

No. 07-1311
(Oral Argument Scheduled for December 18, 2007)

IN THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

UNITED STATES OF AMERICA,
APPELLEE

v.

JOSEPH P. NACCHIO,
APPELLANT

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
(Nottingham, C.J.)

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BRIEF FOR THE UNITED STATES

JURISDICTIONAL STATEMENT

This is an appeal from a final judgment of the district court in a criminal case. The district court had jurisdiction under 18 U.S.C. § 3231. The court entered judgment against appellant Joseph Nacchio on August 3, 2007. Add. 1.¹ Nacchio

¹ “Br.” refers to Nacchio’s opening brief; “Add.” refers to his addendum; “App.” refers to his appendix; “Supp. App.” refers to the government’s supplemental appendix; and “GX” and “DX” refer to audio and video exhibits introduced at trial by the government and defense, respectively. The audio and video exhibits are on a CD-ROM enclosed with the supplemental appendix.

filed a notice of appeal on August 10, 2007. App. 1387. This Court’s jurisdiction rests on 28 U.S.C. § 1291 and 18 U.S.C. § 3742(a).

STATEMENT OF THE ISSUES

1. Whether a reasonable jury could conclude that Nacchio, with the intent to cheat investors, sold Qwest stock based on material inside information.

2. Whether the district court correctly instructed the jury on materiality, non-public information, and good faith.

3. Whether the district court abused its discretion in excluding the opinion testimony of a proposed defense expert.

4. Whether the district court abused its discretion in denying discovery, and admission into evidence, of certain classified information.

5. Whether, for sentencing purposes, the district court correctly calculated “the total increase in value” Nacchio “realized” from his illicit stock sales.

6. Whether, for forfeiture purposes, the district court correctly calculated the “proceeds” Nacchio “obtained” from his illicit stock sales.

STATEMENT OF THE CASE

An indictment returned in the United States District Court for the District of Colorado charged Nacchio with 42 counts of insider trading, in violation of 15 U.S.C. §§ 78j(b) and 78ff and Securities and Exchange Commission (SEC) Rules 10b-5 (17

C.F.R. § 240.10b-5) and 10b5-1 (17 C.F.R. § 240.10b5-1). App. 67-68. Following a jury trial, Nacchio was acquitted of the first 23 counts and convicted on the remaining 19 counts. Add. 1. The 19 counts of conviction comprised Nacchio's stock sales from April 26 to May 29, 2001. The district court sentenced Nacchio to 72 months of imprisonment (Add. 2), assessed a \$19 million fine (Add. 5), and ordered him to forfeit approximately \$52 million (Add. 85).

STATEMENT OF FACTS

Nacchio was the chief executive officer of Qwest Communications International, a large telecommunications company, at all times relevant to this case.

In September 2000, Nacchio raised Qwest's revenue, earnings, and growth targets for 2001. He knew that, to meet those targets, Qwest would need to make a dramatic "shift" in its business model from "one-time" transactions to higher-quality "recurring revenue" streams. He further understood this shift had to happen in early 2001. During exhaustive budget reviews in late 2000, Nacchio's executives warned him that the targets were unrealistic, but he refused to lower them.

By early 2001, the warnings came true. In April, Qwest's first-quarter results showed the company had failed to make the necessary shift to recurring revenue. Worse yet, the April reports showed that one-time transactions would "dry up" during the second half of 2001.

Nacchio knew these reports were important. He knew they meant Qwest would be unable to meet its public targets. He knew investors were persistently asking how much Qwest was relying on one-time transactions in lieu of recurring revenue. And he knew if he disclosed that information, Qwest's stock price would plummet. During an investor call on April 24, Nacchio withheld the information and reaffirmed Qwest's 2001 targets. Two days later, he began dumping his own stock at an unprecedented pace, reaping \$52 million. He then delayed disclosure of the information for months to conceal his scheme.

I. July 2000 To December 2000: Nacchio Sets Unrealistic Targets Dependent On A “Shift” From One-Time Transactions To Recurring Revenue

In July 2000, upon completion of a merger between Qwest and U S West, Nacchio told employees that the newly-formed Qwest would “grow or die.” GX 514A. He explained that Qwest's stock price would suffer if the company did not meet its high revenue, earnings, and growth targets. GX 506A; App. 2117-2122.

In September 2000, Nacchio raised Qwest's targets, telling the public that the company expected revenue to grow by 15% to 17%, and earnings by 20%, through 2005. App. 4781-4782. For 2001, he announced a revenue target range of \$21.3 to \$21.7 billion. *Ibid.* He did so although his executives had not even begun the 2001 budgeting process. App. 2137-2138, 2716.

Nacchio’s senior executives—Afshin Mohebbi (then Qwest’s president of worldwide operations and later its chief operating officer), Robin Szeliga (then head of financial planning and later chief financial officer), and the heads of Qwest’s three main business units (wholesale, global business, and national mass markets)—told him that the \$21.3 to \$21.7 billion public target was unrealistic. App. 2122-2156, 3110-3143. Specifically, Nacchio learned that: even “if everything went right,” the wholesale unit would fall \$362 million short of its internal target, App. 2481-2482, 4940; the global business unit, “to have any chance” of making its internal target, would need to increase productivity by 68%, App. 2602, 2617-2618; and the national mass markets unit, even after Nacchio had threatened its top staff with termination, would be at least \$364 million short of its internal target, App. 2748; *see* App. 2147, 2742-2744 (gap was more likely \$444 million).

Knowing that these gaps made the targets a “huge stretch” (App. 4990), Nacchio nevertheless required the unit heads to “sign up” to the targets (App. 2486). And he then raised the wholesale unit’s target by another \$172 million. App. 2487. Greg Casey, that unit’s head, was “outraged” (App. 2489-2490) and told Nacchio and others the new number was “bullshit” (Supp. App. 228).

There was a minor difference between Qwest’s internal targets—which totaled \$21.8 billion—and the \$21.3 to \$21.7 billion public target. App. 2164-2165, 4975.

But this “cushion to the street” was at most \$500 million. App. 2165. The units’ gaps easily outstripped that amount. Szeliga warned Nacchio that when she “aggregated” the gaps, she expected Qwest to book no more than \$20.4 billion of revenue in 2001 — almost “a billion dollars” below the bottom end of the *public* target. App. 2134, 2423-2424.

Mohebbi, Szeliga, and the business units further warned Nacchio about the *way* the targets would have to be reached. *E.g.*, App. 3143-3144. Qwest had traditionally relied on “non-recurring revenue” as a last-resort “gap filler[.]” to meet growth targets. App. 2461-2463. It earned such revenue mainly through the wholesale unit’s sale of indefeasible rights of use (IRUs), which were property rights in Qwest’s network. App. 2458-2459. Because revenue from an IRU sale was booked all at once, and because Qwest had to discover new IRUs every quarter, it was “axiomatic” that IRUs were less reliable income than “recurring revenue” — *i.e.*, income earned monthly from regular subscribers. App. 2463, 2466; *see* App. 2459-2460. Nacchio himself had long acknowledged that IRUs were an “accounting trick[.]” Qwest used to “make [its] numbers” when recurring revenue fell short, and that recurring revenue was “more valuable” than IRUs “in terms of what the marketplace valued in Qwest.” App. 2461, 2464-2466.

To grow fast enough to meet the public targets, Qwest would need to make an “aggressive pivot,” or “shift,” from IRUs to recurring revenue streams. App. 2177, 2600. The 2001 budget required Qwest to *double* its 2000 growth rate for recurring revenue. App. 2203, 2599-2600. Nacchio knew this shift was “unnatural” and probably not “achievable” (App. 2604), because Qwest had a poor “track record” in growing recurring revenue (App. 4990). And he knew the shift would have to happen “right out of the gates” in 2001. App. 2176-2179. Qwest needed new subscribers early in the year so it could count on and build upon their revenue; if it failed to sign up enough new customers early in the year, it would not later benefit from sufficient “compounding” to reach the public target. App. 2179; *see* App. 3166 (“[I]f somebody at home subscribes to a telephone service that costs \$1 a month, if you sell it in January, you’re going to collect \$12 because they paid 12 times. If you sell that same product in December, you collect \$1.”).

Qwest’s budget counted on this compounding to generate “a ramp-up in revenues for [the] third and fourth quarter[s]” of 2001. App. 3200. Mohebbi told Nacchio that “if we don’t crank up recurring growth by April,” “we got big problems” — “there won’t be enough one timers to close the gap in 3Q and 4Q.” Supp. App. 231. If recurring business did not “literally take off” by April (App. 4990), Qwest would “have to bring the numbers down” (App. 3199). Nacchio understood that a

slow start in obtaining new recurring revenue would have “a snowball effect,” dooming Qwest’s year-end target. App. 2493-2494. At a 2001 kick-off event, he told Qwest’s sales staff that “something big” had to happen “by April.” GX 559B; *see also* GX 551A (Nacchio said first half of 2001 would be “absolutely critical” and “[s]liding into home in December * * * is probably not the way you can make this year’s numbers”).

II. January 2001 To April 2001: Qwest Fails To Make The “Shift” To Recurring Revenue And “Drains The Pond” Of IRUs, But Nacchio Withholds That Information From Investors

A. Throughout the first quarter of 2001, Nacchio received wave after wave of bad news. In January, the head of the national mass markets unit,² Qwest’s biggest source of recurring revenue, began “routine[ly]” telling Nacchio that the unit’s 2001 target was “not attainable” in light of early results. App. 2879-2880. By April, the unit reported that it would miss its year-end number by \$323 million. App. 2900. Nacchio was “not pleased.” App. 2921. Similarly, the global business unit reported that it was “way off” of its recurring revenue target and had to rely on IRUs to meet its first-quarter numbers. App. 2635-2638. Nacchio “express[ed] concern,” because this meant the unit would not be able to “ramp” up recurring revenue in the third and

² In 2001, the “national mass markets” unit changed its name to “consumer and small business.” App. 2875. This brief uses “national mass markets” throughout.

fourth quarters of 2001. App. 2635. Szeliga gave Nacchio the bottom line on April 9: Qwest had failed to make the shift to recurring revenue “at the rate expected”—it was behind the recurring revenue growth target by 19%—and the year-end gaps would somehow have to be “filled by IRUs.” App. 2210-2212, 5000-5001. Nacchio was “visibly disappointed” with this news. App. 3260.

Worse yet, Nacchio then learned during the wholesale unit’s first-quarter review on April 13 that Qwest would not be *able* to fill the gaps with IRUs because the IRU market was already “drying up” and the unit saw no IRUs in the “funnel” for the third and fourth quarters. App. 2496, 2505; *see generally* App. 2224-2229, 2494-2512. Casey explained that the carriers that normally purchased IRUs were going out of business. App. 2494. Therefore, “going into th[e] second quarter” in early April, the wholesale unit “pretty much knew the entire universe” of coming IRU sales, and it would be “draining the pond” of those IRUs in the second quarter, with none left for the third and fourth quarters.³ App. 2495-2496. Casey told Nacchio that the IRUs were “going away” and that, as a result, the wholesale division alone faced a \$675 million gap and could not fill gaps from other units. App. 2499, 2508-2509. Nacchio “wasn’t * * * happy” with this news. App. 2493.

³ Many remaining IRUs were “swaps” — transactions in which Qwest traded its network and thus received no cash. Like other IRUs, these transactions (of which “accountants had a very dim view”) were “com[ing] to an end.” App. 2494-2495.

B. With other carriers lowering their targets in 2001, analysts and investors persistently questioned Nacchio and Lee Wolfe (the head of Qwest’s investor relations group) about how Qwest could still meet its targets. App. 1557-1558, 1599-1620. From January to April, they repeatedly asked for the makeup of Qwest’s revenue. App. 1600, 1611-1612; Supp. App. 237 (Mohebbi told Nacchio the market was “demanding” a revenue “breakdown”). Mark Schumacher (Qwest’s controller) advocated disclosure of that information because the IRU sales—which comprised 39% of the company’s first-quarter growth—were an “over significant” source of income. App. 2755, 2759. Wolfe told Nacchio “three or four times” that he should disclose the information because investors needed it to determine whether Qwest would “be able to continue to grow” and because it would enable them “to make an informed decision whether to buy or sell the stock.” App. 1632-1633, 1655, 1799.

Nacchio exercised close control and “final say” over everything Qwest told the public (App. 1536; *see* App. 1533-1537), and he refused the calls for disclosure, asking Wolfe, “[C]an you guarantee me the stock price won’t go down?” App. 1655. When Wolfe responded, “[I]t’s going to go down,” Nacchio would say, “[S]crew them, go tell them to buy.” App. 1657, 1799. Going a step further, Nacchio directed Wolfe to tell Qwest executives that, when speaking with investors, they could not “engage in any conversations about the use of the one-time transactions.” App. 1829-

1830. Wolfe did as he was told. App. 1830, 2468.

By April 2001, investors were growing “increasingly frustrated” because Qwest had still given them no “visibility” into the “black box” of revenue and growth. App. 1592, 1615, 1618. As Wolfe and Nacchio regularly discussed, the investors’ questions became more “accusatory in terms of * * * ‘what are you guys doing that enables you to continue to meet the numbers.’” App. 1618-1619.

C. Though Nacchio was “not pleased” with the news he was receiving (*e.g.*, App. 2921), he “very bullish[ly]” (App. 3579) told investors on Qwest’s April 24 first-quarter earnings call that “we are very pleased with the quarter reconfirming our estimates for 2001” and that “[w]e see nothing to dissuade us from the plan we announced” (GX 594A; *see* App. 4833). He did not mention that Qwest’s budget had required recurring revenue to “literally take off” early in 2001. App. 3579-3580. Nor did he mention that recurring revenue growth had already fallen short by 19%, which meant Qwest was facing a billion-dollar shortfall from its 2001 public target. *Ibid.* And though investors had for months demanded a “breakdown” of Qwest’s growth numbers, Nacchio did not tell them that IRUs comprised 39% of first-quarter growth. *Ibid.*

III. April 2001 To May 2001: Nacchio Dumps Qwest Stock Based On His Inside Information

On April 19, 2001, Qwest’s general counsel’s office informed Nacchio that the company’s second-quarter trading window would open on April 26. Supp. App. 211. The notice “remind[ed]” Nacchio that “you may not trade in Qwest’s securities even during the trading window if you have any material non-public information.”⁴ *Ibid.* The window had been closed since February 15. App. 2029.

As soon as the window opened on April 26, Nacchio—who had made such bullish representations two days earlier—sold 350,000 shares of Qwest stock. App. 68; Supp. App. 239. The next day, he sold another 300,000 shares. *Ibid.* In comparison, Nacchio had averaged sales of about 131,000 shares per *month* from 1998 to 2000 — meaning that, in the first two trading days after the window opened, he made about five months’ worth of sales. App. 3733.

Nacchio sold 210,000 additional shares in the next two trading days and 395,000 more in the following eight trading days. App. 68; Supp. App. 239, 242-243.

⁴ Nacchio himself had sent Qwest’s insider-trading policy to all employees. App. 4775-4780. The policy defined “[m]aterial information” as “information potentially affecting the market price of” Qwest stock. App. 4775. It included a “non-exclusive list” of examples, such as “[p]rojections of future earnings or losses, which depart materially from market expectations based on prior disclosures.” App. 4780. Wolfe relied on this document in telling Nacchio he should disclose Qwest’s revenue breakdown and the IRUs’ contribution to growth. App. 1517, 1522-1527.

From April 26 to May 15, he sold 1,255,000 shares, reaping total proceeds of nearly \$50 million. He averaged sales of about 105,000 shares per trading day. In comparison, he had averaged sales of about 27,000 shares per trading day from 1998 to 2000. App. 3734.⁵

IV. June 2001 To September 2001: Nacchio Further Delays Disclosure To Conceal His Scheme

Over the next several months, Nacchio continued to reject calls for disclosure. App. 1641-1678, 3668-3680. In June 2001, the *Wall Street Journal* published a negative article about Qwest and the telecommunications industry. App. 2251-2253. In response, and despite vigorous opposition by Szeliga (his CFO), Nacchio issued a press release reaffirming Qwest's 2001 targets. App. 1645-1646, 2253-2255.

During Qwest's second-quarter earnings call on July 24, Nacchio again refused to disclose the breakdown of IRUs and recurring revenue. App. 1652. He confided in Wolfe that he "didn't want to muddy what he felt was * * * a good news quarter." *Ibid.* On the call, Nacchio pretended that the growth target for annual earnings he had announced back in September 2000 was "17 percent, or 17 plus" (App. 1658), when in fact the target had been 20% (App. 4782; *supra* p. 4). Investors "were beside[] themselves" at this dissembling (App. 1661), and Prashant Khemka (a Goldman

⁵ Nacchio sold 75,000 more shares (for nearly \$3 million) through the rest of May 2001. App. 68.

Sachs analyst) warned Wolfe and Nacchio: “Agreed that most investors are fools, but at least don’t tell * * * them in their face.” Supp. App. 225; App. 1661-1670, 3674-3675.

Following the July 24 call, investors again demanded a revenue breakdown so they could determine the “[q]uality” of Qwest’s revenue. Supp. App. 226; App. 3676-3677. Khemka, who had been seeking that information “throughout” 2001 and was “not getting answers” (App. 3663), sent an angry letter to Wolfe and Nacchio telling them there was “a big credibility issue now surrounding Qwest” because of the “opaqueness in * * * your revenue breakdown.” Supp. App. 224 (“[T]he lack of transparency [sic] is going to hurt you because investors don’t know how many cockroaches you still have in your bag.”). The “revenue breakdown” to which Khemka referred was how much Qwest was relying on IRUs (including “swaps”) instead of recurring revenue. App. 3677-3680. Wolfe discussed Khemka’s letter with Nacchio, who did not respond to it. App. 1662, 3680.

Nacchio decided in August 2001 to disclose some of the information, but told Wolfe he wanted to “spin” it because investors “would not be happy,” they “would be surprised at the magnitude of the [IRUs],” and “the stock price would go down.” App. 1652-1653. So he released the bad news over time. On August 7, he told some investors that Qwest “was going to disclose its use of the one-timers.” App. 1672.

He then waited until August 15 to actually report past IRU information in the company's second-quarter SEC 10Q filing. App. 1651-1652. From the 10Q, investors learned for the first time that Qwest had relied on IRUs to make its first- and second-quarter numbers. App. 1672-1673. Wolfe told Nacchio that analysts were "very surprised by the magnitude" of the IRU revenue and had revised their existing models to ensure Qwest received "no credit for [IRU] revenues." App. 1673-1676; App. 1819 (without IRUs, Qwest was "only growing 6 or 7 percent as opposed to [the] 12 percent" it had reported). Nacchio told Wolfe: "[S]ee, this is what happens when you disclose." App. 1676. And the August disclosures still did not reveal that there were no IRUs in the funnel for the third and fourth quarters or that Qwest had planned on, but failed to make, a dramatic shift to recurring revenue.

Nacchio waited even longer to lower Qwest's public target. In August, Wolfe overheard Nacchio discussing with Drake Tempest, Qwest's general counsel, the need for a further delay "to give the sense that [there] was something *new* that caused the lowering of the targets." App. 1677 (emphasis added). Nacchio said he wanted investors to think that "lowering the targets was something that * * * [he] would not have reasonably known" about earlier. App. 1678. On September 10, he finally issued a press release (App. 4933) taking the target down to \$20.5 billion — essentially lowering it by the billion-dollar amount Szeliga had reported back on

April 9. App. 2258-2259.

Even under that new target, however, Qwest missed its third-quarter numbers, largely because “the one-time transactions had dried up.” App. 1681, 3442. Qwest also missed its numbers in the fourth quarter, when it was unable to complete *any* IRU sales. App. 2512, 2714. In January 2002, Khemka asked Nacchio how he intended to restore Qwest’s credibility. App. 3683-3684. Nacchio responded: “Never believe a word of what management says at the time of a merger.” App. 3684.

SUMMARY OF THE ARGUMENT

1. Viewing this evidence in the government’s favor, a reasonable jury could conclude that: Nacchio dumped his stock on the basis of the dire reports he had just received; the information was material; and Nacchio knew as much.

a. The evidence shows that the inside information was a “significant factor” in Nacchio’s decision to sell. At the earliest opportunity after learning of (and expressing disappointment with) Qwest’s first-quarter failures, Nacchio sold more than a million shares in a matter of *days*. In prior years, he took several *months* to sell that many shares. His alleged concern that his options would expire more than two years later cannot explain such precipitous selling. He could have exercised his options *without* selling — which he presumably would have done if he were as bullish on Qwest as he told investors.

b. Reasonable investors contemplating whether to buy or sell Qwest stock would certainly consider Qwest's first-quarter failures important. Nacchio knew, and they did not, that Qwest's budget required a shift from IRUs to recurring revenue by April; the shift did not occur by April; Qwest had relied on IRUs to meet its first-quarter numbers; and its current IRU funnel showed no IRUs for the second half of the year. These were not vague "forecasts" (Br. 6-8). They were hard facts about the present quality and sustainability of Qwest's revenue — facts that Nacchio and his executives agreed would, if disclosed, surprise investors and cause Qwest's stock price to plummet. And plummet it did as Nacchio trickled out some (but not all) of these facts — it fell by half even before Qwest lowered its 2001 target.

c. Nacchio knew these facts were important to investors. His executives told him as much, and there was no evidence Qwest's general counsel and audit committee ever told him otherwise. Nacchio himself emphasized how "critical" the shift to recurring revenue would be. He likewise acknowledged that recurring revenue was "more valuable" to investors than IRUs. That is precisely why he refused the calls for disclosure and lied to investors about how "pleased" he and his executives were with the first-quarter results.

2. The district court’s instructions correctly stated the law and sufficiently covered the issues presented.

a. As Nacchio does not dispute, the court correctly instructed that materiality depends on whether a “reasonable investor” would “consider * * * important” the information Nacchio knew. The court properly refused Nacchio’s additional “reasonable basis” and “bespeaks caution” instructions, which improperly focused on Qwest’s public projections instead of Nacchio’s inside information. Additionally, the “reasonable basis” instruction was based on SEC regulations having nothing to do with insider trading, let alone materiality of inside information. And the “bespeaks caution” doctrine does not apply for a slew of reasons. Nor did the court err in refusing to instruct on “probability/magnitude” and “total mix” principles, because Nacchio never requested those instructions and this Court does not require them.

b. The court correctly instructed that, to prove the information at issue was “non-public,” the government did not need to show that Qwest was required to disclose it. Nowhere did this instruction “direct[] the jury to ignore” whether others at Qwest believed the information was *material* or whether Nacchio *relied* on their beliefs (Br. 9, 35-36). The instruction said nothing about materiality or *mens rea*. And the court instructed the jury to consider all facts and circumstances bearing on

Nacchio's state of mind.

c. The court correctly instructed on good faith. The court did not instruct that “*any* dishonest act” defeats good faith (Br. 9). Rather, it instructed that engaging in “insider trading” with the “intent to defraud” would not demonstrate good faith, even if Nacchio harbored an honest belief about some unrelated matter. This longstanding fraud principle is reflected in the leading pattern instruction, which the court used as a model. Several courts have approved virtually identical instructions.

3. The court did not abuse its discretion in excluding the proposed opinion testimony of defense expert Daniel Fischel. The defense only belatedly told the government what topics Fischel would cover. And though directed to do so, the defense *never* disclosed the *bases and reasons* for Fischel's opinions. Nonetheless, it urged the court that the summary it had provided was sufficient to satisfy Rule 702.

The court properly found that the defense failed to establish the reliability of Fischel's opinions. Nacchio does not even challenge that finding. The court also properly found that the defense's violation of Fed. R. Crim. P. 16 warranted exclusion. Finally, the court properly excluded the proposed fact-laden testimony under Rules 403, 602, and 702.

Nacchio suffered no prejudice from any error. Fischel still testified, as a summary witness. The government called no experts. The two analysts who testified

as *fact* witnesses for the government were forbidden to opine about materiality, and only the defense sought to elicit opinions from them. And even then the court made clear that it would permit the defense to “call its own analysts [to] disagree” with the government’s analysts.

4. As explained in the classified excerpt, the court properly denied discovery, and admission into evidence, of certain classified information.

5. Under U.S.S.G. § 2F1.2 (2000), the court correctly determined that Nacchio “gained” \$28 million through his sales — \$52 million in gross receipts minus option costs, taxes, and fees. Using this net gain does not mean Nacchio was “wrongly punished * * * for the normal appreciation in Qwest’s shares from 1997 to 2001” (Br. 10). If he had obeyed the law, he would not have sold *any* stock in April and May 2001. Accordingly, his gain from violating the law was the full \$28 million he pocketed.

6. In ordering Nacchio to forfeit \$52 million in “proceeds,” the court correctly refused to deduct the option costs and fees associated with his sales. Insider trading is an “unlawful activit[y]” under 18 U.S.C. § 981(a)(2)(A). That provision defines “proceeds” as the gross receipts of the offense.

ARGUMENT

I. The Government’s Evidence Was Sufficient

On review for evidentiary sufficiency, this Court views the evidence—and all reasonable inferences—in the government’s favor and may overturn a jury’s verdict “only if *no* rational trier of fact” could have found the defendant guilty. *United States v. Wiles*, 102 F.3d 1043, 1063 (10th Cir. 1996).⁶ Under this standard, the evidence suffices to show that Nacchio sold Qwest stock based on material inside information with the requisite intent to defraud.

A. The inside information was a “significant factor” in Nacchio’s decision to sell.

1. Rule 10b5-1 provides that an insider sells stock “on the basis of” inside information if he sells while merely “aware” of the information. 17 C.F.R. § 240.10b5-1(b). The district court chose a tougher standard, instructing the jury that

⁶ Nacchio’s unsupported suggestion (Br. 3) that a “vindictive” press led to a “prejudicial” jury does not change this deferential standard. The court conducted what the defense at the time called “painstaking” voir dire. Supp. App. 184 (quotation omitted); App. 1253. Nacchio did not even use all of his peremptory challenges. Supp. App. 185. Most potential jurors perceived the press’s pre-trial coverage as “neutral.” Supp. App. 202-210. The court reminded the jury daily not to read about the case. This Court must presume the jurors followed instructions. *Wiles*, 102 F.3d at 1062-1063. The jury deliberated for several days and acquitted Nacchio of 23 counts. Afterward, the court found that publicity had not inflamed the jury. App. 1253-1255.

the inside information had to be a “significant factor” that was “actually used” in Nacchio’s decision to sell.⁷ App. 4559.

2. A reasonable jury could conclude that the April 2001 reports of Qwest’s first-quarter failures were at least *one* “significant factor” in Nacchio’s selling spree when the trading window opened two weeks later. *United States v. Larrabee*, 240 F.3d 18, 23-24 (1st Cir. 2001) (“suspicious timing” and “unusual * * * pattern” of trades sufficient to show defendant “used” information).

Nacchio’s statement in October 2000 about his intention to sell (DX 1560)—a statement made shortly after he raised Qwest’s 2001 targets without a budget to support them (App. 2137-2138, 2716)—does not prove otherwise. The jury did not have to credit that misleading announcement, which bent the truth in several ways.⁸ Most importantly, when Nacchio announced he would be exercising his \$5.50 options, he said he would “dribble [them] out” every quarter before they expired in

⁷ Rule 10b5-1, enacted in 2000, abrogated prior cases requiring proof that the insider “used” non-public information. 65 Fed. Reg. 51716, 51727 & n.97 (Aug. 24, 2000).

⁸ Nacchio claimed, “I have to sell,” but he had a deadline for *exercising* options, not for *selling* shares. App. 1891, 3774. He claimed, “I can’t just exercise and hold,” but he knew he could; he had exercised and held before. App. 3753-3754, 4022-4023. He claimed he had a “short window,” but he had almost three years. App. 3739. And he claimed he had to sell “a million a quarter,” but it was substantially less (7.4 million in 11 quarters).

June 2003. DX 1560. “Dribbling” hardly describes unloading 860,000 shares (\$34 million) in four days, or 1,255,000 shares from April 26 to May 15. App. 68.

Also, if Nacchio were so “bullish” (Br. 13), a concern about expiration could not explain his decision to *sell*. Bullishness would have led him to exercise his options and *hold* the stock — to avoid expiration and to realize the appreciation he allegedly expected.⁹ App. 1681-1682, 3774. Alternatively, he could have avoided expiration by remaining in the Rule 10b5-1 trading plan he had entered in February, which would have enabled him to sell 11,500 shares per day—even outside Qwest’s “short trading windows” (Br. 11)—and to exercise all of his \$5.50 options well before they expired. App. 1884, 3738-3739; Supp. App. 213-223. Nacchio says (Br. 13-14) he cancelled the February trading plan because it would have forced him to sell below \$38 per share. Even if true, that would not explain why he dumped 860,000 shares in the first four days after the window opened on April 26. The jury could conclude that the timing shows he decided to cash out of a large amount of stock, quickly, upon learning that: Qwest had failed to make the shift to recurring revenue; there were no IRUs in the funnel for the second half of 2001; and Qwest expected to miss its public target by nearly a billion dollars.

⁹ The defense suggested (App. 4303) Nacchio could not exercise and hold because he would have had to pay taxes. But he had more than enough cash to pay them. App. 3004-3006 (Nacchio was “sitting on well over \$70 million of cash”).

The jury could also rely on testimony from Nacchio’s executives that when he learned these facts, he was “visibly disappointed” (App. 3260), “concern[ed]” (App. 2635), unhappy (App. 2493), and “not pleased” (App. 2921).¹⁰ And the jurors could rely on Nacchio’s deceitful conduct during the April 24 call two days before he started dumping stock. App. 3579-3580. They could find that his statement, “We see nothing to dissuade us from the plan we announced” (GX 594A), misrepresented his (and his executives’) knowledge. They could conclude that this misrepresentation was an effort to prop up the stock price before his selling spree. *SEC v. Warde*, 151 F.3d 42, 47, 49 (2d Cir. 1998) (defendant’s “deceptive conduct” supported inference that he traded on inside information).

That Nacchio still held \$90 million in options in mid-2001 (Br. 12) does not negate scienter. He started the year with just over 4.4 million vested \$5.50 options. App. 4765. He sold about *half* of those by the end of May — with the majority of sales from April 26 to May 15. App. 4027, 4765. During that timeframe, he sold at a daily rate nearly four times greater than his rate from 1998 to 2000. *Supra* p. 13; *cf. Larrabee*, 240 F.3d at 23-24 (evidence showed “use” of information where trade

¹⁰ Nacchio cites testimony from David Weinstein, his financial advisor, about his (Nacchio’s) allegedly “bullish” view of Qwest. Br. 13. But Nacchio never discussed Qwest’s internal business or budgets with Weinstein. App. 2946. The jury could conclude that he misled Weinstein the same way he misled other investors.

“was nearly twice as large as any * * * previous trades”).

Nacchio stopped selling stock after May, but the jury was entitled to conclude that he did so because the stock price plummeted (*infra* pp. 31-32)—eventually leaving most of his options “under water” (App. 4039-4040)—and because he wanted to avoid detection. His desire to avoid detection is confirmed by his discussion with his general counsel about the need to further delay disclosure so investors would think the information was not something he had known all along. App. 1677-1678.

Nacchio cites no case requiring proof that an inside trader dumped *all* his shares. Such a rule would capture only the clumsiest of criminals, and it is not the law. *United States v. Smith*, 155 F.3d 1051, 1069 (9th Cir. 1998) (“[a]ny number of types of circumstantial evidence might” demonstrate “use” of inside information, including “unique trading patterns or unusually large trading quantities”); *Larrabee*, 240 F.3d at 23-24.

B. The inside information was material.

1. Under Rule 10b-5, materiality “depends on the significance the reasonable investor would place on the withheld * * * information.” *Basic Inc. v. Levinson*, 485 U.S. 224, 240 (1988). Because this “fact-specific inquiry” (*ibid.*) is “peculiarly [suited] for the trier of fact” (*TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 450 (1976)), it may “be resolved as a matter of law” only “where the information

is so obviously * * * unimportant to an investor * * * that reasonable minds cannot differ.” *Garcia v. Cordova*, 930 F.2d 826, 829 (10th Cir. 1991).

Contrary to Nacchio’s recitation of “rules” (Br. 16-19),¹¹ materiality cannot be reduced to “a rigid formula.” *Basic*, 485 U.S. at 236 (“Any approach that designates a single fact or occurrence as always determinative * * * must necessarily be overinclusive or underinclusive.”). A reasonable jury may consider a range of factors, including: the information’s effect on market value when disclosed, *SEC v. Cochran*, 214 F.3d 1261, 1269 (10th Cir. 2000); its specificity, *Elkind v. Liggett & Myers, Inc.*, 635 F.2d 156, 167 (2d Cir. 1980); “the reaction of [insiders] exposed” to it, *id.* at 166; the facts on which it is based, *Flynn v. Bass Bros. Enters.*, 744 F.2d 978, 988 (3d Cir. 1984); and the qualifications of those who prepared it, *ibid.* These factors apply whether the information is “hard,” “soft,” or in between. *Garcia*, 930 F.2d at 830 (“predictive information” may be material depending on its “importance, reliability and investor impact”). Because current information often affects anticipated future performance, “the same precise data, viewed through two different lenses, can at once be both ‘soft’ and ‘hard.’” *Smith*, 155 F.3d at 1064 n.22 (present

¹¹ Nacchio relies heavily on SEC Rules 3b-6 and 175. By their terms, however, these provisions do not apply to an insider who trades on omitted information. 17 C.F.R. § 240.3b-6(b) (Rule applies to issuer’s affirmative “forward-looking statement[s] * * * made in a document filed with the [SEC]”); 17 C.F.R. § 230.175(b) (same). Nor do the provisions mention, let alone define, materiality. Add. 98-99.

revenue figures affecting ability to meet projections could be characterized as “hard” or “soft”).

2. Under these principles, the jury could conclude that a reasonable investor would “consider * * * important” (App. 4558) the information to which Nacchio was privy.

a. Nacchio sold with first-quarter results in hand. On April 9, he learned that Qwest had not “crank[ed] up recurring growth” quickly enough for sufficient compounding (Supp. App. 231; App. 2179, 2210, 5000-5001), and that it would have to double its reliance on IRUs to meet its growth targets (App. 2215).¹² On April 13, Casey told him that would be impossible, because there were no IRUs in the funnel for the third and fourth quarters — purchasers had *already* gone out of business and Qwest was *already* “draining the pond” of all remaining IRUs. App. 2494-2496.

These were “objective and verifiable” accounts “concerning then-present factual conditions.” *Grossman v. Novell, Inc.*, 120 F.3d 1112, 1123 (10th Cir. 1997). They were reported by Nacchio’s top executives after close study of their units. None

¹² Nacchio says (Br. 22) Szeliga’s April 9 report showed “2001 revenues would reach \$21.56 billion.” But the report (App. 5000-5001) simply “plug[ged] in” the amounts Qwest would *need* to reach its target of \$21.56 billion. App. 2508; *see* App. 2210-2211, 2653, 3257-3260. The “current estimate” remained \$21.56 billion because only Nacchio had authority to reduce Qwest’s targets, and he did not do so. App. 2210, 3134-3135, 3144-3145, 3886-3887.

of the units' gaps stemmed from "sandbagging." App. 2430-2431, 2482-2483, 2612-2613, 2749. Neither Nacchio nor anyone else ever "debate[d]" (Br. 22) the *factual basis* for the executives' reports. Nacchio "rhetorical[ly]" "challenged" Casey, "[A]re you ready to take down the numbers?" App. 2493. But he "accepted" Casey's "assessment of the IRU market."¹³ App. 2508. As for IRUs, Casey had never before given Nacchio such an "adamant" warning. App. 2509, 2581 ("Th[e] market was drying up. There was nothing there. It was qualitatively and quantitatively different than what I had said in the past[.]"). The jury could credit these undisputed, detailed reports as evidence of materiality. *Cf. Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1090 (1991) (finding "no serious question" about materiality of corporate directors' statements).

Nacchio himself acknowledged IRUs were an "accounting trick[]" and recurring revenue was "more valuable" "in terms of what the marketplace valued in Qwest." App. 2464-2466. He further predicted, correctly (*infra* pp. 31-32), that "the stock price would go down" when the IRUs were disclosed because investors "would be surprised at the magnitude." App. 1652-1653.

¹³ Szeliga's testimony (App. 2230) was not to the contrary. The meetings followed a general pattern: the executives gave Nacchio detailed reports showing that his targets were unattainable; and he would listen without disputing the facts underlying the reports. App. 2147-2148, 2482-2483, 2493, 2742-2743, 2867.

Nacchio's senior executives reached similar conclusions about the information's significance. App. 1632-1633, 1655, 1799 (Wolfe); App. 2177, 2240 (Szeliga); App. 2759, 2765-2766 (Schumacher). Szeliga believed it material that Qwest's first- and second-quarter revenue mix was not "as portrayed" to investors. App. 2246, 2309. Wolfe believed it material "that we were using one-timers to make our numbers." App. 1622. Their views, and Nacchio's own selling spree, are further evidence of materiality. *Basic*, 485 U.S. at 240 n.18 ("trading (and profit making) by insiders can serve as an indication of materiality" (emphasis omitted)).

The investors' conduct is also telling. They persistently demanded a revenue breakdown, and when they finally got it, they "stripp[ed]" the IRUs to reflect that Qwest had been growing by only 6% or 7%, not the 12% Qwest had reported. App. 1819 (Wolfe). These growth numbers were crucial — Nacchio himself had remarked that Qwest needed to "grow or die" (GX 514A) and would get "whacked" (GX 506A) if it missed its growth targets.

b. These April reports about the present quality of revenue and growth obviously bore on whether Qwest would "meet its year-end numbers eight months in the future." Br. 19. On April 9, based on all the units' data, Szeliga expected Qwest to book \$20.4 billion in 2001. App. 2423-2424. This \$900 million (4%) shortfall from the \$21.3 billion public target was hardly so "small" (Br. 24) as to be legally

immaterial.¹⁴

In *Ganino v. Citizens Utilities Co.*, 228 F.3d 154 (2000), the Second Circuit rejected an argument that a 1.7% effect on annual revenue was immaterial. *Id.* at 162. Relying on *Basic*, the court emphasized the “fact-specific” nature of the inquiry and that “[q]ualitative” and “quantitative[.]” circumstances together can show materiality. *Id.* at 162-163. So, too, here. Nacchio told his staff in January 2001 that in the existing telecommunications market, even a \$50 million, or 0.2%, miss in the \$21.3 billion target would cause the stock price to drop at least 15% to 20%. GX 559A.

Nacchio’s cases (Br. 24) do not hold that a 4% miss under these circumstances is legally immaterial. *In re Convergent Techs.*, 948 F.2d 507, 514 (9th Cir. 1991) (no material misstatement in press release regarding company’s *second-half* revenues; though company missed third-quarter prediction by 10%, it made up difference in fourth quarter, such that *second-half* revenue was “pretty much what the * * * press release predicted”) (cited in *In re Apple Computer, Inc.*, 127 Fed. Appx. 296, 304 (9th Cir. 2005)); *City of Philadelphia v. Fleming Cos.*, 264 F.3d 1245, 1268 (10th Cir. 2001) (existence of lawsuit against company not material where damages claims were

¹⁴ Nacchio erroneously suggests this “billion dollar risk” related only to the “initial \$22 billion budget target.” Br. 24 (citing App. 2268). Szeliga clarified that Qwest expected to miss the initial \$22 billion target by *\$1.6 billion*, which reflects total expected revenue of \$20.4 billion. App. 2422-2424, 4936. Also, a \$900 million shortfall from a \$21.3 billion target is a miss of 4.2%, not 1.4% (Br. 24).

presumed “inflated by plaintiffs”).

Nor does *Shaw v. Digital Equipment Corp.*, 82 F.3d 1194 (1st Cir. 1996), impose an “extreme departure” standard. Br. 18, 24. *Shaw* assumed as true the plaintiffs’ *allegation* of “an extreme departure from publicly known trends” (82 F.3d at 1211) but nowhere adopted that as a materiality standard. Instead, like *Ganino*, *Shaw* emphasized that a “bright-line rule[]” would be contrary to *Basic*’s fact-intensive approach. *Id.* at 1210.

c. Nacchio states (Br. 1) that Qwest’s stock “fell [so] sharply” in 2001 that “[m]any shareholders lost paper fortunes.” He then argues (Br. 27) that Qwest’s belated disclosure of its failures “had no discernible negative effect on its stock price.” The first statement is correct; the second is not.

On April 24, 2001, the day of the first-quarter earnings call, Qwest’s stock closed at \$37.30. App. 4761. Nacchio dumped 1,255,000 shares (~\$50 million) in the next 12 trading days, at prices between \$37.23 and \$41.12. App. 68; Supp. App. 239, 242-243. By July 24, Qwest had “a big credibility issue” because of the “opaqueness in [its] revenue breakdown” (Supp. App. 224), and the stock price had dropped about 27%, to \$27.05. App. 4762. Nacchio trickled out news of the IRUs’ magnitude in August. App. 1651-1653, 1672-1674. By September 7, the price had fallen another 33%, to \$18.14. App. 4763. Nacchio lowered Qwest’s targets on

September 10 (App. 4933), and Qwest later missed those lower numbers (App. 1677-1681). By the time Qwest had announced its third-quarter miss, its stock had fallen another 34%, to \$12 — less than a *third* of what investors had paid Nacchio for his stock in April and May. App. 1678.

Nacchio mentions (Br. 27) stock prices from the *day after* certain disclosures. He suggests (*ibid.*) those prices fully incorporated the news, such that the jury was required to ignore the overall plunge. But none of his cases can support that proposition,¹⁵ and this Court should reject it. First, it conflicts with *Basic*'s fact-intensive approach. 485 U.S. at 248 n.28 (refusing “to adopt any particular theory of how quickly and completely publicly available information is reflected in market price”); *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. Am. W. Holding Corp.*, 320 F.3d 920, 934 (9th Cir. 2003) (rejecting, as contrary to *Basic*, proposed rule that information is immaterial if disclosure has no “immediate” effect on stock price; rule would ignore “realities of the market,” which does not “instantly react”). Second, the evidence contradicts Nacchio's next-day rule. App. 3588-3592;

¹⁵ *In re Burlington Coat Factory*, 114 F.3d 1410, 1425 (3d Cir. 1997) (citing *Roots P'ship v. Lands' End, Inc.*, 965 F.2d 1411, 1419 (7th Cir.1992), which suggested earnings news was incorporated into stock price over *two months* after release); *In re Merck*, 432 F.3d 261, 269-270 (3d Cir. 2005) (rejecting claim of materiality where stock price rose for five days after disclosure, declined by 1% over next five days, and rose again over next month).

Supp. App. 227 (analyst needed one week to prepare report discussing Qwest’s disclosure). Third, such a rule would reward Nacchio for trickling out the disclosures to avoid detection. *Supra* pp. 14-16. Had he disclosed the information all at once, the stock might have plunged all at once.¹⁶

Nor was the market “attuned” to Qwest’s problems (Br. 25-27). The “warnings” Nacchio quotes were vague boilerplate far removed, in both time and content, from Nacchio’s new and specific inside information.¹⁷ Nacchio himself thought the warnings were meaningless — he often joked that they meant, “[D]on’t believe anything we tell you.” App. 1823-1824. As the district court recognized (App. 3786-3787), the “bespeaks caution” doctrine does not apply to such boilerplate. *Grossman*, 120 F.3d at 1120-1123 (doctrine inapplicable unless warnings are “substantive and tailored,” “sufficiently specific,” and “proximate in time” to predictions). Nor does it protect omissions of present fact. *Id.* at 1123 (“risk disclosures” cannot “immunize” “present factual conditions”); *infra* pp. 42-43.

¹⁶ Nacchio’s attempt to blame the drop on the September 11 attacks (Br. 28) ignores that the stock dropped over 50%, from \$37 to \$18, by September 7. App. 4761-4763.

¹⁷ Though Nacchio said on the April 24 earnings call he was “not pleased” with the national mass markets unit’s performance (Br. 26), he did not disclose the recurring revenue shortfall, instead touting the unit’s “enormous upside” (App. 4807). And though Qwest’s SEC filings said Qwest had IRU revenue (Br. 26), they nowhere disclosed *how much*. App. 4682 (10K stated Qwest “[o]ccasionally” sold IRUs).

Qwest’s so-called “cautionary statements” thus do not undermine the jury’s finding of materiality.

C. Nacchio acted with the requisite intent to defraud.

1. 15 U.S.C. § 78ff(a) requires the government to prove Nacchio “willfully” engaged in insider trading. Knowledge of materiality is not required. *United States v. Chiarella*, 588 F.2d 1358, 1371 (2d Cir. 1978), *rev’d on other grounds*, 445 U.S. 222 (1980). Again, the district court chose a tougher standard, instructing that the government had to prove Nacchio acted “with the intention or purpose to deceive or cheat” and to “disobey * * * or disregard the law.”¹⁸ App. 4560.

2. A reasonable jury could find Nacchio intended to cheat investors. First, his own statements clearly reflect his knowledge of materiality:

- He said it was “absolutely critical” (GX 551A) Qwest make the shift to recurring revenue “by April” (GX 559B);
- He said recurring revenue was “more valuable” to investors than IRUs (App. 2464-2466);
- He said investors would be so “surprised” when the IRUs’ magnitude was disclosed that “the stock price would go down” (App. 1653);

¹⁸ This stringent standard and the evidence that meets it—showing Nacchio meant “to deceive or cheat” investors—refute his rhetoric (Br. 1-3) that it was unfair to prosecute him. *United States v. O’Hagan*, 521 U.S. 642, 666 (1997) (Section 78ff(a)’s “requirement * * * of culpable intent” “destroy[ed] any force” to claim that insider-trading prosecution based on misappropriation theory was unforeseen or “unjust”).

- He said the market was so “mercurial” that if Qwest missed its 2001 target “by \$50 million,” its stock price would fall “15% to 20%” (GX 559A); and
- He issued an insider-trading policy stating that “information potentially affecting the market price” of Qwest’s stock was “[m]aterial” (App. 4775).

Second, Nacchio’s executives made clear that the information was material:

- Mohebbi and Wolfe told him the market was “demanding” a “breakdown” of Qwest’s numbers (Supp. App. 237; App. 1600, 1611-1612);
- Wolfe told him investors needed to know the IRUs’ contribution to Qwest’s growth in order “to make an informed decision whether to buy or sell the stock” (App. 1799); and
- Wolfe told him the stock price would go down when the information was disclosed (App. 1657).¹⁹

Knowing all of this, Nacchio stonewalled investors, App. 1799 (“[S]crew them, go tell them to buy.”); then lied to them, GX 594A (“We see nothing to dissuade us from the plan we announced.”); then sold stock; and then decided (with his general counsel, Drake Tempest) to delay disclosure so the investors would not know how

¹⁹ These executives told Nacchio he should disclose Qwest’s problems (*supra* p. 10), should “not * * * be too bullish” with investors (App. 1630), and should not reaffirm the targets (App. 2254-2255). Nacchio notes (Br. 28) that no executive further told him to lower the public targets. But this was Nacchio’s decision to make, not theirs. App. 2493 (Casey explained, “It really wasn’t my place to take down the numbers for the company.”); App 3143-3145 (Mohebbi “express[ed] * * * concerns” about Qwest’s public targets, but only Nacchio had authority to lower them).

long he had been aware of Qwest's problems, App. 1677-1678. The jury could conclude that he took these steps to prop up the stock price before he dumped 1.3 million shares, and to avoid detection thereafter. *United States v. Wenger*, 427 F.3d 840, 854 (10th Cir. 2005) (evidence showed intent to defraud where investment advisor told clientele to buy stock while he sold).

Tempest's alleged "approval" of Nacchio's sales (Br. 29) does not negate this evidence. Tempest signed forms representing that Qwest had approved Nacchio's 10b5-1 *trading plans*. App. 5157, 5172. Nacchio entered the first such plan in February 2001 (App. 5157) but withdrew from it in March (App. 4803), before receiving the negative April reports. Nacchio was not in a trading plan when he dumped 1,255,000 shares from April 26 to May 15. App. 68, 1981-1982. Nothing suggests Tempest, or anyone else, approved those sales. Nacchio did enter a second 10b5-1 plan on May 16 (App. 5172), selling 75,000 shares (App. 68, 1981-1982), but the jury could conclude that he had a pre-existing intent to defraud and simply obtained Tempest's rubber stamp for a few more sales. Nor would the jury have to credit Tempest's approval — he did not have all the information Nacchio did (*e.g.*, App. 2681-2682, 2925) and did not stop Nacchio from misleading investors by delaying disclosure (App. 1677-1678).

Nor can Nacchio claim good-faith reliance on Qwest’s auditors. Br. 29-30. Nacchio was not on the audit committee and took no part in any meeting it held concerning IRU disclosure. App. 2388, 2853. Furthermore, Qwest’s auditors did not settle the IRU disclosure issue until “mid May,” after the bulk of Nacchio’s sales. App. 2851. Most importantly, Qwest’s auditors addressed whether *Qwest’s* disclosure positions were consistent with generally accepted accounting principles (GAAP) and auditing standards (GAAS). App. 2387. There is no evidence they addressed the “fact-specific inquiry” of whether a “reasonable investor” would consider Nacchio’s inside information significant in deciding to trade.²⁰ Nor is there evidence that the audit committee ever opined on the recurring revenue shortfall or the empty IRU funnel, let alone in Nacchio’s presence. Nacchio suggests (Br. 31) this was “proprietary information” that *Qwest* did not have to disclose. But even if that were so, *Nacchio* could not trade using *Qwest’s* proprietary information. *Garcia*, 930 F.2d at 829 (where, for corporate reasons, “disclosure cannot be made, the insider is obligated to abstain from trading”); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 850 n.12 (2d Cir. 1968) (en banc) (same).

²⁰ The jury heard from two members of the audit committee — Szeliga (Qwest’s CFO) and Schumacher (Qwest’s controller). Both made clear they believed the IRUs’ magnitude was material for insider-trading purposes. App. 2177, 2246, 2309, 2765. As for Qwest’s lawyers and outside auditors, Nacchio did not present testimony from them.

II. The Jury Instructions Were Correct And Complete

Because “a district judge has substantial discretion in formulating [jury] instructions,” this Court’s review “is confined to determining whether,” “as a whole,” they “sufficiently cover the issues presented” “and constitute correct statements of the law.” *United States v. Davis*, 953 F.2d 1482, 1492 (10th Cir. 1992). Refusal to give a particular proposed instruction is reviewed for abuse of discretion. Br. 32. Instructions to which the defendant did not object are reviewed for plain error. Fed. R. Crim. P. 30(d).

A. The materiality instruction was correct and complete.

The district court instructed that omitted information is material if “a reasonable investor would consider it important” in deciding whether to buy or sell Qwest’s stock. App. 4558. That was a correct statement of the standard. *Basic*, 485 U.S. at 240. Nacchio contends (Br. 33-35) the court was required to add (1) his “reasonable basis” instruction, App. 755-757; (2) his “bespeaks caution” instruction, App. 758-761; and (3) the *government’s* “probability/magnitude” and “total mix” instructions, App. 741-742. He is mistaken.²¹

²¹ Nacchio cites no insider-trading case in which a “reasonable basis” instruction or a “bespeaks caution” instruction has been given.

1. Nacchio’s “reasonable basis” instruction would have focused the jury on Qwest’s *public* targets and statements by (a) telling the jury that, “[i]n this case, the forward-looking financial statement[s] consisted of the September 7, 2000 projection * * * and each subsequent affirmation of that projection”; (b) requiring proof that the targets and statements were material; (c) telling the jury the targets and statements could not be material unless they were made “without a reasonable basis” or “other than in good faith”; and (d) discussing whether Qwest had a “duty to correct” the targets and statements. App. 755-757. That would have been wrong for several reasons.

First, Nacchio was charged with *trading on inside information*. He was not charged with making misstatements or failing to correct past misstatements.²² Thus, the instruction would have identified unnecessary legal tests, improperly required proof beyond what was required, and misled the jurors.

Second, the instruction would have been hopelessly one-sided. It would have proclaimed that projections are “inevitably inaccurate” and that “things almost never go exactly as planned.” App. 755. It thus would have invited the jury to disregard as immaterial all of the bad news Nacchio had received. That would have flouted

²² Qwest’s public targets and statements may have been relevant, but by no means were they the “sole” evidence of materiality (Br. 33).

Basic's fact-intensive approach (485 U.S. at 240), under which a company's internal predictions of a public shortfall may be material. *E.g.*, *Smith*, 155 F.3d at 1064-1066; *Folger Adam Co. v. PMI Indus., Inc.*, 938 F.2d 1529, 1534 & n.8 (2d Cir. 1991); *cf.* *Stransky v. Cummins Engine Co.*, 51 F.3d 1329, 1333 (7th Cir. 1995) (investors "invest with the future in mind"). The court did not abuse its discretion in declining to give an instruction that would have filtered the evidence "through the rose-colored glasses of the defense." *Davis*, 953 F.2d at 1492.

Third, the proposed instruction was based on SEC provisions that only protect certain forward-looking statements filed with the SEC. 17 C.F.R. §§ 230.175, 240.3b-6.²³ The cases and instructions Nacchio cites (Br. 16, 34) address protections only for such statements.²⁴ But insider trading is not premised on *statements*; it involves *trading* in violation of an insider's duty to shareholders. *O'Hagan*, 521 U.S. at 652. Extending these provisions to protect *trading* on *undisclosed* information

²³ As discussed (*supra* note 11), these "reasonable basis" provisions say nothing about materiality. And, logically, a statement's "reasonable basis" does not show it is immaterial to investors — it bears instead on whether the statement is misleading.

²⁴ The plaintiffs in *Wielgos* (Br. 7, 16-18, 34) challenged registration statements; they did not allege insider trading. *Wielgos v. Commonwealth Edison Co.*, 688 F. Supp. 331, 334 (N.D. Ill. 1988), *aff'd*, 892 F.2d 509 (7th Cir. 1989). The Seventh Circuit concluded that those "forward-looking statements," filed with the SEC, qualified for protection under SEC Rule 175. 892 F.2d at 513.

would ignore their text and undermine their purpose of “promot[ing] greater accessibility to * * * information for all investors.” 44 Fed. Reg. 38810, 38813 (July 2, 1979); *cf.* 69 Fed. Reg. 67392, 67402 (Nov. 17, 2004).

Anyhow, the proposed instruction was unnecessary. Nacchio argued his good-faith/reasonable-basis theory to the jury using the *mens rea* and good-faith instructions. App. 4452-4453; *see United States v. Bryant*, 892 F.2d 1466, 1468 (10th Cir. 1989) (reversal warranted “only when the failure to give a requested instruction serves to prevent the jury from considering the defendant’s defense” (quotation omitted)).²⁵ He acknowledges (Br. 16) that the reasonable-basis protections require “good faith.” Because the jury found beyond a reasonable doubt that Nacchio’s insider trading was in *bad* faith, any error was likewise harmless beyond a reasonable doubt.

2. Nacchio’s “bespeaks caution” instruction was likewise erroneous and unnecessary. First, it would have mandated acquittal “[i]f the materiality of the *September 7, 2000 guidance* has not been proven.” App. 759 (emphasis added). And

²⁵ *United States v. Lake*, 472 F.3d 1247 (10th Cir. 2007), does not change this standard. In *Lake*, the defendants’ good-faith theory turned on whether, *as a factual matter*, they correctly understood SEC regulations. *Id.* at 1253, 1261-1263. The district court did not inform the jury what the regulations required, leaving the jurors unable to “fairly appraise * * * *mens rea*.” *Id.* at 1263. In contrast, Nacchio’s good-faith defense rested on his allegedly bullish views (App. 4452-4453), and was not unusually “dependent on an understanding of an applicable law.” 472 F.3d at 1263.

it would have told the jury that warnings are relevant to the materiality of “projections in a disclosure statement.” App. 758. That is nonsense. Again, Nacchio was not charged with trading on the basis of the *public* targets announced in September 2000 (App. 4781-4782). He was charged with trading on material *inside* information. The instruction was properly refused on this ground alone. *Davis*, 953 F.2d at 1492 (instruction properly refused where it “would preclude the jury from finding the elements of [the] charged offenses”); *United States v. Quarrell*, 310 F.3d 664, 676 (10th Cir. 2002) (defense instruction must be “correct statement of the law”).

Second, the “bespeaks caution” doctrine does not create a new materiality rule. It stands for the “unremarkable proposition” that warnings may be relevant in determining whether “forward-looking representations” are “materially misleading.” *Grossman*, 120 F.3d at 1120. Nothing in the court’s instructions forbade Nacchio from arguing Qwest’s “warnings” to the jury, which was directed to consider “all the evidence.” App. 4544.

Third, the doctrine does not apply to omissions of “then-present factual conditions.”²⁶ *Grossman*, 120 F.3d at 1123. Nacchio traded on verifiable, then-

²⁶ Indeed, because the doctrine derives in part from the civil requirement of proving reliance (*Provenz v. Miller*, 102 F.3d 1478, 1493 (9th Cir. 1996)), it is not clear that it applies *at all* in the criminal context, where reliance is not required (*O’Hagan*, 521 U.S. at 664-665).

present facts: recurring revenue *had not* “taken off” by April, Qwest *had* relied on IRUs to meet its first-quarter numbers, and it was *already* “draining the pond” of all remaining IRU opportunities.

Fourth, the warnings here were far too generalized to support a special instruction. *Grossman*, 120 F.3d at 1120 (doctrine does not apply unless warnings are “substantive and tailored” to risks); *see Davis*, 953 F.2d at 1492 (proposed instruction must be “supported by sufficient evidence for a jury to find in defendant’s favor”). For example, Wolfe provided no special cautions during the April 24 earnings call; he stated merely that the participants’ statements were “subject to risks and uncertainties.” App. 4804. Obviously, that was not “tailored” to the specific problems Qwest was then facing. Nacchio himself had paraphrased the warning as, “[D]on’t believe anything we tell you.” App. 1823-1824.

3. Nacchio’s proposed instructions did not include the “probability/magnitude” and “total mix” principles he now claims were required (Br. 35). Nor did he object to their exclusion. Add. 34-35. Review is thus for plain error. Fed. R. Crim. P. 30(d).

The court did not err in not including any “probability/magnitude” instruction, because this Court does not require it. *Garcia*, 930 F.2d at 829 n.1 (courts are “not * * * obligated to apply that test” outside “context of merger negotiations”). Nor did

it err in not including an instruction about “total mix,” because that concept is merely the reasonable-investor standard “[p]ut another way” (*TSC*, 426 U.S. at 449), and the court correctly instructed on the reasonable-investor standard. Nor has Nacchio even attempted to show that any error “affected the outcome of the * * * proceedings.”²⁷ *United States v. Cotton*, 535 U.S. 625, 632 (2002).

B. The “non-public information” instruction was correct.

The court instructed that, “[t]o prove * * * the information was *non-public*,” the government need not “additionally” show “Qwest was required to disclose” it, because a “corporation has no general duty to disclose all of its non-public or its proprietary information.” App. 4559 (emphasis added).

Nacchio does not claim the instruction misdefined “non-public information.” Nor does he contend that Qwest had a duty to disclose *all* of its information. Instead, he suggests (Br. 35-36) the instruction misled the jury about *materiality*. But it said nothing about materiality, and its reference to Qwest’s non-absolute “duty to disclose” did not transform it into a materiality instruction. *Basic*, 485 U.S. at 235 (company’s “duty to disclose” distinct from “definition of materiality”).

²⁷ Nacchio complains (Br. 8) that the jury was “left * * * on its own” to decide what a reasonable investor would consider important. That does not suffice to show error, let alone prejudice, for “jurors are not children.” *United States v. Rivera-Gomez*, 67 F.3d 993, 999 (1st Cir. 1995). Rather, they have “unique competence” in applying the reasonable-investor standard. *TSC*, 426 U.S. at 450 & n.12.

Moreover, even if the instruction had said what Nacchio imagines—that “the duties of Qwest as speaker and Nacchio as trader” were different (Br. 36)—it would have been correct. *Basic*, 485 U.S. at 240 n.18 (contrasting company’s “duty not to mislead” with insider’s “duty to disclose or abstain”); *SEC v. Geon Indus., Inc.*, 531 F.2d 39, 48 (2d Cir. 1976) (Friendly, J.) (though company may have “good reasons to delay disclosure, they do not justify insider trading * * * during the waiting period”); *In re K-tel*, 300 F.3d 881, 898 (8th Cir. 2002) (“Materiality alone is not sufficient to place a company under a duty of disclosure.”).²⁸

Finally, the court’s instructions in no way “directed the jury to disregard” evidence about the views of Qwest’s lawyers, auditors, and executives, or how those views might bear on Nacchio’s state of mind. Br. 36. The court instructed the jury to consider “all * * * facts and circumstances * * * which logically may aid you in determining [Nacchio’s] state of mind.” App. 4562.

²⁸ Nacchio points to Casey’s testimony (App. 2549-2551) that disclosure of certain IRU information could have given other companies a competitive advantage. Br. 31. But even if Qwest’s delaying disclosure served shareholders’ interests, Nacchio’s trading on the information violated his duty not to “tak[e] unfair advantage of uninformed stockholders.” *O’Hagan*, 521 U.S. at 652; see *Texas Gulf Sulphur Co.*, 401 F.2d at 850 n.12.

C. The good-faith instruction was correct.

As part of its detailed good-faith instruction (App. 4561-4563), the court stated that “[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.” Nacchio’s challenge to this statement (Br. 38-39) reads it in isolation (contra *Davis*, 953 F.2d at 1492) and rests on several mistaken premises.

1. The instruction was not “unprecedented” (Br. 38). It was essentially identical to the leading pattern instruction. 1A FEDERAL JURY PRACTICE & INSTRUCTIONS § 19.06, at 855 (5th ed. 2000) (quoted in *United States v. Janusz*, 135 F.3d 1319, 1322 n.1 (10th Cir. 1998) (“A defendant does not act in ‘good faith’ if, even though he honestly holds a certain opinion or belief, that defendant also knowingly makes false or fraudulent pretenses, representations, or promises to others.”)). Several courts have affirmed instructions using virtually the same language. *E.g.*, *United States v. Goodchild*, 25 F.3d 55, 59-60 (1st Cir. 1994); *United States v. Pelullo*, 964 F.2d 193, 213 & n.19 (3d Cir. 1992) (instruction “made it clear” defendant could not be convicted without requisite intent); *United States v. Behr*, 33 F.3d 1033, 1035 & n.7 (8th Cir. 1994); *United States v. Tarallo*, 380 F.3d 1174, 1191-1192 (9th Cir. 2004) (instruction ensured defendant would not be convicted for mere “puffing”). The only difference here was that the court—in response to a

defense objection (App. 4177-4179)—used the phrase “device * * * to defraud” instead of the “false * * * pretenses” language. Nacchio does not challenge that substitution.

2. The instruction did not permit the jury to convict based on “any dishonest act *unrelated* to the insider-trading charge” (Br. 38). It did not say any dishonest act defeats good faith. Nor can the phrase “device, scheme or artifice to defraud” be construed to include any dishonest act, because the court instructed that “[t]he particular type of device, scheme or artifice to defraud at issue here” was “insider trading.” App. 4556. Also, the court emphasized: “[T]he Government must establish beyond a reasonable doubt * * * [Nacchio] acted with the intent to defraud *charged in the [i]ndictment.*” App. 4561 (emphasis added). The indictment related only to insider trading. App. 64-68. The instruction thus foreclosed the jury from finding guilt based on any unrelated act — including the acts to which David Weinstein testified.²⁹ Br. 39.

²⁹ The government relied on Weinstein’s testimony to argue (App. 4253, 4513-4514) that Nacchio, in bad faith, backdated documents in selling certain “growth shares.” But those sales related only to counts one and two. The jury acquitted on those counts. Weinstein further testified (App. 3063-3066) that Nacchio asked for assistance in another (unidentified) dishonest act. Contrary to Nacchio’s assertion (Br. 39), this testimony was properly admitted. App. 3850-3859; *see* Supp. App. 45-53.

3. The instruction did not permit the jury to convict “*even if [it] found that Nacchio honestly believed his trading was lawful*” (Br. 38). The instruction stated that “[a] person who acts on a belief or an opinion honestly held is not punishable under this statute merely because the belief turns out to be inaccurate, incorrect or wrong.” App. 4561. It also required the government to show an “intent to defraud” to negate good faith. *Ibid.* And in defining “intent to defraud,” the court’s *mens rea* instructions required proof that Nacchio acted with intent “*to disobey * * * or disregard the law.*” App. 4560 (emphasis added).

Taken as a whole, the court’s instructions conveyed that (1) acting on an honest belief would demonstrate good faith, *except* (2) knowingly engaging in “insider trading” with “intent to defraud” would not constitute good faith simply because Nacchio held an honest belief about some collateral matter. That proposition is well settled.³⁰ *Janusz*, 135 F.3d at 1323 (honest belief that venture would succeed did not show good faith, because defendant knowingly used false pretenses with intent to deceive); *see United States v. Bailey*, 327 F.3d 1131, 1143 (10th Cir. 2003); *United States v. Grissom*, 44 F.3d 1507, 1512 (10th Cir. 1995).

³⁰ Likewise correct was the government’s argument in closing that “you cannot be dishonest and have good faith at the same time.” App. 4514. In any event, both the court (App. 4533) and the government (App. 4281) told the jury to follow the court’s instructions, not the lawyers’ comments on the law.

4. The instruction did not “effectively negate[] the prosecution’s burden of proving scienter” (Br. 39). The instruction stated: Nacchio “has no burden to prove anything”; “the Government must establish beyond a reasonable doubt the opposite” of good faith; and “[i]f the evidence * * * leaves you with a reasonable doubt as to whether Mr. Nacchio acted with the intent to defraud or in good faith, then you must acquit him.” App. 4561-4562.

III. The Court Properly Excluded The Opinion Testimony Of Nacchio’s Expert

This Court reviews for abuse of discretion the exclusion of expert opinion testimony, whether based on: a violation of Fed. R. Crim. P. 16 (*United States v. Nichols*, 169 F.3d 1255, 1267 (10th Cir. 1999)); failure to demonstrate reliability under Fed. R. Evid. 702 and *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993) (*United States v. Charley*, 189 F.3d 1251, 1266 (10th Cir. 1999)); or “prejudice, confusion, or waste of time” under Fed. R. Evid. 403 (*United States v. Adams*, 271 F.3d 1236, 1243 (10th Cir. 2001)). Each of these grounds independently justified exclusion of Daniel Fischel’s opinion testimony.

A. Nacchio misstates the procedural history.

Three days before trial (March 16, 2007), the defense disclosed Fischel as an expert.³¹ App. 460-462. The disclosure listed numerous topics, but where it identified opinions, it failed to provide the “bases and reasons” for them, as required by Rule 16(b)(1)(C). It did *not* say Fischel would opine that “the magnitude of Qwest’s IRU revenue” was immaterial or mention any “event study” (Br. 41).

Despite this Rule 16 violation, the court did not exclude Fischel’s testimony. Rather, on the government’s motion (Supp. App. 35-44), it ordered the defense to provide, by March 26, the “bases and reasons” for the stated opinions (App. 352), and further directed the defense “to clarify the character and content of Professor Fischel’s testimony” (*ibid.*).

The defense then asked for more time. App. 2037. The court extended the deadline to March 29, but emphasized the need for sufficient disclosure because the government would have no opportunity to depose Fischel. App. 2041. The government added that it anticipated “*Daubert* issues” with Fischel’s testimony, and the court agreed, citing *Kumho Tire Co. v. Carmichael*, 526 U.S. 137 (1999). App.

³¹ The government had provided its expert disclosures 25 *days* before trial. Nacchio moved to exclude the experts (Supp. App. 1-22), claiming the disclosures were untimely and did not satisfy *Daubert*. The court found the disclosures untimely under Rule 16 and excluded the experts. Supp. App. 27-34.

2042. The defense responded, “forewarned is forearmed.” *Ibid.*

On March 29, the defense proffered another disclosure. It set forth *new* opinions, including that “the magnitude of Qwest’s IRU revenue” was immaterial. App. 431-432. But despite the court’s “forewarn[ing]” about *Kumho*, the disclosure still said nothing about Fischel’s methodology. And it mentioned no event study. The government moved to exclude Fischel’s opinions on numerous detailed grounds, including Rule 16, Rule 702, and Rule 403. App. 362-423.

On April 4, at the end of the government’s case-in-chief, the defense filed an opposition insisting (App. 463-467) that its disclosure had gone “further than required” under Rules 16 and 702 and had “outline[d] the specific testimony” Fischel would provide, ensuring “full disclosure” and “a fair opportunity to test the merit” of the testimony. The opposition still did not provide any methodology, but nonetheless claimed (App. 466) the proposed testimony was “proper under Rule 702.” The defense did not request a *Daubert* hearing or any other opportunity to present evidence.

The next morning, the defense called Fischel to the stand. App. 3913. The court excluded his opinion testimony on several bases, including: (1) the defense had failed to establish that the testimony satisfied Rule 702, App. 3915-3919; (2) the defense’s Rule 16 disclosures were “gross[ly] defect[ive]” in that Fischel’s

methodology was “absolutely undisclosed,” App. 3917, 3921; *see* App. 3930 (pinning down Fischel’s testimony was “like trying to nail jello to the wall”); and (3) under Rule 403, the danger that the jurors would defer to technical-sounding opinions substantially outweighed the probative value of Fischel’s testimony, App. 3917-3920.³² The court determined, however, that Fischel could testify as a summary witness pursuant to Fed. R. Evid. 1006. App. 3922.

The weekend *after* the order, the defense sent the government hundreds of pages of *new* exhibits Fischel proposed to testify about on Monday. Supp. App. 55-56, 76-149. The defense then moved for leave to allow Fischel to testify, using those exhibits, about two issues (an “economic study” of “revenue multiples,” and the “views of other analysts”) and requested a *Daubert* hearing. App. 480-481 & n.4. The government again moved for exclusion. Supp. App. 54-75.

On Monday, after Fischel (Nacchio’s last witness) testified as a summary witness, the court excluded his proposed testimony on the two additional issues, citing the disclosure’s “egregious” untimeliness; the “non-disclosure of * * *

³² The court further found (App. 3920) that much of the proposed testimony was not expert opinion but a “recitation of facts,” of which Fischel lacked personal knowledge under Rule 602. Contrary to Nacchio’s contention (Br. 48 n.18), “when experts testify as to facts and not opinions, [the] exemption from the personal knowledge requirement does not apply.” 27 WRIGHT & GOLD, FEDERAL PRACTICE & PROCEDURE: EVIDENCE § 6025, at 248 (2d ed. 2007).

methodology”; “lack of reliability”; hearsay (as to “other analysts”); and irrelevance. App. 4074-4076.

B. The court properly exercised its discretion.

1. Nacchio avoids, and thereby waives, arguing that he met Rule 702’s requirements. Instead, he contends (Br. 45) the court never made a Rule 702 determination. He is mistaken. The court accepted the defense’s invitation (App. 463-467) to review the second disclosure under Rule 702. App. 3914. It found that Fischel’s opinions were based on no more than data, conclusions, and Fischel’s “ipse dixit,” and that this was “woefully inadequate” to satisfy the requirements of Rule 702. App. 3914-3919.

That determination was proper. “[T]he proponent” of an expert opinion “has the burden of establishing * * * by a preponderance of the evidence” that the opinion is reliable — *i.e.*, that the underlying methodology is sound and can be reliably applied to the facts, and that the opinion will assist the jury. Fed. R. Evid. 702(2), (3) & 2000 Adv. Comm. Notes. Nacchio did not meet this burden. *Kumho*, 526 U.S. at 157 (“ipse dixit” insufficient). Rule 702 is not satisfied when an expert presents facts and conclusions but fails to explain the methodology purportedly connecting them. *Champagne Metals v. Ken-Mac Metals, Inc.*, 458 F.3d 1073, 1079-1080 (10th Cir. 2006); *United States v. Fredette*, 315 F.3d 1235, 1239-1240 (10th Cir. 2003).

2. Nacchio’s challenge to the court’s alternative basis for exclusion—Rule 16—also lacks merit. Rule 16(b)(1)(C) requires disclosure of the “bases and reasons” for an expert’s testimony. The committee notes to Rule 16 cite Rule 702 and explain that disclosure is necessary “to minimize surprise that often results from unexpected expert testimony” and “to provide the opponent with a fair opportunity to test the merit of the expert’s testimony through focused cross-examination.” 1993 Adv. Comm. Notes.

When reviewing an exclusion based on insufficient disclosure, this Court considers, *inter alia*, the “reasons” for the insufficiency, the “prejudice” to the government, and the “feasibility” of curative measures short of exclusion — and it considers all factors supporting the district court’s conclusion even if not “specifically mentioned.” *Nichols*, 169 F.3d at 1268.³³

Even as Fischel approached the stand, neither the government nor the court knew the bases and reasons for his opinions. Fischel’s event study was first presented *after* Nacchio was convicted, in a report Fischel prepared for *sentencing*.³⁴ App. 793-

³³ *Nichols* forecloses Nacchio’s generic reliance (Br. 42-43) on the Sixth Amendment. 169 F.3d at 1267 & n.2 (“if not an abuse of discretion,” exclusion of defense expert based on Rule 16 violation is consistent with Sixth Amendment).

³⁴ Until Nacchio filed his appellate brief, the government had no idea Fischel intended to present that study *at trial*.

803 (dated July 2, 2007; cited at Br. 41-42, 48-49). The prosecution could hardly test an undisclosed methodology. Nor could it properly prepare to cross-examine the *new* opinions introduced in the March 29 disclosure. And those, too, were unsupported by any statement of bases and reasons.

Whether or not the omissions from the *initial* disclosure reflected gamesmanship (NACDL Br. 4), the court gave the defense nearly two weeks to provide Fischel's methodology. The defense failed to do so even in its second disclosure. It again failed to do so in its response to the government's detailed motion challenging Fischel. With Fischel as the defense's last witness, the court was not required to offer a fourth bite at the apple. *Nichols*, 169 F.3d at 1268 ("scheduling considerations alone may justify" exclusion "[e]ven in the absence of prejudice" to government).³⁵

The court excluded only Fischel's expert opinions, permitting him to present much of his proposed testimony as a summary witness. App. 3922. Fischel presented extensive evidence about the "pattern[]" and "timing" of Nacchio's 2001 stock sales. Br. 42; *see* App. 3981-4064. That approach properly limited Fischel to areas where the government could cross-examine his testimony. *United States v. Barile*, 286 F.3d

³⁵ *Amici* suggest (NACDL Br. 6) the court should have granted a continuance. But Nacchio had already received multiple chances, he did not ask for a continuance, and *Nichols* confirms none was required. 169 F.3d at 1269.

749, 758-759 (4th Cir. 2002) (affirming exclusion of expert opinion on materiality where Rule 16 notice failed to specify basis therefor but expert was permitted to testify about other matters).

3. Nacchio says (Br. 45) the court should have held “appropriate proceedings” *sua sponte* to clarify Fischel’s opinions. It did so.

a. Even if a Rule 16 disclosure need not show reliability (Br. 44), the court did not exclude Fischel’s opinions based on the first disclosure. Rather, it required another disclosure, cautioned the defense to clarify the testimony, and “forewarned” the defense about *Kumho*. App. 2042. The defense thus understood before its second disclosure (and then when responding to the motion to exclude) that Fischel’s reliability was at issue.

This exclusion after multiple disclosures was hardly “unprecedented” (Br. 43). In *United States v. Rodriguez-Felix*, 450 F.3d 1117 (10th Cir. 2006), as here, the defense provided a Rule 16 notice; the government argued the notice did not disclose the proposed expert’s methodology; the district court ordered a further proffer; and that proffer was “woefully inadequate” in allowing the court “to assess the reasoning and methodology underlying the expert’s opinion.” *Id.* at 1122, 1125; *see* Appellee’s Brief, *United States v. Rodriguez-Felix* (No. 05-2142), 2005 WL 3516704, at *4-*5. This Court affirmed the expert’s exclusion, “agree[ing]” with the district court that

there was “nothing in this record that allows [for a reliability] determination” and that the defense had thus failed to carry its burden under *Daubert*. 450 F.3d at 1125.

b. The court did not need to hold a hearing. After the court ordered additional disclosure, the defense told the court that Fischel’s opinions, as set forth in the second disclosure, satisfied Rule 702 and provided an opportunity to test the opinions. App. 463-467. The defense’s only request for a hearing came *after* exclusion. *Nichols*, 169 F.3d at 1262 (“*Daubert* does not mandate an evidentiary hearing” even when proponent requests one); *see Kumho*, 526 U.S. at 152 (discussing courts’ “considerable leeway” on this issue).

Nor did the court need to conduct other “proceedings” “to confirm that the jury should be prohibited from hearing the opinion[s].” Br. 45-46. Such proceedings were never requested and still remain unidentified. And the cases *Nacchio* cites hold that, before admitting expert opinion, the court must act as “gatekeeper” to ensure reliability.³⁶ They do not hold that the court must provide “an open-ended * * * opportunity to meet a *Daubert* challenge.” *Oddi v. Ford Motor Co.*, 234 F.3d 136, 154 (3d Cir. 2000).

³⁶ *E.g.*, *Dodge v. Cotter Corp.*, 328 F.3d 1212, 1223-1229 (10th Cir. 2003) (court abused discretion in admitting testimony “off the cuff” and absent *any* determination it was reliable).

4. Likewise, the court properly concluded that Fischel’s opinions would not “assist” the jury as required by Rule 702. On review for abuse of discretion, the question is not whether the testimony may have been “helpful” (Br. 48-50). *United States v. Masat*, 896 F.2d 88, 93-94 (5th Cir. 1990) (no abuse of discretion under Rule 702 even though excluded opinion “might have been helpful” in determining defendant’s mental state; issue was “within the ability of the ordinary juror to decide”).

Nacchio now claims (Br. 48) Fischel would have presented a “complex statistical analysis” about the movement of Qwest’s stock price. Nacchio’s disclosures never hinted at such an analysis. Fischel’s actual disclosure proposed testimony about what the price was on days when some of the inside information was disclosed. As the court noted (App. 3920), that was a simple fact. Indeed, it was in evidence. App. 4762-4763. Because the materiality inquiry turns on the “reasonable investor,” the jurors did not need further spoonfeeding. *TSC*, 426 U.S. 450 & n.12 (noting jury’s “unique competence” in applying reasonable-investor standard).³⁷

³⁷ The “reasonable investor” standard distinguishes *Shad v. Dean Witter Reynolds, Inc.*, 799 F.2d 525 (9th Cir. 1986) (cited at Br. 49), a “churning” case in which statistical testimony was “essential.” *Id.* at 530. *Shad* itself recognized that “the jury generally needs no special expertise to imagine itself in the position of a person of average experience and intelligence.” *Ibid.*

5. The court also properly excluded the testimony under Rule 403. “Expert evidence can be both powerful and quite misleading because of the difficulty of evaluating it,” and courts therefore “exercise[] more control over experts than over lay witnesses” under Rule 403. *Daubert*, 509 U.S. at 595. Here, the court appropriately found a substantial risk that the jurors would unduly defer to Fischel’s proposed “opinions” just because these facts and conclusions would be presented through a professor and sounded technical (but were not). App. 3918-3920; *see Champagne Metals*, 458 F.3d at 1080 n.4 (affirming exclusion based in part on potential for “confusion” where expert appeared to offer facts); *United States v. Call*, 129 F.3d 1402, 1405-1406 (10th Cir. 1997) (affirming Rule 403 exclusion, emphasizing “danger” jury would “overvalue” expert opinion because of its “scientific nature”).

6. Though Nacchio’s initial disclosure said nothing about the “magnitude of Qwest’s IRU revenue,” he now claims (Br. 46) it was the “most critical” part of Fischel’s testimony. He also says (*ibid.*) the court offered no rationale for excluding it. But the court excluded it on the grounds discussed above — and then gave additional reasons after reviewing the defense’s post-exclusion exhibits.

Indeed, the court found the defense’s post-exclusion conduct “even more egregious” than before. Fischel proposed to testify about (1) companies that did not

sell IRUs, and (2) companies that sold IRUs and disclosed their magnitude. Supp. App. 77-81, 102. As the court emphasized (App. 4074-4076), *Qwest* fell into neither category, so the testimony was both irrelevant (Rules 401 and 702) and confusing (Rule 403).³⁸ The testimony was especially unhelpful because it did not address *Qwest's* need, and failure, to “shift” to recurring revenue. The court further emphasized (App. 4075) that Fischel’s methodology was *still* undisclosed. These were proper grounds for denying reconsideration of Fischel’s IRU testimony. *United States v. Castillo-Garcia*, 117 F.3d 1179, 1197 (10th Cir. 1997) (arguments first raised in motion for reconsideration “are not properly before the court” and need not even be addressed).

C. Any error was harmless.

In discussing the significance of Fischel’s testimony (Br. 40-43), Nacchio speaks in generalities unhinged from his second expert disclosure, which contained no suggestion of statistics or event studies. But this Court must consider the facts and arguments presented to the district court. *United States v. Price*, 75 F.3d 1440, 1445 (10th Cir. 1996) (rejecting attempt to “expand the argument on appeal”).

³⁸ Additionally, and notwithstanding his credentials as a law professor (Br. 40 n.12), nothing in Fischel’s curriculum vitae (App. 435-459) suggests he had “sufficient specialized knowledge” about *IRUs* “to assist the jurors.” *Kumho*, 526 U.S. at 156.

Again, as the court found (App. 3920), the disclosure was little more than a recitation of facts, many of which were already in evidence. The jury already knew what Qwest's stock price was throughout the relevant period (App. 4762-4763). It had learned of Nacchio's "diversification strategy" (Br. 42) from his financial advisor, David Weinstein (App. 3017, 3021, 3040, 3049). Fischel himself testified (App. 3981-4064) about the "pattern[]" and "timing" of Nacchio's 2001 sales (Br. 42). And Fischel's proposed IRU testimony was irrelevant. *Supra* pp. 59-60. Accordingly, any error in excluding his proposed "opinions" was harmless. *United States v. Sarracino*, 340 F.3d 1148, 1171 (10th Cir. 2003) (exclusion harmless unless it had "substantial influence" on outcome).

Nacchio's main claim of prejudice (Br. 43, 46-48) is that Fischel's exclusion left him unable to rebut the "materiality" "opinions" of analysts Drake Johnstone and Prashant Khemka. But they did not offer any opinions, let alone about materiality. The government called them to testify, as *fact* witnesses, about what information they received from Qwest in 2001. App. 3559-3594, 3650-3684. The court concluded that the evidence was relevant to whether the information was "public." App. 357. But the court forbade the government from eliciting the analysts' opinions about whether the information was "important." App. 357-361.

The government abided by the court's order.³⁹ Over the government's objection, however, the *defense* cross-examined Johnstone on his "opinion about prominence of IRUs." App. 3637. Finding this tactic "unbelievable," the court precluded further questioning on the matter. *Ibid.* When the defense later moved to strike the analysts' alleged opinion testimony (App. 474-482), the court reviewed the transcript and denied the motion, finding that the only opinions were elicited by the defense and that the government had not "sought to take advantage." App. 4070; *see* App. 3969-3974, 4065-4073.

Nacchio hardly needed to rebut opinions never offered. Moreover, the court made clear that the defense could "call its own analysts who disagree" with Johnstone and Khemka. App. 4069. It chose not to do so. Holding it to that choice does not constitute prejudice.

IV. The Court Properly Denied Discovery, And Admission Into Evidence, Of Certain Classified Information

See classified excerpt.

³⁹ Only once during direct examination did the analysts offer an (unsolicited) opinion on materiality — Johnstone testified that Qwest's reliance on "one-time" revenue "warranted a change in [his] rating." App. 3590. The court immediately struck this testimony and instructed the jury to disregard it. App. 3590-3591. As for Khemka's alleged "opinion" testimony (Br. 47), the court found that it merely "recit[ed] what revenues were reported and what revenues were not." App. 4071.

V. The Court Correctly Calculated Nacchio's Gain

A. The insider-trading guideline (U.S.S.G. § 2F1.2 (2000)) directs a sentencing court to enhance the defendant's offense level based on "the gain resulting from the offense." Add. 100. The commentary defines "gain" as "the total increase in value realized through trading in securities." *Ibid.* Under *Stinson v. United States*, 508 U.S. 36, 45 (1993), the commentary "must be given controlling weight unless it is plainly * * * inconsistent with" the guideline itself.

B. Nacchio does not dispute that he "realized" \$28 million through his sales — \$52 million in gross receipts minus option costs, taxes, and fees. Add. 13. Nor could he. As the en banc Eighth Circuit has observed, the ordinary meaning of "realize" is "to convert securities * * * into cash." *United States v. Mooney*, 425 F.3d 1093, 1100 (2005) (applying insider-trading guideline).

Nacchio instead contends (Br. 52) that the commentary "conflict[s]" with the guideline. He says the guideline adopts a market-absorption theory, such that "gain" equals "the value of the stock sold while in possession of material, nonpublic information" minus "the market value of such stock once the material information was made public." *Ibid.*; see Br. 40-42, 52-53. But the guideline says no such thing. *Mooney*, 425 F.3d at 1099 (guideline "does not say 'the gain in market value'"). Indeed, the guideline itself does not define the terms "gain" or "offense." That alone

rebutts any claim of conflict. *United States v. Farnsworth*, 92 F.3d 1001, 1007 (10th Cir. 1996) (“commentary should not be found to contradict the guideline” unless “following one will result in violating the dictates of the other”); *United States v. Pedragh*, 225 F.3d 240, 245 (2d Cir. 2000).

Moreover, the “offense” of insider trading involves *trading*, not just withholding information. *O’Hagan*, 521 U.S. at 652 (insider possessing material non-public information must “abstain from trading”). Had Nacchio obeyed the law, he would have sold *no* stock and reaped *no* return — not even from his options’ pre-offense appreciation (Br. 52). Accordingly, Nacchio’s gain from violating the law is the full \$28 million “realized through *trading*.”⁴⁰ *Mooney*, 425 F.3d at 1099.

And the rule of lenity (Br. 54) applies “only if, after seizing everything from which aid can be derived”—*including* the commentary—a defendant “can make no more than a guess” about a guideline’s meaning. *United States v. Wells*, 519 U.S. 482, 499 (1997); *United States v. Newsome*, 409 F.3d 996, 999 (8th Cir. 2005) (refusing to apply rule where, “[i]n order to create an ambiguity” in guideline, defendant “ignored relevant commentary”). Nacchio cannot claim he did not know

⁴⁰ Civil cases such as *SEC v. Happ*, 392 F.3d 12 (1st Cir. 2004) (cited at Br. 52) do not avail Nacchio because they do not involve the insider-trading guideline, and they are narrowly concerned with making private victims whole (and preventing windfall recovery) rather than punishing criminals. *Mooney*, 425 F.3d at 1098-1100 & n.6.

“gain” meant the amount “realized” where the commentary told him so.

Nacchio’s market-absorption theory would also be bad policy. The guideline measures the offender’s “gain” rather than the “victims’ losses” “[b]ecause the victims and their losses are difficult if not impossible to identify.” Add. 100. The instant facts confirm that difficulty. There is no way of knowing what Qwest’s stock price would have been if Nacchio had disclosed all the inside information at once — in reality, Nacchio disclosed bits of the information over time *without* revealing Qwest’s recurring revenue failures or its empty IRU funnel. Under Nacchio’s approach, criminal punishment would turn on experts hypothesizing “what ifs” about the undisclosed information. The guideline wisely rejects that approach, opting for one in which a putative inside trader who knows the stock price will also know his *precise* exposure at the time of his sale. *Mooney*, 425 F.3d at 1101 (guideline’s “clear and coherent” standard provides defendants fair notice, eliminates “extensive factfinding,” and eschews “questionable” calculations about “how quickly the stock market could learn and absorb material information”).

Nor would the market-absorption theory promote sentencing uniformity under 18 U.S.C. § 3553(a)(6). “Gain” would depend as much on the expert retained and the guesswork permitted as on actual conduct. Nacchio raises a “Larry, Moe, and Curly” issue (Br. 53) about inside traders who *purchase* stock (*i.e.*, not Nacchio). In such a

situation, a court would be required to impose a “reasonable” sentence and could depart or vary from the advisory range as justice and uniformity demanded. *Rita v. United States*, 127 S. Ct. 2456, 2465 (2007); *see* App. 1285-1286 (Nacchio sought variance based on alleged overstatement of gain). Nacchio’s hypothetical does not justify jettisoning Section 2F1.2’s language and speculating about the unknowable.

Finally, Nacchio’s calculation of a \$1.8 million gain (Br. 54) is baseless. Fischel’s event study to that effect (App. 793-803) ignores the information Nacchio did not disclose and only examines the *next-day* stock prices associated with certain disclosures. That is a flawed methodology. *Supra* pp. 32-33; *see* Supp. App. 166-167 (market often needs *months* to absorb information fully). Even calculating Nacchio’s gain based on the price drop from April 24 (\$37) to September 7 (\$18)—which would not take into account the information Nacchio still withheld, or that Qwest lowered its targets on September 10 (and then missed those)—would still yield a gain of over \$25 million (\$19 x 1,330,000 shares). That, in turn, would yield the same 63- to 78-month range the court used (Add. 15).

VI. The Court Correctly Calculated The Forfeiture Amount

The court properly ordered forfeiture of \$52 million—the gross receipts of Nacchio’s unlawful sales—without deducting option costs and fees of approximately \$7.4 million.

A. Nacchio concedes (Br. 55) that insider trading is a “specified unlawful activity” under 18 U.S.C. § 981(a)(1)(C), such that any “proceeds” are subject to forfeiture. But he argues (Br. 54-57) that, in insider-trading cases, “proceeds” is defined by Section 981(a)(2)(B) (which deducts “direct costs incurred in providing the goods or services”) rather than by Section 981(a)(2)(A) (which does not allow deductions). He is wrong.

1. Section 981(a)(2)(A) applies to “cases involving illegal goods, illegal services, unlawful activities, and telemarketing and health care fraud schemes.” Section 981(a)(2)(B) applies to “cases involving lawful goods or lawful services * * * sold or provided in an illegal manner.” Given the textual link between “specified unlawful activity” in Section 981(a)(1)(C) and “unlawful activities” in Section 981(a)(2)(A), Congress presumably intended Section 981(a)(2)(A) to define “proceeds” for most “specified unlawful activit[ies].” *Gustafson v. Alloyd Co.*, 513 U.S. 561, 570 (1995) (ordinarily, “identical words used in different parts of the same act are intended to have the same meaning”). The legislative history supports this presumption, especially as to “specified unlawful activit[ies]” involving fraud. H.R. Rep. 105-358(I), 1997 WL 677201, at *48 (under statute, person committing fraud generally “has no right to recover the money he invested in the fraud scheme”).

2. Insider trading is clearly an “unlawful activit[y],” not the rare offense that falls within the narrow scope of Section 981(a)(2)(B).

Securities are not “goods” or “services.” BLACK’S LAW DICTIONARY 714 (8th ed. 2004) (“goods” do *not* include “investment securities”); *see ibid.* (quoting UCC Article 2, which governs sale of goods, and distinguishing Article 8, which governs securities); MERRIAM-WEBSTER’S COLLEGIATE DICTIONARY 501 (10th ed. 2001) (“goods * * * usu. exclud[e] * * * securities”).

And even if securities *were* goods, Section 981(a)(2)(B) applies where the only illegality is in the “manner” of sale. Here, the *sale itself* was illegal, because Nacchio had a duty to abstain. *O’Hagan*, 521 U.S. at 652. Moreover, by allowing deductions for the goods’ cost, Section 981(a)(2)(B) presumes the goods, though sold in an unlawful manner, are fine (*i.e.*, worth the direct cost). But for insider trading involving selling, the securities are *not* fine.⁴¹ Under Nacchio’s theory, an executive who bought stock at \$40, then learned distressing inside information, then immediately sold at \$40 before the information was disclosed could deduct the full

⁴¹ Because Section 981(a)(2)(B), by its terms, does not apply to *purchases*, Nacchio’s reading would create separate forfeiture regimes for inside buyers and inside sellers. *But see Small v. United States*, 544 U.S. 385, 391 (2005) (statutory construction should avoid “anomalies”).

cost of acquiring the shares.⁴² The executive would not forfeit a dime under Section 981(a)(2)(B) even though (like Nacchio) he saved millions. That would flout Congress’s “hawkish[] focus[] on punishment and deterrence.” Add. 84-85 (citing cases); see *Caplin & Drysdale, Chartered v. United States*, 491 U.S. 617, 629-630 (1989) (forfeiture serves penal and remedial interests “beyond merely separating a criminal from his ill-gotten gains”).

B. Finally, the district court correctly rejected Nacchio’s argument (Br. 57 n.20) that he did not “obtain” the full \$52 million. Add. 82. It does not matter that he never *pocketed* the money that paid his option costs and fees, because he still *used* tainted proceeds to pay those costs and fees. *United States v. McHan*, 101 F.3d 1027, 1043 (4th Cir. 1996) (one defendant could not deduct proceeds received by other defendant because amount “obtained” includes all property “derived” from scheme).

⁴² Nacchio assumes the “direct costs incurred in providing” the securities under Section 981(a)(2)(B) include not only brokerage fees but also the amount he paid to *obtain* the securities — the option costs. But even if Section 981(a)(2)(B) applied, a seller would not “incur[]” option costs as part of his transaction with a buyer. Indeed, the option exercise and subsequent stock sale may be years apart.

CONCLUSION

Nacchio's convictions and sentence should be affirmed.

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CERTIFICATE OF SERVICE

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CERTIFICATE OF COMPLIANCE

In accordance with Fed. R. App. P. 32(a)(7)(C), the undersigned counsel of record certifies that: the foregoing Brief for the United States was prepared in a 14-point, proportionally spaced, serif font (Times New Roman), using WordPerfect 12; the public portion of the Brief contains 16,037 words; the classified excerpt, filed separately with the court security officer, contains 954 words (exclusive of the heading reproduced from and counted in the public portion); the total word count for both the classified and unclassified portions of the brief is 16,991 words; and, accordingly, the brief complies with the requirements of Fed. R. App. P. 32(a)(7) and this Court's order of October 10, 2007, granting the government leave to file an extra-length brief not to exceed 17,000 words.

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CERTIFICATE OF DIGITAL SUBMISSION

The undersigned counsel certifies that:

(1) there were no privacy redactions to be made in the foregoing Brief for the United States, and the Digital Form version e-mailed to the Court on this day is an exact copy of the written document that was sent to the Clerk; and

(2) the Digital Form version of the Brief for the United States e-mailed to the Court on this day has been scanned for viruses with McAfee Virus Scan, version 3.6.0.569, which is continuously updated, and according to that program is free of viruses.

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