IN THE UNITED STATES DISTRICT COURT
DISTRICT OF COLORADO

Criminal Case No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

v.

JOSEPH P. NACCHIO,

Defendant.

UNITED STATES' RESPONSE TO DEFENDANT'S TRIAL BRIEF

The United States, by its undersigned counsel, respectfully responds to Defendant Joseph P. Nacchio's Trial Brief filed on March 9, 2007 [hereinafter "Def. Tr. Br."], pursuant to the Court's permission at the March 9, 2007 conference. A table of contents is provided on the following page.

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I. THE COURT SHOULD NOT BAR REFERENCE TO THE GROWTH SHARE INSTRUCTIONS IN OPENING.

The government intends to prove that the sales charged in Counts One and Two of the indictment were directed by Defendant though a backdated "irrevocable instruction" to sell. Defendant has not filed a motion in limine addressing this evidence, but apparently seeks to have his Trial Brief treated as such a motion so the Court will exclude such evidence. *See* Def. Tr. Br. at 1-2.

On January 31, 2007, the government expressly notified defense counsel that this evidence is *not* Rule 404(b) evidence. The government explained that "we fully intend to open on what we have entitled 'Backdating of 'Irrevocable Instructions.' Our view is that the evidence we will offer about the backdating of these instructions is intrinsic to the insider trading changes contained in the indictment." *See* Exhibit 1 (January 31, 2007 letter). That evidence is addressed below.

A. Defendant used the backdated instruction to direct the sales charged in Counts One and Two.

The sales charged in Counts One and Two related to Defendant's sales of restricted stock deriving from growth shares he had been issued by Qwest. Defendant Nacchio sold these shares almost immediately upon receipt. These shares were ones Qwest had determined to grant to him years back, although nothing in that grant required Defendant to turn around and sell them immediately upon receipt. *See* Def. Mot. to Exc.,

Ex. A (letter to Defendant granting growth shares). Indeed, on prior occasions Defendant had elected not to sell.

The sales were completed on January 2 and 3, 2001. This was during a closed trading window at Qwest – *i.e.*, a period during which corporate insiders ordinarily could not sell.

Defendant Nacchio sold these shares by signing an "Irrevocable Instruction" document that was dated November 3, 2000. (That document is attached as Exhibit 2.) Defendant's clear purpose for signing this "Irrevocable Instruction" was to insulate himself from charges of insider trading. He states in the Irrevocable Instruction, "It is my intent to require the sales to be made in accordance with the provisions of Rule 10b5-1." *See* Ex. 2. As the Court is aware, SEC Rule 10b5-1 enables corporate insiders to avoid charges of insider trading by entering into a pre-set trading plans in which an insider must, before becoming aware of material nonpublic information and in good faith, adopt a firm plan for trading securities that meets certain criteria. Here, Defendant Nacchio indicated that his plan to sell was "irrevocable" and could not be abandoned, stating, "Please note that these instructions are final and cannot be revoked by the undersigned." *See* Ex. 2.

As noted, the Irrevocable Instruction is dated November 3, 2000. Defendant Nacchio certified in the document that he had no material information as of that date,

attesting that "In accordance with the Company's insider trading policy, the undersigned certifies that, *as of the date hereof,* he has no material non-public information and is not otherwise prohibited from trading in the Company's securities." *See* Ex. 2 (emphasis added).

The government intends to show that this Irrevocable Instruction was *not* signed on November 3, 2000, but was instead signed by Defendant more than a month later, in mid-December 2000. The November 3, 2000 date is significant. It is a date within the last open trading window, a window that had been open during a brief period from October 30, 2000 through November 17, 2000. After November 3, Defendant Nacchio received very material adverse nonpublic information about Qwest's future prospects – *i.e.*, information upon which he could not have traded. The government thus will show that the "irrevocable instruction" for the sales at issue in Counts One and Two was actually signed in mid-December, but had been conveniently backdated to November 3, 2000.

There is a variety of evidence that shows this backdating. For example, it includes a December 9, 2000 telephone call between Defendant Nacchio and his financial adviser, David Weinstein, in which Defendant told Mr. Weinstein that he was "signing an irrevocable election to sell the shares now and that is why he can sell the shares during a nonwindow period." *See* Def. Mot. to Exc. at 11 n.4. It includes the statements of

Gregory Patti, an O'Melveny & Myers attorney representing Qwest, who sent Yash Rana (the corporate counsel at Qwest who effected the sale for Defendant) a draft 10b5-1 attestation for the instruction on December 10, 2000. *See* Def. Mot. to Exc., Ex. E at 4. It also includes information from the hard drive of Yash Rana, which shows that the draft 10b5-1 attestation was not received from Mr. Patti until December 10, 2000, was entitled *nacchio.doc*, and was transformed into *IrrevocableInstructions.doc* on December 13, 2000 — a document that is *identical* to the document signed by Defendant Nacchio dated November 3, 2000 – except that the latter bears Defendant Nacchio's signature.

This evidence of the backdated instruction is central to the offense charged in Counts One and Two. Through this instruction, Defendant directed the sales charged in those counts. The date on the instruction — November 3, 2000 — is shown on the document itself. *See* Ex. 2. And that date is not some irrelevant detail. Rather, as noted, the government intends to show that key adverse nonpublic information came to Defendant's attention *after* November 3, that Defendant did not issue the written instruction until *after* he had been informed of the adverse information, and that the backdating was designed to cover up the fact that his instruction was not issued until mid-December 2000.

B. This evidence is intrinsic to Counts One and Two.

The Tenth Circuit has held that other act evidence is intrinsic to the crime charged

when any one of three criteria are met: (1) when "both acts are part of a single criminal episode"; (2) when "the evidence of the other act and the evidence of the crime charged are inextricably intertwined"; or (3) when the other acts are "necessary preliminaries to the crime charged." *United States v. Nichols*, 374 F.3d 959, 966 (10th Cir. 2004), *vacated by* 543 U.S. 1113 (2005), *reinstated by* 410 F.3d 1186 (10th Cir. 2005).[1] The government previously explained in its Trial Brief that the evidence regarding the backdated instruction meets not just one, but all three of these criteria.

Defendant contends that the government "appears to rely on *United States v. Nichols*, 374 F.3d 959, 966 (10th Cir. 2004), *vacated by* 543 U.S. 1113 (2005), *reinstated by* 410 F.3d 1186 (10th Cir. 2005)" and *United States v. Johnson*, 42 F.3d 1312, 1316 (10th Cir. 1994) . *See* Def. Tr. Br. at 6. Defendant contends that those cases are distinguishable because they were drug conspiracy cases. *See id.*

This argument lacks merit. As an initial matter, the fact that those two cases are drug cases as opposed to insider trading cases does not make the three-part standard that they set forth inapplicable. Nothing in those cases suggest that the definition of intrinsic evidence is limited to drug conspiracy cases.

More importantly, Defendant fails to acknowledge that the government also relied on ten other Tenth Circuit decisions. Defendant makes no attempt to distinguish those

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[1] Defendant's brief misstates the test from *Nichols* by omitting any reference to the third criterion. *See* Def. Tr. Br. at 5 (referring to only "two exceptions").

decisions. Rather, Defendant simply ignores those decisions and the analysis in the government's trial brief.

To briefly recap that brief, the Tenth Circuit has indicated that evidence is intrinsic if it relates to the "preliminary planning" or "structure" of the offense. *See United States v. Lowe*, No. 93-5241, 1994 WL 237502, at *1 (10th Cir. June 3, 1994) (ruling that prior statements were intrinsic to a robbery where they related "to the *motive for and structure of this crime*") (emphasis added); *United States v. Lambert*, 995 F.2d 1006, 1008 (10th Cir. 1993) (holding that conversations in the "preliminary planning" of a robbery were intrinsic).

The Tenth Circuit has indicated that evidence about the documents connected to the offense is also intrinsic. *See, e.g., United States v. Arney*, 248 F.3d 984, 992 (10th Cir. 2001) (where a defendant made misrepresentations to banks to get loans for his cattle operations, evidence of later inaccurate cattle inventory reports was properly admitted as intrinsic); *United States v. O'Brien*, 131 F.3d 1428, 1432 (10th Cir. 1997) (holding that where the defendants were charged with illegal gambling, evidence of a ledger detailing the accounts of the gambling operation was "intertwined" with the crime and thus "intrinsic" even though the ledger included unrelated events and events outside the time period charged); *United States v. Oles*, 994 F.2d 1519, 1522 (10th Cir. 1993) (ruling that evidence of transfers with banks not listed in the indictment was "intrinsic" because the

transfers were related to the overall check kiting scheme).

The Tenth Circuit has further indicated that other "necessary preliminaries" are intrinsic, such as evidence that provides important background on the "beginning stages" of the criminal episode or is otherwise "necessary to understand the flow of events." *See United States v. Armour*, 112 Fed. Appx. 678, 679-81 (10th Cir. 2004) (unpublished) (ruling that an investigator's prior meetings with the defendant were intrinsic where the meetings showed why the investigator recognized the defendant); *United States v. Collins*, 97 Fed. Appx. 818, 824-25 (10th Cir. 2004) (unpublished) (holding that evidence of prior drug dealing activities that preceded the charged conspiracy — in some cases by several years — was "intrinsic" where it was offered "to prove the beginning stages of the conspiracy, how it developed, and how it continued"); *United States v. Gorman*, 312 F.3d 1159, 1162 (10th Cir. 2002) (in a case charging unlawful possession of a firearm, ruling that testimony that the defendant also was found to have drugs in his possession was intrinsic because it was "necessary to understand the flow of events").

Defendant does not try to address these arguments, or even try to argue that the backdating evidence does not meet any of these standards. Instead, his main contention appears to be that this evidence is "a theory in search of a witness," and thus is not intrinsic to the testimony of any witness. *See* Def. Tr. Br. at 6. This argument lacks merit. As noted above, the issue is not whether the evidence is intrinsic to the testimony

of a witness, but whether it is intrinsic to the offense. Moreover, the backdating is shown not only by documents, but also by several potential witnesses (Messrs. Patti, Weinstein, Stroz and Rubin).

Defendant also refers repeatedly to the fact that the date of his instruction to sell does not expressly appear in the indictment or the bill of particulars. *See* Def. Tr. Br. at 5-6. But as noted above, this is not the legal standard. Defendant does not cite any case that suggests that evidence can be intrinsic only if was specifically identified in the indictment. Moreover, Defendant does not show that he ever sought this information in his motion for bill of particulars. The Court's order on his motion did not grant it in any respect that would have required inclusion of this evidence in the bill of particulars. On the contrary, in ruling on the motion, the Court stated that "[e]xcept as just specified, the motion for a bill of particulars is denied. I think much of this is evidentiary in nature. Much of it improperly attempts to eliminate or confine the Government's proof at trial." *See* Transcript of March 24, 2006 Hearing at 31:19-22, *United States v. Nacchio*, 05-cr-00545-EWN.

C. The Court should not exclude this evidence as irrelevant.

Defendant next contends that this evidence of backdating is not even relevant to the case. Defendant's argument simply rehashes the arguments he made in his motion to

exclude the government's experts, to which the government has already responded.[2]

In brief, and as the government has set forth previously, this evidence of backdating is highly relevant. It is proper for the jury to consider the day Defendant made the decision to trade. Because the jury will be considering whether Defendant made that decision on the basis of material nonpublic information, it is proper to offer evidence from which the jury could determine that Defendant did not issue this instruction until mid-December 2000. The jury could reasonably conclude that Defendant backdated this instruction in an attempt to cover up that the instruction was not actually given until the date he signed it, and may consider whether this backdating was innocent or whether it shows that Defendant had a bad purpose and a lack of good faith. This evidence thus easily meets the standard of relevance. *Cf. Old Chief v. United States*, 519 U.S. 172, 178-79 (1997) (in a prosecution for possession of a firearm, rejecting the argument that showing that a prior conviction was for assault rather than for some other crime was irrelevant despite the fact that the evidence was "not itself an ultimate fact").

Defendant makes only two new arguments regarding relevance in this later-filed brief. First, he argues that the testimony of Gregory Patti — the O'Melveny & Myers attorney who prepared the draft irrevocable instruction — is irrelevant. *See* Def. Tr. Br.

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[2] *See* Defendant's Motion to Exclude Proposed Government Expert Testimony at 6-13; United States' Response to Defendant's Motion to Exclude Proposed Government Expert Testimony at 11-14.

at 9. But Mr. Patti's testimony is not irrelevant, as he can explain that he did not prepare that draft until December 2000. Defendant opines that Mr. Patti might testify that "there is nothing inherently wrong with backdating such a document," but does not show that Mr. Patti has ever made this statement, and does not explain why such testimony would conclusively establish that the backdating was irrelevant under the circumstances of this case.

Second, Defendant suggests obliquely that because there is no requirement under Rule 10b-5 that shares must be traded in an open window, "the growth shares instruction is irrelevant to the extent it would be offered to show compliance or lack of compliance with corporate policy." *See* Def. Tr. Br. at 10. This argument lacks merit. The government does not need to prove that every action of Defendant that is alleged in the case was independently illegal. Here, evidence that Defendant backdated a document to evade a corporate policy may be relevant to show his lack of good faith. The backdating of the instruction is also relevant for other even more important purposes, such as to show that it was backdated to a point before Defendant learned certain adverse nonpublic information.

D. Exclusion of this evidence under Rule 403 is not warranted.

Defendant's last argument regarding the backdating evidence is that it should be excluded under Federal Rule of Evidence 403. *See* Def. Tr. Br. at 13-14. This argument

simply rehashes arguments Defendant previously made in his motion to exclude, to which the government has already responded.[3]

E. The Court should not bar the Government from opening on this evidence.

Defendant suggests that the Court should not bar the government from referring to this backdated instruction in its opening statement. The government submits that such a bar would not only be unwarranted, but also would be extremely prejudicial to the government's case, particularly as to Counts One and Two. As set forth above, this evidence is central to the offense charged in those counts. Defense counsel's focus on this evidence is clearly due to the fact that he recognizes that this evidence is important and probative and that exclusion of such evidence on opening would therefore give Defendant a significant tactical advantage.[4]

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[3] *See* Defendant's Motion to Exclude Proposed Government Expert Testimony at 14-16; United States' Response to Defendant's Motion to Exclude Proposed Government Expert Testimony at 16-27.

[4] Defense counsel clearly is aware of the advantages of excluding harmful evidence from the government's opening. He has himself suggested:

> Use the motion in limine before opening and even before trial. Here, again, you should play on the psychology of the judge.... For example, you might say, "Your Honor, wouldn't it be best to postpone the decisions until we are further into the case? I suggest you merely instruct my adversary not to open on the disputed evidence...." ... No matter how he ultimately rules, you have at least denied something to your adversary at the most influential moment of the trial — the opening.

See Herbert Stern, Trying Cases to Win: Voir Dire and Opening Argument, at 163 (1991 ed.).

II. THE GOVERNMENT WILL ADDRESS THE OTHER ACTS AT A LATER TIME DURING TRIAL.

Defendant's trial brief addresses evidence of Ayco invoices that Defendant backdated and his transfers of assets out of his name. That evidence is not addressed in this brief because it is the government's understanding that the Court prefers to evaluate Rule 404(b) evidence in the context of the trial, when it can better assess how the proffered evidence fits into the case. *See* Transcript of August 25, 2006 Conference at 49:4-13, *United States v. Nacchio*, 05-cr-00545-EWN. Accordingly, the government will raise those issues at the appropriate time during the trial. The government also notes that on January 31, 2007, the government informed defense counsel that it will not open on those two 404(b) issues. *See* Exhibit 1.

III. THE TESTIMONY OF ANALYSTS AND INVESTORS IS NOT IRRELEVANT.

Defendant argues that the Court should not allow testimony from investment analysts and others relating to whether the information at issue was material and nonpublic. This argument lacks merit.

A. Defendant's speculation about the testimony is inaccurate.

Defendant's description of the proposed testimony from professional analysts suggests that Defendant is speculating that these individuals will opine, based on a set of facts provided to them, about how the market might have reacted to certain information

about Qwest and whether that information was "material." This is not what the government intends to offer.

Rather, the government will offer testimony from analysts who actually followed Qwest stock, and their testimony will relate numerous historical facts, such as their personal involvement with Qwest, what specific information they requested from Qwest, what specific information was disclosed to them, what information was not disclosed to them, and what information they considered important about Qwest.

B. The testimony of professional analysts and investors is not irrelevant to whether the information at issue was material.

Defendant contends that the testimony of professional analysts and investors must be irrelevant because the materiality standard is an objective one. Defendant contends that "[a] professional securities analyst has no more personal knowledge about these subjects than any other individual, and their testimony is unnecessary and irrelevant" to the materiality inquiry. *See* Def. Tr. Br. at 26.

The objective standard does not make all actual testimony by human beings irrelevant. The government cannot call the "reasonable investor" or "hypothetical investor" to the stand. Instead, it must call actual people. Defendant cites no case suggesting that the views of actual individuals must be excluded because the materiality test is an objective one. *See Branch-Hess Vending Svcs. Employees' Pension Trust v. Guebert*, 751 F. Supp. 1333 (C.D. Ill. 1990) (in securities fraud action alleging a failure

to disclose material information, the court considered the actual investors' testimony, noting that "[w]hile the test of materiality depends on the hypothetical *reasonable* investor, the actual Plaintiffs' own testimony is both persuasive and revealing").

Moreover, the reasonable investor standard cannot be applied in a vacuum, but requires assessment of the factual circumstances, which can include facts known about the stock to market professionals. *Cf. Basic, Inc. v. Levinson*, 485 U.S. 224, 247 n.24 (1988) (observing that "market professionals generally consider most publicly announced material statements about companies, thereby affecting stock prices"); *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (providing that materiality involves an assessment of importance in view of the "total mix" of information).

Professional analysts and investors thus have routinely testified in cases involving securities fraud as to issues involving their own knowledge of and involvement with the securities at issue — issues that relate to whether the material was public and whether it was material. *See, e.g., United States v. Stewart*, 433 F.3d 273, 281 (2d Cir. 2006) (in an insider trading case, both the prosecution and defense offered testimony from securities analysts regarding stock price movements and trading volume); *United States v. O'Hagan*, 139 F.3d 641, 648 (8th Cir. 1998) (in a "tippee" case involving trading on material nonpublic information, financial analysts testified that press reports speculating about a takeover had not been taken seriously); *Grassi v. Information Resources, Inc.*, 63

F.3d 596, 603 (7th Cir. 1995) (in a securities fraud case, the court considered the deposition testimony of several analysts discussing their understanding of what the company meant when it referred to "fundamentals"); *In re Apple Computer Securities Litigation*, 886 F.3d 1109, 1119 (9th Cir. 1989) (considering testimony from four securities analysts about how news of a backlog of computer hardware orders was received); *Elkind v. Liggett & Myers, Inc.*, 635 F.3d 156, 167 (2d Cir. 1980) (in determining that tipped information was not material, the court considered the statements of an analyst that he "attributed significance" to the tipped information, and why he attributed significance to it).[5]

It is true that under an objective standard, the personal experience of any one analyst is not determinative. But the fact that the testimony of any one analyst is not binding on the jury does not establish that it is not relevant at all. That extreme position is not supported by *United States v. Victor Teicher & Co.*, 1990 WL 29697, at *1 n.3 (S.D.N.Y. Mar. 9, 1990), which Defendant cites. In *Teicher*, the court did not even address the admissibility of analyst testimony, but simply described the materiality

[5] *See also United States v. Rigas*, 2004 WL 3604444, at *1 (S.D.N.Y. Feb. 20, 2004) (in a securities fraud case, the court rejected a motion to exclude evidence from analysts, explaining that testimony from the analysts about their questions to a defendant, the questions they asked, the reasons why they asked those questions, and their reactions to the statements made was all admissible); *In re Biogen Securities Litigation*, 179 F.R.D. 25, 37 (D. Mass. 1997) (observing that the testimony of a financial analyst about the significance of FDA concerns regarding the efficacy of a new drug supported the contention that such information "would be material to the market").

standard and, in doing so, quoted from a jury instruction it had previously given, which, in turn, stated that the jury is not required to accept the views of any particular professional trader. *Id.* The *Teicher* decision nowhere indicates that testimony of professional securities traders cannot be considered. *Id.* Indeed, it appears reasonable to assume that the court had allowed such professionals to testify; if the court had excluded such professionals, its instruction explaining that the jury was not required to accept the views of such professionals would have been entirely unnecessary.

C. Internal projections are not immaterial as a matter of law.

Defendant also misstates the materiality standard in his brief. He states that "once Qwest made reasonable forward-looking statements of future revenue, internal projections that conflicted with its publicly-issued projections are not considered material under the law, and Qwest and Mr. Nacchio would not be required to disclose such tentative internal projections unless they were so certain that they showed the published figures to have been materially misleading." *See* Def. Tr. Br. at 29-30. This statement is incorrect for several reasons.

First, the materiality standard does not focus just on whether the information would make one particular prior public statement misleading. Rather, the focus is more generally on whether there is a substantial likelihood that a reasonable investor would have considered the information important in making a decision about the securities. *See*

TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) (holding, in the context of a challenge to a proxy statement, that "[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.").

Second, Defendant's statement focusing on when "Qwest and Defendant would not be required to disclose" information is incorrect. *See* Def. Tr. Br. at 29-30. Whether a corporation has a duty to disclose information is a very different question from whether an insider can trade on the information before its disclosure. *See* Transcript of March 24, 2006 hearing at 24-25, *United States v. Nacchio*, 05-cr-545-EWN (observing, in pertinent part, that "[a] corporation is not … under a general duty to disclose all non-material public information in the possession of the corporation …. The individual [insider], however, … is under a duty not to trade on the basis of the material information.... Mr. Nacchio had a duty to refrain from trading on the basis of material inside information."); *Gross v. Summa Four, Inc.*, 93 F.3d 987, 992 (1st Cir. 1996) (observing that "[b]y itself, however, Rule 10b-5, does not create an affirmative duty of disclosure. Indeed, a corporation does not commit securities fraud merely by failing to disclose all nonpublic material information in its possession.").[6]

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[6] *See also Garcia v. Cordova*, 930 F.2d 826, 828-29 (10th Cir. 1991) (observing that "insiders involved in securities transactions have a further additional duty" to disclose material nonpublic information or abstain from trading); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 850 n.12 (2d Cir. 1968) (*en banc*) ("We do not suggest that material facts must be disclosed

Third, Defendant's radical position that internal projections are immaterial as a matter of law is not supported by any of the cases he cites. *See McDonald v. Kinder-Morgan*, 287 F.3d 992, 998 (10th Cir. 2002) (holding that statements that has been "accurate recitations of historical successes" were not actionable); *Garcia v. Cordova*, 930 F.2d 826, 829 (10th Cir. 1991) (explaining that whether "soft information" is material depends on its significance under "the facts of each case"); *In re Healthcare Compare Corp. Sec. Litig.*, 75 F.3d 276, 282 (7th Cir. 1996) (addressing when a corporation has an affirmative duty to disclose an updated projection); *SEC v. Butler*, 2005 U.S. Dist. LEXIS 7194, at *22-23 (E.D. Pa. 2005) (finding after a bench trial that the information provided to the defendant "did not make it any more likely than not that [the company] would fail to meet either internal or external revenue projections").

Defendant primarily relies on *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509 (7th Cir. 1989), but he does not accurately describe it. In *Wielgos*, the plaintiff was a class of investors that challenged the omission of certain statements from a utility's public

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immediately; the timing of disclosure is a matter for the business judgment of the corporate officers entrusted with the management of the corporation within the affirmative disclosure requirements promulgated by the exchanges and by the SEC.... We do intend to convey, however, that where a corporate purpose is thus served by withholding the news of a material fact, those persons who are thus quite properly true to their corporate trust must not during the period of nondisclosure deal personally in the corporation's securities ...."); *In re Enron Corp. Securities, Derivative & ERISA Litigation*, 258 F. Supp. 2d 576, 589 (S.D. Tex. 2003) (observing that "Rule 10b-5 does not impose on a corporation an affirmative duty to disclose all nonpublic material information that it has about the corporation" and citing cases in support).

statements about the future. The Seventh Circuit observed that such statements about the future are significant, as "[i]nvestors value securities because of beliefs about how firms will do tomorrow, not because of how they did yesterday." *Id.* at 514. The court observed that until 1978, the SEC "discouraged firms from making projections or commenting beyond the domain of 'hard' information, such as last year's sales." *Id.* But in 1978, the SEC adopted Rule 175, which provided various safe harbors for forward looking statements and projections by a corporation. *Id.* at 513. The court explained that absent Rule 175, the fact that corporations often update internal projections might prevent them from raising new capital at times, but that "Rule 175 is designed to release enterprises from such binds." *Id.* at 516.

Wielgos thus does not support Defendant's position that internal projections that conflict with prior publicly-issued projections are not material as a matter of law. Nor did the court rule that insiders may freely trade after receiving internal projections that conflict with public guidance. The court simply observed that there is a special SEC rule for *corporations* that allows them, when certain defined requirements are present, to trade before disclosing such projections. *Id.* at 516.

Moreover, the *Wielgos* court expressly declined to resolve the case based on materiality grounds. *Id.* at 517 ("Our case may be decided, however, without regard to materiality."). Instead, it concluded that the public statements at issue in the case did not

result in liability because the omitted information at issue was public knowledge. *Id.* at 516-18. Nowhere did the *Wielgos* court suggest that internal predictions are always immaterial. On the contrary, it explained that materiality "is hard to pin down in the abstract" and is a highly "fact-specific inquiry," as "[e]ven very improbable events may be material if the injury is great enough." *Id.*

D. The testimony of professional analysts and investors is not irrelevant to whether the information at issue was nonpublic.

Defendant also contends that the testimony of professional analysts and investors is not "relevant to whether or not the information was effectively disseminated to the investing public." *See* Def. Tr. Br. at 32.

This argument, too, lacks merit. In determining whether information had been effectively disseminated, it is entirely proper for the jury to consider the testimony of professionals who closely followed Qwest stock. For example, if an analyst requested information from Qwest and was rebuffed, then that testimony would support the conclusion that such information was nonpublic.

The government also notes that Defendant's definition of "nonpublic" is incorrect. Defendant defines it in terms of "availability" — *i.e.*, whether the information is "available to investors." *See* Def. Tr. Br. at 32. This is not the correct definition because the proper focus is on whether the information has been broadly and effectively *disseminated* to the investing public, not just on whether it is available. *See Dirks v.*

SEC, 463 U.S. 646, 653 n.12 (1983) (observing that the SEC views an insider's disclosure as adequate where it is "'effected by a public release through the appropriate public media, designed to achieve a broad dissemination to the investing public generally and without favoring any special person or group'") (quoting *In re Faberge, Inc.*, 45 S.E.C. 249, 256 (1973)); *SEC v. Mayhew*, 121 F.3d 44, 50 (2d Cir. 1997) ("Information becomes public when disclosed 'to achieve a broad dissemination to the investing public generally and without favoring any special person or group.'") (quoting *Dirks*, 463 U.S. at 653 n.12); *SEC v. Happ*, 392 F.3d 12, 31 (1st Cir. 2004) (observing that "[i]n an insider trading case, the proper amount of disgorgement is generally the difference between the value of the shares when the insider sold them ... and their market value a reasonable time after *public dissemination* of the inside information") (citing cases) (internal quotation marks omitted).[7]

Indeed, if the test were mere availability, it would be easy for insiders to use inside information by trading as soon as the information had been made available through some

[7] It is clear that some selective disclosure is not sufficient. *See* Selective Disclosure and Insider Trading: Final Rule, 65 Fed. Reg. 51,716, 51,716 (Aug. 24, 2000) (providing that where selective disclosure of material nonpublic information is made, the person "must make public disclosure of that information"); *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 313 (1985) (observing that "insiders and broker-dealers who selectively disclose material nonpublic information commit a potentially broader range of violations than do tippees who trade on the basis of that information"); *Dirks*, 463 at 661 n.21 (recognizing that the SEC views disclosure just to the SEC as insufficient if the information has not been also disclosed to the market).

means, rather than having to wait until the information had been broadly and effectively disseminated. *See SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 853-54 (2d Cir. 1968) (*en banc*) (holding that an insider could not rely on sporadic news reports but instead "should have waited until the news could reasonably have been expected to appear over the media of widest circulation").

E. No expert disclosure is required for the proposed testimony.

Defendant also expresses concern that such analysts will not be "simply testifying in their individual capacity, but rather in the capacity of a person with particular experience or expertise in the area of evaluating the type of information that is important to the investing community as a whole." *See* Def. Tr. Br. at 33. Defendant contends that if the analysts ventured into such testimony, "[s]uch opinion testimony would only be admissible by someone qualified as an expert witness, and the government has failed to provide notice of such expert testimony as required by Fed. R. Crim. P. 16(a)(1)(G)." *See id.*[8]

Defendant's concern is unfounded. The government does not anticipate any testimony on such broad matters of opinion as "what was material to the marketplace." *See* Def. Tr. Br. at 35. Rather, these witnesses are expected to simply describe their own

[8] Defendant also asserts, without citation, that the Government has "persistently claimed that there would be no experts in its case in chief." *See* Def. Tr. Br. at 33. This is simply wrong.

experiences. They are expected to recount their personal involvement with Qwest, such as what specific information they requested from Qwest, why they wanted that information, what specific information was disclosed to them, and what information was not disclosed to them. All of this testimony will be based on their personal knowledge and is entirely proper. *See* Fed. R. Evid. 602 (permitting testimony based on personal knowledge).

The government further observes that even if these witnesses were to offer inferences or opinions, the government expects that such inferences or opinions would be confined to their own first-hand knowledge, observations, and participation in the events by virtue of their positions within their business, and their inferences from their own perceptions of the facts. As the Court has previously determined, testimony by a businessperson about his or her business that is based on that person's first-hand knowledge and experiences in the business is considered lay testimony. *See* Docket No. 151 at 35 (concluding that "Rule 701 'does not preclude testimony by business owners or officers on matters that relate to their business affairs. Indeed, an officer or employee of a corporation may testify to industry practices and pricing without qualifying as an expert.'") (quoting *Texas A&M Research Found. v. Magna Transp., Inc.*, 338 F.3d 494 (5th Cir. 2003)); *Tampa Bay Shipbuilding & Repair Co. v. Cedar Shipping Co.*, 320 F.3d 1213, 1217, 1221-23 (11th Cir. 2003) (rejecting the position that testimony by a ship

repairer as to whether charges were reasonable was not precluded, because it was "based upon their particularized knowledge garnered from years of experience within the field," and explaining that the Advisory Committee intended to make clear that such evidence was not subject to Rule 702).[9] The government thus contends that if the analysts' testimony includes inferences based on their first-hand business knowledge, such inferences will be proper and will not convert their testimony into expert testimony within the meaning of Rule 702.

F. The testimony of non-professional investors is not irrelevant.

Defendant also challenges the testimony of non-professional witnesses and contends that such testimony, if offered, would be irrelevant. *See* id. at 36-40.

Like the professional analysts, they are expected testify about relevant issues based on their first-hand involvement with Qwest, such as what information they considered

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[9] *See also* Fed. R. Evid., 2000 Adv. Comm. Notes (observing that corporate officers may testify about their business without needing to be qualified as experts under Rule 702 "because of the particularized knowledge that the witness has by virtue of his or her position in the business"); *Lifewise Master Funding v. Telebank*, 374 F.3d 917, 930 (10th Cir. 2004) (explaining that although a company president could not testify as to a damages model where he did not have personal knowledge of that model, he "could have testified solely as a businessperson based on his personal knowledge and his experience as president of the company"); *United States v. Polishan*, 336 F.3d 234, 242 (3d Cir. 2003) (holding that under Rule 701, "[a] witness testifying about business operations may testify about inferences he could draw from his perception of a business's records, or facts or data perceived by him in his corporate capacity") (internal quotation marks omitted); *Mississippi Chem. Corp. v. Dresser-Rand Co.*, 287 F.3d 359, 373 (5th Cir. 2002) (observing that a business employee with direct knowledge of the business could testify as to lost profits without being qualified as an expert pursuant to Rule 702) (citing similar cases).

significant and what information had been disclosed or not disclosed.

Defendant further contends that testimony by individual investors "about hearing Mr. Nacchio speak positively about the financial projections of the company on one (or even two or several) occasions is anything but objective." *See* Def. Tr. Br. at 40. However, their views of Defendant from having heard him speak does not render their testimony irrelevant. To the extent that Defendant believes that these witnesses are not objective for one reason or another, his counsel can bring those facts out on cross-examination. *See Healey v. Chelsea Resources, Ltd.*, 947 F.2d 611, 620 (2d Cir. 1991) (rejecting the argument that testimony that is self-serving should not be allowed, and explaining that "[t]he fact that such testimony may be self-serving goes to its weight rather than its admissibility").

The fact that an investor may have lost money does not render his or her testimony irrelevant. *Cf. United States v. Rigas*, 2004 WL 360444, at *1 (S.D.N.Y. Feb. 26, 2004) (in a securities fraud case, observing that testimony by an investor in stock that he "later sold it at a loss simply completes the story: the failure to allow the witness to testify as to this would simply leave the matter up in the air, inviting the jury to speculate as to what happened next").[10]

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[10] *See also Old Chief v. United States*, 519 U.S. 172, 188 (1997) (observing that "the prosecution may fairly seek to place its evidence before the jurors, as much to tell as story of guiltiness as to support an inference of guilt, to convince the jurors that a guilty verdict would be morally reasonable as much as to point to the discrete evidence of

In essence, Defendant argues that the facts known to non-professional investors are irrelevant. He again relies on the faulty premise that under an objective standard, all human testimony is irrelevant. For the same reasons set forth above, this premise is incorrect; just because the testimony of an individual investor is not binding on the jury does not makes it automatically irrelevant.

IV. EVIDENCE THAT MS. SZELIGA PLEADED GUILTY IS PROPER AND SHOULD NOT BE EXCLUDED FROM EVIDENCE OR OPENING.

Defendant observes that Robin Szeliga, Qwest's Chief Financial Officer during the period charged, pleaded guilty to insider trading. *See* Def. Tr. Br. at 42. Defendant contends that this evidence "is admissible only [under] Fed. R. Evid. 609." *Id.* Defendant further states that he does not intend to present this specific evidence unless it is raised first by the government, and therefore requests that the government should not be permitted to introduce the evidence on direct examination or to refer to it in opening. *Id.* Defendant contends that admission of this testimony would be improper vouching, and cites *United States v. Harlow*, 444 F.3d 1255 (10th Cir. 2006).

This request for exclusion is without basis. Rule 609 only limits the introduction of evidence of a prior conviction for impeachment – not on direct examination. *See* Fed. R. Evid. 609(a) (limiting when such testimony may be used "[f]or the purpose of attacking the credibility of a witness"); *Ohler v. United States*, 529 U.S. 753, 756 (2000)

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a defendant's legal fault").

(observing that Rule 609 "authorizes the eliciting of a prior conviction on direct examination").

Indeed, the very Tenth Circuit decision Defendant cites, *United States v. Harlow,* observes that "it is perfectly permissible for a prosecutor to introduce a witness's plea agreement on direct examination, even if it includes a truthfulness provision." 444 F.3d at 1262. *Harlow* does observe that use of the truthfulness portions of plea agreements can become impermissible vouching if the prosecutors proceed to "indicate that they can monitor and accurately verify the truthfulness of the witness' testimony." *See id.* at 1262-66 (explaining that impermissible vouching occurred where the prosecutor also introduced evidence of the government's Rule 35(b) motions as well as the actual court order reducing the witness's sentence, and where the prosecutor told the jury that the district judge had signed off on the witness's testimony). However, the government does not intend to engage in such impermissible vouching here.

Because the plea is admissible and because the government will offer proof of it in its case in chief, there is no proper basis for Defendant's request that this information not be referred to in opening. The government should not be forced to skip a topic in opening based on Defendant's ambiguous and unenforceable promise not to introduce the plea into evidence. Notably, Defendant does not promise not to attack Ms. Szeliga on opening. Defense counsel is fully aware that it is important for the government to bring

this information straightforwardly to the jury, and Defendant simply wants to deprive the government of this opportunity.[11] As he cites no legal basis for doing so, the Court should deny his request.

V. DEFENDANT MUST LAY A FOUNDATION BEFORE INTRODUCING EVIDENCE RELATING TO CLASSIFIED MATERIALS.

In its Trial Brief, the government argued that before Defendant seeks to introduce evidence of classified matters, he is required by the Federal Rules of Evidence to lay a proper foundation through his testimony. *See* U.S. Tr. Br. at 28-30. The government contended that this foundation is necessary pursuant to Federal Rules of Evidence 401 and 104 to show that the classified matters are actually probative of his state of mind, and also to show that the probative value of this testimony outweighs the potential prejudice from misleading the jury and wasting their time pursuant to Rule 403. *See id.*

Defendant responds that this assertion lacks support and subverts his right to testify. Those arguments lack merit.

As an initial matter, the government's argument is not unsupported. It rests on the rules of evidence. "Simply stated, a criminal defendant does not have a constitutional right to present evidence that is not relevant and not material to his defense." *United*

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[11] Defense counsel has previously recognized that "seasoned and experienced prosecutors open on the criminal records of their witnesses" in order to "draw[] the sting" and "inoculate" the witness. *See* Herbert Stern, Trying Cases to Win: Voir Dire and Opening Argument, at 174 (1991 ed.).

States v. Solomon, 399 F.3d 1231, 1239 (10th Cir. 2005). "[I]n presenting evidence the defendant must comply with established rules of evidence and procedure ... to assure both fairness and reliability in the ascertainment of guilt and innocence." *Id.* (internal quotation marks omitted); *see also United States v. Libby*, 467 F. Supp. 2d 20, 27 (D.D.C. 2006) (explaining that a defendant's right to present a defense involving classified matters is "not absolute" and that "courts frequently limit the presentation of a defendant's defense based on the Federal Rules of Evidence").

Moreover, there is recent authority supporting the government's position. In the *United States v. Libby* case, where there were numerous matters covered by CIPA, the district court recently explained in a detailed opinion that various classified matters were not admissible "in the absence of the defendant's testimony." *See United States v. Libby*, __ F. Supp. 2d __, 2007 WL 623646, at *8 (D.D.C. Mar. 1, 2007) (attached as Exhibit 3).

In that case, the defendant sought to present to the jury various matters involving classified information when the defendant had not testified. *Id.* The defendant contended that this information was relevant to his state of mind because it was information he had seen at the time of the events charged in the indictment and showed that he had been consumed with other important matters at that time. The Court excluded most of the classified evidence, holding that "[w]ithout the defendant's testimony, however, much of

the classified evidence that this Court concluded was relevant no longer satisfied this evidentiary predicate for admissibility. Thus, substitutions for evidence that this Court concluded would be relevant if the defendant testified became irrelevant once the defendant exercised his right not to testify." *Id.*[12]

The *Libby* court further found that such evidence was inadmissible under Rule 403. It explained that given the nature of the evidence, "whatever evidentiary value the description of these matters still possessed once the defendant exercised his right not to testify, it was far outweighed by the potential prejudice and confusion their presentation would occasion." *Id.* at *9. The court observed that it was also "cognizant of the potential for prejudice that would have arisen if the defendant had been permitted to portray his own state of mind without allowing the government any effective means of cross-examination." *Id.* at 11.

The *Libby* court further rejected the argument — which Defendant makes here — that requiring that the defendant's evidence be preceded by a proper foundation and not be more prejudicial than probative violated Defendant's right not to testify. The court rejected the argument that the Constitution "entitled [defendant] the unfettered right to

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[12] As to one piece of evidence — a "Statement of Admitted Facts" — the Court also noted its understanding that in providing the admitted facts, the government had not stipulated to their admissibility but instead had rested on the assumption that defendant would lay a foundation by testifying. *Id.* at *9. The same understanding is true here; the government has assumed (until Defendant's trial brief) that Defendant will testify to lay a foundation for the materials at issue.

present evidence the Court found irrelevant or otherwise inadmissible." *Id.* at *13. The Court observed that "[t]he central teaching of the Supreme Court's holdings in this area of law is that the Fifth Amendment does not command courts to equalize the costs and benefits defendants face in deciding whether to testify." *Id.* at 15. It further explained that

> the Court's ruling excluding such evidence absent adequate foundation simply reflected the reality — implicitly acknowledged by the Supreme Court in *Brooks* [*v. Tennessee*, 406 U.S. 605 (1972)] and *McGautha* [*v. California*, 402 U.S. 183 (1971)] — that declining to testify comes at the unavoidable cost of forfeiting the opportunity to introduce evidence that is irrelevant or not otherwise independently admissible. Just as a defendant who invokes the Fifth Amendment privilege to refrain from testifying, therefore abandoning the opportunity to present what may be the best evidence available to him, the defendant here elected to sacrifice the benefit the disputed evidence might have afforded him.

Id. at * 16.

In any event, it seems that Defendant may recognize that he must lay a foundation before he can introduce evidence of classified matters. He suggests that such a foundation might theoretically be laid not through his own testimony but by documents or witnesses through lay opinion testimony or under the state of mind exception to the hearsay rule. *See* Def. Tr. Br. at 43-44.

The Court should carefully scrutinize any such attempt to lay a foundation as to Defendant's state of mind though a vehicle other than his own testimony. Such a

foundation must adequately and directly connect the *particular* classified matter to Defendant's *own* state of mind. The government notes that in *Libby*, the court rejected the defendant's contention that an adequate foundation for admission of the evidence relating to classified materials had been laid through the testimony of another individual that the information was "significant" and through the alleged significance of the documents themselves. *See* 2007 WL 623646, at *9 n.17. The court examined this alleged foundational evidence and found that it did not lay an adequate foundation, as neither type of evidence showed that the defendant himself was consumed with the information. *Id.*

In sum, the government contends that until sufficient foundational testimony has been offered by Defendant, the CIPA evidence should not be admitted.

CONCLUSION

In sum, the government suggests that the Court should not seek to evaluate in advance of trial Defendant's speculations about the admissibility of the testimony, but should consider the actual testimony in context at trial.

Respectfully submitted this 14th day of March, 2007.

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