

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No.

07 - CV - 01549 - ZLW - BVB

FILED
UNITED STATES DISTRICT COURT
DENVER, COLORADO

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

RICHARD E. FRESIA,

Defendant.

JUL 23 2007
GREGORY C. LANGHAM
CLERK

COMPLAINT

Plaintiff Securities and Exchange Commission ("Commission"), for its complaint, alleges:

I. SUMMARY

1. During the second and third quarters of 2002, **Defendant Richard E. Fresia**, the former chief financial officer ("CFO") of Expanets, Inc. ("Expanets"), a large telecommunications subsidiary of NorthWestern Corporation ("NorthWestern"), participated in a scheme to hide from the investing public Expanets' ongoing operational problems and poor financial performance.

2. First, Fresia failed to properly account for Expanets' uncollectible receivables and adjustments to customer bills that resulted from computer system problems, causing overstatements of NorthWestern's reported income of 90% and 109% in the second and third quarters of 2002, respectively. Alternatively, Fresia caused NorthWestern's failure to properly disclose the possibility of losses relating to Expanets' uncollectible receivables and adjustments to customer bills.

3. Second, Fresia and NorthWestern senior executives misled investors about the nature of Expanets' and NorthWestern's reported income. While NorthWestern publicly claimed that Expanets had achieved profitability and met earnings targets through its operations and cost savings, Fresia and NorthWestern senior executives concealed from the public that in fact, Expanets' reported income during 2002 was derived, in large part, from non-recurring and undisclosed reserve reductions, and from its receipt of unusual non-compete payments.

4. Fresia's misconduct helped facilitate NorthWestern's completion of more than \$800 million in securities offerings in September and October 2002, including raising approximately \$87.5 million in an equity offering that provided the company with badly needed operating capital to temporarily improve its liquidity position.

5. However, just two months later, in December 2002, NorthWestern disclosed that Expanets would take more than \$50 million of charges for uncollectible accounts receivable and adjustments to customer bills.

6. In April 2003, NorthWestern restated its Forms 10-Q for the first three quarters of 2002 and erased Expanets' previously reported income for those periods. The company also disclosed significant ongoing problems with the EXPERT system, and the impact of unusual non-compete payments on Expanets' 2002 financial results.

7. Also in April 2003, NorthWestern filed its 2002 Form 10-K, in which it wrote off substantially all of its past investment of hundreds of millions of dollars in Expanets. In that filing, NorthWestern announced that, despite past assurances, Expanets would not generate future cash flow in sufficient amounts to help service NorthWestern's elevated debt.

8. Over the next five months, NorthWestern's liquidity situation continued to deteriorate until the company declared bankruptcy in September 2003.

II. JURISDICTION AND VENUE

9. The Commission brings this action pursuant to the authority conferred upon it by Section 20(b) of the Securities Act of 1933 (“Securities Act”) [15 U.S.C. § 77t(b)] and Sections 21(d) and (e) of the Securities Exchange Act of 1934 (“Exchange Act”) [15 U.S.C. §§ 78u(d) and (e)] for an order permanently restraining and enjoining Defendant and granting other equitable relief.

10. This Court has jurisdiction over this action pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Sections 21(e) and 27 of the Exchange Act [15 U.S.C. §§ 78u(e) and 78aa].

11. Venue lies in this Court pursuant to Section 22(a) of the Securities Act and Section 27 of the Exchange Act [15 U.S.C. §§ 77v(a) and 78aa].

12. In connection with the transactions, acts, practices, and courses of business described in this Complaint, Fresia directly or indirectly, made use of the means or instrumentalities of interstate commerce, of the mails, of the facilities of a national securities exchange, and/or of the means and instruments of transportation or communication in interstate commerce.

13. Certain of the transactions, acts, practices and courses of business constituting the violations of law alleged herein occurred within this judicial district. Moreover, Fresia resides in this judicial district.

III. DEFENDANT

14. **Richard E. Fresia**, age 52, is a resident of Evergreen, Colorado. Fresia served as Expanets’ CFO from April 2002 through May 2003. Fresia was licensed as a certified public accountant in Colorado in 1985, but his license is now inactive. Fresia is currently an officer of a public company.

IV. RELATED PARTIES

15. **NorthWestern**, a Delaware corporation with its principal executive offices in Sioux Falls, South Dakota, operates a regulated utility business in South Dakota, Nebraska and Montana. During the period described herein, NorthWestern controlled and consolidated the financial results of Expanets. NorthWestern's common stock was registered with the Commission under Section 12(b) of the Exchange Act and was required to file periodic reports with the SEC on Forms 10-K and 10-Q. NorthWestern stock traded on the New York Stock Exchange until it was delisted shortly before NorthWestern declared bankruptcy in September 2003. In November 2004, NorthWestern emerged from bankruptcy. Its common stock is now registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the NASDAQ Global Select Market.

16. **Expanets**, a Delaware corporation formerly headquartered in Englewood, Colorado, provided networked telecommunications equipment and services to medium-sized businesses nationwide. Expanets was comprised of approximately 26 small telecommunications equipment resellers and a former sales division of Lucent Technologies. NorthWestern wrote off substantially all of its investment in Expanets in its 2002 Form 10-K and announced its intent to sell Expanets in April 2003. In the second quarter of 2003, Expanets' operations were discontinued, and in May 2004, Expanets filed for bankruptcy. Proceeds from the sale of Expanets' assets were distributed in bankruptcy.

V. SUMMARY OF VIOLATIONS AND MATERIALLY FALSE STATEMENTS

17. Fresia violated Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)] and Sections 10(b) and 13(b)(5) of the Exchange Act [15 U.S.C. §§ 78j(b) and 78m(b)(5)] and Rules 10b-5 and 13b2-1 thereunder [17 C.F.R. §§ 240.10b-5 and 240.13b2-1], and aided and abetted NorthWestern's violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act

[15 U.S.C. §§ 78m(a), 78m(b)(2)(A) and 78m(b)(2)(B)] and Rules 12b-20, 13a-11 and 13a-13 thereunder [17 C.F.R. §§ 240.12b-20, 240.13a-11 and 240.13a-13], and unless restrained and enjoined will violate or aid and abet violations of such provisions.

18. Fresia's violations as alleged below occurred in connection with the following Commission filings: NorthWestern's Form 10-Q for the period ended June 30, 2002, filed on August 14, 2002 ("NorthWestern's Form 10-Q for the second quarter of 2002"), and NorthWestern's Amended Form 10-Q for the period ended June 30, 2002, filed on September 20, 2002; NorthWestern's Form 10-Q for the period ended September 30, 2002, filed on November 14, 2002 ("NorthWestern's Form 10-Q for the third quarter of 2002"); NorthWestern's Forms 8-K with attached press releases filed on August 8, 2002, September 20, 2002, and November 7, 2002; NorthWestern's Form S-4/Amendment #2 filed August 16, 2002; Form S-4/Amendment #3 filed September 9, 2002; and NorthWestern's equity offering prospectus supplements filed with the Commission on September 30, 2002 and October 3, 2002.

19. Fresia caused the misstatement of NorthWestern's financial statements filed with its Forms 10-Q for the second and third quarters of 2002. Fresia also reviewed and assisted in the preparation of NorthWestern's false and misleading disclosures pertaining to Expanets in the company's Forms 10-Q for second and third quarters of 2002.

20. Fresia knew or was reckless in not knowing that NorthWestern's misstated financial results for the second and third quarters were also disseminated to the public in NorthWestern's corresponding press releases attached to NorthWestern's Forms 8-K filed on August 8, 2002, September 20, 2002, and November 7, 2002.

21. Fresia knew or was reckless in not knowing that NorthWestern's misstated financial results and false and misleading disclosures pertaining to Expanets were repeated in NorthWestern's amended second quarter Form 10-Q filed on September 20, 2002.

22. Fresia also knew or was reckless in not knowing that NorthWestern's false financial statements and false and misleading disclosures pertaining to Expanets in the company's Form 10-Q for the second quarter of 2002 was incorporated by reference into NorthWestern's amended Forms S-4 filed with the Commission on August 16, 2002 and September 9, 2002, as well as the equity offering prospectus supplements that NorthWestern filed with the Commission on September 30, 2002 and October 3, 2002.

VI. FACTS

A. **Background -- NorthWestern's Expansion And Expanets' Poor Performance Prior to 2002**

23. For more than seventy years, NorthWestern operated a public utility business, providing electricity and natural gas to customers in South Dakota and Nebraska.

24. In approximately 1998, NorthWestern formed a non-utility entity, Expanets, to diversify into the potentially high-growth sector of telecommunications. NorthWestern intended for Expanets to acquire telecommunications companies and then make the combined businesses more profitable.

25. NorthWestern expected that following an initial growth phase, Expanets would provide substantial additional earnings and cash flow to NorthWestern through dividends on NorthWestern's preferred stock holdings in Expanets. However, despite NorthWestern's investment of hundreds of millions of dollars in Expanets, Expanets incurred large losses in most years and posted only small profits in other years. By December 31, 2001, NorthWestern had

invested \$314.1 million in Expanets. Notwithstanding this sizeable investment, Expanets had not returned significant cash to NorthWestern.

26. Despite the poor performance of Expanets, in February 2002, NorthWestern quadrupled its customer base for utility operations by acquiring Montana Power Company (“Montana Power”) for approximately \$1.1 billion. NorthWestern financed a substantial part of this acquisition with debt through the company’s issuance of \$720 million in unregistered notes.

B. Fresia Knew That NorthWestern’s Planned Equity Offering Placed Heightened Pressure on Expanets to Meet Financial Performance Targets During 2002

27. NorthWestern’s markedly increased debt used to acquire Montana Power threatened the company’s historically stable liquidity and top-tier credit ratings. Therefore, in early February 2002, NorthWestern publicly announced its intention to conduct an equity offering, and then use the proceeds to pay down a portion of its elevated debt. NorthWestern senior executives also repeatedly confirmed the company’s public guidance of between \$2.30 and \$2.55 earnings per share for 2002.

28. Throughout his employment with Expanets, Fresia knew that the historical poor performance of Expanets and NorthWestern’s expansion of its utility operations together placed enormous pressure on Expanets’ 2002 financial performance. Throughout his employment with Expanets, Fresia also knew that NorthWestern’s equity offering planned for later in 2002 was critical to NorthWestern’s consolidated liquidity situation.

29. Throughout his employment with Expanets, Fresia knew that NorthWestern’s ability to meet its public earnings per share guidance for 2002 was dependent in part upon achieving markedly increased profitability at Expanets. Notwithstanding Expanets’ 2001 earnings before interest, taxes, depreciation and amortization (“EBITDA”) loss of approximately \$48 million,

NorthWestern publicly projected that Expanets' 2002 EBITDA would be between \$80 and \$87 million.

C. Fresia's Role in the Preparation of Expanets' Financial Statements And NorthWestern's Public Disclosures

30. Fresia began his employment as CFO of Expanets on or about April 15, 2002. Throughout his tenure as CFO of Expanets, Fresia was responsible for the preparation of Expanets' financial statements and for overseeing Expanets' accounting and finance organization.

31. Although Expanets did not file reports with the Commission, Expanets maintained its own books and records, and prepared its own separate financial statements. Throughout his employment with Expanets, Fresia knew or was reckless in not knowing that Expanets' financial results were reported as a segment and consolidated into NorthWestern's financial statements which were filed with the Commission and otherwise disseminated to the public.

32. Fresia communicated frequently with NorthWestern senior management and other accounting and finance personnel regarding, among other things, Expanets' operations and financial results. For example, Fresia reviewed and approved Expanets' detailed monthly operations reports to NorthWestern and attended corresponding monthly operations review meetings with NorthWestern senior management.

33. Fresia actively participated in the preparation of NorthWestern's Forms 10-Q for the second and third quarters of 2002. Fresia knew or was reckless in not knowing that NorthWestern's financial statements in those filings, as well as NorthWestern's disclosures pertaining to Expanets, would be disseminated to the public.

34. Following passage of the Sarbanes-Oxley Act ("SOX") and before NorthWestern's filing of its Form 10-Q for the second quarter of 2002, NorthWestern instituted internal SOX

disclosure procedures designed to support the certification of NorthWestern's Commission filings by NorthWestern's CEO and CFO pursuant to Section 906 of SOX and Commission Order 4-460.

35. NorthWestern's SOX disclosure process primarily consisted of due diligence sessions in which Fresia, along with various other individuals affiliated with NorthWestern and its subsidiaries, drafted, reviewed, and internally confirmed, among other things, the accuracy of the financial statements and disclosures included within NorthWestern's Forms 10-Q for the second and third quarters. By virtue of his participation in NorthWestern's SOX process alone, Fresia knew or was reckless in not knowing that false or misleading financial statements or disclosures in the company's Forms 10-Q would be filed with the Commission and otherwise disseminated to the public.

36. Fresia substantially participated in the preparation of NorthWestern's 2002 second quarter Form 10-Q because he supervised the preparation of Expanets' financial statements, reviewed the Form 10-Q, participated in at least one due diligence session with other individuals, and confirmed that Expanets' financial statements were consistent with generally accepted accounting principles ("GAAP") and that NorthWestern's Form 10-Q did not contain any material misstatements or omissions, and was accurate and complete.

37. Prior to the filing of NorthWestern's 2002 third quarter Form 10-Q, the company enhanced its SOX disclosure procedures by creating more formalized committees to draft, review and internally attest to, among other things, that the disclosures of that filing were accurate and complete. Specifically, NorthWestern formed a disclosure committee at the parent level and also various disclosure subcommittees at the subsidiary levels. Fresia was a member of Expanets' disclosure subcommittee.

38. Fresia substantially participated in the preparation of NorthWestern's 2002 third quarter Form 10-Q because he supervised the preparation of Expanets' financial statements and, as a member of Expanets' disclosure subcommittee, he reviewed NorthWestern's Form 10-Q, participated in due diligence sessions with other individuals, confirmed that Expanets' financial statements were consistent with GAAP and that NorthWestern's Form 10-Q did not contain any material misstatements or omissions, and signed an internal certification attesting that, among other things, the disclosures of that filing relating to Expanets were accurate and complete.

39. Because of his role during NorthWestern's internal SOX disclosure procedures for the second and third quarters of 2002, Fresia was obligated to ensure the accuracy and completeness of the financial statements and disclosures within those filings as they related to Expanets. Furthermore, as CFO of Expanets during the second and third quarters of 2002, Fresia was similarly obligated to ensure that Expanets' financial statements conformed with GAAP.

D. Throughout His Employment With Expanets, Fresia Knew Of The Ongoing Problems With Expanets' Computer System

40. During 2000 and 2001, Expanets developed a new computer system called "EXPERT" to serve as a platform for virtually all of its operations, including sales, inventory, project management, billing, collections and financial statement preparation. Because of EXPERT's planned scope and impact across operations, the functionality of the system was critical to Expanets' operations and financial results.

41. Following the implementation of EXPERT in November 2001, the system was unable to perform many of the basic tasks for which it had been designed. In particular, the EXPERT system experienced severe problems in generating timely and accurate customer bills and tracking customer payments.

42. For example, for approximately one month following implementation, EXPERT could not generate any customer bills. Even after EXPERT could generate customer bills, until approximately May 2002, the bills did not contain beginning or ending balances notifying customers of payment history or amounts past due.

43. From its implementation until the third quarter of 2002, EXPERT also could not perform basic accounting functions. For example, EXPERT could not accurately track the aging of accounts receivable or accurately apply customer payments to particular invoices.

44. Almost immediately after he began his employment with Expanets, through various communications, including emails, written reports, analyses, and/or verbal discussions, Fresia became aware of the ongoing problems with the EXPERT system.

45. Throughout the remainder of 2002, Fresia was constantly kept apprised of ongoing functionality problems with the EXPERT system. Among other things, EXPERT functionality problems were a standing agenda item for every monthly operations review meeting between Expanets and NorthWestern throughout 2002.

46. Fresia also received more detailed periodic reports regarding EXPERT functionality problems and proposed repairs. For example, in June 2002, Fresia received an extensive briefing from Expanets' chief information officer ("CIO") as to ongoing EXPERT problems, particularly relating to billing and collections. Among other things, Expanets' CIO explained that EXPERT problems and planned fixes would persist at least through the end of 2002.

47. Emails and other internal documents authored by Fresia demonstrate that he was well aware of EXPERT functionality problems and their impact on operations, particularly Expanets' customer billing and collections. For example, in a July 3, 2002 email to NorthWestern personnel, Fresia stated "I know the cash flow pressures that you guys are facing

and I want this fix as badly as anyone. Collecting from these pre-fix bills is a disaster. This billing system (and other modules as well) our [sic] VERY hosed.”

48. Similarly, in an August 27, 2002 email, Fresia wrote “It’s an unfortunate situation, but the EXPERT system is an absolute [expletive] disaster.”

49. As alleged below, the inability of the EXPERT system to generate accurate or timely customer bills caused a spike in both Expanets’ uncollectible receivables and adjustments to customer bills.

E. Fresia Was Responsible For Expanets’ Material Understatement Of Its Bad Debt Reserve and NorthWestern’s Related False and Misleading Disclosures

50. In anticipation that some customer accounts might prove uncollectible, Expanets maintained a “bad debt” reserve, which had the effect of reducing Expanets’ operating income.

51. Under GAAP, if Expanets’ additional losses from uncollectible accounts receivable were probable and could be reasonably estimated, Expanets should have increased its bad debt reserve even if the particular receivables that were uncollectible were not identifiable.

Furthermore, under GAAP, NorthWestern was required to disclose contingent losses relating to Expanets’ uncollectible receivables, even if the amount of the probable losses was not reasonably estimable, as long as the loss was considered at least reasonably possible.

52. With respect to the second and third quarters of 2002, Fresia failed to ensure that the published financial statements of NorthWestern conformed with GAAP applicable to Expanets’ uncollectible receivables.

53. Prior to the filing of NorthWestern’s Form 10-Q for the second quarter of 2002, Fresia knew or was reckless in not knowing that millions of dollars of Expanets receivables predated the implementation of the EXPERT system in November 2001, and therefore likely were uncollectible because they had aged more than 180 days.

