IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
Judge Edward W. Nottingham

Criminal Case No. 05–cr–00545–EWN

UNITED STATES OF AMERICA,

Plaintiff,

v.

1. JOSEPH P. NACCHIO,

Defendant.

ORDER AND MEMORANDUM OF DECISION

This is a criminal securities fraud and insider trading case. The United States of America ("the Government") alleges that Defendant Joseph P. Nacchio sold Qwest Communications International Inc. ("Qwest") securities while aware of and on the basis of material, nonpublic information. The matter is now before the court on Defendant's "Motion for Dismissal of Indictment Due to Prosecutorial Misconduct in the Grand Jury," filed May 1, 2006. The motion seeks an order to: (1) dismiss the indictment because of alleged prosecutorial misconduct before the grand jury; or (2) direct the Government to produce unreleased portions of grand jury transcripts. Jurisdiction is based on 15 U.S.C. §§ 78j, 78ff (2006), 17 C.F.R. §§ 240.10b–5, 240.10b5–1 (2006), 18 U.S.C. § 981 (2006), and 28 U.S.C. § 2461 (2006).

FACTS

1. Factual Background

The following information is taken from the Government's indictment. From January 1997 through June 2002, Qwest employed Defendant Joseph P. Nacchio as its chief executive officer and a member of its board of directors. (Indictment ¶ 1 [filed Dec. 20, 2005] [hereinafter "Indictment"].) Qwest, through Defendant and others, reported its financial results, including its revenues, earnings, and growth rates to the public each fiscal year. (*Id.* ¶ 3.) Qwest reported its financial results in press releases, direct communications with investors and investment analysts, and quarterly and annual reports to the United States Securities and Exchange Commission ("SEC"). (*Id.*) Qwest also issued financial guidance generally referred to as "targets" to the investing public concerning Qwest's future revenue, growth, and earnings. (*Id.*) Qwest's business included two types of revenue: recurring revenue and non-recurring revenue. (*Id.* ¶ 5.) Recurring revenue was revenue that Qwest earned each month during the life of a customer as it rendered services to that customer. (*Id.*) Non-recurring revenue typically resulted from one-time quarter-end transactions. (*Id.*) The Government contends that beginning no later than December 4, 2000 through September 10, 2001, Defendant was aware of material nonpublic information about Qwest's business, including, but not limited to:

> (a) Qwest's publicly stated financial targets, including its targets for 2001 were extremely aggressive and a "huge stretch;" (b) in order to achieve its publicly stated financial targets for 2001, Qwest would be required to significantly increase its recurring revenue business during the first few months of 2001; (c) Qwest's past experience or "track record" in growing recurring revenue at a sufficient rate to meet is publicly stated financial targets was poor; (d) Qwest's recurring revenue business was underperforming from early 2001 and was not growing at a sufficient rate to meet Qwest's publicly stated financial targets; (e) there were material undisclosed risks relating specifically to Qwest's recurring and non-recurring

> revenue streams that put achievement of Qwest's 2001 publicly stated financial targets in jeopardy; (f) the gap between Qwest's publicly stated financial targets and Qwest's recurring revenue was increasing, thus increasing Qwest's reliance on risky and unsustainable one-time transactions; (g) there would be insufficient non-recurring revenue sources to close the gap between Qwest's publicly stated financial targets and its actual performance.

(*Id.* ¶ 6.)

The Government contends that beginning in January 2001 through September 10, 2001, Defendant "knowingly and willfully s[old], using the instrumentalities of interstate commerce and the facilities of a national securities exchange more than [one-hundred] million [dollars] worth of Qwest [securities] . . . while aware of and on the basis of material, non-public information . . . ." (*Id.* ¶ 9.) At all times relevant to the indictment, Qwest had an insider trading policy prohibiting its employees from selling Qwest common stock and other Qwest securities while in possession of material nonpublic information. (*Id.* ¶ 4.)

2. Procedural History

On December 20, 2005, a federal grand jury returned an indictment alleging forty-two counts of insider trading against Defendant pursuant to: (1) 15 U.S.C. § 78j, (2) 15 U.S.C. § 78ff, (3) 17 C.F.R. § 240.10b–5, and (4) 17 C.F.R. § 240.10b5–1. (Indictment ¶ 9.) On January 11, 2006, the Government filed a motion to disclose portions of its grand jury transcripts and exhibits to Defendant. (Govt.'s Mot. to Disclose Grand Jury Material to Def. [filed Jan. 11, 2006].) On January 18, 2006, this court granted the Government's motion to disclose. (Order Concerning Disclosure of Grand Jury Materials [filed Jan. 18, 2006].) On February 10, 2006, Defendant filed his first motion to dismiss the indictment. (Mot. for Dismissal of Indictment [filed Feb. 10, 2006].) On March 24, 2006, this court denied Defendant's first motion to dismiss the indictment.

(*See* Rep.'s Tr. Pre-Trial Conference Mar. 24, 2006 at 8 [hereinafter "Rep.'s Tr."].) On May 5, 2006, Defendant filed a second motion to dismiss the indictment, which is the subject of this Order. (Mot. for Dismissal of Indictment Due to Prosecutorial Misconduct in the Grand Jury [filed May 5, 2006] [hereinafter "Def.'s Br."].) In his motion, Defendant alleges the Government: (1) improperly rested its grand jury presentation on alleged violations of internal Qwest policy rather than federal law; and (2) erroneously instructed the grand jury on an essential element of the federal insider trading offense. (*Id.* at 1.) On June 2, 2006, the Government filed its response to Defendant's motion for dismissal. (Govt.'s Resp. to Def.'s Mot. for Dismissal of Indictment Due to Prosecutorial Misconduct in the Grand Jury [filed June 2, 2006] [hereinafter "Govt.'s Resp."].) On June 22, 2006, Defendant filed his reply. (Reply to the Govt.'s Resp. to Mot. for Dismissal of Indictment Due to Prosecutorial Misconduct in the Grand Jury [filed June 22, 2006] [hereinafter "Def.'s Reply"].) This matter is fully briefed.

ANALYSIS

1. Legal Standard

The grand jury exists not to determine guilt or innocence, but to assess whether there is an adequate basis for bringing a criminal charge. *Rose v. Mitchell*, 443 U.S. 545, 575 (1979). To ensure grand jury independence, federal courts have very limited supervisory authority over grand jury proceedings. *United States v. Williams*, 504 U.S. 36, 46–47 (1992). A grand jury is thus a "constitutional fixture in its own right" that is functionally independent of the federal judiciary. *Id.* at 47 (internal quotation marks omitted). The limited power federal courts have over grand juries is "not remotely comparable" to the power federal courts maintain over their own proceedings. *Id.* at 50.

A "presumption of regularity" is accorded to all grand jury proceedings. *United States v. Edmonson*, 962 F.2d 1535, 1539 (10th Cir. 1992). Such a presumption is "a difficult burden to overcome and requires very significant misconduct on the part of the prosecutor." *Id.* Indeed, dismissal of an indictment is an extraordinary remedy, which the Supreme Court has characterized as "drastic," *United States v. Morrison*, 449 U.S. 361, 367 (1981), and the Tenth Circuit has described as "draconian." *United States v. Gonzalez*, 248 F.3d 1201, 1205 (10th Cir. 2001). Hence, an indictment returned by a legally constituted and unbiased grand jury, if valid on its face, is enough to call for trial of the charge on the merits notwithstanding challenges to the competency or adequacy of the evidence presented to the grand jury. *Costello v. United States*, 350 U.S. 359, 363 (1956); *see also United States v. Buchanan*, F.2d 477, 487 (10th Cir. 1986) ("Challenges going only to the instructions given to the grand jury as to the elements of the offenses are not grounds for dismissal of an indictment that is valid on its face.").

In the absence of "fundamental error" in grand jury proceedings—a category thus far limited to racial and gender discrimination in the selection of grand jurors—a district court may not dismiss an indictment for errors in grand jury proceedings unless such errors prejudiced the defendant. *Bank of Nova Scotia v. United States*, 487 U.S. 250, 254, 256–57 (1988). Under the standard of prejudice articulated by the Supreme Court in *Nova Scotia*, dismissal of an indictment is appropriate only if: (1) it is established that misconduct substantially influenced the grand jury's decision to indict; or (2) there is grave doubt that the decision to indict was free from the substantial influence of such misconduct. *Id.* at 256.

Finally, federal courts' supervisory power to dismiss indictments is further limited to the enforcement of "legally compelled standards of prosecutorial conduct before the grand jury."

Williams, 504 U.S. at 47 (discussing *Nova Scotia*, 487 U.S. 250). Thus, "[a]ny power federal courts *may* have to fashion, of their own initiative, rules of grand jury procedure is a very limited one. . . ." *Id.* (emphasis added).

2. Evaluation

a. Defendant Is Not Entitled to Dismissal of the Indictment

Defendant argues that the indictment should be dismissed because the Government misinformed the grand jury as to the requisite *mens rea* for insider trading liability. (Def.'s Br. at 7.) Defendant asserts criminal and securities law prohibits only "knowing use" of inside information when buying or selling securities. (*Id.* at 15–16.) In contrast, Defendant notes that Qwest's internal insider trading policy prohibited its employees from buying or selling Qwest securities while merely in "possession" of inside information. (*Id.* at 13–14.) Defendant asserts portions of the disclosed grand jury transcripts indicate that in "a misguided effort to sway the grand jury and secure an indictment, the prosecution used [the Qwest] internal policy in place of the requisite, and more stringent ['knowing use'] standard imposed by criminal and securities law." (*Id.* at 13.) Defendant also alleges that if the Government relied on SEC Rule 10b5–1 at all in its instructions to the grand jury, such reliance was misplaced because Rule 10b5–1 violates the Constitution as well as federal securities laws and regulations. (*Id.* at 4, 16–22; Def.'s Reply at 4.) Defendant suspects that transcripts of the colloquy between the Government and the grand jury as well as the legal instructions furnished to the grand jury, which have not been released by the Government, will affirm his allegations of misconduct. (Def.'s Reply at 2; Def.'s Br. at 27.) Consequently, Defendant seeks an order to: (1) dismiss the indictment because of alleged prosecutorial misconduct before the grand jury; or (2) disclose all colloquy between the

Government and the grand jury as well as the instructions given to the grand jury prior to its deliberations. (Def.'s Br. at 2.)

The ensuing discussion demonstrates that even accepting as true Defendant's allegations of misconduct, Defendant's motion to dismiss the indictment fails on two alternative grounds. For reasons set forth below, the court finds that: (1) under Tenth Circuit case law, inadequate legal instructions such as those alleged by Defendant do not require dismissal; and (2) the prosecutorial misconduct Defendant alleges could not have caused him sufficient prejudice to warrant dismissal.

i. Tenth Circuit Case Law Precludes Dismissal

Accepting as true Defendant's allegation that the Government improperly relied on the "possession" standard set forth in Qwest internal policy as a substitute for violation of criminal and securities law in order to procure the grand jury indictment, (*id.* at 3), such misconduct would not be sufficient to dismiss the indictment. In *United States v. Buchanan*, the defendant alleged that the prosecuting attorney incorrectly stated the law of aiding and abetting in response to a grand jury member's question pertaining thereto. 787 F.2d at 487. The court responded:

> An indictment returned by a legally constituted and unbiased grand jury, if valid on its face, is enough to call for trial of the charge on the merits. . . . An indictment may be dismissed for prosecutorial misconduct so flagrant that there is some significant infringement on the grand jury's ability to exercise independent judgment. . . . Challenges going only to the instructions given to the grand jury as to the elements of the offenses are not grounds for dismissal of an indictment that is valid on its face.

Id. (citing *Costello*, 350 U.S. at 363); *accord United States v. Battista*, 646 F.2d 237, 242 (6th Cir. 1981) (citing *Costello*, 350 U.S. 359) (stating in dicta that "even if an incorrect instruction was given to the grand jury . . . the indictment was valid on its face and was sufficient to require a

trial of the indictment on its merits"); *United States v. Welch*, 201 F.R.D. 521, 524–525 (D. Utah 2001) (citing *Buchanan*, 787 F.2d at 487) (other citation omitted) (rejecting attempt to attack alleged legal error before grand jury on basis of grand jury's return of facially valid indictment); *United States v. Finn*, 919 F. Supp. 1305, 1327 (D. Minn. 1995) (citing *Buchanan*, 787 F.2d at 487) (other citation omitted) ("[A] challenge to an instruction to the [g]rand [j]ury is not a proper basis for the dismissal of an [i]ndictment that is valid on its face."); *United States v. Beech-Nut Nutrition Corp.*, 659 F. Supp. 1487, 1499 (E.D.N.Y. 1987) (citing *Buchanan*, 787 F.2d at 487) (other citation omitted) ("[M]isinforming the grand jury as to the applicable law does not constitute grounds for dismissal."). This court has already determined that the Government's indictment is valid. (Rep.'s Tr. at 8.) Indeed, the indictment alleges Defendant "knowingly and willfully" sold Qwest securities "on the basis of" inside information—not that Defendant merely "possessed" such information when he sold the securities. (Indictment ¶ 9.) Thus, even accepting as true Defendant's allegation that the Government blurred the line between Qwest policy and federal criminal and securities law, any such improper expression of the law would fail to constitute misconduct so "flagrant" as to overcome the "presumption of regularity" accorded to all grand jury proceedings. *See Buchanan*, 787 F.2d at 487; *Edmonson*, 962 F.2d at 1539.[1]

Indeed, the defendants in *United States v. Burger*, 773 F. Supp. 1430 (D. Kan. 1991), raised virtually the same argument that Defendant now makes. In *Burger*, the defendants claimed the government "misinformed or misled the grand jury into believing civil regulatory violations

[1]For an example of the sort of flagrant, pervasive misconduct that has warranted dismissal of an indictment, see *United States v. Breslin*, 916 F. Supp. 438, 443–46 (E.D. Pa. 1996) (dismissing indictment without prejudice based on seven distinct areas of grave concern with prosecutor's presentation to grand jury).

created criminal culpability." 773 F. Supp. at 1435. The court held: "such a claim is insufficient to justify dismissal of the indictment. Giving erroneous legal instructions to a grand jury does not constitute grounds for dismissing an indictment valid on its face." *Id.* (citing *Buchanan*, 787 F.2d at 487). Accordingly, I find that the misconduct Defendant alleges is insufficiently egregious to merit application of the drastic remedy of dismissal of the indictment. Defendant's motion to dismiss must be denied.

Defendant makes two lines of argument counseling against this result. First, Defendant argues that case law from the Southern District of New York calls for a contrary outcome. (Def.'s Br. at 24–26.) Specifically, Defendant argues that such case law can be read to stand for the following proposition: "[d]ismissal is appropriate where the prosecutor supplied to the grand jury legal instructions which are erroneous and misleading." (*Id.* at 24–25 [citing *United States v. Peralta*, 763 F. Supp. 14 (S.D.N.Y. 1991); *United States v. Vetere*, 663 F. Supp. 381 (S.D.N.Y. 1987)].) In *Peralta*, at the close of the government's case against them, the defendants moved for dismissal of the indictment based on several alleged inconsistencies, revealed for the first time at trial, between the testimony of the arresting law enforcement officer given at trial and the grand jury testimony of a special agent not present at the arrest, who was the sole witness before the grand jury. 763 F. Supp. at 14. After reviewing *in camera* two partial transcripts of the grand jury proceedings, the court determined that: (1) the special agent's testimony before the grand jury was both inaccurate and completely based on hearsay; and, additionally, (2) the prosecutor had failed to explain adequately an essential element of one of the counts alleged against the defendants. *Id.* at 21, 19. Thus, the *Peralta* court found:

> [T]he defendants were seriously prejudiced by the *cumulative effect* of the

> government's misleading statements of the law *and* its use of inaccurate hearsay authority. *These defects* in the grand jury leave us with "grave doubt that the decision to indict was free from the substantial influence" of the errors.

Id. at 21 (quoting *Nova Scotia*, 487 U.S. at 256) (other citations omitted) (emphases added). Thus, *Peralta* does not stand for the proposition Defendant propounds. Moreover, *Peralta* is readily distinguishable from the present case. Here, Defendant does not argue that inaccurate hearsay statements were made before the grand jury, but in *Peralta* such statements, along with inconsistencies between trial testimony and grand jury testimony: (1) convinced the court to review grand jury transcripts; and (2) were subsequently critical to the court's motion to dismiss the indictment. *Id.*

Moreover, *Peralta* is an unavailing alternative to Tenth Circuit authority on point. First, *Peralta* relied on a line of Second Circuit authority flouting Supreme Court jurisprudence, set forth in *Costello*, 350 U.S. at 363, restricting federal courts' power to dismiss indictments based on such courts' determinations concerning the competency and adequacy of the evidence presented to the grand jury. *See Peralta*, 763 F. Supp. at 20–21 (citing *United States v. Estepa*, 471 F.2d 1132 [2d Cir. 1972]; *United States v. Brito*, 907 F.2d 392 [2d Cir. 1990]).[2] Second, *Peralta* cursorily distinguished *Buchanan*, which itself is premised on the rationale espoused in

[2]Even before the Supreme Court expressly disapproved *Estepa*, *see Williams*, 504 U.S. at 55 n.8, the Tenth Circuit had already declined to follow *Estepa* as contrary to the Supreme Court's holding in *Costello*. *United States v. Rogers*, 652 F.2d 972, 975 (10th Cir. 1981). Courts in the Second Circuit now recognize that *William*'s disapproval of *Estepa* undermined *Brito* as well. *See, e.g.*, *United States v. Carter*, No. 04CR594, 2005 WL 180914, at *3 (S.D.N.Y. Jan. 25, 2005) (collecting Southern District of New York cases recognizing *Brito*'s abrogation).

Costello[3] and rejected by the Second Circuit under the now-discredited line of opinions following *Estepa*. *See id.* at 20 n.10. Thus, *Peralta* runs contrary to the Tenth Circuit's unequivocal pronouncement: "[c]hallenges going only to the instructions given to the grand jury as to the elements of the offenses are not grounds for dismissal of an indictment that is valid on its face." *Buchanan*, 787 F.2d at 487; *see also United States v. Larrazolo*, 869 F.2d 1354, 1359 (9th Cir. 1989), *overruled on other grounds by Midland Asphalt Corp. v. United States*, 489 U.S. 794, 799–800 (1989) (stating prosecutor has no duty to outline all elements of crime provided that either the instructions given are not flagrantly misleading or all elements are at least implied). This court is bound by Tenth Circuit precedent unless overruled *en banc* or superseded by a contrary Supreme Court decision. *Haynes v. Williams*, 88 F.3d 898, 900 n.4 (10th Cir. 1996).

Defendant cites to another New York case, *Vetere*, 663 F. Supp. 381. (Def.'s Br. at 25.) This citation is even less availing. In *Vetere*, the defendant sought dismissal of the indictment for a wide variety of prosecutorial misconduct before the grand jury. 663 F. Supp. at 383. The *Vetere* court took note of "instructions on the law . . . which could be considered erroneous and misleading." *Id.* Nevertheless, the court's decision to dismiss the indictment rested squarely on the government's presentation of factually prejudicial grand jury testimony—notwithstanding

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[3]In *Costello*, the defendant appealed the denial of his motion to dismiss the indictment on the grounds that the only evidence before the grand jury was hearsay. 350 U.S. at 361. The Supreme Court held: "[a]n indictment returned by a legally constituted and unbiased grand jury . . . if valid on its face, is enough to call for trial of the charge on the merits." *Id.* at 363. The court cautioned that a contrary rule would cause great delay by allowing a preliminary trial on "the competency and adequacy of the evidence before the grand jury." *Id. Buchanan* similarly rejected "an attempt to prevent trial by attacking alleged legal errors in the grand jury proceedings," stating that "[a]n indictment returned by a legally constituted and unbiased grand jury, if valid on its face, is enough to call for trial of the charge on the merits." 787 F.2d at 487 (citing *Costello*, 350 U.S. at 363) (other citation omitted).

Costello—such as: (1) "non-relevant, highly prejudicial, and erroneous information about [the defendant's] criminal record;" and (2) "hearsay or double hearsay" that "contained factual errors about the offense and factual errors about the [defendant's] background." *Id.* at 383–86. Thus, the *Vetere* court relied even less on possible misstatements of the law than did the *Peralta* court. *See id*. at 387 (disapproving of government's reliance on "a 'bad-guy' theory" before grand jury). Consequently, Defendant's argument that law from the Southern District of New York counsels in favor of dismissal is unavailing. Instead, absent "flagrant" misconduct, which Defendant does not allege, *Buchanan* and its progeny counsel against dismissal notwithstanding the error Defendant alleges. *See Buchanan*, 787 F.2d at 487; *Welch*, 201 F.R.D. at 524–525; *Burger*, 773 F. Supp. at 1435; *Beech-Nut*, 659 F. Supp. at 1499; *Finn*, 919 F. Supp. at 1327.

Next, Defendant argues: "[t]oday the fact that the indictment in this case is 'facially valid' . . . no longer suffices to conceal misconduct behind the closed doors of the grand jury room."[4] (Def.'s Reply at 3.) This argument requires some unpacking. Although Defendant never asserts that *Buchanan* and its ample progeny are no longer good law, Defendant suggests that the rationale of *Costello*, the case from which *Buchanan* draws its reasoning, was somehow eviscerated by the Supreme Court's opinion in *Nova Scotia*, 487 U.S. 250. (*Id.* at 3; Def.'s Br. at

[4]Immediately after making this statement, Defendant asserts: "[a]nd the lethal sin of misleading the grand jury tops the list of those sins which warrant dismissal." (Def.'s Reply at 3.) As Defendant explains in his own brief, however, misleading grand jurors hardly "top[s] the list" of "lethal sin[s]" that warrant dismissal. (*See* Def.'s Br. at 10–11.) Instead, "fundamental error" is the most egregious type of grand jury misconduct. (*Id.* [citing *Nova Scotia*, 487 U.S. at 257].) Fundamental error, such as racial or sexual discrimination in the selection of the grand jury, renders grand jury proceedings so conspicuously unfair as to justify a presumption of that a defendant was prejudiced by such error. *Nova Scotia*, 487 U.S. at 257. The misconduct Defendant alleges does not begin to approach the wildly egregious misconduct that could justify a finding of fundamental error.

10–13.) Defendant's argument appears to be that: (1) *Nova Scotia* broadened a defendant's right to mount a pre-conviction challenge to an indictment; therefore (2) *Costello*'s facial validity standard, as well as opinions resting on *Costello*, are contrary to a defendant's entitlement to mount a pre-conviction challenge under *Nova Scotia*. (*See* Def.'s Br. at 9–10; Def.'s Reply at 3.) Defendant's argument fails at both steps.

First, *Nova Scotia* hardly wrought the sea change that Defendant contends. Defendant's suggestion that *Nova Scotia* somehow *broadened* a defendant's right to challenge effectively misconduct is contrary to the opinion's holding, which *limited* federal courts' supervisory powers over grand jury proceedings to instances in which a defendant is prejudiced by misconduct.[5] *See Nova Scotia*, 487 U.S. at 265 (Marshall, J., dissenting) ("Today's decision reduces [Federal Rule of Criminal Procedure Six] to little more than a code of honor that prosecutors can violate with virtual impunity."); *United States v. Gillespie*, 974 F.2d 796, 800 (7th Cir. 1992) ("Both *Williams* and *Nova Scotia* articulate clear limits on our authority to exercise our supervisory powers as a means of imposing preferred policies in the absence of any constitutional or congressional imperative."). Indeed, while *Nova Scotia* articulates the general standard for assessing prayers for dismissal of indictments for misconduct before the grand jury prior to the conclusion of trial, the articulated standard is quite restrictive. *See Nova Scotia*, 487 U.S. at 256 (stating dismissal is appropriate only if misconduct substantially influenced grand jury's decision to indict or if there is grave doubt that the decision to indict was free from substantial influence of such violations); *see*

[5]Indeed, *Nova Scotia* affirmed the judgment of the Tenth Circuit overturning a Colorado district court's pretrial dismissal of the indictment for grand jury prosecutorial misconduct. *See* 487 U.S. at 264; *see also United States v. Kilpatrick*, 575 F. Supp. 325, 326 (D. Colo. 1983) (indicating that the dismissal of the indictment at issue in *Nova Scotia* was ordered prior to trial).

also Howard W. Goldstein, *Grand Jury Practice* § 14.04(1)(b) (2005) (discussing the "difficult burden" on defendants seeking dismissal under *Nova Scotia*). Moreover, the standard articulated in *Nova Scotia* is similar to the standard applied by lower federal courts prior to *Nova Scotia*. *See Buchanan*, 787 F.2d at 487 (citing *United States v. Pino*, 708 F.2d 523, 530 [10th Cir. 1983]) ("An indictment may be dismissed for prosecutorial misconduct which is so flagrant that there is some significant infringement on the grand jury's ability to exercise independent judgment."); 1 Wright & Miller, *Federal Practice and Procedure: Criminal* § 111.1 (3d ed. 1999) ("The *Bank of Nova Scotia* case reemphasizes principles and practices that the lower courts had already understood."). Thus, any change wrought by *Nova Scotia* is hardly favorable to Defendant's prayer for dismissal.

Second, Defendant's attack on *Costello* and *Buchanan* is unpersuasive. Defendant suggests that the Supreme Court's opinion in *Nova Scotia* undermines its earlier opinion in *Costello*. (Def.'s Reply at 5.) In *Costello*, the court refused to look behind a valid indictment to consider whether inadequate or incompetent evidence was presented to the grand jury. 350 U.S. at 363. Hence, the unstated implication of Defendant's contention is that if *Nova Scotia* eroded *Costello*, then the Tenth Circuit's *Buchanan* opinion, which relied in part on *Costello*, might also be called into question. *See Buchanan*, 787 F.2d at 487 (citing *Costello*, 350 U.S. at 363). Yet Defendant fails to cite a single case stating, suggesting, or implying that *Nova Scotia* undermines *Costello*. This is so because *Nova Scotia* itself applies the very aspect of *Costello* that Defendant claims *Nova Scotia* eviscerates. *See Nova Scotia*, 487 U.S. at 260–61. In assessing whether the district court's findings contravened the "substantial influence or grave doubt" standard of prejudice, the *Nova Scotia* court relied on *Costello* and a subsequent Supreme Court case

affirming *Costello* to determine that the district court had erred by finding the government's proffer of inaccurate and misleading testimony before the grand jury constituted prejudicial misconduct. *See id.* (citing *Costello*, 350 U.S. at 363 and *United States v. Calandra*, 414 U.S. 338, 344–45 [1974]) (stating that an indictment valid on its face is not subject to a challenge to the evidence upon which it was based); *see also Williams*, 504 U.S. at 55 (1992) (citing *Costello*, 350 U.S. at 364) (stating that neither justice nor any concept of a fair trial would allow an evidentiary challenge to a facially valid indictment); *United States v. Wood*, 207 F.3d 1222, 1232 n.6 (10th Cir. 2000) (applying the *Costello* standard post-*Nova Scotia*). In light of the foregoing—particularly the fact that *Nova Scotia* itself relies on *Costello*—Defendant's argument that *Nova Scotia* undermines *Costello* is unpersuasive. Consequently, I am unenticed by Defendant's unstated conclusion that *Buchanan* and its progeny are no longer good law. In light of all of the foregoing, Defendant's motion to dismiss the indictment must fail.

ii. Defendant Fails to Show Prejudicial Error

Defendant's motion must fail also because, although Defendant characterizes reliance before the grand jury upon the awareness standard set forth in Rule 10b5–1 as error, any reliance by the Government on Rule 10b5–1 was entirely proper. Moreover, even accepting Defendant's claim that the Government may have relied before the grand jury on the possession standard set forth in Qwest's insider trading policy, such error could not have prejudiced Defendant.

(a) The Government Was Entitled to Rely on Rule 10b5–1's Awareness Standard

Defendant speculates that the Government may have relied on Rule 10b5–1, 17 C.F.R. § 240.10b5–1 (2006), in its legal instructions to the grand jury. (Def.'s Br. at 4; Def.'s Reply at 4.)

Defendant further contends any such reliance was inappropriate because Rule 10b5–1 violates the Constitution, section 10(b) of the 1934 Act, and Rule 10b–5 thereunder.[6] (Def.'s Br. at 16–22.) Nevertheless, Defendant admits that since the SEC's adoption of Rule 10b5–1 in 2000, there has only been one reported criminal insider trading case addressing the validity of Rule 10b5–1. (*See* Def.'s Reply at 9 [citing *United States v. Causey*, No. H-04-025-SS, 2005 WL 3560632 (Dec. 29, 2005)].) Before engaging two fundamental flaws in Defendant's argument, I pause briefly to contextualize the SEC's promulgation of Rule 10b5–1.

Rule 10b5–1 was announced in 2000 in response to the "unsettled issue in insider trading law [of] what, if any, causal connection must be shown between the trader's possession of inside information and his or her trading." Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,727 (Aug. 24, 2000). The "unsettled issue" the SEC sought to resolve was a circuit split concerning whether insider trading liability arises in connection only with a trader's "use" of inside information or whether mere "possession" of such information at the time of a trade suffices for liability. *Id.* The SEC recognized that "[a]lthough the Supreme Court has variously described an insider's violations as trading 'on' or 'on the basis of' material nonpublic information, it has not addressed the use [versus] possession issue." *Id.* Thus, the SEC sought to find a middle ground between use and possession by crafting a broad general rule prohibiting

[6]At the outset, this court notes that Defendant's line of argument is a thinly veiled attempt to seek a preliminary determination concerning the correct requisite *mens rea* standard for insider trading. Were the standard sufficiently clear to warrant dismissal of an indictment based on the prejudicial misstatement thereof by the Government, Defendant would need not include ten-plus pages of argument in his briefs concerning why the 10b5–1 "awareness" standard is incorrect. (*See* Def.'s Br. at 14–24; *see also* Def.'s Reply at 8–17.) The court expressly declines at this juncture to opine concerning the appropriate *mens rea* in this case. *Compare* 17 C.F.R. § 240.10b5–1 (2006) *with* 15 U.S.C. § 78ff (2006).

trading while "aware of" material inside information, which is balanced by several "carefully enumerated affirmative defenses." *Id.*; *see* 17 C.F.R. § 240.10b5–1(b) (2006) ("[A] purchase or sale of a security of an issuer is 'on the basis of' material nonpublic information about that security or issuer if the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale."). With this context in mind, I turn to the flaws in Defendant's argument.

The first fundamental flaw in Defendant's argument is his contention that the Government's interpretation of 10b5–1 is off the mark. (Def.'s Br. at 4.) Defendant's argument has little to do with the Government's "interpretation" of Rule 10b5–1 and much to do with the impact of the plain language of the rule on his defense on the merits of this case. Indeed, Defendant's own statements indicate that his attack centers on Rule 10b5–1 itself, not the Government's interpretation thereof: "[i]n adopting Rule 10b5–1, the SEC purported to re-interpret [section] 10(b) of the Securities Exchange Act of 1934, a [sixty-six] year old [sic] statute at that time. In actuality, the SEC instead transformed a statute requiring willful intent to deceive into one applying strict liability" for the sale of securities when a person is aware of material inside information. (Def.'s Br. at 16; *see id.* at 14–22 [arguing that 10b5–1 is invalid].) Thus, the target of Defendant's argument is not the Government's interpretation of Rule 10b5–1, but rather the Government's entitlement to rely on the rule's clearly expressed awareness standard.

This explains the considerable effort Defendant devotes in his briefs to a line of argument contending that Rule 10b5–1 violates the Constitution, section 10(b) of the 1934 Act, and Rule 10b–5 thereunder. (*See* Def.'s Br. at 14–22; Def.'s Reply at 8–17.) This line of argument

attempts to tiptoe around the elephant in the corner—namely, Defendant's unjustified, unspoken assumption that the Government was not entitled to rely on Rule 10b5–1 in making its case before the grand jury. Defendant would gloss over the fact that the SEC adopted Rule 10b5–1's awareness standard in response to an "unsettled issue" of securities law that had split three courts of appeal.[7] Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,727. In its attempt to clarify this "unsettled issue," the SEC expressly disclaimed the use standard Defendant asserts to be so clearly required by the Constitution and securities laws and regulations. *See id.* ("[I]n our view, the goals of insider trading prohibitions . . . are best accomplished by a standard closer to the ['awareness'] standard than to the 'use' standard."). This court fails to see how the Government's alleged reliance before the grand jury on a standard established by a regulation promulgated by the SEC to guide interpretation of an unsettled securities law issue could plausibly constitute prejudicial prosecutorial misconduct.

Indeed, Defendant admits that neither the Supreme Court nor the Tenth Circuit has addressed the question whether the awareness standard set forth in Rule 10b5–1 violates the Constitution or securities laws and regulations. (*See* Def.'s Reply at 9.) Consequently, I reject

[7]The SEC's statement collected the cases that comprised the circuit split. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,727 n.97; *United States v. Teicher*, 987 F.2d 112, 120–21 (2d Cir. 1993), *cert. denied*, 510 U.S. 976 (1993) (suggesting that "knowing possession" is sufficient); *SEC v. Adler*, 137 F.3d 1325, 1337 (11th Cir. 1998) (stating "use" required, but proof of possession provides strong inference of use); *United States v. Smith*, 155 F.3d 1051, 1069 & n.27 (9th Cir. 1998), *cert. denied*, 525 U.S. 1071 (1999) (requiring proof of "use" in a criminal case).

Defendant's suggestion that any reliance by the prosecution on the relatively untested awareness standard set forth in Rule 10b5–1 constitutes misconduct.[8]

Additionally, a decision by the Government to ignore Rule 10b5–1's awareness standard would seem to run contrary to the Government's duty to vigorously prosecute perceived criminal conduct. As Justice Sutherland noted more than seventy years ago, "[t]he United States Attorney . . . may prosecute with earnestness and vigor—indeed, he should do so. But, while he may strike hard blows, he is not at liberty to strike foul ones." *Berger v. United States*, 295 U.S. 78, 88 (1935). Any reliance on Rule 10b5–1 before the grand jury would hardly constitute a foul blow.[9] Defendant's arguments to the contrary fail.

(b) The Alleged Legal Error Did Not Prejudice Defendant

Defendant asserts the Government's presentation to the grand jury improperly rested on the Qwest insider trading policy's standard, which prohibited trading while in "possession" of material inside information, instead of a more stringent "use" standard, which Defendant alleges to be required by criminal and securities law. (Def.'s Br. at 13.) I have already determined that the Government was entitled to rely on Rule 10b5–1's awareness standard. *See supra Analysis* § 2a(ii)(a). Accordingly, I now determine whether any substitution of the Qwest policy's

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[8]A ruling to the contrary would negate the possibility of testing novel prosecutorial theories—particularly under new legislation—and would thus bind the development of federal criminal law in a precedential straightjacket.

[9]At this juncture, I need not reach the question whether the awareness standard withstands more exacting scrutiny. This is not to say that Defendant is not entitled to challenge the validity of Rule 10b5–1 before this court. While such a challenge is inappropriate in connection with a motion to dismiss the indictment for prosecutorial misconduct, the challenge would be ripe for consideration should this case reach a hearing concerning jury instructions.

"possession" standard for the SEC's "awareness" standard could have prejudiced Defendant under the standard of prejudice set forth in *Nova Scotia*. *See* 487 U.S. at 256.

Even assuming the Government intentionally used allegations that Defendant violated the possession standard set forth in Qwest internal policy as a proxy for violations of criminal and securities law in order to procure the indictment, (*see* Def.'s Br. at 13), such alleged error would not have prejudiced Defendant. *See Nova Scotia*, 487 U.S. at 256 (applying harmless error standard to pre-conviction motion to dismiss indictment). Defendant cannot sidestep the fact that the Qwest policy's possession standard is sufficiently similar to the awareness standard set forth in Rule 10b5–1 such that any use of the possession standard in place of the awareness standard hardly constitutes the sort of "flagrant" misconduct that might justify dismissal of an indictment. *See Pino*, 708 F.2d at 530. A comparison of Rule 10b5–1 and Qwest policy bears out this conclusion. As discussed above, Rule 10b5–1 prohibits insiders from trading while they are "*aware of* . . . material nonpublic information." 17 C.F.R. § 240.10b5–1 (2006) (emphasis added). Similarly, the Qwest internal policy prohibited the company's employees from trading Qwest securities "*while [they] ha[d]* material nonpublic information." (Def.'s Br., Ex. A at 3 [Qwest Insider Trading Policy] [emphasis added].) Thus, when adjusted to account for my determination that the Government was entitled to rely on Rule 10b5–1, Defendant's allegation that the Government prejudicially "blurred the line between an internal policy and federal criminal and securities law" is unavailing. Indeed, the line between the internal policy's possession standard and Rule 10b5–1's awareness standard is relatively indeterminate, particularly as applied to the chief executive officer of a company who would presumably understand all inside information in his possession. Moreover, it has been held that a "prosecutor has no duty to

outline all the elements of conspiracy so long as the instructions given are not flagrantly misleading or so long as all the elements are at least implied." *Larrazolo*, 869 F.2d at 1359. Thus, any conflation of the distinction between awareness and possession with respect to Defendant, the highest officer at Qwest, hardly rises to the level of "flagrantly misleading" conduct.[10]

More importantly, Defendant's own argument that Rule 10b5–1 eliminates *scienter* from securities fraud liability would negate the impact of the Government's alleged reliance on a possession standard rather than an awareness standard. Defendant objects to the Government's use of a possession standard because he believes that such a standard eliminates *scienter* from the determination whether he committed securities fraud. (Def.'s Br. at 12.) Yet Defendant also argues that Rule 10b5–1's "awareness" standard eliminates *scienter* from securities fraud liability. (*Id.* at 16.) Thus, per Defendant, both standards suffer from the same infirmity. I have already determined, however, that the Government was entitled to rely before the grand jury on Rule 10b5–1. *See supra Analysis* § 2a(ii)(a). If, as Defendant argues, Rule 10b5–1 can be said to eliminate *scienter* from securities fraud liability, then any prosecutorial reliance on a possession standard which also eliminates *scienter* would constitute harmless, non-prejudicial error. *See Nova Scotia*, 487 U.S. at 254–55 (stating harmless error standard applies to motions to dismiss indictments). Accordingly, even assuming the Government instructed the grand jury that possession rather than awareness or actual use suffices for securities fraud liability, such alleged

[10]Additionally, possession of information could plausibly be said to imply awareness. Indeed, if proof of possession can be said to provide an inference of use, then possession could provide a strong inference of awareness. *See Adler*, 137 F.3d at 1337 ("[W]hen an insider trades while in possession of material nonpublic information, a strong inference arises that such information was used by the insider in trading.").

misconduct would hardly create a "grave doubt" that the grand jury's decision to indict was substantially influenced by prosecutorial misconduct. *Id.* at 256. Thus, Defendant has failed to satisfy the heavy burden required to meet the standard of prejudice set forth in *Nova Scotia*. *See id.* Dismissal of the indictment is unwarranted.

iii. Collected Ephemera

I pause to dispatch two other unavailing arguments included in Defendant's briefs. First, Defendant appears to suggest that the doctrine of lenity would require the Government to instruct the grand jury based on the use standard Defendant favors. (Def.'s Br. at 22–23 [citing *United States v. Bass*, 404 U.S. 336, 347–48 (1971)].) Lenity is a doctrine courts apply to ambiguous criminal statutes. *Bass*, 404 U.S. at 347–48. Defendant fails to cite to any authority supporting the application of the doctrine of lenity to a prosecutor's presentation of the law to a grand jury. (Def.'s Br., *passim*; Def.'s Reply, *passim*.) Notwithstanding this and other more fundamental deficiencies inhering to Defendant's unusual argument, my determination that the Government was entitled to rely on the plain language of Rule 10b5–1 nullifies the argument.

Next, Defendant argues that the Tenth Circuit's adherence to the defense of good faith "is another reason why the indictment should be dismissed if the government instructed the grand jury that it could indict" based on the possession standard. (Def.'s Br. at 23.) Defendant is wrong. It is not the grand jury's function "'to enquire . . . upon what foundation [the charge may be] denied,' or otherwise to try the suspect's defenses, but only to examine 'upon what foundation [the charge] is made' by the prosecutor." *Williams*, 504 U.S. at 51–52 (alterations in original) (quoting *Respublica v. Shaffer*, 1 U.S. [1 Dall.] 236, 1 L.Ed. 116 [O.T. Phila. 1788]).

b. Defendant Is Not Entitled to Further Disclosure of Grand Jury Materials

As an alternative to dismissal, Defendant asks this court, pursuant to Federal Rule of Criminal Procedure 6(e), to direct the Government to turn over: (1) transcripts of the colloquy between the Government and the grand jury; and (2) the minutes of instruction to the grand jury. (Def.'s Br. at 2, 27.) The Supreme Court has "consistently construed [Rule 6(e)] . . . to require a strong showing of particularized need for grand jury materials before any disclosure will be permitted." *United States v. Sells Engineering, Inc.*, 463 U.S. 418, 443 (1983) (citations omitted). The burden of demonstrating particularized need rests upon the party seeking disclosure. *Douglas Oil Co. v. Petrol Stops N.W.*, 441 U.S. 211, 223 (1979) (citations omitted). A court called upon to determine whether grand jury materials should be released "is infused with substantial discretion." *Id.* Indeed, it has been held that a defendant cannot show particularized where an indictment is valid on its face. *Welch*, 201 F.R.D. at 524; *United States v. Trie*, 23 F. Supp. 2d 55, 62 (D.D.C. 1998) ("Since the indictment is facially valid . . . [defendant] has not established any particularized need for the grand jury instructions."); *United States v. Espy*, 23 F. Supp. 2d 1, 10 (D.D.C. 1998) (same). This court has determined that the indictment is valid. (Rep.'s Tr. at 8.) This is sufficient grounds for denying Defendant's request.

Moreover, I have already determined, accepting Defendant's allegations as true, that Defendant's motion to dismiss the indictment fails under the law set forth in: (1) *Buchanan*, 787 F.2d at 487; and (2) *Nova Scotia*, 487 U.S. at 256. Consequently, there is no need, "particularized" or otherwise, for this court to invoke its "substantial discretion" to order the Government to turn over any further grand jury evidence. Defendant's request for disclosure of grand jury materials must be denied.

3. Conclusion

Based on the foregoing it is therefore ORDERED that:

1. Defendant's motion (#56) is DENIED.

Dated this 25th day of August, 2006

BY THE COURT:

s/ Edward W. Nottingham
EDWARD W. NOTTINGHAM
United States District Judge