NO. 07-1311

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

UNITED STATES OF AMERICA,

Plaintiff-Appellee,

v.

JOSEPH P. NACCHIO,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
THE HONORABLE JUDGE NOTTINGHAM
DISTRICT COURT NO. 1:05-cr-00545-EWN

APPELLANT'S OPENING BRIEF

Herbert J. Stern
Jeffrey Speiser
STERN & KILCULLEN
75 Livingston Avenue
Roseland, New Jersey 07068
(973) 535-1900 (telephone)
(973) 535-9664 (facsimile)

Maureen E. Mahoney
Alexandra A.E. Shapiro
J. Scott Ballenger
Nathan H. Seltzer
LATHAM & WATKINS LLP
555 11th Street, N.W.
Suite 1000
Washington, DC 20004
(202) 637-2200 (telephone)
(202) 637-2201 (facsimile)
Maureen.Mahoney@lw.com

Counsel for Defendant-Appellant

Dated: October 9, 2007

Oral Argument Scheduled For December 18, 2007
Includes Attachments in Digital and Scanned PDF Format

TABLE OF CONTENTS

TABLE OF CONTENTS i

TABLE OF AUTHORITIES ii

STATEMENT OF PRIOR OR RELATED CASES ix

JURISDICTIONAL STATEMENT 1

ISSUES FOR REVIEW 1

STATEMENT OF THE CASE 1

STATEMENT OF FACTS 3

SUMMARY OF ARGUMENT 6

I. THE EVIDENCE WAS INSUFFICIENT 10

- A. Nacchio Did Not Trade Because Of Inside Information 11
- B. The Omissions At Issue Were Not Material 15
- C. Nacchio Did Not Know The Information Was Material 28

II. ERRONEOUS JURY INSTRUCTIONS REQUIRE A NEW TRIAL 31

- A. The Jury Was Given No Guidance On The Materiality Of Omissions Relating To Financial Projections 32
- B. The Flawed Good Faith Instruction Requires A New Trial 38

III. THE EXCLUSION OF PROFESSOR FISCHEL'S EXPERT OPINION TESTIMONY WAS REVERSIBLE ERROR 39

- A. Fischel's Proposed Testimony Was Critical To The Defense 40
- B. The Exclusion Was Reversible Error 43

IV. THE COURT MISINTERPRETED RULE 16 AND CIPA 50

V. THE SENTENCE SHOULD BE REDUCED 50

- A. The Court's Guideline Interpretation Was Erroneous 50
- B. The Forfeiture Analysis Was Wrong 54

CONCLUSION 57

TABLE OF AUTHORITIES

CASES

Page(s)

Alexander v. United States,
509 U.S. 544 (1993) 54

Arthur Andersen LLP v. United States,
544 U.S. 696 (2005) 38

Basic Inc. v. Levinson,
485 U.S. 224 (1988) 6, 15, 35

Cheek v. United States,
498 U.S. 192 (1991) 42, 43

City of Philadelphia v. Fleming Cos.,
264 F.3d 1245 (10th Cir. 2001) 24, 28

Daubert v. Merrell Dow Pharmaceuticals, Inc.,
509 U.S. 579 (1993) 10, 46

Dodge v. Cotter Corp.,
328 F.3d 1212 (10th Cir. 2003) 44, 45, 46

Garcia v. Cordova,
930 F.2d 826 (10th Cir. 1991) 34

Grossman v. Novell, Inc.,
120 F.3d 1112 (10th Cir. 1997) 9, 16, 25, 27, 35, 37

Harris v. Union Electric Co.,
787 F.2d 355 (8th Cir. 1986) 41

Hillson Partners Limited Partnership v. Adage, Inc.,
42 F.3d 204 (4th Cir. 1994) 17

In re Apple Computer, Inc. (Hawaii Structural Iron Workers Pension Trust Fund v. Apple Computer, Inc.), 127 Fed. Appx. 296 (9th Cir. 2005) 7, 17, 24

In re Apple Computer Securities Litigation,
886 F.2d 1109 (9th Cir. 1989) 15

Page(s)

In re Burlington Coat Factory Securities Litigation,
114 F.3d 1410 (3d Cir. 1997) 27

In re Craftmatic Securities Litigation,
890 F.2d 628 (3d Cir. 1989) 25

In re Healthcare Compare Corp. Securities Litigation,
75 F.3d 276 (7th Cir. 1996) 17

In re Merck & Co. Securities Litigation,
432 F.3d 261 (3d Cir. 2005) 27

In re Worlds of Wonder Securities Litigation (Miller v. Pezzani),
35 F.3d 1407 (9th Cir. 1994) 13, 14, 19, 25, 49

Isquith v. Middle South Utilities,
847 F.2d 186 (5th Cir. 1988) 16

Kowal v. MCI Communications Corp.,
16 F.3d 1271 (D.C. Cir. 1994) 16, 17

Krim v. BancTexas Group, Inc.,
989 F.2d 1435 (5th Cir. 1993) 17, 27

Kumho Tire Co. v. Carmichael,
526 U.S. 137 (1999) 45, 46

Malone v. Microdyne Corp.,
26 F.3d 471 (4th Cir. 1994) 16

Marx v. Computer Sciences Corp.,
507 F.2d 485 (9th Cir. 1974) 16

Miller v. Asensio & Co.,
364 F.3d 223 (4th Cir. 2004) 41

Mitchell v. Maynard,
80 F.3d 1433 (10th Cir. 1996) 57

Petruzzi's IGA Supermarkets, Inc. v. Darling-Delaware Co.,
998 F.2d 1224 (3d Cir. 1993) 50

Page(s)

Provenz v. Miller,
102 F.3d 1478 (9th Cir. 1996) 16

Quiet Tech. DC-8, Inc. v. Hurel-Dubois UK Ltd.,
326 F.3d 1333 (11th Cir. 2003) 40

Rubinstein v. Collins,
20 F.3d 160 (5th Cir. 1994) 35

Safeco Insurance Co. of America v. Burr,
127 S. Ct. 2201 (2007) 28

Scheidler v. NOW,
537 U.S. 393 (2003) 57

Schwartz v. System Software Associates, Inc.,
32 F.3d 284 (7th Cir. 1994) 34

SEC v. Adler,
137 F.3d 1325 (11th Cir. 1998) 13

SEC v. Happ,
392 F.3d 12 (1st Cir. 2004) 52

SEC v. Peters,
978 F.2d 1162 (10th Cir. 1992) 48

SEC v. U.S. Environmental, Inc.,
No. 94Civ.6608, 2002 WL. 31323832 (S.D.N.Y. Oct. 16, 2002) 49

Shad v. Dean Witter Reynolds, Inc.,
799 F.2d 525 (9th Cir. 1986) 49

Shaw v. Digital Equipment Corp.,
82 F.3d 1194 (1st Cir. 1996) 7, 18, 24, 27, 34

Smith v. Ingersoll-Rand Co.,
214 F.3d 1235 (10th Cir. 2000) 45, 46

Stransky v. Cummins Engine Co.,
51 F.3d 1329 (7th Cir. 1995) 16, 17

Page(s)

Taylor v. Illinois,
484 U.S. 400 (1988) 40

TRW, Inc. v. Andrews,
534 U.S. 19 (2001) 56

TSC Industries, Inc. v. Northway, Inc.,
426 U.S. 438 (1976) 15

Unger v. Amedisys,
401 F.3d 316 (5th Cir. 2005) 41, 49

United States v. All Funds on Deposit in United Bank of Switzerland,
188 F. Supp. 2d 407 (S.D.N.Y. 2002) 55

United States v. Bilzerian,
926 F.2d 1285 (2d Cir. 1991) 49

United States v. Booker,
543 U.S. 220 (2005) 53

United States v. Bowen,
437 F.3d 1009 (10th Cir. 2006) 8, 9

United States v. Brawner,
173 F.3d 966 (6th Cir. 1999) 49

United States v. Brown,
411 F.2d 1134 (10th Cir. 1969) 43

United States v. Crockett,
435 F.3d 1305 (10th Cir. 2006) 32

United States v. Finley,
301 F.3d 1000 (9th Cir. 2002) 45

United States v. Fox,
902 F.2d 1508 (10th Cir. 1990) 10, 11

Page(s)

United States v. Garber,
607 F.2d 92 (5th Cir. 1979) 43

United States v. Gay,
240 F.3d 1222 (10th Cir. 2001) 54

United States v. Herndon,
982 F.2d 1411 (10th Cir. 1992) 55

United States v. Hurn,
368 F.3d 1359 (11th Cir. 2004) 42

United States v. Jackson,
51 F.3d 646 (7th Cir. 1995) 44

United States v. Lake,
472 F.3d 1247 (10th Cir. 2007) 8, 29, 37, 38

United States v. Lankford,
955 F.2d 1545 (11th Cir. 1992) 42, 43, 48

United States v. Lueben,
812 F.2d 179 (5th Cir.), *vacated in part on other grounds*, 816 F.2d 1032 (5th Cir. 1987) 48

United States v. Mooney,
425 F.3d 1093 (8th Cir. 2005) 51, 52, 53

United States v. Neujahr,
No. 97-4260, 1999 U.S. App. LEXIS 3770 (4th Cir. Mar. 10, 1999) 43

United States v. Novey,
78 F.3d 1483 (10th Cir. 1996) 52

United States v. Parshall,
757 F.2d 211 (8th Cir. 1985) 43, 48

United States v. Payne,
978 F.2d 1177 (10th Cir. 1992) 43

Page(s)

United States v. Powell,
955 F.2d 1206 (9th Cir. 1991) ... 43

United States v. Quattrone,
441 F.3d 153 (2d Cir. 2006) ... 57

United States v. Rahseparian,
231 F.3d 1257 (10th Cir. 2000) ... 10, 15

United States v. Ritchie,
342 F.3d 903 (9th Cir. 2003) ... 55

United States v. Roberts,
88 F.3d 872 (10th Cir. 1996) ... 50

United States v. Robertson,
350 F.3d 1109 (10th Cir. 2003) ... 51

United States v. Rodriguez-Felix,
450 F.3d 1117 (10th Cir. 2006) ... 40

United States v. Russo,
74 F.3d 1383 (2d Cir. 1996) ... 41

United States v. Sandoval,
390 F.3d 1294 (10th Cir. 2004) ... 45

United States v. Sellers,
566 F.2d 884 (4th Cir. 1977) ... 48

United States v. Smith,
155 F.3d 1051 (9th Cir. 1998) ... 13, 35

United States v. Sternstein,
596 F.2d 528 (2d Cir. 1979) ... 43

United States v. Velarde,
214 F.3d 1204 (10th Cir. 2000) ... 40, 46

United States v. Victor Teicher & Co., L.P.,
1990 U.S. Dist. LEXIS 2620 (S.D.N.Y. Mar. 9, 1990) ... 48

Page(s)

United States v. Weidner,
437 F.3d 1023 (10th Cir. 2006) ... 54

Wedelstedt v. Wiley,
477 F.3d 1160 (10th Cir. 2007) ... 55

Wielgos v. Commonwealth Edison Co.,
892 F.2d 509 (7th Cir. 1989) ... 7, 16, 17, 18, 34

STATUTES AND REGULATIONS

15 U.S.C. §78j ... 3

15 U.S.C. §78ff ... 3

18 U.S.C. §981(a)(2) ... 54

18 U.S.C. §3553(a)(6) ... 53

18 U.S.C. §3742 ... 1

28 U.S.C. §991(b) ... 53

28 U.S.C. §1291 ... 1

17 C.F.R. §230.175(a) ... 16

17 C.F.R. §240.3b-6 ... 7, 16, 17

17 C.F.R. §240.10b-5 ... 3

17 C.F.R. §240.10b5-1 ... 3, 12

OTHER AUTHORITY

Black's Law Dictionary (8th ed. 2004) ... 56

7-107 E. Michael Bradley & Anthony L. Paccione, *Securities Law Techniques*
(Matthew Bender ed., 2007) ... 41

Page(s)

3 Alan R. Bromberg & Lewis D. Lowenfels, *Bromberg & Lowenfels on Securities Fraud & Commodities Fraud* (2d ed. 2007) 40, 41

5 *Business & Commercial Litigation in Federal Courts* (Robert L. Haig ed., 2005) 40

Eleventh Circuit Pattern Jury Instructions (Civil Cases), Instruction 4.2 (2005) 34

Fed. R. Evid. 702, advisory committee's notes to 2000 amends. 42, 46

Modern Federal Jury Instructions – Pattern Jury Instructions (Civil), Ninth Circuit (Matthew Bender ed., 2007) 34

SEC Release Nos. 33-5992, 34-15305, 43 Fed. Reg. 53,246 (Nov. 15, 1978) 16

1 David B. Smith, *Prosecution and Defense of Forfeiture Cases* (2007) 56, 57

7 Louis Loss & Joel Seligman, *Securities Regulation* (3d ed. 1991) 34

4 Jack B. Weinstein & Margaret A. Burger, *Weinstein's Federal Evidence* (2d ed. 2007) 50

STATEMENT OF PRIOR OR RELATED CASES

United States v. Nacchio, appeal docketed, No. 07-1311 (10th Cir. Aug. 2, 2007) (granting application for release pending appeal).

JURISDICTIONAL STATEMENT

The district court entered judgment on August 3, 2007. Nacchio filed a timely notice of appeal on August 10, 2007. This Court has jurisdiction under 28 U.S.C. §1291 and 18 U.S.C. §3742.

ISSUES FOR REVIEW

1. Whether Defendant is entitled to an acquittal because the evidence was insufficient.

2. Whether Defendant is entitled to a new trial because:

   (a) the jury was improperly instructed on the elements of materiality and scienter;

   (b) expert opinion testimony was erroneously excluded; and

   (c) classified information was erroneously shielded from discovery and excluded from evidence.

3. Whether the sentence must be reduced because the district court erroneously calculated the sentencing guidelines range and the amount of forfeiture.

STATEMENT OF THE CASE

The indictment, trial, and conviction of Joseph P. Nacchio took place in an atmosphere of prejudgment and vitriol. In 2001 and 2002, shares of Qwest Communications International ("Qwest")—one of Denver's largest employers—fell sharply, as the once high-growth telecommunications industry slowed and Qwest announced an accounting restatement. Many shareholders lost paper fortunes, employees

lost jobs as the company downsized, and all demanded someone to blame.[1] That person, it turned out, was the man who built Qwest into a telecommunications giant, and who, despite the vicissitudes of the stock market and the economy, believed more than anyone else in the company's future.

After years of investigation, prosecutors apparently concluded that they could not prove any crime based on the accounting restatement, and settled on insider trading. Their theory was that Qwest's public financial projections for year-end 2001, first issued in September 2000 and reaffirmed several times into the spring of 2001, were "risky," and that Nacchio traded in Qwest stock on the basis of that inside knowledge. Yet the prosecution did not charge Nacchio, or Qwest, with making material misstatements when they issued and continually reaffirmed those projections. The prosecution did not allege that Nacchio misled investors, but that he traded on the basis of knowledge that he was misleading them. By dressing up a misleading statements case as an insider-trading case, it sought to avoid settled legal rules that narrowly limit charges of fraud based on financial projections that do not pan out.

This is an unprecedented prosecution. Insider trading cases invariably charge executives with trading ahead of merger news or imminent quarterly earnings announcements, or on the basis of some other "hard" inside information. The extraordinary charges here are based on the claim that Nacchio knew, eight months or

---

[1] Nacchio has been accosted on Denver streets by a person hoping he would "get cancer and die," depicted on the web site of the Denver Post alongside Stalinist North Korean dictator Kim Jong Il, and gloated over by the U.S. Attorney for the District of Colorado, who boasted, "'Convicted felon Joe Nacchio' has a very nice ring to it." *See* Appendix filed herewith ("APP-") 775, 782, 785.

more in advance, that Qwest *might* not make its year-end 2001 financial projections. Counsel is aware of no other case where the government has predicated a criminal charge of insider trading on predictions about financial results for future quarters. This prosecution is even more extraordinary in that the government presented *no* evidence of *any* internal forecast or *any* statement by any Qwest executive warning, at the time of Nacchio's trades, that Qwest would not make its public projections. The prosecution yoked an unprecedented theory to plainly insufficient facts, and hoped, in a bitter and vindictive atmosphere, that it would be enough to win a conviction from a Denver jury. It was.

STATEMENT OF FACTS

1. The indictment charged forty-two counts of insider trading in violation of 15 U.S.C. §§78j and 78ff, and 17 C.F.R. §§240.10b-5 and 240.10b5-1, and alleged that Nacchio sold Qwest stock between January and May 2001 "while aware of and on the basis of material, non-public information." APP-67. The prosecution's *only* theory of materiality, in the indictment and at trial, was that Nacchio knew that Qwest's "publicly stated financial targets" were "risky" and "aggressive." *E.g.*, APP-65–66.

Before trial, Nacchio sought a change of venue because the atmosphere in Denver had become pervasively prejudicial. APP-103–45. The motion demonstrated that the Denver press frequently published vindictive comments about Nacchio from former Qwest employees, as it continued to do throughout the trial. *Id.* The district court denied the motion. APP-189.

2. The trial spanned a month. The central facts, detailed in Section I below, were not in genuine dispute. This case instead turns on what inferences can be drawn beyond a reasonable doubt.

In summary, Nacchio announced in October of 2000 that he would begin exercising and selling one million stock options per quarter because the board was unable to extend the options' June 2003 expiration date. APP-1928–29. Thereafter, some Qwest employees expressed doubt about whether Qwest could achieve its *internal* revenue targets for year-end 2001. APP-2132–34, 2492, 2581. Those targets, at their peak, exceeded the public projections by $700 million. APP-2369.

Despite the pessimists, Qwest's revenues met public expectations in the first and second quarters, and nearly equaled the internal targets. APP-2309–10. There were further internal debates, however. Subscriber revenues were weaker than hoped, and 8% of first-quarter revenues came from sales of capacity on Qwest's fiber optic network, known as indefeasible rights of use (IRUs). APP-4860, 2754. One manager predicted that demand for IRUs would "dry[] up" by year end. APP-2581.

In April, Qwest's managers produced an internal estimate forecasting that Qwest would fall short of its internal target for the year, *but meet its public projections*. APP-5001, 2323. Shortly thereafter, Nacchio made the trades in question, in conformity with the plan announced in October 2000. Several months later, Qwest disclosed the percentage of its IRU revenues and reduced its public guidance. APP-4860, 4933.

The government had to prove that Nacchio knew he had material inside information. Although Nacchio allegedly believed the stock would drop if Qwest did not

meet its projections, APP-4477–79, no one at Qwest advised Nacchio, at the time of the relevant trades, to lower the public projections or that the internal budget debates or revenue mix constituted material information that had to be disclosed before trading. Qwest's general counsel knew the details of these issues and represented that Nacchio did not have material inside information when he traded in May. *See* APP-5157, 5172.

Nacchio sought to introduce expert testimony on materiality and scienter and to obtain evidence related to classified government IRUs that he believed Qwest would receive in 2001. The court thwarted him on both fronts. It declined to permit Professor Daniel Fischel to testify as an expert witness, shielded important classified information from discovery, and excluded it from the trial.

Nacchio moved for a judgment of acquittal at the close of the prosecution's case and after all the evidence. APP-3776, 4326. The district court denied both motions. APP-3808, 4326. Nacchio also objected to the district court's jury instructions on materiality and scienter. APP-4169–70, 4179.

3. Nacchio was acquitted on twenty-three counts covering trades from January 2 to March 1, 2001, and convicted on nineteen counts covering trades between April 26 and May 29, 2001. Nacchio moved again for a judgment of acquittal, new trial, and change of venue. APP-767–92, 1252–55.

The court sentenced Nacchio to six years' imprisonment, fined him $19 million, and ordered forfeiture of $52,007,545.47. APP-1368, 1371–72. The district court denied Nacchio's motion for release pending appeal. This Court granted release.

SUMMARY OF ARGUMENT

1. Nacchio is entitled to an acquittal. The evidence was insufficient to permit the jury to find beyond a reasonable doubt that any undisclosed information was material, that Nacchio knew it was material, or that he traded because of that information.

First, Nacchio told the public six months in advance that he would make the trades at issue because these options were expiring in June 2003 and could not be extended. The government did not even contend that Nacchio had any inside information at the time he announced this plan. It instead asked the jury to surmise—without a shred of evidence—that Nacchio's motivation had secretly shifted to a desire to bail out of Qwest stock in anticipation of an impending collapse. That illogical conjecture cannot support an inference of *mens rea*.

Second, the *only* theory of materiality charged in the indictment or presented at trial was that Nacchio was aware of an undisclosed degree of "risk" concerning Qwest's year-end 2001 financial projections, eight months into the future. Nacchio's supposed inside information concerning that "risk" came from internal debates about the likelihood of reaching higher *internal* budget targets, and from predictions about the market for IRUs. Assessing the materiality of information about uncertain future events requires at least "'a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.'" *Basic Inc. v. Levinson*, 485 U.S. 224, 238 (1988) (citation omitted). During the quarter when Nacchio traded, the company met market expectations and the internal debates and forecasts suggested only some uncertain possibility, eight months away, that Qwest

would miss its year-end public projections by only a small amount—likely less than 1.5%. Indeed, Qwest managers did not recommend that the projections should be reduced until months after Nacchio's last trade. Risks like these are understood by investors and immaterial as a matter of law even in a civil case. *See, e.g., Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1211 & n.21 (1st Cir. 1996) (evidence suggesting a future earnings decline is immaterial unless the end of the reporting period is imminent and the executive has "hard" inside information showing that the results will be an "extreme departure" from what the public expects); *In re Apple Computer, Inc. (Haw. Structural Iron Workers Pension Trust Fund v. Apple Computer, Inc.)*, 127 Fed. Appx. 296, 304 (9th Cir. 2005) ("[A] revenue estimate that was missed by approximately 10% was immaterial as a matter of law.").

Courts and the SEC have also developed specific rules governing when information relating to financial projections can be considered "material," because the risks of applying 20/20 hindsight are so severe. If a company has a good faith reasonable basis for its public projections, then undisclosed assumptions or risks relating to the projections, and even conflicting internal estimates, are immaterial as a matter of law. *See* 17 C.F.R. §240.3b-6; *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 513 (7th Cir. 1989). "Any firm generates a range of estimates internally or through consultants," but a company (or an insider) is not liable for trading without revealing "tentative internal estimates, even though they conflict with published estimates, unless the internal estimates are so certain that they reveal the published figures as materially misleading." *Wielgos*, 892 F.2d at 515-16. Nacchio clearly had a good faith reasonable basis for

Qwest's public projections at the time of these trades. The prosecution's theory is that he was nonetheless required to disclose the particular revenue mix assumptions underlying those projections, or internal doubts or conflicting estimates prepared by certain Qwest managers. That is inconsistent with settled law.

Third, there is insufficient evidence that Nacchio *knew* that he had any "material" information that had to be disclosed prior to trading. All of the direct evidence (including his own trading decisions) shows that Nacchio was bullish and believed Qwest stock was undervalued throughout this period. Nacchio also knew that the general counsel, the audit committee, and Qwest's outside auditors determined—during this same time period—that the information at issue *was not* material. Indeed, the general counsel expressly approved many of the trades that formed the basis for the conviction.

2. At a minimum, a new trial is required. This Court reviews *de novo* whether "instructions correctly stated the governing law *and* provided the jury with *an ample understanding of the issues and applicable standards*." *United States v. Bowen*, 437 F.3d 1009, 1016 (10th Cir. 2006).[2] In *United States v. Lake*, 472 F.3d 1247, 1262–63 (2007), this Court reversed a fraud conviction because the instructions failed to inform the jury of SEC rules that were relevant to a fair understanding of the defendants' state of mind. The errors and omissions here were even more prejudicial.

The court left the jury on its own to decide what information was "important" to investors and refused to instruct the jury to apply the specific rules governing the materiality of information related to forward-looking statements. As a consequence, the

[2] All emphases are added unless noted.

jury could have convicted Nacchio for failing to disclose internal debates *even if it determined that he reasonably believed that Qwest would meet its projections*. The court also refused to instruct the jury that Qwest's cautionary statements must be considered, flatly refusing to follow this Court's holding that cautionary language is a "valid defense to a securities fraud claim in the Tenth Circuit," and "cannot be ignored in construing the materiality of optimistic predictions." *Grossman v. Novell, Inc.*, 120 F.3d 1112, 1121 (10th Cir. 1997). The court reasoned that all of these principles are only relevant to cases charging *false statements*—not *insider trading*. But these rules stem from materiality principles (and binding SEC regulations) that apply to any theory of liability under the federal securities laws. Rather than charging Nacchio with willfully defrauding investors by issuing materially misleading projections, the government charged him with willfully defrauding investors by *trading* when he knew that those projections were materially misleading. That reformulation does not change the materiality inquiry. Instructions that do not inform the jury of legal rules that constitute a "valid defense" to "securities fraud," *id.*, do not convey "an ample understanding" of the "applicable standards," *Bowen*, 437 F.3d at 1016.

The court compounded those errors by instructing the jury that Qwest's disclosure obligations and Nacchio's were not the same—which wrongly directed the jury to ignore the relevance to Nacchio's state of mind of how others at Qwest (such as the general counsel and the audit committee) were assessing Qwest's own obligations at the time. It also wrongly instructed the jury that "good faith" is inconsistent with *any* dishonest act, which opened the door for the prosecution to argue (and argue it did, with great zeal) that

the jury could convict Nacchio based on dishonest acts having nothing to do with the crime actually charged.

3. The court also excluded Nacchio's nationally-recognized expert on the materiality of financial information on the unprecedented ground that Nacchio's Rule 16 statement (a routine disclosure exchanged in discovery and not even filed with the court) failed to establish the reliability of the testimony under Rule 702 and *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579 (1993). Its alternative holding that expert testimony on materiality would not assist the jury contravenes settled law. It compounded those errors by allowing the *government*'s witnesses to opine about materiality without permitting rebuttal testimony.

4. The court's errors under Classified Information Procedures Act ("CIPA") are discussed in a classified supplement.

5. Finally, the court's sentencing calculations wrongly punished Nacchio for the normal appreciation in Qwest's shares from 1997 to 2001, which had nothing to do with the offense charged: failing to disclose material information prior to trading. It also applied the wrong subsection of the forfeiture statute.

I. THE EVIDENCE WAS INSUFFICIENT

This Court reviews the sufficiency of the evidence *de novo*. *United States v. Rahseparian*, 231 F.3d 1257, 1261-62 (10th Cir. 2000). Nacchio must be acquitted unless, as to each element, the evidence is "such that a reasonable jury could find the defendant guilty beyond a reasonable doubt." *United States v. Fox*, 902 F.2d 1508, 1513

(10th Cir. 1990). Where the "evidence is equally consistent with both guilt and innocence the conviction cannot be sustained." *Id.* at 1513–14.

The prosecution's evidence fell short in three ways: it failed to demonstrate that Nacchio traded on the basis of inside information; that any undisclosed information in Nacchio's possession was material; or that Nacchio knew that information was material and intended to violate the law.

A. Nacchio Did Not Trade Because Of Inside Information

1. Nearly six months before the trades at issue, Nacchio told investors *exactly* why he was going to sell a large volume of stock in the second quarter of 2001. Nacchio held more than 7.4 million $5.50 options that would expire in June 2003. He did not want to sell them and asked the board to extend the term. APP-1929–30. For accounting reasons, the board was unable to do so. APP-1855–56, 1925, 1930. In order to protect Qwest by spreading the sales over time, APP-1879, Nacchio announced in October 2000 that he would begin exercising and selling one million options per quarter (so long as the price was reasonable, APP-2958), but that he would not sell any of his vast holdings that did not have a sunset problem. APP-1929. There is no contention that Nacchio had material adverse information at that time, and indeed the jury acquitted him of any wrongdoing in connection with his sales through March of the next year. *See* APP-1392 (gov't opening) ("[I]n December 2000, Mr. Nacchio learned of problems that Qwest would be facing in 2001.").

All of Nacchio's trades in the succeeding months were consistent with his stated intentions. Qwest policy only permitted trades during short "trading windows" following

the announcement of quarterly earnings. APP-1879. Nacchio accordingly exercised options and sold during the fourth-quarter 2000 and first-quarter 2001 trading windows. On February 15, 2001, Nacchio entered into an automatic sales plan pursuant to SEC Rule 10b5-1 which instructed his broker to exercise 11,500 options and sell the corresponding shares each trading day.[3] APP-5142. That automatic plan allowed sales outside the otherwise limited trading windows, and would have spread the sales over two and a half years.

When Qwest's stock fell below $38 on March 1, Nacchio canceled the 10b5-1 plan and announced that he would not sell at that price. APP-1890–91, 3742, 4803. The stock rebounded and Nacchio resumed sales when the trading window reopened in April 2001—selling 1.2 million shares—but still not enough to reach the target set in October. APP-4765; APP-4760-61. At the close of the second-quarter trading window in May, Nacchio entered into a second 10b5-1 plan to exercise 10,000 options per day as long as the stock price was at least $38—a floor Nacchio included because he expected the price to rise. APP-2000, 3044, 5158–59. After May 29, 2001, Qwest's stock price fell below $38 and remained there. APP-4761–63. Nacchio never sold another share. In 2001, he held on to more than 9 million vested options and more than 500,000 shares, and ended the year with more vested options than he had at the beginning. APP-4765a. At the end of May, the value of his vested options alone exceeded $90 million. APP-4761; APP-4765.

[3] Rule 10b5-1 provides a safe harbor for trades made according to a predetermined plan, if the insider enters the plan while not aware of material inside information. *See* 17 C.F.R. §240.10b5-1.

The government's witnesses testified without contradiction that Nacchio believed Qwest's shares were underpriced. Nacchio's financial adviser described Nacchio as "entirely and completely bullish" through at least August 2001. APP-3014–15, 3017–18, 3030–31, 3041–44. When Qwest's stock price declined in 2001, Nacchio continued to maintain that Qwest, and the industry, would recover. APP-3030–31.

2. "It is the insider's use, not his possession, that gives rise to an informational advantage and the requisite intent to defraud." *United States v. Smith*, 155 F.3d 1051, 1068 (9th Cir. 1998); *see also SEC v. Adler*, 137 F.3d 1325, 1338 (11th Cir. 1998). The prosecution's theory was that Nacchio's original motivation to spread out his sales somehow became a desire to unload Qwest stock in advance of collapse. But the sole evidence for that theory is that Nacchio (1) sold more shares in 2001 than in previous periods and (2) sold more shares in April and May than he would have sold if he continued the February sales plan.

The first observation proves nothing. Nacchio's October announcement explained why upcoming sales would depart from prior trading patterns. *See In re Worlds of Wonder Sec. Litig. (Miller v. Pezzani)*, 35 F.3d 1407, 1427-28 (9th Cir. 1994) (fact that defendants "provided credible and wholly innocent explanations for [their] stock sales" and that trades were consistent with a previously announced plan "conclusively rebut[s]" any inference of scienter) (internal quotation marks omitted).

The second observation fares no better. Nacchio canceled the February plan because it forced him to sell below $38, and he expected Qwest's share price to rise. APP-3044. After canceling the plan, Nacchio was once again restricted to selling his

million shares per quarter within narrow trading windows, which is exactly what he did in April. Of course that meant he made more sales *during the window* than he would have made if he had not stopped the automatic daily sales plan. The relevant comparison is that Nacchio's sales from the time of his announcement in October even through his last trade averaged less than the one million shares per quarter he planned in advance to sell. *See* APP-4764–65.

Moreover, the prosecution's theory—that Nacchio canceled the February plan not because it forced him to sell below $38, but in order to dump stock faster, APP-4273, 4508–09—is highly implausible. Nacchio would somehow had to have known on March 1 that the stock price would be above $38 seven weeks later during a narrow 21-day trading window and then collapse. No one can predict stock prices with that kind of precision. And Nacchio could not have known whether Qwest would even meet market expectations for the first quarter because he canceled the plan a month before the end of the quarter. Qwest never knew whether it would meet its targets until the last two weeks of the quarter, APP-3351–52, and this quarter was no exception, *see* APP-3370; APP-4998 (COO Mohebbi "came close to a heart attack twice" about meeting first-quarter expectations).

Nacchio's trading patterns demonstrated that he thought Qwest's stock price was too low—a fact consistent with Nacchio's own explanation for his sales, and entirely inconsistent with the prosecution's claim that he sold because he knew Qwest was a "house of cards." *See, e.g.*, APP-4221, 4256, 4263–64; *see also In re Worlds of Wonder*, 35 F.3d at 1427 (no inference of scienter where defendants sold only a fraction of their

holdings and "ended up reaping the same large losses as did Plaintiffs when [the company] collapsed") (internal quotation marks omitted); *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1118 (9th Cir. 1989) (refusing to infer scienter where "defendants retained the great bulk of their … holdings, and held on in the face of a decline in value of almost 75%"). A reasonable jury simply could not infer beyond a reasonable doubt that Nacchio sold in order to bail out of Qwest. *See Rahseparian*, 231 F.3d at 1264 (a jury "may draw an inference only where that inference can be made *beyond a reasonable doubt*").

B. The Omissions At Issue Were Not Material

1. Even in civil cases, liability can only rarely be imposed on the theory that a defendant somehow had "material" information that a *prediction* would not come true. In general, the materiality of information about contingent future events "'depend[s] at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.'" *Basic*, 485 U.S. at 238 (citation omitted); *see also TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (requiring "a *substantial likelihood* that the disclosure of the omitted fact would have been viewed by the reasonable investor as having *significantly* altered the 'total mix' of information"). *Basic* involved undisclosed merger discussions, and the Court noted that simple "probability/magnitude" analysis might not be sufficient for "other kinds of contingent or speculative information, such as earnings forecasts or projections." 485 U.S. at 232 n.9.

In the specific context of earnings projections, many courts have drawn a hard line that "projections of *future* performance … [are] actionable under §10(b) … only if they are supported by specific statements of fact or are worded as guarantees." *Malone v. Microdyne Corp.*, 26 F.3d 471, 479 (4th Cir. 1994) (emphasis in original). That rule is dispositive here. But even courts that have not embraced that strict an approach have held that a projection "can lead to liability under Rule 10b-5 only if it was not made in good faith or was made without a reasonable basis." *Stransky v. Cummins Engine Co.*, 51 F.3d 1329, 1333 (7th Cir. 1995); *Provenz v. Miller*, 102 F.3d 1478, 1487 (9th Cir. 1996); *Kowal v. MCI Commc'ns Corp.*, 16 F.3d 1271, 1276–77 (D.C. Cir. 1994); *Wielgos*, 892 F.2d at 513; *see also Grossman*, 120 F.3d at 1119 n.6 (suggesting that projections "may be actionable if the opinion is known by the speaker at the time it is expressed to be untrue or to have no reasonable basis in fact").

That rule has a long history in case law under Rule 10b-5, and has been restated and codified in two SEC rules.[4] A forward-looking statement "shall be deemed not to be a fraudulent statement … unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith." 17 C.F.R. §240.3b-6(a); 17 C.F.R. §230.175(a). A "fraudulent statement" is defined to include "a statement which … constitutes the employment of *a manipulative, deceptive, or fraudulent device,*

[4] Rule 175 applies to the Securities Act of 1933; Rule 3b-6 applies to the Securities Exchange Act of 1934. Otherwise, the rules are identical. The rules were promulgated to "encourage companies to disclose management projections," SEC Release Nos. 33-5992, 34-15305, 43 Fed. Reg. 53,246, 53,247 (Nov. 15, 1978), and in effect restated earlier case law regarding when forward-looking statements may be deemed materially misleading. *See, e.g., Marx v. Computer Scis. Corp.*, 507 F.2d 485, 490 (9th Cir. 1974); *Isquith v. Middle S. Utils.*, 847 F.2d 186, 204 n.12 (5th Cir. 1988).

contrivance, scheme, transaction, act, practice, course of business, or an artifice to defraud, as those terms are used in the Securities Exchange Act of 1934 or the rules or regulations promulgated thereunder." 17 C.F.R. §240.3b-6(d). In other words, "fraudulent statement" is "shorthand for *all* the bases of liability in the … Act and its implementing rules." *Wielgos*, 892 F.2d at 513.[5]

Under the "reasonable basis" standard, data, assumptions, estimates, and other information that might cast doubt on the public projection need not be disclosed unless that information is "so certain that [it] reveal[s] the published figures as materially misleading." *Wielgos* 892 F.2d at 514–16; *Krim v. BancTexas Group, Inc.*, 989 F.2d 1435, 1449 (5th Cir. 1993) (defendant must know "to a *certainty*" that the projections are unattainable); *In re Healthcare Compare Corp. Sec. Litig.*, 75 F.3d 276, 282 (7th Cir. 1996) (estimates diverging from public projections not material omissions unless "certain and reliable"). The evidence must show that the undisclosed "problems were so widespread and severe" that the defendant knew its projection was "unattainable." *In re Apple Computer*, 127 Fed. Appx. at 300. These rules are essential: "Any other position would mean that once the annual cycle of estimation begins, a firm must cease selling stock until it has resolved internal disputes and is ready with a new projection. Yet

---

[5] Rule 3b-6 applies directly to this case, because Qwest's public projections were filed with the SEC. *See* 17 C.F.R. §240.3b-6(b)(1). Regardless, courts have broadly applied these legal standards to all cases involving forward-looking information. *See, e.g.*, *Stransky*, 51 F.3d at 1333 & n.8 (applying reasonable basis standard even though "Rule 175, strictly speaking, is not applicable to [this] case"); *Kowal*, 16 F.3d at 1276–77 (applying reasonable basis standard without mentioning SEC rules); *Hillson Partners Ltd. P'ship v. Adage, Inc.*, 42 F.3d 204, 216-17 (4th Cir. 1994) (same).

because large firms are eternally in the process of generating and revising estimates—they may have large staffs devoted to nothing else—a demand for revelation or delay would be equivalent to a bar on the use of projections if the firm wants to raise new capital." *Wielgos,* 892 F.2d at 516. *Wielgos* involved sales by the company, but a rule that prohibited individual insiders from trading until all internal forecasts and estimates have been made public would similarly bar insiders from buying or selling company stock altogether.

Courts have applied similar principles to internal estimates or intra-quarterly operating results even when there are no published projections. In *Shaw*, for example, plaintiffs claimed that a company sold stock eleven days before the end of a quarter without disclosing "material knowledge of facts indicating that the … quarter would be an unexpectedly disastrous one." 82 F.3d at 1206. The First Circuit held that "soft" information in the form of internal predictions is always immaterial, *id.* at 1211 n.21, but that "[i]f … the issuer is in possession of [hard] nonpublic information indicating that *the quarter in progress at the time of the public offering* will be an *extreme departure* from the range of results which could be anticipated based on currently available [public] information," then the company must either disclose that information or refrain from selling. *Id.* at 1210.

The claim in *Shaw* met that standard, but the Court emphasized that nondisclosure claims based on information presaging possible developments four to six months in the future have been dismissed because the omissions should be "deemed immaterial as a matter of law." *Id.* at 1211. Similarly, in *In re Worlds of Wonder*, the plaintiffs claimed

that the company failed to disclose recent sales figures allegedly portending that its sales would decline precipitously six months in the future. 35 F.3d at 1418–20. Affirming dismissal, the Ninth Circuit held that this argument "distill[ed] to a contention that [the company] should have predicted the collapse in sales that occurred in late 1987, long after the [prospectus]"—a prediction the company had "no duty" to make. *Id.* at 1420.

2. As discussed below, the verdict must be reversed because *none* of these legal principles were charged to the jury. But Nacchio was entitled to a judgment of acquittal in any event, because the evidence was insufficient to support a finding, under the probability/magnitude standard of *Basic* or the more specific rules governing projections, that Nacchio had *material* inside information.

a. *At the time of the trades, the information available to Nacchio did not reveal, to* any *degree of certainty, that Qwest would fail to meet its year-end numbers eight months in the future.*

On September 7, 2000, Qwest raised its 2001 revenue projections to a range of $21.3 billion to $21.7 billion. APP-4781. That was a modest (1.4%) increase from a $21.0 billion estimate prepared earlier by major investment banks in connection with the merger of Qwest and U.S. West. APP-1756–58, 2355. Qwest was already running ahead of those bankers' projections for 2000, and ultimately exceeded them by 2.5%. APP-1758–59, 2355, 3324–25. Nacchio believed that matching Qwest's entrepreneurial culture with U.S. West's customer base would lead to strong growth in 2001. *See* 1759–61, 2379–80 (Qwest's senior managers, including Nacchio, believed 2001 would be a "barn burner"), APP-2396 (Nacchio expected enormous U.S. government demand for

fiber optic capacity). Developments between December and May did not establish that the projections had become unattainable or even improbable.

First, Qwest's internal budget process supported the year-end projections. The overall *internal* revenue target for 2001 was initially set by senior management at $22 billion—$700 million above the low end of the public projections. APP-2126–27, 2267, 2429–30. These were called "stretch" budgets, which were "aspirational and generally set higher than street numbers to encourage the employees to exceed the public values." APP-2138–39, 1918, 2373–77, 3336–37. Business units prepared plans to meet their assigned targets. APP-2138–39, 2326. The managers had a personal incentive to depress expectations because their compensation was tied to beating their targets. APP-2369–70, 2374–77. The first 2001 budget "submissions" from the business units in October 2000 nevertheless totaled over $21.3 billion, even though they were constructed on estimates for 2000 revenues that proved to be too low. APP-4967. In February, the Board ultimately approved an *internal* budget with a 2001 revenue target of $21.8 billion—a "stretch" of just 2.3% more than the initial plans from the business units, and $500 million above the low end of the public projections. APP-2164, 4967, 4975. The budget process continued, but the combined estimates in the submissions of the business units always exceeded $21.3 billion—the low end of the public revenue projections. APP-4967. During the period of Nacchio's trades, *there was not a single internal Qwest estimate forecasting 2001 revenues below $21.3 billion*.

The government nevertheless succeeded in confusing the jury by repeatedly presenting evidence of "gaps" between the business units' proposals and their budgeted

targets. But the “gaps” related only to the higher *internal* budget. For example, the indictment alleged that COO Afshin Mohebbi told Nacchio that the projections were a “huge stretch” in a December 2000 memorandum. But Mohebbi, a government witness, confirmed that the memo was only referring to the initial $22 billion *internal* budget target. APP-4990–92, 3163–64. The memo expressed the view that “recurring business” had “to literally take off by April-May” to hit $22 billion, but it also identified the steps to achieve it. APP-4990–92. Nacchio took all of them. APP-3360–61.

Second, Qwest met market expectations and nearly equaled the *internal* targets in the first and second quarters. Qwest’s first-quarter revenues were only $4 million short of the internal goal of $5.055 billion. APP-4699–700, 2384. These results were realized virtually simultaneously with the April trades for which Nacchio was convicted.

In May, Qwest’s performance was still strong. According to the financial summary, or “dashboard,” presented to Nacchio in mid-May, the company fell just 2.3% short of its estimate for April. APP-5020. The consumer unit—a main driver of recurring revenue—came within $1 million (or 0.2%) of its estimate, APP-5022, and forecasted that it would fall just short of its third-quarter internal budget target and exceed its fourth-quarter target, APP-5095, 2924. Moreover, the wholesale markets unit—the supposed epicenter of impending disaster—beat its internal target for April, APP-5021, and the unit head, Greg Casey, told Mohebbi on May 10 that they were generating strong *recurring* sales and revenue “looked pretty good.” APP-2571–72. Indeed, Qwest’s second-quarter revenues ultimately met investors’ expectations. APP-2381–82.

Third, on April 9, 2001, senior managers led by CFO Robin Szeliga, the government's chief witness, produced an internal "current estimate" that 2001 revenues would reach $21.56 billion—comfortably above the low end of the public projections. APP-5001. Although recurring revenue was not as strong as had been hoped, non-recurring revenue was considerably stronger. *Id.* As the CFO confirmed at trial, "as of April the 9th, *with all of the debates* … the internal current view of Qwest was that they would reach $21.5 billion by December 31st, 2001." APP-2323; *see also* APP-3276–77 (COO Mohebbi confirming the same).

The only quantified "risk" presented to Nacchio in the April 2001 estimate was in the wholesale markets forecast, which was predicated on Greg Casey's predictions about the future of the economy.[6] Casey, head of the wholesale unit, identified $350 million of budget "risk" for the remainder of the year from a softening IRU market. APP-2496, 2545, 5037. Szeliga testified that this $350 million is what "Casey was trying to point out" when he said that "demand was lessening … for the IRUs." APP-2228–29. The internal budget goals already expected the IRU market to decline, APP-2155–56, 2167, 5002, and Nacchio challenged Casey's prediction that the IRU market would be still weaker than forecasted, APP-2230. The hard data from first quarter 2001 gave Nacchio reasonable grounds for his view. As of April 9, "non-recurring" revenues had exceeded internal goals by $107 million, or 26%, mostly on the strength of the global business unit's IRU sales. APP-5008, 5015, 5061. After this strong quarter, the company raised

[6] Because Qwest had an "unlimited supply of capacity to sell," APP-1703, Qwest's ability to sell IRUs was strictly a function of economic demand.

its estimate for IRU revenue from the global business unit. (The entire increase in forecasted IRU revenues in the April 9 product update came from higher forecasts in this unit. APP-5008, 5010.) It also became clear after the April planning meetings that there were additional IRU opportunities which had not been forecasted or budgeted for by Qwest's managers, including a large deal with Microsoft. APP-2572–73, 2700–03.

Nacchio was not compelled to adopt Casey's opinion. Revenues at Qwest routinely materialized despite self-interested pessimism from managers. In October 2000, Casey's wholesale unit estimated a fourth-quarter target miss of $170 million, *or nearly 16%.* APP-4939. Yet the unit ultimately *exceeded* its year-end estimate by $276 million. APP-4943, 4980. Similarly, the global business unit exceeded its November current estimate for year-end 2000 by $377 million, APP-5100, 4980, despite having forecasted a fourth-quarter target *miss* of $121 million, or 8%, APP-5098. In March 2001, Nacchio was told that Qwest would need $486 million from "risky" "C" revenue initiatives to meet internal goals for the first quarter. APP-4995. *Nearly all* the initiatives materialized. *See* APP-4258. These were the type of "C" initiatives Casey had included in his 2001 target budget, and that the government contends were so "risky" Qwest should have valued them at nothing. APP-2485. These internal scenarios were repeated over and over in Qwest's history through 2001, *see, e.g.*, APP-2375–76, 3196, 3324–25, 3343–44, 3351–52, 3371–72—and yet the company met or exceeded its public numbers for seventeen straight quarters. APP-2259, 2341–42.

In sum, a reasonable jury could not find that Nacchio had information in April revealing that it was certain, or even probable, that Qwest would not reach its public projections by year end.

b. *The "magnitude" of any shortfall reasonably anticipated in April also was not large enough to be material.*

The centerpiece of the government's case was Casey's April 2001 prediction that wholesale IRUs were "drying up." APP-2581. Even if Qwest had eliminated those revenues from the budget *in their entirety*, the adjusted current estimate would have been only 0.4% short of the public projections. APP-5037. The "magnitude" of that shortfall would be immaterial as a matter of law under *Basic*. And the same holds true for the prosecution's (misleading) argument that there was a "billion dollars of risk" in the internal budget. *See* APP-2211. Even if the jury thought that "risk" was a *certainty*, Qwest still would have exceeded 2000 revenues by a wide margin and only missed its *public projections* by a mere 1.4%. *See* APP-2268 ("billion dollar risk" pertained to initial $22 billion budget target). A miss that small is immaterial as a matter of law. *See In re Apple Computer*, 127 Fed. Appx. at 304 ("[A] revenue estimate that was missed by approximately 10% was immaterial as a matter of law"); *City of Philadelphia v. Fleming Cos.*, 264 F.3d 1245, 1268 (10th Cir. 2001) (dismissing complaint where contingency threatened only 2.4%–3.5% of company's assets and 10% of company's net worth); *Shaw*, 82 F.3d at 1210 (shortfall must represent an "extreme departure from the [expected] range of results").

Of course, those calculations greatly overstate the risks. Companies are not allowed to deliberately err on the side of caution by valuing uncertain revenues at zero, since excessive pessimism is just as actionable as unwarranted optimism. *See In re Worlds of Wonder*, 35 F.3d at 1419; *In re Craftmatic Sec. Litig.*, 890 F.2d 628, 644 (3d Cir. 1989) ("[H]ad the omitted projections been made, we are confident that plaintiffs would have asserted that such predictions lacked a reasonable basis ….").

c. *The "risks" identified within Qwest in early 2001 also would not have significantly altered the "total mix" of information already available to the market, because the market was already largely attuned to these risks.*

This Court held in *Grossman* that "[f]orward-looking representations are … immaterial when the defendant has provided the investing public with sufficiently specific risk disclosures or other cautionary statements concerning the subject matter of the statements at issue to nullify any potentially misleading effect." 120 F.3d at 1120. That "bespeaks caution" doctrine is a "valid defense to a securities fraud claim in the Tenth Circuit," and "cannot be ignored in construing the materiality of optimistic predictions." *Id.* at 1121. In this case, repeated cautionary statements accompanying every public projection warned investors of various risks, including adverse economic conditions and the risk that the company would not "achieve the projected synergies and financial results expected to result from the acquisition of U S West." APP-4789. For example, Qwest's April 26, 2001 filing with the SEC identified "important risk factors" such as "intense competition in the communications services market, changes in demand for Qwest's products and services, [and] dependence on new product development and

acceleration of the deployment of advanced new services, such as broadband data, wireless and video services." APP-4717–18. The release's cautionary language also directed investors to Qwest's other SEC filings, which expressly stated that Qwest recognized revenue from IRUs. *Id.*; *see* APP-4682, 2390–91, 2828–29. The April 24, 2001 release reaffirming Qwest's public projections contained virtually identical warnings.

The jury could not conclude that the warnings were inadequate. Investors knew that Qwest's projections were subject to risk. APP-1571, 1577, 1584–85, 1611–14, 1618–19, 1632–34, 1710. They also knew that Qwest's recurring revenue business had not done as well as the company had predicted. APP-3629, 3636. On April 24, 2001, Nacchio himself told analysts that the consumer and small business unit experienced slower than expected first-quarter growth, noting, "we are not pleased with the performance of that unit." APP-4807; APP-3636. Analyst Drake Johnstone wrote in his April 25, 2001 report that he "doubt[ed] the company will achieve its objective of doubling wireless subscribers from 800,000 to 1.6 million by year-end." APP-4935, 3629. (Nacchio addressed these problems by replacing the unit head. APP-4807.)

And they certainly knew that Qwest continued to sell IRUs (APP-3610–12, 3614–17, 3626, 3662, 3690–91)—a high-margin product that had formerly been the lion's share of Qwest's revenue. APP-1789–90, 2569–70. Yet the *only* "risk" to IRU revenues that Casey predicted concerned his personal assessment of the future of the economy and demand for fiber optic capacity—a risk common to the whole industry and known to

investors. APP-2405, 2414, 3610–12. "[N]egligence in predicting the future economic climate … is not actionable under the federal securities laws." *Krim*, 989 F.2d at 1449.

Moreover, the fact that subsequent disclosures had no effect on Qwest's stock price confirms that the warnings had been effective and that the information at issue was immaterial. An efficient market rapidly incorporates material information into stock prices. In this context, "the concept of materiality translates into information that alters the price of the firm's stock." *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1997) (Alito, J.); s*ee also In re Merck & Co. Sec. Litig.*, 432 F.3d 261, 269 (3d Cir. 2005); *Shaw*, 82 F.3d at 1218; *cf. Grossman*, 120 F.3d at 1123 (plaintiffs failed to allege that there was "any impact on Novell's stock price when [the] falsity [of prior statements] was disclosed").

Qwest's subsequent disclosures had no discernible negative effect on its stock price. On August 7, 2001, Nacchio reported to investors that IRUs would likely amount to an estimated 8% of 2001 revenues. APP-4738. Over the course of August 7 and 8, Qwest's stock price declined a mere $0.09, or 0.37% (against a 1.4% decline in the S&P 500 during the same period). APP-4762, 801. In its 10-Q filed on August 14, 2001, Qwest made additional disclosures about the percentage of IRU revenues in the first and second quarters of 2001. APP-4860. In the two days of trading on August 14 and 15, Qwest shares rose by $0.58, or 2.35%. APP-4762. Similarly, on September 10, 2001, before the market opened, the company issued a press release lowering its public projections for 2001 revenues. APP-4933. That day, the stock rose $1.76, or 9.30%.

APP-4763. Shortly thereafter, Qwest stock, and the broader market, began a steep decline brought on by the September 11, 2001 terrorist attacks.

C. Nacchio Did Not Know The Information Was Material

To prove that Nacchio acted "willfully," the prosecution had to prove that he *knew* that the internal debates and revenue mix were "material" information that needed to be disclosed prior to trading. *See Safeco Ins. Co. of Am. v. Burr*, 127 S. Ct. 2201, 2209 n.9 (2007) ("willfully" in the context of a criminal statute requires proof that the defendant "'acted with knowledge that his conduct was unlawful'") (citation omitted); *Fleming Cos.*, 264 F.3d at 1264. The evidence permitted no such finding, and certainly not beyond a reasonable doubt.

Qwest waived its attorney client privilege, yet the government offered *no* evidence that Nacchio was ever told that this information was "material," or that he should not be trading in Qwest shares. The evidence demonstrated that Nacchio was optimistic throughout the period, believed Qwest's share price was too low, and believed that the "risks" identified by Qwest's managers were an ordinary part of the budgeting process—similar to fears expressed during the preceding seventeen quarters in which Qwest had nonetheless made its numbers. It is undisputed that during the relevant period *not a single person at Qwest recommended to Nacchio that the public projections be lowered or advised him not to reaffirm guidance*. Szeliga testified that "there was no conversation from me to [Nacchio] or back insisting that the numbers be brought down at that time [i.e., in April]." APP-2238. Indeed, it was not until mid-August—long after the trades at

issue here—that anyone advised Nacchio to lower the revenue projections. APP-2255–56.

Nacchio's understanding was also informed by the judgments of Qwest's outside auditors, audit committee, and general counsel, who monitored Qwest's compliance with SEC rules. *See* APP-1981–82, 2076–77, 2083, 2387, 4769–80. Qwest's general counsel, Drake Tempest, was closely apprised of Qwest's financial performance, regularly participated in internal financial reviews, and knew what Nacchio knew.[7] Yet, on two occasions Tempest "represent[ed] and warrant[ed]" on Qwest's behalf that Nacchio's automatic sales plans, which covered seven of the trades at issue, "[did] not conflict with [Qwest's] insider trading policy" (which, of course, prohibited trading on material inside information). APP-5157, 5172; *see* APP-3472–74, 477–79.[8] It was also Tempest's duty to close the trading windows if he believed insiders had material non-public information. APP-2076–77. He never did. *See Lake*, 472 F.3d at 1261 (failure of general counsel to report personal use of corporate aircraft bore on whether other defendants' omissions were knowing and willful).

The audit committee, together with Qwest's outside auditors, considered the issue of IRUs on at least four occasions in 2000 and 2001, and concluded that the IRU revenue percentage did not need to be disclosed. Szeliga testified that "we relied on [the outside

---

[7] *See, e.g.*, APP-1689–90, 1786, 1809, 2189, 2201, 2575–76, 3161–62.

[8] Contrary to the government's contention, the insider trading policy did not establish that Nacchio knew that he had material information. The policy stated that "[p]rojections of future earnings or losses, which depart materially from market expectations based on prior disclosures" "may be considered material," APP-4780, but the only internal "projections" *confirmed* the public guidance.

auditor] to give us guidance" about accounting rules and disclosure requirements. APP-2386; *see also* APP-2789, 2798–99. At multiple meetings of the audit committee throughout the relevant period, Arthur Andersen told the committee that Qwest's disclosure positions, including with respect to IRUs, "were supportable and not unduly aggressive." APP-4579; *see also* APP-4589, 4620, 4622, 4645, 4672, 4677, 4682, 4695, 4707, 2387–91, 2789–2800. It was not until "sometime in the summertime" of 2001, after all of the trades at issue here, that Arthur Andersen recommended additional disclosures about IRU percentages. APP-2797.[9] At its May 2 meeting, the audit committee reviewed management's current estimate, Qwest's "ability to meet its targets," and the "challenges posed by the current economic conditions." APP-4695, 4699. It required no additional disclosures.

In their closing, prosecutors relied heavily on the testimony of Lee Wolfe, who handled relations with analysts. APP-4279–80, 4478–79. Although Wolfe testified that analysts had "no business knowing about … the internal budget," APP-1720, he told Nacchio that the analysts wanted more detail about Qwest's IRU revenues, APP-1798–99. According to Wolfe, Nacchio "basically … responded, screw them, go tell them to buy." APP-1799. Wolfe also stated that when he told Nacchio that analysts were

[9] Long after the government's investigation began, Szeliga, who sold shares during this period to renovate her kitchen, APP-2270–71, pleaded guilty to insider trading because she "had inside, non-public information that was inappropriate," APP-2246. Szeliga testified that her plea agreement stated that she "knew by at least April 24, 2001, that various Qwest business units were not going to meet revenue targets and expectations for the first and second quarters of 2001 as portrayed to the investing public." APP-2309. In fact, as Szeliga acknowledged, Qwest made its public targets for the first and second quarters. APP-2309–10.

revising their models after Qwest reported IRU percentages in August 2001, Nacchio said, "see, this is what happens when you disclose." APP-1676. Though likely to inflame the jury, these statements did not establish that Nacchio *knew* that the revenue mix was material inside information at the time of his trades.[10] Indeed, on multiple occasions Nacchio asked Wolfe what effect he thought disclosure of IRU percentages would have on the stock. APP-1653–57. Wolfe predicted that disclosure of IRU percentages would likely cause Qwest's stock price to fall initially, but *then recover*. APP-1653, 1657. But Nacchio was entitled to rely instead on the contrary view of the lawyers and auditors, who were vested with responsibility for making the judgment, that the IRU percentage was not material. Wolfe's testimony also confirmed that Nacchio had an important reason to withhold the volume of IRU revenues if permissible. Nacchio "did not want to give competitors information about how Qwest was employing its network." APP-1799. Indeed, Casey confirmed that he opposed disclosure of this proprietary information for competitive reasons. APP-2549–51.

II. ERRONEOUS JURY INSTRUCTIONS REQUIRE A NEW TRIAL

At a minimum, a new trial is necessary under appropriate instructions. This Court reviews "jury instructions *de novo* to determine whether, as a whole, they correctly state the governing law and provide the jury with an accurate understanding of the relevant

---

[10] In a similar vein, the prosecution relied heavily on an analyst's testimony that Nacchio told him in 2002, while *smiling*, to "[n]ever believe a word of what management says at the time of a merger." APP-3684; *see* APP-4280, 4514. This purported statement concerned five-year projections issued in July 1999, some two years before the relevant trades. The government's indictment never charged, and the jury certainly did not believe (for it acquitted on the early trades), that Nacchio traded on inside information that the five-year growth projections were misleading.

legal standards and factual issues in the case." *United States v. Crockett*, 435 F.3d 1305, 1314 (10th Cir. 2006) (citation omitted). Nacchio "is entitled to an instruction on his theory of the case if the instruction is a correct statement of the law, and if he has offered sufficient evidence for the jury to find in his favor." *Id.* Failure to give a particular requested instruction is reviewed for abuse of discretion. *Id*.

A. The Jury Was Given No Guidance On The Materiality Of Omissions Relating To Financial Projections

The district court refused to instruct the jury about *any* of the settled legal rules, described above, governing the materiality of information related to forward-looking predictions. APP-4163–65, 4181–84. Nacchio requested instructions that would have told the jury that forward-looking statements are not materially misleading unless they lack "a reasonable basis"; that "data, assumptions, and methods" or "internal projections," need not be disclosed unless they are "so certain that they show the published figures to have been without a reasonable basis"; and that a forward-looking statement cannot be materially misleading if "the investing public has been provided with sufficient[ly] specific risk disclosures, or other cautionary statements to nullify any potentially misleading effect." APP-755–61; *see also* APP-4162–63, 4180–81.

Instead, the court told the jury that there are no special legal standards and that the law treats forward-looking predictions like any other kind of "information." It instructed the jury that:

> Information may be material even if it relates not to past events but to forecasting and forward-looking statements so long as a reasonable investor would consider it important in

> deciding to act or not to act with respect to the securities transaction at issue.

APP-4558. The court also instructed the jury, over Nacchio's objection, APP-4162-63, that "[t]o prove that the information was non-public, the Government is not required to additionally prove that Qwest was required to disclose the information at issue," and that "[a] corporation has no general duty to disclose all of its non-public or its proprietary information." APP-4559. The court even rejected the government's materiality instruction, which at least would have included the "probability/magnitude" and "total mix" standards from *Basic* and *TSC*. APP-741–42; 4167.

1. The district court refused to give a "reasonable basis" or "bespeaks caution" instruction because it wrongly thought those rules apply only in *false statement* cases and are "wholly inappropriate for this type of insider trading case." APP-4159. That was a lethal error that infected every aspect of this trial.

First, the prosecution's *sole* theory of guilt was that Nacchio possessed material inside information about the risks inherent in Qwest's public projections. It presumably settled on this theory because the only debate within Qwest concerned the amount by which they would exceed 2000 revenues. Having tied its entire theory of materiality to the importance the market placed on Qwest meeting its public projections, the prosecution cannot run away from the rules the law has developed for assessing whether a reasonable investor could be misled by those projections. Even in *civil* securities fraud cases involving projections, juries are instructed on "reasonable basis" principles to avoid the substantial risk that they will wrongly impose liability on the basis of 20/20 hindsight.

See, e.g., Eleventh Circuit Pattern Jury Instructions (Civil Cases), Instruction 4.2 (2005) ("If, at the time the predictions, expressions of opinion or projections were made, and the speaker actually believed them or there was a reasonable basis for making them, then the statements are not materially misleading statements of fact."); Modern Federal Jury Instructions – Pattern Jury Instructions (Civil), Ninth Circuit ¶ 21.2 cmt. (Matthew Bender ed., 2007) (materiality instruction "should be adjusted for cases involving … statements of reasons, opinions or beliefs" and "when the alleged fraud concerns certain forward-looking statements the jury may be compelled to examine whether the statement falls within the safe harbor"); *Schwartz v. Sys. Software Assocs., Inc.*, 32 F.3d 284, 289 (7th Cir. 1994).

Second, many of the reported cases about forward-looking statements are *trading* cases not just false statement cases, because the allegedly misleading statement was included in a prospectus that the company used to sell stock. In *Wielgos*, for example, the company was accused of selling stock with a registration statement that incorporated cost projections lower than the company's own internal estimates. 892 F.2d at 512. The company's duty not to mislead investors by withholding material information in *Wielgos* was no different from Nacchio's here. *See also Garcia v. Cordova*, 930 F.2d 826, 830 (10th Cir. 1991) (applying limitations on the materiality of forward-looking information in a civil insider trading case). The federal securities laws draw no distinction between an insider and a corporation for insider trading purposes. *Shaw*, 82 F.3d at 1203-04 ("Courts … have treated a corporation trading in its own securities as an 'insider' for purposes of the 'disclose or abstain' rule."); 7 Louis Loss & Joel Seligman, *Securities*

Regulation 3499 (3d ed. 1991) ("When the issuer itself wants to buy or sell its own securities, it has a choice: desist or disclose.").

Similarly, *Grossman* directed that the "bespeaks caution" doctrine is a "valid defense to a securities fraud claim," and held that cautionary language "cannot be ignored in construing the materiality of optimistic predictions." 120 F.3d at 1121. The standard for materiality is not somehow lower because this is an insider trading case. *See Smith*, 155 F.3d at 1065 ("The standard for materiality is a constant (at least for Rule 10b-5 purposes); it does not vary 'depending on who brings the action or whether insiders are alleged to have profited.'" (quoting *Basic*, 485 U.S. at 240 n.18)). If Qwest's warnings were adequate, investors cannot claim to have relied on or been misled by the projections. *See Rubinstein v. Collins*, 20 F.3d 160, 167 (5th Cir. 1994).

Even leaving aside the failure to provide "reasonable basis" and "bespeaks caution" instructions, the district court's materiality instruction was wholly inadequate to guide the jury in its deliberations. At a minimum, the court was required to instruct the jury on the "probability/magnitude" and "total mix of information" principles explained by the Supreme Court in *Basic* and *TSC*, and proposed as instructions even *by the government* here.

2. The district court also instructed the jury that "[t]o prove that the information was non-public, the government is not required to additionally prove that Qwest was required to disclose the information at issue. A corporation has no general duty to disclose all of its non-public or its proprietary information." APP-4559. The defense objected. APP-4160–65. This instruction, requested by the government, was designed to

tell the jury that Qwest's decision not to disclose the information at issue was irrelevant to Nacchio's guilt or innocence of *insider trading*—a point the prosecution argued repeatedly. APP-1397, 1410.

That instruction was profoundly wrong and prejudicial to Nacchio's defense. If and when doubts about the guidance reached a sufficient level of certainty, the duties of Qwest as speaker and Nacchio as trader were precisely the same. Even if Qwest had no affirmative duty to update its disclosures, it certainly had a duty not to *reaffirm* projections that had become materially misleading—and Qwest continued to reaffirm the guidance throughout this period. APP-2908. For that reason, Qwest's lawyers and other senior managers—all of whom possessed the very same "inside" information that Nacchio possessed, *see supra*, at 29–30—were necessarily confronted at the time with essentially the same questions on which this prosecution has turned.

The district court's instruction therefore effectively directed the jury to disregard the best contemporaneous evidence of Nacchio's state of mind concerning whether what he knew was material, by instructing the jury that the company's decision not to disclose the information that Nacchio is accused of trading upon was irrelevant. That error devastated Nacchio's defense, because it led the jury to believe that the same information the company—including the board, lawyers, auditors, and other senior executives—was disregarding for disclosure purposes could nonetheless be "material" for purposes of his trading.

3. This Court recently reversed a criminal fraud conviction precisely because the district court failed to inform the jury of legal rules relevant to its assessment of guilt.

See Lake, 472 F.3d at 1263. In *Lake*, the crucial issue was the defendants' state of mind regarding their failure to disclose certain personal use of corporate aircraft. The defendants contended that SEC rules that arguably did not require such disclosure shed light on their intent, and that the jury should have been instructed about those rules. This Court held that although it was "not dispositive of defendants' intent, … in assessing the state of mind of each defendant, the jury would likely be influenced by knowing that the omission on the D&O forms apparently did not cause any errors in the reports to the SEC." 472 F.3d at 1262. Reversal was necessary because the jury "was not fairly informed of what the SEC required," and the judge instead left that issue for counsel to argue at closing. *Id.* This Court held: "When a defendant's defense is so dependent on an understanding of an applicable law, the court has a duty to instruct the jury on that law." *Id.* at 1263.

Lake's analysis controls here. The district court's erroneous "non-public" instruction distorted the jury's consideration of Nacchio's state of mind just as in *Lake*. But more importantly the missing instructions would have provided the legal standards *governing the principal elements of the offense*. The "reasonable basis" standard and SEC Rule 3b-6 provide a complete defense to any form of liability under §10(b), and this Court has held squarely that adequate cautionary language "is a valid defense to a securities fraud claim in the Tenth Circuit." *Grossman*, 120 F.3d at 1121.

The absence of a proper instruction allowed the prosecution to argue (as it repeatedly did) that the jury could convict *even if* it concluded that the information Nacchio possessed was not certain and definite enough to deprive the projections of a

reasonable basis. The jury was led to believe that *any* undisclosed risk in the projections—whether Casey's prediction about the economy, APP-4265–66, the internal debates about the higher *internal* targets, APP-4229–30, or the IRU revenue percentages, APP-4478–79—was enough. The court should have instructed the jury otherwise. "It was error for the district court to abdicate its responsibility in this regard and let opposing counsel argue their competing theories, especially when the defendants' view of the law was the correct one." *Lake*, 472 F.3d at 1263.

B. The Flawed Good Faith Instruction Requires A New Trial

The court's unprecedented good faith instruction permitted the jury to convict without finding the requisite scienter—an error that by itself requires reversal. Over objection, APP-4179, the court told the jury: "A defendant does not act in good faith if even though he honestly holds a certain opinion or a belief … he also knowingly employs a device, scheme or artifice to defraud." APP-4561. That instruction is confusing and internally incoherent. It also required the jury to reject Nacchio's claim of good faith on the basis of any dishonest act *unrelated* to the insider-trading charge, *even* if the jury found that Nacchio honestly believed his trading was lawful. This deprived Nacchio of the benefit of the good faith instruction. *Cf. Arthur Andersen LLP v. United States*, 544 U.S. 696, 706 (2005) (reversing conviction where jury was improperly instructed that "even if [the defendant] honestly and sincerely believed that its conduct was lawful, you may find [it] guilty").

The prosecutors took full advantage of the erroneous instruction by seizing on improperly admitted testimony from David Weinstein, Nacchio's former financial

advisor, that he was "aware of another occasion in 2000 where" "Nacchio asked [him] to assist [Nacchio] in an act of dishonesty involving Qwest." APP-3066. The court initially precluded the government from eliciting such evidence on direct after Nacchio moved *in limine* to preclude it, *see* APP-2892, but permitted the evidence on re-direct, over Nacchio's objection, to rebut Weinstein's testimony on cross-examination that he believed Nacchio was "telling … the truth" when he said he thought Qwest's stock would rise again. APP-3031. The district court's initial decision barring this evidence was correct under Federal Rule of Evidence 404(b), and the testimony elicited on cross-examination does not modify the analysis.[11] The prosecution nevertheless emphasized this impermissible evidence in closing, and tied it directly to the court's flawed good faith instruction. After reading the instruction aloud, the prosecution informed the jury, "you cannot be dishonest and have good faith at the same time," and cited Weinstein's testimony as proof of Nacchio's dishonesty. APP-4514. Under the court's instruction, the prosecution was right. If the jury determined that Nacchio had been dishonest with Weinstein, it was *required* to find bad faith—even if it concluded that Nacchio honestly believed he was not trading on the basis of material inside information. The instruction effectively negated the prosecution's burden of proving scienter.

III. THE EXCLUSION OF PROFESSOR FISCHEL'S EXPERT OPINION TESTIMONY WAS REVERSIBLE ERROR

The court erred when it excluded testimony by a nationally-renowned expert, never before excluded from testifying and often retained by the government to testify on

[11] Weinstein was cross-examined about whether Nacchio was telling the truth on a particular occasion, not whether he was generally a truthful person.

similar subjects.[12] This testimony was vital to explain the circumstantial evidence bearing on materiality and intent, and to rebut testimony by two government-called analysts, who provided testimony about what a reasonable investor would find important even though the court had barred them from doing so. These errors affected Nacchio's substantial rights and require a new trial. *United States v. Velarde*, 214 F.3d 1204, 1211 (10th Cir. 2000); *see also United States v. Rodriguez-Felix*, 450 F.3d 1117, 1121 (10th Cir. 2006) (citing *Taylor v. Illinois*, 484 U.S. 400, 408 (1988)).

A. Fischel's Proposed Testimony Was Critical To The Defense

1. Fischel would have testified about the nature of the undisclosed information, how information of that character is absorbed by the market and reflected in prices, and how the market in fact reacted to disclosure of the matters this prosecution focused on. Expert testimony on such matters is routinely admitted.[13]

---

[12] "[A]n expert's overwhelming qualifications may bear on the reliability of his proffered testimony …." *Quiet Tech. DC-8, Inc. v. Hurel-Dubois UK Ltd.*, 326 F.3d 1333, 1341 (11th Cir. 2003). And Fischel is President of a consulting firm that applies economics to legal and regulatory issues, Professor of Law and Business at Northwestern, and former dean of the University of Chicago Law School. He has published approximately fifty articles in leading legal and economics journals; courts of all levels, including the Supreme Court, have cited his articles. He has advised the DOJ, SEC, NASD, and NYSE, and has testified as an expert 200 times on a wide range of financial issues. APP-425–27, 435–59, 3914.

[13] 3 Alan R. Bromberg & Lewis D. Lowenfels, *Bromberg & Lowenfels on Securities Fraud & Commodities Fraud* §6:153 (2d ed. 2007) ("Opinion evidence, e.g., by experts … is admissible on whether information would have a substantial market impact."); *id.* §6:159 ("Experts … should be able to testify that the information would have had a substantial effect on the market price or that reasonable investors would have considered it important."); *id.* §6:151 (same); 5 *Business & Commercial Litigation in Federal Courts* §62:77, at 1042 (Robert L. Haig ed., 2005) (In securities cases, "economic experts often play the most significant role of any witness" especially

Fischel would have provided important context about how the market incorporates earnings estimates and other predictions, and about the economics and profitability of IRU transactions and their importance to Qwest's overall market valuation. APP-430–34. Fischel also would have identified for the jury the relevant disclosures, APP-431, 433–34, 796–97, wherein Qwest reduced its guidance or disclosed the magnitude of IRU revenues and, using an "event study," would have explained the effect of each disclosure on Qwest's stock price, APP-798. He would have testified about the significance of these reactions so that the jury could assess whether the information significantly altered the "total mix," and would have opined "that the economic evidence does not establish that the information concerning the magnitude of Qwest's IRU revenue would have been material to reasonable investors on the dates of the Questioned Sales." APP-431–32.

Through this "economic evidence," APP-431, Fischel would have explained that, on a one-day basis, none of the disclosures had a statistically significant negative impact on Qwest's stock, some of the disclosures had a statistically significant *positive* impact on the price of the stock, only two events were associated with statistically significant two-day residual returns, and that, when the impact of all the relevant disclosures is considered in totality, they did not cause Qwest's stock to decline and the information

---

"whether the disclosure of certain information had an effect on the market price and, if so, what amount" and whether it "was 'material.'"); 7-107 E. Michael Bradley & Anthony L. Paccione, *Securities Law Techniques* §107.03 (Matthew Bender ed., 2007) ("In securities litigation, expert testimony has been found helpful and been admitted with respect to a wide variety of matters," including "to demonstrate materiality."); *Unger v. Amedisys*, 401 F.3d 316, 325 (5th Cir. 2005); *United States v. Russo*, 74 F.3d 1383, 1395 (2d Cir. 1996); *Miller v. Asensio & Co.*, 364 F.3d 223, 233 (4th Cir. 2004); *Harris v. Union Elec. Co.*, 787 F.2d 355, 365-67 (8th Cir. 1986).

was not material, APP-801–02; 431–32. This was plainly relevant and admissible testimony, as even the drafters of Rule 702 have highlighted "the venerable practice of using expert testimony to educate the factfinder on general principles," including "*how financial markets respond to corporate reports*." Fed. R. Evid. 702, advisory committee's notes to 2000 amends.

2**.** Fischel's testimony was also relevant to the jury's assessment of whether Nacchio knew the information was material. "[T]he more unreasonable the asserted beliefs … are, the more likely the jury … will find that the Government has carried its burden of proving knowledge." *Cheek v. United States*, 498 U.S. 192, 203-04 (1991). Thus, it is "highly probative" to show the reasonableness of Nacchio's beliefs; "evidence of a belief's reasonableness tends to negate a finding of willfulness and to support a finding that the defendant's belief was held in good faith." *United States v. Lankford*, 955 F.2d 1545, 1550–51 (11th Cir. 1992); *United States v. Hurn*, 368 F.3d 1359, 1365 (11th Cir. 2004). From Fischel's testimony on how the market—*i.e.*, a reasonable investor—responded to the information, the jury could infer that Nacchio's beliefs were reasonable and held in good-faith.

Fischel would also have rebutted the government's claim of unusual trading patterns, by testifying that, based on timing, magnitude, and incentives, Nacchio's sales during the first two quarters of 2001 were consistent with prior years, did not accelerate in January 2001, and were consistent with diversification strategy, APP-428–30.

Where state of mind is an element of the offense, "forbidding the jury to consider evidence that might negate willfulness would raise a serious question under the Sixth

Amendment's jury trial provision." *Cheek*, 498 U.S. at 203. This Court has therefore held that a defendant "is entitled to *wide latitude*" to introduce evidence "which tends to show lack of specific intent. '[E]vidence on the question of intent … may take a wider range than is allowed in support of other issues ….'" *United States v. Brown*, 411 F.2d 1134, 1137 (10th Cir. 1969) (citation omitted) (alteration in original);[14] *see also Lankford*, 955 F.2d at 1550–51 (reversing conviction where district court excluded defendant's expert testimony that the defendant's belief in the legality of his acts was reasonable). By excluding Fischel (and also the CIPA evidence), the district court excluded Nacchio's most relevant and probative evidence on intent.

B. The Exclusion Was Reversible Error

The court excluded the testimony on an unprecedented and illogical basis: that the Rule 16 notice did not conclusively establish the reliability of the testimony under Rule 702. The court did not hold a *Daubert* hearing, voir dire Fischel (though he was sitting in the courtroom), or permit argument on the admissibility of the testimony. Most critically, it failed to provide any rationale for excluding Fischel's testimony that the IRU-mix would not have been material to a reasonable investor. The court egregiously compounded this error by allowing two of the government's analysts to testify that the IRU disclosure was material but precluded Fischel's rebuttal testimony. And its

---

[14] *See also United States v. Payne*, 978 F.2d 1177, 1182 (10th Cir. 1992); *United States v. Neujahr*, No. 97-4260, 1999 U.S. App. LEXIS 3770, at *27 (4th Cir. Mar. 10, 1999) (unpublished); *United States v. Powell*, 955 F.2d 1206, 1214 (9th Cir. 1991); *United States v. Parshall*, 757 F.2d 211, 213–14 (8th Cir. 1985); *United States v. Sternstein*, 596 F.2d 528, 530 (2d Cir. 1979); *United States v. Garber*, 607 F.2d 92, 99 (5th Cir. 1979) (en banc).

alternative reasons for excluding portions of the testimony contravened controlling authority.

This Court reviews *de novo* "whether the district court applied the proper standard and actually performed its gatekeeper role." *Dodge v. Cotter Corp.*, 328 F.3d 1212, 1223 (10th Cir. 2003). If the district court applies the proper standard and actually fulfills its gatekeeper role, "whether to admit or exclude an expert's testimony [is reviewed] for abuse of discretion." *Id.*

1. The district court found that Nacchio's Rule 16(b)(1)(C) notice did not conclusively establish the reliability of Fischel's proposed testimony under Rule 702 and *Daubert*. *See*, *e.g.*, APP-3914 ("the deficiencies under *Daubert* and *Kumho Tire* in the [Rule 16 notice] are so egregious"), 3921 (excluding testimony "primarily [for] the [Rule 16 notice's] gross defect in failing to reveal the methodology"), 4075 ("The March 29, 2007 [Rule 16] disclosure contained no methodology or reliable application of methodology to the case."). The court did not find that the notice failed to satisfy Rule 16; only that it did not satisfy 702. We are unaware of *any court ever* upholding the exclusion of a defense expert on this basis.

A defendant does not have an obligation to establish the reliability of the expert's testimony preemptively in a routine discovery notice. The Criminal Rules, unlike the Civil Rules, do not require expert reports. Rule 16 requires only a "summary" of the proposed testimony, and the bases and reasons for the opinions. It can be quite terse, *see United States v. Jackson*, 51 F.3d 646, 650 (7th Cir. 1995), is not filed with the court, and is merely designed to provide an adversary with notice of the "general nature" of the

expert's testimony, *United States v. Finley*, 301 F.3d 1000, 1017 (9th Cir. 2002) (reversing conviction). Nacchio's notice plainly met these requirements. A Rule 16 notice is not the means by which the ultimate reliability of expert testimony is judged—let alone the *exclusive* means.

The court *never* found that Fischel's testimony was *un*reliable—that Fischel's expertise is "*fausse*" and his economics "junky," *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 159 (1999) (Scalia, J., concurring)—merely that the Rule 16 notice alone did not provide it sufficient information to make the reliability findings. Yet it refused to make any inquiry to assess whether Fischel employed "'the same level of intellectual rigor that characterizes the practice of an expert'" in the field. *Dodge*, 328 F.3d at 1222–23 (quoting *Kumho Tire*, 526 U.S. at 152). The Supreme Court and this Court have held that a district court must hold the appropriate proceedings when it does not have adequate information and that a court abuses its discretion by "unreasonably limiting the evidence upon which to base a decision." *Id.* at 1228; *Smith v. Ingersoll-Rand Co.*, 214 F.3d 1235, 1243 (10th Cir. 2000). Even the government below acknowledged that economic analysis is "frequently the subject of *extensive Daubert* hearings." APP-87. The court plainly failed to properly perform the gatekeeping function. *Id.*; *see also United States v. Sandoval*, 390 F.3d 1294, 1301 (10th Cir. 2004).[15]

---

[15] In the bail proceedings, the government asserted that Nacchio failed to request a *Daubert* hearing and therefore the district court's ruling was justified. That is belied by the record. *See* Application for Release Pending Appeal at 15 n.8 (10th Cir. filed Aug. 2, 2007).

2. The district court's most critical error was its exclusion of Fischel's IRU materiality testimony. The court itself acknowledged that the "most important thing that the jury could take away from the government's evidence" is that it was "necessary to rely on these IRUs." APP-3806. However, the court failed to provide *any* rationale for excluding Fischel's key testimony "that the economic evidence does not establish that information concerning the magnitude of Qwest's IRU revenue would have been material to reasonable investors on the date of the Questioned Sales." APP-431–32; *see* APP-3914–22.

This failure to "'adequately demonstrate by *specific findings on the record* that [the lower court] has performed its duty as a gatekeeper'" was manifestly an abuse of discretion. *Dodge*, 328 F.3d at 1223 (citation omitted) (emphasis added in original). Rule 702 does not set a high bar for the admissibility of expert testimony, *Daubert*, 509 U.S. at 588, and "rejection of expert testimony is the exception rather than the rule," Fed. R. Evid. 702, advisory committee's notes to 2000 amends. Therefore, before excluding an expert, the court must "undertake whatever inquiry is necessary" to confirm that the jury should be prohibited from hearing the opinion. *Ingersoll-Rand Co.*, 214 F.3d at 1243; *Dodge*, 328 F.3d at 1222–23; *Kumho Tire*, 526 U.S. at 152. This requires that the court "'on the record, make *some* kind of reliability determination,'" *Dodge*, 328 F.3d at 1223 (quoting *Velarde*, 214 F.3d at 1209 (reversing due to lack of reliability determination)) (emphasis in original), which did not occur here.

The district court compounded this error by allowing two of the government's analysts to testify that the IRU revenue mix *was material* to investors, but refusing to

permit Fischel to rebut their testimony. Johnstone testified that "investors … did not know that [Qwest's Q1 numbers] included over $400 million of one-time optical capacity revenue," and that disclosure of this information altered the total mix of information "warrant[ing] a change in rating and point of view on the company." APP-3588–90. Analyst Khemka similarly testified that Qwest's IRU revenues were "not meaningful" to investors. APP-3671.[16] The court denied Nacchio's motion to allow Fischel to rebut the analysts' testimony, inexplicably finding that "maybe it requires rebuttal, but it doesn't require an expert," APP-4070, and that neither analyst testified about materiality, APP-4075.

Nacchio was entitled to rebut the analysts' testimony about what information they would have found important to investors. And Fischel's testimony would have been far more helpful: whereas an individual analyst's subjective views of what was important has little probative value, Fischel was going to testify about the "total mix" of information, including what *all* analyst reports were telling the market, and about the economic evidence of the information's *actual impact*.[17] At sentencing, moreover, the government

---

[16] The court initially ruled that the analysts could not testify regarding what information would be important to a reasonable investor because the government did not disclose its intent to introduce expert testimony as required by Rule 16 and because in cases where analysts testified "the financial analysts were qualified as experts and testified … on their expert opinion as to what reasonable investors would have considered material." APP-360. However, the court then permitted their testimony on the importance of IRU revenue, how the market valued that revenue, and whether the disclosure of the magnitude of IRU revenues altered the total mix of information.

[17] Nor does the testimony of analysts Johnstone and Khemka establish materiality. "[I]t does not necessarily follow that because a professional trader is interested in particular information that the information is material when judged through the eyes of a

itself emphasized contrasts between the materiality analysis in the analyst report by Johnstone, "a highly sophisticated professional analyst," which was introduced into evidence and about which he testified, and Fischel's analysis of the disclosures' impact—which the court never let the jury see. APP-1147–48.

"It is an abuse of discretion 'to exclude the otherwise admissible opinion of a party's expert on a critical issue, while allowing the opinion of his adversary's expert on the same issue.'" *Lankford*, 955 F.2d at 1552 (quoting *United States v. Sellers*, 566 F.2d 884, 886 (4th Cir. 1977)); *see also Parshall*, 757 F.2d at 213–14; *SEC v. Peters*, 978 F.2d 1162, 1171–72 (10th Cir. 1992). Moreover, in *United States v. Lueben*, 812 F.2d 179 (5th Cir.), *vacated in part on other grounds*, 816 F.2d 1032 (5th Cir. 1987), the Fifth Circuit held "that the district court abused its discretion … because it allowed the government to offer evidence on the issue of materiality, but not the defense…. We find it difficult to understand why this testimony would not confuse the jury when offered by the government but would confuse the jury when offered by the defendant." *Id.* at 184.

3. The district court alternatively held that Fischel's testimony would not be helpful to the jury or was not proper expert testimony.[18] That is plainly incorrect. Expert testimony on materiality is useful and routinely admitted. *Supra* n.13. Fischel intended to testify about a complex statistical analysis of movements in Qwest's stock price that is the "conventional practice in finance," APP-799–800, but well beyond the common

reasonable investor." *United States v. Victor Teicher & Co., L.P.,* 1990 U.S. Dist. LEXIS 2620, at *3 n.3 (S.D.N.Y. Mar. 9, 1990) (unpublished).

[18] The district court also excluded some testimony under Rule 602. Rule 602 does not apply to expert opinion testimony, and none of Fischel's testimony regarding IRU revenues or materiality was excluded on this basis.

knowledge of any jury. The district court's finding that the "significan[ce]" of the stock's response to disclosures "are facts" that are "perfectly obvious" is unduly simplistic, APP-3921, as the drafters of 702 have explicitly explained. *See also Unger*, 401 F.3d at 325 ("Many variables have the potential to and do affect a stock price …. To this end, expert testimony may be helpful because of the *utility of statistical event analysis for this inquiry*."); *United States v. Bilzerian*, 926 F.2d 1285, 1294 (2d Cir. 1991) ("Particularly in complex cases involving the securities industry, expert testimony may help a jury understand unfamiliar terms and concepts."). Similarly, "federal courts have admitted expert testimony to assist the trier of fact in understanding trading patterns," *SEC v. U.S. Envtl., Inc.*, No. 94Civ.6608, 2002 WL 31323832, at *2 (S.D.N.Y. Oct. 16, 2002), precisely because evidence of economic consistency in trading patterns or previously announced plans can negate an inference of scienter. *E.g.*, *In re Worlds of Wonder*, 35 F.3d at 1427–28.

Raw numbers and percentages are not enough: "If an *expert* is not allowed to testify that given statistics evidence excessive trading, the jury is left with *meaningless numbers from which they cannot judge the appropriateness of the transactions*." *Shad v. Dean Witter Reynolds, Inc.*, 799 F.2d 525, 530 (9th Cir. 1986). The court excluded Fischel's testimony, concluding that an expert may not offer "an opinion … that the jury can draw from other evidence" and "the jury does not *need* to have an expert opinion to assist it." APP-3917–19. That is the wrong standard: "It is … well settled that 'necessity' is not a condition precedent for the admissibility of opinion testimony …, the test is whether the opinion 'will assist the trier of fact,'" *United States v. Brawner*, 173

F.3d 966, 969 (6th Cir. 1999), and "expert testimony is admissible if it will simply assist the trier of fact to understand *the facts already in the record*, even if all it does is put those facts in context," 4 Jack B. Weinstein & Margaret A. Burger, *Weinstein's Federal Evidence* § 702.03[1] (2d ed. 2007).

Nor was Rule 403 a proper basis to exclude Fischel's testimony. "'Rule 403 is an extraordinary remedy and should be used sparingly.'" *United States v. Roberts*, 88 F.3d 872, 880 (10th Cir. 1996) (citation omitted). This evidence was highly probative, essential to Nacchio's defense, and "if expert testimony survives … Rules 702 and 703, then Rule 403 becomes an unlikely basis for exclusion …." *Petruzzi's IGA Supermarkets, Inc. v. Darling-Delaware Co.*, 998 F.2d 1224, 1239 (3d Cir. 1993). Nor would it "be a needless presentation of evidence," "lead to delay and waste of time" or "mislead the jury," APP-3919–20, especially when the government was permitted to present its version. Certainly those factors do not "substantially outweigh" the evidence's "probative value." A new trial is essential.

IV. THE COURT MISINTERPRETED RULE 16 AND CIPA

See Classified Excerpt.

V. THE SENTENCE SHOULD BE REDUCED

A. The Court's Guideline Interpretation Was Erroneous

Guideline §2F1.2(b)(1) limits the amount of "gain" used to increase the base-offense-level to "gain resulting from the offense." The government argued that the "gain resulting from the offense" was the *total* amount received from the trades—$52 million—resulting in a guidelines range of 70-87 months. Nacchio argued that "the offense" is the

failure to disclose material inside information prior to trading, and calculated the gain from that offense at $1.8 million, APP-802, resulting in a 41-51 months' range. Relying on the commentary and *United States v. Mooney*, 425 F.3d 1093 (8th Cir. 2005) (en banc), the court concluded that Nacchio's gain was about $28 million, after subtracting option exercise costs, taxes, and broker fees and commissions that Nacchio did not "realize," resulting in a 16-level increase and a 63-78 month range.

In setting Nacchio's sentence, the court opined (without any evidence) that "trading on inside information was a familiar, accepted occurrence at Qwest," and that Nacchio "condoned a culture in which this could occur." APP-1317. The court said that "I see no reason why this man who grew up, the son of Italian immigrants … should ever have come out here to Colorado," APP-1324, and opined that "the defendant's entire presence in Colorado was occasioned primarily because of greed," APP-1317. He accused Nacchio of "overarching" and "flagrant greed," APP-1317–18, "because of, perhaps, a character flaw," APP-1327. The court then remarked on Nacchio's devotion to Catholicism, and used events from the life of Sir Thomas More to justify the need for a strong sentence. APP-1329–30. It sentenced Nacchio to 72-months' imprisonment and the maximum fine of $19 million (in addition to $52 million forfeiture).

A court's guideline interpretation is reviewed *de novo*. *United States v. Robertson*, 350 F.3d 1109, 1112 (10th Cir. 2003). "The legally operative language is found in the Guideline itself …." *Id.* at 1118. If that is clear, "it is not necessary to look beyond the plain language." *Id.* at 1116.

The *Mooney* dissent was correct. The plain language addresses the gain "resulting from the offense," and "[t]he offense [of insider trading] inheres not in the purchase [or sale] itself, but in any deception that may be entwined with the purchase [or sale]." *Mooney*, 425 F.3d at 1106 (Bright, J., dissenting). The "gain resulting from the offense," therefore, is that portion of the sale proceeds representing the difference between the value of the stock sold while in possession of material, nonpublic information, and the market value of such stock once the material information was made public—in this case, $1.8 million. The vast majority of the amount calculated by the court reflects years of legitimate price appreciation in Qwest stock since the options were granted, and should not have played a role in determining Nacchio's relative culpability. In other cases, the government has not disputed this interpretation of §2F1.2. *E.g.*, *United States v. Rieker*, No. CR-H-04-192, Sentencing Tr. (S.D. Tex. Dec. 1, 2006) & Ex. A to Plea Agreement (S.D. Tex. May 19, 2004). This is also consistent with disgorgement (ill-gotten gain) in civil insider trading cases. *E.g.*, *SEC v. Happ*, 392 F.3d 12, 31 (1st Cir. 2004).

The court, however, bypassed the plain language of the guideline and looked *first* to the "plain language of the commentary," APP-1306, 1309, which defines the gain as "the total increase in value … realized … through trading in securities." Guideline commentary, however, may "not conflict with the guideline." *United States v. Novey*, 78 F.3d 1483, 1488 (10th Cir. 1996). It does here, and because the commentary does not even mention or define the key phrase "resulting from the offense," the district court's interpretation creates dis-uniformity in sentencing dependent upon market forces having nothing to do with the deceptive conduct.

As Judge Bright explained, imagine three executives (Larry, Moe, Curly) working at the same company who, at the same time and with the same inside information, buy 1,000 shares at $5 per share. When the information is disclosed and absorbed by the market, the stock rises to $15. Larry sells immediately and makes $10,000. His entire gain is attributable to inside information. Moe sells later when the stock has risen to $50. Moe's gain includes the illicit $10,000, but also $35,000, the result of separate market forces untainted by any deception. Curly waits longer and sells after a market crash where the stock plummets to $2. Curly sustains a loss. *Mooney*, 425 F.3d at 1107 (Bright, J., dissenting). Each defendant has the same amount of illicit gain—$10,000—but each has a different total gain due to unrelated market conditions. If Nacchio is correct and the gain is the deceptive gain, each defendant who committed the exact same crime here would receive the same enhancement. However, under the district court's interpretation, each defendant who committed the exact same crime will receive a different enhancement.

The district court acknowledged that Judge Bright's hypothetical is "troublesome," but chose to ignore its logic because, "that's not this case." APP-1269–70. But punishment should not be determined by market forces independent of criminal culpability. That cannot be what Congress intended. *United States v. Booker*, 543 U.S. 220, 254 (2005) (emphasizing importance of "relationships between sentences and real conduct"). *See also* 18 U.S.C. §3553(a)(6) ("the need to avoid unwarranted sentence disparities"); 28 U.S.C. §991(b).

Even if the commentary cast some doubt on the plain language of the guideline itself, "[t]he rule of lenity requires courts to interpret ambiguous statutes, including the Sentencing Guidelines, in favor of criminal defendants." *United States v. Gay*, 240 F.3d 1222, 1232 (10th Cir. 2001); *United States v. Weidner*, 437 F.3d 1023, 1046-47 (10th Cir. 2006).

Nacchio is entitled to resentencing under the correct range, 41-51 months. This Court should also vacate the fine for further consideration in light of the relevant monetary gain. Imposition of a $19 million fine, in combination with a forfeiture of $44 million (see below), would represent a penalty 35-times greater than the $1.8 million gain, raising a serious Eighth Amendment question. *See Alexander v. United States*, 509 U.S. 544, 558–59 (1993) (remanding on whether combined fine/forfeiture was excessive).

B. The Forfeiture Analysis Was Wrong

Nacchio received $28,554,316.57 from the stock sales. The district court ordered forfeiture of $52,007,545.47, which includes the cost of exercising the options ($7,315,000), the brokerage commissions and fees paid ($60,081.09), and the taxes withheld ($16,078,147.81). The court's calculation was based on the definition of "proceeds" under Subsection (A) of 18 U.S.C. §981(a)(2) , but a different definition of "proceeds" in Subsection (B) governs insider trading offenses. The correct forfeiture amount is not more than $44,632,464.38 (gross proceeds less the cost of exercising the options, the brokerage commissions and fees).

This question of statutory interpretation is reviewed *de novo*. *Wedelstedt v. Wiley*, 477 F.3d 1160, 1165 (10th Cir. 2007). "Because forfeitures are disfavored, forfeiture laws … are 'strictly construed … against the government.'" *United States v. Ritchie*, 342 F.3d 903, 910 (9th Cir. 2003) (citations omitted) (second omission in original); *see also United States v. Herndon*, 982 F.2d 1411, 1418 n.9 (10th Cir. 1992). Subsection (A) makes forfeitable any property "obtained" in cases "involving illegal goods, illegal services, unlawful activities, and telemarketing and health care fraud schemes." Subsection (B) states that: "In cases involving lawful goods or lawful services that are sold or provided in an illegal manner, the term 'proceeds' means the amount of money acquired through the illegal transactions … less the direct costs [excluding taxes and overhead] incurred in providing the goods and services …."

Subsection (A) applies to inherently unlawful activities such as selling drugs. Insider trading is a lawful transaction conducted in an unlawful manner, and therefore covered by (B). The district court applied (A) for three erroneous reasons.

First, the court correctly noted that insider trading is a "specified unlawful activity," under §981(a)(1)(C), which makes CAFRA applicable to this case. But it then incorrectly reasoned that because it is a "specified unlawful activity" under §981(a)(1)(C), it must also be an "unlawful activity" under §981(a)(2)(A). That reasoning would eliminate §981(a)(2)(B)-(C) from the statute and *all* forfeitures under the statute would fall under the gross proceeds provision of (A).[19] It would also have

---

[19] The district court relied on *United States v. All Funds on Deposit in United Bank of Switzerland*, 188 F. Supp. 2d 407 (S.D.N.Y. 2002). APP-1231–32. But, for the

been redundant for Congress to list “telemarketing and health care fraud schemes” in (A), because those crimes, like insider trading, are already “specified unlawful activities” under §981(a)(1)(C).

Second, the court applied subsection (A), because (A) includes “other kinds of fraud,” APP-1238, including “telemarketing and health care fraud schemes.” But specific exceptions indicate that “other kinds of fraud” are not to be implied. *TRW, Inc. v. Andrews*, 534 U.S. 19, 28 (2001) (‘“Where Congress explicitly enumerates certain exceptions …, additional exceptions are not to be implied ….’”) (citation omitted). And there was good reason for Congress to include “telemarketing and health care fraud schemes” in (A): Pre-CAFRA, specific statutes *already* required gross-proceeds forfeiture for telemarketing and healthcare fraud schemes. *See* Smith, *supra,* at n.19.

Third, the court rejected (B) on the erroneous basis that it applies to “goods or services,” and the court determined (without citation) that stock is a “commodity.” APP-1231. But (A) too speaks in terms of “illegal goods” and “illegal services,” without specific reference to securities, and *Black’s Law Dictionary* 714 (8th ed. 2004), defines “goods” as “[t]hings that have value, whether tangible or not.”

Subsection (B) applies to insider trading, which is the unlawful sale of a lawful good. The government’s attempt to liken the exercise costs to the purchase of illegal

---

reasons discussed, the leading forfeiture treatise describes that decision’s reasoning as “ill-considered.” 1 David B. Smith, *Prosecution and Defense of Forfeiture Cases* §5.03[2] n.8 (2007).

drugs for resale ignores the legitimate value of the Qwest stock untainted by any wrongdoing.[20]

CONCLUSION

This Court should direct a judgment of acquittal or in the alternative reverse defendant's convictions and remand for a new trial. If a new trial is granted, Nacchio respectfully requests this Court to exercise its "inherent power … to reassign this case to a different district judge." *Mitchell v. Maynard*, 80 F.3d 1433, 1448 (10th Cir. 1996). Where, like *Mitchell*, "there would be little unnecessary duplication of effort in having a different judge preside over the new trial," and the record reflects "expressions of [the judge's] disapproval toward [the defendant], his attorney[s] and his claims," *e.g.*, APP-1317, 1324, 1326, 1327, 1329–30, 2393, 2813–14, 3923, 3924, 3927–28, 3928–29, 3973, this Court, without finding that the judge "harbored any personal bias or acted improperly," can still exercise its power "merely on the conclusion that the interests of justice would be best served by remanding the case with instructions that a different judge be assigned." 80 F.3d at 1450; *see also United States v. Quattrone*, 441 F.3d 153, 192-93 (2d Cir. 2006).

---

[20] Even if (A) did apply, the district court still incorrectly applied it. In no sense did Nacchio "obtain" the cost of exercising the options, *see Scheidler v. NOW*, 537 U.S. 393, 403 n.8 (2003) (construing "obtain" to mean "gain possession of"). Thus, the forfeiture would still have to be reduced to $44,692,545.47.

Respectfully submitted,

s/ Maureen E. Mahoney

Herbert J. Stern
Jeffrey Speiser
STERN & KILCULLEN
75 Livingston Avenue
Roseland, New Jersey 07068
(973) 535-1900 (telephone)
(973) 535-9664 (facsimile)

Maureen E. Mahoney
Alexandra A.E. Shapiro
J. Scott Ballenger
Nathan H. Seltzer
LATHAM & WATKINS LLP
555 11th Street, N.W., Suite 1000
Washington, DC 20004
(202) 637-2200 (telephone)
Maureen.Mahoney@lw.com

Dated: October 9, 2007

Counsel for Defendant-Appellant

CERTIFICATE OF COMPLIANCE WITH RULE 32

I hereby certify in accordance with Fed. R. App. P. 32(a)(7)(C) that this brief has been prepared with the type-volume limitations of Fed. R. App. P. 32(a)(7)(B), and, this brief contains 15,902 words (per this Court's order of August 30, 2007, authorizing 17,000 words), excluding the parts of the brief exempted by Fed. R. App. P. 37(a)(7)(B)(iii).

I further certify that the classified excerpt, filed separately with the court security officer, contains 1,041 words, exclusive of the heading which is reproduced and counted in the main filing.

I further certify that the total word count for both the classified and unclassified portions of the brief is 16,943.

I hereby certify that this brief complies with the typeface requirements of 10th Circuit Rule 32(a) because this brief was prepared using Microsoft Word 2003 in 13-point Times New Roman font.

s/ Maureen E. Mahoney
Maureen E. Mahoney
Latham & Watkins LLP
555 11th Street, N.W.
Suite 1000
Washington, D.C. 20004
(202) 637-2200 (telephone)
(202) 637-2201
Maureen.Mahoney@lw.com

CERTIFICATION OF DIGITAL SUBMISSIONS

I, Maureen E. Mahoney, hereby certify that:

(1) there were no privacy redactions to be made in the documents submitted on October 9, 2007, and every document submitted in Digital Form or scanned PDF format is an exact copy of the written document that was sent to the Clerk; and

(2) the digital submissions have been scanned for viruses using Anitgen, version 9.00.1055, subscription expiring September 20, 2010, and according to the program, are free from viruses.

s/ Maureen E. Mahoney
Maureen E. Mahoney
Latham & Watkins LLP
555 11th Street, N.W.
Suite 1000
Washington, D.C. 20004
(202) 637-2200 (telephone)
(202) 637-2201
Maureen.Mahoney@lw.com

AMENDED CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of October, 2007, I caused the foregoing **APPELLANT'S OPENING BRIEF,** originally submitted electronically on the 9th day of October, 2007, to be resubmitted via electronic mail to include the **ADDENDUM to APPELLANT'S OPENING BRIEF** to:

U.S. Court of Appeals for the 10th Circuit:
esubmission@ca10.uscourts.gov

Stephan Oestreicher
Stephan.Oestreicher@usdoj.gov

Kevin Traskos
kevin.traskos@usdoj.gov

Leo J. Wise
leo.wise@usdoj.gov

Tory Eid
Troy.Eid@usdoj.gov

I further certify that on the 9th day of October, 2007, I caused two (2) paper copies of the foregoing **APPELLANT'S OPENING BRIEF** and one (copy) of the **APPENDIX TO APPELLANT'S OPENING BRIEF, VOLUMES 1–15, and VOLUME 16** filed under seal to be sent via U.S. mail postage prepaid to:

Stephan E. Oestreicher, Jr.
Criminal Division, Appellate Section
U.S. Department of Justice
P.O. Box 899
Ben Franklin Station
Washington, DC 20044-0089

Kevin Traskos
Troy A. Eid
U.S. Attorney's Office-Denver Colorado
District of Colorado
1225 17th Street
Suite 700
Denver, CO 80202

(303) 454-0100

Leo J. Wise
U.S. Department of Justice
Criminal Division-Fraud Section
1400 New York Ave., N.W.
3rd Fl.
Washington, DC 20530
(202) 514-9842

s/ Maureen E. Mahoney

Maureen E. Mahoney
Latham & Watkins LLP
555 11th Street, N.W., Suite 1000
Washington, DC 20004
(202) 637-2200 (telephone)
(202) 637-2201 (facsimile)
Maureen.Mahoney@lw.com