No. 08-1172

In the Supreme Court of the United States

JOSEPH P. NACCHIO,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

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

BRIEF OF AMICUS CURIAE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

The petition for a writ of certiorari presents three questions. This brief addresses only the following:

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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INTEREST OF AMICUS CURIAE[1]

The Chamber of Commerce of the United States of America ("Chamber") is the world's largest business federation and represents an underlying membership of more than three million companies and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files amicus curiae briefs in cases that raise issues of vital concern to the nation's business community.

This case presents an issue of great importance to the hundreds of thousands of businesses that are subject to the federal securities laws. The rule adopted below—that mere doubts about revenue predictions for months-distant financial reporting periods can constitute "material" nonpublic information—is fundamentally misguided and portends serious consequences for American business interests. The decision below affects not only the conditions under which corporate insiders may trade in a company's stock (itself an important issue), but also how companies collect, use, and disseminate

[1] The parties received timely notice of this brief and have consented to its filing; letters of consent have been filed with the Clerk. No counsel for a party has authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person or entity, other than amicus curiae, its members, or its counsel, has made a monetary contribution to this brief's preparation or submission.

forward-looking information. Indeed, if left undisturbed, the Tenth Circuit's rule may have the perverse effect of *discouraging* rather than *promoting* the full and prompt flow of accurate information to the marketplace. This case is therefore of extraordinary importance to the Chamber and its membership, and to the markets themselves.

STATEMENT

Petitioner Joseph P. Nacchio is the former CEO of Qwest Communications. Like most companies, Qwest regularly issued public revenue projections for future fiscal periods. On September 7, 2000, Qwest announced that it projected revenues of $21.3 to $21.7 billion for fiscal year 2001. Pet. App. 102a. Qwest also maintained internal revenue targets that exceeded the publicly announced figures; the internal target for fiscal year 2001 was $22 billion, later revised to $21.8 billion. *Ibid.*

In late 2000 or early 2001, a Qwest employee working on Qwest's 2001 budgeting process informed petitioner that she saw "a billion dollars of risk as it related to the target that [Qwest] had set" for 2001 revenue. Pet. App. 229a-230a. She orally advised petitioner of that "aggregated * * * risk," *id.* at 230a, but there was some dispute as to whether her estimate suggested a possible 4.2% deviation from the public projections or a possible 1.4% shortfall. The courts below adopted the former interpretation of her testimony, and we do not dispute that conclusion here.

Qwest met or exceeded its public revenue projections in the first and second quarters of 2001.

Pet. App. 104a. On April 24, 2001, petitioner reaffirmed the public guidance for the year, *id.* at 105a, although he advised shareholders that those numbers could be affected by "softness" in the economy, *id.* at 289a. Petitioner also informed investors that Qwest's small-business and consumer-business units—the principal drivers of Qwest's "recurring" revenues—had missed budgeted expectations by approximately 20%. *Id.* at 277a. The employee who had earlier advised petitioner of a possible revenue shortfall testified that she remained confident in the company's guidance at that time. *Id.* at 294a.

The quarterly trading window for corporate employees opened a few days later. Pet. App. 108a. At the time, petitioner held more than 7 million stock options that were set to expire in 2003. *Id.* at 106a. Petitioner also owned significant additional amounts of Qwest stock acquired over the course of his career. *Id.* at 108a. Consistent with a decision he had announced months earlier (before anyone had even questioned whether Qwest would make its numbers), petitioner sold approximately 1.2 million of the option shares over the next month. *Ibid.* Petitioner never sold another share of company stock. *Ibid.*

Petitioner was indicted on 42 counts of insider trading, 19 of which were based on the April and May trades described above and 23 of which were based on prior trades. Pet. App. 109a. At trial, the defense requested that the district court instruct the jury that forward-looking statements cannot be materially misleading if they had a "reasonable basis" when made, and that a corporate insider is not required to disclose "internal projections" unless the projections are "so certain that they show the published figures to have been without a reasonable basis." *Id.* at 341a-348a. The government proposed to instruct the jury that the materiality of forward-looking information must be judged in light of the "probability" that an event would occur and its expected "magnitude." *Id.* at 338a-340a. The district court refused to give either charge. Instead, it instructed the jury that "[i]nformation may be material even if it relates not to past events but to forecasting and forward-looking statements 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." *Id.* at 274a. The district court also rejected petitioner's contention that the nonpublic information in his possession was immaterial as a matter of law and therefore insufficient to support a conviction. After six days of deliberations, the jury convicted petitioner of 19 counts of insider trading based on the April and May stock sales.[2]

A panel of the Tenth Circuit ordered a new trial on other grounds, but—in a ruling left standing by the en banc court—it rejected petitioner's challenge to the materiality instruction and evidence. Pet. App. 128a-145a. As principally relevant here, the panel concluded that petitioner's proposed instruction mistakenly mirrored SEC Rule 175, which immunizes securities issuers from fraud liability for making forward-looking statements, "unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith." 17 C.F.R. §230.175; see Pet. App. 135a

[2] The jury acquitted petitioner of the 23 counts relating to sales in January and March 2001.

(quoting same). The panel acknowledged that "a number of cases" have prohibited the imposition of liability for failing to disclose forward-looking information that suggested a possible deviation from published expectations, unless it is shown that the public statements were made or reaffirmed "without a reasonable basis or in bad faith." Pet. App. 135a. The panel concluded, however, that "those cases [do not] apply in this context," *ibid.*, because "Rule 175 and the insider trading rules are conceptually distinct," *id.* at 136a. In the panel's view, the fact that an insider may abstain from trading if he is in possession of material nonpublic information distinguishes insider trading from corporate disclosure rules. It "is not the law," the panel reasoned, that an insider is prohibited from trading "only when it would be affirmatively misleading not to disclose" a particular piece of information. *Ibid.*

The panel then concluded that a "risk" that Qwest might end up with "a 4.2% shortfall" in a future reporting period is not immaterial as a matter of law. Pet. App. 140a. The panel admitted that this was "a close question," but determined that 4.2% is "close to the 5% rule of thumb" the SEC has adopted for assessing the materiality of accounting errors for *reported* figures. *Id.* at 143a (citing Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150 (1999)). Although 4.2% is *less than* that 5% threshold, the panel conceded, the "state of the economy" and the "'mercurial'" nature of the telecommunications industry rendered that possible deviation from public projections arguably material. Pet. App. 143a.

The Tenth Circuit granted rehearing en banc to consider only the ground upon which petitioner was granted a new trial. In a 5-4 decision (and over multiple dissents), the court reversed that judgment and reinstated petitioner's convictions. The en banc court did not address the materiality question.

SUMMARY OF ARGUMENT

I. The panel's materiality analysis squarely conflicts with decisions by at least four other courts of appeals. Those courts have held that internal information bearing on a company's ability to meet financial projections is immaterial as a matter of law unless it is established to at least a high probability that the projection is not likely to come true. The Tenth Circuit mistakenly attempted to distinguish those decisions on the ground that they involved companies—rather than individuals—selling stock. The fact that corporate-disclosure obligations do not always overlap with insider-trading duties does not mean that the former never inform the latter. Moreover, there is little reason to believe that insiders owe greater duties to the market than the company itself when trading in corporate stock. And for all practical purposes, the Tenth Circuit's decision will be viewed as squarely rejecting the reasoning of those other courts.

II. The Tenth Circuit was wrong to hold that forward-looking information can be material without regard to threshold legal determinations of certainty. Predictions necessarily rely on assumptions and imperfect information, and they therefore are inherently inaccurate. It makes little sense to deem such information material, and courts must attempt to distinguish between marginal speculation and predictions that are less prone to error. It is unrealistic to assume that juries—viewing these issues with perfect hindsight—will internalize such considerations, particularly in the absence of specific instructions to do so. Nor should disclosure be encouraged at all costs; cluttering the marketplace with relatively insignificant data tends to make it more difficult for investors to identify and react appropriately to truly important information.

III. The Tenth Circuit's rule will have adverse consequences for American businesses. It imposes significant disincentives for making forward-looking statements and for collecting information that might turn out to be inconsistent with prior predictions—particularly for companies about to participate in a securities transaction. To the extent the rule simply makes it more difficult for insiders to trade company stock, it seriously undermines the use of stock-based compensation systems to align shareholders' and insiders' interests.

REASONS FOR GRANTING THE PETITION

I. THE TENTH CIRCUIT'S MATERIALITY RULE SQUARELY CONFLICTS WITH DECISIONS BY OTHER CIRCUITS

As petitioner has correctly explained (Pet. 17-24), the Tenth Circuit stands alone in holding that concerns about a marginal decrease in revenue projections for a future reporting period can be material as a matter of law. Petitioner is also correct that at least four courts of appeals have squarely rejected attempts to base securities violations on the failure to disclose such information when a company is buying or selling its own stock. See *Glassman* v. *Computervision Corp.*, 90 F.3d 617, 631 (1st Cir. 1996); *Shaw* v. *Digital Equipment Corp.*, 82 F.3d 1194, 1210-1211 (1st Cir. 1996); *Krim* v. *BancTexas Group, Inc.*, 989 F.3d 1435, 1449 (5th Cir. 1993); *Wielgos* v. *Commonwealth Edison Co.*, 892 F.2d 509, 515-516 (7th Cir. 1989); *Walker* v. *Action Indus., Inc.*, 802 F.2d 703, 708-710 (4th Cir. 1986). Petitioner has accurately described those cases, and we need not re-plow that ground here. The Tenth Circuit's attempt to evade that conflict, however, merits additional discussion because it rests on a distinction that is illogical, unsupported, and—in the litigious world in which businesses operate—impractical.

A. The court of appeals did not dispute that there are "a number of cases limiting liability for false statements of material fact [regarding future events] to cases where those statements were made without a reasonable basis or in bad faith." Pet. App. 135a. Nor did the court of appeals quarrel with Judge Easterbrook's observation that such a rule makes sense because predictions are inherently inaccurate: Even when "'estimates are made carefully and honestly, half will turn out too favorable to the firm and the other half pessimistic.'" *Id.* at 136a (quoting *Wielgos*, 892 F.2d at 514).

The Tenth Circuit nonetheless concluded that *Wielgos* and similar decisions are inapposite because petitioner was "prosecuted for concealing true information while trading, not for making misleading statements." Pet. App. 136a. In the Tenth Circuit's view, insider trading is "conceptually distinct" from whether a company's forward-looking statement is materially misleading because an insider may *abstain* from trading if he is not permitted to disclose material nonpublic information. *Id.* at 136a. That is, because there may be occasions in which an insider may possess material information that the company is not (yet) under an affirmative duty to disclose, forward-looking information can be material for insider trading purposes even if the company's disclosures are adequate. Accordingly, the Tenth Circuit reasoned, cases holding that information bearing on revenue projections (including inconsistent internal predictions) need not be *disclosed* have no bearing on whether such information was material for *insider-trading* purposes.

That logic is flawed. Just because an insider may be prohibited from trading when in possession of information that the company is not *always* required to disclose immediately, that does not mean that the company's disclosure obligations are *categorically irrelevant* to assessing materiality for insider trading purposes. As we explain below, a company's disclosure obligations are analytically indistinguishable from insider trading obligations when a company is buying or selling its own securities. But the more immediate point is that the Tenth Circuit's conclusion—*i.e.*, that disclosure is "conceptually distinct" from insider trading—does not flow from its premise that the two sets of obligations are *sometimes* independent.

B. Logical defect aside, the Tenth Circuit's attempt to distinguish cases such as *Glassman*, *Shaw*, *Krim*, *Wielgos*, and *Walker* is insubstantial. In all of those decisions, the question was whether a company's performance projections were materially misleading as a matter of law because the company had not disclosed interim operating data or conflicting internal predictions, when the company itself was buying or selling stock. *Glassman*, 90 F.3d at 623-624; *Shaw*, 82 F.3d at 1201; *Krim*, 989 F.2d at 1446; *Wielgos*, 892 F.2d at 513-514; *Walker*, 802 F.2d at 706-711. And in all of those cases the court of appeals held that internal information immaterial as a matter of law, because it did not establish a high probability of a material deviation from market expectations (*Glassman* and *Shaw*); because the company did not expect a shortfall with certainty (*Krim*); or because such data are always immaterial unless they are sufficiently certain that they show the public numbers to be materially misleading (*Wielgos*).

The Tenth Circuit held that forward-looking information is not subject to any such scrutiny; rather, it (apparently) distinguished those cases on the ground that they involved stock transactions by the company rather than an individual. That is truly a distinction without a difference. Tellingly, the Tenth Circuit offered no reason why information that is immaterial to an investor buying stock directly from the company, *e.g.*, *Glassman*, 90 F.3d at 620 (sale of $600 million in securities via initial public offering), is somehow material to an investor buying shares sold by a corporate employee. From the buyer's perspective, information is no more or less significant depending upon who is selling the stock. And the jury here was specifically instructed to assess materiality from the perspective of "reasonable investor." Pet. App. 274a.

Moreover, there is scant authority actually holding that disclosure obligations are different—

much less *reduced*—when a company is buying or selling securities than when a corporate insider is doing the same. As petitioner correctly notes, one court of appeals appears to have adopted that position (Pet. 23 (citing *J&R Marketing, SEP* v. *GMC*, 549 F.3d 384, 396-397 (6th Cir. 2008)), but the weight of authority has reached the opposite conclusion. See Pet. 23 n.7 (collecting authorities). The SEC certainly has never stated that issuers are held to a lower disclosure standard than insiders, which should come as no surprise because a company typically issues or repurchases shares in large increments, presenting a far greater potential impact on the market than typically smaller sales by corporate insiders. Accordingly, there is little comfort to be found in the Tenth Circuit's implicit assumption that issuers of securities enjoy more modest disclosure obligations than corporate insiders contemplating a trade.

C. As a result, the decision below will have a profound effect on companies in those jurisdictions that have not squarely rejected attempts to require corporations to disclose revenue projections before buying or selling securities. Even if one could draw a hypothetical distinction between issuers' and insiders' disclosure obligations, the absence of supporting authority—coupled with the specter of massive liability if a court later determines that distinction to be false—leaves firms little practical alternative but to treat the Tenth Circuit's rule as applying to issuers.

Indeed, a cloud of uncertainty already surrounds the disclosure requirements associated with forward-looking information. "There is no SEC regulation that explicitly speaks to the question of when, if ever, a company must provide the public with operating results pertaining to a fiscal quarter that has yet to be concluded." Gulati, *When Corporate Managers Fear a Good Thing Is Coming to an End: The Case of Interim Nondisclosure*, 46 U.C.L.A. L. REV. 675, 678 (1999). And courts have offered little in the way of coherent guidance. See Langevoort & Gulati, *The Muddled Duty to Disclose Under Rule 10b-5*, 57 VAND. L. REV. 1639, 1641-1642 (2004); see also Pet. 25 n.8 (collecting authorities). The Tenth Circuit's decision only heightens that uncertainty.

Imagine, for example, that a company's general counsel is reviewing a draft prospectus prepared in anticipation of a stock offering. Suppose further that the prospectus accurately discloses the company's prior financial results, but it does not discuss recent events that *might* affect the company's ability to hit revenue targets in future quarters. Even a mildly risk-averse decisionmaker would read the Tenth Circuit's decision to require disclosure. After all, the court upheld the imposition of *criminal* liability on an individual for failing to disclose precisely the same sort of information; it requires no paranoia to fear that a court might impose *civil* liability on a corporate seller. Companies thus will find little comfort in the fact that the Tenth Circuit must have concluded (without expressly saying so) that an issuer is not required to meet the same disclosure obligations when selling stock as a corporate insider. And even if the Tenth Circuit's rule does not technically apply when a company is buying or selling stock, the issuer is left to wonder what kinds of forward-looking information could be material to an insider but somehow not require disclosure. For all practical purposes, then, the conflict created by the Tenth Circuit's decision is stark.

II. THE DECISION BELOW IS WRONG

The notion that doubts about revenue projections can be material as a matter of law—without a rigorous threshold establishing the certainty of such information—is fundamentally misguided. It obscures the simple but indisputable fact that predicting future financial performance is an inherently uncertain exercise. It also invites juries to find fraud only with the aid of perfect hindsight, which is precisely what the securities laws ought to avoid. And, quite perversely, it may *impair* the market's ability to identify and digest information that is genuinely material to an issuer's financial condition.

A. Judge Easterbrook correctly identified the fundamental problem with allowing internal financial predictions to be deemed material. Because projections are simply predictions about the future, they are always wrong, at least to some extent. See *Wielgos*, 892 F.2d at 514. For the same reason, *changes* in projections also tend to be wrong; a revised prediction may turn out to be better than the one it replaced, or it may turn out to be worse—in either event, it is still a mere prediction of uncertain future events. It makes little sense to impose liability for failing to disclose information that is, by its very nature, uncertain.

Predictions are not all created equal, of course: Forecasting tomorrow's weather generally will produce fewer and smaller errors than predicting whether it will rain on a given day months from now. The Tenth Circuit's rule ignores that simple reality, however, because it permits the imposition of liability without even attempting to distinguish highly speculative financial projections from predictions that, perhaps because they do not look that far into the future, are likely to have a lower rate of error.

A simple hypothetical illustrates the point. Suppose that the CEO of Company A receives information in the first quarter of the fiscal year suggesting that sales of one of the company's products are trending slightly downward, such that there is a one-percent marginal increase in the chance that the company will miss its earnings target for the fourth quarter. Suppose further that the CEO of Company B learns just days before the end of the current quarter that a deal the company had expected to close has collapsed for lack of financing, and that there is a 95% chance that a substitute lender cannot be identified before the quarter ends. The information in the hands of Company A's executive is plainly immaterial—indeed, it is overwhelmingly likely that the projection remains as accurate (or as uncertain) as ever. Company B's CEO, by contrast, possesses information that is all but certain to affect the company's very next financial report. The decision below permits courts to hand both cases to the jury on equal footing.

Internal, forward-looking information is material only if, as the First Circuit has explained (and as the Fourth, Fifth, and Seventh Circuits have stated in slightly different terms), it establishes a high probability of an imminent and significant shortfall from public expectations. *Glassman*, 90 F.3d at 631; *Shaw*, 82 F.3d at 1210. That principle fully accords with this Court's longstanding view that materiality turns on a pragmatic assessment of "'both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.'" *Basic Inc.* v. *Levinson*, 485 U.S. 224, 238 (1988) (quoting *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968)).

B. It is no answer to suggest that juries will automatically factor in such considerations simply by assessing whether a "reasonable investor" would want to know forward-looking information. For starters, jury instructions must do more than supply a facially correct statement of the law; rather, they must provide meaningful guidance. Moreover, our system recognizes that judgment as a matter of law (or, in a criminal case, a directed verdict of acquittal) is appropriate if the evidence falls short of the legal minimum—even if the jury would otherwise be properly instructed. Accordingly, the Tenth Circuit's observation that the jury instructions delivered here "were not legally incorrect" merely begs the question whether they were legally adequate in light of the legal theories and evidence presented at trial.

The assumption that juries will fully consider the uncertainties inherent in forward-looking information also ignores the practical difficulty in proving that a particular estimate that ultimately proved inaccurate was reasonable when made. Consider again the hypothetical CEO of Company A, who sensibly concludes that information indicating an additional one-percent chance that the company will miss a future earnings target need not be disclosed. Chances are overwhelmingly good that his decision will never be questioned. But if there are 100 CEOs facing the same set of facts, the case that will find its way to court is the one in which that extraordinarily unlikely event—that one event in 100—already has come to pass. The jury has no knowledge of the 99 cases in which the very same decision was never subject to challenge; as a result, the jury is primed to conclude that the odds were never 1 in 100 in the first place.

The danger that juries will find fraud simply because they view evidence "in the broad gleam of hindsight" is ever-present in securities cases, particularly with respect to forward-looking information. *Texas Gulf Sulphur*, 401 F.2d at 867. That phenomenon is not unique to the securities context. Consider the cost-benefit analysis the FDA conducts when deciding whether to approve a product—say, a medical device—for introduction into the market. The FDA attempts to predict, based on the necessarily limited information available to it at the time, whether a particular device will be "safe and effective" in widespread use. When, as is inevitable, an approved device is found to have injured a particular individual, it is tempting to conclude that the FDA's approval was erroneous—*i.e.*, that the FDA must have misjudged the effectiveness of the device relative to its risk of harm. As this Court has observed, however, putting such questions to a jury skews the analysis: "A jury * * * sees only the cost of a more dangerous design, and is not concerned with its benefits; the patients who reaped those benefits are not represented in court." *Riegel* v. *Medtronic, Inc.*, 128 S. Ct. 999, 1008 (2008).

So too here, allowing a jury to assess retrospectively the materiality of forward-looking information without adequate guidance regarding its inherent uncertainty invites error. Even if it was entirely reasonable not to disclose a particular piece of forward-looking information at the time, jurors will focus on the fact that even the most unlikely events ultimately came to pass. They will "see only the cost" of nondisclosure, and will not take into account the numerous unseen instances in which an identical judgment call was beyond reproach.

C. Nor will juries be in a position to consider the harm that excessive disclosure can inflict upon consumers of information. A fundamental premise of the Tenth Circuit's holding is that investors always are better off if companies disclose even speculative forward-looking information. Indeed, the panel mocked the notion that "insiders could trade *without* disclosing" such data, claiming that such a rule "would turn [SEC regulations] on [their] head by sheltering those who keep predictions quiet, rather than rewarding them for disclosure." Pet. App. 137a.

But maximizing disclosure is not always to be rewarded. Increasing the flow of information to the market will, at some point, *harm* investors' ability to separate the truly important data from the flood of information that flows through a company on a daily basis. The information at issue here illustrates that point. According to the Tenth Circuit, an employee's *doubts* about whether the company will miss a revenue target by *less than five percent* several *months* in the future is material. The variety and volume of data that would meet such a low threshold—particularly in larger corporations—is staggering. As Judge Easterbrook correctly observed, many companies "may have large staffs devoted" exclusively to the task of establishing, reviewing, and revising internal projections on a virtually continuous basis. *Wielgos*, 892 F.3d at 516. Under the Tenth Circuit's analysis, every updated spreadsheet or progress report is potentially material, and companies should be encouraged to disclose it.

The Tenth Circuit assumed that encouraging such disclosures would benefit investors, but inundating the market with that information can have the precisely the *opposite* effect. As this Court has recognized repeatedly, "'simply to bury the shareholders in an avalanche of trivial information * * * is hardly conducive to informed decision-making.'" *Basic*, 485 U.S. at 231 (quoting *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 448-449 (1976). Again, consider the FDA's role in warning consumers about the dangers of a particular drug or device. The FDA does not seek to require manufacturers to warn against every harm imaginable, because "[o]verwarning has the effect of not warning at all. The reader stops paying attention to excess warnings." FDA, Write It Right 7 (1993); see also 44 Fed. Reg. 37,447 (1979) (excess warning can cause truly important information to "lose its significance"). It is no different for disclosures in the securities context: Flooding the market with data of questionable value threatens to drown out or obscure truly significant information.

III. THE TENTH CIRCUIT'S RULE PORTENDS SERIOUS ADVERSE CONSEQUENCES FOR THE WAY COMPANIES DO BUSINESS

The decision below will severely and negatively affect the way a multitude of companies do business. The Tenth Circuit's materiality analysis will quickly find its way into the civil arena, threatening companies with a wave of unprecedented litigation and, as a result, discouraging companies from the critical self-analysis that ultimately redounds to shareholders' benefit. Even if the rule had no application beyond insiders' ability to buy and sell stock, those restrictions would be far more onerous than the Tenth Circuit seemed to recognize and would seriously impair the ability of stock-based compensation to align the interests of employees and shareholders.

A. It requires little imagination to appreciate the ways in which civil securities plaintiffs will deploy the Tenth Circuit's decision. As explained above (*supra* pp. 10-11), it is far from clear that the rule adopted below does not apply directly to companies buying and selling their own securities. Businesses would therefore be at risk whenever they conduct an initial or secondary stock offering, issue certain debt instruments, or attempt to repurchase the same. For many corporations, such transactions are a regular (and crucial) component of their operations.

As a result, the Tenth Circuit's rule threatens to change the way many companies collect and disseminate information. If one employee's doubts about whether a company will miss a future earnings target by less than five percent is material, companies may well find it preferable to limit (or discontinue altogether) making public revenue projections. That is the premise of SEC regulations designed to encourage companies to make forward-looking statements. See, *e.g.*, 17 C.F.R. §§240.3b-6(a), 230.175(a) (forward-looking statement not fraudulent unless it lacked "a reasonable basis or was disclosed other than in good faith"). But if those safe harbors have no application when a company buys or sells securities, then companies will re-evaluate whether to issue forward-looking statements at all. That is particularly true for companies that plan to participate in a securities transaction. The rule adopted below thus would *discourage* firms from disclosing expectations about future performance at precisely the moment when investors want *more* information to evaluate the impending transaction.

Alternatively, companies that continue to issue financial projections may change the way they solicit and distribute information that could affect those predictions. A company that has already disclosed revenue estimates for future quarters, for example, may scale back forecasting operations in anticipation of a securities transaction for fear of generating data that might require disclosure. Or there may simply be a subtle shift in attitudes toward forward-looking information, such that employees are discouraged from raising concerns about prior predictions for fear of tying the companies' hands or prompting the disclosure of sensitive internal deliberations.

The same is true even if the Tenth Circuit's rule applies only to corporate insiders and not to the company itself. If the consequence of reporting doubts about future financial targets is a categorical ban on stock sales, employees will think twice before collecting, reporting, or inquiring about such information. Such a reaction would not necessarily be in bad faith—or even unreasonable—because doubts about future performance are a dime a dozen in corporate America. Every e-mail or memo suggesting a change in financial projections would effectively freeze a stock-compensation system, even where (as is frequently the case) such information ends up bearing little resemblance to reality.

But to say that most forward-looking information is immaterial is not to say that a rule that discourages its collection and dissemination is of no concern. What starts out as an immaterial doubt about future prospects may, *in due time*, become a significant development or trend. Shareholders are decidedly better off if possible concerns (or opportunities) are identified as early as possible, such that there remains sufficient time for the company to respond effectively. If a company predicts decreased sales in a particular product line, for example, it might try to re-energize the sales force or bring a new product to market more quickly. Or further investigation might reveal the initial concern to be ill-founded, allowing the company to avoid a costly overreaction. In either event, it is in the shareholders' interests to foster critical thinking, frank internal discussion, and open communication among employees. The Tenth Circuit's rule strongly discourages such a corporate culture.

B. Under even the most benign scenario, the Tenth Circuit's rule will severely restrict insiders' ability to buy and sell company stock. While at first blush that might seem desirable, it would in fact damage a longstanding and successful means of ensuring that insiders' and shareholders' interests are properly aligned.

For starters, it is important to appreciate just how restrictive the Tenth Circuit's rule is in operation. The court held that a corporate insider must abstain from trading if he is aware that even one individual is concerned that the company might miss an earnings target for a future quarter by as little as five percent, *without a clear indication that the doubt would be realized*. Any number of pieces of information would meet that minimal threshold, particularly for large businesses facing (as many are today) difficult economic conditions. Indeed, during such volatile periods, it is entirely conceivable that already limited trading windows for corporate insiders would be closed almost continuously.

It is also important to bear in mind that the Tenth Circuit's rule would punish *under*estimating just as severely as *over*estimating. Accordingly, if an employee buys stock while in possession of information suggesting the company's performance might exceed published expectations in a future period, the employee would face insider-trading liability. Indeed, merely setting an internal target above public expectations—as countless companies do to encourage better performance—effectively prohibits all insider purchases.

Avoiding overbroad restrictions on employees' ability to buy and sell company stock is essential to the proper alignment of shareholders' and insiders' interests. Stock-compensation plans—*e.g.*, stock options, restricted stock awards, employee stock purchase plans—are ubiquitous. To the extent employees own company stock, they have clear financial incentives to maximize shareholders' returns. And because stock-compensation plans frequently require a lengthy vesting period, they promote the pursuit of strategies that will maximize long-term growth. Insiders are rewarded only to the extent that Wall Street validates the company's performance, allowing shareholders to participate directly in the company's success.

Insiders' ability to sell their holdings is, perhaps contrary to popular belief, *essential* to the proper long-term functioning of stock-compensation plans. If insiders' opportunities to sell their stock are severely limited, the incentives of employing such compensation are likewise diminished. Stock that cannot be sold is a poor motivator.

It is no answer to suggest that insiders' interests are aligned with shareholders' because the insiders can simply sell their shares at a later date. A rule that restricts insiders' ability to sell their stock with some regularity is both impractical and unwise. It is impractical because stock-based compensation frequently imposes significant and immediate tax burdens on recipients. The vesting of certain types of stock options, for example, can obligate the recipient immediately to pay taxes on at least a portion of the value of the award. An insider thus may have little choice but to exercise the options and sell the stock.

The Tenth Circuit's rule is unwise because corporate insiders—particularly those whose company stock holdings are significant—should be encouraged to diversify their holdings by selling stock. An insider with a disproportionate amount of his net worth bound up in the stock of his company may feel increasing pressure to protect the share price at all costs. The properly motivated executive is one who stands to gain (and not just on paper) if the stock does well, but who does not have everything to lose if it disappoints. The securities laws therefore should not discourage corporate executives from exercising and selling their shares periodically—*i.e.*, in a manner that is consistent with the consistent, long-term performance of the company. The rule adopted below does precisely that.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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APRIL 2009