material fact or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon any person, in violation of Exchange Act Section 10(b) and Rule 10b-5.
- 97) Fiallo violated and unless restrained and enjoined will in the future violate Exchange Act Section 10(b) and Rule 10b-5.
- 98) Alternatively, by reason of the conduct alleged in paragraphs 1 through 84, Enterasys violated Exchange Act Section 10(b) and Rule 10b-5 thereunder, and Fiallo aided and abetted Enterasys's violations by knowingly and substantially

assisting those violations. Unless restrained and enjoined, Fiallo will in the future aid and abet violations of Exchange Act Section 10(b) and Rule 10b-5 thereunder.

SECOND CLAIM FOR RELIEF
Falsified Books and Records - Exchange Act Section 13(b)(5) and Rule 13b2-1
[15 U.S.C. § 78m(b)(5) and 17 C.F.R. § 240.13b2-1]

- 99) The SEC realleges paragraphs 1 through 94 above.
- 100) Fiallo knowingly circumvented or knowingly failed to implement a system of internal accounting controls, knowingly falsified books, records, or accounts and directly or indirectly falsified or caused to be falsified books, records or accounts described in Section 13(b)(2) of the Exchange Act.
- 101) Fiallo violated and unless restrained and enjoined will in the future violate Section 13(b)(5) of the Exchange Act and Rule 13b2-1.

THIRD CLAIM FOR RELIEF
Deceit of Auditors - Exchange Act Rule 13b2-2
[17 C.F.R. § 240.13b2-2]

- 102) The SEC realleges paragraphs 1 through 94 above.
- 103) Fiallo directly or indirectly made, or caused others to make, materially false or misleading statements, or omitted, or caused others to omit, to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, to Enterasys's accountants and outside auditor in connection with an audit or examination of Enterasys's financial statements or in the preparation or filing of Enterasys's documents or reports filed with the SEC.
- 104) By reason of the foregoing, Fiallo violated and unless restrained and enjoined Fiallo will in the future violate Exchange Act Rule 13b2-2.

FOURTH CLAIM FOR RELIEF
False SEC Filings - Exchange Act Section 13(a) and Exchange Act
Rules 12b-20, 13a-1, and 13a-13
[15 U.S.C. § 78m(a) and 17 C.F.R. §§ 240.12b-20,
240.13a-1, and 240.13a-13]

- 105) The SEC realleges paragraphs 1 through 94 above.
- 106) Fiallo aided and abetted Enterasys, in that he provided knowing and substantial assistance to Enterasys, which as an issuer of securities registered pursuant to Section 12 of the Exchange Act, filed materially misleading annual and quarterly reports with the SEC in violation of Exchange Act Section 13(a) and Rules 12b-20, 13a-1, and 13a-13 thereunder.
- 107) Unless restrained and enjoined, Fiallo will in the future aid and abet violations of Exchange Act Section 13(a) and Rules 12b-20, 13a-1, and 13a-13.

FIFTH CLAIM FOR RELIEF
False Books and Records - Exchange Act Section 13(b)(2)(A)
[15 U.S.C. § 78m(b)(2)]

- 108) The SEC realleges paragraphs 1 through 94 above.
- 109) Fiallo aided and abetted Enterasys's failure to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflected the company's transactions and dispositions of its assets.
- 110) By reason of the foregoing, Enterasys violated Exchange Act Section 13(b)(2)(A), and Fiallo aided and abetted Enterasys's violations. Unless restrained and enjoined, Fiallo will in the future aid and abet violations of Section 13(b)(2)(A) of the Exchange Act.

SIXTH CLAIM FOR RELIEF
Inadequate Internal Accounting Controls – Exchange Act Section 13(b)(2)(B)
[15 U.S.C. § 78m(b)(2)]

- 111) The SEC realleges paragraphs 1 through 94 above.

- 112) Fiallo aided and abetted Enterasys's failure to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions were recorded as necessary to permit preparation of financial statements in conformity with GAAP or any other criteria applicable to such statements.
- 113) By reason of the foregoing, Enterasys violated Exchange Act Section 13(b)(2)(B), and Fiallo aided and abetted Enterasys's violations. Unless restrained and enjoined, Fiallo will in the future aid and abet violations of Section 13(b)(2)(B) of the Exchange Act.

PRAYER FOR RELIEF

The SEC respectfully requests that this Court:

- 1) Find that Fiallo committed the violations alleged;
- 2) Enter an Injunction, in a form consistent with Rule 65(d) of the Federal Rules of Civil Procedure, permanently restraining and enjoining Fiallo from violating, directly or indirectly, or aiding and abetting violations of the laws and rules alleged in this Complaint;
- 3) Order Fiallo to disgorge all ill-gotten gains in the form of any benefits of any kind derived from the illegal conduct alleged in this Complaint, including, but not limited to, salary, bonuses, loan forgiveness amounts, severance payments, and proceeds from stock sales, plus pre-judgment interest;
- 4) Order Fiallo to pay civil penalties, including post-judgment interest, pursuant to Exchange Act Section 21(d)(3) [15 U.S.C. § 78u(d)(3)], in an amount to be determined by the Court;

- 5) Bar Fiallo from serving as an officer or director of a public company pursuant to Exchange Act Section 21(d)(2) [15 U.S.C. § 78u(d)(2)]; and
- 6) Order such other relief as is necessary and appropriate.

Respectfully submitted, February 8, 2007.

/s/ Leslie J. Hughes
Leslie J. Hughes (Colo. 15043)

/s/ Jeffrey S. Lyons
Jeffrey S. Lyons (Colo. 27389)

/s/James A. Scoggins
James A. Scoggins (Colo. 28094)

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