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' TRIAL BRIEF

The United States hereby submits its trial brief. Pursuant to the Court's direction, this submission is being submitted to the Court directly in hard copy, and not electronically filed with the Clerk.

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I. SUMMARY OF THE CASE

What follows is a very brief summary of what the government intends to prove at trial.

Defendant Joseph P. Nacchio was the Chief Executive Officer of Qwest Communications International and a member of Qwest's Board of Directors from 1997 through 2002. In the summer of 1999, he announced a merger with U.S. West. In his plan for the combined company, he promised spectacular annual growth. The merger was completed on June 30, 2000.

In 2000 and early 2001, top executives at Qwest gave Defendant Nacchio important warnings and information. They repeatedly informed him that he had set Qwest's external targets too high and that Qwest's recurring revenue business was not performing according to the internal plan. He was informed that one-time "non-recurring" deals would not be sufficient to make up for the underperforming recurring revenue to meet Qwest's external targets in the third and fourth quarters of 2001.

During this period, Defendant Nacchio chose not to disseminate this information publicly to investors. The internal information he possessed about Qwest's financial performance varied dramatically from the information he and Qwest were disseminating to the investing public.

Nevertheless, from January 2, 2001 to May 29, 2001, Nacchio himself sold over $100 million of Qwest stock. He cancelled a pre-determined "safe harbor" trading plan to sell Qwest stock, and instead sold at a rate that was drastically faster than the plan into which he had entered.

Nacchio knew he could not sell stock on the basis of material inside information. He had received training and information regarding the limitations of selling stock under such

circumstances.

Defendant Nacchio is charged with 42 counts of engaging in insider trading securities fraud in violation of Title 15, United States Code, Section 78j(b) and SEC Rule 10b-5 and 10b5-1. The indictment alleges that from January 2, 2001 to May 29, 2001, Defendant Nacchio sold 2,528,723 shares of Qwest stock on the basis of material nonpublic information, generating total proceeds of $100,812,582.02.

II. THE OFFENSE OF INSIDER TRADING

A. Elements of the offense

To prove the securities fraud of insider trading, the government must prove that Defendant Nacchio, while in possession of material nonpublic information, traded in Qwest stock on the basis of that information in breach of duties of trust and confidence he owed to the investors to whom he sold shares. *See generally United States v. O'Hagan*, 521 U.S. 642, 652 (1997) (explaining that the "classical theory" of insider trading "targets a corporate insider's breach of duty to shareholders with whom the insider transacts").

The Supreme Court has explained that an insider's sale or purchase of stock for personal gain on the basis of material nonpublic information is a fraudulent or deceptive device under the securities laws. *O'Hagan*, 521 U.S. at 652 (explaining that insider trading on material nonpublic information "*qualifies as a deceptive device* under § 10(b)"); *cf.. Chiarella v. Unites States*, 445 U.S. 222, 228-30 & n.9 (1980) (explaining that where a corporate insider has a duty to disclose or abstain from trading, "silence in connection with the purchase or sale of securities may operate as a fraud actionable under § 10(b)").

This rule against insider trading addresses the unfairness that would result from allowing insiders with access to material, nonpublic information intended to be used only for corporate purposes to benefit from trading on the basis of such information. *See Dirks v. SEC*, 463 U.S. 646, 654 (1983) (explaining that the fraud of insider trading "derives from the 'inherent unfairness involved where one takes advantage' of 'information intended to be available only for a corporate purpose and not for the personal benefit of anyone'") (quoting *In re Merrill Lynch, Pierce, Fenner & Smith Inc.*, 43 S.E.C. 933, 936 (1968)).

The government understands that it disagrees with Defendant Nacchio with regard to the proper definitions of certain elements of the offense of insider trading, such as the definitions of "material" information and "nonpublic" information. The government will address these issues in its objections to Defendant's proposed disputed jury instructions.

B. The potential "good faith" defense

At the October 12, 2006 hearing, the Court indicated that if a good faith instruction is to be given to the jury at trial, the Court intends to rely on the generic O'Malley form instruction.

The government notes two issues relating to this potential good faith defense. First, the final determination whether to provide a good faith instruction should not be made until the defendant has presented sufficient evidence to warrant such an instruction. The defendant will be entitled to such an instruction only if "the evidence, if believed, has the capacity to rebut all evidence of false and misleading conduct, all failures to disclose that which should have been disclosed and all matters that deceive and were intended to deceive another. A benign explanation of only some of the acts is insufficient...." *United States v. Janusz*, 135 F. 3d 1319,

1322 (10th Cir. 1998).

Second, if the Court determines that a good faith instruction is warranted, it should ensure that the generic O'Malley good faith instruction is sufficiently tailored and relevant to the evidence presented that it does not mislead the jury. In this regard, the government notes that some good faith does not rebut criminal intent. *See United States v. Platte*, 401 F.3d 1176, 1184 (10th Cir. 2005) (holding that the defendants' good faith did not rebut their criminal intent under the circumstances). A proper good faith defense must "negate[] the requisite element of intent." *United States v. Grissom*, 44 F.3d 1507, 1512 (10th Cir. 1995). Any such instruction thus should explain the good faith that would be sufficient to negate scienter.

The *scienter* required by insider trading requires (1) intentionally trading on the basis of inside information without disclosing the information, and (2) knowledge that the conduct is unlawful. Any good faith defense offered by Defendant thus must address and negate those elements. For example, Defendant might present evidence that the trade was not done intentionally. *Cf. Aaron v. SEC*, 446 U.S. 680, 690 (1980) (rejecting liability for negligent conduct). Alternatively, Defendant might present evidence that he believed the conduct was actually lawful. *Contrast Overholt*, 307 F.3d at 1247 (holding that a defendant was not entitled to a good faith instruction where he failed to present "any evidence that he personally believed that [the conduct] was actually lawful").

However, certain types of "good faith" behavior that might be presented at trial might *not* negate scienter. For example, a defendant cannot avoid insider trading liability just by showing that he had a legitimate purpose for a trade. *See SEC v. Lipson*, 278 F.3d 656, 661-62 (7th Cir.

2002) (explaining that under the law prior to the adoption of Rule 10b5-1, "the existence of the legitimate purpose would not sanitize the illegitimate one").

III. EVIDENTIARY ISSUES

A. Intrinsic evidence of backdating

The government expects to offer evidence relating to how Defendant Nacchio signed a backdated document when he directed the trades charged in Counts 1 and 2 of the Indictment.

In brief summary, the government expects the evidence to show as follows. On October 30, 2000, Qwest's internal "trading window" opened. The last day of the trading window was November 17, 2000. In November and December 2000, Defendant Nacchio received negative information about Qwest's future prospects. Sometime after December 13, 2000 and before January 2, 2001, after receiving this negative information, Defendant Nacchio signed an "irrevocable instruction" related to the sale of restricted stock deriving from the growth shares. This instruction provided for the sale of large number of his shares and attested that at the time of its signing he was not in possession of material, nonpublic information.

Defendant Nacchio did *not,* however, put on the "irrevocable instruction" the date that he actually signed it. Instead, he signed an "irrevocable instruction" that had been backdated to November 3 — a date that created the false impression that the "irrevocable instruction" had been signed before he learned certain key negative information about Qwest, and had been signed during the open trading period.

On January 2 and 3, 2001, Defendant Nacchio sold 356,723 shares of restricted stock, at a gross sales price of $14,270,814.29 during a closed window. His signing of this backdated

irrevocable instruction suggested that this sale had been arranged back on November 3.

The government contends that this evidence of backdating is central to the offense charged in Counts 1 and 2 of the Indictment. Certain key material nonpublic information came to Defendant Nacchio's attention *after* November 3, 2000, and he traded on the basis of that information in the sales charged in Counts 1 and 2. The government contends that the backdating shows that it was not until December 2000 that Defendant Nacchio directed the trades set forth in Counts 1 and 2. Thus, this information came to Defendant Nacchio's attention *before* he directed those trades.

Because this evidence of backdating is central, it is intrinsic to Counts 1 and 2. The Tenth Circuit has held that "other act" evidence is intrinsic to the crime charged when 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). The government submits that not just one, but *all three* of these criteria are met with respect to the backdated instruction relating to Counts 1 and 2.

First, this backdating is part of a "single criminal episode." *Nichols*, 374 F.3d at 966. The backdated instruction is the instruction for the sales that are charged in Counts 1 and 2 of the indictment. The date on which this instruction was *actually* signed is significant in showing what material nonpublic information that Defendant Nacchio had when he directed those trades. The fact of the backdating is also significant because it is relevant to Defendant Nacchio's

wrongful intent.

The backdated instruction thus is properly considered part of the scheme charged in Counts 1 and 2, as it relates to the structure and planning of this offense. *See United States v. Johnson*, 42 F.3d 1312, 1316 (10th Cir. 1994) (ruling that prior drug sales were not extrinsic to the charged offense because they "could be considered 'part of the scheme for which defendant [was] being prosecuted'") (quoting *United States v. Orr*, 864 F.2d 15050, 1510 (10th Cir. 1988)); *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).

Second, the circumstances of this backdated instruction are also "intertwined" with the facts relating to Counts 1 and 2. *See Nichols*, 374 F.3d at 966. The Tenth Circuit has found evidence to be sufficiently intertwined to be intrinsic in situations where the evidence was far less interrelated with the offense than it is here. *See, e.g., United States v. Jeffrey*, 128 Fed. Appx. 680, 688-89 (10th Cir. 2005) (ruling that evidence of a defendant's possession of firearms was intertwined with the proof of his drug distribution crimes because the "use of firearms is a well-established characteristic of the drug distribution business"); *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, subsequent inaccurate cattle inventory reports were 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, 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).

Here, the backdating is intertwined with Defendant's actions that led to the sales charged in Counts 1 and 2. The instruction is not unrelated to those sales; it led to them. The backdating is intertwined with not only with Defendant's decision to trade but also with his knowledge and intent.

Third, the backdating of the documents is a "necessary preliminary" to the trades at issue in Counts 1 and 2. *Nichols*, 374 F.3d at 966. The date on which Defendant decided to direct the trades charged in Counts 1 and 2 is an essential detail: without knowing the date the instruction was actually signed, the jury cannot appropriately assess what material nonpublic information he had on that date. Thus, even if the backdating were not part of the offense or intertwined with the offense, it is a necessary preliminary to the crimes charged.

Again, the Tenth Circuit has found far less significant details to be intrinsic. *See, e.g., 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").

B. 404(b) evidence

Pursuant to Federal Rule of Evidence 404(b), extrinsic evidence of other acts is admissible if it is offered for a proper purpose, relevant, admissible under Rule 403, and subject (upon request) to a limiting instruction. *See Huddleston v. United States*, 485 U.S. 681, 691-92 (1988).

It is the government's understanding that the Court ordinarily declines to resolve the admissibility of Rule 404(b) extrinsic evidence prior to trial, and instead resolves these issues in the context of the actual evidence at trial. The government believes that the admissibility of its Rule 404(b) evidence may become more apparent in the context of the trial, but is raising these issues at the current time to afford the Court advance notice as to some issues that may arise relating to this evidence.

1. Changes of dates on Ayco invoices

At trial, the government intends to offer evidence that the backdating of the irrevocable instruction to early November 2000 was not the result of accident or mistake but was intentionally done. The government intends to produce evidence to show that such backdating was a specific type of practice in which Defendant Nacchio had knowingly engaged from time to time, particularly on occasions where he may have desired to conceal the inappropriate nature of

his action.

Specifically, the government intends to offer evidence that Defendant Nacchio had been involved in the backdating of documents on various occasions. The government will offer evidence that (1) on or about October 17, 2000, Defendant Nacchio requested that his financial adviser, The Ayco Company LP, alter the date on an invoice in the amount of $4,900 so that Nacchio could present the bill to Qwest for payment that he would otherwise be required to pay himself; (2) on or about June 18, 2002, Defendant Nacchio directed Ayco to pre-bill him for $25,000 in financial counseling services that Ayco had not yet rendered, again so that Defendant Nacchio could present Qwest with the bill for payment, and (3) on or about August 16, 2002, Defendant Nacchio directed Ayco to restructure other invoices in a continuing scheme to deplete all of the funds Qwest allotted for Defendant Nacchio to use for financial consulting services.

Although it is not yet known what the precise trial context will be at the time the Ayco invoices are offered into evidence, the government believes that there will be one or more proper purposes for offering this evidence. For example, the government believes that this evidence that Defendant Nacchio was involved in the altering of dates on multiple occasions is probative of absence of mistake or accident in the backdating of the irrevocable instruction in December 2000 (which relates to Counts 1 and 2). The absence of mistake or accident is a valid purpose for offering 404(b) evidence. *See United States v. Rackstraw*, 7 F.3d 1476, 1479 (10th Cir. 1993) (affirming the admission of evidence of other acts to show "intent, knowledge, and absence of mistake"). Admissibility on this ground is appropriate because "'the recurrence of similar acts incrementally reduces the possibility that the given instance ... is the result of inadvertence,

mistake, or other innocent event." *United States v. Holloway*, 740 F.2d 1373 (6th Cir. 1984) (quoting *United States v. Semak*, 536 F.2d 1142, 1144-45 (6th Cir. 1976)).

Numerous courts have admitted evidence relating to other acts that tended to show that an action in controversy was not the result of a mistake or accident. *See, e.g., United States v. Johnson*, 463 F.3d 803, 808 (8th Cir. 2006) (holding that evidence of overpayments was admissible to show that other overpayments were not the result of a mistake); *United States v. Walsh*, 928 F.2d 7, 9-10 (1st Cir. 1991) (in a case charging the filing of false reports, affirming a ruling allowing into evidence other discrepancies in the defendant's receipts); *United States v. Knight*, 898 F.2d 436, 439 (1st Cir. 1990) (holding that evidence of incorrectly reported expenses was admissible to show that the making of a false tax return was not the result of mistake or accident); *United States v. Micke*, 859 F.2d 473, 478-79 (7th Cir. 1988) (holding that evidence of an offer by the defendant to backdate a document for one client was properly admissible to show absence of mistake or accident in preparing false tax returns for another client); *United States v. McNeill*, 728 F.2d 5, 13 (1st Cir. 1984) (holding that an instance where the defendant had provided a false address was admissible in a case where the defendant had sought to attribute inconsistencies in backdated documents to carelessness or mistake); *United States v. Cooper*, 577 F.2d 1079, 1087 (6th Cir. 1978) (holding that a defendant's willingness to falsify a financial statement was admissible to show that another misrepresentation on another form (an altered age) was not the product of accident or mistake).

2. Transfer of assets

At trial, the government may offer evidence that in February 2002, Defendant Nacchio

directed the transfer of over $120 million in assets from accounts held in his name or held jointly in his name and his spouse's name to accounts held solely in the name of his spouse. More specifically, the transfers involved (but were not limited to) the movement of Qwest securities, cash, and non-Qwest securities from accounts held solely in the name of Defendant Nacchio (at Solomon Smith Barney, Bear Stearns and Donaldson Lufkin & Jenrette) or jointly in the name of Defendant Nacchio and his spouse, Anne M. Esker (at Solomon Smith Barney) into accounts solely in the name of Ann Esker (at Solomon Smith Barney, Donaldson Lufkin & Jenrette, and Bear Stearns). The government also may offer evidence that in March 2002, Defendant Nacchio authorized the transfer of ownership of real property located at 8 Drake Lane, Chester, New Jersey, from his name to the name of his spouse, Anne M. Esker. The government may offer evidence that Defendant Nacchio ordered the transfers of such assets out of his name as well as the purchase of additional assets in solely in the name of his spouse in an attempt to put them beyond the reach of potential creditors who had filed or were about to file suit against Defendant Nacchio.

The government submits that this evidence of Defendant Nacchio's efforts to conceal his assets may be admissible in the context of the trial under Rule 404(b) under various grounds. For example, such evidence may be admissible to show consciousness of wrongdoing and to rebut any claim of good faith. Evidence that shows consciousness of wrongdoing is properly admissible under Rule 404(b). *United States v. Esparsen,* 930 F.2d 1461, 1476 n.16 (10th Cir. 1991) (observing that two prior decisions had upheld the admission of evidence of consciousness of guilt and that such cases must have implicitly applied Rule 404(b) "[b]ecause matters such as

motive, intent, plan or knowledge essentially involve 'consciousness of guilt'"); *see also United States v. Harper,* 463 F.3d 663, 668 (7th Cir. 2006) (evidence of a letter than "spurred [the defendant] to cover his tracks" was properly admitted because it was "strong circumstantial evidence of his guilty conscience"); *United States v. Lim*, 57 Fed. Appx., 701, 703-04 (7th Cir. Jan. 23, 2003) (unpublished) (ruling that a defendant's "efforts to spread his ill-gotten gains among several financial institutions is probative of an intent to defraud by demonstrating his desire to conceal the proceeds")*; United States v. Wonderly*, 70 F.3d 1020, 1023-24 (8th Cir. 1995) (ruling that evidence of subsequent misconduct with investors had properly been admitted to show that prior similar misconduct with investors was not the result of a "good faith" mistake); *United States v. Harris*, 903 F.2d 770, 776 (10th Cir. 1990) (ruling that where the defendant's claim to FBI agents about his ownership of certain money was inconsistent with a civil claim he had filed in a forfeiture lawsuit, the evidence of his inconsistent civil claim was properly "admissible to prove circumstantial consciousness of guilt or unlawful intent"); *United States v. D'Arco*, 1991 WL 264503, at **6-7 (N.D. Ill. Oct. 9, 1991) (unpublished) (ruling that evidence that the "defendant discussed the prospect of hiding money from the IRS" was admissible under Rule 404(b)).

The government notes that although these transfers of substantial amounts of assets out of Defendant Nacchio's name were effected after the period charged in the indictment, that timing does not render them inadmissible under Rule 404(b). "It is settled in the Tenth Circuit that evidence of 'other crimes, wrongs, or acts' may arise from conduct that occurs *after* the charged offense." *United States v. Mares*, 441 F.3d 1152, 1157 (10th Cir. 2006) (emphasis in original).

"Subsequent acts evidence is particularly relevant when a defendant's intent is at issue." *Id.* While the subsequent act must bear a clear nexus to the crime charged, this similarity can be demonstrated through the "defendant's indulging himself in the same state of mind" in both the extrinsic act and the charged offense. *Id.* Here, the government anticipates that it will be able to identify a sufficient nexus at trial between the crimes charged and the subsequent transfers of assets by Defendant Nacchio out of his name that such evidence may be admissible under Rule 404(b).

C. Memoranda of conversations with Defendant's financial consultant

The government anticipates offering into evidence various memoranda of conversations prepared by David Weinstein. Mr. Weinstein was a Senior Account Manager for The Ayco Company LP, a financial counseling company. He served as a financial consultant to Defendant Nacchio before, during, and after the period charged in the indictment. He spoke regularly with Defendant Nacchio and, after these conversations, regularly dictated his recollection of the conversations. Those dictations were then transcribed into written memoranda, which Mr. Weinstein maintained for his business use. These memoranda set forth in detail numerous conversations that Mr. Weinstein had with Mr. Nacchio.

The government believes that these notes will be admissible at trial on several grounds.

First, the government believes that these memoranda will qualify as business records pursuant to Federal Rule of Evidence 803(6). Rule 803(6) applies, in relevant part, to "A memorandum, report, record, or data compilation, in any form, of acts, events, conditions, opinions, or diagnoses, made at or near the time by, or from information transmitted by, a person

with knowledge, if kept in the course of a regularly conducted business activity, and if it was the regular practice of that business activity to make the memorandum, report, record, or data compilation ... unless the source of information or the method or circumstances of preparation indicate lack of trustworthiness."

Here, the reliability and trustworthiness requirements are satisfied by the regularity with which these records were prepared, and by the fact that Mr. Weinstein himself used these records. *See* Fed. R. Evid. 803(6), 1972 Adv. Comm. Notes (noting that the reliability of records could be shown by "systematic checking, by regularity and continuity which produce habits of precision, by actual experience in business in relying upon them, or by a duty to make an accurate record as part of a continuing job or occupation"). "Given the separate treatment in Rule 803(6) of untrustworthiness, ... the regular practice requirement should be generously construed to favor admission." *See Zenith Radio Corp. v. Matsushita Elec. Indus. Co. (In re Japanese Elec. Prods. Antitrust Litigation)*, 723 F.2d 238, 288-89 (3d Cir. 1983) (explaining that the district court had applied too stringent a standard), *rev'd on other grounds by Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

Courts have routinely determined that notes taken as part of a normal business practice qualify under this rule. *See United States v. Kingston*, 971 F.2d 481 (10th Cir. 1992) (affirming a district court's decision to admit, pursuant to Rule 803(6), notes that had been taken by government witnesses during telephone conversations); *cf. Hoselton v. Metz Baking Co.*, 48 F.3d 1056, 1061 (8th Cir. 1995) (ruling that the district court properly admitted an accountant's notes where the notes were prepared in the course of the witness's accounting and consulting business

as part of his usual practice); *United States v. Goodchild*, 25 F.3d 55, 61-62 (1st Cir. 1994) (ruling that computer printouts of memoranda regarding telephone conversations that were made in a regularly conducted business activity were admissible under Rule 803(6)); *Keogh v. Commissioner of Internal Revenue*, 713 F.2d 496, 499-501 (9th Cir. 1983) (noting that "personal records kept for business reasons may be able to qualify'" under Rule 803(6) and concluding that an employee's personal work diary was properly admitted under that rule where the evidence showed that the employee normally made entries after night shifts or within a few days) (quoting 4 Weinstein's Evidence ¶ 803(6)[03] (1981 ed.)); *United States v. Hedman*, 630 F.2d 1184, 1197-98 (7th Cir. 1980) (affirming the admission into evidence of an employee's diary where the "entries were recorded with regularity at or near the date" of the events recorded and where it was unlikely that the employee "would have made false entries," and observing that "the fact that [the employee] was not told to keep the diary and did not make it available to others at [his company] does not affect its admissibility under Rule 803(6)"); *United States v. McPartlin*, 595 F.2d 1321, 1347-48 (7th Cir. 1979) (ruling admissible an employee's desk calendar diaries, despite the fact that there were discrepancies in the dates in the calendars).

The government observes that with respect to some of Mr. Weinstein's memoranda, there may be hearsay within hearsay – *e.g.*, statements by him to Defendant Nacchio or by Mr. Nacchio to him – that must be separately found admissible. *Hoselton*, 48 F.3d at 1061 (observing that where business records contain other out-of-court statements, these statements must be examined to determine whether they are admissible); *Goodchild*, 25 F.3d at 62-63 (observing that "normally statements by one not a party to the business are not admissible for the truth of the

matter stated unless some exception other than the business records exception is involved"). The government believes that here, such other statements will also be admissible because they are generally either admissions by the defendant or statements to the defendant that are relevant to the defendant's state of mind.

Second, the government believes that these records will also qualify as present sense impressions pursuant to Rule 803(1). That rule applies to "[a] statement describing or explaining an event or condition made while the declaration was perceiving the event or condition, or immediately after." This rule recognizes that "in many, if not most, instances precise contemporaneity is not possible and hence a slight lapse is allowable." *See* Fed. R. Evid. 803(1), 1972 Adv. Comm. Notes.

Notes or memoranda made at or near the time of an event or conversation may be admissible under this exception. *See Cargill, Inc. v. Boag Cold Storage Warehouse, Inc.*, 71 F.3d 545, 555 (6th Cir. 1996) (holding that an employee's notes were admissible under Rule 803(1) where there was no indication that the employee changed his notes when he typed them up, and there was little likelihood of deliberate misrepresentation); *Tracinda Corp. v. DaimlerChrysler AG*, 362 F. Supp. 2d 487, 502 (D. Del. 2005) (ruling that where an employee had notes from meetings, the notes qualified for admission under Rule 803(1) despite the fact that the employee acknowledged that the notes were "filtered" though his own thinking); *United States v. Sheets*, 125 F.R.D. 172, 174 n.2 (D. Utah 1989) (observing that a "diary may be admissible as an exception to the hearsay rule under 803(1)").

Third, these records will also qualify as past recollection recorded pursuant to Rule

803(5). That rule applies to "[a] memorandum or record concerning a matter about which a witness once had knowledge but now has insufficient recollection to enable the witness to testify fully and accurately, shown to have been made or adopted by the witness when the matter was fresh in the witness' memory and to reflect that knowledge correctly." The government believes that Mr. Weinstein's notes will qualify under this rule. *Cf. United States v. Ramsey*, 785 F.2d 184, 192-93 (7th Cir. 1986) (ruling that despite the facts that an employee made only "[m]iscellaneous jottings" in his desk calendar and that the jottings were specifically prompted by a desire to record dealings only with one entity, the jottings were still sufficient to qualify as a recorded recollection under 803(5)).[1]

Fourth, the government believes that even if these records do no qualify under one of the exceptions noted above, they should qualify for admission pursuant to the residual hearsay exception in Rule 807. That rule applies to a statement having "circumstantial guarantees of trustworthiness" if "(A) the statement is offered as evidence of a material fact; (B) the statement is more probative on the point for which it is offered than any other evidence which the proponent can procure through reasonable efforts; and (C) the general purposes of these rules and the interests of justice will best be served by admission of the statement into evidence." *See United States v. Treff*, 924 F.2d 975, 983 (10th Cir. 1991) (ruling that a diary entry was admissible under the residual hearsay exception); *cf. Mandal v. City of New York*, No. 02-1234-WHP, 2006 WL 3405005, at *3 (S.D.N.Y. Nov. 26, 2006) (unpublished) (ruling that an

[1] Rule 803(5) permits reading of the document but limits admission of the actual document to certain circumstances defined in the rule.

individual's notes and articles were admissible under Rule 807 in view of the "circumstantial assurances of veracity associated with [the evidence], the availability of the individuals concerned for cross examination, and the compelling need for the evidence they contain"); *United States v. Santos*, 65 F. Supp. 2d 802 (N.D. Ill. 1999) (ruling that notes of a conversation were admissible under Rule 807); *In re Columbia Securities Litigation*, 155 F.R.D. 466, 475 (S.D.N.Y. 1994) (ruling that notes and articles were admissible under the residual exception, and noting that "[c]ourts have been willing to admit hearsay evidence under [the residual exception] when the declarant is available and subject to cross-examination and the hearsay statement in question was not the product of faulty perception, memory or meaning, the dangers against which the hearsay rule seeks to guard").

D. Testimony of analysts and investors

The government anticipates offering testimony from investment analysts and others regarding the significance of insider information that was not publicly disseminated during the period during which Defendant Nacchio directed the trades charged in the indictment.

The government submits that such evidence is relevant for a few reasons. Most significantly, it is relevant to whether the information was material to a reasonable investor. Information is material if there is a substantial likelihood that the information would have been viewed by a reasonable investor as important in deciding whether to buy, sell, or hold securities, or at what price to buy or sell, including whether such information would have significantly altered the total mix of information made available concerning the company. *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); *Basic Inc. v. Levinson*, 485 U.S. 224, 238, 108

S. Ct. 978, 987 (1988).

In addition, such evidence will be relevant to whether the information was "nonpublic" — *i.e.*, whether it was effectively disseminated to the investing public. *See 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 v. SEC,* 463 U.S. 646, 653 n.12 (1983)); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 853-54 (2d Cir. 1968) (*en banc*) ("Before insiders may act upon material information, such information must have been effectively disclosed in a manner sufficient to insure its availability to the investing public."); *see id.* at 853-54 (holding that an insider could not rely on sporadic news reports, but "should have waited until the news could reasonably have been expected to appear over the media of widest circulation").

E. Evidence postdating the trades

Some evidence the government will offer at trial will postdate the trades charged in the indictment. As an example, the government anticipates that its "post-trading" evidence will include evidence of Defendant Nacchio's conduct in the months directly following May 2001 (when the last of the trades charged occurred), including evidence relating to his state of mind at and around that time, such as evidence regarding the information he chose to publicly disseminate (or not to disseminate) about Qwest during this period. The government also anticipates that the post-trading evidence will include evidence of how and when crucial nonpublic information about Qwest was eventually disseminated to the investing public in 2001, and the reactions of investors and analysts (including changes in the share price) once this

information was finally disseminated.

The government understands that the Court will consider relevance in context, but submits that this evidence will be relevant. First, the Government notes that the defendant's own behavior in the period following the charged trades in question trades is intrinsically related to the charged trades themselves. It is appropriate to introduce evidence of how a crime was brought to its conclusion, and how the defendant handled himself in the period following the charged offense. *Cf. United States v. Sasser*, 971 F.2d 470, 479 (10th Cir. 1992) (explaining that although the defendant's statements to investigators was "made after the conspiracy had terminated," it nevertheless was "evidence of defendant's consciousness of wrongdoing and knowing involvement in the conspiracy' and thus was "intrinsic evidence of the charged crimes"). In this case, how the defendant chose to handle nonpublic information about Qwest's growth, performance, and earnings forecasts around the time that the charged period of trading came to an end and in the following months is intrinsic evidence of the charged crimes.

In addition, the defendant's course of conduct during this period following his trades is particularly relevant because his intent is at issue. Where fraud is alleged, viewing the defendant's course of conduct over the period of time surrounding the offense is appropriate in assessing whether the defendant had a fraudulent intent. "Fraudulent intent of course may be established by circumstantial evidence, or by inferences drawn from a course of conduct. Subsequent conduct is often probative of one's intent on a prior occasion." *Farmers Co-operative Ass'n of Talmage, Kan. v. Strunck*, 671 F.2d 391, 395 (10th Cir. 1982) (internal citations omitted) (rejecting an argument that a bankruptcy judge had erred when, in determining

the intent of an individual on a particular date, the judge considered the individual's conduct after that date); *cf. United States v. Mares*, 441 F.3d 1152, 1157 (10th Cir. 2006) ("Subsequent acts evidence is particularly relevant when a defendant's intent is at issue."); *Bergeson v. Dilworth*, No. 90-3170, 959 F.2d 245, 1992 WL 64887 at *3 & n.11 (10th Cir. Mar. 30, 1992) (rejecting an argument that a person's conduct after an incident was logically and legally irrelevant to the person's state of mind at the time of the incident). Evidence that Defendant Nacchio continued to resist disclosure of the information during the months immediately following the charged trades is relevant to prove his intent, as it is evidence of concealment and consciousness of guilt. Evidence of lulling and concealment that postdates acts of fraud may be relevant because such conduct furthers the fraud by making apprehension of the defendant's illegal conduct less likely. *See, e.g., United States v. Lane*, 474 U.S. 438, 451 (1986) (holding that post-fraud mailings were in furtherance of the scheme in mail fraud prosecution); *United States v. Kelly*, 929 F.2d 582, 585 (10th Cir. 1991) (same).

Moreover, in the securities fraud context, evidence postdating the alleged fraud is routinely addressed as relevant to the issues of whether the information at issue was material and nonpublic. In addressing those issues, courts have considered the behavior of investors and the stock price at the time that the information at issue is finally — *i.e.*, after the alleged fraud — disseminated to the investing public. *See, e.g., In re Merck & Co Securities Litigation*, 432 F.3d 261, 269 (3d Cir. 2005) (discussing at length the effects that various disclosures eventually had on the stock price); *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.*, 320 F.3d 920, 934-35 (9th Cir. 2003) (declining to adopt a "bright-line rule

assuming that the stock price will instantly react" and instead noting that although a disclosure at issue "had no immediate effect on the market price," the stock price did drop significantly two to three months later when the "full economic effects" were disclosed, which "supports a finding of materiality"); *Oran v. Stafford*, 226 F.3d 275, 282 (3d Cir. 2000) (noting that if an efficient market is assumed, "the materiality of disclosed information may be measured *post hoc* by looking to the movement, in the period immediately following disclosure, of the price of the firm's stock"); *Schneider v. Vennard (In re Apple Computer Securities Litigation)*, 886 F.2d 1109, 1116 (9th Cir. 1989) (addressing whether information was material and observing that "[d]ramatic price movements in response to an optimistic statement would provide a strong indication that the statement itself was material"); *cf. Basic, Inc. v. Levinson*, 485 U.S. 224, 248 n.28 (1988) (declining to resolve "how quickly and completely public information is reflected in market price").

Here, the government intends to prove that the material nonpublic information was incrementally disclosed to investors during the several months following the charged trades, and that this trickling out of the information had a corresponding negative effect on the price of Qwest stock.

F. Qwest's insider trading policy

The government expects to introduce at trial Qwest's insider trading policy. The government submits that this policy will be relevant in multiple ways. First, it is relevant to help the jury understand Qwest's rules regarding the trading "windows" when executives like Defendant Nacchio could trade. Second, it is relevant in establishing Defendant Nacchio's

fiduciary duties. Third, it is relevant to establish Defendant Nacchio's knowledge of the insider trading rules, and his *scienter* more generally.

The government notes that evidence of internal company policies regarding insider trading has been commonly considered by courts evaluating securities fraud claims. *See, e.g., United States v. Mooney,* 425 F.3d 1093, 1097 (8th Cir. 2005) (noting that the defendant had been suspended for violating the company's insider trading policy); *SEC v. Happ*, 392 F.3d 12, 29-30 (1st Cir. 2004) (noting that although an internal trading policy was not properly admitted to show intent where there was no evidence suggesting that the defendant had seen or even knew about the policy, the internal policy nevertheless could be considered relevant in establishing his fiduciary duties; also ruling that other prior correspondence to the defendant regarding the rules against insider trading was properly admitted as it was probative of the defendant's state of mind); *In re Cardinal Health Inc. Securities Litigation*, 426 F. Supp. 688, 731-32 (S.D. Ohio 2006) (discussing the significance of open and closed trading windows in a company's insider trading policy); *SEC v. Pardue*, 2005 WL 736884, at *1 (E.D. Pa. Apr. 1, 2005) (unpublished) (after a § 10(b) trial to the court, making a factual finding about the defendant's awareness of a company policy against insider trading); *SEC v. Lipson*, 129 F. Supp. 2d 1148 (N.D. Ill. Jan. 11, 2001) (discussing the company's insider trading policy in detail).

G. Safe harbor trading plans

The government anticipates that there will be evidence at trial of "safe harbor" trading plans. Such plans were adopted in SEC Rule 10b5-1, which took effect on August 24, 2000. *See* 17 C.F.R. § 240.10b5-1 (2000). Such plans were established to enable corporate insiders to

avoid charges and claims of insider trading by entering into a pre-set trading plan.

The basic terms of such plans are set forth in the regulation. The insider must, before becoming aware of material nonpublic information and in good faith, adopt a written plan for trading securities that meets certain criteria (such as specifying an amount of securities to be sold at a particular price on a particular date; providing for trades to be made pursuant to a written formula, algorithm, or computer program; or granting a non-insider — *i.e.*, someone without material nonpublic information — authority to exercise control over trades). *See generally* 17 C.F.R. § 240.10b5-1(c).

In the Indictment, the government alleges that Defendant Nacchio established such a plan, then decided not to follow the plan.

H. Irrelevant evidence of Qwest's disclosure obligations

The government anticipates that Defendant Nacchio may seek to introduce evidence regarding whether Qwest was obligated to disclose various internal information. The government submits that Qwest's disclosure obligations are not relevant. The government is not required to prove that Qwest was required to disclose any information at issue. As the Court has previously observed, a corporation has no general duty to disclose all of its nonpublic information. *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.").[2]

IV. CIPA ISSUES

A. Defendant should not be permitted to offer CIPA evidence until he testifies

The government notes the potential inadmissibility of information that has been the subject of hearings pursuant to the Classified Information Procedures Act.

The Court has, in various pretrial CIPA rulings, addressed the potential relevance and admissibility of certain classified information. This classified information does not tend to rebut the allegation that Defendant Nacchio was in possession of other material nonpublic information; rather, it is relevant only if Defendant Nacchio claims that he lacked *scienter*. Accordingly, Defendant Nacchio should not be permitted to introduce these CIPA matters unless he testifies at trial, for several reasons.

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[2] *See also 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 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).

First, as noted, the evidence addressed in the CIPA hearings is relevant at trial only if Defendant Nacchio can show that he lacked *scienter* because of it. Defendant Nacchio is required by Federal Rule of Evidence 104 to lay an adequate evidentiary predicate for any such evidence by testifying that it affected his state of mind. The information is not relevant for any other purpose. Unless and until he offers such testimony, the information should be excluded as irrelevant.

Second, if Defendant Nacchio decides not to testify, it would create unfair prejudice pursuant to Federal Rule of Evidence 403. It would be unfairly prejudicial to allow him not to testify but to present other CIPA evidence at trial, from which he would hope to have the jury blindly speculate at how the evidence might have affected his state of mind. The government would be severely prejudiced if Nacchio were permitted to put this evidence before the jury without affording the government an opportunity to cross-examine him. Accordingly, due to this prejudice, the Court should exclude such evidence unless and until Defendant Nacchio testifies.

Third, there are additional concerns, beyond prejudice, relating to the CIPA evidence if Defendant Nacchio does not testify. If Defendant Nacchio proffers CIPA evidence, this will threaten to inject into the case a mini-trial on government agency programs, because there are factual inaccuracies in Defendant's proffers as to various agencies. There will likely be a substantial amount of rebuttal evidence offered in the event Defendant attempts to put these facts before the jury. If he does not testify, the minor probative value of those proffered facts would be substantially outweighed by the risk of confusing the issues or misleading the jury, as well as by the risk of undue delay or waste of the jury's time.

Fourth, the government further notes that allowing Nacchio to present such information without testifying also would be inconsistent with CIPA. CIPA was intended to afford a defendant a reasonable opportunity to support a defense relating to classified information. It was not created to enable a defendant to obtain pretrial "commitments" of relevance from the Court that can be strategically relied on to gain the admissibility at trial of evidence that otherwise would not be admissible.

The government notes that Nacchio has suggested in prior CIPA hearings that he may testify to support the evidence at issue in those hearings. The government does not contend that Defendant Nacchio cannot change his mind about testifying, but simply that until such foundational testimony has been offered by Defendant Nacchio, the CIPA evidence should not be admitted.

B. Special CIPA trial procedures

The government notes that the Classified Information Procedures Act sets forth certain special rules applicable to trials involving classified information. The government highlights a few such rules here.

First, section 5(a) of CIPA makes clear that a defendant may not disclose, through testimony or otherwise, any information that may be classified unless notice of the information has been provided pursuant to § 5 of CIPA and the United States has had a reasonable opportunity to invoke the procedures set forth in CIPA §§ 6 and 7:

> No Defendant shall disclose any information known or believed to be classified in connection with a trial or pretrial proceeding until notice has been given under this subsection and until the United States has been

> afforded a reasonable opportunity to seek a determination pursuant to the procedure set forth in section 6 of this Act, and until the time for the United States to appeal such determination under section 7 has expired or any appeal under section 7 by the United States is decided.

18 U.S.C. App. 3 § 5(a) (2006); *see also* S. Rep. at 11, *reprinted in* 1980 U.S. Code Cong. & Admin. News at 4304 ("If the Defendant knew that a question or line of inquiry would result in disclosure of classified information, he presumably would have given the government notice of such a case and the procedures in section 5 could be used."). "The Classified Information Procedures Act, 18 U.S.C. App. ('CIPA') applies to classified testimony as well as to classified documents." *United States v. North*, 708 F. Supp. 399, 399 (D.D.C. 1988).

Second, CIPA provides the government with an opportunity to seek excision of classified information from a document to be offered at trial. Specifically, § 8(b) provides that:

> The court, in order to prevent unnecessary disclosure of classified information involved in any criminal proceeding, may order admission into evidence of only part of a writing, recording, or photograph, or may order admission into evidence of the whole writing, recording, or photograph with excision of some or all of the classified information contained therein, unless the whole ought in fairness be considered.

18 U.S.C. App. 3 § 8(b) (2006). Therefore, in the event that the Government or the Defendant seeks to enter in evidence documents that are classified, the Government may move to admit redacted versions of these documents to protect national security.

Third, CIPA provides the government with an opportunity to object to lines of inquiry that may lead a witness to disclose classified information. Specifically, § 8(c) states:

> During the examination of a witness in any criminal proceeding, the United States may object to any question or line of inquiry that may require the witness to disclose classified information not previously found

> to be admissible. Following such an objection, the court shall take such suitable action to determine whether the response is admissible as will safeguard against the compromise of any classified information. Such action may include requiring the United States to provide the court with a proffer of the witness' response to the question or line of inquiry and requiring the defendant to provide the court with a proffer of the nature of the information he seeks to elicit.

18 U.S.C. App. 3 § 8(c) (2006).

Finally, the government notes that it is gathering information regarding the procedures that have been used in other trials where CIPA has been an issue, and will seek to apprise the Court of any special CIPA procedures of which it learns.

Respectfully submitted this 1st day of March, 2007.

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