IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Criminal Case No. 05-cr-00545-EWN

UNITED STATES OF AMERICA,

Plaintiff,

v.

1. JOSEPH P. NACCHIO,

Defendant.

UNITED STATES' RESPONSE TO DEFENDANT'S ARGUMENTS REGARDING GAIN CALCULATION, VARIANCE, AND FINE

The United States of America, by its undersigned counsel, hereby responds to the defendant's proposed gain calculation, his request for a variance from the Sentencing Guidelines' range, and his request that the fine be capped at $6 million.[1]

[1] The arguments addressed herein – regarding gain, variance, and fine — were presented as part of Mr. Nacchio's Response to the Presentence Report. That response was not filed, but was submitted directly to Probation. It is the United States' understanding, however, that the particular arguments addressed herein all raise issues that are not deemed confidential by defense counsel; rather, each addresses either the law, or publicly known facts .

In contrast, the United States understands that the other arguments in Mr. Nacchio's response that relate to the defendant's downward departure motion are considered confidential by the defendant. The United States' response to those arguments is not included in this public filing, but will be separately submitted to the Court.

I. Defendant's gain calculation is incorrect.

The defendant asserts two alternative "gain" calculations in applying the insider trading section of the Sentencing Guidelines – § 2F1.2. First, he argues that the defendant's gain was only $1.8 million based on an "event study" analysis prepared by his retained "expert." Alternatively, he argues that if the Court determines that gain is the profit he made from his illegal sales, the profit should be reduced by income tax withholdings from his proceeds. Both calculations are contrary to law.

The United States previously addressed, in its Sentencing Statement, why the defendant's calculations are wrong under the Sentencing Guidelines and applicable precedent. Doc. 442. This response will *briefly* summarize why the defendant's "event study" methodology is the wrong analysis under the law, and then point out the flaws in the defendant's so-called "event study."

A. Defendant's methodology is contrary to USSG § 2F1.2.

The number the defendant hits with his calculation – $1.8 million of gain based on his sale of 1.33 million shares of Qwest stock for $52 million – is patently unrealistic and completely fails to address the severity of the offense. If this analysis were credited, it would mean that the serious adverse information that the defendant kept from the public when dumping his stock impacted Qwest's stock price by only $1.37/share or approximately 3.5%. This conclusion not only defies common sense, but is also inconsistent with the jury's finding. The jury necessarily found that the defendant, with the intent to deceive or cheat, actually used "material" inside information in selling Qwest stock and that the inside information was a significant factor in his decision to sell the stock. Tr. 3171-73. The jury also found that the inside information that the defendant took advantage of was "of such importance that it could reasonably be expected to cause a person to" trade Qwest stock. Tr. 3171.

As explained more fully in the United States' Sentencing Statement, the defendant's "event study" is the wrong analysis in applying the Sentencing Guidelines.

1. The plain language of USSG §2F1.2 dictates that the proper measure of the severity of the offense is the profits the defendant realized by illegally selling the stock.

The Sentencing Commission promulgated a separate guideline section for insider trading offenses that instructs courts: "Because victims and their losses are difficult if not impossible to identify, the gain, *i.e.*, the total increase in value realized through trading in securities by the defendant . . . is employed instead of the victims' losses." USSG § 2F1.2, cmt. background (2000). The defendant's analysis ignores this commentary and amounts to a purported estimate of the victims' losses by the purchasers of the exact shares the defendant sold. The only case law the defendant cites to support this type of analysis is the **dissent** in the *en banc* decision *United States v. Mooney*, 425 F.3d 1093 (8th Cir. 2005). The majority in *Mooney* held that total profits are the proper measure of gain in criminal insider trading cases under § 2F1.2. *Id.* In addition to the Eighth Circuit, the Second, Fifth, and Seventh Circuits have similarly upheld sentences calculated using total profits as the proper measure of gain. *See United States v. Cusimano*, 123 F.3d 83 (2d Cir. 1997); *United States v. Nichols*, 376 F.3d 440, 443 (5th Cir. 2004) (holding that the district court properly applied the Guidelines when it increased the defendant's offense level by the amount of he profited from insider trading); *United States v. Cherif*, 943 F.2d 692, 702 (7th Cir. 1991).

The dissent in *Mooney* relied on a concern in a hypothetical that is wholly inapplicable to this case. In the dissent's "Larry, Moe and Curly" hypothetical (as in the *Mooney* case), the insiders *bought* stock based on inside information. The dissent's concern was the difficulty in calculating the associated gain because it depended on when the insider sold after the information was public. Here, the defendant *sold* stock based on inside information, so his gain from the illegal transaction is easy for anyone to determine; the defendant would have known his gain the day of the sale.

2. The defendant's gain was his profit, because the defendant was prohibited from doing what he did.

The law is clear: because the defendant made the decision not to disclose the adverse information, it was illegal for him to do what he did — i.e., sell *any* stock on the basis of that information. Accordingly, 100% of the profit he made from his sales was his gain from the offense.

3. The defendant would not have sold if he had disclosed.

If the defendant had disclosed all of the material adverse information during Qwest's April 24, 2001 earnings call, as a practical matter he would not have been able to dump 1.33 million shares during the next month. The defendant knew how sensitive analysts and institutional investors were to large sales by him. He was well aware of the investor crisis that would have been created if he was dumping large quantities of stock after such negative disclosures. In fact, the defendant's conduct once the negative information started trickling out confirms this – he did not sell any more stock even though he had millions of vested, in-the-money options.

Accordingly, because he would not have sold if he disclosed, 100% of his profits represent his gain from the offense.

4. The defendant's "event study" analysis is inapplicable to this criminal insider trading case.

As noted, the defendant's "event study" is a purported estimate of the loss in value of other investors. It thus addresses losses rather than gain, and thus is contrary to the guideline. This focus on losses — derived from civil cases involving individual plaintiffs seeking to show their damages — also lacks force in the context of criminal punishment. *Mooney*, 425 F.3d at 1098.

Moreover, the Guidelines direct courts to use a bright line rule to measure the severity of the offense rather than a speculative analysis with imprecise standards like the one proposed by the defendant. "The focus in [the guideline] on the increase in value realized by the defendant's trades provides a simple, accurate, and predictable rule for judges to apply and follows the congressional mandate that sentences reflect the seriousness of the offense." *Id.* at 1101.

5. By using only the actual shares the defendant sold, the defendant's analysis grossly understates the harm caused by the offense.

As stated above, the defendant's analysis is a purported estimate of the *loss* in value to purchasers of the stock the defendant sold. However, that analysis is contrary to *gain* approach required by § 2F1.2. Even if victim losses was the proper measure of the offense conduct, the defendant's methodology grossly understates the harm caused by the defendant's conduct. The evidence at trial established that:

- the defendant controlled what information Qwest disclosed to the public;
- the defendant exploited what information was and was not disclosed to the public to benefit himself at the expense of common investors;
- the defendant set unrealistic growth targets to inflate Qwest's stock price;
- the defendant refused to disclose important information about how Qwest was growing;
- the defendant refused to tell investors that Qwest's non-recurring revenue business had dried up and they did not have any new source of revenue to offset that gap.

If the proper analysis was to look at losses to victims of the offense, **all** investors who purchased or decided not to sell Qwest stock during the Spring 2001 were harmed by the defendant's conduct, which was motivated by his intent to defraud. The defendant's methodology grossly understates the harm by only including purchasers of the actual shares of stock he sold.

B. The study by Professor Fischel is flawed.

In addition, the specific economic model on which the defendant relies is flawed. The model presented by Professor Daniel Fischel is legally improper, based on unrealistic and incomplete assumptions, factually deficient, methodologically flawed, and contrary to common sense. It fails to account for disclosure of much of the material inside information established at trial, such as the defendant's knowledge of Qwest's IRU business. The defendant's model is a clear example of the morass that the Sentencing Commission clearly was seeking to avoid when it developed its definition of gain for insider trading offenses.

1. Professor Fischel's model ignores the legal duty the defendant violated.

Professor Fischel states that he was asked to "estimate the portion of Mr. Nacchio's sales proceeds that can be attributed to inside information concerning these issues." *See* Fischel Report at 2, ¶ 5.[2] He purports to examine how much money the defendant would have made had he sold at the same time that he did, in the same quantities he did, but in a world where the material inside information was public.

This analysis is improper because it ignores the legal duty that the defendant violated. As noted, under the law of insider trading, because Qwest's material

---

[2] Professor Fischel's report is not presented as a confidential report: it contains no references to information from the Presentence Report or any other confidential information.

information was not disclosed, the defendant had a clear duty to *abstain* from trading on the basis of such information. As the Supreme Court has explained:

> Trading on [material nonpublic] information qualifies as a "deceptive device" under § 10(b), we have affirmed, because "a relationship of trust and confidence [exists] between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation." That relationship, we recognized, "gives rise to a duty to disclose [or to abstain from trading] because of the necessity of preventing a corporate insider from ... tak[ing] unfair advantage of ... uninformed ... stockholders."

United States v. O'Hagan, 521 U.S. 642, 652 (1997) (quoting *Chiarella v. United States*, 445 U.S. 222, 228-29 (1980)).

Professor Fischel's model does not really address what would have happened if the defendant had followed the law. Rather, it purports to address what would have happened where the defendant had acted in exactly the same way, but in an imaginary world where the material inside information all had been disclosed. This kind of analysis is not justified. It is not proper to examine gain by changing the facts of the world in which a defendant lived in such a way to make his conduct legal, rather than assuming the defendant followed the law.[3]

The gain the defendant would have foregone by following the law was clear. The jury's verdict clearly shows that in April and May 2001, the defendant had material

---

[3] Professor Fischel does not even explain how the facts of the defendant's world have been changed for his analysis. When does he assume the disclosures were made? All at once? By Nacchio? One can only wonder.

nonpublic information, and had an intent to use that information to sell stock. But the defendant could have still followed the law — if he had abstained from trading. And if he had done so, he would have had no proceeds at all.

In short, Professor Fischel's model is contrary to law because it ignores the defendant's duty to abstain, and the clear manner in which the defendant could have followed the law.

2. The model is based on an unrealistic assumption.

Another problem with Professor Fischel's model is that it rests on a wholly unrealistic assumption. His model effectively posits a world where (1) on April 24, 2001, the defendant had told investors *all* of the material inside information he knew, and then (2) two days later, the defendant started a selling spree, selling well more than a million shares in a month.

This assumption is preposterous. It is wholly unrealistic to speculate that two days after a dramatic and negative disclosure — one that surely would have had an impact on the company's stock — the defendant would have been able, as a practical matter, to launch his identical selling spree. This is not an attempt to realistically assess how the defendant would have gained had he made the disclosures.

Indeed, the evidence at trial showed that investors closely monitored the defendant's trading activity. *See* Tr. 293:17 to 294:10 (Wolfe), 2315:2-24 (Khemka), GX 719. This monitoring would have made it wholly impracticable for the defendant to dump a huge volume of stock immediately following an extremely negative announcement. Indeed, Also, as a factual matter, once Qwest's dire information began to trickle out later in 2001 and Qwest's stock was in sharp decline, the defendant did not sell a single share.

In short, the model's underlying assumption — that the defendant could have dumped stock rapidly and in very high volumes after disclosing all of the dire information about Qwest — is not a rational economic assumption, but a fantasy belied by the evidence.

3. The model ignores numerous ways the defendant gained from his conduct.

Another major flaw in Professor Fischel's model is that it fails to take into account the numerous ways the defendant benefitted from his conduct.

For example, it ignores the *huge* advantage the defendant obtained by selling *when* he did. By dumping his stock in April and May 2001, he was able to sell when Qwest's stock price was stable and high. He was able to cash out his options in an orderly and enormously profitable way.

The model also fails to take into account the advantage the defendant obtained by starting his selling spree immediately after he had reassured – and misled — investors on the April 24, 2001 conference call. As background, it is important to recall that the defendant told investors on that call that after three weeks of detailed operational reviews, he was very bullish on Qwest's results and outlook. GX 594A; Tr. 2192 (Johnstone). He reaffirmed Qwest's 2001 guidance, and told investors that "we are very pleased with the quarter reconfirming our estimates," and added, "We see nothing to dissuade us from the plan we announced almost 18 months ago." GX 593A; Tr. 240-43 (Wolfe), 1521 (Smith), 2192 (Johnstone); GX593. This was a lie.

That lie enabled the defendant to sell large volumes of stock right after making positive statements to investors — statements that would have had a significantly favorable effect on their view of Qwest. Professor Fischel's model nowhere takes into account the fact that the defendant vigorously pumped Qwest stock — thus keeping the stock price high — right before he sold.

Furthermore, the model ignores the fact that the defendant's conduct enabled him to sell his stock quickly without attracting scrutiny. Because investors did not know in April and May 2001 what the defendant knew about Qwest's very dire prospects for late 2001, the defendant was able to sell stock at a time before investors would have been too suspicious of his very large stock sales.

4. The model fails to accurately identify when the material information was finally disclosed.

Another major flaw in Professor Fischel's approach can be seen in his identification of the disclosures. In his model, he purports to determine the effect on Qwest's stock price of the disclosures of the material nonpublic information the defendant relied on. His first step is thus to identify the relevant disclosures. *See* Fischel Report at 3 ¶ 6 ("I first identified relevant disclosures that were made after the Insider

Trading Period"). He identifies just four "disclosures," plus one analyst report. However, these five events did not even come close to disclosing all of the dire information the defendant knew when he sold his stock in April and May 2001.

a. In April 2001, the defendant had a substantial amount of material nonpublic information.

The evidence at trial showed that as of April 2001, the defendant had a huge amount of dire inside information about Qwest's prospects. To take just a few examples, he knew that:

- Qwest had "drain[ed] the pond" on IRUs because "the market was drying up. There was nothing there." Tr. 1109-10, 1158, 1194 (Casey). IRUs were "going away." Tr. 1122 (Casey). Also, most of Qwest's IRUs in early 2001 had been "swaps" or trades with other companies, rather than outright sales. Tr. 1108 (Casey).

- Qwest's wholesale unit showed a projected gap of $675 million — two thirds of a billion dollars — for the rest of 2001. Tr. 1109, 1194 (Casey); GX 959 at 6.

- Qwest's consumer and small business unit was going to miss its 2001 revenue target by about a third of a billion dollars — $323 million. Tr. 1508-10, 1513 (Smith).

- Qwest's global business unit had missed its objective for recurring revenue for the first quarter of 2001, and was "way off target" in its recurring revenue results. Tr. 1243, 1248 (Graham).

b. The disclosures Professor Fischel analyzes did not disclose all the inside information.

The disclosures Professor Fischel identifies did not come close to disclosing all of this dire inside information the defendant had as of April 2001.

Professor Fischel identifies five disclosures:

- A July 24, 2001 press release on Qwest's financial results for the second quarter of 2001.
- An August 7, 2001 statement by the defendant at an analyst conference.
- An August 14, 2001 10Q report by Qwest, in which it disclosed the magnitude of its first and second quarter IRU transactions in 2001.
- An August 22, 2001 analyst report by Drake Johnstone of Davenport and Company, analyzing the August 14, 2001 10Q report.
- A September 10, 2001 press release in which Qwest reduced its guidance for the second half of 2001 and for 2002.

Report at 3-4, ¶ 7.

These disclosures did not come close to disclosing all that the defendant knew. Indeed, Professor Fischel's inclusion of the July 2001 release is surprising, given that in this report, there was still no useful disclosure of inside information the defendant had since April 2001. In fact, the evidence at trial was that in July 2001 earnings call, the defendant affirmatively tried to *deceive* investors. Lee Wolfe, Qwest's head of investor relations, testified that on that call, the defendant "tried to finesse – he tried to change the EBITDA earnings target, lower it without acknowledging that [was] what he was doing." Tr. 270:6-12 (Wolfe).

Other releases show similar misleading statements by the defendant. In the August 7, 2001 statement, the defendant insisted that although Qwest would disclose past one-time transactions, it "would continue to meet the financial targets," even though the defendant knew that Qwest's one-time revenue had dried up. Tr. 283:8-14 (Wolfe). Similarly, in the press release on September 10, 2007, when Qwest lowered its guidance, the defendant did not mention that it did not expect to have any IRU sales or that demand for IRU sales had dried up; rather, the defendant stated that the lowered guidance "reflects deteriorating economic conditions both nationally and within the 14 Western states in which Qwest provides local communication services." GX 646. The defendant refused in these releases to tell investors the full story — that IRU sales had completely dried up. Indeed, he again set out to *deceive* investors in that release: before the September 2001 press release, he stated that he needed to "give the sense that this was something new that caused the lowering of the targets." Tr. 289:8-22 (Wolfe).

It is plain that these disclosures did not come close to disclosing all of the dire information the defendant had about Qwest prospects back in April 2001. For example, there was no disclosure of the facts that demand for IRU sales had dried up; that Qwest did not expect to have any IRU sales in the second half of 2001; that they had no source of revenue to replace IRUs; and that Qwest's business units expected to miss their 2001 targets by hundreds of millions of dollars. These disclosures trickled out some information, but they continued to be very misleading, and they were clearly incomplete.

c. Professor Fischel ignores several later disclosures of the inside information.

The material nonpublic information the defendant knew in April 2001 did not trickle out to investors until several months after September 2001.

For example, when Qwest announced results for the third quarter of 2001, and after investors learned that Qwest had missed the lowered target it had announced only a month before in September 2001, Qwest's stock price dropped precipitously to $12. Tr. 290:14-24 (Wolfe). In an associated press release, Qwest finally mentioned a "decline in optical capacity asset sales and non-recurring IP equipment revenue," and mentioned that this decline "resulted from softening wholesale demand." *See* Ex. 1 (Oct. 31, 2007 10Q press release) at 2. This was information that the defendant had in April before he dumped his stock. This was still an incomplete disclosure – Qwest did not reduce its guidance or report that it had zero IRU sales in the pipeline.

In the ensuing months, Qwest continued to trickle out the adverse information. On December 13, 2001, Qwest lowered its earnings guidance again, reporting that this reduced guidance reflected, in part, "a decrease in demand for wholesale broadband capacity services." *See* Ex. 2 (Dec. 13, 2007 press release) at 1. Qwest still did not, however, report that it would have *zero* IRU sales in the pipeline for the fourth quarter of 2001. The first time investors would have learned that fact — which the defendant knew back in April 2001 — would have been when the fourth quarter 2001 earnings were reported, in early 2002.

Professor Fischel does not offer any explanation for why he excluded these subsequent disclosures. He does not purport to have reviewed the testimony at trial about what the defendant knew in April 2001, or to have analyzed any disclosures by Qwest after September 10, 2001.

d. The exclusion of these other important disclosures makes the analysis grossly inadequate.

Because the disclosures Professor Fischel analyzed did not include all of the inside information the defendant knew in April 2001, his analysis — even for what it is worth — is hopelessly incomplete. The evidence makes clear that there was no single, clear moment when Qwest told investors what the defendant knew in April 2001.

Professor Fischel's states that his project is to "estimate the portion of Mr. Nacchio's sales proceeds that can be attributed to inside information concerning these issues." *See* Fischel Report at 2, ¶ 5. But he cannot seriously estimate the value of the inside information, even under his approach, absent a serious attempt to include all of the disclosures of the inside information in his analysis. All that the Court can conclude is that even under the flawed model Professor Fischel uses, he does not accurately determine the value of that information.

5. There are additional major flaws in Professor Fischel's model.

Professor Fischel's approach also suffers from other specific flaws that make it very unreliable.

a. The two-day window is far too short to capture the effects of the disclosures.

One major problem with Professor Fischel's methodology is that the two-day "event windows" he examined to determine the total effect of the disclosures are unrealistically short.

To determine the total effect of the disclosures on Qwest's stock price, Professor Fischel examined the stock price on the day of the disclosure, and then the next day. *See* Fischel Report at 5 ¶ 9 ("In order to evaluate the effect of the Subsequent Disclosures on the price of Qwest's stock, I analyzed changes in Qwest's common stock price on the first day on which trading occurred following each Subsequent Disclosure, and separately analyzed changes during the two-day period that includes both the trading day of and the trading day following each Subsequent Disclosure.") He claims that use of these short windows is "appropriate because in an efficient market, stock prices react quickly to new information." *Id.*

This two-day window is unrealistically short in the context of the inside information at issue in this case. Professor Fischel fails to take in to account the well-known economic phenomenon that negative earnings information – the type of inside information the defendant kept from the public when he sold – takes *several months* to be fully reflected in the stock price. *See, e.g,* S. Stickel, "Common Stock Returns Surrounding Earnings Forecast Revisions: More Puzzling Evidence," in *The Accounting Review* 402 (1991) (observing that where there is an earnings revision, "prices continue to drift in the direction of the revision for about six months"); J. Liu, "Market and Analyst

Reactions to Earnings News: an Efficiency Comparison" at 6 (2003) (discussing "post-earnings announcement drift, where the market appears to under-react to earnings news .... The returns of good news firms continue to drift up and those of bad news firms drift down. It is to date one of the most robust market 'anomalies' in the stock market"); J. Livnat, "Post-Earnings-Announcement Drift: The Role of Revenue Surprises" at 1 (2003) (noting that this drift is "[o]ne of the most puzzling market anomalies" and lasts "up to a year"); J. Francis *et al.*, "Information Uncertainty and Post-Earnings Announcement Drift" at 2 (2006) (explaining that post-earnings announcement drift is "concentrated in the six months following the earnings announcement"); K. Anderson *et al.,* "Opinion Divergence and Post-Earnings Announcement Drift" at 1 (2007) (noting that this drift is well documented and "lasts for up to nine months"), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=969736.

In fact, the *majority* of a stock price's reaction to bad news may be delayed. *See* Q. Sun, "The Timing of Earnings Announcements and Market Response to Earnings News" at 11 (2006) (finding that negative earnings announcements by companies were followed "by a total value depreciation of 6.40% (-2.38% surrounding the announcement date *and -4.12% in the following quarter*)") (emphasis added).

This point — that the stock price will not immediately reflect the bad news — can been seen in a concrete example shown in Professor Fischel's own discussion of the evidence. After Qwest issued its August 14, 2001 report disclosing the magnitude of its

IRUs earlier in 2001, it took Drake Johnstone — a highly sophisticated professional analyst — more than a week to issue a report addressing this disclosure. Professor Fischel found that the initial disclosure on August 14 did not produce a significant reaction, but then found that Johnstone's report, several days later, led to a whopping drop of 12.35% in Qwest's stock price as compared to the NASDAQ. *See* Fischel Report at 8 ¶ 13(d). The fact that it took a professional more than a week to digest Qwest's disclosure shows how unrealistic it is to expect that the entire market will have digested the news within a day of the disclosure.

In sum, the two-day window Professor Fischel uses is wholly inadequate for capturing the full effect of the disclosures he chose to analyze. Even if such a short study might be useful in determining whether the market had any immediate positive or negative reaction to the news, it could not possibly capture the full effect of the disclosure on the market price. Professor Fischel make no adjustment to his results to address this inadequacy.

b. Professor Fischel's analysis of the market's reaction to the September 10, 2001 guidance is flawed and misleading.

Another flaw in Professor Fischel's model is apparent in his conclusions regarding the market's reaction to Qwest's reduction in earnings guidance on September 10, 2001.

Professor Fischel finds that Qwest's significant *reduction* in earnings guidance on September 10, 2001 produced a 10.07% *increase* in Qwest's stock price as compared to the NASDAQ over the next two trading days. In other words, he found that the *bad* news led to a rapid *increase* in Qwest's stock.

This conclusion — that the bad news made the stock price soar — flies in the face of common sense, and thus illustrates the unreliability of Professor Fischel's model. Professor Fischel acknowledges that the next trading day after September 10, 2001 was not until a week later (September 17, 2001), but he does not seek to make *any* adjustment for the dramatic events that intervened between those two trading days. He finds no need to even discuss whether on September 17, 2001 — the first trading day after the most significant event in decades — investors were thinking of something other than Qwest's reduced guidance on September 10.

But Professor Fischel does not reach this obviously incorrect result in isolation. Instead, he uses it to maximum effect in his ultimate results. As noted earlier, Professor Fischel had found that Drake Johnstone's report on August 22, 2001 led to a steep 12.35 % drop — suggesting that this report had a significant effect on investors. But Professor Fischel manages to slash this dramatic-seeming 12.35 % drop by "compounding" it with the 10.07 % increase after the September 10, 2001 reduced guidance. By compounding these two numbers together, he concludes that the *cumulative* change to those two events was a decrease of only 3.52 %. *See* Fischel Report at 9 & n.19.

In other words, Professor Fischel takes a ridiculous result — that the fact that Qwest wouldn't make its earnings targets was good news to investors — and unabashedly uses that result to try to disguise the significance of other prior bad news. He offers no basis for compounding these two numbers, and there is none — other than the obvious result-oriented goal of trying to figure out how to reduce that dramatic 12.35% drop to only a 3.52% drop.[4]

In sum, for the reasons set forth in the United States' Sentencing Statement and as set forth above, the Court should use the defendant total profits to calculate his gain under § 2F1.2 of the U.S. Sentencing Guidelines.

II. The Court should deny the defendant's request for a variance

The Court should also deny the defendant's request for a variance pursuant to 18 U.S.C. § 3553(a). The various "ameliorating factors" he cites do not warrant a sentence at the bottom of the range, let alone a variance. On the contrary, they confirm the blameworthiness of the defendant's conduct.

A. The defendant's pattern of deceptive conduct

The insider trading was not an anomaly in an otherwise "unblemished" record. On the contrary, this deceptive conduct by the defendant did not stand alone. This can be seen from reviewing just the year surrounding the insider trading.

---

[4] There are other issues with Professor Fischel's model, such as his choice of the NASDAQ as a comparison (rather than an telecom index), and his failure to provide the data that underlie his chart (which makes it impossible to verify his calculations or results).

- In late 2000, the defendant asked his financial advisor, David Weinstein, to assist him in an act of dishonesty involving Qwest. Tr. 1679 (Weinstein).

- In December 2000, the defendant signed a backdated document. GX 100, 210; Tr. 2081 (Grossman); 2139, 2143, 2156 (Patti), 2722 (Olson).

- In April 2001, the defendant flat-out lied to investors, saying, "We see nothing to dissuade us from the plan we announced almost 18 months ago." GX 593A; Tr. 240-43 (Wolfe), 1521 (Smith), 2192 (Johnstone); GX593.

- In April and May 2001, the defendant defrauded investors through his insider trading.

- In July 2001, the defendant tried to deceive investors by suggesting that a changed EBITDA target had not changed. Tr. 270:6-12 (Wolfe).

- Before the September 2001 press release, the defendant set out to deceive investors, stating that he needed to "give the sense that this was something new that caused the lowering of the targets." Tr. 289:8-22 (Wolfe).

In fact, the defendant's deceptions were not limited to 2001. Ample evidence shows that starting in 2002, the defendant made huge and sudden fraudulent transfers that were expressly intended to defeat creditors. Contemporaneous memoranda by his financial advisor, David Weinstein, document not just one, but *numerous* conversations in which the defendant made this intent clear:

- "Although Joe is aware of the 12 month lookback rule in the event of bankruptcy, as Joe put it, once the money is in his possession, he is one step ahead of the game!"

- "Joe basically wants to have no assets in his name and he can then claim he is bankrupt."
- "The bottom line is Joe does not want creditors to attach any of his assets...."
- "Joe is exploring the possibility of a divorce for financial reasons. The money that was transferred to Anne prior to March would then be considered an equitable distribution and not subject to the claims of creditors.""Joe then was thinking about buying a $20 million house in Florida. Florida real estate is not subject to the claims of creditors...."

Docket No. 419 at 5-11.

The defendant's insider trading thus fits into a consistent pattern of deceptive conduct. This pattern of deceptive conduct is not an ameliorating factor, but an aggravating one.

B. There is no evidence of any impact on him in April and May 2001

The defendant also asks the Court to take into account the pressures on him in the spring of 2001.

At trial, there was evidence of some impact on the defendant in January 2001 as a result of his son David's attempted suicide. At that time, he briefly discussed quitting with Philip Anschutz.

But the insider trading charges on which the jury found him guilty related to conduct primarily in late April and May of 2001. There is no evidence that any family issues had, during that period, an impact on the defendant similar to the impact he claimed in earlier 2001. There is no evidence that in April or May 2001, the defendant had any discussions of quitting Qwest due to personal issues. Nor is there evidence that in that time period he sought to take any substantial leave of absence. Given the absence of any evidence of an impact on him at work during this time period, the Court should not find that the pressures on him at that time were so great that they somehow ameliorate his conduct.

C. The defendant's selling spree in April-May 2001 was not consistent with his prior announcement.

The defendant suggests that he sold his shares in accordance with an announcement he had made on October 31, 2000. This argument is misleading. What the defendant said in October 2000 was that he would "dribble out his shares." Tr. 104. His all-out selling spree in April and May 2001 was hardly a dribble. Indeed, the evidence indicated that his original plan was to sell 11,500 shares a day, not 1.3 million over the course of a month.

Moreover, defense counsel made this argument to the jury, and the jury rejected it. Tr. 104.

D. His acquittal on other counts is not an ameliorating circumstance.

The defendant also highlights all of the trading days in early 2001 as to which he was found not guilty. While the jury may not have found the defendant guilty as to those stock sales, its finding of not guilty clearly does not mean his conduct was commendable as to those trades. On the contrary, it is proper for the Court to consider those highly suspect trades as relevant conduct in imposing sentence.

E. Qwest's duties do not show his conduct was excusable.

The defendant highlights the fact that the United States did not seek to prove at trial that Qwest was required to disclose the material inside information. But this fact — that it was Qwest's information to disclose or not — does not somehow show that the defendant's conduct was commendable.

Even if Qwest did not have to *disclose* the adverse information, that did not mean that it was permissible for the defendant to *affirmatively mislead* investors by assuring them that he and others at Qwest saw "nothing to dissuade us" from Qwest's targets. GX 593A; Tr. 240-43 (Wolfe), 1521 (Smith), 2192 (Johnstone); GX593.

Also, the proprietary nature of the information confirms that the defendant's conduct was wrong. After all, it was Qwest's proprietary information, not the defendant's, and so the defendant was not allowed to Qwest's information to defraud investors for his own benefit.

In sum, there is no basis for a variance. As noted previously, the United States contends that the sentence should be at the top of the range.

III. The fine relating to Counts 24-42 should be $19 million.

The defendant contends that the cap on fines should be $6 million, not $19 million. This argument should be rejected.

A. The fine for Counts 24-42 should not be capped at $6 million.

The defendant acknowledges that there was a separate violation for each of the nineteen transactions completed — the stock sales at issue in Counts 24 through 42. He also does not dispute that the maximum fine for each of these nineteen transactions is $1 million. He argues instead that the fine imposed should not reflect all nineteen transactions, but instead a smaller number.

As to Counts 24 through 35, the defendant argues that the maximum fine should be capped at $5 million instead of $12 million. He cites the fact that one of the brokers, Salomon Smith Barney, carried out two of his block sales orders over ten days total, rather than effecting those trades immediately. His argument is essentially that if Salomon had sold over the space of one day each time rather than several trading days, there would have been two counts at issue for those trades, instead of ten.

This speculation about how the transactions might have been otherwise structured does not warrant capping the fines. As the defendant acknowledges, as a factual matter, there were indeed ten transactions, spread over ten trading days. And the jury found him guilty as to each of those trading days.

Moreover, and contrary to what the defendant clearly suggests, the daily sales were *not* carried out with no personal involvement by the defendant. Rather, the defendant himself was integrally involved in the spreading.

This personal involvement by the defendant can be seen in the documents surrounding the SSB trades. The defendant first personally signed forms indicating to the Securities and Exchange Commission his intent to sell a block of shares over the next several days. *See* Ex. 3 (Form 144s). But he then followed up on those forms by directing sales of specific, smaller amounts of shares to be sold on specific days. *See* Ex. 4 (individual instructions). He personally signed an instruction to SSB for each of these daily trades. *See id.* And after making the trades, SSB issued a trade confirmation to the defendant personally, showing the amount of the trade that day. *See* Ex. 5 (daily trade confirmations).

The defendant thus was not somehow cut off from the decision to sell smaller amounts of shares on individual days. Instead, he was personally involved in directing the amounts of the smaller trades on each of those individual days, and he received a trade confirmation for each day's trades. The fact that the defendant had earlier filled out a form indicating his general intention to sell a block of shares over several trading days does not show that he was not personally involved in each individual sale.[5]

The defendant also seeks to have the 10b5-1 plan he initiated on May 16, 2001 — the trading plan at issue in Counts 36-42, which resulted in several stock sales — treated as just a single transaction for purposes of the fine calculation. The defendant argues that the fine for these seven stock sales should be no more than $1 million, because there was just one trading plan covering this period from May 16, 2001 to May 29, 2001.

This argument, too, lacks merit. The defendant intentionally set up his 10b5-1 plan to make a separate trade each day. A trade was then effected each trading day, with

[5] Indeed, the defendant knew that the reason for spreading out these trades over several trading days was to maximize his sales price in selling a large quantity of shares.

a confirmation issued to the defendant personally on a daily basis. Each day, the defendant would have known that he could have stopped that day's selling. Indeed, when the defendant had entered into a trading plan in February 2001, he clearly did monitor every day's trades, since he stopped that plan shortly after it began. In May 2001, he allowed his trading plan to proceed for seven trading days, knowing that he was selling stock to other investors every single trading day. The defendant thus made a decision to trade every day, and the cap should reflect *all* of the counts corresponding to those trading days.

B. Other facts confirm that $19 million is the appropriate fine.

There are several other factors that support a determination that $19 million is the appropriate amount for the fine.

First, this sum is not out of line with the crime. The sums involved in this insider trading make it one of the largest insider trading verdicts ever.

Second, this sum is actually small in comparison with the defendant's gain. For an average insider trading defendant who made less than $1 million from a trade, a fine of $1 million per count might be far more than the amount involved in the sale. Here, the opposite is true: the amount involved in the sale far *exceeds* $19 million.

Third, the evidence shows that this amount is one that will "afford adequate deterrence to criminal conduct." 18 U.S.C. § 3553(a)(2)(B). In short, the $19 million is warranted by the need to deter and punish this defendant. In determining the amount sufficient to deter the conduct and punish the defendant, it is proper for the Court to consider the defendant's net gain and his ability to pay. Here, his net gain was $44 million, and his ability to pay is in the hundreds of millions. Thus, after imposition of any fine, he still will retain enormous assets. Under these circumstances, a fine of less than $19 million would amount to a barely noticeable slap on the wrist.

CONCLUSION

For the reasons set forth in the United States' Sentencing Statement and those set forth above, the United States requests that the Court sentence the defendant to 87 months' incarceration followed by three years of supervised release, and the maximum fine of $19 million.

Respectfully submitted this 23rd day of July, 2007.

TROY A. EID
UNITED STATES ATTORNEY

s/Kevin T. Traskos
Cliff Stricklin
James O. Hearty
Kevin Traskos
Assistant U.S. Attorneys
United States Attorney's Office
1225 17th Street, Suite 700
Denver, Colorado 80202
Telephone: (303) 454-0100
Fax: (303) 454-0400
E-mail: cliff.stricklin@usdoj.gov
james.hearty@usdoj.gov
kevin.traskos@usdoj.gov

s/Colleen Conry
Colleen Conry
Senior Litigation Counsel
Leo Wise
Trial Attorney
United States Department of Justice
1400 New York Avenue, N.W.
Washington, DC 20005
Telephone: (202) 514-0658
Fax: (202) 514-0152
E-mail: Leo.Wise@usdoj.gov
Colleen.Conry@usdoj.gov

Attorneys for the United States

CERTIFICATE OF SERVICE

I hereby certify that on this 23rd day of July, 2007, I electronically filed the foregoing **UNITED STATES' RESPONSE TO DEFENDANT'S ARGUMENTS REGARDING GAIN CALCULATION, VARIANCE, AND FINE** with the Clerk of the Court using the CM/ECF system which will send notification of such filing to the following e-mail addresses:

Herbert J. Stern
dpenna@sgklaw.com

Marci A. Gilligan
mgilligan@rglawoffice.net gmiller@rglawoffice.net

Edward S. Nathan
enathan@sgklaw.com lspector@sgklaw.com

John M. Richilano
jmr@rglawoffice.net gmiller@rglawoffice.net

Joel M. Silverstein
jsilverstein@sgklaw.com

Jeffrey Speiser
jspeiser@sgklaw.com

Alain Leibman
aleibman@sgklaw.com

Also, a courtesy copy of the documents was emailed to:

Caryl Ricca
U.S. Probation Officer
Caryl_Ricca@cod.uscourts.gov

s/Andrea K. Hough
Andrea K. Hough
Office of the U.S. Attorney