

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
HONORABLE MARCIA S. KRIEGER**

Criminal Action No. 05-cr-00545-MSK

UNITED STATES OF AMERICA

Plaintiff,

v.

JOSEPH P. NACCHIO,

Defendant.

JOSEPH P. NACCHIO’S SENTENCING STATEMENT

This Court’s Order Regarding Sentencing described a two-step sentencing process. The first step “involves a calculation of the sentence range in accordance with the Guidelines.” Order at 6 (Docket No. 584). The critical question in step one, for purposes of this resentencing, is determining “the gain resulting from the offense” under U.S.S.G. §2F1.2 (2000). The second step of the sentencing process “addresses the requirements of 18 U.S.C. §3553(a).” Order at 7.

In this sentencing statement, Nacchio addresses “the gain resulting from the offense” under §2F1.2. Nacchio also addresses the amount of forfeiture under 18 U.S.C. §981(a)(2)(B), and, as an exception to the mandate rule, the amount of the fine. As noted in the Joint Motion

filed today by the parties, the factors under 18 U.S.C. §3553(a) will be addressed in subsequent briefing.¹

INTRODUCTION

The advisory guidelines range governing this sentencing proceeding depends on “the gain resulting from the offense” under §2F1.2. The Tenth Circuit’s opinion makes clear that the gain resulting from the offense in an insider trading case is *only* that portion of the stock price attributable to the material inside information that the defendant knew, and the market did not. Nacchio and the government have exchanged “event studies” from expert witnesses that purport to calculate Nacchio’s gain by reference to how the market actually reacted to the disclosure of particular information on particular days. But the calculations are wildly divergent. Nacchio’s event study demonstrates that the gain resulting from the offense actually charged and tried in this case is at most \$1.8 million. The government’s event study calculates a gain of \$24.1 to \$33.8 million.

The difference between the gain numbers submitted by the parties is explained by the disclosure dates—*i.e.*, the dates on which the inside information was disclosed to the market—the respective experts used in their models. Nacchio’s expert focused on the market’s response to the disclosure of the specific inside information that Nacchio was charged with trading on in this case—specifically, the “risk” associated with Qwest achieving its year-end revenue projections, and the diminishing market for IRU sales. The government produced its vastly

¹ Nacchio requests oral argument on the “gain” determination. The Joint Motion also states that the parties do not believe an evidentiary hearing is necessary for purposes of the Phase I determinations. Of course, there is at present no reliability challenge to the methodology or conclusions of Nacchio’s expert, Professor Daniel Fischel. Should the government challenge Fischel’s testimony under Rule 702 or *Daubert*, Nacchio will respond to the government’s challenge and state whether a hearing is required.

higher “gain” number by recycling the event study it submitted in the civil case brought by the Securities and Exchange Commission (“SEC”). In other words, the event study the government submitted to determine the appropriate sentence in this criminal case relies on exactly the same disclosure dates the SEC used in the civil case, even though the SEC case concerns a much broader category of allegedly undisclosed problems at Qwest, such as the accounting issues (which the SEC concedes Nacchio had no knowledge of) that ultimately led to Qwest’s earnings restatement. As a consequence, the government is relying on disclosures that have nothing to do with this criminal case or this defendant—including one disclosure that occurred prior to the date on which the government claimed that any information relevant to the criminal charge was first disclosed, and four disclosures that post-date Qwest’s September 10, 2001 disclosure that its year-end guidance was a billion dollars too high. The effect of focusing on the market’s response to the disclosure of the other information in the SEC case would be to base Nacchio’s sentence on issues that have never been a part of “the offense” charged or tried in this criminal proceeding. In effect, after losing the sentencing issues on appeal, the government is trying to gerrymander itself into the same sentencing range Judge Nottingham used at the initial sentencing by abandoning the indictment, bill of particulars, and evidence at trial, and asking this Court to sentence Nacchio for an entirely different supposed “offense.”

The government’s approach is inconsistent with the plain language and structure of the guidelines, which require that the guidelines range be based on “the offense” actually charged and tried. It is inconsistent with the Tenth Circuit’s mandate, which directs this Court to calculate the gain attributable to Nacchio’s nondisclosure of the particular information that has always formed the basis of these criminal charges. And it is separately barred by the law of this

case because Judge Nottingham already ruled, correctly, that the information underlying these charges was fully disclosed to the market as of September 10, 2001—and that the government’s evidence concerning the market’s reaction to *other* information, disclosed later, is irrelevant and inadmissible. The government did not appeal those evidentiary rulings and cannot now defy them by sneaking evidence of market gyrations after September 10 into its event study.

I. THE “GAIN RESULTING FROM THE OFFENSE”

Under the applicable guidelines manual from 2000, the relevant guideline is U.S.S.G. §2F1.2 (2000). The base offense level is 8. Nacchio does not contest the two-point enhancement for abuse of a position of trust under §3B1.3. In light of this Court’s Order Regarding Sentencing, the only remaining issue for guidelines purposes is calculating “the gain resulting from the offense.”

Under §2F1.2, the base offense level is increased corresponding to the “gain resulting from the offense,” according to the table found in §2F1.1. “[T]he offense” referenced by the guideline can only mean the specific conduct with which the defendant was charged, and for which he was convicted. For purposes of this section of the guidelines, uncharged conduct is completely irrelevant. The Tenth Circuit held in this case that the “gain resulting from the offense” is “*the value of the defendant’s misrepresentation.*” *United States v. Nacchio*, 573 F.3d 1062, 1073-74 (10th Cir. 2009) (“*Nacchio III*”) (quoting 4 Thomas Lee Hazen, *The Law of Securities Regulation* §12.12[3], at 195 (6th ed. 2009)). Because “[u]nder the government’s prosecution theory, the market would have viewed *the inside information* in a negative light, and disclosure of *that information* would have detrimentally impacted the value of Qwest stock ... [i]t is that illicit, artificially high value that should be reflected in the gain calculation, not the

underlying value of the stock.” *Id.* at 1076 (emphasis added). Another way to look at the calculation, the Tenth Circuit explained, is that the “gain” is the “loss avoided” by the defendant’s nondisclosure of the particular information that the law required him to disclose before trading. *See id.* at 1076 n.12 (citing *SEC v. Patel*, 61 F.3d 137, 139 (2d Cir. 1995)). This approach “takes into consideration the fact that stocks have inherent value (quite apart from criminally fraudulent conduct) and seeks to exclude that unrelated value from the computation of a defendant’s punishment, and it sets a logical, temporal cutoff point for assessing the gain of the illegal conduct, *i.e.*, the point when the information is disclosed and absorbed by the market.” *Id.* at 1082. The Tenth Circuit further emphasized the need to exclude the impact on Qwest’s stock price of factors unrelated to the fraud—most specifically, negative industry developments and negative company specific information unrelated to the fraud for which Nacchio was convicted. *E.g., id.* at 1074, 1085. Accordingly, any proper calculation of the “gain” depends on identifying what proportion of the sales prices were attributable to the material inside information Nacchio was charged with and convicted of possessing at the time of the trades.

Both Nacchio and the government have approached that calculation through an “event study,” which is a common statistical method for identifying the market impact of particular information and separating it from, for example, the general collapse in telecommunications stocks that occurred throughout 2001. Professor Fischel’s event study conducts that analysis in a manner that is sound and consistent with the actual charges in this case. The government’s event study, by contrast, was blindly imported from an inapposite civil case brought by the SEC and relies on data that has already been ruled to be irrelevant and improper in these proceedings. Fundamentally, the government’s study reflects not “gain resulting from the offense” but instead

the market consequences of *other* alleged problems at Qwest for which Nacchio has never been charged with any criminal responsibility, and the broader problems faced by the entire telecommunications industry in 2001.

Leaving the technical issues aside, common sense demonstrates that the government's calculation cannot possibly be right. The Tenth Circuit held that it was a close question whether this information was material at all, and reversed Judge Nottingham's \$28 million gain calculation because it failed to separate Nacchio's gain from the charged fraud from other contributing factors, and remanded for this Court to conduct an analysis tightly focused "on ensuring that the gain figure resulting from the offense excludes to the extent possible, within the institutional constraints of criminal sentencing, factors unrelated to the defendant's criminally culpable conduct." 573 F.3d at 1080. The government has now come back with a calculation (\$24.1 to \$33.8 million) that is potentially even higher than the one the Tenth Circuit reversed.

A. The "Offense" Actually Charged And Tried

Until the government lost the sentencing issues on appeal, its entire theory of this case was that Nacchio knew in the spring of 2001 that there was a substantial risk that Qwest's year end guidance to the public was a billion dollars too high. It charged that Nacchio was warned of this risk by Qwest's CFO, Robin Szeliga in December 2000/January 2001, and that at the time of his trades Nacchio had inside information that certain business units were underperforming relative to Qwest's year-end budget and making up the difference with "IRU" sales that would not be available in the second half of the year. That is the *only* theory of criminality charged in the indictment or tried. And the government, Judge Nottingham, and the Tenth Circuit all recognized that that allegedly billion dollar "risk" was disclosed to the market in a series of

statements between August 7 and September 10, 2001—and was fully disclosed as of September 10, when Nacchio and Qwest actually reduced their public guidance *by the full amount supposedly at risk*. Of course we now know that Qwest ultimately restated earnings for 1999-2001, and that restatement forms the basis of the SEC’s broader civil case against Qwest and Nacchio. But the government was clear from the outset that those other issues *were not* a part of this criminal case, and Judge Nottingham consistently excluded evidence that would have expanded this case beyond the theory of nondisclosure charged in the indictment, which included any information disclosed on dates after September 10, 2001.

The trial court required the prosecution to file a bill of particulars that would confine the scope of the trial. In response, the government charged that Nacchio knew “that 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 in September 7, 2000.” Bill of Particulars (Docket No. 47), attached hereto as Exhibit 1, at 8. The bill of particulars says nothing whatsoever about the legality of Qwest’s accounting. The government further explained in its opening statement that “[w]e will prove ... that investors outside Qwest did not know what Mr. Nacchio knew about the risks of Qwest’s ability to achieve that guidance that he told investors to expect in 2001,” Trial transcript (“Tr.”), attached hereto as Exhibit 2, at 16 (Tr. Vol. 1, Docket Nos. 285, 321), and that this “isn’t a case about accounting,” *id.* at 6. And in its closing, the government stressed that when “the company took down its number on September 10 of 2001 ... They took it down by a billion dollars. Not coincidentally the same billion dollars of risk [Szeliga] told him about in the fall, they finally realized and tell the public what he’s known all along. So ... from the guidance in place at the time, new

guidance is 2[0].5 billion, that's in the press release on September 10, like a good card trick, the 20.5, 20.4 billion has been there all along, because that's really what they had a shot at, and defendant knew that all along.” *Id.* at 2747 (Tr. Vol. 24, Docket No. 370); *see also id.* at 2754 (government's closing: “If you know that your people haven't a plan to hit these targets and they're telling you they're unrealistic, you can't keep that inside and continue to sell your stock.”); *id.* at 2794 (“The evidence shows that the defendant's goal during the summer of 2001 was to put as much distance between ... eventually having to take down that number, because he knows it's coming, and that last sale.”).²

At trial when the government attempted to introduce an exhibit of stock prices after September 20, 2001, and to question a witness on the subject, Nacchio objected, stating that “[p]ost-September [10] is totally irrelevant to the issues in this case. This document runs through the end of—through December 31, 2002, which is way beyond the period in this case.” Ex. 2 at 1455 (Tr. Vol. 12, Docket No. 324). The Court ruled: “Right. The objection is sustained. I won't allow in the exhibit that shows stock prices after September 10, 2001.” *Id.* Judge Nottingham similarly shut down any efforts by the government to introduce evidence relating to the accounting issues not encompassed by the indictment. When the government sought to question a witness about Qwest's 2002 restatement of earnings, the court refused to permit the questions and ruled that Qwest's financial results were “restated *for a lot of different reasons*

² The Tenth Circuit also stated that the “risks” in the guidance “were increasingly confirmed” throughout the summer of 2001. Then, “[o]n August 15, Qwest disclosed its IRU sales in a filing with the SEC. App. 1672. ... On September 10, 2001, Mr. Nacchio lowered Qwest's public guidance by one billion dollars. Mr. Wolfe testified that Mr. Nacchio and Drake Tempest had sought to put enough time between the disclosure regarding reliance on IRU sales and the change in guidance that it would not seem as if Mr. Nacchio had been concealing information.” *United States v. Nacchio*, 519 F.3d 1140, 1148 (10th Cir. 2008).

having nothing to do with this case.” Ex. 2 at 1057 (Tr. Vol. 9, Docket No. 312) (emphasis added). The government did not appeal Judge Nottingham’s relevance rulings as to any of those issues, and they are all now law of the case. As this Court has noted, “[t]he ‘law of the case doctrine’ provides that findings and determinations made in one stage of a case are binding during subsequent stages in the litigation.” Order 4 (citing *United States v. Webb*, 98 F.3d 585 (10th Cir. 1996), and *United States v. Bell*, 988 F.2d 247, 250 (1st Cir. 1993)).

Szeliga’s warning of a billion dollars of risk to the public revenue projection of \$21.3 to \$21.7 billion was also the basis of the government’s arguments on appeal, and the *only* ground on which the Tenth Circuit held the evidence to be sufficient for conviction. *United States v. Nacchio*, 519 F.3d 1140, 1163 (10th Cir. 2008) (“*Nacchio I*”) (“The [materiality] dispute revolves around interpreting testimony given by Qwest’s vice-president of financial planning, Robin Szeliga. She is the official who told Mr. Nacchio about the *risks to the public projections.*”) (emphasis added), *aff’d in part, vacated in part, remanded by* 555 F.3d 1234 (10th Cir.) (“*Nacchio II*”), *remanded on subsequent appeal*, 573 F.3d 1062 (10th Cir. 2009) (“*Nacchio III*”), *and cert. denied*, 130 S. Ct. 54 (2009). The Tenth Circuit framed the charges in this case this way: “*Specifically*, the government alleged that Mr. Nacchio knew that Qwest was relying heavily on IRU (indefeasible rights of use) sales—a nonrecurring source of revenue—to meet its first- and second-quarter public guidance and that the company had not made the necessary shift to recurring revenue and, thus, it was at substantial risk of not meeting its year-end guidance.” *Nacchio III*, 573 F.3d at 1064.³ This risk, the government alleged, was known to Nacchio

³ See also *Nacchio I*, 519 F.3d at 1148 (“The government alleged that Mr. Nacchio’s sales from January to May 2001 were on the basis of inside information, because he had material

because Qwest’s Chief Financial Officer, Robin Szeliga, told Nacchio there was “about a billion dollars of risk” in Qwest’s budget, *Nacchio I*, 519 F.3d at 1163, and a Qwest manager expressed his view that “the IRU market was worsening” and that IRU sales would be insufficient to make up the “gap” in the budget, *id.* at 1146. Thus, the “inside” information was a “substantial risk of [Qwest] not meeting its year-end guidance” because there would not be sufficient IRU sales in the second half of the year. *Nacchio III*, 573 F.3d at 1064; *id.* at 1162-64 (Nacchio “argues that the government failed to provide sufficient evidence that *his* information was significan[t to] the reasonable investor,” and “[t]hus, we are asked to decide whether a risk that a company’s revenue will fall \$900 million short of its public guidance—a 4.2% shortfall—is necessarily immaterial to investors”); *id.* at 1169 (“Mr. Nacchio knew in April that the company’s earnings were in jeopardy and he acted on *this* information when deciding to trade in April and May.”). Because “[u]nder the government’s prosecution theory ... disclosure of *that* information would have detrimentally impacted the value of Qwest stock [i]t is that illicit, artificially high value that should be reflected in the gain calculation, not the underlying value of the stock.” *Id.* at 1076 (emphasis added).

The Tenth Circuit also recognized, with Judge Nottingham, that the material inside “information” charged “[u]nder the government’s prosecution theory,” *id.*, was fully disclosed to the market in a series of disclosures culminating on September 10, 2001. The court of appeals explained that two months after Nacchio’s trades, “[o]n July 24, 2001, Qwest issued a press release reporting its financial results for the second quarter of 2001 and the company hosted a

nonpublic information about Qwest—*specifically* that the company was relying heavily on IRU sales, a non-recurring source of revenue to meet its first and second quarter public guidance, and that the company had not made the needed shift to recurring revenue which placed the company at *substantial risk of not meeting its year-end guidance.*”) (emphasis added).

conference call with investors in which it announced that its expected revenue for 2001 would be near the lower end of previously announced ranges.” *Id.* at 1066. Qwest then began disclosing the information the government alleged Nacchio “knew ... all along”:

On August 7, 2001, Mr. Nacchio gave a presentation in which he showed a slide reporting Qwest’s annual actual and estimated IRU sales as a percentage of revenue from 1996 to 2001; this presentation was filed publicly with the U.S. Securities and Exchange Commission (‘SEC’). Then on August 14, 2001, Qwest for the first time disclosed the magnitude of its 2000 and 2001 IRU sales in a filing with the SEC. Qwest’s vice-president of investor relations testified that ‘there had been ... some disclosure after the first quarter’ that some of Qwest’s revenue was one-time rather than recurring, ‘[b]ut ... the magnitude was not known,’ until the August 14, 2001, filing. *Aplt. App.* at 1673. On September 10, 2001, Mr. Nacchio issued a press release lowering Qwest’s public revenue targets for 2001 and for 2002.

Id.

The Tenth Circuit also specifically pointed out that “there is no indication that Mr. Nacchio’s *deception* rendered Qwest’s stock worthless” because “Qwest stock price on *September 21, 2001*, closed at \$19/share.” *Id.* at 1076. In other words, the Tenth Circuit recognized (as Judge Nottingham squarely held) that the “deception” that formed the basis of these criminal charges ended in early September—and that the market price after that point reflected either true value or mispricing for which Mr. Nacchio is not criminally responsible. Thus, “the value of the defendant’s misrepresentation” can be determined by quantifying the “impact[] [on] the value of Qwest stock” from those disclosures. *Id.* at 1074, 1076.

The three opinions issued by the Tenth Circuit accordingly leave no doubt that the material information at issue in these proceedings—the “risk that [Qwest’s] revenue [would] fall \$900 million short of its public guidance,” 519 F.3d at 1164—was fully disclosed when that guidance was reduced by a billion dollars on September 10, 2001, *see also id.* at 1066 (describing the key events at issue as culminating on September 10, 2001 when “Mr. Nacchio

issued a press release lowering Qwest’s public revenue targets”); *id.* at 1145-46 (Nacchio sold “a few months before the company was forced to lower its guidance by a billion dollars, the amount previously estimated by Qwest’s financial officers” and “the public was unaware of the degree of this [billion dollar] risk” to “the public guidance”); *id.* at 1163 (the “Government contends” that the “size of the potential shortfall” in the public guidance that was known from internal “predict[ions] to Mr. Nacchio” was \$900 million).

“The offense” for purposes of the guideline calculation has been defined by the government’s charges in the indictment and bill of particulars, by its evidence at trial, by the district court’s unchallenged evidentiary rulings, and by the Tenth Circuit on appeal. The Tenth Circuit remanded for this court to determine what role the specific charged “deception” played in supporting Qwest’s stock price at the time of Nacchio’s trades. As this Court has recognized, “[t]he ‘mandate rule’ is a corollary to the law of the case doctrine. The mandate rule generally requires a district court to limit its consideration to the issues articulated in the remand.” Order at 4.

B. Calculation Of The Gain Resulting From The Offense

An event study is an accepted method for separating out market-wide and industry-wide influences on a company’s stock price by “linking the *culpable* disclosure to the stock-price movement.” *Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261, 271 (5th Cir. 2007). Both the government’s expert, Professor Thakor, and Nacchio’s expert agree that the market for Qwest stock is efficient, and that the market’s reaction to a particular disclosure is therefore best assessed by examining price movements over a one to two day window after the disclosure. *See* Corrected Report of Daniel R. Fischel (July 2, 2007), attached hereto as Exhibit

4, at 5; Resentencing Report of Daniel R. Fischel (Nov. 23, 2009), attached hereto as Exhibit 3; Report of Anjan V. Thakor, attached hereto as Exhibit 5, at 7; *see also, e.g.*, Jonathan R. Macey et al., *Lessons from Financial Economics: Materiality, Reliance, and Extending the Reach of Basic v. Levinson*, 77 Va. L. Rev. 1017, 1031 (1991) (“When computing a stock return due to an event, financial economists often define the event period as the two-day period consisting of the announcement day and the following day”); *Grossman v. Novell Corp.*, 120 F.3d 1112, 1124 (10th Cir. 1997) (when fraud was allegedly disclosed on August 19, 1994 (a Friday), court reviewed complaint for allegations regarding the impact on “Novell’s stock price on August 22, 1994” (a Monday, the next trading day)).⁴

The disagreement between the experts relates to which disclosures they have chosen to analyze. The selection of the proper dates is critical to an accurate result from an event study. As the Tenth Circuit has explained, “[t]o be [a] corrective [disclosure], the disclosure need not precisely mirror the earlier misrepresentation, but it must at least relate back to the misrepresentation and not to some other negative information about the company.” *In re Williams Sec. Litig. – WCG Subclass*, 558 F.3d 1130, 1140 (10th Cir. 2009); *see also Nacchio*

⁴ This well-established economic approach is also consistent with the government’s theory at trial that if Nacchio disclosed the “inside” information, he could have immediately sold his stock. Ex. 2 at 2788-89 (explaining that if Nacchio had disclosed to investors “at the other end of that [conference] call” on Qwest’s April 24, 2001 earnings call, Nacchio could have sold his stock when the Qwest trading window opened on April 26, 2001); *id.* at 2737 (“If that’s all he did—I want to be very clear about this, if that’s all he did is not tell investors, none of us would be here, because, ladies and gentlemen, this is not a disclosure case. If the defendant had simply chosen not to tell investors, we would not be here. But the decision he made—if we could pull up 63, please. The decision he made which landed him in this courtroom today is not telling investors and then selling his stock. And it’s a very simple theme I’d like to impress upon you; that is, if you don’t tell, you can’t sell. It’s that simple. He decided not to tell. He couldn’t sell.”).

III, 573 F.3d at 1068 n.7 (explaining that event studies “‘focus[] on the reaction that the market had to the revelation of the fraud’” (citation omitted) (alteration in original)); *In re Motorola Sec. Litig.*, 505 F. Supp. 2d 501, 546 (N.D. Ill. 2007) (“[T]he standard cannot be so lax that every announcement of negative news becomes a potential ‘corrective disclosure.’”). A corrective disclosure, therefore, must “disclose[]” the facts a defendant’s “omission concealed ... from the market.” *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 173 (2d Cir. 2005).

1. Fischel’s Event Study Focuses On The Relevant Disclosures

Professor Fischel, Nacchio’s expert witness, conducted an event study to “estimate the portion of Mr. Nacchio’s sales proceeds that can be attributed to inside information ... i.e., how much lower the sales proceeds ... would have been if the inside information had been disclosed prior to the sales.” Ex. 3 at 2. Fischel determined the impact of the relevant disclosures made by Qwest—July 24, August 7, August 14, and September 10—the only dates that the Tenth Circuit referenced when recounting the key events at issue in its sentencing opinion. *Nacchio III*, 573 F.3d at 1066. Out of an abundance of caution, in light of the government’s arguments at trial, Fischel also considered an analyst report from August 22 discussing Qwest’s IRU disclosures. Ex. 3 at 3-4. Fischel concluded that when considering the cumulative impact of all of the relevant disclosures, the inside information did not cause Qwest’s stock price to decline and Nacchio had no gain. *Id.* at 1-2 ¶2 (citing ¶13(f) of the initial sentencing report, Ex. 4) (explaining that the two-day residual return “‘was 4.20 percent, a positive, but not statistically significant amount.’ Therefore, if all of the Subsequent Disclosures were considered, the event study approach shows that none of Mr. Nacchio’s sales proceeds were attributable to the profitable use of inside information.”). Fischel noted, however, that if only the August 22 and

September 10 disclosures were considered—those dates with statistically significant price movement—the “maximum portion of Mr. Nacchio’s sales proceeds that would be attributable to inside information is \$1,832,561 (i.e., 3.52 percent of his total proceeds of \$52,007,549).” *Id.* at 1-2 (citing ¶14 of the initial sentencing report).

2. Thakor’s Event Study Is Fundamentally Flawed

Unlike Fischel’s event study, which directly corresponds to the theories and events relied upon by the Tenth Circuit, the government’s event study is not based on “the offense” charged and tried in this criminal case. Instead, the prosecution has submitted *the exact same event study with the exact same dates from the SEC case*—a case having nothing to do with warnings given to Nacchio concerning Qwest’s ability to achieve its public guidance of \$21.3 to \$21.8 billion, or Nacchio’s failure to disclose risks to that guidance. The SEC has explained that its case against Nacchio is *backward looking*, and focuses on Qwest’s failure to separately disclose revenues earned and reported “upfront” versus revenues recorded monthly during the years 1999 through 2001. The SEC itself acknowledges that its case is based on an entirely different theory than the one presented in the criminal trial. *See, e.g.*, SEC Response in Opp. to Defendants’ Motions to Dismiss, *SEC v. Nacchio*, No. 05-480 (D. Colo. Docket No. 393), attached hereto as Exhibit 6, at 2 (“[T]he SEC’s case against the defendants is that they misrepresented Qwest *past performance* to investors.”); *id.* (“[T]he *historical focus of the SEC’s case* renders the prospect of future [earnings] irrelevant.”); SEC Response to Robert S. Woodruff’s Motion for Summ. J. (D. Colo. Docket No. 677), attached hereto as Exhibit 7, at 6 n.2 (stating that the SEC’s case is not about misstatements that were “false and misleading due to a failure to disclose [future] financial risks”).

Professor Thakor has included in his event study several disclosures that he believes may be relevant to the very different allegations in the SEC's civil case, but which have nothing to do with the criminal charges against Nacchio and indeed have already been ruled to be irrelevant in these proceedings—in evidentiary rulings that the government did not challenge on appeal, and that have become law of the case. Thakor also *omitted* disclosures that were specifically referenced in the Tenth Circuit's opinion, including the central disclosure date in this case.

The additional five dates analyzed by Thakor (that Fischel did not analyze) are June 20, 2001, September 27, 2001, October 31, 2001, February 13, 2002, and July 29, 2002. Ex. 5 at 3-4 ¶13; *id.* at 9-10 ¶26. These disclosures are not relevant for a number of reasons and should not be included in any event study used to determine the gain in this case. All five of the additional disclosures Thakor analyzed fall outside the relevant time frame, as determined by the district court and Tenth Circuit. Two of the five disclosures have also specifically been ruled irrelevant and have been excluded from this case. And *none* of them relate to the inside information that Nacchio was charged with knowing. Instead these disclosures concerned events as disparate as accounting write-downs in adjustments of the purchase price allocation from Qwest's merger with US West, a KPNQwest investment write-down, pension fund accounting, capitalized software accounting, sales of telecommunications equipment in the years 1999-2002, off-balance sheet financing, and an accounting restatement *after* Nacchio left the company. *Compare* Ex. 2 at 6 (Government's Opening Statement: "It isn't a case about accounting.").

Thakor's selection of dates for this case is indefensible. It reflects at best a fundamental misunderstanding of this case and at worst an improper effort by the prosecution to gerrymander a large gain while ignoring its indictment, evidence, representations to the Court and jury, the

express evidentiary rulings of the Court, and its arguments on appeal to the Tenth Circuit. This Court should disregard Thakor's event study entirely, either because the majority of the dates Thakor considered are irrelevant, or because his analysis does not satisfy Federal Rule of Evidence 702 or *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993).

a. Dates On Which Fischel And Thakor Agree

Fischel and Thakor agree that Qwest's disclosure of its IRU sales on August 7, 2001, is a relevant disclosure. *See Nacchio III*, 573 F.3d at 1064 (inside information is that "Qwest was relying heavily on IRU (indefeasible rights of use) sales—a nonrecurring source of revenue—to meet its first- and second-quarter public guidance").⁵ Both Fischel's and Thakor's analysis produced the same result: no statistically significant price movement following this disclosure.

Fischel and Thakor agree that Qwest's 10-Q for the period ending June 30, 2001, filed August 14, 2001, was also a relevant disclosure. Ex. 4 at 3-4; Ex. 5 at 8-9. In Qwest's 10-Q, it disclosed that: "During the three and six month periods ended June 30, 2001, we recognized \$430 million and \$857 million, respectively, in optical capacity sales under indefeasible rights of use ('IRU') agreements versus \$197 million and \$416 million, respectively, for the comparable periods in 2000." Qwest 10-Q (GX641), attached hereto as Exhibit 8, at 26. Thus, Qwest disclosed its reliance on IRUs to meet its "first- and second-quarter public guidance," the information Nacchio was convicted of not disclosing prior to his trades. *See also* Gov't Br. (10th

⁵ Thakor states that this August 7, 2001 disclosure "was the first acknowledgement by the company since 1999 that it was still involved in IRU transactions." Ex. 5 at 8. Though not material to the gain calculation, this statement underscores the carelessness of Thakor's analysis. Among other disclosures, Qwest's 2000 10-K, filed on March 16, 2001, stated: "[T]he Company sells capacity under indefeasible rights of use contracts." Qwest's 10-Q for the quarter ending March 31, 2001 also stated: "[A]s part of our continuing effort to expand our global operating capabilities, principally in Asia and Europe, we entered into several indefeasible right of use ('IRU') agreements with major network providers during the first quarter."

Cir. filed Nov. 9, 2007), attached hereto as Exhibit 9, at 29 (stating that investors had “demanded a revenue breakdown” and “they finally got it” in August). Fischel and Thakor also both found no statistically significant abnormal return following this disclosure.

Professors Fischel and Professor Thakor both considered a negative analyst report from August 22, 2001, Morgan Stanley Dean Witter Report, *Qwest: Listening to the 10-Q* (Aug. 22, 2001), attached hereto as Exhibit 10, and both found a negative price reaction. Ex. 3 at 8-9; Ex. 5 at 12-13.

b. Thakor Omitted Relevant Disclosures From His Analysis

Thakor did not consider the July 24, 2001 date when Qwest told the market it expected its year-end results would be at the lower end of the publicly issued targets, which Fischel considered in his event study. Nor did Thakor analyze the most critical disclosure in the case: the September 10, 2001 disclosure where Qwest reduced its year-end 2001 guidance by a full billion dollars and explained that the reduction was in part because “[i]t currently expected optical capacity sales to generate less revenue for the second half of 2001 than previously announced.” Qwest 8-K (Sept. 10, 2001), attached hereto as Exhibit 11, at 2.

The government’s claim was that Nacchio “knew ... that there were risks associated with his projections” of \$21.3 to \$21.8 billion in revenue, *Nacchio I*, 519 F.3d at 1162, and he failed to disclose those risks and reduce the guidance. *Supra* 9; *see also* Gov’t Br. in Opp to Certiorari (filed June 1, 2009), attached hereto as Exhibit 12, at 6 (“After his trades, petitioner delayed disclosure of Qwest’s inability to meet its public targets Petitioner eventually decided to lower [the] public targets in September 2001”). In the prosecution’s words, it was in the September 10 disclosure that Qwest told “the public what [Nacchio’s] known all along.” Ex. 2 at

2747; *see also Nacchio III*, 573 F.3d at 1066; 519 F.3d at 1148. As the government stated on appeal: “On September 10, he finally issued a press release (App. 4933) taking the target down to \$20.5 billion—essentially lowering it by the billion-dollar amount Szeliga had reported back on April 9.” Ex. 9 at 15-16.

The September 10 disclosure was the key date in the case, but Thakor failed to consider it. In his rebuttal report, Thakor bizarrely claims that the September 10 disclosure is “unrelated to the inside information that Mr. Nacchio possessed at the time of his sales.” Rebuttal Report of Anjan V. Thakor, attached hereto as Exhibit 13, at 2. That is a peculiar view of the evidence. This a case about Nacchio’s failure to disclose a “risk” that Qwest’s year-end guidance might be a billion dollars too high. Surely the market’s reaction to Qwest’s disclosure that it believed its guidance was a billion dollars too high, and Qwest’s reduction of its guidance by that amount, is relevant to any fair assessment of the market significance of the information charged and tried here. As set forth, the Tenth Circuit recited that date as the culminating event when describing the background of the fraud at issue in the sentencing phase of the case. *Nacchio III*, 573 F.3d at 1066.

The government and its expert want to ignore the market’s reaction on September 10, 2001, because of the inconvenient (for them) fact that when Qwest announced that billion dollar shortfall the stock actually went up. But that phenomenon vividly illustrates that the market’s reaction to the August disclosures Thakor *did* consider cannot fairly be assessed without including September 10 in the study as well. The stock price increased on September 10 because, as even Thakor concedes, market participants at that point anticipated that Qwest would lower its guidance by even more than a billion dollars. The government emphasized in its

closing argument that analysts stripped IRU revenues out of estimates for Qwest's 2001 revenues (referencing an August 22 analyst report), and then concluded that Qwest's guidance was too high by "over" a billion dollars. Ex. 2 at 2804-06. In other words, the stock price reaction to the August disclosures was an overreaction that was subsequently corrected on September 10. Other analyst reports recognized that possibility in August,⁶ and confirmed that the September 10 increase was correcting their overreaction.⁷ Against that backdrop, constructing a study based on

⁶ E.g., Baird Equity Research Department Report, *Q: Revenue Concerns Appear Overdone; Buy On Weakness* (Aug. 24, 2001), attached hereto as Exhibit 14, at 1 ("Qwest has sold off sharply over the past several days on heightened concerns regarding the quality of its revenue and its ability to meet its growth targets. These concerns stem from disclosure in the company's most recent 10-Q regarding revenue contribution from optical capacity sales."); *id.* ("[W]e believe the recent sell-off is an overreaction to [the IRU sales]."); A.G. Edwards Report, *Qwest to Buy from Accumulate* (Aug. 24, 2001), attached hereto as Exhibit 15, at 1 ("We are upgrading Qwest to BUY from ACCUMULATE for Aggressive accounts. While we believe that recent concerns about the sustainability of the current revenue growth has some merit, it appears to us that the selling has been overdone."); Prudential Securities Report, *Q: Stock Under Pressure, But Valuation Low and Business Healthy* (Aug. 27, 2001), attached hereto as Exhibit 16, at 1 (stating that following IRU disclosures "Qwest's share price has been under pressure, but we believe the concerns in the market are overstated."); *id.* ("We believe concerns about infeasible right of use (IRU) sales at Qwest have been overstated.").

⁷ E.g., ABN-Amro Report, *Estimates and Capex Reduced* (Sept. 10, 2001), attached hereto as Exhibit 17, at 1 ("We believe today's announcement should eliminate a sizable overhang, as most investors were expecting a revision, and should alleviate some of the pressure on shares of Qwest stock over the next few trading sessions."); Salomon Smith Barney Report, *Q: Lower Guid. Removes an Overhang; Lowering Target but Stock Very Good Value* (Sept. 10, 2001), attached hereto as Exhibit 18, at 2 ("[T]he lowering of numbers removes a huge overhang to the stock."); Jessica Hall, *Qwest cuts outlook, to trim work force*, Reuters, Sept. 11, 2001, attached hereto as Exhibit 19 ("The warning had been widely expected. Analysts said investors were relieved the voice and data services provider had not cut its outlook further and its stock rose 9.7 percent to recoup some of its recent losses. ... 'We believe the vast majority of investors had already factored in ... a reduction'").

the August disclosures while omitting September 10 obviously leads to an improper and inflated assessment of the market's reaction to the information at issue here.⁸

c. The Additional Dates Considered By Thakor Are Irrelevant

The additional five disclosures Thakor considered are not relevant to the case, as a group, and individually.

(1) June 20, 2001 Morgan Stanley Report

Thakor asserts that he only “identified disclosures specifically pertaining to the levels of recurring and non-recurring revenues.” Ex. 5 at 7. That is not true. The first disclosure Thakor considered is a June 20, 2001 Morgan Stanley analyst report—which even Thakor concedes is about “accounting issues.” *Id.* at 8. This report is irrelevant for a number of reasons.

First, Judge Nottingham already ruled that the report is irrelevant and that ruling is law of the case. Ex. 2 at 251-52 (Tr. Vol. 2, Docket Nos. 289, 322). At trial, the government sought to question a witness about this report. The district court recognized that the report is about “different accounting issues,” questioned what the report has to do with the “material omission that we’ve heard about,” and then ruled that the report “*is irrelevant and will be excluded.*” *Id.*

⁸ Thakor also claims that the date should not be considered because there is “a commingling of unrelated contaminating news.” Ex. 13 at 3. He claims (without economic analysis or a single citation to any analyst report) that the market was instead responding to Qwest’s statement that it was also attempting to cut its costs in light of the economic downturn. *Id.* But this is simply *ipse dixit* that the Court should disregard. It is inconsistent with the analysts’ reports, and if Thakor truly believed the market was responding to Qwest’s announcement of a cost-cutting initiative (an initiative that Qwest did not project would compensate for the billion-dollar shortfall simultaneously announced), he would have conducted an economic analysis to remove this allegedly “confounding information.” He did not. He also had no problem considering disclosures with “confounding information,” including disclosures not relevant to *Nacchio* or *his knowledge* at all.

(emphasis added).⁹ The Court’s ruling could not be more clear, the government did not appeal it, and the irrelevance of this disclosure to the issues in this case is therefore now law of the case.

Second, Judge Nottingham was correct. The Morgan Stanley/DW Report, *Qwest: Listening to the 10-K* (June 20, 2001), attached hereto as Exhibit 20, has nothing to do with the inside information in this case. The report raised four “key issues at Qwest”—(1) “write-downs in Adjustments of the Purchase Price Allocation” resulting from the “merger with US West”; (2) “KPNQwest Write-Down” regarding Qwest’s “investment in KPN Qwest”; (3) “Pension Assumptions” related to “accounting” for pension fund assets; and (4) “Capitalized Software” “[a]ccounting rules.” *Id.* at 1, 5-6; *see also* Credit Suisse First Boston, *Qwest Dispels Reports of Accounting Issues* (June 21, 2001), attached hereto as Exhibit 21, at 1 (explaining that the Morgan Stanley claimed to identify accounting concerns “with respect to [Qwest’s] merger purchase accounting, the accounting on its pension fund benefits, the value of its KPNQwest

⁹ The relevant transcript section states:

“MR. WISE: ... Morgan Stanley issued a report suggesting accounting irregularities.

THE COURT: Of Qwest?

MR. WISE: They question Qwest’s accounting

THE COURT: Those are different accounting—are those different accounting issues?”

...

THE COURT: What does it have to do with the one material omission we’ve heard about so far, which in the Court’s mind is the omission to state the significance of these [IRUs]

....

THE COURT: ... As a matter of relevance, [the Morgan Stanley report] injects different issues into the case, and it injects accounting issues, correctness of those accounting issues, whether he was right on the accounting issues.

MR. WISE: We don’t intend to put in whether the accounting issues were right....

THE COURT: I’m ready to rule The [Morgan Stanley report] is irrelevant and will be excluded.” *Id.*

holdings, and the PP&E write-down.”). The report does not mention IRU sales or the risks Nacchio was charged with not disclosing,¹⁰ and is not relevant to the gain calculation.

Third, nothing “nonpublic” was revealed by the analyst report. The report itself expressly states that the accounting issues it was describing were disclosed in “Qwest’s recent 10-K and previous financial reports.” Ex. 20 at 1.

(2) September 27, 2001 Disclosure By CalPoint

Thakor also considered an online column from September 28, 2001, discussing a disclosure by another company, CalPoint, where, on September 27, 2001, CalPoint stated that in the third quarter of 2001, it agreed to purchase telecommunications *equipment* from Qwest, for approximately \$200 million. Georges Mannes, *For Qwest, More Accounting Gripes*, TheStreet.com, Sept. 28, 2001, attached hereto as Exhibit 23. This article is not relevant for a number of reasons.

First, the article post-dates Qwest’s August disclosure of the impact of IRU sales, and its September 10 reduction in guidance. Because Judge Nottingham already ruled that all dates after September 10 are irrelevant, that ruling is law of the case. By September 10, 2001, all of the inside information identified by the government was already disclosed. Moreover, the deal was not negotiated or entered into until the third quarter of 2001—months *after* Nacchio’s trades. There is absolutely no evidence that Nacchio knew about this potential transaction in April or

¹⁰ The government also argued at trial and on appeal that no inside information was disclosed until at least August 7, 2001. Ex. 9 at 14-15. And it is also worth noting that in Thakor’s report in the SEC case, he wrote that this disclosure “revealed to the market Qwest’s previously undisclosed aggressive accounting policies, *including those related to IRU transactions and equipment sales.*” Report of Anjan V. Thakor, *SEC v. Nacchio*, No. 05-480, attached hereto as Exhibit 22, at 25 (emphasis added). This is obviously false, and raises serious questions as to whether Thakor even read the disclosures he purports to have analyzed.

May 2001. And this article was not a “disclosure” of historical undisclosed information; it was a disclosure of a new agreement for a future sale. To be relevant to the inquiry, the disclosure must disclose a fact that the defendant’s “omission concealed ... from the market.” *Lentell*, 396 F.3d at 173; *see also In re Williams Sec. Litig. – WCG Subclass*, 558 F.3d at 1140; *In re Motorola Sec. Litig.*, 505 F. Supp. 2d at 546 (“[T]he standard cannot be so lax that every announcement of negative news becomes a potential ‘corrective disclosure.’”).

Second, the disclosure is not even about the inside information in this case. This case has nothing to do with Qwest’s sales of telecommunications equipment. The word “equipment” does not appear in the government’s indictment, or opening or closing statements. Moreover, the inside information was a prediction that Qwest would not be able to make any IRU sales in the third and fourth quarter. This is a disclosure (albeit regarding equipment) that Qwest *had in fact just made a third quarter sale* of over \$200 million.

Third, the online column cited by Thakor states that “what’s upsetting investors” is “[t]he accounting treatment of this transaction.” Ex. 23. The government repeatedly stated that this “isn’t a case about accounting.” Ex. 2 at 6; *see also id.* at 252 (“We don’t intend to put in whether the accounting issues were right.”); *id.* at 1057 (“[T]his [case] is not about [accounting] numbers.”); *id.* at 278 (Tr. Vol. 3, Docket Nos. 290, 323) (“I’m not going to ask about accounting issues.”). Investors were not reacting negatively because of this information’s impact on Qwest’s guidance issued on September 7, 2000—which Qwest had already reduced by the full billion dollars that the government contends was “at risk” in the spring, when Nacchio traded. *See, e.g.*, Ex. 1 at 2 (“For purposes of the time period in the Indictment, the relevant financial guidance was first issued on or about September 7, 2000, [and] remained in effect until

on or about September 10, 2001 That guidance included 2001 revenue between \$21.3 billion and \$21.7 billion"); *id.* at 8 (Nacchio knew “that 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.”).

This disclosure is not relevant to the gain calculation.

(3) October 31, 2001 Third Quarter Earnings Announcement

Thakor also considered Qwest’s third-quarter earnings announcement in his analysis. Ex. 5 at 9. Qwest’s 10-Q stated that Qwest recognized \$133 million in third-quarter IRU sales, which reflected a “decline[] in optical capacity” IRU sales for the quarter. This disclosure is not relevant for several reasons.

First, again, the disclosure post-dates September 10, 2001, and any reliance on it is absolutely barred by the law of the case. Judge Nottingham already ruled that this disclosure has nothing to do with Qwest’s ability to achieve its already reduced year-end guidance *issued on September 7, 2000*. See, e.g., Ex. 1 at 2.

Second, Thakor identifies no previously undisclosed information revealed by this disclosure. On September 10, 2001, Qwest disclosed to the market that it was reducing its guidance by one billion dollars due to the fact that “[i]t currently expected optical capacity sales to generate less revenue for the second half of 2001 than previously announced.” *Supra*. In its closing argument, the government agreed that the relevant information was disclosed in August and September, the *third* quarter of 2001. Ex. 2 at 2796-97 (“The first time that Qwest reveals and Mr. Nacchio reveals that the IRUs actually went away and were going away was in the third quarter. So he doesn’t tell the investing public what he knows in the fall of 2000 until almost a

year later.”). Qwest’s 10-Q and October 31 earnings announcement was a month into the *fourth* quarter and simply confirmed what the September 10 third-quarter disclosure already told the market: there would be fewer third quarter IRU sales. This is not new information. *Cf., In re Williams Sec. Litig. – WCG Subclass*, 558 F.3d at 1143 (affirming exclusion of expert opinion testimony where “[t]hough [the expert] points to four disclosures, he simultaneously concedes that the market knew of the misrepresentations even before those disclosures”).

(4) February 13, 2002 *Wall Street Journal* Article

Thakor’s inclusion of a newspaper article from 2002 discussing minor transactions “over the previous two years in which Qwest sold equipment” (Ex. 5 at 9) with one particular company and raising concerns about “off balance sheet financing” that had absolutely nothing to do with Qwest’s ability to achieve its year-end 2001 financial guidance is improper on its face and also barred by the law of the case, as explained above.

In addition, there was absolutely no new relevant information disclosed by this article. A newspaper article digesting information already public is not *new* information and in an efficient market, its potential impact on a stock price is not relevant. *See Teachers’ Retirement Sys. of La. v. Hunter*, 477 F.3d 162, 187 (4th Cir. 2007); *In re Merck & Co. Securities Litigation*, 432 F.3d 261, 270 (3d Cir. 2005). In *In re Merck & Co.*, for example, the company disclosed information on April 17, and there was no negative impact on the company’s stock price. *The Wall Street Journal* published an article, approximately two months later, negatively describing the disclosed information, and the stock price declined significantly. 432 F.3d at 269. The Third Circuit held that because the market was efficient market, the relevant price reaction was on April 17, when the company disclosed the information, not two months later when *The Wall Street Journal*

provided a negative characterization of the information. Because the stock did not react negatively to the initial disclosure, the court held that the information was immaterial as a matter of law. *Id.* at 269-70.

So too with the Wall Street Journal article here. Even assuming information about Qwest's equipment sales revenue or off balance sheet financing has any relevance to this case, *Qwest already fully disclosed its equipment sales revenue—and the specific transactions with KMC—prior to this newspaper article.*

First, in his previous paragraph of his report, Thakor concedes that in the October 31 disclosure Qwest “disclosed the existence of ... equipment sales.” Ex. 5 at 9. That alone warrants exclusion of Thakor's opinion. *In re Williams Sec. Litig.*, 558 F.3d at 1143 (affirming exclusion of expert opinion where “[t]hough [the expert] points to four disclosures, he simultaneously concedes that the market knew of the misrepresentations even before those disclosures”).

Second, Qwest disclosed the existence of its equipment sales revenues for 2001 as well as *the specific transactions with KMC*, and discussed concerns over off balance sheet financing, in a December 13, 2001 analyst conference call. *See* Transcript of Analyst Conference Call (Dec. 13, 2001), attached hereto as Exhibit 24. During the call, Nacchio stated that Qwest had approximately \$1.2 billion of “IRUs and some equipment sales” in 2001. *Id.* at 8 (Speaker: Nacchio) . Indeed, the Securities & Exchange Commission stated in its complaint in No. 1:05-cv-00480-MSK-CBS, that “Qwest first disclosed revenue amounts from its one-time equipment sales in a conference with analysts in December 2001.”

Robin Szeliga also specifically discussed the KMC transactions—in detail. *Compare* Deborah Solomon & Steve Liesman, *Deals with KMC Helped Qwest to Improve Its Books*, Wall Street Journal, Feb. 13, 2002, attached hereto as Exhibit 25, at 2 (“[T]he KMC network is being used to serve customers of two leading Internet-service providers, AOL Time Warner Inc.’s America Online and Microsoft Corp.’s MSN.”) *with* Ex. 24 at 7 (Speaker: Szeliga) (Robin Szeliga: “We’ve leased ports primarily from KMC in an effort to build a national footprint to address large ISP customers. We’ve begun putting customers on the [KMC] leased network, primarily MSN and AOL.”). Szeliga also discussed the market’s concerns regarding off balancing sheet financing in light of Enron’s recent collapse. *Compare* Ex. 25 at 1 (characterizing the transaction as potential “off-balance-sheet financing” which has come under “intense investor and regulatory scrutiny in the collapse of Houston’s Enron Corp.”) *with* Ex. 24 at 7-8 (Speaker: Szeliga) (responding to “[q]uestions I’ve been receiving over the last couple of weeks around off balance sheet financing activities,” discussing the financing surrounding the KMC and CalPoint transactions, and stating that “I want to be really clear. There are no other activities of this sort. I don’t have any other off balance sheet financing to talk to you about today. There are none.”).¹¹

¹¹ *See also* Ex. 24 at 8-9 (Speaker: Szeliga) (analyst question from “Jack”: “Robin, just as a follow-up to the off balance sheet stuff that you had—are there any obligations—debt obligations from KMC and/or CalPoint that are recourse to you, so when we look at your totality of the enterprise that—or if the credit agencies, more importantly, do, is there anything from CalPoint or KMC—debt obligations—that are recourse back to you? Thanks. R. Szeliga: In both of those transactions, we have made commitments. When we did those transactions, we estimated our future needs. We set targets, and we committed to 75 percent of those targets. Those, in fact, are out there. They represent \$300 million to \$400 million of annual expense to us and are reflected over a five-year period. ... Jack: So when we look at—you alluded to Enron in another context—but, you know, when we look at debt on your balance sheet, what we

Third, Qwest again disclosed the full extent of its equipment sales revenues for 2001 in its press release and analyst teleconferences for the fourth quarter and full year 2001, which took place on January 29, 2002—more than two weeks before this *WSJ* article. Qwest’s press release explained that it was adjusting how it reported results to separate out “Internet equipment sales,” Press Release, *Qwest Communications Reports Fourth Quarter, Year-End 2001 Results* (Jan. 29, 2002), attached hereto as Exhibit 26, at 2, and also stated that there was a “decline in optical capacity asset sales and certain Internet equipment sales,” which accounted for the fourth quarter decrease in commercial services revenue. *Id.* These reported results of equipment sales revenue included the *KMC* transactions that took place in 2001.¹²

Thus, the market already knew the information in this newspaper article, and its impact on Qwest’s stock price is entirely irrelevant. Thakor’s repeated statement (at 3, 7) that he considered only dates involving the disclosure of “new information” is patently untrue.¹³

see is what we get? There is no off balance sheet stats that recourse back to you? R. Szeliga: Yes, that’s correct—other than the ‘take or pay’—if you let me use that term—commitments on those two and, yes, it is operating—thanks, Joe—it’s operating expense to us, it’s flowing through our numbers, it’s embedded in the numbers that I’ve shown you, and the only other obligations that we have are normal course operating leases that we disclosed in our 10K.”

¹² The Securities & Exchange Commission’s proposed expert witness, Sally Hoffman, states in her report that by January 29, 2002, “Qwest management provided *full disclosure of the impact of upfront revenue generated by IRUs and equipment sales.*” See Expert Report of Sally L. Hoffman (Apr. 30, 2009), attached hereto as Exhibit 27, at 149 (emphasis added); see also *id.* at 145 (In the press release and analyst teleconference of January 29, 2002, Qwest “explain[ed] the amounts and impact [for 2001] of the Optical Capacity and equipment transactions.”); *id.* at 149 (“[I]n its press release and analysts teleconference for the fourth quarter and full year of 2001, Qwest management provided full disclosure of the impact of upfront revenue generated by IRUs and equipment sales.”).

¹³ It is also worth noting that even if equipment sales were relevant to the case, Thakor did not consider the December 13 disclose of Qwest’s equipment sales revenue (identified by the SEC as the date Qwest first disclosed these revenues). And just like his failure to consider the

(5) Qwest's July 29, 2002 Press Release

In July 2002, more than 14 months after Nacchio's last trade, nearly a year after Qwest disclosed its IRU sales for the first and second quarters of 2001, nearly a year after Qwest reduced its year-end guidance for 2001, after Nacchio left the company, and for reasons totally unrelated to whether there were undisclosed "risks" in Qwest's year-end guidance for 2001, new Qwest management told the market that it expected to issue an accounting restatement for financial results from 1999 through 2001. The government's event study pretends that the market's reaction to that disclosure is relevant to the gain calculation here. It is not.

First, the press release had nothing to do with "risks" in Qwest's guidance for year-end 2001. Qwest 8-K (filed July 29, 2002), attached hereto as Exhibit 28, at 2

Second, this was not a case about the proper accounting for IRUs; the government repeatedly told the Court and the jurors so. One of the first things the government said in its opening statement was: "It isn't a case about accounting." Ex. 2 at 6. Throughout trial, the government repeatedly said that it was not raising accounting issues or asking accounting questions. *Supra*. Recognizing as much, *the district court expressly ruled that the accounting restatement was not relevant to the case*. The government once attempted to ask a witness whether Qwest's financial results were ever restated. Ex. 2 at 1056. In response to an objection, the district court stated that "if we get into these accounting issues ... we are going to be here a long time." *Id.* at 1057. The court then refused to permit the questions and found that Qwest's financial results were "restated *for a lot of different reasons having nothing to do with this case.*" *Id.* (emphasis added).

September 10 disclosure, the reason is obvious: Qwest's stock price *increased*, and that is not a convenient fact for the government.

Third, even if accounting issues had any conceivable relevance to this case, there is no evidence whatsoever that Nacchio knew or suspected the accounting to be incorrect at any time during his trades or thereafter. Tellingly, in the SEC proceeding the SEC has alleged accounting fraud *but not against Nacchio*. The SEC has claimed that Qwest’s accounting was flawed for several technical reasons: (1) improper “grooming” of IRU circuits; (2) improper “porting” of IRU circuits; (3) backdated contracts, undisclosed side agreements, and the failure to ensure proper procedures for accounting of IRU transactions; and (4) non-GAAP compliant accounting for “swap” transactions. *See* Defendant’s First Set of Interrogatories to SEC, No. 05-480 (D. Colo.), attached hereto as Exhibit 29, at 27, 30, 32. But the SEC has expressly conceded that its allegations regarding the accounting “do not relate to and are not relevant to any claims by the Commission against Nacchio” and there is no evidence “that Nacchio had knowledge of” any of the alleged flaws in Qwest’s accounting. *See* SEC’s Answers to Interrogatories 1-33, No.05-480 (D. Colo.), attached hereto as Exhibit 30, at 100, 99. Thakor’s inclusion of this data point in an event study for a civil securities case against *Qwest* might be defensible, but it has nothing to do with this criminal case against Nacchio.

The price reaction to the July 29, 2002 announcement that Qwest expected to restate earnings for 1999, 2000, and 2001, due to technical accounting issues nobody has ever alleged Nacchio knew anything about, is irrelevant to the gain calculation.

* * *

This Court should disregard Thakor’s event study in its entirety. The majority of the dates considered are barred by the law of the case and are simply irrelevant. Moreover, Thakor’s event study does not satisfy the standards of Federal Rule of Evidence 702 or *Daubert*, and

should be excluded for that reason as well. Rule 702 states that an expert may offer testimony “in the form of an opinion” if “(1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.” Fed. R. Evid. 702; *see also Daubert*, 509 U.S. at 591 (“Expert testimony which does not relate to any issue in the case is not relevant and, ergo, non-helpful [under Rule 702].”) (citation omitted); *id.* (“An additional consideration under Rule 702—and another aspect of relevancy—is whether expert testimony proffered in the case is sufficiently tied to the facts of the case The consideration has been aptly described ... as one of “fit.””) (citation omitted); *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 141 (1999) (expert testimony does not satisfy Rule 702 if it is not “relevant to the task at hand”) (quoting *Daubert*, 509 U.S. at 597). An event study is an accepted means of determining the impact of information on stock price—but if it analyzes the wrong information, like Thakor’s event study does, it does not sufficiently “fit” the facts of the case and fails to satisfy Rule 702.¹⁴ Thakor’s

¹⁴ *See, e.g., Weiss v. Amkor Tech., Inc.*, 527 F. Supp. 2d 938, 947 (D. Ariz. 2007) (“The stock price drop following the July 26 Release [about other issues] cannot be the proximate result of the stock option misrepresentations and omissions alleged in the SAC.”); *McKowan Lowe & Co. v. Jasmine, Ltd.*, No. Civ.94-5522 RBK, 2005 WL 1541062, at *9-11 (D.N.J. June 30, 2005) (granting summary judgment, in part, because plaintiff’s expert had failed to connect the identified corrective disclosures to the alleged misrepresentations, and holding the corrective disclosures insufficient because they only revealed poor financial performance and not the falsity of prior statements), *aff’d*, 231 Fed. Appx. 216 (3d Cir. 2007); *In re IKON Office Solutions, Inc. Sec. Litig.*, 131 F. Supp. 2d 680, 688-91 (E.D. Pa. 2001) (granting summary judgment on loss causation and rejecting the contention of plaintiffs’ expert that particular company announcements were causally related to the alleged misstatements), *aff’d*, 277 F.3d 658 (3d Cir. 2002); *Garber v. Legg Mason, Inc.*, 537 F. Supp. 2d 597, 607, 617 (S.D.N.Y. 2008) (no corrective disclosure where allegedly concealed facts—the planned departure of a key manager and his clients and increasing customer withdrawals due to broker attrition—were not disclosed by the company’s announcement of client cash outflows), *aff’d*, 2009 WL 3109914 (2d Cir. Sept. 30, 2009); *In re TECO Energy, Inc. Sec. Litig.*, No. 8:04-CV-1948-T-27EAJ, 2006 WL 845161,

gain figure is also implausible on its face. The unanimous panel of the Tenth Circuit held that it was “a close question” whether the information was immaterial as a matter of law. 519 F.3d at 1164. Thakor’s analysis requires the Court to believe that information that was barely material caused a stock price decline of between 46%-65%.

C. Fischel’s Additional Analysis Demonstrates That The \$1.8 Million Figure Is Conservative And The Gain Might Be As Small As Zero

The Tenth Circuit’s opinion acknowledged that although an event study may be an appropriate way to determine “gain” in this case, a simpler approach might be preferable. 573 F.3d at 1079-81 & nn.14, 15. Accordingly, to supplement his event study, Fischel also calculated “the portion of Mr. Nacchio’s sales proceeds, if any, attributable to the use of inside information that take into consideration unrelated negative market and industry developments but do not require the estimation of a regression model or other statistical analysis.” *See* Ex. 3 at 2. Fischel performed these calculations by comparing Qwest’s stock price movement to the movement of the Nasdaq Telecom Index—in order to remove unrelated market and industry developments—following each of “the relevant disclosures,” and over the time period from August 6 through September 20. By removing the unrelated market and industry developments, as the Tenth Circuit instructed, Fischel was able to reasonably approximate the Qwest-specific stock price movement during this period. *See, e.g., In re Williams Sec. Litig. – WCG Subclass*, 558 F.3d at 1133 (comparing rise and decline of WCG’s stock to Telecom Index); *id.* (“WCG’s stock price ... had fallen more than 50% During that time period the Telecom Index declined

at *1, *4-*5 (M.D. Fla. Mar. 30, 2006) (no corrective disclosure where allegedly concealed facts—the abandonment of a business model, increased liabilities and the inability to maintain a dividend—were not disclosed in analyst reports questioning future performance for other reasons).

28%."); *id.* at 1134 (same comparisons); *id.* at 1135 (faulting expert for concluding that the entire WCG stock price decline was caused by fraud “despite the fact that the decline in WCG share price closely correlated with the overall decline in the telecommunications industry as a whole”); *id.* at 1139 (same); *id.* at 1140-41 (noting that WCG stock price decline was not significant in light of the market’s fall that same day); *Lentell*, 396 F.3d 161, 174 (2d Cir. 2005) (when a decline “coincides with a marketwide phenomenon causing comparable losses to [everyone], the prospect that the [decline] was caused by the fraud decreases”).

Fischel’s alternative approach is consistent with settled law and particularly appropriate in this case. The Tenth Circuit and courts across the country have explained that in 2001 the telecommunications industry underwent “an industry meltdown of historic proportions” and that because of the “industry-wide debacle,” “the value of publicly traded securities throughout the telecommunications sector” was “largely obliterated.” *In re Williams Sec. Litig.*, 496 F. Supp. 2d 1195, 1201, 1264 (N.D. Okla. 2007), *aff’d*, 558 F.3d 1130, 1143 (10th Cir.) (discussing “the total meltdown of the telecommunications industry”), *subsequent appeal*, 558 F.3d 1144, 1146 (10th Cir. 2009) (noting “the Telecommunications Index ... major downturn” that rendered the stock of one of Qwest’s competitors “practically worthless”).¹⁵ The government’s witnesses at trial

¹⁵ See also *Oscar Private Equity Invs.*, 487 F.3d at 263 (“Allegiance’s stock, like that of the rest of the telecom industry, was plunging ...”); *Chabria v. EDO W. Corp.*, No. 2:06-CV-00543, 2009 WL 891746, at *5 (S.D. Ohio Mar. 30, 2009) (noting “the unforeseen downturn in the telecommunications market”); *Schleicher v. Wendt*, No. 1:02-CV-1332-DFH-TAB, 2009 WL 761157, at *11 (S.D. Ind. Mar. 20, 2009) (“market-wide decline in the value of telecom stocks”); *In re XO Commc’s, Inc.*, 398 B.R. 106, 109 (Bankr. S.D.N.Y. 2008) (“[T]he telecommunications industry was in a downward spiral.”); *SEC v. Dunn*, 587 F. Supp. 2d 486, 493 (S.D.N.Y. 2008) (“an overall downturn in the telecommunications sector”); *In re Redback Networks, Inc. Sec. Litig.*, No. C 03-5642 JF (HRL), 2007 WL 4259464, at *5 (N.D. Cal. Dec. 4, 2007) (“the general decline the telecommunications industry”), *aff’d*, 329 Fed. Appx. 715 (9th Cir. 2009); *In re*

further testified that the stocks of telecom companies were plummeting for reasons unrelated to IRUs and revenue projections. Ex. 2 at 2312 (Tr. Vol. 18, Docket No. 342) (“Q. Now, the telecom industry was having a hard time in the year 2001, correct? A. Yes. Q. And many companies’ stocks plummeted during that year, telecom stocks, correct? A. Yes. Q. Many companies that had nothing to do with IRUs, correct? A. Yes.”); *id.* at 2247-49 (government analyst Johnstone testifying that “Qwest’s stock did go down [in 2001] as did the other [telecom] stocks.”).

WorldCom, Inc., 377 B.R. 77, 88 (Bankr. S.D.N.Y. 2007) (“[T]he entire telecommunications industry faced a steep decline in their collective share prices.”); *Todd v. Alcatel USA Res., Inc.*, 565 F. Supp. 2d 745, 747 (E.D. Tex. 2007) (“a downturn in the telecommunications industry”); *Adams v. Lucent Tech.*, No. 2:03CV300, 2007 WL 14593, at *2 (S.D. Ohio Jan. 3, 2007) (as of May 2001, “the telecom industry continued its downturn”); *RSL Commc’ns PLC v. Bildirici*, No. 04-CV-4517 (KMK), 2006 WL 2689869, at *8 (S.D.N.Y. Sept. 14, 2006) (describing the “particularly precarious time in the telecommunications industry”); *In re Global Crossing, Ltd. Sec. Litig.*, 471 F. Supp. 2d 338, 349 (S.D.N.Y. 2006) (“a downturn in the telecommunications sector”); *In re Redback Networks, Inc.*, No. C03-5642 JF (HRL), 2006 WL 1805579, at *3 (N.D. Cal. Mar. 20, 2006) (“Redback’s stock price began to decline, along with the stock of other telecommunications and Internet companies.”); *In re Acterna Corp. Sec. Litig.*, 378 F. Supp. 2d 561, 588 (D. Md. 2005) (“[T]he global communications industry experienced a severe economic slowdown . . .”); *In re XO Commc’ns, Inc.*, 330 B.R. 394, 401 (Bankr. S.D.N.Y. 2005) (“XO, like other firms in the telecommunications business, encountered severe financial difficulties in 2001. Market valuations of telecommunications firms declined significantly.”); *In re Tellium, Inc. Sec. Litig.*, No. Civ.A.02CV5878FLW, 2005 WL 2090254, at *4 (D.N.J. Aug. 26, 2005) (“decline in stock prices in general and the telecommunications sector in particular”) (citation omitted); *In re Tellium, Inc. Sec. Litig.*, No. Civ.A.02CV5878FLW, 2005 WL 1677467, at *27 (D.N.J. June 30, 2005) (“uncommonly severe decline in stock prices across all sectors of the U.S. economy and in the telecommunications sector in particular”) (citation omitted); *In re Asia Global Crossing, Ltd.*, 326 B.R. 240, 246 (Bankr. S.D.N.Y. 2005) (“severe downturn in the telecommunications industry”); *In re Alcatel Sec. Litig.*, 382 F. Supp. 2d 513, 520-21 (S.D.N.Y. 2005) (“rapid decline” and “downward trend in the telecommunications industry”); *In re WorldCom, Inc. Sec. Litig.*, 346 F. Supp. 2d 628, 680 (S.D.N.Y. 2004) (“[T]he telecommunications sector was in decline”); *In re Corning Sec. Litig.*, No. 01-CV-6580-CJS, 2004 WL 1056063, at *19, *32 (W.D.N.Y. Apr. 9, 2004) (noting “industry-wide problem[s]” and explaining that “the downturn in the telecommunications market [in 2001] was more severe than analysts had predicted at the end of 2000”); *Stavros v. Exelon Corp.*, 266 F. Supp. 2d 833, 837 n.2 (N.D. Ill. 2003) (“the decline of the telecommunications market”).

The Tenth Circuit and other courts have recognized that a proper way to exclude market factors is to compare the decline in the company's stock price with the decline in a relevant market index. In *In re Williams Securities Litigation*, for example, in faulting an expert witness for failing to exclude "the total meltdown in the telecommunications industry" from his opinion about the cause of the decline in WCG's stock price, 558 F. 3d at 1143, the Tenth Circuit consistently compared the decline of WCG's stock to the decline of the Nasdaq Telecom Index. *E.g., id.* at 1133 (comparing rise and decline of WCG's stock to Nasdaq Telecom Index); *id.* ("WCG's stock price ... had fallen more than 50% During that same period the Telecom Index declined 28%."); *id.* at 1134 (same comparisons); *id.* at 1135 (faulting expert for concluding that the entire WCG stock price decline was caused by fraud "despite the fact that the decline in WCG share price closely correlated with the overall decline in the telecommunications industry as a whole"); *id.* at 1139 (same); *id.* at 1140-41 (noting that WCG stock price decline was not significant in light of the market's fall that same day).

Other courts have conducted similar comparisons. *E.g., Gordon Partners v. Blumenthal*, No. 02 Civ. 7377(LAK)(AJP), 2007 WL 431864, at *7, *13 (S.D.N.Y. Feb. 9, 2007) (comparing decline in stock to overall decline in "[a] Bloomberg index of telecommunications stocks" in order to "eliminat[e] ... that portion of the price decline that is the result of forces unrelated to the wrong") (citation omitted); *In re Acterna Corp. Sec. Litig.*, 378 F. Supp. 2d 561, 588-89 (D. Md. 2005) (explaining that "[t]his decline, however, was not unique to Acterna, as evidenced by the near 50% drop in the Dow Jones U.S. Telecommunications Index during the Class Period," and finding that the decline in Acterna stock was not attributable to corrective disclosures "but rather a continuation of the rapid decline that began due to the economic slowdown commencing

in 2001”); *In re Sawtek Inc. Sec. Litig.*, No. 603CV2940RL31DAB, 2005 WL 2465041, at *13 (M.D. Fla. Oct. 6, 2005) (“Further, as is obvious to anyone familiar with recent history, America’s economy underwent a recession and the U.S. stock market suffered a substantial decline during the same time frame.”); *id.* at *13 n.5 (“During 2001, the broad U.S. stock market declined 11.46 percent, as measured by the Russell 3,000 Index. The U.S. telecommunications sector fared even worse, falling 18.66 percent as measured by Barclay’s U.S. Telecommunications Index (symbol ‘IYX’). In the first quarter of 2001 alone, the share price for Sawtek’s largest customer, Motorola, fell approximately 25 percent.”); *JP Morgan Chase Bank v. Winnick*, 350 F. Supp. 2d 393, 411 (S.D.N.Y. 2004) (comparing percentage decline in Global Crossing stock price with “a similar decline in stock prices in the telecommunications industry in general”); *In re Merrill Lynch & Co. Research Reports Sec. Litig.*, 272 F. Supp. 2d 243, 254 (S.D.N.Y. 2003) (“Prior to April 8, the Fund’s net asset value per share had declined approximately 76.5% (This decline is an amount proportional to the decline in the entire technology sector. For example, the Dow Jones World Technology Index declined during the same period, by -69.3%.)”); *see also Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc.*, 343 F.3d 189, 197 (2d Cir. 2003) (“[I]f the loss was caused by an intervening event, like a general fall in the price of Internet stocks, the chain of causation will not have been established.”); *Lentell*, 396 F.3d at 174 (2d Cir. 2005) (when a decline “coincides with a marketwide phenomenon causing comparable losses to [everyone], the prospect that the [decline] was caused by the fraud decreases”) (citation omitted).¹⁶

¹⁶ *See also D.E. & J. L.P. v. Conaway*, 284 F. Supp. 2d 719, 749 n.26 (E.D. Mich. 2003) (explaining that although the price of Kmart stock had declined 87% during the relevant period,

Fischel compared the movements in Qwest stock to broader market baselines in two different ways. Each calculation produced the same result: zero gain. These calculations show that Fischel's event study produced a conservative gain figure, and the gain could be as small as zero.

First, Fischel calculated the impact of the disclosures where Qwest disclosed information about IRUs or lowered its guidance—August 7, 2001, August 14, 2001, and September 10, 2001—by determining the change in dollar value of Qwest stock. Fischel also considered August 22, 2001, the date of a negative analyst report regarding Qwest's IRU revenues. Consistent with his event study (and Thakor's event study) Fischel performed his calculations over one- and two-day windows. He also extended the window and performed the calculations in three- and four-day windows. The results show that following these disclosures (over the course of one, two, three, and four-day windows), the price of Qwest stock *increased* in value relative to the Nasdaq Telecom Index. Ex. 3 at 3-4 ¶¶5-7. Thus, this calculation shows that there was no "illicit, artificially high value" to Qwest stock as a result of the disclosure of the "inside information."¹⁷

Because the Tenth Circuit approvingly cited the Second Circuit's decision in *Patel*, 61 F.3d at 139, which calculated the gain based on *percentage* changes in stock price, rather than absolute dollar amounts, Fischel also performed the above calculation by measuring the

the court was taking judicial notice of the fact that "the stock market, in general, was in a period of decline during this period"), *aff'd*, 133 Fed. Appx. 994 (6th Cir. 2005); *Keithley Instruments, Inc. Sec. Litig.*, 268 F. Supp. 2d 887, 896 & n.6 (N.D. Ohio 2002) (taking judicial notice in a motion to dismiss of the stock prices of the defendant's primary competitor, the NASDAQ composite, and the Dow Jones Semiconductor Index over the period in question).

¹⁷ The result is the same when July 24 is also included in the analysis.

cumulative percentage difference on the dates of those four disclosures. The result was the same: Qwest increased 9.52% in value relative to the Nasdaq Telecom Index. Ex. 3 at 3 n.6.

Second, instead of determining the change in the price of Qwest stock following each of the four disclosures, Fischel calculated the cumulative dollar difference over the relevant disclosure period, from August 6, 2001, the day before the first IRU disclosure, through all market days from September 10, 2001 (the date of the last relevant disclosure) to September 20, 2001 (a date several trading days after the last relevant disclosure by which time the information disclosed was reflected in Qwest’s stock price). Ex. 3 at 4 ¶8.

This calculation also shows that “Qwest stock performed better than the Nasdaq Telecom Index during each date range. For example, during the period from August 6, 2001 to September 10, 2001, Qwest’s stock price increased by \$1.34 relative to the Nasdaq Telecom Index.” *Id.* In other words, during the time the “inside information” was disclosed—which, under the government’s theory would “detrimentally impact[] the value of Qwest stock,” Qwest stock *outperformed* the telecom industry. *Nacchio III*, 573 F.3d at 1076. This calculation, likewise results in a “gain” of *zero*.

Fischel also calculated the cumulative percentage difference over the course of the relevant period. Ex. 3 at 2-3. The result is the same. For example, from August 6, 2001 to September 10, 2001, Qwest’s cumulative daily return exceeded the cumulative daily return of the Nasdaq Telecom Index by 7.36%. Ex. 4 at 4 n.8.

* * *

Fischel’s event study demonstrates that the maximum gain is \$1.8 million, and his supplemental analysis shows that to be a conservative estimate and the gain might be as small as

zero. On the other hand, Thakor's selection of disclosure dates—both individually and collectively—is fatally misguided and his gain calculation is utterly unreliable and wrong. This Court should disregard Thakor's analysis, and the government's gain calculation, completely.

If this Court were to find that the gain was \$1.8 million, the offense level would be 22, with a guidelines range of 41-51 months. If this Court determines that the gain is zero, the total offense level is 10, with a guidelines range of 6-12 months.

II. FORFEITURE

This Court's Order Regarding Re-Sentencing stated that it would address the amount of forfeiture in Phase I.

On appeal, the Tenth Circuit agreed with Nacchio that the forfeiture amount in this case is governed by 18 U.S.C. §981(a)(2)(B), which states that the forfeiture is the “amount of money acquired through the illegal transactions ... less the direct costs incurred.” Pursuant to the stipulation jointly filed by the parties today, Nacchio and the United States have agreed that the statute authorizes a forfeiture of \$44,632,464.38—except to the extent that amount would be constitutionally excessive. Thus, the parties' stipulation does not foreclose Nacchio's Eighth Amendment argument—that the forfeiture and fine, even if authorized by statute, must be reduced to avoid violating the Eighth Amendment's prohibition on excessive fines—which he makes below.

III. THE FINE UNDER U.S.S.G. §5E1.2

This Court's Order Regarding Re-Sentencing found that the Tenth Circuit did not reverse the fine, and that the Court would not consider the fine in Phase I, unless there was an exception to the mandate rule. Other arguments with respect to the fine will be considered in Phase II.

Order at 8. Nacchio respectfully seeks reconsideration of the Court’s ruling on this issue, objects for purposes of appeal to the Court’s ruling that the Tenth Circuit did not reverse the fine, and states briefly why he believes the Court’s ruling is in error. Even if the Tenth Circuit did not reverse the fine, this Court has explained that in Phase I it will consider “arguments with regard to the fine,” subject to the mandate rule. Order at 8. Such an exception exists here, and it is proper for this Court to consider the fine in Phase I. According to this Court’s instructions, Nacchio will address other factors relevant to the fine in Phase II briefing.

A. Nacchio Respectfully Requests That This Court Reconsider Its Decision That The Tenth Circuit Did Not Reverse The Fine

This Court held that (1) “the fine was not reversed by the Circuit,” and (2) “the calculation of the amount of the fine was not based upon the erroneous calculation of gain,” because “the amount was set in accordance with the statutory provisions of 15 U.S.C. §78ff in order to satisfy the sentencing objectives of 18 U.S.C. §3553(a).” Order at 8 n.10. Nacchio respectfully submits that both holdings are incorrect, and that this Court should reconsider its decision and set the fine guidelines range in Phase I.

First, the Tenth Circuit’s opinion stated that it was “revers[ing] the district court’s *sentencing order* with respect to its gain calculation.” *Nacchio III*, 573 F.3d at 1090 (emphasis added). The “sentencing order,” the Tenth Circuit reversed expressly included both the term of imprisonment and the fine as two elements of the “sentence” imposed in the same paragraph in the order. *See* Memorandum of Sentencing Hearing ¶17 (Docket No. 459). This Court’s Order did not address this operative language in the Tenth Circuit’s opinion. Nacchio respectfully submits that the plain language of the Tenth Circuit’s opinion reversed the fine.

Second, there is no dispute that the offense level and advisory guidelines range for purposes of the fine was incorrectly determined. That is, therefore, procedural error, and is reversible unless the error is harmless. As the Tenth Circuit has held, “[w]hen a district court does err in calculating the applicable Guidelines range, we must remand for resentencing, whether or not the district court’s chosen sentence is substantively reasonable, unless we are able to ascertain that the court’s calculation error was harmless.” *United States v. Todd*, 515 F.3d 1128, 1135 (10th Cir. 2008). The government *could have* argued on appeal that the guidelines error was harmless in light of Judge Nottingham’s decision to impose the maximum fine, *but it did not do so*. By concluding that the above-guidelines fine was imposed “in accordance with the statut[e],” Order at 8 n.10—which is true for every above-guidelines sentence—and therefore “not based upon the erroneous calculation of gain,” this Court has belatedly conducted the harmless error analysis that the government failed to request from the Tenth Circuit, and hence forfeited.¹⁸ Moreover, the fine was in part “based upon the erroneous calculation of gain,” because one of the factors a district court is required to consider before imposing the fine is “the gain to the defendant.” U.S.S.G. §5E1.2(d)(1) (2000). Judge Nottingham therefore considered what he believed “the gain to the defendant” was, which, the Tenth Circuit has held, was wrong. Judge Nottingham’s discretionary decision to impose the statutory maximum was, therefore,

¹⁸ For example, suppose a statute provides for a maximum sentence of five years imprisonment, and the court calculates the guidelines range to be 27-33 months. A sentence of five years is imposed “in accordance with the statut[e]” (just as a sentence of 34 months, 30 months, 20 months, probation, or indeed, any sentence is), but if an appellate court determines that the guidelines range is in fact 18-24 months, the district court has committed procedural error and the sentence imposed will be reversed—unless *the appellate court* determines that the procedural error was harmless. This is no less true simply because the court imposed the statutory maximum. The legal error exists in all cases, and it is *the government’s burden* to establish that the legal error is harmless on the facts of any specific case.

infected by a misunderstanding of the law and should be revisited under a correct understanding. *See Koon v. United States*, 518 U.S. 81, 100 (1996) (explaining that “[t]he abuse-of-discretion standard includes review to determine that the discretion was not guided by erroneous legal conclusions”).

Accordingly, Nacchio respectfully submits that the Tenth Circuit did reverse the fine, and therefore this Court must reconsider the fine in Phase I, and set the fine guidelines range.

B. An Exception To The Mandate Rule Is Met Here And The Court Should Consider The Fine In Phase I

This Court explained that an exception to the mandate rule exists where “a blatant error in the prior sentencing decision would result in serious injustice if not corrected.” Order at 4. Nacchio submits that the district court’s original decision with respect to the fine was “a blatant error that would result in serious injustice if not corrected” for two reasons.

First, as explained above, in setting the fine, Judge Nottingham relied on an erroneous understanding of the “gain resulting from the offense.” The Tenth Circuit held that Judge Nottingham’s calculation punished Nacchio for gyrations in Qwest’s stock price having absolutely nothing to do with “the offense.” By relying on that understanding of the gain, the court made a blatant error that results in serious injustice if not corrected—it punishes Nacchio for stock price movements having nothing to do with his criminal conduct. Being punished for something he is not responsible for is certainly a “serious injustice.”

Second, as explained *infra*, the \$19 million fine imposed by Judge Nottingham is blatantly erroneous as a matter of reasonableness review, and also raises grave constitutional concerns.

Under U.S.S.G. §5E1.2 (2000) (“Fines for Individual Defendants”), the guidelines range for a gain of \$1.8 million (and an offense level of 22) produces a fine range of \$7,500 - \$75,000. (For an offense level of 10, the range is \$2,000 - \$20,000.) Even the maximum guidelines fine for an offense level of 38 and above—to which Nacchio is not even close—is \$250,000. In this case, however, the statutory maximum fine is \$1 million per count and thus—pursuant to §5E1.2(c)(4)—the maximum fine permitted by statute is \$19 million.

In determining the fine, the court is required to consider eight factors, including “the need for the combined sentence [*i.e.*, the term of imprisonment and the fine] to reflect the seriousness of the offense (including the harm or loss to the victim and the gain to the defendant), to promote respect for the law, to provide just punishment and to afford adequate deterrence.” *See* U.S.S.G. §5E1.2(d) (2000). The Commentary explains that the guideline ranges are designed so that “for most defendants, the maximum of the guideline fine range ... will be at least twice the amount of gain ... resulting from the offense.” U.S.S.G. §5E1.2 commentary note 4 (2000). Because the gain is no more than \$1.8 million, pursuant to the guidelines, the fine should not exceed \$3.6 million.

Indeed, although the statutory maximum may be \$19 million, courts consider any fine imposed above the guidelines range to be an upward variance that, like an upward variance from a range of imprisonment, must be adequately justified by the court. In *United States v. Rinaldi*, for example, the Seventh Circuit “review[ed] the district court’s decision to impose the statutory maximum [fine] for unreasonableness. As with all sentences outside of the suggested Guidelines range, we look to see if the district court has given us an adequate explanation for its divergence.” 461 F.3d 922, 931 (7th Cir. 2006) (citations omitted). In that case, the district

court had imposed a fine that was “more than twelve times the Guidelines suggestion,” and the Seventh Circuit stated that “the district court’s reasons must be particularly compelling.” *Id.*

The Tenth Circuit similarly treats any fine greater than the suggested guidelines range as a variance assessed for reasonableness. *See United States v. Greene*, 239 Fed. Appx. 431, 448 (10th Cir. 2007); *see also United States v. Sharma*, 85 F.3d 363, 365 n.1 (8th Cir. 1996) (“reject[ing] the argument” that a fine imposed pursuant to “alternative maximum fine” provisions under §5E1.2, is “not a departure” and concluding that “such a deviation remains a departure, and as such must be justified”).

The \$19 million fine is more than *150 times* even the incorrect guidelines range from the prior sentencing. It is more than *250 times* the top of the correct guidelines range with a gain of \$1.8 million. And it is even more than *75 times* the top of the maximum guidelines fine for the highest sentencing range under the guidelines. There are no extraordinary facts here that would justify such an upward variance. Leaving the fine in place would endorse an obvious and blatant error that would fail reasonableness review.

For similar reasons, the error is one of constitutional proportions. The Excessive Fines Clause of the Eighth Amendment applies, and for the reasons stated below, the \$19 million fine would violate the Constitution.

For these reasons, an exception to the mandate rule exists, and the Court should consider the fine in Phase I, and set the fine guidelines range at \$20,000 - \$75,000, with the fine amount to be determined in Phase II.

C. A Combined Fine And Forfeiture Exceeding Nacchio’s “Gain Resulting From The Offense” By A Ratio Of 2:1 Would Violate The Eighth Amendment

The Eighth Amendment provides: “Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted.” U.S. Const. amend. VIII. “[T]he word “fine” was understood to mean a payment to a sovereign as punishment for some offense.” *United States v. Bajakajian*, 524 U.S. 321, 327 (1998) (citation omitted) (finding Eighth Amendment violation). “The Excessive Fines Clause thus ‘limits the government’s power to extract payments, whether in cash or in kind, “as punishment for some offense.”’” *Id.* at 328 (citation omitted). Both Nacchio’s fine and forfeiture are subject to the Excessive Fines Clause.

The Supreme Court has explained that “[t]he touchstone of the constitutional inquiry under the Excessive Fines Clause is the principle of proportionality: The amount of the forfeiture [or fine] must bear some relationship to the gravity of the offense that it is designed to punish.” *Id.* at 334. “[A] punitive forfeiture violates the Excessive Fines Clause if it is grossly disproportional to the gravity of a defendant’s offense.” *Id.*; *Alexander v. United States*, 509 U.S. 544, 558-59 (1993) (remanding on whether combined fine/forfeiture was excessive). That a fine or forfeiture is statutorily permissible “cannot override the constitutional requirement of proportionality review,” 524 U.S. at 339 n.14, and a fine and forfeiture “many orders of magnitude” greater than Nacchio’s gain—which was, at most, \$1.8 million—would violate the Eighth Amendment, *id.* at 339-40.

The Supreme Court has recognized the analytical similarities between its “grossly disproportional” inquiry under the Eighth Amendment and its inquiry into whether punitive damages are “grossly excessive” under the Due Process Clause. *See Cooper Industrs., Inc. v.*

Leatherman Tool Group, Inc., 532 U.S. 424, 433-35 (2001). Indeed, “[t]he points of similarity are obvious.” *Exxon Shipping Co. v. Baker*, 128 S. Ct. 2605, 2628 (2008). “[P]unitive damages advance the interests of punishment and deterrence, which are also among the interests advanced by the criminal law.” *Id.* (quoting *Browning-Ferris Indus. v. Kelco Disposal, Inc.*, 492 U.S. 257, 275 (1989) (alteration in original) and citing Restatement §908 cmt. a, at 464 (1977) (purposes of punitive damages are “the same” as “that of a fine imposed after a conviction of a crime”)). In *Cooper*, for example, the Court noted that “the relevant constitutional line is ‘inherently imprecise,’ *Bajakajian*, 524 U.S. at 336, rather than one ‘marked by a simple mathematical formula,’ *Gore*, 517 U.S. at 582. But in deciding whether that line has been crossed, we have focused on the same general criteria: the degree of the defendant’s reprehensibility or culpability; the relationship between the penalty and the harm to the victim caused by the defendant’s actions; and the sanctions imposed in other cases for comparable misconduct.” 532 U.S. at 434-35 (citations omitted).

In punitive damage cases, the Court has cited a 4-to-1 punitive to compensatory damages ratio as the presumptive *maximum*, unless “compensatory damages are substantial,” in which case “a lesser ratio” of punitive to compensatory damages, “perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee.” *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 425 (2003); *see also Exxon Shipping Co. v. Baker*, 128 S. Ct. 2605 (2008) (enforcing 1:1 ratio maximum as a matter of admiralty law). And even at the outer edges for unusually reprehensible conduct, resulting in physical injury or death, “few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process.” *Id.*

Any combined fine and forfeiture exceeding a 2:1 ratio to the \$1.8 million gain here would violate the Eighth Amendment

First, as explained above, the seriousness of the offense and Nacchio's gain does not justify a large fine or forfeiture. Nacchio's gain was, at most, \$1.8 million. The forfeiture authorized by statute (\$44.6 million) on these facts is constitutionally excessive—it alone is nearly *25 times* Nacchio's gain from the offense. Any fine would only exacerbate the constitutional violation. And this is not the rare and extreme case meriting financial punishment on a scale vastly exceeding the actual economic harm. The ordinary presumptive maximum 4:1 ratio would suggest a combined fine and forfeiture of at most \$9 million (\$1.8 million in forfeiture, the analog of compensatory damages, and four times that in additional punishment). Even a 9:1 ratio, which the Supreme Court has said can be exceeded only in the most rare and unusually reprehensible circumstances, would suggest at most an \$18 million combined fine and forfeiture.

Second, the sanctions imposed in other comparable cases demonstrate that a fine or forfeiture exceeding Nacchio's gain by a ratio greater than 2-to-1 would be constitutionally excessive. "Excessive means surpassing the usual, the proper, or a normal measure of proportion." *Bajakajian*, 524 U.S. at 335. Of the 137 defendants sentenced for insider trading from October 1, 1998 to September 30, 2008, only 4 cases involved defendants with a fine that exceeded the "gain" amount by a ratio greater than 2-to-1 (and two of those cases involved defendants where the "gain" was zero). *See* Declaration of Herbert J. Hoelter, attached hereto as Exhibit 31. *Each* of those four cases where the fine was more than double the "gain," involved defendants who received a sentence of no more than 1-5 months imprisonment, combined with a

short term of home confinement or community service, and thus included a greater fine likely to ensure that the combined sentence under the guidelines was punitive. *See* U.S.S.G. §5E1.2 (2000) (“The amount of the fine should always be sufficient to ensure that the fine, taken together with other sanctions imposed, is punitive.”).

In sum, a fine and/or forfeiture exceeding Nacchio’s gain of \$1.8 million by a ratio greater than 2-to-1 would violate the Eighth Amendment.

Respectfully submitted this 12th day of January, 2010.

s/ Sean M. Berkowitz

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CERTIFICATE OF SERVICE

I hereby certify that on this 12th day of January 2010, I electronically filed the foregoing **JOSEPH P. NACCHIO SENTENCING STATEMENT** 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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