

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO**

Civil Action No. _____ ()

Securities and Exchange Commission,

Plaintiff,

v.

William L. Eveleth,

Defendant.

Complaint

Plaintiff Securities and Exchange Commission for its complaint alleges as follows:

I. Summary

- 1) In a fraudulent scheme orchestrated to meet at all costs public predictions by senior management of Qwest Communications International Inc. that the company would achieve double-digit revenue growth, defendant, with others, engineered two manipulative transactions for the purpose of inflating materially the company's revenues and overstating its business performance. Defendant, with others, knew Qwest was falling short of quarterly revenue targets for the quarters ending September 30, 2000 and September 30, 2001, respectively. Therefore, defendant, with others, artificially filled this revenue gap through the two transactions described in this complaint.
- 2) The first fraudulent transaction was concocted for the purpose of fraudulently recognizing revenue, in violation of Generally Accepted Accounting Principles

("GAAP"), in the quarter ended September 30, 2000. As a result of the fraudulent transaction, Qwest recognized improperly \$100 million of revenue and claimed \$80 million in earnings before interest, taxes, depreciation, and amortization ("EBITDA") in its quarter ended September 30, 2000. Qwest's September 30, 2000 quarterly report, December 31, 2000 annual report, March 31, 2001 quarterly report, June 30, 2001 quarterly report, September 30, 2001 quarterly report, and December 31, 2001 annual report therefore were all materially false and misleading.

- 3) The second fraudulent transaction was created for the purpose of recognizing revenue, in violation of GAAP, in the quarter ended September 30, 2001. In that quarter Qwest recognized improperly \$85.5 million in revenue from the transaction. As a result, Qwest's September 30, 2001 quarterly report, and December 31, 2001 annual report, were materially false and misleading.
- 4) By this conduct defendant Eveleth violated Section 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 13(b)(5) of the Securities Exchange Act of 1934 ("Exchange Act") and Rules 10b-5 and 13b2-1 thereunder [15 U.S.C. §§ 77q(a), 78j(b), and 78m(b)(5) and 17 C.F.R. §§ 240.10b-5 and 240.13b2-1], and aided and abetted violations of Sections 13(a) and 13(b)(2) of the Exchange Act [15 U.S.C. §§ 78m(a) and 78m(b)(2)] and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11, and 240.13a-13], and unless restrained and enjoined will in the future violate such provisions.
- 5) The Commission brings this action pursuant to the authority conferred upon it by Section 20(b) of the Securities Act [15 U.S.C. § 77t(b)] and Section 21(d) of the Exchange Act [15 U.S.C. §78u(d)] and seeks an order permanently restraining and enjoining defendant from each of the statutory violations set out above pursuant to Section 20(b) of the

Securities Act [15 U.S.C. § 77t(b)] and Section 21(e) of the Exchange Act [15 U.S.C. § 78u(e)] and granting other relief.

- 6) The Commission seeks an order requiring defendant to pay civil penalties pursuant to Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)] and Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)].
- 7) The Commission seeks an order pursuant to the equitable authority of the court requiring disgorgement.
- 8) The Commission seeks an order pursuant to the equitable authority of the court barring defendant Eveleth from being an officer or director of any public company.

II. Jurisdiction and Venue

- 9) This Court has jurisdiction over this action pursuant to Section 22(a) of the Securities Act [15 U.S.C. §77u(a)] and Sections 21(e) and 27 of the Exchange Act [15 U.S.C. §§78u(e) and 78aa]. Venue lies in this Court pursuant to Section 22(a) of the Securities Act and Section 27 of the Exchange Act.
- 10) In connection with the transactions, acts, practices, and courses of business described in this Complaint, defendant, directly and indirectly, has made use of the means or instrumentalities of interstate commerce, of the mails, and/or of the means and instruments of transportation or communication in interstate commerce.
- 11) Certain of the transactions, acts, practices and courses of business constituting the violations of law alleged herein occurred within this district.

III. Defendant

- 12) **William L. Eveleth**, 47, of Gulf Breeze, Florida, began working for Qwest in July 1997, and held various positions with the company until his resignation in January 2004. He held various executive positions at Qwest, including vice president (“VP”) and senior vice president (“SVP”) of financial planning & analysis, and SVP of corporate planning

and operational finance. At all relevant times to this complaint, Eveleth reported to Qwest's chief financial officer. Currently, Eveleth is self-employed and owns a consulting business.

IV. Related Party

- 13) **Qwest Communications International Inc.**, is a telecommunications and Internet services company with its corporate headquarters in Denver, Colorado. Qwest's common stock is registered with the Commission and the company files annual and quarterly reports with the Commission. Qwest common stock is traded on the New York Stock Exchange. During 2000 and 2001, Qwest made public offerings of its securities. Qwest's financial statements were audited by Arthur Andersen, LLP for Qwest's fiscal years ended December 31, 1999, 2000, and 2001.
- 14) **The Global Business Markets** was a unit of Qwest focused on selling Qwest services to businesses within the United States, federal, state and local governments, and global multinational corporations. Global Business Markets had its own revenue and earnings targets, but its earnings and revenues were included in Qwest's consolidated statement of operations.

V. Facts

A. Background

1. Qwest Acquires US West

- 15) Qwest entered into a merger agreement on July 18, 1999, for a reverse acquisition of US West, Inc. The merger was completed on June 30, 2000, and the surviving company, US West, changed its name to Qwest. After the merger, Qwest's executive officers controlled the surviving company. Prior to the merger, US West was a regional Bell operating company, or "baby Bell" local telephone company. Prior to the merger Qwest was a broadband Internet-based data, voice and image communications company. Qwest

was a wholly-owned subsidiary of the Anschutz Company until its initial public offering on June 23, 1997.

2. Qwest Senior Executives Publicly Projected Huge Earnings Growth

- 16) Qwest promoted itself to stock analysts and the investing public as a progressive, new generation technology company not to be compared with the stodgy, old-style telephone company which had been US West. In earnings releases, Qwest emphasized its EBITDA and emphasized the company's enormous projected earnings and revenue growth. Moreover, analysts and investors following Qwest viewed revenue and EBITDA as a good indicator of Qwest's business performance. Qwest senior management publicly predicted double-digit growth every quarter, both prior to and after the completion of the merger.

3. Qwest Senior Management Demanded Their Subordinates Meet Or Exceed Inflated Earnings Objectives At All Costs

- 17) Beginning in mid-1999, Qwest senior executives publicly made aggressive earnings growth projections. This conduct continued after the merger with US West. Further, Qwest senior executives created rigid and inflexible revenue objectives for the various business units of the company, including the Global Business Markets unit. The senior executives also placed extraordinary pressure on their subordinate executives, managers and employees to meet or exceed those earnings objectives at all costs. Management and employee bonuses were largely dependent on Qwest meeting overall its publicly announced revenue targets and individual managers meeting revenue targets for their business units. Qwest officers, executives and employees understood that falling short of revenue projections was not acceptable and could lead to termination. As a result, no Qwest executive, manager, or employee wanted to be the first to cause a division or the company to miss publicly announced revenue expectations.

B. Fraudulent Genuity, Inc. Equipment Sales and Service Contract Engineered by Eveleth and others

1. Summary

- 18) In the third quarter of 2000, Qwest recognized fraudulently \$100 million in revenue based on a September 22, 2000, transaction with Genuity, Inc., an Internet service provider, that provided that Qwest would supply certain equipment and Internet-related services. Despite the understanding of both Qwest and Genuity that the entire transaction for equipment and services was a single arrangement for Internet connectivity, defendant Eveleth, with others, fraudulently split this transaction into two purportedly separate contracts solely for the purpose of allowing the Global Business Markets unit to reach its revenue goals for the quarter ending September 30, 2000. The first contract purported to sell equipment to Genuity for \$100 million. The second contract purported to sell services for \$160 million over five years.
- 19) Qwest's immediate recognition of the \$100 million in revenue did not comply with GAAP. This revenue should not have been recognized immediately because, among other reasons, the risk of loss on the equipment did not transfer to Genuity, Qwest did not substantially accomplish all of the terms of the sales agreement, the revenue apportioned to the equipment sale was not based on the fair value of the equipment, and the equipment sale was part of a related agreement for provision of services.
- 20) Qwest, in violation of GAAP, fraudulently recognized \$100 million of revenue from the equipment sale and \$20.5 million as cost of goods sold in the third quarter of 2000, thereby allowing Qwest to also include EBITDA of approximately \$80 million in its third quarter earnings.
- 21) As a result of this fraudulent transaction, Qwest's September 30, 2000 quarterly report, December 31, 2000 annual report, March 31, 2001 quarterly report, June 30, 2001

quarterly report, September 30, 2001 quarterly report, and December 31, 2001 annual report were all materially false and misleading.

2. The Equipment Sale and Services Contract Were Separated Solely For The Purpose Of Recognizing Fraudulent Revenue

a) Eveleth's Knowledge Of And Participation In The Fraud

- 22) By early September 2000, the Senior Vice President of the Global Business Markets unit (“SVP of Global”) made it clear to the Senior Vice President in Product Development for Qwest Internet Solutions (“SVP in Product Development”) and others that the equipment sale portion of the agreement needed to generate \$100 million in revenue for the third quarter 2000. To implement this fraudulent scheme, at the SVP in Product Development’s suggestion, the SVP of Global decided to split the equipment sales apart from the service portion of the transaction. This was to be done solely for the purpose of recognizing revenue from the purported sale of equipment by the end of the quarter to meet previously announced corporate revenue goals.
- 23) Eveleth approved the structure of the equipment purchase agreement with Genuity and knew that contrary to GAAP, the services contract placed the risk of ownership of the equipment with Qwest.

b) Qwest's Accounting for the Genuity Transaction was Improper

(1) The Contracts Were Inextricably Linked

- 24) Immediate recognition of revenue for the equipment sale was improper under GAAP because the equipment and services were inextricably linked as they were part of a single transaction.
- 25) Eveleth and others knew that the equipment and services contracts with Genuity were in reality part of a single transaction and that the equipment sale and services provisions had

been artificially split in order to justify the immediate recognition of \$100 million of revenue from the equipment side of the transaction.

(2) There Was No Evidence Of Fair Value

- 26) Recognition of the revenue from the equipment sale violated GAAP because there was no evidence the contract price was the fair value of the equipment and because Qwest would lose money on the services contract. The price of the equipment was determined arbitrarily by dividing the number of units sold into the predetermined revenue number of \$100 million. This per unit cost of \$500 per unit was not reasonably related to the market price of such equipment.
- 27) Moreover, Eveleth and others received an e-mail on September 14 from a Qwest financial analyst that cautioned them that immediate revenue recognition might be questioned due to the \$500 per unit price. Eveleth and others knew the price of the equipment was arbitrary and not related to its fair value. They also knew the price was derived solely for the purpose of recognizing immediately \$100 million of revenue.
- 28) The Qwest financial analyst warned Eveleth and another Qwest executive that the services contract, standing alone, would cause Qwest to lose money. Prior to his approval of the contract, Eveleth knew that an analysis of the services contract showed that the net present value of the services contract standing alone was negative \$38 million. Eveleth and the SVP for Global knew that it was not normal business practice for Qwest to enter into a transaction with such a large negative net present value.

(3) Cost of Goods Sold Was Fraudulently Recorded After The Third Quarter of 2000

- 29) Qwest violated GAAP in accounting for the cost of goods sold related to the equipment purchase. In the subsequent quarter, the fourth quarter of 2000, Qwest booked an additional \$17 million in cost of goods sold, for total cost of goods sold associated with

the Genuity equipment sale of approximately \$37.5 million. The additional \$17 million, which should have been booked in the third quarter of 2000, included \$7 million for routers and switches necessary to make the equipment delivered in the third quarter of 2000 fully operational. The remaining \$10 million of cost of goods sold was for equipment originally intended to be used as part of the contracted services to Genuity.

- 30) Eveleth and others knew that the cost of goods sold in the third quarter was understated because they received an e-mail on September 14, 2000, from the Qwest technical accountant on the Genuity transaction expressing a concern about the apparent understatement of the cost of goods sold for the equipment due to the unusually high margin for the transaction.

(4) The Services Agreement Placed Risk of Ownership With Qwest

- 31) Under GAAP, in order for Qwest to recognize any revenue from the sale of the equipment to Genuity, among other things, the risk of ownership of the equipment had to pass to Genuity. The services contract provided that the risks of ownership purportedly transferred to Genuity in the equipment sale were reassumed by Qwest. Specifically, the services agreement stated "... Qwest shall be responsible for safeguarding and protecting such [equipment] from and against all risks of destruction or damage, failures, whether functional, operational or otherwise, and any cost, expenses and liabilities arising therefrom."
- 32) Eveleth and others knew that the services agreement placed the risk of ownership of the equipment with Qwest, but nonetheless caused the recognition of the revenue from the sale in the third quarter of 2000.

3. Financial Statement Impact of Improper Accounting

- 33) Qwest's Form 10-Q for the third quarter of 2000 and Form 10-K for fiscal year 2000 filed with the Commission contained materially false and misleading financial statements as a

result of the Genuity transaction. Qwest announced that the \$4.8 billion in revenue for the third quarter 2000 reflected an increase of 12.4 percent from the same period in the prior year thus meeting the company prediction of double-digit growth every quarter. If the Genuity equipment sale transaction had not been recognized in that quarter, Qwest would have fallen short of its double-digit revenue increase promises by management and had to report revenue growth of 9.8 percent, a material difference given management's earlier promises about revenue growth. In addition, Qwest reported net loss of \$248 million and net income of \$36 million for three and nine months ended September 30, 2000 respectively. The impact of the Genuity transaction resulted in an understatement of the net loss of 32 percent for the three months then ended and an overstatement of net income changing it from a net income to a net loss of \$44 million for the nine months then ended. Qwest also claimed EBITDA of \$1.9 billion and \$5.4 billion in its third quarter earnings press release for the three and nine months ended September 30, 2000, respectively. This amounted to a material overstatement of EBITDA of 4.3 percent and 1.5 percent, respectively, for the periods then ended.

C. Qwest's Fraudulent Transaction With Enron Broadband Services, Inc.

1. Summary

- 34) On October 1, 2001, Qwest and Enron Broadband Services, Inc. ("Enron") executed a transaction under which Qwest and Enron sold assets to each other. Eveleth knew that the transaction had been backdated to September 30, 2001, the last day of the third quarter 2001, so that Qwest could fraudulently recognize revenue in the third quarter in violation of GAAP.
- 35) In connection with the transaction, Eveleth knew that in violation of GAAP, Qwest purchased assets from Enron that Qwest did not need, at higher than market rates, so that

Enron would in turn purchase assets from Qwest upon which Qwest could immediately recognize revenue.

- 36) In connection with the transaction, certain of the assets Qwest purchased from Enron were assets that Qwest had sold previously to Enron, but that Qwest had failed to deliver. Eveleth knew that the transaction was structured to make it appear falsely that Qwest had in fact delivered the assets previously sold to Enron, so that Qwest would avoid reversing, in violation of GAAP, millions of dollars of revenue it had previously recognized.
- 37) Qwest recognized improperly revenue in the amount of \$85.5 million in its quarter ended September 30, 2001, from the fraudulent transaction with Enron. As a result, Qwest's September 30, 2001 quarterly report and December 31, 2001 annual report were materially false and misleading.

2. Eveleth Knew the Enron Contract was Backdated to Demonstrate Falsely Contract Completion

- 38) In 2001, Eveleth acted as Qwest's lead negotiator with respect to Qwest's transaction with Enron dated September 30, 2001. Pursuant to the terms of the transaction, the parties agreed to purchase assets from each other. As lead negotiator, Eveleth knew that neither party would have agreed to the transaction without reciprocal purchases. Pursuant to the terms of the transaction, Qwest sold to Enron fiber-optic capacity (fiber containing equipment necessary to carry telecommunications traffic) from Qwest's fiber-optic network. At the same time, under a separate agreement, Enron sold to Qwest various dark fiber (fiber without equipment necessary to carry telecommunications traffic) routes located in the United States.
- 39) The parties' agreements were not executed until October 1, 2001, the first day of the fourth quarter 2001. Eveleth, however, knew that the agreements had been backdated to

September 30, 2001, so that Qwest could recognize revenue in the third quarter. As a result, Qwest fraudulently recognized \$85.5 million of revenue from the transaction in the third quarter of 2001. Enron recognized revenue from the transaction in the fourth quarter of 2001.

3. Eveleth Caused Qwest To Purchase Assets From Enron That Qwest Did Not Need

- 40) Pursuant to the parties' transaction dated September 30, 2001, Eveleth caused Qwest to purchase dark fiber, and other equipment, related to the dark fiber, from Enron even though Qwest did not have any business use for most of the dark fiber or the equipment. Eveleth knew that the purchase of that dark fiber and equipment from Enron was necessary in order to permit Qwest's sale fiber-optic capacity to Enron, so that Qwest could immediately recognize revenue from the transaction and inflate its reported revenue and earnings. Further, Eveleth knew that Qwest paid millions of dollars in excess of fair market value for Enron's dark fiber routes, so that Enron would in turn purchase fiber-optic capacity from Qwest. Under these circumstances, Eveleth knew that Qwest's recognition of revenue from its sale to Enron violated GAAP.
- 41) In addition, Eveleth assisted in structuring the transaction with Enron dated September 30, 2001, so that Qwest could fraudulently avoid reversing revenue that Qwest had recognized from previous transactions with Enron. By early 2001, Eveleth knew that Qwest had failed to deliver certain assets sold to Enron under previous agreements. Eveleth and others evaluated the issue and determined that pursuant to GAAP, Qwest's failure to deliver required Qwest to reverse millions of dollars of previously recognized revenue. To circumvent GAAP, Eveleth assisted in structuring the transaction dated September 30, 2001, so that Enron "accepted" as delivered the assets Qwest sold under

the previous transactions, and then Qwest immediately bought back its own assets from Enron. Eveleth knew that the delivery by Qwest and acceptance by Enron was a fraud created to avoid the reversal of revenue previously recognized by Qwest.

FIRST CLAIM FOR RELIEF

(Violations of Section 17(a)(1) of the Securities Act)

[15 U.S.C. § 77q(a)(1)]

- 42) Paragraphs 1 through 41 are re-alleged and incorporated by reference.
- 43) Defendant Eveleth, directly or indirectly, with scienter, in the offer or sale of Qwest securities, by use of the means or instruments of transportation or communication in interstate commerce or by use of the mails, have employed a device, scheme, or artifice to defraud in violation of Section 17(a) of the Securities Act.
- 44) By reason of the foregoing, defendant Eveleth violated and unless restrained and enjoined will violate Section 17(a)(1) of the Securities Act.

SECOND CLAIM FOR RELIEF

(Violations of Section 17(a)(2) and 17(a)(3) of the Securities Act)

[15 U.S.C. § 77q(a)(2) and (3)]

- 45) Paragraphs 1 through 44 are re-alleged and incorporated by reference.
- 46) Defendant Eveleth, directly or indirectly, in the offer or sale of Qwest securities, by use of the means or instruments of transportation or communication in interstate commerce or by use of the mails, have obtained money or property by means of untrue statements of material fact or omissions 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 transactions, practices, or courses of business which have been or are operating as a fraud or deceit upon the purchasers of Qwest securities in violation of Sections 17(a)(2) and (a)(3) of the Securities Act.
- 47) By reason of the foregoing, defendant Eveleth violated, and unless restrained and enjoined will violate Sections 17(a)(2) and (3) of the Securities Act.

THIRD CLAIM FOR RELIEF

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

- 48) Paragraphs 1 through 47 are re-alleged and incorporated by reference.
- 49) Defendant Eveleth, directly or indirectly, with scienter, in connection with the purchase or sale of Qwest securities, by use of the means or instrumentalities of interstate commerce or by use of the mails, have employed devices, schemes, or artifices to defraud; have 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 has engaged in acts, practices, or courses of business which have been and are operating as a fraud or deceit upon the purchasers or sellers of such securities in violation of Section 10(b) of the Exchange Act and Rule 10b-5 and aided and abetted such violations.
- 50) By reason of the foregoing, defendant Eveleth violated, and aided and abetted violations and unless restrained and enjoined will violate and aid and abet violations of Section 10(b) of the Exchange Act and Rule 10b-5.

FOURTH CLAIM FOR RELIEF

(Violations of Section 13(b)(5) of the Exchange Act and Rule 13b2-1)
[15 U.S.C. § 78m(b)(5) and 17 C.F.R. § 240.13b2-1]

- 51) Paragraphs 1 through 50 are re-alleged and incorporated by reference.
- 52) Defendant Eveleth 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.
- 53) By reason of the foregoing, Eveleth violated, and unless restrained and enjoined will violate Section 13(b)(5) of the Exchange and Rule 13b2-1.

FIFTH CLAIM FOR RELIEF

(Aiding and Abetting Violations of Section 13(a) of the Exchange Act and
Rules 12b-20, 13a-1, 13a-11, and 13a-13)

[15 U.S.C. § 78 m(a) and 17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11, and 240.13a-13]

- 54) Paragraphs 1 through 53 are re-alleged and incorporated by reference.
- 55) Defendant Eveleth aided and abetted Qwest, as an issuer of a security registered pursuant to Section 12 of the Exchange Act, in filing materially misleading annual and quarterly reports with the Commission and failing to file with the Commission, in accordance with rules and regulations the Commission has prescribed, information and documents required by the Commission to keep current information and documents required in or with an application or registration statement filed pursuant to Section 12 of the Exchange Act and annual reports and quarterly reports as the Commission has prescribed.
- 56) By reason of the foregoing, Eveleth aided and abetted violations of, and unless restrained and enjoined will aid and abet violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13.

SIXTH CLAIM FOR RELIEF

(Aiding and Abetting Violations of Section 13(b)(2) of the Exchange Act)

[15 U.S.C. § 78m(b)(2)]

- 57) Paragraphs 1 through 56 are re-alleged and incorporated by reference.
- 58) Defendant Eveleth aided and abetted Qwest'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 and 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 generally accepted accounting principles or any other criteria applicable to such statements.

59) By reason of the foregoing, Eveleth aided and abetted violations of, and unless restrained and enjoined will aid and abet violations of Section 13(b)(2) of the Exchange Act.

PRAYER FOR RELIEF

The Commission respectfully requests that the Court:

I.

Find that the defendant committed the violations alleged.

II.

Enter an Injunction, in a form consistent with Rule 65(d) of the Federal Rules of Civil Procedure, permanently restraining and enjoining defendant from violating, or aiding and abetting, directly or indirectly, the provisions of law and rules alleged in this complaint.

III.

Order defendant to pay civil penalties, including pre and post-judgment interest, pursuant to Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)] and Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] in an amount to be determined by the Court.

IV.

Order pursuant to its equitable powers that defendant Eveleth be barred from serving as an officer or director of any public company.

V.

Order that defendant pay disgorgement, including pre-judgment and post-judgment interest.

VI.

Grant such other relief as this Court may deem just or appropriate.

Dated: _____

Respectfully submitted,

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