IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 07-CV-01549-ZLW-BNB

FILED
UNITED STATES DISTRICT COURT
DENVER, COLORADO

JUL 23 2007

GREGORY C. LANGHAM
CLERK

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

RICHARD E. FRESIA,

Defendant.

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 pre-dated the implementation of the EXPERT system in November 2001, and therefore likely were uncollectible because they had aged more than 180 days.

54. Fresia knew and acknowledged that Expanets had millions of dollars of uncollectible receivables pre-dating EXPERT implementation through various communications, including emails, written reports, analyses and/or verbal discussions.

55. For example, on May 30, 2002, Fresia drafted a memorandum in which he stated that 47% of Expanets' receivables were more than 90 days old. Similarly, in an August 2002 email, Fresia again admitted to Expanets personnel that Expanets had nearly a quarter of a billion dollars within its receivables account, some of which dated back to Thanksgiving of 2001.

56. With respect to the second quarter of 2002, Fresia also knew or was reckless in not knowing that millions of dollars of Expanets receivables generated after the implementation of the EXPERT system likely were uncollectible because of EXPERT's delayed and inaccurate customer billing, and other functionality problems.

57. Fresia was repeatedly informed that Expanets was unable to collect millions of dollars of receivables generated after EXPERT implementation through various communications, including emails, written reports, analyses and/or verbal discussions.

58. For example, in a June 17, 2002 email to other Expanets personnel, Fresia provided a progress report on Expanets' collections for June in which he acknowledged that "to say that month to date results are not good would be an understatement."

59. Similarly, in an August 9, 2002 email entitled "Collections" sent to Fresia just days before NorthWestern filed its Form 10-Q for the second quarter, an Expanets employee within the company's collections group wrote:

> Based on my learning's [sic] over the past two months, the greater majority of our collections problems and poor receivable performance is directly related to the Expert system and our lack of knowledge company wide [sic] on how we should be using it. Notice Expanets receivables prior to November of last year were in line with most providers [sic] aging within our space. Now, our receivable is completely out of control. We have dedicated over 400 people from care &

> collections over a 3 month period to address the problem and we are seeing little upturn in cash.
>
> * * * * *
>
> We are all aware we currently have a significant issue with the Maintenance billing, however our Expert problems go much deeper from a receivable & cash collection perspective. We currently do not have the appropriate tools within Expert & Precise to then manage the collections process & customer related issues through to resolution. The overall expert system is currently lacking quality reports, data integrity, workflow tools, system performance, end user interface, system stability, & training of these systems to appropriately service our customer base. We are hamstrung in our ability to use the system to help up [sic] perform our jobs effectively.

60. Based upon his receipt of information regarding the status of Expanets' receivables that both pre-dated and post-dated the implementation of EXPERT, Fresia knew or was reckless in not knowing that Expanets' bad debt reserve policy was inadequate and that Expanets should have increased its bad debt reserve prior to NorthWestern's filing of its 2002 Form 10-Q for the second quarter.

61. For example, prior to the implementation of EXPERT, Expanets' bad debt reserve policy was to reserve 25% of receivables that were more than 90 days old. However, because EXPERT could not generate an accurate aging report through at least the first two quarters of 2002, Expanets implemented an interim policy during those periods which required Expanets to reserve 0.8% of current monthly sales. This percentage was based on the historical bad debt rate in existence prior to implementation of EXPERT.

62. Fresia knew or was reckless in not knowing that Expanets' interim policy was not appropriate for calculating Expanets' bad debt reserve for at least two reasons.

63. First, use of the 0.8% rate assumed that Expanets was experiencing the same level of collections on its 2002 sales as it had experienced during 2001. However, through various communications, including emails, written reports, analyses, and/or verbal discussions, Fresia

knew or was reckless in not knowing that information available to Expanets contradicted this assumption.

64. For example, a key performance indicator of Expanets' ability to collect on its accounts receivable was the "days sales outstanding" metric ("DSO"). DSO is the measure of the average number of days that a company takes to collect revenue after a sale has been made. Expanets tracked this metric and included it within its monthly operations reports that were shared with NorthWestern during Fresia's employment with Expanets as its CFO. As compared with 2001 metrics, Expanets' 2002 DSO had essentially doubled during the first six months of 2002, indicating that it was taking Expanets twice as long to collect on its receivables as it had taken the previous year.

65. Second, the interim bad debt reserve policy applied to future bad debt associated only with current monthly sales, and it did not apply to the continued deterioration of the aging of prior months' receivables, including those receivables that pre-dated Expanets' implementation of EXPERT. Accordingly, Fresia knew or should have known that Expanets' interim reserve policy was inadequate for this alternative reason.

66. In addition to the inadequacy of Expanets' interim policy during at least the first six months of 2002, Fresia knew or should have known that Expanets' bad debt reserve was materially understated by the filing of NorthWestern's Form 10-Q for the second quarter based on the aging information that was available to Expanets.

67. For example, an Expanets' aging report for the month ended June 2002 showed that Expanets had over $80 million in receivables that were more than 90 days old. However, Expanets' bad debt reserve as of the month ended June 2002 was only approximately $6.4

million, far short of the reserve that would be required if Expanets had reserved 25% of the $80 million under the old policy.

68. Accordingly, based on Expanets' prior bad debt policy of reserving 25% of such outstanding receivables, Fresia knew or was reckless in not knowing that Expanets' current reserve levels were materially understated.

69. Based upon his receipt of accounts receivable aging information and his failure to properly adjust Expanets' bad debt reserve for badly aged receivables, Fresia knew or was reckless in not knowing that the failure to increase Expanets' bad debt reserve in the second quarter of 2002 would and did cause a material misstatement of Expanets' and NorthWestern's reported income for that period.

70. Fresia reviewed and affirmed NorthWestern's disclosures pertaining to Expanets during NorthWestern's SOX disclosure process for the second quarter of 2002. Accordingly, in the alternative, based on his role in reviewing and approving that Commission filing, Fresia knew or was reckless in not knowing that NorthWestern's Form 10-Q for the second quarter of 2002 was false and misleading in that it failed to disclose the reasonable possibility of any contingent losses relating to Expanets' uncollectible receivables.

71. Fresia knew or was reckless in not knowing that NorthWestern's amended second quarter Form 10-Q filed on September 20, 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 were false and misleading in that they included the materially misstated financial statements of Expanets regarding its understated bad debt reserve or, in the alternative, failed to

disclose the reasonable possibility of any contingent losses relating to Expanets' uncollectible receivables.

72. Prior to the filing of NorthWestern's Form 10-Q for the third quarter of 2002, through various communications, including emails, written reports, analyses, and/or verbal discussions, Fresia also knew or was reckless in not knowing that millions of dollars of Expanets receivables from before and after EXPERT implementation had aged further and likely remained uncollectible.

73. For example, on or about September 19, 2002, approximately two weeks before NorthWestern's equity offering, Fresia met with NorthWestern personnel to discuss the status of Expanets' accounts receivable. At that meeting, Fresia provided NorthWestern personnel with a written report which indicated that $52 million of Expanets' receivables were over 180 days old, including $21 million of receivables that were over 300 days old.

74. Because these severely aged receivables were not likely to be collected, standard collection parameters, as indicated within the report, suggested either writing off Expanets' receivables or increasing its bad debt reserve by approximately $46 million. Because many of Expanets' aged receivables resulted from billing lapses and delays, Fresia informed NorthWestern personnel that Expanets believed its bad debt reserve was understated by a lesser amount, approximately $32 million. Accordingly, the analysis within the report ultimately quantified a bad debt write-off of approximately $32 million. However, following this meeting, Fresia did not increase Expanets' bad debt reserve by any amount.

75. In other internal communications authored by Fresia prior to NorthWestern's filing of its Form 10-Q for the third quarter, Fresia repeatedly acknowledged his belief that losses

stemming from the need to increase Expanets' bad debt reserve were both probable and reasonably estimable.

76. For example, in an October 6, 2002 email to other Expanets personnel regarding a working capital analysis, Fresia stated that he "believe[s] that a $30M writedown of the really old stuff is inevitable."

77. Similarly, in an October 8, 2002 email to other Expanets personnel, Fresia wrote the following about the status of Expanets' level of days sales outstanding ("DSO"):

> DSO – we are preparing a normalized view of the DSO after a $30M write-down for really old A/R accounts. Our more detailed aging has resulted in our having a much better handle on what is and is not realizable. A typical D&B [Dunn & Bradstreet] assessment would say $46M is at risk. Due to our situation, I'm subjectively saying that only 2/3 of that number is at risk ($46M * 2/3 = $30M). If the $30M is subtracted from the A/R balances for each Q in 2003 the DSO is substantially lower (like two weeks lower). This makes improvement more difficult than what one might otherwise think. In my opinion, DT [Deloitte & Touche LLP] will not accept our $7M bad debt reserve as adequate for the age of the A/R that we currently have. Therefore, I believe that the $30M adjustment will need to be a 4thQ charge.

78. On or about October 22, 2002, Fresia met with NorthWestern personnel and informed them that Expanets' accounts receivable balance had shown virtually no improvement since his September 19 report and presentation. During this meeting, Fresia made a new presentation to NorthWestern personnel regarding Expanets' accounts receivables, the unlikely event of collecting them all, and the need to increase Expanets' bad debt reserve by approximately $30 million to account for this loss. However, following this meeting, Fresia did not increase Expanets' bad debt reserve by any amount.

79. Based upon his receipt of accounts receivable aging information and his failure to adjust the bad debt reserve for badly aged receivables, Fresia knew or was reckless in not knowing that the failure to increase Expanets' bad debt reserve in the third quarter of 2002 would

and did cause a material misstatement of Expanets' and NorthWestern's reported income for that period.

80. As a member of Expanets' disclosure subcommittee for purposes of NorthWestern's internal SOX disclosure process for the third quarter of 2002, Fresia reviewed and assisted NorthWestern personnel in drafting the company's Form 10-Q as it pertained to Expanets. As part of that process, Fresia affirmed the accuracy of the following disclosure in NorthWestern' Form 10-Q filed with the Commission:

> In the integration of customers and the migration to Expert, Expanets experienced billing lapses and data conversion issues that may cause a need to increase the current reserve for bad debt, which could negatively impact financial performance in future quarters.

81. Fresia knew or was reckless in not knowing that this disclosure was false and misleading because, by that time, Expanets' bad debt reserve was, in fact, already materially understated.

82. In April 2003, NorthWestern filed its 2002 Form 10-K which included fourth quarter 2002 charges of approximately $20 million relating to Expanets' uncollectible accounts receivable, and simultaneously restated its financial results for the second and third quarters of 2002, increasing Expanets' bad debt reserve for each of these periods by approximately $5.1 million and $6.3 million, respectively.

83. As a result of Fresia's improper accounting for Expanets' uncollectible accounts receivable, NorthWestern overstated its income from continuing operations by approximately 19% and 39% for the second and third quarters of 2002, respectively, as reported in its Forms 10-Q and corresponding earnings releases attached to Forms 8-K. Moreover, in its segment reporting for Expanets, NorthWestern overstated Expanets' operating income by approximately 86% and 270%, respectively, for the second and third quarters of 2002.

F. Fresia Was Responsible For Expanets' Material Understatement Of Its Reserve For Adjustments to Customer Bills For the Second and Third Quarters of 2002

84. As a result of the inaccurate customer bills generated by the EXPERT system, Expanets issued partial credits to affected customers. Expanets recorded these credits as "billing adjustments," which reduced both its revenue and income in the current period. Since Expanets credited customer accounts in periods after it initially recognized revenue from a transaction, Expanets maintained a "billing adjustment reserve" for anticipated credits to customer accounts.

85. Under GAAP, if Expanets' additional losses from billing adjustments were probable and could be reasonably estimated, Expanets should have increased its billing adjustment reserve. 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' billing adjustments.

86. In the second quarter of 2002, Expanets personnel repeatedly informed Fresia that due to the serious ongoing problems with EXPERT's billing function, year-to-date actual billing adjustments, as well as billing adjustments forecasted through the remainder of 2002, were continuing to far outpace the higher levels anticipated for 2002.

87. For example, on August 14, 2002, the same day NorthWestern filed its Form 10-Q for the second quarter of 2002, Fresia received a report from Expanets personnel indicating that Expanets' billing adjustments for July 2002 alone were approximately $9.6 million, which was an increase from June's billing adjustments of approximately $6.3 million. That report also estimated that Expanets' billing adjustments for the third and fourth quarters of 2002 would be approximately $28.7 million and $18 million, respectively.

88. Furthermore, emails and other internal documents authored by Fresia demonstrate that he knew or was reckless in not knowing of the magnitude of Expanets' actual year-to-date

billing adjustments, forecasted billing adjustments during the remainder of 2002, and their negative impact on Expanets' financial results.

89. For example, during a July 2002 meeting, Fresia warned NorthWestern senior executives that Expanets' billing adjustment reserve might be understated by as much as $30 million for 2002.

90. Despite Fresia's knowledge and internal correspondence reflecting his belief that Expanets' billing adjustment reserve was already likely *understated*, with Fresia's knowledge and approval, for the second quarter of 2002, Expanets *reduced* its billing adjustment reserve by $2.3 million for the purpose of enhancing Expanets' reported income.

91. At the time of the second quarter reduction of Expanets' billing adjustment reserve, Expanets' assistant controller told Fresia that she was uncomfortable with the decision to reduce the reserve because, among other things, Expanets' billing adjustments were trending upwards.

92. Fresia therefore knew or was reckless in not knowing that the reduction of Expanets' billing adjustment reserve in the second quarter of 2002 would and did cause a material misstatement of Expanets' and NorthWestern's reported income for that period.

93. In the third quarter of 2002, Expanets personnel repeatedly informed Fresia that due to the serious ongoing problems with EXPERT's billing function, Expanets' existing billing adjustment reserve would not be sufficient to absorb year-to-date actual billing adjustments, and billing adjustments forecasted through the remainder of 2002. As a result, Expanets personnel told Fresia that "extraordinary billing adjustments," that is, billing adjustments in excess of existing or planned reserves, would negatively impact Expanets' reported revenue and income.

94. For example, in an August 2002 report to NorthWestern that Fresia reviewed and approved, Expanets estimated that it would experience $14 million in "extraordinary billing

adjustments" for the remainder of the year. These projected extraordinary billing adjustments were material since they decreased Expanets' projected 2002 EBITDA at that time from approximately $94 million down to approximately $80 million.

95. Similarly, in reports distributed in September and October to NorthWestern that Fresia reviewed and approved, Expanets estimated that it would experience $14.2 million and $15.5 million, respectively, in extraordinary billing adjustments for the period June through December 2002. Again, these extraordinary billing adjustments were material to Expanets' projected 2002 EBITDA which, by October 2002, had decreased to approximately $71.2 million.

96. Fresia's internal correspondence prior to the filing of NorthWestern's Form 10-Q for the third quarter reflected his belief that Expanets' billing adjustment reserve was already likely understated. For example, in an October 13, 2002 email in which Fresia discussed his current projections for Expanets' 2002 operating results, Fresia wrote: "I've assumed another $2M in BAs [billing adjustments]. We came in at $6M overall in September. That's an extraordinary $3.4M – $300K more than we'd anticipated. I think that the $2.5M (extra) that we have forecasted for the 4thQ is light."

97. Despite Fresia's knowledge and internal correspondence reflecting his belief that Expanets' billing adjustment reserve was already likely *understated*, with Fresia's knowledge and approval, for the third quarter of 2002, Expanets *reduced* its billing adjustment reserve by an additional $4.0 million for the purpose of enhancing Expanets' reported income.

98. At the time of the third quarter reduction of Expanets' billing adjustment reserve, Expanets' assistant controller again told Fresia that she was uncomfortable with the decision to reduce the reserve because, among other things, the reserve did not appear sufficient to absorb forecasted billing adjustments during the remainder of 2002.

99. Fresia therefore knew or was reckless in not knowing that Expanets' reduction of its billing adjustment reserve and Expanets' failure to increase the billing adjustment reserve to account for forecasted billing adjustments during the remainder of 2002 in the third quarter of 2002 would and did cause a material misstatement of Expanets' and NorthWestern's reported income for that period.

100. In April 2003, NorthWestern restated its financial results for the first three quarters of 2002, increasing the billing adjustment reserve by $33 million. For the second and third quarters of 2002, NorthWestern's restated financial results corrected the understatement of Expanets' billing adjustment reserve by reducing reported quarterly revenue by approximately $10.1 million and $5.4 million, respectively.

101. As a result of Expanets' improper accounting for billing adjustments, NorthWestern overstated its income from continuing operations by approximately 46% and 31% for the second and third quarters of 2002, respectively, as reported in its Forms 10-Q and corresponding earnings releases attached to Forms 8-K. In its segment reporting for Expanets, NorthWestern overstated Expanets' operating income by approximately 1094% and 164%, respectively, for the second and third quarters of 2002 based on this improper accounting.

G. In the Alternative, Fresia Was Responsible For NorthWestern's Failure to Disclose Expanets' Contingent Losses Regarding Billing Adjustments in the Company's Form 10-Q for the Third Quarter of 2002

102. Under GAAP, even if the amount of the probable losses was not reasonably estimable, NorthWestern was required to disclose contingent losses relating to Expanets' billing adjustments, as long as the loss was considered at least reasonably possible.

103. Therefore, in the alternative, Fresia was responsible for NorthWestern's failure to disclose the reasonable possibility of contingent losses relating to Expanets' billing adjustments.

104. Fresia knew or was reckless in not knowing that Expanets faced at least the reasonable possibility of material contingent losses relating to its billing adjustments by at least August of 2002. For example, just hours before NorthWestern filed its 2002 second quarter Form 10-Q with the Commission, Fresia proposed that NorthWestern make the following disclosure regarding Expanets' billing adjustments:

> While the EXPERT system implementation and migration of historical data from Avaya was successful overall, we experienced some conversion anomalies with regard to maintenance billing. The rate modifications are currently being addressed via an electronic automated solution throughout the third quarter. An increase in billing adjustments related to this process is expected during this period. Beginning in the fourth quarter of 2001, the company increased the rate of billing adjustment reserves. It is anticipated that these additional reserves will be consumed in the third quarter through the correction of these maintenance anomolies [sic].

105. NorthWestern personnel declined to include this proposed language in the company's 2002 second quarter Form 10-Q, at least in part, on the grounds that Fresia's proposed disclosure was submitted too late for inclusion. Therefore, NorthWestern made no disclosure as to the reasonable possibility of any contingent losses relating to Expanets' billing adjustments in its second quarter Form 10-Q.

106. In a September 1, 2002 email to NorthWestern's CFO, Fresia explained his motivation for his belated recommendation that NorthWestern make some disclosure regarding Expanets' billing adjustment exposure as follows:

> We're all working harder than we ever have and we'll get it done, but we need to consider resetting expectations with the Street. I know that we're somewhat painted into a corner by the need to issue equity, but other than the (non-recurring) billing setbacks, Expanets has a great success story in this economy. . . . [W]e don't know each other well and I'm trying to be straight with you. **I tried to create a glide path in the [NorthWestern's second quarter Form] 10Q with that subtle comment on billing adjustments. I wanted to be able to demonstrate (down the road) that we had made a previous disclosure.** (emphasis added)