IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Action No. 05-cr-00545-MSK

UNITED STATES OF AMERICA

Plaintiff,

v.

JOSEPH P. NACCHIO,

Defendant.

EMERGENCY MOTION BY JOSEPH P. NACCHIO FOR CONTINUED RELEASE PENDING SUPREME COURT RESOLUTION OF A PETITION FOR CERTIORARI

On February 25, 2009, a divided 5-4 *en banc* Tenth Circuit affirmed Joseph P. Nacchio's conviction for insider trading. On March 4, 2009, Nacchio filed a motion in the Tenth Circuit pursuant to the Bail Reform Act of 1984, 18 U.S.C. §3143(b), seeking bail pending Supreme Court action on a petition for certiorari. Last night, the Tenth Circuit issued an order denying the motion "without prejudice to renewal subject to initial submission of that application to the United States District Court for the District of Colorado." Order, *United States v. Nacchio*, No. 07-1311 (Mar. 10, 2009). Nacchio therefore moves and submits this memorandum in support of his motion for an order continuing release under §3143(b) pending the resolution of a petition to the Supreme Court for a writ of certiorari.

This Court has issued an order of surrender requiring Nacchio to report to the custody of the Bureau of Prisons by noon on March 23, 2009. We respectfully request that this Court decide this motion on a highly expedited basis, by Monday, March 16, 2009, to allow sufficient

time for review (if necessary) by the Tenth Circuit and the Supreme Court prior to that date. In the alternative, if this Court denies the motion, we respectfully request that this Court stay its order of surrender so that the Tenth Circuit and the Supreme Court may have a full and fair opportunity to review this issue.

Under 18 U.S.C. §3143(b), continuing release is appropriate if the court finds by clear and convincing evidence that the defendant is not a flight risk or a danger, and also finds that his petition for certiorari is not for purposes of delay and raises a "substantial question" for review. As both Judge Nottingham and the Tenth Circuit have already determined (and the government has never claimed otherwise), Nacchio is not a flight risk or a danger. (Exhibit A (Sentencing Tr.) at APP-1351.)[1]. Nor is Nacchio's petition for the purposes of delay. Nacchio will file his petition for certiorari by March 27, 2009, months before the Supreme Court's deadline, in order to ensure that the Court acts on the petition before its summer recess. If the government files its opposition to certiorari on time, Nacchio's petition will be distributed for the Supreme Court's conference on May 28. Even if the government seeks and obtains a 30-day extension, the petition will still be considered at the Supreme Court's June 25 conference. The Supreme Court almost always acts on petitions for certiorari within a few days of the conference at which the petition is considered.

Thus, the only remaining question is whether Nacchio's petition will raise a "substantial question" for review. 18 U.S.C. §3143(b)(1)(B). A "substantial question" is a "'close' question or one that very well could be decided the other way.'" *United States v. Affleck*, 765 F.2d 944, 952 (10th Cir. 1985) (citation omitted). In granting Nacchio bail pending appeal on August 22,

[1] "APP-" refers to the Appendix to Appellant's Opening Brief filed Oct. 9, 2007 (10th Circuit).

2007, the Tenth Circuit already determined that Nacchio's appeal raises at least one "substantial" or "close" question. A unanimous panel of the Tenth Circuit then held on the merits that it was "a close question" whether Nacchio was entitled to acquittal as a matter of law on materiality grounds. *United States v. Nacchio*, 519 F.3d 1140, 1164 (10th Cir. 2008). That section of the panel's opinion was not vacated by the *en banc* court. And the *en banc* court's bitterly divided 5-4 decision regarding the exclusion of Nacchio's expert witness leaves no doubt that those issues also raise a "close" question that "very well could be decided the other way."

The relevant facts and procedural history are explained in the panel and *en banc* opinions of the Tenth Circuit, the Rule 33 motion (Doc. No. 532) filed with this court last week, and Nacchio's opening brief on appeal, which is attached hereto as Exhibit B.

I. THE EXCLUSION OF PROFESSOR FISCHEL'S EXPERT TESTIMONY PRESENTS A SUBSTANTIAL QUESTION

The Tenth Circuit's panel decision correctly held that the district court's decision to exclude Nacchio's expert witness, Professor Daniel Fischel, was based on an erroneous understanding of Rule 16, and that that error requires a new trial. The *en banc* court did not disagree with the panel's Rule 16 analysis; instead, it recast the district court's exclusion order as a freestanding *Daubert* ruling, and held that a *Daubert* dismissal was within the district court's discretion. As the *en banc* dissenters explain, that reformulation is inconsistent with the district court's actual reasoning. But even if the *en banc* court's erroneous premises are accepted, its analysis rests on a misunderstanding of the burdens of proof on a motion *in limine*, conflicts with other circuits, and merits Supreme Court review.

1. The *en banc* court erroneously determined that it was Nacchio's responsibility to establish the reliability of Fischel's methodology in response to a motion to exclude. (Exhibit C

(*En Banc* Op) at. 26 n.13, 23 n.11, 33.) Of course Nacchio bore the ultimate burden of laying a sufficient foundation for admissibility at trial. But when a litigant moves *in limine* to exclude evidence, *the movant* bears the burden of demonstrating (at least) serious reasons for doubt. The movant cannot simply rely on the fact that the non-moving party must establish admissibility and has not yet met that burden. *See United States v. Stoddart*, 48 Fed. Appx. 376, 380 (3d Cir. 2002) ("A district court may deny a motion to suppress without a hearing when the defendant fails to provide a factual basis for the hearing and merely relies upon the government's 'burden of proof to establish adequate *Miranda* warnings.'") (citation omitted); *United States v. Howell*, 231 F.3d 615, 621 (9th Cir. 2000) (same); (Exhibit D (*En Banc* Br.) at 27-28 & nn.14, 15). The posture is like summary judgment, where the movant has the *prima facie* burden to prove the absence of a triable dispute.

Neither the district court nor the *en banc* court ever suggested that the government made such a showing. The government did not even argue that the record established that Fischel's testimony was unreliable; it repeatedly argued that Nacchio's Rule 16 "disclosure does not set forth any 'reliable principles and methods' that Professor Fischel might possibly have used." (Exhibit E (Doc. No. 334) at APP-398; Exhibit D at 6-7.) The district court faulted Nacchio for a supposed "gross defect in failing to *reveal* [Fischel's] methodology," (Exhibit F (Tr.) at APP-3921), and ruled that it was "*undisclosed* in this expert disclosure." (*Id*. at APP-3917; *see also* Exhibit G (Tr.) at APP-4075 ("The March 29, 2007, disclosure [Nacchio's Rule 16 notice] contained no methodology or reliable application of methodology to the case.").) But uncertainty about Fischel's methodology at the motion *in limine* stage was the *government's* problem, since it bore the burden to show that the necessary foundation could not be laid.

Of course the district court could have shifted the burden by clearly ordering Nacchio to establish the grounds for Fischel's admissibility prior to putting him on the stand. Contrary to the *en banc* court's reasoning, however, the government does not accelerate the defendant's ultimate burden to show admissibility merely by filing a motion *in limine* pointing out that the defendant has not yet carried that burden. That would nullify the rule that the moving party bears the burden on a motion *in limine*, and squarely conflict with cases like *Stoddart* and *Howell*, *supra*.

In the *Daubert* context, the Supreme Court has explained that when the movant "call[s] sufficiently into question" the reliability of the expert's testimony, the district judge must hold "appropriate proceedings" to "investigate reliability," which can include "special briefing" or "other proceedings," where the judge is to "ask questions." *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 149, 151-52 (1999); *see also* Fed. R. Evid. 702, advisory committee's note to 2000 amends.; Fed. R. Evid. 104(a), advisory committee's note to 1972 proposed rule. None of that would be necessary if the expert could be excluded merely because the proponent had not yet proven reliability.

The Third Circuit has held several times that it was reversible error for a district court to grant a *Daubert* motion without holding a hearing, when the record was still insufficient to allow the court to assess the reliability of the testimony.[2] If the mere filing of a *Daubert* motion

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[2] *See, e.g.*, *In re Paoli R.R. Yard PCB Litig.*, 916 F.2d 829, 854-55 (3d Cir. 1990) (reversing exclusion because the district court did not "provide[] the [proponents] with sufficient process for defending their evidentiary submissions" and "should have been given an opportunity to be heard on the critical issues before being effectively dispatched from court"); *Padillas v. Stork-Gamco, Inc.*, 186 F.3d 412, 418 (3d Cir. 1999) (reversing exclusion of expert without hearing where report did not disclose methodology because that did not "establish that [the

notifies the proponent of expert testimony that he must supplement the record to establish reliability before the court rules on that motion, as the *en banc* court held here, then the Third Circuit would have held that the proponents failed to carry their burdens and all of those cases would have come out the other way. Instead the Third Circuit consistently holds that "failure to hold a hearing"—regardless of whether the proponent requests one—constitutes "an abuse of discretion where the evidentiary record is insufficient to allow a district court to determine what methodology was employed by the expert in arriving at his conclusions." *Murray*, 2008 WL 2265300, at *2. This is a square circuit split, and the *en banc* court's efforts to distinguish those cases are entirely unpersuasive. It was equally true in *Padillas*, for example, that the court would have to determine admissibility at some point; that a *Daubert* motion was "ripe for decision"; and that the proponent of the expert testimony "passed over" "opportunities" to offer additional clarification about methodology. (Exhibit C at 45.)

Other circuits agree. The Sixth Circuit has reversed the exclusion of an expert on the grounds that "a district court should not make a *Daubert* determination when the record is not adequate to the task" and "should only do so when the record is complete enough to measure the proffered testimony against the proper standards of reliability and relevance." *Jahn v. Equine Servs., PSC*, 233 F.3d 382, 393 (6th Cir. 2000); *see also Busch v. Dyno Nobel, Inc.*, 40 Fed.

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expert] may not have 'good grounds' for his opinions, but rather, that they are insufficiently explained and the reasons and foundations for them inadequately and perhaps confusingly explicated" and thus the proponent must have an "opportunity to respond to the court's concerns") (citation omitted); *Elcock v. Kmart Corp.*, 233 F.3d 734, 745 (3d Cir. 2000) (holding that where court cannot determine what methodology was used and methodology raises "significant reliability questions," a *Daubert* hearing is "a necessary predicate for a proper determination as to the reliability of [the expert's] methods"); *Murray v. Marina Dist. Dev. Co.*, No. 07-1147, 2008 WL 2265300, at *2 (3d Cir. June 4, 2008) (unpublished); *cf. Oddi v. Ford Motor Co.*, 234 F.3d 136, 153-55 (3d Cir. 2000) (affirming exclusion where record was complete).

Appx. 947, 961 (6th Cir. 2002) (reversing exclusion of expert because district court "is charged with the responsibility of ensuring that the record before the court is adequate"). The First Circuit has explained that "courts will be hard-pressed in all but the most clearcut cases to gauge the reliability of expert proof on a truncated record" and "must be cautious—except when defects are obvious on the face of a proffer—not to exclude debatable scientific evidence without affording the proponent of the evidence adequate opportunity to defend its admissibility." *Cortes-Irizarry v. Corporacion Insular de Seguros*, 111 F.3d 184, 188 (1st Cir. 1997). The advisory committee notes to the Rule 702 2000 amendments endorse *Cortes-Irizarry*, and the Third Circuit's decision in *In re Paoli Railroad Yard PCB Litigation*, as examples of how courts should "consider[] challenges to expert testimony under *Daubert*." Fed. R. Evid. 702, 2000 advisory committee's note. Other circuits have affirmed decisions to exclude testimony without a hearing only after emphasizing that the record was sufficient to permit a fair evaluation of the expert's methodology. *E.g., Miller v. Baker Implement Co.*, 439 F.3d 407, 413 (8th Cir. 2006) (court must have "an adequate record on which to base its ruling"); *In re Hanford Nuclear Reservation Litig.*, 292 F.3d 1124, 1138-39 (9th Cir. 2002) (court had "an adequate record before it to make its ruling" including "the experts' reports, some deposition testimony, and the experts' affidavits").

Commentators agree that *Kumho Tire* and basic evidentiary principles require a movant seeking to exclude expert testimony to establish serious reasons for doubting its reliability, on an adequate evidentiary record.[3] This is an important and recurring issue on which the lower courts

[3] *See also* Robert J. Goodwin, *The Hidden Significance of Kumho Tire*, 52 Baylor L. Rev. 603, 626-32 (2000) (explaining that *Kumho Tire* plainly holds that it is the *movant's* burden to

are divided, and presents a substantial issue for certiorari.

2. The *en banc* court's decision also, as a practical matter, nullifies Rule 16 and imposes civil disclosure burdens on criminal defendants. The government now effectively concedes that criminal defendants have *no* obligation under Rule 16 to offer disclosures sufficient to justify the admissibility of an expert's testimony under *Daubert*. But the *en banc* court has held that the government can force a criminal defendant to supply such disclosures—the equivalent of a civil expert report and "all available arguments for the testimony's admissibility," (Exhibit C at 26 n.13)—simply by filing a motion pointing out that the defendant has not yet disclosed what the rules do not require him to disclose. The government will exploit this loophole in every case, and the consequences for the administration of justice present a substantial question meriting Supreme Court review.

II. THE STANDARD FOR ASSESSING THE MATERIALITY OF INTERIM INFORMATION PORTENDING FUTURE RESULTS PRESENTS A SUBSTANTIAL QUESTION THAT HAS DIVIDED THE CIRCUITS

Nacchio's opening brief to the Tenth Circuit explained, and the government has never denied, that this case represents the first time a corporate executive has ever been criminally prosecuted for insider trading based on supposedly material "inside" information that earnings projections for future quarters might not be met. The Tenth Circuit held that the conviction could be sustained on the basis of testimony from Qwest's Chief Financial Officer Robin

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establish a "threshold level of unreliability" by "call[ing] sufficiently into question" the reliability of the testimony); Margaret A. Berger, *Procedural Paradigms for Applying the* Daubert *Test*, 78 Minn. L. Rev. 1345, 1365 (1994) ("[T]he evidentiary policies underlying *Daubert*'s competing rationales, efficiency and fairness concerns, and the structure of the discovery rules, all dictate placing a burden on the opponent of the evidence to make a *prima facie* showing that the proponent's evidence suffers from the deficiencies identified in *Daubert*," and that "the evidence should be presumed to be admissible until the opponent discharges its burden to show the contrary").

Szeliga—which it believed *might* be interpreted to suggest that she warned Nacchio in December 2000 or January 2001 of $1.2 billion (4.2%) in total "risk" to Qwest's revenue projections for *year-end* 2001. *United States v. Nacchio*, 519 F.3d 1140, 1163 (10th Cir. 2008). The panel acknowledged that it is "a close question" whether Nacchio is entitled to acquittal as a matter of law by reference to the SEC's rule of thumb that discrepancies under 5% between *past* reported earnings and *past* actual earnings are generally immaterial. *Id.* at 1162-1164. But it held that the evidence was nonetheless (barely) sufficient for conviction because of testimony that the "skittish" and "mercurial" stock market would punish Qwest for even a small shortfall. *Id.* at 1164. That reasoning makes no allowance for the fact that Szeliga was talking about an uncertain *risk* eleven or twelve months in the future. The SEC's guideline that errors in reported earnings under 5% generally are not material relates to *past shortfalls that have already occurred*, not to *risks* of events that are nearly a year away and dependent on the vicissitudes of the economy.[4]

Other circuits have adopted stringent standards for assessing the materiality of information bearing on uncertain future events, under which Nacchio would clearly be entitled to

[4] The Tenth Circuit suggested that "in this case the parties have focused *solely* on the magnitude of the shortfall, should it occur," not "the probability that the event will occur." *Nacchio*, 519 F.3d at 1164 n.10 (emphasis added) (citing Exhibit B at 24). That was a clear error. The court was citing section I.B.2.b., a *one-page* section of Nacchio's brief—but overlooked section I.B.2.a., titled: "*At the time of the trades, the information available to Nacchio did not reveal, to* any *degree of certainty, that Qwest would fail to meet its year-end numbers eight months in the future*," *id*. at 19—a *five-page section* (nearly 10% of Nacchio's brief), that argued that the information was too uncertain to be material. The Supreme Court has summarily reversed on similar grounds before, and should do so again here. *See Dye v. Hofbauer*, 546 U.S. 1, 3-4 (2005) (summary reversal where circuit held that defendant failed to raise argument when "[t]he fourth argument heading in his brief" plainly "sets out the … claim").

acquittal as a matter of law. Indeed, in several circuits allegations like these would promptly be dismissed as a matter of law even in a civil case. The standards for assessing the materiality of internal predictions and interim operating results present a question of great national importance, but "[n]either the Securities and Exchange Commission (SEC) nor the courts have answered the[] question[] with either uniformity or clarity."[5] The Tenth Circuit's resolution of those issues rests on a premise—that insider trading cases against executives should be governed by entirely different standards than "false statement" claims against the company—that is highly debatable and very important. Even if that premise were accepted, the court's analysis would still conflict with holdings of several other circuits. There is *at least* a "substantial question" for certiorari.

A. The Tenth Circuit's Decision Squarely Conflicts With The Materiality Standards Applied By Other Circuits

1. The Tenth Circuit held that the cases applying heightened materiality standards to predictive or forward-looking information are inapposite here, because "Mr. Nacchio is being prosecuted for concealing true information while trading, not for making misleading statements." *Nacchio*, 519 F.3d at 1160. But several circuits have applied far more rigorous standards, under which Nacchio would have been acquitted as a matter of law, when assessing the materiality of

[5] Mitu Gulati, *When Corporate Managers Fear a Good Thing Is Coming to an End: The Case of Interim Nondisclosure*, 46 U.C.L.A. L. Rev. 675, 678 (1999). Commentators agree that the answer is "uncertain," *id.* at 728-29, "frustrati[ng]," Donald C. Langevoort, *Rereading Cady, Roberts: The* Ideology *& Practice of Insider Trading Regulation*, 99 Colum. L. Rev. 1319, 1337 (1999), that "[t]he confusion has turned to a hopeless clutter," Donald C. Langevoort & G. Mitu Gulati, *The Muddled Duty to Disclose Under Rule 10b-5*, 57 Vand. L. Rev. 1639, 1641-42 (2004), and is "a controversial topic" that has "troubled" courts due to "concern[] over imposing potentially enormous liability [including, here, *imprisonment*] for failure to disclose such potentially uncertain information," Bruce A. Hiler, *The SEC and the Courts' Approach to Disclosure of Earnings Projections, Asset Appraisals, and Other Soft Information: Old Problems, Changing Views*, 46 Md. L. Rev. 1114, 1129-30, 1195 (1987).

information just like this *in trading cases*.

The leading cases are *Shaw v. Digital Equipment Corp.*, 82 F.3d 1194 (1st Cir. 1996), and *Glassman v. Computervision Corp.*, 90 F.3d 617 (1st Cir. 1996). *Shaw* involved undisclosed internal predictions and interim operating results just like this case, and the company *sold its stock* while knowing of allegedly "material facts portending the unexpectedly large losses for the third quarter of fiscal 1994 that were announced later." 82 F.3d at 1201-02. The First Circuit "conceptualize[d]" the company "as an individual insider transacting in the company's securities," to examine whether it was required to disclose or abstain from trading. *Id.* at 1203. And it held that "soft" information in the form of internal *predictions* is always immaterial as a matter of law. *Id.* at 1211 n.21.

Turning to the "hard" intra-quarterly operating results the company already had in hand, the First Circuit held that the defendant could continue selling stock without disclosing those results unless it "is in possession of nonpublic information indicating that the quarter in progress at the time of the public offering will be *an extreme departure* from the range of results which could be anticipated based on currently available information." *Id.* at 1210 (emphasis added). The court agreed that interim results may sometimes be material, but squarely rejected any obligation for a corporate or individual stock seller to "disclose interim operating results for the quarter in progress whenever it perceives a possibility that the quarter's results may disappoint the market." *Id.*[6] The standard was satisfied in *Shaw* because the results were truly dire and the end of the quarter was only eleven days away. But it also emphasized that claims based on

[6] The court detailed this analysis in the context of a Section 11 claim, but also held that the same standards apply to claims under Section 10(b). 82 F.3d at 1222 & n.37.

interim information presaging results four to six months in the future have been dismissed because the omissions should be "deemed immaterial as a matter of law." *Id.* at 1210-11.

In *Glassman*, the company sold stock ahead of its third quarter earnings release while knowing that "as of week seven of the third quarter … [sales] were only about *24% of Computervision's internal forecasts* for those weeks." 90 F.3d at 630. Although that was more than halfway through the quarter, the First Circuit held that the company could sell its stock without disclosing what it knew about the interim results and trends because "the undisclosed hard information … did not indicate a 'substantial likelihood that the quarter would turn out to be an extreme departure from publicly known trends and uncertainties.'" *Id.* at 631 (citation omitted). The company was not required to "disclose or abstain," and even *civil* liability was inappropriate as a matter of law.[7]

2. Nacchio would be entitled to acquittal as a matter of law in the First Circuit, which developed its *Shaw* test explicitly by reference to individual insider trading cases, and clearly would apply that test here. Under *Shaw*, the evidence the Tenth Circuit found dispositive—Szeliga's forecast of 4.2% in "risk" to the 2001 projections—is "soft" predictive information and thus categorically immaterial. 82 F.3d at 1211 n.21. And that prediction was particularly "soft." The forecasting process continued to be refined well after Szeliga communicated any risk to Nacchio. There was never a single internal Qwest estimate forecasting 2001 revenues below $21.3 billion. Even Szeliga and Mohebbi testified that, based on the revised budget, it was their good-faith belief *at the time of Nacchio's trades* that Qwest would meet its year-end projections.

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[7] *See also In re* Burlington *Coat Factory Sec. Litig.*, 114 F.3d 1410, 1426 (3d Cir. 1997) (Alito, J.) (citing *Shaw* and *Glassman* as "claims of omissions or misstatements that are obviously so unimportant that courts can rule them immaterial as a matter of law").

Graham also testified that the April 9 budget, which included his projection of *increased* indefeasible rights of use (IRU) sales, "provid[ed] our best belief of what things were going to happen." (Exhibit H (Tr.) at APP-2702.) Casey's assessment about IRUs—that he did not "have any visibility to what IRUs would be doing after the second quarter," (Exhibit I (Tr.) at APP-2496)—was also "soft," based on his assessment of the unpredictable path of the economy, and far from certain. Revenues were *35% greater* than Casey's recent prediction for results *two months* in the future; the prediction the government has focused on here was for results *eight months* in the future, contradicted Graham's assessment, and, regardless, identified only $350 million of "risk" in projected IRU sales, which even if treated as a certainty, would have resulted in a 0.4% shortfall.[8]

The "hard" interim operating results that Nacchio had in April or May of 2001 certainly did not "indicate a 'substantial likelihood that the quarter would turn out to be an extreme departure from publicly known trends and uncertainties.'" *Glassman*, 90 F.3d at 631 (citation omitted). Qwest's first-quarter revenues were only $4 million short of the internal "stretch" goal of $5.055 billion. (Exhibit J (Trial exhibit A-20) at APP-4699-700.) In April, the company fell only 2.3% short of its internal estimate, (Exhibit K (Trial exhibit 940) at APP-5019), and Casey's wholesale markets unit—the supposed epicenter of impending disaster—*beat* its internal target, (*id*. at APP-5021). Indeed, Qwest's second-quarter revenues ultimately met investors'

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[8] *See also James v. Gerber Prods. Co.*, 587 F.2d 324, 327 (6th Cir. 1978) (no violation of §10(b) for failing to disclose interim results in connection with sale of stock because interim figures and projections "only rise to the level of materiality when they can be calculated with substantial certainty"); *Arber v. Essex Wire Corp.*, 490 F.2d 414, 421 (6th Cir. 1974) (no violation of §10(b) for failing to disclose information about future prospects and expectations before corporate and individual insider stock purchases because the law "does not require an insider to volunteer any economic forecast").

expectations, (Exhibit L (Tr.) at APP-2381–82), and "non-recurring" revenue achieved 98% of the Board's budget *for the year*, (Exhibit M (Trial exhibit GX932); Exhibit N (Trial exhibit GX947)). In *Glassman* the company knew five weeks before the end of the quarter that its sales *for that quarter* were running at only 24% of internal projections, and the First Circuit held that knowledge to be immaterial as a matter of law, even though the stock dropped 30% in one day when the shortfall was announced. The information Nacchio had about the current quarter was very positive. The government's case here is based on interim data that, at most, ambiguously suggested a small shortfall in year-end results, *eight months in the future*.[9] *Shaw* held that even "hard" information is immaterial as a matter of law if the events it supposedly portends are four to six months away, because the necessary inferences are inherently too uncertain. 82 F.3d at 1211.

And even if any "risk" of a 4.2% shortfall eight months in the future were treated as a certainty, a 4.2% shortfall is not "an extreme departure" from market expectations and did not "forebod[e] disastrous [year]-end results." *Id*. at 1207, 1211. That risk was less than the threshold for materiality of errors in *already reported* revenues under SEC guidelines, which is also consistent with guidelines applied in other circuits. *See In re Apple Computer, Inc.*, 127 Fed. Appx. 296, 304 (9th Cir. 2005) ("[A] revenue estimate that was missed by approximately

[9] The Tenth Circuit noted that "recurring" subscriber revenue had not accelerated by April to the extent Qwest had budgeted for. *Nacchio*, 519 F.3d at 1146. But two days before the first trade at issue *Nacchio disclosed that fact*, specifically telling the market that although Qwest had projected growth of 8-9% in the consumer and small business sector they had achieved only 6.3% (a 21% shortfall), that "we are [now] going to be talking somewhere between 6 and 8 percent" for the year, and that Qwest would have to rely more heavily on other sources to make the year-end projections. (Exhibit O (Trial exhibit GX593) at APP-4828, 4807-08.) The prosecution's own analysts understood that disclosure loud and clear. (Exhibit P (Tr.) at APP-3636; Exhibit Q (Trial exhibit GX726).)

10% was immaterial as a matter of law."); *Roots P'Ship v. Lands' End, Inc.*, 965 F.2d 1411, 1418 (7th Cir. 1992) (describing an internal projection that differed from public projection by 4%-6.2% as a "slight[]" "deviat[ion]").

B. The Tenth Circuit's Rejection Of Reasonable Basis Principles Also Presents A Substantial Question

Numerous courts have held, and SEC rules provide, that a forward-looking statement like an earnings prediction "shall be deemed not to be a fraudulent statement …, unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith." 17 C.F.R. §§240.3b-6(a), 230.175(a). "Fraudulent statement" is defined broadly to encompass "all of the bases of liability" under the securities laws. *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 513 (7th Cir. 1989). The Tenth Circuit held that "reasonable basis" principles are inapposite in insider trading cases because the issue here is whether Nacchio possessed material inside information, not whether Qwest's earnings projections had become misleading. There is at least a substantial question whether that distinction is supportable in cases like this one.

The Tenth Circuit is certainly correct that false statement cases and insider trading cases are different, and that it is possible for an insider to possess material information even if the company's public projections are not materially misleading. The insider's information might be material independent of whether it casts doubt on the projections, or the projections may be stale or heavily qualified and the company may have no duty to update them. But the information Nacchio knew was alleged to be material *only* because it supposedly suggested that Qwest's public projections, which were reaffirmed contemporaneously with his trades, were unrealistic or

subject to more risk than the market would understand.[10] In that posture, whether the projections were materially misleading without further disclosure and whether Nacchio's information was material *to an evaluation of whether the projections were misleading* are the same question.

Other circuits confronted with allegations like these have not distinguished between "false statement" and "insider trading" theories. The Tenth Circuit distinguished the Seventh Circuit's decision in *Wielgos* on the ground that the defendant was charged with making false statements, not insider trading. *Nacchio*, 519 F.3d at 1161 n.9. But the issue in *Wielgos* was whether the company violated the securities laws "when it sold [its] stock" when internal cost projections were more pessimistic than its public projections. 892 F.2d at 512.[11] The court did not label that claim a "false statement" or "insider trading" theory, but instead held that "reasonable basis" principles constrain "all of the bases of liability" under the securities laws. *Id*. at 513. The Seventh Circuit held that a company "need not disclose tentative internal estimates, even though they conflict with published estimates, unless the internal estimates are so certain that they reveal the published figures as materially misleading," and could "sell[] [its] stock on the basis of [its public estimates]" until they "'no longer [have] a reasonable basis.'" *Id.*

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[10] The charge was that Nacchio knew "the business units were underperforming with regard to their specific internal budgets, and that *such underperformance would inhibit Qwest's ability to meet its 2001 financial guidance issued on September 7, 2000.*" Bill of Particulars 8 (emphasis added). That is the *only* theory of materiality in the indictment or argued at trial, and the conviction cannot be affirmed on any other basis. (*See* Exhibit R (12/11/07 Letter from Maureen Mahoney to Elisabeth Shumaker, pursuant to FRAP 28(j).) And this Court held that Szeliga's lower revenue prediction could be material, despite the SEC's guidance in SAB 99, only because the "skittish" and "mercurial" stock market would react negatively to any shortfall *as compared to the projections*. *Nacchio*, 519 F.3d at 1164; 3/10/09 Letter from Maureen Mahoney to Elisabeth Shumaker, pursuant to FRAP 28(j).

[11] There is no basis for distinguishing between sales by the company and individual insiders. *E.g.*, *McCormick v. Fund Am. Cos.*, 26 F.3d 869, 876 (9th Cir. 1994).

at 515-16 (citation omitted).

Several other circuits have applied "reasonable basis" or similar principles in cases where the company sold stock without disclosing internal estimates or interim operating results that might suggest a departure from public expectations. In *Walker v. Action Industries, Inc.*, 802 F.2d 703, 709-10 (4th Cir. 1986), the Fourth Circuit held that the company had no duty to disclose internal financial reports projecting a sharp increase in first quarter "actual orders" and "projected sales"—a 95%-129% increase compared with the previous year's first quarter—in connection with its tender offer. The court reasoned that the interim projections and actual results were still "uncertain." *Id.* at 710. Similarly, in *In re Worlds of Wonder Securities Litigation*, 35 F.3d 1407, 1419-20 (9th Cir. 1994), the company did not disclose declining demand and that "first quarter sales were disappointing," which cast doubt on projections in its Debenture Offering. The Ninth Circuit held that the company "had no duty" to disclose the interim results, or "predict[] the collapse in sales [the first-quarter results foretold] that occurred in late 1987, long after the Debenture Offering." *Id.* at 1417-18, 1420.

The Tenth Circuit's analysis suggests that the plaintiffs in cases like *Wielgos* simply attached the wrong label to their claim, and that if they had accused the company of insider trading rather than misleading statements they would have won. But the Seventh Circuit explained that the reasonable basis rule is essential: "Any other position would mean that once the annual cycle of estimation begins, a firm must cease selling stock until it has resolved internal disputes and is ready with a new projection. Yet because large firms are eternally in the process of generating and revising estimates—they may have large staffs devoted to nothing else—a demand for revelation or delay would be equivalent to a bar on the use of projections if

the firm wants to raise new capital." *Wielgos*, 892 F.2d at 516. This is a crucial substantive rule, not a pleading issue.

As a practical matter, the Tenth Circuit's reasoning puts companies and insiders in an impossible position. Under that court's decision, Nacchio did not commit fraud by reaffirming Qwest's projections on April 24th despite his knowledge of the internal IRU projections at issue here (again, the shortfall in "recurring" revenue *was disclosed*, *supra* n. 9), but he somehow did engage in fraudulent practices by selling his stock two days later on the basis of the same knowledge. Criminal liability cannot turn on such vague distinctions.

The Tenth Circuit's suggestion that a tougher standard for insider trading claims serves the purposes of the "reasonable basis" rule by further encouraging disclosure is, with respect, unrealistic. Under the government's theory of the case and the court's explicit reasoning, Nacchio's inside information was "material" *only* because Qwest had first made projections and the "mercurial" stock market would punish the company for missing them. *Nacchio*, 519 F.3d at 1164. If making a projection can render internal forecasts and interim operating results "material" without the protections of the reasonable basis rule, companies will not make projections public in the first instance. Doing so would mean the company must constantly bare its internal forecasting and strategic thinking to the market and to competitors, or face a complete bar on raising capital and on stock purchases or sales by insiders. Courts and the SEC have recognized that the threat of civil liability under §10(b) will deter companies from issuing projections without the reasonable basis rule. Executives will be no less careful with their own freedom.

III. THE JURY INSTRUCTIONS PRESENT A SUBSTANTIAL QUESTION

The standards the Tenth Circuit applied in reviewing the materiality instruction conflict with the tests applied in other circuits in two ways that raise substantial questions.

1. The Tenth Circuit held that the instruction was "not particularly informative" and recognized the danger of asking "untrained jurors to judge *ex post* what would have been important to reasonable investors *ex ante*," but nonetheless refused to find instructional error unless the uninformative instruction affirmatively "misstated the law," *Nacchio*, 519 F.3d at 1159-1161. That is the wrong standard. "A trial judge's duty is to give instructions sufficient to explain the law," *Kelly v. South Carolina*, 534 U.S. 246, 256 (2002), and an instruction is erroneous if it does not "contain[] an adequate statement of the law to guide the jury's determination," *United States v. Park*, 421 U.S. 658, 675 (1975). Other circuits have held that reversible error occurs when a facially correct instruction is "'incomplete[],'" *United States v. Escobar-de Jesus*, 187 F.3d 148, 164 n.10 (1st Cir. 1999) (citation omitted), or "'inadequate to guide the jury's deliberations,'" *United States v. Marsh*, 894 F.2d 1035, 1040 (9th Cir. 1989) (citations omitted). *See also United States v. Dotson*, 895 F.2d 263, 264 (6th Cir. 1990) ("[T]he instruction given in this case was correct as far as it went, but it did not go far enough."); *United States v. Holley*, 502 F.2d 273, 276 (4th Cir. 1974) ("[A] facially correct statement of the law by the district judge" is "reversible error" if it "fail[s] to sufficiently relate the law to the particular facts of the case.").[12]

[12] *See also* 9C Charles A. Wright & Alan R. Miller, *Federal Practice and Procedure* §2558 (3d ed. 2008) ("It is universally accepted that … the appellate court in reviewing instructions … is to satisfy itself that the instructions show no tendency to confuse or mislead the members of the jury *or insufficiently inform them with respect to the applicable principles of*

2. The Tenth Circuit held that Nacchio's "reasonable basis" instruction was confusingly worded and did not accurately state the law. Even if his proposed fix was not perfect, Nacchio correctly identified that the instructions gave inadequate guidance on materiality in light of the uncertain nature of these forecasts. In at least seven circuits, "'[t]he fact that counsel did not tender perfect instructions does not immunize from scrutiny on appeal a failure to instruct the jury adequately concerning the issues in the case.'" *Heller Int'l Corp. v. Sharp*, 974 F.2d 850, 856 (7th Cir. 1992) (citation omitted).[13]

IV. SUMMARY REVERSAL IS APPROPRIATE

There is also a substantial question whether the *en banc* court's decision should be

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law.") (emphasis added); *United States v. Hastings*, 918 F.2d 369, 373 (2d Cir. 1990) (instructions "were sufficiently incomplete" and "inadequate with respect to the element of knowledge"); *United States v. Gordon*, 290 F.3d 539, 545 (3d Cir. 2002) ("[T]he instruction was incomplete and therefore incorrect …."); *Wichmann v. Bd. of Trustees of S. Ill. Univ.*, 180 F.3d 791, 804 (7th Cir. 1999) ("[W]e must determine whether the instruction misstates *or* insufficiently states the law.") (emphasis added), *vacated on other grounds*, 528 U.S. 1111 (2000); *Kisor v. Johns-Manville Corp.*, 783 F.2d 1337, 1340 (9th Cir. 1986) ("[W]e must determine whether … the court gave adequate instructions … to ensure that the jury fully understood the issues.").

[13] *Webster v. Edward D. Jones & Co.*, 197 F.3d 815, 820 (6th Cir. 1999) ("'[E]ven if an incorrect proposed instruction is submitted which raises an important issue of law involved in light of proof adduced in the case, it becomes the duty of the trial court to frame a proper instruction on the issue raised ….'") (citation omitted); *Wilson v. Maritime Overseas Corp.*, 150 F.3d 1, 10 (1st Cir. 1998) ("[W]e need not decide whether the defendants' proffered instructions were correct as a matter of law. The requests sufficed to alert the district court to the need for some instructions, even if not the specific ones urged by the defendants …."); *Bueno v. City of Donna*, 714 F.2d 484, 490 (5th Cir. 1983) ("So long as an inadequate or improper request is sufficient to direct the court's attention to a legal defense, the court is thereby alerted that a proper instruction is required."); *Walker v. AT&T Techs.*, 995 F.2d 846, 849 (8th Cir. 1993) (same); *United States v. Jones*, 909 F.2d 533, 538-39 (D.C. Cir. 1990) (Ginsburg, R., J.) (same); *Posttape Assocs. v. Eastman Kodak Co.*, 537 F.2d 751, 757 (3d Cir. 1976) (same); *see also* 9C Wright & Miller, *Federal Practice and Procedure* §2552 ("If the request directs the court's attention to a point upon which an instruction to the jury would be helpful or necessary, the court's error in failing to charge on the subject may not be excused because of technical defects in the request.").

summarily reversed for clear misapplication of Supreme Court precedent.

1. Even if the district judge was entitled to exclude Fischel under *Daubert*, the decision to do so without permitting a hearing, voir dire, or argument was an exercise of discretion. The *en banc* court held that it "agreed to a rehearing on the question of the admissibility of Professor Fischel's expert testimony," (Exhibit C at 19 n.9), and acknowledged that its grant of rehearing embraced whether the district court abused its discretion, *id.* at 47-49 n.21. Nacchio pointed out that "'[t]he abuse-of-discretion standard includes review to determine that the discretion was not guided by erroneous legal conclusions,'" and that the court's exercise of discretion was infected by its erroneous belief that Nacchio had committed an egregious Rule 16 violation, and that the proposed testimony was irrelevant and would not assist the jury. (Exhibit S (*En Banc* Reply Br.) at 22-23 (quoting *Koon v. United States*, 518 U.S. 81, 100 (1996)).)

The *en banc* court seemed to hold that this argument either was not within the *en banc* grant or that it is frivolous and does not "merit analytical attention." (Exhibit C at 47-49 n.21.) Both suggestions are flatly inconsistent with the holding of *Koon*, and decisions of other circuits applying that principle.[14] The *en banc* court also cannot take for itself, and away from the

[14] *See, e.g., Torres-Rivera v. O'Neill-Cancel*, 524 F.3d 331, 335-36 (1st Cir. 2008) (court abuses its discretion "if it relies on an improper factor in working that [decisional] calculus … [and] an error of law is always tantamount to an abuse of discretion"); *United States v. Street*, 531 F.3d 703, 710 (8th Cir.) ("'An abuse of discretion occurs when … an irrelevant or improper factor is considered and given significant weight ….'") (citation omitted), *cert. denied*, 129 S. Ct. 432 (2008); *Parra v. Bashas', Inc.*, 536 F.3d 975, 977-78 (9th Cir. 2008) ("An abuse of discretion occurs when the district court, 'in making a discretionary ruling, relies upon an improper factor ….'"); *LaSalle Nat'l Bank v. First Conn. Holding Group, L.L.C. XXIII*, 287 F.3d 279, 288 (3d Cir. 2002) (same); *A Helping Hand, LLC v. Balt. County*, 515 F.3d 356, 370 (4th Cir. 2008) (same); *Marlin v. Moody Nat'l Bank NA*, 533 F.3d 374, 377 (5th Cir. 2008) (same); *United States v. Crucean*, 241 F.3d 895, 898 (7th Cir. 2001) (same); *Wexler v. Lepore*, 385 F.3d 1336, 1338 (11th Cir. 2004) (same); *Se. Fed. Power Customers, Inc. v. Geren*, 514 F.3d 1316,

original panel, the authority and responsibility to decide whether the district court abused its discretion—and then simply refuse to consider one aspect of that issue under binding Supreme Court precedent, such that it falls through a crack between the panel and *en banc* decisions and cannot be resolved. An appellate court cannot simply duck an issue it finds inconvenient.

2. The *en banc* court repeatedly cited *Sprint/United Management v. Mendelsohn*, 128 S. Ct. 1140 (2008), to presume that the district court's order excluding Fischel rested on Rule 702 grounds rather than a misunderstanding of Rule 16. In *Sprint* the Supreme Court reversed the Tenth Circuit for presuming that an ambiguous district court opinion rested on erroneous grounds, and held that "[a] remand directing the district court to clarify its order … would have been the better approach." *Id.* at 1146. The *en banc* court here committed the very same error the Supreme Court reversed in *Sprint*, but in reverse.

CONCLUSION

This Court should continue bail pending disposition of a petition for certiorari.

1321 (D.C. Cir. 2008) (same), *cert. denied*, 129 S. Ct. 898 (2009).

Respectfully submitted this 11th day of March, 2009.

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CERTIFICATE OF SERVICE

I hereby certify that on this 11th day of March 2009, I electronically filed the foregoing **EMERGENCY MOTION FOR CONTINUED RELEASE PENDING SUPREME COURT RESOLUTION OF A PETITION FOR CERTIORARI** with the Clerk of the Court using the Court's CM/ECF system, which will send notification of the filing to the following:

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