News Release

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COURT URGED TO OVERTURN CONVICTION FOR INSIDER TRADING

(*Nacchio v. United States,* No. 08-1172)

The Washington Legal Foundation (WLF) this week urged the U.S. Supreme Court to review (and ultimately overturn) the insider trading conviction of a high-level business executive. Prosecutors accused the executive, the former CEO of Qwest Communications, of selling Qwest stock while knowing internal Qwest predictions that the company was at risk of missing year-end financial projections – *i.e.,* projections of revenues eight to twelve months in the future.

In a brief filed in *Nacchio v. United States*, WLF argued that the "soft" information of which the executive was aware cannot be deemed "material" and thus cannot serve as the basis for an insider trading conviction. WLF argued that the rules adopted by the lower courts in upholding the conviction are so stringent that they essentially would prohibit executives from selling stock of their companies.

"We are aware of no previous case in which an executive has been charged with insider trading under even remotely similar circumstances. As was true of the stock of many companies in the wake of the collapse of the telecommunications bubble, the stock of Qwest fell precipitously in the year following the 2001 sales at issue in this case," said WLF Chief Counsel Richard Samp after filing WLF's brief. "But basing insider trading prosecutions on such after-the-fact analyses creates a grave danger that juries will find 'fraud by hindsight.' When as here, the only non-public information available to an executive consists of future revenue projections for periods months or years in the future, there can be no legitimate basis for charging the executive with making stock sales on the basis of *material* inside information," Samp said.

The executive in question is Joseph P. Nacchio, who recently began serving a lengthy prison sentence for insider trading. In September 2000, Qwest released estimates of projected revenues for 2001. It met those projections for the first two quarters of 2001. An internal Qwest risk projection, which Nacchio saw in the spring of 2001, said that it was possible that Quest might miss its 2001 sales projection by several percentage points. The consensus among company executive nonetheless was that Qwest could still meet its 2001 sales projection, and it so stated in an April 2001 public announcement. In April-May 2001, Nacchio (pursuant to a previously announced plan) sold in excess of one million shares of Qwest stock. Quest did not reduce its 2001 sales projections until August 2001, after experiencing disappointing sales in the summer of 2001.

Federal prosecutors thereafter charged Nacchio with insider trading, alleging that his early 2001 stock trades were based on "material" nonpublic information that Qwest was at risk of not meeting revenue projection for the end of 2001. A jury convicted Nacchio on 19 of 42 counts after the judge instructed the jury that forecasts of future sales could constitute "material" information "so long as a reasonable investor would consider it important in deciding to act or not to act with respect to the securities transaction at issue." The judge provided this open-ended definition over the objection of Nacchio, who advocated a ruling that internal risk forecasts need not be disclosed unless they throw into serious doubt the reliability of existing published projections.

A three-judge panel of the U.S. Court of Appeals for the Tenth Circuit overturned Nacchio's conviction. However, on rehearing *en banc*, the appeals court voted 5-4 to affirm the conviction. Nacchio has now petitioned the Supreme Court to review the case.

In its brief urging that review be granted, WLF argued that the Tenth Circuit's decision conflicts with rulings from several other federal appeals courts. WLF noted that other appeals courts have held that internal predictions and interim operating results are immaterial as a matter of law unless they establish a very strong likelihood that the company's eventual reported performance will be substantially below what the market is expecting.

WLF argued that the practical effect of the Tenth Circuit's decision is that corporate insiders cannot ever sell company shares because they cannot be sure that internal company forecasts would not be deemed in hindsight to constitute "material" information. WLF also argued that the decision would discourage companies from making public forecasts – despite the federal government's policy that seeks to encourage publicly traded companies to assist investors by making such forecasts.

WLF is a public interest law and policy center with supporters in all 50 States. WLF devotes a substantial portion of its resources to defending and promoting free enterprise, individual rights, and a limited and accountable government. In particular, WLF has appeared in numerous federal and state courts in cases raising securities law issues. WLF's brief was drafted with the pro bono assistance of Andrew J. Levander, David S. Hoffner, Jason O. Billy, and David P. Staubitz, attorneys in the New York City office of Dechert LLP; and Michael Kichline of Dechert's Philadelphia office.

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For further information, contact WLF Chief Counsel Richard Samp, 202-588-0302. A copy of WLF's brief is posted on its web site, www.wlf.org.