

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

Criminal Case No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

v.

1. JOSEPH P. NACCHIO,

Defendant.

SUPPLEMENT TO GOVERNMENT’S BILL OF PARTICULARS

The United States of America, by and through its undersigned counsel, hereby submits this supplement to its previously filed Bill of Particulars pursuant to the Court’s August 25, 2006 Order [*Dkt # 147*]. The Court ordered the government to further describe the allegations in Paragraphs 6(e) and 8 of the Indictment.

Paragraph 6(e) of the Indictment:

1. “identify the material undisclosed risks ‘relating specifically to Qwest’s recurring and non-recurring revenue streams.’” (Order and Memorandum of Decision [*Dkt # 147*] at 12.)

Material undisclosed risks, in addition to those alleged in paragraph 6 of the indictment and further described in Item 2 of the Bill of Particulars, include the following:

- deteriorating economic conditions in the telecommunications industry were adversely affecting Qwest's financial performance contrary to the defendant's public statements that Qwest's public targets were insulated from the lagging economy.
- In previous years, Qwest had relied on non-recurring revenue sources to offset shortfalls in its recurring revenue performance as compared to internal budgets. In 2001, however, the defendant was aware that Qwest's internal budget forecasted a significant decline in non-recurring revenue for the year – particularly in the third and fourth quarters. The defendant was aware of at least the following factors contributing to Qwest's forecast for decreasing non-recurring revenue:
 - a. Difficulty selling fiber optic capacity unless Qwest would purchase capacity from the other party in transactions referred to as “balanced deals” or “swaps.” In 2001, however, Qwest's fiber optic network was largely complete and therefore Qwest did not have a need to purchase additional capacity which, in turn, made it much more difficult to sell fiber optic capacity in IRU sales.
 - b. Increased scrutiny by regulators and auditors of the revenue accounting on Qwest's capacity sales making up front revenue recognition on Qwest's IRU sales more difficult

- c. Precipitous price declines in the market on capacity sales reducing expected revenue from such sales.
 - d. Fewer Qwest customers having the financial ability to purchase additional fiber optic capacity making it more difficult for Qwest to sell fiber optic capacity.
- In order for Qwest to meet its revenue targets for 2001, it would have to grow its recurring revenue at an amount greater than it had in the past in spite of deteriorating economic conditions in the telecommunications industry. In the past, Qwest had not been able to increase its recurring revenue to achieve its internal business plan. Rather, Qwest met its revenue targets by relying on non-recurring revenue sources, such as IRUs, at the end of each quarter to make up for shortfalls in its recurring revenue performance. As stated above, in 2001 Qwest's internal budgets forecasted a significant reduction in non-recurring revenue that it had relied upon in the past.
 - The 2001 revenue targets communicated to investors were based on overly aggressive internal targets that the defendant imposed on the business units. Due to overly aggressive revenue targets, Qwest business units structured transactions to maximize up front revenue recognition which in turn impacted Qwest's long term economic health and reduced future income and revenue generation.

2. “[I]dentify what way the risks themselves put the financial targets in jeopardy.”
(Order and Memorandum of Decision [*Dkt # 147*] at 13.)

In order to achieve Qwest’s revenue targets for 2001, Qwest needed to grow its recurring revenue at an amount that it had not done in the past in spite of deteriorating economic conditions in the telecommunications industry. Moreover, because Qwest’s internal projections forecast a precipitous decline in non-recurring revenue in 2001, Qwest would not be able to rely on non-recurring revenue to make up for the recurring revenue shortfall to meet its revenue targets as it had in prior years. Further compounding these risks, if Qwest’s recurring business did not achieve the required growth from the beginning of 2001, Qwest would miss its revenue targets in the third and fourth quarters because of the nature of the growth projections quarter over quarter. This is due to the fact that (1) declining non-recurring revenue required recurring revenue to increase at a greater rate than total revenue to offset the non-recurring decline, and (2) if recurring revenue did not grow according to plan in the first quarter, the rate of growth in subsequent quarters would have to be even greater to make up for the first quarter miss.

Paragraph 8 of the Indictment:

“[I]dentify additional material non-public information Defendant learned in January of 2001.” (Order and Memorandum of Decision [*Dkt # 147*] at 15.)

The allegation is that as the defendant became aware of the material non-public information alleged in Paragraph 6 of the Indictment and further described in the Bill of Particulars, he accelerated his sales of Qwest stock. The alleged acceleration of his sales based upon the alleged inside information began in January of 2001. The allegation is not intended to mean that the defendant accelerated his sales of Qwest stock based upon information that he became aware of in January. In January 2001, however, the defendant was informed of additional information indicating that the alleged material non-public information was very important to investors. Specifically, he was told that investors were scrutinizing how Qwest would achieve its 2001 targets in spite of problems in the telecommunications industry and the economy as a whole. He was also informed that investors were requesting more visibility into the makeup of Qwest’s revenue numbers.

Respectfully submitted this 11th day of September, 2006.

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CERTIFICATE OF SERVICE

I hereby certify that on this 11th day of September, 2006, I electronically filed the foregoing **SUPPLEMENT TO GOVERNMENT'S BILL OF PARTICULARS** with the Clerk of the Court using the CM/ECF system which will send notification of such filing to the following e-mail addresses:

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