NO. 07-1311

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

UNITED STATES OF AMERICA,

Plaintiff-Appellee,

v.

JOSEPH P. NACCHIO,

Defendant-Appellant.

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

APPELLANT'S APPLICATION FOR RELEASE PENDING SUPREME COURT ACTION ON A PETITION FOR CERTIORARI

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Nacchio hereby applies for an order continuing release pursuant to the Bail Reform Act of 1984, 18 U.S.C. §3143(b), and Federal Rule of Appellate Procedure 9, pending the disposition of a petition for a writ of certiorari to the Supreme Court. He is not a flight risk or a danger and his petition is not for the purposes of delay. Nacchio will file his petition in three weeks, and that petition will raise several "substantial question[s]" for review. 18 U.S.C. §3143(b)(1)(B); *United States v. Affleck*, 765 F.2d 944, 952 (10th Cir. 1985). Nacchio must report on March 23, 2009. We respectfully request that this Court decide the motion prior to that date and, if it is denied, stay the district court's order of surrender until the Supreme Court acts on the bail application.

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

This panel correctly held that the district court's decision excluding Professor Fischel was based on an erroneous understanding of Rule 16 rather than on any freestanding *Daubert* challenge. But even if the *en banc* court's erroneous premises are accepted, its reasoning 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. *En Banc* Op. 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); *En Banc* Br. 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." APP-398; *En Banc* Br. 6-7. The court faulted Nacchio for a supposed "gross defect in failing to *reveal* [Fischel's] methodology," APP-3921, and ruled that it was "*undisclosed* in this expert disclosure." APP-3917; *see also* 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.

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.[1] If the mere filing

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[1] *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 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).

of a *Daubert* motion 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. *En Banc* Op. 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. 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 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*." 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.[2] This is an important and recurring issue

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[2] *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 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

on which the lower courts 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 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," *En Banc* Op. 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 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. This court held that the conviction could be sustained on the basis of ambiguous testimony from Robin 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*

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deficiencies identified in *Daubert*," and that "the evidence should be presumed to be admissible until the opponent discharges its burden to show the contrary").

2001. Panel Op. 45-46.[3] This Court concluded 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 46-47. But this Court's reasoning makes no allowance for the fact that Szeliga was talking about an uncertain *risk* eleven or twelve months in the future, not a proven shortfall that had actually occurred.[4] The standards for assessing the materiality of internal predictions and interim operating results present a question of great

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[3] The government argued that the risk was 4.2% and this Court agreed, reasoning that. Szeliga's testimony on the issue was ambiguous and it was "required to interpret the evidence in the light most favorable to the government." Panel Op. 46. Respectfully, this Court overlooked testimony from Szeliga on direct examination that "when we originally presented the budget and *I articulated that I thought we had a billion dollars of risk built into the stretch targets*." APP-2211. Moreover, just before the testimony on re-direct that this Court quoted, Szeliga stated that she did *not* discuss the September 5, 2000 memo with Nacchio, and a close read of her testimony reveals that the prosecution was simply walking Ms. Szeliga through the calculations on the memo, but she never testified *that* was what she communicated to Nacchio. APP-2421 ("I discussed the billion dollar risk with Mr. Nacchio at that time, *not this—not the specifics of this memo, necessarily*.") (emphasis added).

Today Nacchio filed a Rule 33 motion in the district court seeking a new trial on the ground that Ms. Szeliga has now clarified, in sworn testimony in a case brought by the SEC, that the billion dollars of "risk" she warned Nacchio of related to the internal stretch targets. The district court's consideration of that motion does not deprive this court of jurisdiction. *United States v. Cronic*, 466 U.S. 648, 667 n.42 (1984).

[4] This Court 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." Panel Op. 47 n.10 (emphasis added) (citing Nacchio Brief 24). That was a clear error. This 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*," Nacchio Brief 19—a *five-page section* (nearly 10% of Nacchio's brief), that argued that the information was too uncertain to be material. *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").

national importance, but "[n]either the Securities and Exchange Commission (SEC) nor the courts have answered the[] question[] with either uniformity or clarity."[5] This Court'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. And even if that premise were accepted, this Court's analysis would still conflict with holdings of several other circuits. There is *at least* a "substantial question" for certiorari.

A. This Court's Decision Squarely Conflicts With The Materiality Standards Applied By Other Circuits

1. This Court 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." Panel Op. 39. But several courts of appeals have applied far more rigorous standards, under which Nacchio would have been acquitted as a matter of law, when assessing the materiality of information just like this *in trading cases*.

The leading cases are *Shaw v. Digital Equipment Corp.*, 82 F.3d 1194 (1st Cir.

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[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).

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 interim information presaging results four to six months in the future have been dismissed

[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.

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 this Court 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. Graham also

[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").

testified that the April 9 budget, which included his projection of *increased* IRU sales, "provid[ed] our best belief of what things were going to happen." APP-2702. Casey's assessment about IRUs—that he did not "have any visibility to what IRUs would be doing after the second quarter," 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. APP-4699-700. In April, the company fell only 2.3% short of its internal estimate, APP-5019, and Casey's wholesale markets unit—the supposed epicenter of impending disaster—*beat* its internal target, APP-5021. Indeed, Qwest's second-quarter revenues ultimately met investors' expectations, APP-2381-82, and "non-recurring" revenue achieved 98% of the Board's budget *for the year*, GX 932,

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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").

GX 947. 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 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

[9] This Court noted that "recurring" subscriber revenue had not accelerated by April to the extent Qwest had budgeted for. Panel Op. 58. 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. APP-4828, 4807-08. The prosecution's own analysts understood that disclosure loud and clear. APP-3636, 4935.

projection that differed from public projection by 4%-6.2% as a "slight[]" "deviat[ion]").

B. This Court'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). This Court 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.

This Court 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. This Court distinguished the Seventh Circuit's decision in *Wielgos* on the ground that the defendant was charged with making false statements, not insider trading. Panel Op. 40 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]"

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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 under-performance 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* 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*. Panel Op. 47.

[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).

until they "'no longer [have] a reasonable basis.'" *Id.* 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.

This Court'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, this Court's reasoning puts companies and insiders in an impossible position. Under this 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 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.

This Court'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 this Court's explicit reasoning, Nacchio's inside information was "material" *only* because Qwest had first made earnings projections and the "mercurial" stock market would punish the company for missing them. Panel Op. 47. 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.

C. This Court Should Correct Factual Errors In Its Materiality Analysis

As explained *supra* at nn. 3, 4, and 9, this Court's materiality analysis rests on several erroneous assertions about the record and briefing. This Court can and should *sua sponte* correct its opinion and reconsider its materiality conclusions.

III. THE JURY INSTRUCTIONS PRESENT A SUBSTANTIAL QUESTION

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

1. This Court 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," Panel Op. 35-37. 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]

2. This Court 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]

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[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 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*

IV. SUMMARY REVERSAL IS APPROPRIATE

There is also a substantial question whether the *en banc* court's decision should be summarily reversed for clear misapplication of Supreme Court precedent.

1. Even if the district judge was entitled to exclude Fischel under *Daubert*, his 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," *En Banc* Op. 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. *En Banc* Reply Br. at 22-23 (quoting *Koon v. United States*, 518 U.S. 81, 100 (1996)).

The *en banc* court seems to hold that this argument either was not within the *en banc* grant or that it is frivolous and does not "merit analytical attention." *En Banc* Op. at 47-49 n.21. Both suggestions are flatly inconsistent with the holding of *Koon*, and

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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.").

decisions of other circuits applying that principle.[14] The *en banc* court also cannot take for itself, and away from the 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 may not duck an issue, particularly when the consequence is to deprive a party of his freedom.

2. The *en banc* court repeatedly cites *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 this Court 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.

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

Respectfully submitted,

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CERTIFICATION OF DIGITAL SUBMISSIONS

I, Maureen E. Mahoney, hereby certify that:

(1) there were no privacy redactions to be made in the documents submitted on March 5, 2009, and every document submitted in Digital Form or scanned PDF format is an exact copy of the written document that was sent to the Clerk; and

(2) the digital submissions have been scanned for viruses using McAfeeAgent Version 4.0.0.1345, McAfee VirusScan Enterprise Workstation, Virus Definitions 4.0.5544, McAfee Anti-Spyware Enterprise Module, version 8.0.0.989, last updated on March 5, 2009, and, according to the program, are free from viruses.

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CERTIFICATE OF SERVICE

I hereby certify that on this 5th day of March, 2009, I caused the foregoing **APPELLANT'S APPLICATION FOR RELEASE PENDING SUPREME COURT ACTION ON A PETITION FOR CERTIORARI** to be submitted via electronic mail to:

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I further certify that on the 5th day of March, 2009, I caused copies of the foregoing **APPELLANT'S APPLICATION TO CONTINUE RELEASE PENDING APPEAL** to be sent via U.S. mail postage prepaid to:

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