No. 08-1172

IN THE

Supreme Court of the United States

JOSEPH P. NACCHIO,
Petitioner,

v.

UNITED STATE OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari To the United States Court of Appeals For the Tenth Circuit

BRIEF OF WASHINGTON LEGAL FOUNDATION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Amicus curiae addresses the following issue only:

Whether the defendant is entitled to acquittal or a new trial because the Tenth Circuit, in conflict with the standards applied in other circuits, erred by upholding the jury instructions bearing on the materiality of the type of information at issue, and by holding that there was sufficient evidence that the defendant failed to disclose material information and knew it.

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BRIEF OF WASHINGTON LEGAL FOUNDATION AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

INTEREST OF *AMICUS CURIAE*

The Washington Legal Foundation (WLF) is a nonprofit public interest law and policy center based in Washington, D.C., with supporters in all 50 States.[1] WLF devotes a substantial portion of its resources to defending and promoting free enterprise, individual rights, business civil liberties, and a limited and accountable government. To that end, the WLF has frequently appeared before this Court and other federal courts in numerous cases that raise these issues. In particular, WLF has participated as *amicus curiae* in cases about the proper scope of securities law, scienter, and mens rea. *See, e.g.*, *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.,* 128 S. Ct. 761 (2008); *Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 127 S. Ct. 2499 (2007); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71 (2006); *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336 (2005).

In addition, WLF publishes policy papers that oppose abusive securities class action cases that are detrimental to the public interest. *See, e.g.*, James Maloney, *Strict Standing Requirement For Securities Fraud Suits Upheld* (WLF Counsel's Advisory, June 3,

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[1] Pursuant to Supreme Court Rule 37.6, *amicus curiae* states that no counsel for a party authored this brief in whole or in part; and that no person or entity, other than *amicus* and its counsel, made a monetary contribution intended to fund the preparation and submission of this brief. More than ten days prior to the due date, counsel for *amicus* provided counsel for Respondent with notice of intent to file.

2005); Lyle Roberts & Paul Chalmers, *Lower Courts Will Determine Impact Of Supreme Court's Securities Fraud Suit Ruling* (WLF Legal Backgrounder, May 20, 2005).

WLF submits that the issues presented in this case are of the utmost public interest and importance in the area of securities law. Petitioner Joseph Nacchio ("Nacchio") was convicted of insider trading based on an instruction as to the essential element of materiality that improperly deprived the jury of any guidance as to how to perform the delicate assessment of determining the materiality of internal "soft" information. Accordingly, the Court should grant Nacchio's petition for a writ of certiorari (the "Petition" or "Pet.")

WLF has no direct financial interest in the outcome of this case. It is filing this amicus brief with the consent of all parties. The written consents have been lodged with the Clerk of the Court.

REASONS FOR GRANTING THE PETITION

As noted in the Petition, the prosecution of Nacchio is 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. Pet. 2. The WLF is troubled by the conviction of Nacchio for insider trading and believes that review by this Court is necessary in light of the district court's erroneous and highly prejudicial jury instructions defining "materiality" based on the possession of "soft" information. If a conviction based on such jury instructions is allowed to stand, the door will likely be opened to the prosecution, both civilly and criminally, of securities fraud claims any time there is trading while in the possession of the merest ephemera of "soft" information that ultimately turns out to have been a harbinger of negative results.

Such a precedent would potentially criminalize nearly all securities trading by insiders while in the possession of nonpublic soft information and contribute to a climate of fear inhibiting the exchange of information as to future financial trends and performance, a dialogue that is essential to the proper functioning of both corporations and the market in general. In addition, if the district court's jury instructions on materiality are allowed to pass muster, companies will be severely limited in their ability to allow employees to purchase or sell the corporation's securities. "Blackout periods" will become the norm rather than the exception and opportunities for employees to diversify their investment portfolios by selling stock received through grants or option exercises will be dramatically reduced, thereby harming the ability of public companies to recruit and retain employees.

Indeed, in this case, Nacchio was convicted of insider trading based on jury instructions as to "materiality" that ceded to the jury full and unfettered discretion to find "materiality" on the basis of even the most inchoate and speculative soft information. Review is warranted because, at a minimum, the instructions should have given the jury far more guidance as to how to make the very difficult and nuanced determination as to when "soft" information is sufficiently certain and definite that it may be deemed "material."

The charges against Nacchio were based entirely on the Government's allegation that Nacchio had received new internal information that should have led him to realize that prior publicly issued financial projections were likely to be inaccurate. By tying the allegedly material new "soft" information to the earlier public projections by Qwest Communications International, Inc. (the "Company"), Nacchio's proposed instructions with respect to materiality would have provided the jury with the proper context to analyze the charges in this case. As the defense sought, the jury should have been instructed that the new soft information was "material" only if it was so certain that it caused the earlier publicly disclosed projection to no longer have a "reasonable basis." At a minimum, the district court should at least have provided the jury with the materiality instruction proposed by the Government, which was uncontroversial but nonetheless rejected by the district court in favor of an instruction that provided even less guidance. Such errors effectively deprived Nacchio of the ability to argue that the soft information at issue was not certain enough and not substantial enough to constitute material information.

I. REVIEW IS WARRANTED BECAUSE THE DISTRICT COURT'S INSTRUCTIONS AS TO MATERIALITY FAILED TO PROVIDE THE JURY WITH ADEQUATE INSTRUCTION AS TO HOW TO DRAW A LINE BETWEEN "MATERIAL" AND "IMMATERIAL" "SOFT" INFORMATION

The linchpin of the prosecution's theory of the case was that, in early 2001, Nacchio came into possession of information that led him to conclude that the Company's "publicly stated financial targets" issued in September 2000 were risky and "aggressive." Petitioner's Appendix ("Pet. App.") 204a-05a. Notably, the prosecution did not argue that this new information would have been material in the absence of the public projections. Nonetheless, the district court's proffered jury instruction omitted any mention whatsoever of the public projection and instead invited the jury to find materiality as to the new "soft" information[2] if it simply concluded that "a reasonable investor would consider it important in deciding to act or not to act with respect to the securities transaction at issue." Pet. App. 274a. The only caveat the district court provided the jury was an admonition that securities fraud "does not cover minor or meaningless or unimportant matters or omissions." *Id.*

In reaching the determination to provide the jury with these perfunctory instructions as to materiality, the district court rejected the instructions proposed by

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[2] The Tenth Circuit has defined soft information as "information about a particular issuer or its securities that inherently involves some subjective analysis or extrapolation, such as projections, estimates, opinions, motives, or intentions." *Garcia v. Cordova*, 930 F.2d 826, 830 (10th Cir. 1991) (quoting Bruce A. Hiler, *The SEC and the Courts' Approach to Disclosure of Earnings Projections, Asset Appraisals, and Other Soft Information: Old Problems, Changing Views*, 46 Md. L. Rev. 1114, 1116 (1987)). "Soft information contrasts with hard information which is typically historical information or other factual information that is objectively verifiable and subject to disclosure if material to the relevant transaction." *Garcia*, 930 F.2d at 830 (internal citation omitted).

the defense that would have required that, in order to be "material," the jury determine that the new information rendered the earlier public disclosure without a "reasonable basis" and that the materiality of the new information be viewed in light of the cautionary language accompanying the prior public disclosure. Pet. App. 134a-35a, 137a. Notably, the district court also spurned even the Government's far from controversial proposed instruction. Pet. App. 272a. Although it failed to tie the materiality of the new soft information to the earlier public projection, the prosecution's proposed instruction at least delineated materiality in terms of this Court's teachings in *Basic Inc. v. Levinson*, 485 U.S. 224, 238 (1988), and *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976), by directing the jury that, in order to find materiality, it must be "substantially likely that a reasonable investor would have viewed [the information] as significantly altering the total mix of information made available concerning the company." Pet. App. 338a-40a.[3]

Review is warranted because even in civil securities fraud cases involving projections, juries are normally afforded far more guidance than the district court provided here in a criminal case with respect to "materiality." Such guidance is necessary to mitigate the risk that juries will wrongly impose liability on the

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[3] The Government's Proposed Instruction No. 12 would also have instructed the jury that "[i]n evaluating whether forecasts and forward-looking information is material, you should evaluate the importance of the information to a reasonable investor, such as the probability that the future events will or will not occur and the anticipated magnitude of the events in light of the totality of company activity." Pet. App. 339a.

basis of hindsight. *See*, *e.g.*, Modern Federal Jury Instructions – Pattern Jury Instructions (Civil), Ninth Circuit ¶ 21.2 cmt. (Matthew Bender ed. 2006) (materiality instruction "should be adjusted for cases involving ... statements of reasons, opinions or beliefs" and "when the alleged fraud concerns certain forward-looking statements the jury may be compelled to examine whether the statement falls within the safe harbor and therefore does not qualify as a fraudulent statement under the Act"); Eleventh Circuit Pattern Jury Instructions (Civil Cases), Instruction 4.2 (2005) ("If, at the time the predictions, expressions of opinion or projections were made, and the speaker actually believed them or there was a reasonable basis for making them, then the statements are not materially misleading statements of fact.").

Yet, here, in a criminal context where the defendant's liberty was at stake, the district court rejected even these basic safeguards. Instead, the district court offered an instruction to the jury that was devoid of any useful guidance as to how to assess the materiality of the new soft information in the context of the prior public pronouncement. Such circumstances make review especially warranted in this case because the prosecution's case explicitly hinged on the public projection that the Government claimed was, in light of the new information, no longer accurate. Given the Government's theory of the case, as well as the unique issues presented by any criminal prosecution for insider trading premised on the possession of allegedly material "soft" information, a more detailed instruction providing the jury with more guidance was clearly required.

Indeed, even though the Tenth Circuit declined to reverse Nacchio's conviction on the basis of the jury instructions as to materiality, it nonetheless recognized the troublesome nature of the materiality analysis and the problems inherent in advising jurors as to how to tackle such a nuanced determination. In fact, the Panel acknowledged that "the fact-specific nature of the materiality determination [makes] it [] important to give a jury enough guidance to sort out material information from noise" and conceded that "[i]t is difficult for untrained jurors to judge *ex post* what would have been important to reasonable investors *ex ante*." Pet. App. 132a.

Moreover, the Panel got to the very heart of what WLF believes is the root problem with the jury instructions as to materiality when it recited the obvious truism that "[a]fter the fact, whenever anybody has made money trading stock it is easy to say that one would have wanted to know whatever the trader knew." Pet. App. 132a. The Panel's recognition of how "easy" it is for a jury to find materiality in hindsight proves the inadequacy of the instructions here. If the conviction in this case is allowed to stand, the district court's open-ended jury instructions as to materiality will be endorsed. A criminal conviction should not stand on such a basis.

Indeed, even the Tenth Circuit panel, in denying the appeal, felt obliged at least to acknowledge that the district court's instructions on "materiality" were "not particularly informative." Pet. App. 133a. The instruction provided the jury with *no* basis for understanding how to draw the line between the rare case of near *certain* soft information, which indeed may be material, and the routine estimates and prognostications that companies circulate internally that are not. Absent more concrete guidance, the *Nacchio* jury was free to determine materiality improperly without any reference to the "total mix" of information and the underlying disclosure that was at the crux of the Government's case and without any sensitivity to the fact that, although an investor might, out of context, consider forecasts to be important, the law recognizes that such information may nevertheless still be speculative and without sufficient certainty to make it "material."

As detailed by Nacchio in his Petition, the need for review by the Court of the jury instructions as to materiality is further supported by the conflict between the Tenth Circuit's decision upholding the jury instructions in this case and the many Circuits holding that internal soft information, including internal projections, is immaterial as a matter of law, except in relation to prior public forecasts. Pet. 17-24. Without question, there is confusion among courts as to how to instruct juries to assess the materiality of internal projections, and whether and to what extent such materiality assessment hinges on the substance of a prior publicly made projection or forecast. *See, e.g.*, Donald C. Langevoort & G. Mitu Gulati, *The Muddled Duty to Disclose Under Rule 10b-5*, 57 Vand. L. Rev. 1639 (2004). This Court's decision in *Basic* is a good starting point for any such analysis, but *Basic* itself recognizes that a determination of the materiality of soft information presents a particularly difficult problem. *Basic*, 485 U.S. at 232.

In light of the total lack of guidance provided to the *Nacchio* jury as to when soft information becomes so material as to preclude securities trading by a corporate insider, the conviction of Nacchio violates basic principles of fairness and the rule of lenity. *See Bell v. United States*, 349 U.S. 81, 83 (1955). A criminal conviction for insider trading simply cannot be premised on a materiality instruction that offered the jury absolutely no guidance and allowed conviction on the basis of soft information that anyone in hindsight could simply say one "wanted to know." Pet. App. 132a.

II. REVIEW IS WARRANTED BECAUSE THE DECISION BELOW UNDERMINES THE IMPORTANT PROTECTIONS AFFORDED TO INTERNAL "SOFT" INFORMATION

The general difficulties inherent in performing determinations of materiality under this Court's standard for materiality, as articulated in *Basic*, 485 U.S. at 238, and *TSC Industries*, 426 U.S. at 449, are well recognized. One commentator has noted:

> The facial simplicity of the basic legal standard governing materiality masks the complexities encountered by transaction planners, litigants, the SEC, the U.S. Department of Justice . . . and courts in interpreting and applying that standard. The interpretation and application of the materiality standard are highly fact-dependent and do not always produce predictable or certain planning options or judicial results.

Joan MacLeod Heminway, *Materiality Guidance in the Context of Insider Trading: A Call For Action*, 52 Am. U. L. Rev. 1131, 1138-39 (2003).

Such determinations are even more difficult when the information whose materiality is being assessed is so-called "soft" information and is, by definition, lacking absolute certainty and clarity. Indeed, until 1973, the United States Securities and Exchange Commission (SEC) prohibited the inclusion of forward-looking information in a public disclosure document out of concern that the dissemination of soft information could not be adequately gauged by the marketplace. Statement by the Commission on the Disclosure of Projections of Future Performance, Securities Act Release No. 5362, Exchange Act Release No. 9984, 38 Fed. Reg. 7220 (Feb. 2, 1973).

Over the last 35 years, however, the enactment of statutory and administrative "safe harbors" and the judicial adoption of the "bespeaks caution" doctrine reflect the growing recognition that corporations and their officers and directors must have the latitude to make good faith pronouncements of financial estimates and projections to the market without running the risk that they will be sued or held liable if, as frequently happens, such projections turn out to be erroneous. The *Nacchio* prosecution and conviction run counter to this trend of increased protections with respect to securities claims premised on "soft" information.

Indeed, in the early 1970s, the SEC began to acknowledge various overriding factors supporting the release of forward-looking statements: the relevance of future-oriented data in investment decisions; the increased reliability and sophistication of corporate forecasts due to both improved information systems and increasing use of budgets and forecasts in corporations; and the need for companies to disclose projections to investors in a nondiscriminatory manner. *See* John C. Burton, Chief Accountant, SEC at the Northwestern University Conference on Public Reporting of Corporate Financial Forecasts, *Forecasts: A Changing View From the Securities and Exchange Commission* (Apr. 2, 1973), *available at* http://www.sec.gov/news/speech/1973/040273burton.pdf.

As a result of this emerging view of the normative advantages of allowing forward-looking statements, the SEC and Congress implemented administrative and statutory protections with the goal of promoting the exchange of forward-looking information. In 1979, the SEC formally adopted a "safe harbor" for the release of forward-looking statements made with good faith and with a reasonable basis, with the goal of "encouraging the disclosure of projections and other items of forward-looking information." In adopting the safe harbor, the SEC noted that several commentators "urged the adoption of a safe harbor rule for projections made by issuers and reviewed by third parties, stating that the absence of a safe harbor rule might discourage the dissemination of projections." Safe Harbor For Forward-Looking Statements, Securities Act Release No. 7101, Exchange Act Release No. 34831, Investment Company Act Release No. 20613, 59 Fed. Reg. 52723 (Oct. 13, 1994).

Since the lifting of the SEC's prohibition on forward-looking statements, the public dissemination of soft information has come to play a critical role in maintaining and enhancing visibility, predictability, and uniformity of access to information in the marketplace. The increasing importance of the public availability of soft information has been recognized by Congress through the codification of safe harbor protections for forward-looking statements in the Private Securities Litigation Reform Act, 15 U.S.C. § 78u-5 (1995), passed for the primary purpose of reducing the "chill on voluntary disclosures by issuers." S. Rep. No. 104-98, at 5 (1995), *as reprinted in* 1995 U.S.C.C.A.N. 679, 684.

The importance of the availability of soft information to the overall economy has also been recognized by the SEC, which has acknowledged that forward-looking statements "occup[y] a vital role in the United States securities markets":

> Investors typically consider management's forward-looking information important and useful in evaluating a company's economic prospects and consequently in making their investment decisions. Analysts and other market participants report that they view considerations of management's own performance projections, i.e., earnings and revenues, to be critical to their own forecasts of company's future performance. As such, forward-looking information is often considered a critical component of investment recommendations made by broker-dealers, investment advisors and other securities professionals.

Safe Harbor For Forward-Looking Statements, Securities Act Release No. 7101, Exchange Act Release No. 34831, Investment Company Act Release No. 20613, 59 Fed. Reg. 52723 (Oct. 13, 1994). Indeed, "[i]f a company won't provide information, investors become reluctant to invest . . . . [and,] [w]ithout investors, companies wither on the vine. . . [and,] [i]n the end, the entire American economy suffers." Securities Litigation Abuses: Hearing Before the Subcomm. on Securities of the S. Comm. on Banking, Housing and Urban Affairs (Oct. 29, 1997) (testimony of Thomas E. O'Hara, Chairman, National Association of Investors Corporation), *available at* 1997 WL 683748.

Comporting with the expressed public policy of Congress and the SEC, lower courts have consistently recognized the need to protect corporate use of soft information in the form of forward-looking statements to the market and internally-generated projections. Every Court of Appeals addressing this issue has adopted protections such as the "bespeaks caution doctrine," which "provides a mechanism by which a court can rule as a matter of law . . . that defendants' forward-looking representations contained enough cautionary language or risk disclosure to protect the defendant against claims of securities fraud." *Grossman v. Novell, Inc.*, 120 F.3d 1112, 1120 (10th Cir. 1997) (quoting *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1413 (9th Cir. 1994), *cert. denied*, 516 U.S. 868 (1995)).[4]

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[4] *See also Romani v. Shearson Lehman Hutton*, 929 F.2d 875, 879 (1st Cir. 1991); *I. Meyer Pincus & Assoc., v. Oppenheimer & Co.*, 936 F.2d 759, 763 (2d Cir. 1991); *In re Donald J. Trump Casino Sec. Litig*, 7 F.3d 357, 371-73 (3d Cir. 1993), *cert. denied*, 510 U.S. 1178 (1994); *Gasner v. Board of Supervisors*, 103 F.3d 351, 358 (4th Cir. 1996); *Rubinstein v. Collins*, 20 F.3d 160, 167 (5th Cir. 1994); *Sinay v. Lamson & Sessions Co.*, 948 F.2d 1037, 1040 (6th Cir. 1991); *Harden v. Raffensperger, Hughes & Co.*, 65 F.3d 1392, 1404-06 (7th Cir. 1995); *Polin v. Conductron Corp.*, 552 F.2d 797, 807 n.28 (8th Cir. 1977), *cert. denied*, 434 U.S. 857 (1977); *Saltzberg v. TM Sterling/Austin Assocs.*, 45 F.3d 399, 400 (11th Cir. 1995). *Cf. In re XM Satellite Radio Holdings Sec. Litig.*, 479 F. Supp. 2d

In implementing these principles, however, it is essential that the public dissemination of financial projections does not lead to the destructive result of forcing companies to update such disclosures every time new internal data, information or analysis is received that might arguably have an impact on such prior public assessment. The United States Court of Appeals for the Seventh Circuit was confronted with this very situation in *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509 (7th Cir. 1989). In *Wielgos*, the court made clear the importance of ensuring that companies have the benefit of free and unfettered internal discussion and debate as to business prospects and forecasts without being compelled constantly to worry that the daily vicissitudes of business render their prior public statements inaccurate and preclude the company or its officers from buying or selling securities. In concluding that a company's possession of internal information with respect to projections of construction costs did not preclude it from selling its own securities to the market, the Seventh Circuit stated:

> Because firms may withhold even completed estimates, they may withhold in-house estimates that are in the process of consideration and revision. Any other position would mean that once the annual cycle of estimation begins, a firm must cease selling stock until it has resolved internal disputes and is ready with a new projection. Yet because large firms are eternally in the process of generating and revising estimates – they may have large staffs devoted to

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165, 177-78 (D.D.C. 2007).

> nothing else – a demand for revelation or delay would be equivalent to a bar on the use of projections if the firm wants to raise new capital.

Id. at 516 (citing *Painter v. Marshall Field & Co.*, 646 F.2d 271, 291-93 (7th Cir. 1986)).

Review by this Court of the Nacchio conviction is warranted because, as recognized by the Seventh Circuit in *Wielgos*, the practical effect of the open-ended jury instructions here will be that corporate insiders will be severely restricted from trading in company shares for fear of prosecution and thereby deprived of the ability to diversify their assets. Moreover, in an attempt to alleviate such concerns, corporations may cease issuing guidance in order, among other things, to enhance the ability of corporate insiders to purchase or sell stock without the impediment of constant blackout periods or the fear of a criminal prosecution based on soft information that casts doubt on an existing projection.

In order to provide the jury with sufficient guidance, the *Nacchio* jury should have been instructed that to find that the new information that Nacchio allegedly possessed was "material," the information had to be "so certain" that, as a result, the previously publicly announced forecast no longer had a "reasonable basis." At a minimum, the jury should have been advised, as the Government's proposed but rejected instruction acknowledged and as this Court's decision in *Basic*, 485 U.S. at 231-32, mandates, that in order to find that the soft information at issue was material, it had to be "substantially likely that a reasonable investor would have viewed it as significantly altering the total mix of information made available concerning the company" and that materiality determinations require a balancing of "probability" and "magnitude." Pet. App. 338a-40a.

The failure of the district court to instruct the jury adequately in this regard was reversible error, which if not rectified by this Court, will accentuate the already uncertain landscape of corporate obligations with respect to soft information, severely hamper the ability of corporate insiders occasionally to diversify their assets (and thus impair the ability of public companies to recruit and retain talent) and have a deleterious impact on the ability of corporations to engage in the open and uninhibited internal dialogue that is so essential to the health and future of American business. Indeed, as Judge Easterbrook stated in *Wielgos*, "[i]f enterprises cannot make predictions about themselves, then securities analysts, newspaper columnists, and charlatans ["whose access to information is not as good as the issuer's"] have protected turf." *Wielgos*, 892 F.2d at 514.

CONCLUSION

For all the foregoing reasons, WLF respectfully requests that the Court grant the petition for a writ of certiorari.

Respectfully submitted,

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