

FILED
U.S. DISTRICT COURT
DISTRICT OF COLORADO

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

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Civil Action No. **98-5-1636**

SECURITIES AND EXCHANGE COMMISSION
450 Fifth Street, N.W.
Washington, D.C. 20549,

Plaintiff,

v.

**RONALD J. HOTTOVY,
JIMMY DUCKWORTH,
JOSEPH I. MORRIS, and
EUGENE A. BREITENBACH,**

Defendants.

COMPLAINT

Plaintiff Securities and Exchange Commission ("Commission") alleges:

SUMMARY

1. During 1993, 1994 and 1995, Scientific Software-Intercomp, Inc. of Denver, Colorado ("SSI") materially overstated its revenue and earnings by backdating or misdating contracts, booking revenue without contracts, overaccruing project revenues and providing confidential side letters modifying payment obligations. As a result of these practices, SSI reported false and misleading information in its Annual Reports for fiscal 1993 and 1994, its Quarterly Reports for the first three quarters of fiscal 1994 and the first quarter of fiscal 1995. In addition, SSI conducted an offering of 2 million shares of common stock from which the company

obtained more than \$8 million on a registration statement that materially overstated revenue, net income and earnings per share for the 1993 fiscal year and the first quarter of 1994.

2. Defendants Hottovy, Duckworth, Morris and Breitenbach, all senior officers of SSI, participated, directly or indirectly, in SSI's material misstatements and concealed them from SSI's independent auditors by manipulating SSI's accounting records, withholding documents, and making false statements to the auditors. By engaging in such conduct, the defendants violated Section 17(a) of the Securities Act of 1933, and Sections 10(b) and 13(b)(5) of the Securities Exchange Act of 1934 and Rules 10b-5, 13b2-1 and 13b2-2 thereunder.

JURISDICTION

3. The Court has jurisdiction pursuant to Section 22 of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77u] and Sections 21 and 27 of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §§ 78u and 78aa].

4. The defendants made use of the means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange in connection with their acts, transactions, practices and courses of business alleged herein.

ISSUER

5. Scientific Software-Intercomp, Inc., a Colorado corporation with its principal place of business in Denver, Colorado, develops, sells and provides software and consulting services for the oil and gas industry. SSI's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act [15 U.S.C. § 78l(g)] and during the relevant period was listed on NASDAQ. On June 30, 1994, SSI conducted an offering of common stock

pursuant to a registration statement filed with the Commission on Form S-1, and sold 2 million newly issued common shares, receiving net proceeds of \$8.1 million. SSI's annual revenues during 1994 were approximately \$28 million. On September 11, 1997, the Commission filed a civil injunctive complaint in the United States District Court for the District of Columbia, captioned SEC v. Scientific Software-Intercomp, Inc., 97-CV-2091 (JGP) (D.D.C.), against SSI alleging violations of Section 17(a) of the Securities Act of 1933 and Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-11 and 13a-13 thereunder. Simultaneous with the filing of the complaint, SSI consented, without admitting or denying the allegations of the complaint, to injunctive relief and agreed to restate its financial statements for the years ending December 31, 1993, 1994 and 1995.

PARTIES

6. The Commission brings this action pursuant to Sections 20(b) and (e) of the Securities Act [15 U.S.C. §§ 77t(b) and (e)] and Sections 21(d) and (e) of the Exchange Act [15 U.S.C. §§ 78u(d) and (e)].

7. Ronald J. Hottovy, age 50, was chief financial officer ("CFO") of SSI, and a certified public accountant, at all relevant times. He resigned from SSI in April 1996.

8. Jimmy L. Duckworth, age 52, was executive vice president of sales and a member of the board of directors of SSI, with direct responsibility for SSI's Pipeline and Facilities Division, at all relevant times. Duckworth is a certified public accountant. He resigned from SSI in June 1995.

9. Joseph M. Morris, age 48, was vice president-corporate controller of SSI from 1991 until he left the Company in July 1995. He is a certified public accountant.

10. Eugene A. Breitenbach, age 61, a founder of the Company, was chief executive officer, president and chairman of the board of directors of SSI at all relevant times. He resigned from all his positions at SSI in April 1996.

FIRST CLAIM

Violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder

11. During the relevant period, SSI's Pipeline and Facilities Division ("P&F Division"), headquartered in Houston, Texas, provided software and consulting services for oil and gas companies, principally in the areas of pipeline monitoring and simulation and leak detection. For 1994, the P&F Division contributed approximately 26% of the total revenues of the company as a whole.

12. Beginning in the early 1990's, the P&F Division began a marketing program using value added resellers ("VAR"s) to sell its software products. Under a typical VAR arrangement, SSI entered into an agreement with the VAR to purchase and resell SSI's software; and the VAR would market the software. The typical agreement provided that the VAR's purchase would be unconditional.

13. The American Institute of Certified Public Accountants ("AICPA") issued Statement of Position on Software Revenue Recognition 91-1 ("SOP 91-1") on December 12, 1991, to provide guidance on applying generally accepted accounting principles ("GAAP") to

software license revenue. SOP 91-1 established that revenue from sales of software generally cannot be recognized until the software is delivered, collectibility is probable and the vendor has no significant obligations remaining under the sales arrangement. It also established the following rules: (1) for software licenses intended to be evidenced by a written contract signed by the vendor and the customer, revenue should not be recognized until persuasive evidence of the agreement exists; usually a signed contract provides such evidence; (2) revenue from cancelable licenses should not be recognized until the cancellation privileges lapse; and (3) if, after delivery, there is significant uncertainty about customer acceptance of the software, license revenues should not be recognized until the uncertainty becomes insignificant.

14. Beginning in the third quarter of 1993 through the first quarter of 1995, SSI materially overstated its revenues, which came primarily from the P&F Division, contrary to GAAP.

Side Letters

15. Beginning in at least 1993, SSI began recognizing revenues on contracts with VARs that included confidential side letters given by SSI either excusing payment to SSI until the VARs received a resale payment from a third-party, or rendering the contract ineffective and cancelable until a specified future event, normally the sale of SSI's software to the VARs' customers.

16. In the third and fourth quarters of 1993 and the first quarter of 1994, a P&F Division vice president, with the authorization and knowledge of Duckworth, gave several side letters to ABB, a VAR, that excused payment until ABB resold SSI's product to end users with

whom contracts were pending. Despite the fact that ABB had not sold the product by year-end, and in at least one instance the contract was signed after year-end, the revenue on these contracts, amounting to more than \$575,000, was recognized by SSI in the second half of 1993.

17. The same P&F Division vice president, with the authorization and knowledge of Duckworth, gave a side letter to Valmet Automation, another VAR, that excused payment until Valmet completed a sale of SSI's product to another party. The full amount of this contract, \$200,000, was recognized by SSI in the first quarter of 1993 and remained on SSI's financial statements throughout 1993 even though Valmet had not sold any of SSI's products by the end of 1993 and thus was not obligated to pay SSI under the contract.

18. In the first quarter of 1994, SSI recognized \$160,000 for a purported sale to Controles Texas, another VAR, despite the fact that Duckworth gave Controles Texas a side letter excusing payment to SSI until Controles Texas was paid by a specified end user. No payment was made to Controles Texas by the end user by the end of the quarter. Thus Controles Texas had no obligation to pay SSI under the contract.

19. In the first quarter of 1994, SSI recognized \$500,000 for a contract it had with Envirotech Controls, Inc., another VAR to whom a P&F Division vice president had given a side letter, with the knowledge of Duckworth, Hottovy and Morris. At the time the revenue was recognized by SSI, Envirotech had not made any sales of SSI's software as required by the side letter for the contract to commence, and thus Envirotech had no obligation to make payment to SSI under the contract.

20. During the relevant period, Duckworth was responsible for the P&F Division and encouraged the use of side letters as a means of improperly recognizing revenue from cancelable agreements. In addition to the Controles Texas side letter he executed, Duckworth either authorized or was informed of every side letter at the time it was executed and knew that the revenue could not be properly recognized by SSI on these cancelable agreements.

21. Throughout the relevant period, Hottovy and Morris were kept informed by Duckworth about the status of these cancelable and ineffective contracts, deemed in certain instances "problem accounts." Nevertheless, SSI improperly recognized the software licensing fees called for in these cancelable agreements as revenue before SSI was entitled to, that is, before the cancellation privileges lapsed or the contracts became effective, with Hottovy's and Morris's knowledge. Duckworth and Hottovy deliberately withheld the side letters from SSI's independent auditors.

22. In all, in the third and fourth quarters of 1993 and throughout 1994, SSI recognized revenue of over \$2 million from at least nine agreements with VARs that had been given side letters either excusing payment or rendering the agreement ineffective, contrary to GAAP. Hottovy and Duckworth knew these contracts were not enforceable, and, in order to conceal the fraud, instructed sales and accounting personnel within SSI not to bill or otherwise seek payment from the customer.

23. Hottovy, Duckworth, Morris and Breitenbach knew, or were reckless in not knowing, of SSI's use of side letters and corresponding improper revenue recognition contrary to GAAP.

Backdating or Misdating of Contracts and Shipping Documents

24. During the period from 1993 through June 1995, SSI backdated a significant number of its contracts by signing the contracts "effective" as of the last day of the quarter, even though the actual contracts were signed and became binding after the quarter-end. Duckworth and others within the sales force of the P&F Division requested SSI's customers to execute the "effective" dated contracts in exchange for product or price concessions. Hottovy and Morris knew that these contracts were prematurely recognized by SSI as revenue in SSI's quarterly financial statements contrary to GAAP.

25. In addition to the backdating of contracts, throughout the same period, SSI recognized revenue contrary to GAAP where, with Duckworth's knowledge, the P&F Division shipped software after the quarter-end, with backdated shipping documentation falsely reflecting that software was shipped in a prior quarter.

26. In still other instances, revenues from sales of software were recognized contrary to GAAP where software was not shipped at all, or software was shipped that was unusable by the customer. On at least one occasion Duckworth placed software in his own office on the last day of the fiscal year and created a false shipping document to provide documentary support for the improper recognition of revenue.

27. Throughout the relevant period, Hottovy, Duckworth, Morris and Breitenbach knew, or were reckless in not knowing, of SSI's backdating of contracts and shipping documents, and the corresponding improper revenue recognition contrary to GAAP.

Lack of Written Contracts

28. On numerous occasions, SSI recognized revenue before persuasive evidence of an agreement existed, and where no written contract existed, contrary to GAAP.

29. In the first fiscal quarter ended March 31, 1995, SSI recognized \$700,000, over 10% of the SSI's total revenues for the quarter, on a purported agreement with the United States Navy for which no documentation existed except a request for pricing that had been exchanged between the SSI salesperson and the agency. Despite the fact that there was no contract at quarter-end, by recognizing this \$700,000 of revenue, SSI was able to report earnings of \$0.01 per share rather than a loss of \$0.06 per share for the quarter. Moreover, despite that fact that only a proposal had been exchanged with the Navy, SSI falsely reported in its first quarter Form 10-Q that there was a "sale" with the Navy by quarter-end, and falsely reported that software was installed and in use at the Navy. Hottovy, Duckworth, Morris and Breitenbach knew, or were reckless in not knowing, that SSI did not have an agreement with the Navy by quarter-end, yet SSI recognized as revenue the entire amount of the proposal, and falsely reported the transaction in its Form 10-Q.

30. In June 1995, when SSI's independent auditors inquired about the revenue booked in the first quarter related to the Navy transaction, Hottovy and Morris falsely told the auditors that software had been installed and was in use at the Navy and that they could not see any documentation related to the Navy transaction because the transaction was classified. Hottovy created affidavits for Duckworth and Breitenbach, which were provided to the auditors, falsely attesting to the classified nature and validity of the agreement with the Navy. Specifically,

Duckworth signed an affidavit falsely attesting that software was installed and in use, when he knew no delivery of software had been made to the Navy. Breitenbach signed an affidavit attesting that he had verified Duckworth's affidavit, which he had not properly done.

31. Hottovy, Duckworth, Morris and Breitenbach knew, or were reckless in not knowing, that their statements to SSI's auditors regarding the Navy contract were materially false or misleading, and knew or were reckless in not knowing that the affidavits prepared by Hottovy, and signed by Duckworth and Breitenbach, were false or misleading.

Advance Booking of Project Revenues

32. SSI also recognized project revenues contrary to GAAP, which generally requires companies to recognize revenue on project agreements as the work is performed or over the life of the agreement. During the period from 1993 through June 1995, SSI booked revenues on long-term contracts in excess of contemplated revenues of the contracts. In certain instances, SSI booked the full amount of revenue on a long term contract where little or no work had been completed and was not anticipated in the near term. Specifically, on one occasion SSI recognized in excess of \$200,000 of revenue on a project in which the P&F Division vice president only forecast revenue of \$140,000, a 30% overaccrual, contrary to GAAP. In other instances, SSI recognized training revenue in excess of the stated amount in the written contract.

33. Hottovy, Duckworth, Morris and Breitenbach knew, or were reckless in not knowing, that SSI had recognized project revenues contrary to GAAP.

34. By the end of 1994 and into early 1995, the various accounting improprieties within the P&F Division, including side letters, backdated contracts, nonexistent written contracts

and advance booking of project revenue, resulted in revenues recognized by SSI contrary to GAAP in excess of \$3 million, roughly 33% of the annual revenues of the entire P&F Division.

35. On April 6, 1995, SSI issued a press release announcing that, because certain of its VAR contracts "did not meet all of the necessary requirements to be recognized as revenue," it would post a "substantial loss in the fourth quarter." Following the announcement, in which the exact loss had yet to be quantified, the price of SSI common stock dropped by approximately 25% from a high above \$5 per share. Since then, the price of SSI common stock declined to a trading range between \$.50 and \$.75 per share. Early in 1998, SSI announced it was selling all of its assets.

36. During the period from 1993 through June 1995, Hottovy, Duckworth, Morris and Breitenbach knew or were reckless in not knowing of the side letters, backdating of contracts, booking of revenues without contracts, and overaccrual of project revenues, and knew or were reckless in not knowing that these practices resulted in SSI materially overstating revenues.

37. Between September 1994 and March 1995, Breitenbach received additional compensation from SSI of \$33,600, based on the performance of SSI during fiscal 1993.

38. Between January 14, 1994 and October 10, 1994, Morris exercised options on 11,667 shares of SSI stock at artificially inflated value due to the fraud, which Morris knew but was not publicly disclosed until 1995.

FALSE PUBLIC FILINGS AND DISCLOSURES

39. The material misstatements caused by SSI's false accounting appeared in SSI's financial statements included in each of its periodic filings with the Commission during the

relevant period. On March 31, 1994, SSI filed with the Commission its Annual Report on Form 10-K for its fiscal year ended December 31, 1993. This report contained audited financial statements in which SSI materially overstated revenue, net income and earnings per share for the fiscal year.

40. On May 9, 1994, SSI filed with the Commission a registration statement on Form S-1 for the sale of 2 million shares of common stock. The registration statement contained audited and unaudited financial statements in which SSI materially overstated revenue, net income and earnings per share for the 1993 fiscal year and the first quarter of 1994.

41. On May 23, 1994, August 12, 1994, and November 21, 1994, SSI filed with the Commission its Quarterly Reports on Form 10-Q for the quarters ended March 31, 1994, June 30, 1994, and September 30, 1994, respectively. These Quarterly Reports contained unaudited financial statements in which SSI materially misstated revenue, net income and earnings per share.

42. On June 21, 1995, SSI filed with the Commission its Quarterly Report on Form 10-Q for the quarter ended March 31, 1995. The Quarterly Report contained unaudited financial statements in which SSI materially overstated revenue, net income and earnings per share.

43. During the period from 1993 through June 1995, Hottovy, Duckworth, Morris and Breitenbach knew or were reckless in not knowing that the company's Annual Reports on Form 10-K and Quarterly Reports on Form 10-Q materially overstated revenue, net income and earnings per share.

RESIGNATION OF SSI'S AUDITORS

44. After discovering some of the accounting improprieties occurring at SSI in April 1995, SSI's auditors expressed concern over their ability to complete the audit, and discussed with Hottovy and Breitenbach how the audit might be completed. In response, SSI's board of directors appointed a special committee, headed by Hottovy, to conduct an internal investigation to determine the scope of the financial misstatements. Despite Hottovy's attempts to narrow the committee's investigation of SSI's accounting improprieties, on June 30, 1995, after the committee discovered the side letter executed by Duckworth, the auditors resigned. During the committee's investigation, Duckworth, Morris and Breitenbach told the committee that they had no knowledge of any of the side letters given to VARs. Despite his knowledge of side letters and other accounting improprieties, Hottovy denied to the other committee members that he had any knowledge of side letters, backdating of contracts, or overaccrual of project revenue. Hottovy, Duckworth, Morris and Breitenbach knew, or were reckless in not knowing, that their statements to the committee were materially false or misleading, and would be conveyed to SSI's auditors.

45. In addition to his material misstatements to the committee about his knowledge of the existence of side letters, Duckworth during the first quarter of 1995 encouraged Controles Texas to return a false confirmation to SSI's auditors, confirming that an unconditional contract existed between SSI and Controles Texas, despite the existence of a side letter rendering the contract cancelable or ineffective. In 1994, Duckworth had made a similar request of Valmet.

46. On July 10, 1995, SSI filed a Current Report on Form 8-K, signed by Hottovy, stating that SSI's auditors had resigned and stating that there were no disagreements with the auditors. After reviewing the Form 8-K, the auditors notified the Commission that they disagreed with SSI's representations in the Form 8-K. On August 14, 1995, SSI responded to the auditors' letter by filing another Form 8-K. In that filing, drafted and signed by Hottovy, SSI noted the disagreement with its auditors, but falsely stated that the auditors had not discussed resignation with SSI prior to June 30, 1995.

47. On July 10, 1995, SSI filed with the Commission its Annual Report on Form 10-K for its fiscal year ended December 31, 1994. This report contained unaudited financial statements in which SSI materially misstated revenue, net income and earnings per share for the fiscal year.

48. During the period from 1993 through June 1995, Hottovy, Duckworth, Morris and Breitenbach knew or were reckless in not knowing that the company's Current Reports on Form 8-K were materially false or misleading and that the company's 1994 Annual Report on Form 10-K materially overstated revenue, net income and earnings per share.

49. By reason of the foregoing, Hottovy, Duckworth, Morris and Breitenbach violated Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)], Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5] thereunder.

SECOND CLAIM

Violations of Section 13(b)(5) of the Exchange Act and Rules 13b2-1 and 13b2-2 thereunder

50. Plaintiff realleges and incorporates by reference paragraphs 1 through 48 above.

51. By engaging in the conduct described herein, Hottovy, Duckworth, Morris and Breitenbach violated Section 13(b)(5) of the Exchange Act [15 U.S.C. § 78m(b)(5)] and Rules 13b2-1 and 13b2-2 thereunder [17 C.F.R. § 240.13b2-1 and 13b2-2].

PRAYER

WHEREFORE, the Commission respectfully requests that this Court:

- (a) find that Hottovy, Duckworth, Morris and Breitenbach violated Section 17(a) of the Securities Act, and Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13b2-1 and 13b2-2 thereunder;
- (b) enjoin Hottovy, Duckworth, Morris and Breitenbach from violating, directly or indirectly, Section 17(a) of the Securities Act, and Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13b2-1 and 13b2-2 thereunder;
- (c) order disgorgement from Breitenbach, plus prejudgment interest;
- (d) order disgorgement from Morris, plus prejudgment interest;
- (e) order Hottovy, Duckworth and Breitenbach to pay civil penalties pursuant to Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)], and Morris to pay civil penalties pursuant to Sections 21(d)(3) and 21A of the Exchange Act [15 U.S.C. § 78u(d)(3) and 78u-1];
- (f) prohibit Hottovy and Duckworth from acting as an officer or director pursuant to Section 21(d)(2) of the Exchange Act [15 U.S.C. § 78u(d)(2)]; and

(g) grant such other relief as the Court may deem just and appropriate.

Dated: July 28, 1998

Respectfully submitted,



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