

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
Chief Judge Edward W. Nottingham

Criminal Case No. 05–cr–00545–EWN

UNITED STATES OF AMERICA,

Plaintiff,

v.

JOSEPH P. NACCHIO,

Defendant.

**MEMORANDUM OF SENTENCING HEARING AND
REPORT OF STATEMENT OF REASONS**

Counsel for the Government, defense counsel, and defendant were present for the sentencing hearing. Based on that hearing, the report concerning pre-sentence investigation of defendant (hereinafter, the “PSR”), all other materials submitted to the court during or in connection with the sentencing hearing, and all materials in the court’s file, the court enters the following findings, conclusions, and orders:

1. Pursuant to rule 32(b)(6) and (c)(3) of the Federal Rules of Criminal Procedure, the court verified that the defense attorney and defendant (1) were timely provided a copy of the report of the PSR, excluding only the final recommendation as to sentence, together with all addenda, and (2) had read and discussed the report. No other information was withheld.

2. The court afforded all counsel the opportunity to speak, to introduce testimony or other information relating to the report, and to comment on the probation officer’s determination and on other matters relating to the appropriate sentence. The court addressed defendant personally and determined whether defendant wished to make a statement or present any information in mitigation of the sentence. Pursuant to 18 U.S.C. § 3771 (2007), the court found that the number of crime victims made it impracticable to accord all of the crime victims the right to be reasonably heard and therefore fashioned a reasonable procedure that did not unduly complicate or prolong the proceedings.

**RESOLUTION OF FACTUAL DISPUTES AND
DISPUTES CONCERNING APPLICATION OF ADVISORY SENTENCING
GUIDELINES**

Calculation of Gain

3. The guideline applicable to insider trading cases provides that the base offense level must be ratcheted up level by level as the amount of gain on the transaction increases. Specifically, the court must use the table appearing at U.S.S.G. § 2F1.1 (Nov. 2000)¹ to increase the level “corresponding to the gain resulting from the offense.” U.S.S.G. § 2F1.2. The commentary elaborates, explaining the term “gain” in the following language:

Because the 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.

Id., comment (backg’d). As the Supreme Court explained in *Stinson v. United States*, 508 U.S. 36, 44(1993), the commentary accompanying the guidelines not only explains them, but it “provides concrete guidance as to how even unambiguous guidelines are to be applied in practice.” The commentary is “an authoritative guide to the meaning” of a guideline. *Id.* at 42. (Citation omitted). The court finds the commentary’s explanation of the term “gain” to be unambiguous, inconsistent with the definition proposed by defendant, and straightforward in its application here. According to the direction of the commentary, it is the “total increase in value” which is to be used, not some increase measured by trying to figure out what part of value somehow relates to the undisclosed inside information. It is the value which is “realized”² in the transaction not a hypothetical value calculated at a later time. And it is the total value realized “through *trading* in [the] security,” not the value somehow related solely to the inside information. At least in this case — where defendant sold stock using unfavorable inside information — the court believes that the guideline straightforwardly requires the court, first, to calculate defendant’s net profit on each transaction by using his sale price less the cost of the

¹The PSR proposes use of the guidelines promulgated and effective in November of 2000, since that was the version in effect in April and May of 2001, when defendant committed the offenses of which he has been found guilty. Neither party has objected. The court will apply this version, because application of later versions to the disadvantage of the defendant may be prohibited by the Ex Post Facto Clause of the United States Constitution.

² To “realize” is “[t]o convert (securities, paper money, etc.) into cash, or (property of any kind) into money.” OXFORD ENGLISH DICTIONARY, found at <http://dictionary.oed.com>.

stock to him. *Accord, United States v. Mooney*, 425 F.3d 1093, 1100 (8th Cir. 2005) (majority *en banc* opinion). The court finds that this net profit is accurately set forth in Attachment C to the PSR and that the gain is \$44,692,545.47.

4. That is not the end of the matter, however. One of defendant's arguments — thought not his main one — is that, when he exercised his options, Qwest would deduct the cost of the options and also withhold an amount for taxes. The amount withheld, says defendant, must be deducted in calculating gain, because it represents money defendant never received. The Government resists this conclusion, relying on *United States v. DeFries*, 129 F.3d 1293 (D.C. Cir. 1997). *DeFries* however, was a RICO criminal forfeiture case, and as the court noted, "Congress intended, in allowing forfeiture in a criminal prosecution, to provide an extreme remedy for an extreme situation in which organized crime was corrupting otherwise lawful enterprises and activities with money from illegal drug distribution and other racketeering activities." 129 F.3d at 1314. It is not apparent to the court why cases on criminal forfeiture should be persuasive on the question of how gain should be calculated under the sentencing guidelines. Hence, the court returns to the plain language of the commentary. The commentary directs the court to use the total value "realized" by defendant. Under the dictionary definition of the term (*see* note 2, *supra*), defendant did not realize what was not converted into money, cash, or the equivalent. When the amount withheld and not received by defendant (\$16,078,147.81, according to ex. 1 attached to his response to the PSR) is deducted, defendant's true gain appears to be approximately \$28,000,000.³ The increase in the offense level due to defendant's gain is therefore 16. U.S.S.G. § 2F1.1(b)(Q).

5. Defendant's main argument is that the method of determining gain set forth above, which is consistent with the approach of the Eighth Circuit *en banc* majority in *Mooney*, is flawed. According to defendant, the gravamen of the offense is the deceptive device of using undisclosed inside information, not trading in Qwest shares. Defendant posits that the market value of Qwest shares on any given day is determined by myriad factors, and the court can determine defendant's true gain only by breaking down these factors and isolating the part of the stock's value which can properly be attributed to the undisclosed inside information. Consistent with the dissenting opinion in *Mooney*, defendant would have the court perform this operation by focusing on the time when the inside information was finally disclosed, figuring out how long it took the market to absorb the information, and ascertaining the stock's value on this date of absorption. That, defendant argues, isolates the value of the information and properly values what defendant gained by using the information. As authority for this approach, defendant relies

³The court is rounding because the math does not add up. The problem appears to be an immaterial discrepancy between the PRS's table and the defendant's. The PSR does not deduct the exercise fees and other fees which were withheld and not received by defendant.

primarily on civil insider trading cases, on criminal securities fraud cases where the court was asked to ascertain loss, not gain, and on the dissenting opinion in *Mooney*.

6. Many of defendant's arguments have already been answered by the *en banc* majority in *Mooney*. While principals and rules developed in civil insider trading cases can sometimes be applied in criminal cases (*e.g.*, the proper interpretation of words in a statute having both civil and criminal consequences), that is not the nature of the issue here. A civil plaintiff must ordinarily show a *loss* causally connected to defendant's wrongdoing; otherwise the plaintiff may receive an unwarranted windfall. The market absorption approach advocated by defendant and the dissent in *Mooney*, is intended to measure a civil plaintiff's loss, which bears no necessary relation to the civil defendant's gain. Measurement of loss is not the issue here, because the guideline requires the measurement of gain. For similar reasons, defendant's heavy reliance on the criminal case of *United States v. Olis*, 429 F.3d 540 (5th Cir. 2005) is unavailing, because the court there was addressing the *loss* used in a generic securities fraud case, not the gain required by the guidelines in an insider trading case.

7. Defendant's proposed method of calculating gain suffers from another fundamental flaw — it misconceives the thrust of the statute and the nature of the harm at which the guideline is directed. The Supreme Court has consistently been clear that a person who possesses material inside information is under a duty either to disclose that information or to abstain from trading in the stock. *Chiarella v. United States*, 445 U.S. 222 (1980); *United States v. O'Hagan*, 521 U.S. 642 (1997). As defendant pointed out during trial, corporate insiders (and the corporation itself) commonly possess material inside information which they do not and/or cannot disclose because it is a corporate confidence or would put the corporation at a competitive disadvantage. As a practical matter, then, the thrust of the statutory violation for such a person is *trading* in securities on the basis of inside information, unless the insider can come within the safe harbor provided by rule 10b5-1. As the Government observes, there would be no profit to defendant and no loss to anyone else had defendant complied with his duty not to trade in the shares. By trading he unloaded his shares and pocketed *all* share growth and share value accumulated on that date, not just a hypothetical slice attributable to the inside information. The guideline therefore is consistent with the thrust of the statute in measuring gain according to the total value realized by trading, not just the part of the price reflecting the undisclosed material information.

Miscellaneous

8. The court determines that no finding is necessary concerning the remaining issues raised by the objections. The controverted matters were not taken into account in imposing sentence or would not affect the sentence. *See* Fed. R. Crim. P. 32(c)(1); *United States v. Wach*, 907 F.2d 1038 (10th Cir. 1990). They also would be unlikely to be considered by the United States Bureau of Prisons in classification and designation decisions.

9. Neither the Government nor the defendant has challenged any other aspect of the PSR. Therefore, the remaining factual statements in the report are adopted without objection as the court’s findings of fact concerning sentencing.

GUIDELINE CALCULATIONS AND FINDINGS

10. Based upon all materials before the court, the court determines the appropriate guideline calculations to be as follows:

- a. Base Offense Level 8
- b. Adjustment for Gain +16
- c. Adjustment for Abuse of Position of Trust +2
- d. **Adjusted Offense Level** 26
- e. **Total Offense Level** 26
- f. Criminal History Category I
- g. Imprisonment Range sixty-three to seventy-eight months
- h. Supervised Release Range two to three years
- i. Fine Range \$12,500 to \$19,000,000

FINE

11. The court finds that defendant is able to pay a fine within the guideline range. Therefore, the court will impose a fine within the range. In determining the amount of the fine, the court has considered , as required by 18 U.S.C. §§ 3553(a) and 3572 and by section 5E1.2(d) of the guidelines, the nature and circumstances of the offense and the history and characteristics of the defendant. The court has also considered the need for the fine imposed to reflect the seriousness of the offense, to promote respect for the law, and to provide just punishment for the offense; and to afford adequate deterrence to criminal conduct. Finally, the court has considered defendant’s income, earning capacity, and financial resources; the burden that the fine will impose upon the defendant, any person who is financially dependent on the defendant, or any other person that would be responsible for the welfare of any person financially dependent on the defendant, relative to the burden that alternative punishments would impose; any pecuniary loss inflicted upon others as a result of the offense; the need to deprive the defendant of illegally

obtained gains from the offense; and the expected costs to the government of any imprisonment, and supervised release.

12. With respect to the matters outlined in the previous paragraph, the court finds and concludes as follows. The crimes of which defendant has been found guilty are ones of overarching greed. The testimony of Qwest's former officers permits the inference that trading on inside information was a familiar, accepted occurrence at Qwest. Since he was the chief executive officer of the company, defendant's own actions cannot but have condoned a culture in which this could occur. It is the court's premise that such crimes of greed can be deterred, in part, by not only draining them of all monetary benefit but by exacting additional monetary punishment to give would be perpetrators the message that the crime does not pay; it costs, above and beyond mere payback. It is the court's view that the maximum fine permitted by statute and the guidelines is necessary to afford adequate deterrence to this type of flagrant greed, to provide just punishment for the offenses, and to reflect the seriousness with which the court regards these offenses.

13. The defendant's financial resources as disclosed in the PSR and statements introduced as exhibits at trial disclose to the court's satisfaction that he is able to pay the fine imposed. While the fine will burden defendant, it will not unduly burden his family or any other person financially dependent on him, particularly when it is compared to the alternative punishment of imprisonment. Although the court finds that its forfeiture order entered contemporaneously will deprive defendant of illegally obtained gains, it nevertheless believes the substantial fine to be appropriate because of the considerations previously recited. An additional justification for such a fine is that defendant's conduct has imposed costs on the Government, including the cost of imprisonment and supervised release. Those should be reflected in his monetary punishment. Based on the PSR, the court finds the current cost of imprisonment to be \$2,036.92 per month and the cost of supervised release to be \$294.60 per month.

STATEMENT OF REASONS FOR SENTENCE

14. The reasons for all components of the sentence, *see* 18 U.S.C.A. § 3553(c) (West 2006), were stated in open court and will not be repeated here. In determining each component of the particular sentence to be imposed, the court has considered the nature and circumstances of the offense and the history and characteristics of the defendant. The court has also considered the kinds of sentences available and the sentencing range established in the federal sentencing guidelines. Consideration of those guidelines also serves the purpose of avoiding unwarranted sentence disparities among defendants with similar records who have been found guilty of similar conduct. In addition:

- a. The court finds (1) that a term of incarceration is appropriate and (2) that the length of incarceration imposed is sufficient, but not greater than necessary, to achieve the statutory purposes of such a sentence, including the need

for the sentence imposed to reflect the seriousness of the offense, to promote respect for the law, to provide just punishment for the offense, to afford adequate deterrence to criminal conduct, and to protect the public from further crimes of the defendant. The court recognizes “that imprisonment is not an appropriate means of promoting correction and rehabilitation.” 18 U.S.C.A. § 3582(West 2006). The court further finds that these purposes of incarceration will be adequately achieved by the combination of imprisonment and home detention/community confinement set forth in paragraph 17 below.

b. The court further finds (1) that a term of supervised release following imprisonment is appropriate and (2) that the length of the term and the conditions imposed are reasonably related to — and involve no greater deprivation of liberty than is reasonably necessary to achieve — the statutory purposes of this component of the sentence, including the need for the sentence imposed to afford adequate deterrence to criminal conduct; to protect the public from further crimes of the defendant; and to provide the defendant with needed rehabilitation, professional supervision, educational or vocational training, medical care, or other correctional treatment in the most effective manner.

15. Defendant has moved for imposition of a sentence below the guideline range recommended by the sentencing commission, urging that there exists a “mitigating circumstance of a kind, or to a degree, not adequately taken into consideration” by the commission in formulating the guidelines. *See* U.S.S.G. § 5K2.0, p.s. The Government opposes the motion. Specifically defendant moves for a departure under section 5H1.6 and 5H1.11. In parallel language, these sections provide that “[f]amily ties and responsibilities and community ties are not ordinarily relevant in determining whether a sentence should be outside the applicable guideline range” (section 5H1.6) and that “charitable . . . and similar prior good works are not ordinarily relevant in determining whether a sentence should be outside the applicable guideline range (section 5H1.11). Thus, a departure based on these sections is appropriate only if the court can conclude that the family responsibilities or ties are “extraordinary.” For reasons recited in open court, the court does not find such “extraordinary” circumstances and thus declines to depart.

16. Because of the considerations recited above, especially the need to avoid unwarranted sentencing disparities among defendants with similar records who have been found guilty of similar conduct, the court will impose a sentence within the recommended guideline range.

IMPOSITION OF SENTENCE

17. The sentence imposed is as follows:

a. Defendant is committed to the custody of the United States Bureau of Prisons, to be imprisoned for a period of seventy-two months on each count of conviction, to be served concurrently. The court recommends that the Bureau of Prisons designate FPC Schuylkill for service of sentence.

b. Upon release from his term of imprisonment, defendant will serve a term of two years on supervised release on each count of conviction, to be served concurrently. Within seventy-two hours of his release from the custody of the Bureau of Prisons, defendant will report in person to the probation office in the district to which he is released. Defendant will observe the “standard” conditions of supervised release heretofore adopted by this court, and the clerk shall specifically enumerate these conditions in the judgment prepared under rule 32(d) of the Federal Rules of Criminal Procedure. Defendant will also observe the following special conditions:

i. He will not possess any firearm, destructive device, or any other dangerous weapon, as defined by federal or state statute.

ii. He will not illegally possess or use controlled substances.

iii. Because defendant’s PSR indicates a low risk of future substance abuse by defendant, the court suspends the requirement of 18 U.S.C.A. § 3583(d) (West 2006) concerning mandatory drug testing.

iv. He will not commit a federal, state, or local crime.

v. The defendant shall cooperate in the collection of DNA, as directed by the probation officer.

vi. If the fine has not already been paid, he will pay the fine imposed in paragraph 17.c in equal monthly installments during the period of supervised release.

vii. Defendant will participate in a program for mental health treatment, as directed by the probation officer, until he is released from that program by the probation officer. He will pay all costs of such treatment. The court authorizes the probation officer to release to the treatment agency all psychological reports and/or the PSR, for continuity of treatment.

c. Defendant will pay a fine of \$19,000,000. The fine is due and payable within thirty days of the date of sentencing.

d. The defendant shall pay a special assessment of \$1,900. 18 U.S.C.A. § 3013 (West 2006). This amount shall be payable immediately.

e. Payments made pursuant to the court's judgment shall be applied in the following order: (i.) special assessment, (ii.) fine principal, (iii.) fine interest

MISCELLANEOUS

18. Defendant has been advised of his right to appeal the jury's verdict of guilty and the sentence imposed. If he wishes to appeal, his trial counsel shall assist him in perfecting the appeal. If he cannot pay the cost of an appeal, he may apply to the court for leave to appeal *in forma pauperis*. If defendant so requests, the clerk of the court shall prepare and file forthwith a notice of appeal on behalf of defendant.

19. This Memorandum of Sentencing Hearing and Report of Statement of Reasons is finalized and filed after oral imposition of sentence. It is intended to summarize and supplement the court's findings and conclusions delivered orally at the sentencing hearing. If any errors in the oral findings and conclusions were noted during the process of finalization, they have been corrected herein. Therefore, in the event of inconsistency between the oral findings and the contents of this memorandum, the contents of this memorandum are intended to control unless and until I expressly order otherwise.

20. Defendant was ordered to surrender himself voluntarily to the facility designated by the United States Bureau of Prisons within fifteen days of the date of designation.

21. The probation officer shall prepare the judgment required by rule 32(d) of the Federal Rules of Criminal Procedure, in accordance with this Memorandum of Sentencing Hearing and Report of Statement of Reasons. To comply with 18 U.S.C.A. § 3612(b)(1)(A) (West 2006), a separate section of the judgment styled "ADDENDUM TO JUDGMENT IN CRIMINAL CASE (CONFIDENTIAL INFORMATION CONCERNING DEFENDANT)" shall contain defendant's social security account number, mailing address, and residence address. The probation officer shall maintain this Addendum, and it shall not be filed with the clerk. Unless otherwise ordered, the Probation Department shall disclose the Addendum only to counsel of record and to any attorney for the Government engaged, pursuant to 18 U.S.C.A. § 3612(b)(1)(A), in collection of a monetary obligation imposed by the judgment. The judgment entered and filed by the clerk shall refer to the Addendum and shall recite that it contains defendant's social security number, date of birth, residence address, and mailing address and is withheld from the file pursuant to court order. The court finds that defendant has a privacy interest in keeping this information confidential, that public disclosure of this information may

potentially harm defendant, that the public interest in this information is minuscule, and that the potential harm to defendant outweighs the public interest in disclosure.

22. The court concludes that this statement of reasons for imposing sentence in a criminal case is presumptively a matter of public interest and scrutiny. *See* S. Rep. No. 225, 98th Cong., 1st Sess. 1983, 1984 U.S.C.C.A.N. 3182, 3263 (1983) (“The statement of reasons . . . informs defendant and the public of the reasons for the sentence. It provides information to criminal justice researchers.”) No party has made a sufficient showing of “good cause,” Fed R. Crim. P. 32(i)(4)(c), why it should **not** be a matter of public record. Therefore, to facilitate systematic documentation of any decision concerning departure, in compliance with 18 U.S.C.A. § 3553(c)(2) (West 2006), the probation officer shall attach a copy of this Memorandum of Sentencing Hearing and Report of Statement of Reasons to the judgment filed by the clerk. The Probation Department shall attach a copy of this Memorandum of Sentencing Hearing and Report of Statement of Reasons to the PSR. The Probation Department shall also forward copies to the United States Sentencing Commission and the United States Bureau of Prisons.

Dated this 30th day of July, 2007.

BY THE COURT:

s/ Edward W. Nottingham
EDWARD W. NOTTINGHAM
Chief United States District Judge