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I. INTRODUCTION

Joseph Nacchio, former CEO of Qwest, is currently serving a six-year sentence for insider trading. Nacchio was convicted of insider trading after he exercised his Qwest stock options at the same time he received information that Qwest's 2001 earnings were in danger of falling nearly one billion dollars short of projected revenue estimates. Nacchio's case is unique because it demonstrates the importance of following proper procedure when introducing expert testimony in a criminal trial under the *Daubert* standard, as well as the difficulty of determining "materiality" in an insider trading case based on "soft" information.

The Tenth Circuit's decision in *Nacchio II* is problematic for two reasons: first, the court conflated the requirements of Rule 16 disclosures and the *Daubert* standard for qualifying experts by creating an onerous burden on defendants attempting to admit expert testimony at the early stages of trial. Additionally, *Nacchio II*'s stringent "soft" information requirement may discourage companies from disclosing accurate or ambitious revenue projections to the public given the potential liability for insider trading if internal documents question the accuracy of those projections. Investors may thus be left with less information to inform their investment decisions.

II. FACTS AND PROCEDURAL HISTORY

A. Qwest's 2001 Earnings Estimates

In September 2000, Qwest made public its 2001 earnings projections. Qwest CEO Nacchio[1] announced the company's projected total revenue would be in the range of $21.3 to $21.7 billion.[2] Qwest also prepared internal targets higher than the projections announced publicly.[3]

1. Time magazine named Nacchio one of the top fifty "Cyber Elites" in 1998. TIME DIGITAL ARCHIVE, Jan. 7, 2010, http://www.time.com/time/digital/cyberelite/32.html. At one point his net worth was estimated at $170 million. *Id*. Nacchio has also been described as "[b]rash and outspoken." *Id*.

2. United States v. Nacchio (*Nacchio I*), 519 F.3d 1140, 1145 (10th Cir. 2008); *see*

Qwest officials soon became concerned that the public projections were too high. Qwest executives, including Nacchio, received a "risk estimate" forecasting a potential shortfall in 2001 earnings. The memo indicated earnings could end up nearly $900 million below the public projections. This shortfall was based on Qwest's failure to account for changes in revenue streams. Specifically, Qwest had traditionally counted on revenues from long-term leases of space on Qwest's network known as "indefeasible rights of use" ("IRUs"). Qwest collected the lease payment at the beginning of the lease, and thus, IRU sales produced one-time revenue rather than a perpetual stream of income. As the public projections failed to account for these revenue streams drying up, the risk estimate indicated Qwest would have to make an "aggressive pivot" or "shift" from IRUs to other consistent streams of revenue to meet projections.[4] Nacchio further understood that a slow start to 2001 could have a "snowball effect" on the rest of the year's earnings.[5] Nacchio acknowledged this reality when he told his sales staff that "something big" had to happen by April or earnings would fall short of estimates.[6]

Qwest met its projected earnings in the first two quarters of 2001. However, in early April, Qwest's executive vice president informed Nacchio that the IRU market was drying up. In late April 2001, Nacchio discussed Qwest's earnings estimates with investors. Nacchio told investors the company was "still confirming" company projections. When asked to break down the company's revenue streams into recurring streams and one-time transactions, Nacchio refused.[7] When further pressed about how Qwest planned to meet its

also United States v. Nacchio (*Nacchio II*), 555 F.3d 1234 (10th Cir. 2009) (directing the reader to *Nacchio I* for the full factual background).

3. The internal targets were set higher than the public projections to encourage employees to exceed public projections. Performance bonuses were also based on the internal targets. *Nacchio I*, 519 F.3d at 1145.

4. *Id*. To achieve its revenue projections, Qwest would have had to double its growth rate for recurring revenue. Nacchio knew in December 2000 that the shift from IRUs to recurring revenue had to take place early in 2001, or the company would have to revise its public projections downward. *Id*.

5. *Id*.

6. *Id*.

7. *Id*.

revenue projections, Nacchio merely responded that "Qwest had better products and better management."[8]

B. Nacchio's Stock Sales

Nacchio, as is common for corporate executives, received a substantial portion of his salary in stock options.[9] In October 2000, Nacchio announced that he planned to exercise his options and sell one million shares of Qwest stock per quarter. However, Nacchio did not enter into a fixed sales plan until February 2001. After Qwest stock dropped below $38 a share less than a month later, Nacchio cancelled his fixed sales plan and determined he would sell, as he traditionally had done, during quarterly trading windows.[10]

During the second quarter trading window in 2001, Nacchio sold over 1.2 million shares of Qwest stock. At this time, Qwest stock traded between $37 and $42 a share. Accordingly, Nacchio made over $50 million from the sale of his options. While the number of options Nacchio sold was slightly more than the one million shares per quarter he announced in October 2000, it was four times the average number of shares he sold from 1998 to 2000. After this trading window had closed, Nacchio entered into another fixed sales plan approved by Qwest's general counsel. At the end of May 2001, Qwest's stock price again dropped below $38 a share. Nacchio sold no more shares after this point. Nacchio eventually "finished the year with more vested options than he had owned at the beginning" of the year.[11]

In mid-August 2001, Qwest disclosed its lagging IRU sales in an SEC filing. Initially, the impact on Qwest stock was negligible. Later, on September 10, 2001, Nacchio lowered the company's public earning projections by one billion dollars. One company executive testified at trial that Nacchio announced the revised company earnings projections separately from the SEC filing because he wanted it to seem that he had not been concealing information. By the end of September, Qwest's stock was trading at 40% of its January price. [12]

8. *Id.* at 1146.
9. *Id.*
10. *Id.* at 1147.
11. *Id.*
12. *Id.* at 1148.

C. Nacchio's Prosecution and Trial

After a lengthy investigation, Nacchio was indicted and charged with forty-two counts of insider trading. The government accused Nacchio of trading on the basis of

> material nonpublic information about Qwest—specifically that the company was relying heavily on IRU sales, a non-recurring source of revenue to meet its first and second quarter public guidance, and that the company had not made the needed shift to recurring revenue which placed the company at substantial risk of not meeting its year-end guidance.[13]

Three days before trial, Nacchio announced he would be calling an expert witness. The government requested a summary of the expert's testimony pursuant to Federal Rule of Criminal Procedure 16(b)(1)(c) ("Rule 16"), which Nacchio provided.[14] The government, however, argued that the summary did not comply with the requirements of Rule 16. The district court agreed with the government and concluded that Nacchio's expert testimony "offered no bases or reasons whatsoever for [the expert's] opinions contained in the summary."[15]

Nacchio later submitted a revised summary of his expert's testimony. In the revised disclosure, Nacchio listed the expert's numerous qualifications as an academic, researcher, and teacher in law and finance. The summary also explained that the expert had "analyzed Qwest's [revenue projections], its actual stock performance, and reaction from the investment community; Qwest's [revenue projections] compared to the [revenue projections] history of other telecommunications firms; and various facets of Qwest's revenue from indefeasible rights of use."[16] In a sixty-three page motion to dismiss, the government challenged the expert's testimony and moved to exclude it. The government again argued that Nacchio had not complied with Rule 16 and further contended that the expert's methodology was unreliable under *Daubert v. Merrell Dow Pharmaceuticals* and Federal Rule of Evidence 702.[17] The district

13. *Id*.
14. *Id*. at 1149.
15. *Nacchio II*, 555 F.3d 1234, 1237 (10th Cir. 2009).
16. *Id*. at 1238.
17. *Nacchio I*, 519 F.3d at 1149 ("'*Daubert*' is legal shorthand for the district court's

court again sided with the government and excluded the expert's testimony.[18]

The district court questioned the expert's methodology and found that it did not comply with *Daubert* or Rule 702. The district court was particularly concerned with the expert's methodology.[19] The district judge found that the expert's methodology was "absolutely undisclosed" and that Nacchio had made no attempt to "establish that [the expert's] testimony [was] the product of reliable principles and methods or that [the expert] applied some principles and methods reliably."[20] Thus, the court did not allow Nacchio's expert to testify before the jury as an expert, despite last-ditch efforts by Nacchio's defense team.[21]

After trial and six days of jury deliberation, the jury convicted Nacchio on nineteen counts of insider trading. Nacchio was sentenced to six years imprisonment on each count to be served concurrently, two year's supervised release, a $19 million fine, and forfeiture of $52 million.[22]

D. Tenth Circuit Three-Judge Panel

Nacchio promptly appealed the jury verdict to the Tenth Circuit. Nacchio challenged the district court's decision to exclude his expert witness and questioned the sufficiency of the evidence before the jury.[23] The Tenth Circuit agreed with Nacchio that the district court's decision to exclude his expert testimony was reversible error.[24] The court did not, however, agree that the evidence was insufficient to support the jury's guilty verdict.[25]

obligation to test a proposed expert's methodology in advance of his testimony."); *see also* Daubert v. Merrell Dow Pharm., Inc., 509 U.S. 579 (1993); FED. R. EVID. 702.

18. *Nacchio II*, 555 F.3d at 1239, 1263 (concluding that the deficiencies in Nacchio's disclosures were so glaring that "they hardly warrant[ed] the 63 pages of ink the Government has spilled in opposing the testimony").

19. *Id.* at 1239.

20. *Id.* (noting that there was only "one 'woefully inadequate' sentence" discussing the process undertaken by the expert to inform himself of the facts of the case).

21. *Id.* After the district judge excluded the expert testimony, Nacchio's lawyer asked the judge if he could speak on the issue. *Id.* The judge refused to hear the attorney and said, "I have your motion, I have the government's motion, I have your response. Any argument that you wish to make could have been put in the response." *Id.*

22. *Id.*

23. *Nacchio I*, 519 F.3d 1140, 1148, 1166 (10th Cir. 2008).

24. *Id.* at 1148–49.

25. *Id.* at 1149.

1. Expert testimony

In a split decision, the three-judge panel held that Nacchio's expert testimony had been improperly excluded. The court first looked at Nacchio's disclosures against the Rule 16 standard. Rule 16, the panel explained, requires a defendant to disclose an expert's "opinions, the bases and reasons for those opinions, and the [expert's] qualifications."[26] The court noted that Rule 16 does not require extensive discussion of an expert's methodology, rather the purpose of Rule 16 is to put the government on notice of the expert's testimony to aid in trial preparation.[27]

Here, the panel concluded that Nacchio's Rule 16 disclosure "did exactly what the law required."[28] Rule 16 only requires that a defendant disclose a "written summary of any [expert] testimony" and "describe the witness's opinions, the bases and reasons for those opinions, and the witness's qualifications."[29] The disclosure, the court explained, stated that the expert's opinion was "based on" his analysis of Nacchio's trades, stock price data, and executive options.[30] Likewise, the disclosure stated the expert's reasoning; specifically, that "principles of risk reduction and the pattern of [Nacchio's] sales were inconsistent with" insider trading.[31] Thus, the panel concluded that Nacchio had fully complied with the requirements of Rule 16.

Finally, the panel concluded that the district court had used the Rule 16 disclosure process as a substitute for a *Daubert* hearing. Rule 16, the court explained, is "not designed to allow the district court to move immediately to a *Daubert* determination without briefs."[32] The panel acknowledged that the government had a right to demand a *Daubert* hearing, but ultimately made clear that Rule 16 disclosures do not have to comply with *Daubert*.[33]

26. *Id*. at 1150.

27. *Id*. at 1151.

28. *Id*. The court reasoned that perhaps the district court had confused the civil and criminal standard for expert testimony. In criminal trials, unlike civil cases, an expert "is not required to present and disclose" his testimony before trial. *Id*. at 1152.

29. *Id*.

30. *Id*. at 1151.

31. *Id*.

32. *Id*.

33. *Id*.

2. Sufficiency of the evidence

Nacchio challenged the sufficiency of the evidence on three grounds. First, Nacchio alleged that the information related to Qwest's revenue streams was not material. Second, he argued that he did not act with willful intent, or scienter. Finally, he argued that even if the information regarding Qwest's revenue was material, it was not a factor in his decision to trade. Ultimately, the Tenth Circuit rejected each of these challenges.[34]

a. Materiality. On de novo review, the court looked at the jury instructions "to determine whether they accurately informed the jury of the governing law."[35] The key jury instruction charged the jury to determine "whether the . . . matter omitted was of such importance that it could reasonably be expected to cause a person to act or not to act with respect to the securities transaction at issue."[36] Nacchio contended this instruction was faulty because it failed to incorporate the concepts of probability and magnitude. Nevertheless, the court found that this instruction did not violate the Supreme Court's test for materiality, namely, that the "significance the reasonable investor would place on the withheld . . . information" is the test for materiality.[37]

The court also rejected Nacchio's proposed jury instruction modeled after the "bespeaks caution" rule in false-statement cases.[38] The "bespeaks caution" rule essentially holds that if a speaker qualifies a statement, someone hearing the statement should be wary of it. Nacchio argued that because Qwest issued its public projections in cautious tones, investors should have been wary of Qwest's performance, and thus, traded carefully. As a result, Nacchio argued, had he disclosed the information regarding the slowing revenue streams before trading, investors, who were already wary because of the qualified public projection statements, would not have changed the way they traded Qwest stock, and thus, the information was not material.[39] The court concluded even though

34. *Id.* at 1158.

35. *Id.* at 1158–59 (quoting United States v. McClatchey, 217 F.3d 823, 834 (10th Cir. 2000)) (internal quotations omitted).

36. *Id.* at 1159.

37. *Id.* (quoting Basic, Inc. v. Levinson, 485 U.S. 224, 240 (1988)).

38. *Id.* at 1161.

39. *Id.* at 1161–62.

"the information already made available [to investors] was couched in warnings[, it] does not make new information (such as the information that IRUs constitute a dangerously high part of revenues and that opportunities for new IRU sales were drying up) immaterial."[40] After all, the court concluded, the issue is not whether the information the company disclosed was materially misleading, but whether the information on which Nacchio traded was material.[41]

b. Scienter. Nacchio argued before the Tenth Circuit "that he traded in good faith and did not 'willfully' violate [laws against insider trading]."[42] Specifically, Nacchio complained that portions of the district judge's instruction regarding "bad faith" were improper.[43] The Tenth Circuit reviewed the instructions relating to bad faith and concluded that while the instructions "might have been clearer," the instructions did not prevent the jury from coming to a proper determination regarding Nacchio's willful conduct.[44]

Additionally, the Tenth Circuit held that the evidence presented by the government at trial was sufficient for the jury to infer that Nacchio "acted with the purpose to disobey the law or the knowledge that he was doing so."[45] Reviewing the evidence presented, the court noted Nacchio had several conversations with other Qwest officials that could be reasonably interpreted as efforts at concealing material information from investors. The most damning testimony came from a Qwest official who suggested to Nacchio that the revised earnings projections needed to be made public as soon as possible. Nacchio, the official testified, questioned whether the information needed to be made public. "Why do [investors] need to know?" Nacchio asked.[46] The official responded that investors needed the IRU sales information to make an informed decision about Qwest stock, to which Nacchio replied, "[S]crew them, go tell them to buy."[47] Thus, the court concluded

40. *Id*. at 1162.
41. *Id*.
42. *Id*. at 1164–65.
43. *Id*. at 1166.
44. *Id*.
45. *Id*.
46. *Id*.
47. *Id*. at 1166–67.

that the jury was justified in finding that Nacchio knew and willfully concealed material inside information.[48]

c. Connection of inside information to the questionable trades. In his final argument before the Tenth Circuit, Nacchio argued that "the jury could not have [reasonably] concluded that his trades were 'on the basis of' inside information" as required by federal regulation.[49] The trial judge instructed the jury that to convict Nacchio, the government had to prove beyond a reasonable doubt that Nacchio "actually used material non-public information in deciding to trade," not merely that he possessed the material non-public information.[50]

The Tenth Circuit indicated that this instruction may have been too favorable to Nacchio. Rule 10b5-1 from the Code of Federal Regulations states that an insider trades "on the basis of" material non-public information "so long as he is 'aware'" of the information,[51] unless the individual can rely on a safe-harbor provided by the rule.[52] Thus, under this standard, Nacchio could have been found guilty merely because he was "aware" of the inside information when he traded, even if he had unrelated reasons for executing the stock sales.[53] The court noted that because the jury received an instruction more favorable to Nacchio than the law requires and still convicted Nacchio, when reviewing the sufficiency of the evidence, it would "look to what the law actually requires rather than what the jury was instructed so long as the government objected to the instruction below."[54] The government did object to the instruction below and suggested an instruction stating the "jury must find that the information was 'a factor, however small,'" in Nacchio's decision to sell his options.[55] Thus, the court explained, it did not need to determine whether the evidence was sufficient to

48. *Id.* at 1167.

49. *Id.* (quoting 17 C.F.R. § 240.10b5-1(a)).

50. *Id.* (basing the jury instruction on the Ninth Circuit's decision in *United States v. Smith*, 155 F.3d 1051, 1067 (9th Cir. 1998), which was decided before Rule 10(b)(5)-1 was enacted).

51. *Id.* (quoting § 240.10b5-1(b)).

52. An automatic trading plan approved by the corporation is the most common safe harbor that protects persons with non-public material information from claims of insider trading. *Id.* (citing § 240.10b5-1(c)).

53. *Id.*

54. *Id.* at 1168.

55. *Id.*

demonstrate that Nacchio used the material non-public information as the basis for his trades, merely that it was a "factor, however small," in his decision to sell his options.[56]

Reviewing the sufficiency of the evidence, the court determined that a reasonable jury could have inferred that Nacchio knew in April and May of 2001 that the company's earnings were sliding and that he acted upon this material non-public information when he sold his stock options. The court noted that Nacchio indeed had powerful explanations for his actions. Ultimately, however, it concluded the jury was justified in not believing Nacchio's explanations because testimony amply demonstrated that Nacchio knew "Qwest had not made the necessary shift" from one-time to recurring revenue, and thus, corporate earnings were destined to drop.[57]

3. Retrial

Because the three-judge panel concluded that the trial court had improperly excluded the testimony of Nacchio's expert, it reversed his conviction.[58] However, the panel noted that the government could retry Nacchio a second time because the evidence presented for each element of insider trading was sufficient.[59]

III. EN BANC REHEARING

In February 2009, the Tenth Circuit granted rehearing en banc for the purpose of considering the expert testimony issue. In a 5-4 split, the court held that the expert testimony was properly excluded at trial. Consequently, the court en banc upheld Nacchio's conviction.[60]

A. Expert Testimony

The en banc panel began its analysis of the expert testimony issue by noting that it reviewed whether the district court properly

56. *Id.*

57. *Id.* at 1169.

58. *Id.* Judge Holmes disagreed with the panel's determination that the expert testimony was improperly excluded. *See id.* at 1170–75 (Holmes, J., dissenting).

59. *Id.* at 1169. The panel further concluded that it would be "unreasonably difficult to expect [the current trial judge] to retry the case with a fresh mind," and thus, the panel ordered that a new trial judge be assigned. *Id.* at 1170.

60. *Nacchio II*, 555 F.3d 1234 (10th Cir. 2009).

performed its gatekeeping function under an abuse of discretion standard.[61] Under the abuse of discretion standard, the en banc panel concluded that the district court properly performed its gatekeeping role.[62]

The en banc panel rejected Nacchio's argument (and the three-judge panel's conclusion) that the district court excluded the expert testimony on the supposed deficiencies of the Rule 16 disclosures.[63] The court reasoned that "by the time the district court ruled to exclude [the expert's] testimony, it was clear that the court's principal concern was *Daubert*."[64] Despite the fact that the district court's decision to exclude was reached as the result of the government's challenge to the Rule 16 disclosures, the en banc panel determined that statements made by the district court indicating that the expert's methods did not comply with Federal Rule of Evidence 702 ("Rule 702"), was undoubtedly "the primary rationale for the court's decision."[65] The en banc panel labeled the references to Rule 16 disclosures in the district court's exclusion order as "ambiguous" and "enigmatic,"[66] and thus, the main thrust of the decision to exclude was not based on Rule 16, but on *Daubert* and Rule 702.[67]

The court criticized Nacchio for his argument that he was not on notice that *Daubert* issues had arisen as the trial began and the Rule 16 disclosures were debated. The court cited numerous instances where mention or inference that *Daubert* issues were in play arose. The court was particularly scathing of Nacchio's attempt to characterize the judge as having dismissed his expert testimony saying, "Nacchio is attempting to recast an unremarkable district court evidentiary ruling as an invidious act of judicial hubris. But it will not work."[68]

The court then held that Nacchio not only had notice that *Daubert* and Rule 702 issues were at play, but also had more than adequate opportunity to respond to these challenges. The court

61. *Id*. at 1241.

62. *Id*. at 1241–44.

63. *Id*. at 1242; *see Nacchio I*, 519 F.3d at 1153 ("The most straightforward reading of the transcript is that the judge excluded the evidence on Rule 16 grounds alone.").

64. *Nacchio II*, 555 F.3d at 1242.

65. *Id*.

66. *Id*.

67. *Id*. at 1244.

68. *Id*. at 1247.

reviewed the timeline of the Rule 16 disclosures and the government's challenge to the expert testimony and concluded that Nacchio had a series of opportunities to address the *Daubert* question.[69] The en banc panel further concluded that if Nacchio felt he needed more time to address *Daubert* issues, he bore the burden of requesting more time.[70] Consequently, after reviewing Nacchio's revised Rule 16 disclosures, which provided the most comprehensive information regarding the expert testimony, the en banc panel concluded that it was not an abuse of discretion for the district court to exclude the expert testimony.[71] Specifically, the court found that there was nothing in Nacchio's disclosures that connected the expert's experience to the ultimate conclusions he was making. The court reasoned that the lack of connection between the expert's experience and his ultimate conclusion was essentially Nacchio asking the court to "take the expert's word for it" with nothing more.[72]

B. Petition for Certiorari

Nacchio appealed the Tenth Circuit decision to the United States Supreme Court.[73] The Supreme Court initially appeared to be interested in taking the case as it delayed decision on the petition for several months while it reviewed the issues in the case.[74] Many commentators believed that this was a sign the Court would take the case because of the materiality issue.[75] However, before the Court made its certiorari decision, the Tenth Circuit ruled that the district court's calculations of Nacchio's gains and forfeiture were erroneous.[76] With the new instructions provided by the Tenth

69. *Id*. at 1250.

70. *Id*. at 1252.

71. *Id*.

72. *Id*. at 1258.

73. Dionne Searcey, *Hope Still Alive for Joe Nacchio*, WSJ BLOGS, June 29, 2009, http://blogs.wsj.com/law/2009/06/29/hope-still-alive-for-joe-nacchio/ (last visited Feb. 7, 2010). On the last day of the 2009 term, the court failed to make a decision on the case, but requested the entire case file for review. *Id*.

74. Greg Avery, *Supreme Court to Decide on Nacchio's Request in October*, DENVER BUS. J., July 10, 2009, *available at* http://denver.bizjournals.com/denver/stories/2009/07/13/story10.html.

75. *See id*.

76. Nacchio v. United States, 573 F.3d 1062, 1064 (10th Cir. 2009) (reversing and remanding the case back to the district court for a recalculation of Nacchio's forfeiture and gains).

Circuit for calculating Nacchio's punishment, his total prison term could be reduced from six years to three or four years, and his fine, which originally totaled fifty-two million dollars, could be reduced to forty-four million dollars.[77] Federal prosecutors decided not to pursue an appeal on the issue of forfeiture and gains.[78] The Supreme Court subsequently denied Nacchio's petition for certiorari.[79]

IV. ANALYSIS

Two aspects of the Tenth Circuit's opinion trouble many observers. First, many are concerned that the Tenth Circuit failed to recognize the differences in Rule 16 disclosures and the *Daubert* standard regarding expert witnesses.[80] Second, the Tenth Circuit has broken new ground and, for the first time, has upheld the conviction of a corporate executive on the basis of "soft" information that questions public revenue projections.

A. Expert Testimony

In his dissenting opinion, Judge McConnell was particularly concerned that the Tenth Circuit had conflated the requirements for expert testimony in civil and criminal cases. Judge McConnell explained that in criminal cases, a defendant does not have to establish the foundation of an expert before trial, unless the district court directs the defendant to do so.[81] Here, Nacchio was required to establish the foundation of his expert witness before trial during the pretrial debate over whether his Rule 16 disclosures were sufficient under the much more demanding *Daubert* standard.

Additionally, Judge McConnell explained that the majority's rule required Nacchio to satisfy the *Daubert* requirements for expert testimony through written declarations in advance of trial.[82] Judge

77. Kevin O'Brien, *Nacchio Gains a 10th Circuit Court Victory on his Sentence and Forfeiture*, THERACETOTHEBOTTOM.ORG, Aug. 1, 2009, http://www.theracetothebottom.org/criminal-law-and-governance/nacchio-gains-a-10th-circuit-court-victory-on-his-sentence-a.html (last visited Feb. 7, 2010).

78. *U.S. Government Won't Fight Nacchio Sentence Ruling*, REUTERS, Aug. 17, 2009, *available at* http://www.reuters.com/article/idUSN1734943220090817.

79. Nacchio v. United States, 130 S. Ct. 54 (2009).

80. *See* Avery, *supra* note 74.

81. United States v. Nacchio (*Nacchio II*), 555 F.3d 1234, 1259 (10th Cir. 2009) (McConnell, J., dissenting).

82. *See id.* at 1259–61.

McConnell reasoned that this requirement violated principles of criminal proceedings where a "defendant is entitled to keep his cards close to the vest."[83] Thus, Judge McConnell argued a defendant only has to make the most minimal disclosures during the pretrial phase so as not to lose his adversarial edge in withholding defense strategy until the last moment. Supporting this idea, Judge McConnell reasoned, that "[i]n criminal cases . . . neither side has a general right to discover the other's evidence . . . ."[84]

Further, as the three judge panel recognized,[85] although "Rule 16 provides the defense with some notice, the requirement of setting forth 'the bases and reasons for' the witnesses' opinions does not track the methodological factors set forth by the *Daubert* Court."[86] Rule 16, then, is a lesser standard, requiring little of the defendant. To comply with Rule 16 a defendant must only provide a basic summary of an expert's qualifications and testimony. "In contrast to the detailed information that *Daubert* deemed essential," one scholar has explained, "the disclosures in the [Rule 16] summary are apt to be too conclusory to educate [the other side] or . . . provide them with effective ammunition for cross-examination."[87] Moreover, as the three-judge panel recognized, "a Rule 16 disclosure need not be filed with the court, but only with opposing counsel." [88] In the three-judge panel's estimation, this makes it apparent that a Rule 16 disclosure is "not intended to serve as the basis for a judicial determination regarding admissibility."[89] Thus, when the en banc panel upheld the district court's treatment of a challenge to a Rule 16 disclosure as a challenge under the *Daubert* standard, it subjected

83. *Id*. at 1259–60.

84. *Id*. at 1260.

85. United States v. Nacchio (*Nacchio I*), 519 F.3d 1140, 1151 (10th Cir. 2008).

86. Margaret A. Berger, *Procedural Paradigms for Applying the* Daubert *Test*, 78 MINN. L. REV. 1345, 1360 (1994); *see also* United States v. Rich, 326 F. Supp. 2d 670, 677 (E.D. Pa. 2004) (rejecting a defendant's motion for a new trial partly on the basis that there was no authority supporting the idea that Rule 16 reports must independently meet *Daubert* requirements); Joe S. Cecil & Thomas E. Willging, *Accepting* Daubert*'s Invitation: Defining a Role for Court-Appointed Experts in Assessing Scientific Validity*, 43 EMORY L.J. 995, 1060–62 (1994) (explaining that a pretrial conference in accordance with Rule 16 may be used to narrow pretrial disputes regarding expert testimony, a separate *Daubert* pretrial *Daubert* hearing is common before a judge determines the admissibility of expert testimony).

87. Berger, *supra* note 86, at 1360.

88. *Nacchio I*, 519 F.3d at 1151 (footnote omitted).

89. *Id*.

Nacchio's Rule 16 filing to a much higher standard than is typical in criminal cases.

Conversely, the majority argued that the district court's treatment of the Rule 16 challenge as a challenge under *Daubert* was permissible because it was clear to Nacchio that the Rule 16 issue was no longer at play, rather the *Daubert* standard had been invoked. The majority reasoned that this was the case because of the numerous objections made by the government on the grounds of *Daubert*. Thus, it appears the court imposed a "constructive *Daubert* test" on Nacchio. Despite Nacchio's constructive notice that *Daubert* was at issue, proper briefing of the *Daubert* issue never took place. The district judge indicated that the Rule 16 filings and the relevant party motions were all he needed to make a *Daubert* determination.[90] This notwithstanding the accepted view that "Rule 16 disclosure is not designed to allow the district court to move immediately to a *Daubert* determination without briefs, a hearing, or other appropriate means of testing the proposed expert's methodology."[91]

The new standard adopted by the Tenth Circuit in Nacchio's case places defendants in the difficult situation of having to satisfy the *Daubert* standard for expert witnesses when they file their Rule 16 disclosures, despite the important differences between criminal and civil cases and despite the traditional understanding that Rule 16 disclosures are not a substitute for the more rigorous *Daubert* standard. The Tenth Circuit is alone in this requirement.

B. Materiality and "Soft" Information

Many consider this case to be unique in that it is the first time an individual has been convicted for trading on the basis of "soft" internal corporate information regarding future revenue estimates.[92] Nacchio supporters characterize this case as "the first time that a corporate insider has ever faced insider trading charges based purely on an internal debate regarding the accuracy of a prior public financial projection."[93] The Nacchio camp argues that if a conviction

90. *Id.* at 1150.

91. *Id.* at 1151.

92. Brief of Washington Legal Foundation as Amicus Curiae in Support of Petitioner, Nacchio v. United States, 519 F.3d 1140 (10th Cir. 2008) (No. 07–1311). The information is labeled "soft" due to its uncertain nature. *Id.*

93. *Id.* at 2.

is allowed to stand based on this "soft" information, the floodgates will be open to both civil and criminal prosecutions against corporate officials.

Future earnings estimates are unpredictable and difficult to gauge. For this reason, when Nacchio became aware that Qwest's earning projections may have been overstated, there was no guarantee that Qwest would undoubtedly fall short of the earnings estimates. Nacchio could have led the company on a new path designed to increase ongoing revenue streams to meet earnings estimates. Thus, it is apparent that the future revenue projections were uncertain at best.[94]

With this decision, the Tenth Circuit has entered into the dangerous waters of allowing individuals to be prosecuted on "soft" insider information, without announcing a standard for courts and juries to follow regarding the certainty of the "soft" information. The Nacchio case likely presents a bad example of why this prospect is dangerous, as it seems clear that Nacchio was aware that the one-time revenue stream of IRUs was about to come to an end. And there is no information that Qwest had implemented any policy to improve revenue streams at the time Nacchio traded on the insider information. In other words, it was certain at the time Nacchio traded that there was a serious risk that Qwest would likely fall short of revenue projections and that Nacchio was not implementing the necessary changes to prevent earnings shortcomings.

Nevertheless, future cases are likely to present a much closer call on whether the information is certain enough to be considered material inside information. One can easily imagine a situation where internal projections begin to show that a company will not meet its public earnings estimates, however, a company may be able to weather the storm and quickly change course to prevent a failure to meet revenue projections. Under the Tenth Circuit's standard, while a company debates internal revenue projections, company officials would be forced to either refrain from selling their company shares for fear of prosecution or disclose the negative revenue projections to the investing public, no matter how speculative and uncertain the projections may be. Disclosing this negative information would inevitably cause a loss of investor confidence in a company's ability to meet revenue projections, despite the fact the company could still

94. Searcey, *supra* note 73.

stem the loss and improve revenue streams. Accordingly, disclosure of a potential earnings shortfall would become a self-fulfilling prophecy dooming a company to an earnings shortfall. Unfortunately, the Supreme Court, in denying certiorari in the *Nacchio* case, missed an opportunity to develop a more distinct standard for juries to determine whether "soft" information in the form of internal revenue projections is certain enough to expose company officers to potential insider trading liability.

Amicus briefs offered helpful suggestions to the Supreme Court during the certiorari stage for developing a uniform jury instruction capable of adequately measuring the materiality of internal revenue projections. Specifically, the Washington Legal Foundation has suggested that in an insider trading case based on "soft" information, the trial court should instruct the jury that to be material, new revenue data must be "'so certain' that . . . the previously publicly announced forecast no longer had a 'reasonable basis.'"[95] This would be a practical instruction that would allow the jury to successfully evaluate the "probability" and "magnitude"[96] of the "soft" information available to the defendant when he traded. Because materiality is such an indefinite concept, particularly in the context of "soft" information, more exacting jury instructions are needed.

V. CONCLUSION

Joseph Nacchio is certainly not a sympathetic character. Many view his conviction a "victory over greedy corporate chieftains."[97] However, the Tenth Circuit's decisions in the Nacchio line of cases will impact corporate officials who are honestly trying to comply with insider trading laws, and will generally lead to greater confusion in the Tenth Circuit for juries and judges when faced with complex insider trading issues.

First, in *Nacchio II*, the Tenth Circuit conflated the requirements of Rule 16 disclosures and the requirements for qualifying experts under the *Daubert* standard. Accordingly, an onerous burden has been placed on defendants to satisfy the high *Daubert* standard at an

95. Brief of Washington Legal Foundation as Amicus Curiae in Support of Petitioner, *supra* note 92, at 16.

96. *Id.*; *see* Basic, Inc. v. Levinson, 485 U.S. 224 (1988).

97. *See U.S. Government Won't Fight Nacchio Sentence Ruling*, *supra* note 78.

early stage of a trial. Conflating these two standards will mean that some defendants who believe they have complied with Rule 16 disclosures will later be surprised to find that their expert is unable to testify because they failed to comply with *Daubert*, nor will they be given a second chance to do so. Thus, defendants in the Tenth Circuit must ensure that they comply with the *Daubert* requirements at an earlier stage in the trial than is required by any other circuit court.

Moreover, the Tenth Circuit's en banc decision regarding materiality in the "soft" information context will leave lower court juries and judges uncertain about how to decide the fate of corporate insiders guilty of trading company stock on the basis of uncertain internal corporate revenue projections. Further, the precedent set by the Tenth Circuit in the Nacchio case could have the negative effect of discouraging companies from disclosing optimistic or ambitious revenue projections to the public out of fear that making trades while internal documents question the accuracy of the projections will leave officers potentially liable for insider trading violations. This will mean that investors will have less information as they make their investment decisions. Accordingly, a new standard requiring that "soft" information be certain to a high-degree before insider trading liability can attach is appropriate to avoid the chilling effect that will likely come to corporate insiders doing business in the Tenth Circuit.

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