No. 13-

IN THE

Supreme Court of the United States

ANTHONY CUTI,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

BRIAN C. BROOK
RYAN P. BATES
MATTHEW J. PEED
CLINTON BROOK & PEED
1455 Pennsylvania Ave. NW
Suite 400
Washington, DC 20004

SETH P. WAXMAN
Counsel of Record
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Ave. NW
Washington, DC 20006
(202) 663-6000
seth.waxman@wilmerhale.com

MARK C. FLEMING
BROOK HOPKINS
WILMER CUTLER PICKERING
HALE AND DORR LLP
60 State Street
Boston, MA 02109

QUESTION PRESENTED

Federal Rule of Evidence 701(c) precludes admission of lay opinion testimony based on "technical[] or other specialized knowledge." In this securities fraud prosecution, the government represented that it would call no expert witnesses, but then called two accountants as lay witnesses and elicited detailed opinion testimony—including answers to hypothetical accounting questions—to show what they believed the proper accounting treatment under Generally Accepted Accounting Principles *should have been*. Although this testimony was unquestionably based on "technical[] or other specialized knowledge," the court of appeals ruled it admissible without need for compliance with Federal Rule of Evidence 702 or Federal Rule of Criminal Procedure 16 because it was supposedly "factual testimony" and not "rooted exclusively" in the witness's specialized knowledge. App. 10a-11a. The courts of appeals are divided on the admissibility of lay testimony that is based on specialized knowledge.

The question presented is:

Whether a witness may give opinion testimony based in part on specialized knowledge and in part on personal experience, including answering counterfactual hypothetical questions, without satisfying the reliability and disclosure requirements for expert testimony of Federal Rule of Evidence 702, Federal Rule of Criminal Procedure 16, and/or Federal Rule of Civil Procedure 26.

PARTIES TO THE PROCEEDING

Petitioner is Anthony Cuti, who was defendant-appellant below. William Tennant was also a defendant-appellant below.

Respondent is the United States of America, who was plaintiff-appellee below.

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Anthony Cuti respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. 1a-20a) is reported at 720 F.3d 453. The unpublished summary order of the court of appeals disposing of the remaining claims (*id.* 21a-27a) is available at 528 F. App'x 84. The order denying panel rehearing (*id.* 29a-30a) is unreported. The relevant district court rulings were made on the record during trial and the relevant transcript pages are reproduced in the appendix (*id.* 43a-73a).

JURISDICTION

The judgment of the court of appeals was entered on June 26, 2013, and Mr. Cuti's timely petition for rehearing was denied on January 15, 2014. App. 29a-30a. On March 26, 2014, Justice Ginsburg extended the time to file a petition for certiorari to and including June 13, 2014. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

PERTINENT RULES

At the time of trial,[1] Federal Rule of Evidence 701 provided:

> If the witness is not testifying as an expert, the witness' testimony in the form of opinions or inferences is limited to those opinions or inferences which are:
>
> (a) rationally based on the perception of the witness, and
>
> (b) helpful to a clear understanding of the witness' testimony or the determination of a fact in issue, and
>
> (c) not based on scientific, technical, or other specialized knowledge within the scope of Rule 702.

Federal Rule of Evidence 702 provided:

> If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by

[1] The Rules of Evidence were amended in 2011, but the changes to Rule 701 and 702 were stylistic only. Fed. R. Evid. 701, 702, 2011 advisory committee's notes.

> knowledge, skill, experience, training, or education may testify thereto in the form of an opinion or otherwise, if:
>
> (1) the testimony is based upon sufficient facts or data,
>
> (2) the testimony is the product of reliable principles and methods, and
>
> (3) the witness has applied the principles and methods reliably to the facts of the case.

Relevant provisions of the Federal Rules of Civil and Criminal Procedure are reproduced at App. 33a-41a.

INTRODUCTION

Anthony Cuti was convicted based on specialized accounting testimony regarding corporate revenue recognition proffered by two "expert[s] in lay witness clothing." Fed. R. Evid. 701, 2000 advisory committee's note. The district court permitted them to testify not simply to what they saw and observed, but to their *opinions* as to proper accounting treatment, including by answering hypothetical questions, even though they had not been disclosed as experts or subjected to the rigors of Federal Rule of Evidence 702. The Second Circuit affirmed, not because the testimony was not based on "specialized knowledge"—it clearly was—but because the court believed the testimony was "factual," despite the witnesses' many answers to *counter*factual hypothetical questions, and because the testimony was not "rooted exclusively" in their specialized accounting knowledge. App. 10a-11a. The Second Circuit's reasoning implicates an entrenched circuit split warranting resolution by this Court.

In 2000, the provisions of the Federal Rules of Evidence governing the admission of lay and expert testimony were substantially revised in the wake of this Court's decisions in *Daubert* v. *Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993), *General Electric Co.* v. *Joiner*, 522 U.S. 136 (1997), and *Kumho Tire Co.* v. *Carmichael*, 526 U.S. 137 (1999). Those amendments "affirm[ed] the trial court's role as gatekeeper" to ensure that opinion testimony based on scientific, technical, or other specialized knowledge satisfied the standards for reliability imposed in the Court's trilogy of cases. Fed. R. Evid. 702, 2000 advisory committee's note.

One of the concerns animating the revision was "the risk that the reliability requirements set forth in Rule 702 will be evaded through the simple expedient of proffering an expert in lay witness clothing." Fed. R. Evid. 701, 2000 advisory committee's note. This was addressed by new Rule 701(c), which resolved a longstanding division of authority over whether lay witnesses could offer essentially expert opinions—without requiring them to be qualified as experts—if they also had some first-hand knowledge of the facts underlying those opinions. *Id.* (citing *Asplundh Mfg. Div.* v. *Benton Harbor Eng'g*, 57 F.3d 1190 (3d Cir. 1995)). Rule 701(c) now makes clear that lay witnesses may only provide testimony "*not based* on scientific, technical, or other specialized knowledge within the scope of Rule 702." (Emphasis added.)

Notwithstanding Rule 701(c)'s clear instructions, the circuits remain hopelessly divided. Five circuits hold, consistent with the clear text of the Rule, that testimony based on *any* specialized knowledge is inadmissible through a non-expert witness. By contrast, three circuits have refused to depart from their pre-

amendment precedents permitting testimony that is based in part on specialized knowledge as long as the witness also possesses personal knowledge of the subject. The Second Circuit in this case joined the latter group, deepening the split and further undermining Rule 701(c)'s essential purpose of preventing the introduction of surprise expert testimony through witnesses who have not satisfied the requirements of Rule 702.

This case illustrates the serious harm and unfairness that results when courts fail to follow Rule 701(c)'s dictates. At trial, when it became clear that the prosecution could not prove its primary theory of the case—that the transactions at issue lacked economic substance—the government changed course and sought to prove that the transactions were accounted for improperly. It was too late to introduce expert testimony, so the prosecution used two of its fact witnesses, who happened to be accountants, in an effort to show that the accounting treatment of those transactions was improper. The witnesses testified not only about their activities as accountants for the company, but also about how, "[f]rom an accountant's perspective," certain documents—which the witnesses claimed they had never seen—would affect the accounting. *E.g.*, App. 46a-47a. The prosecution also presented a number of hypothetical scenarios to the purportedly lay witnesses and asked, "what would the accounting treatment be?" *E.g.*, App. 58a-60a. This testimony severely prejudiced Mr. Cuti. Without the notice required by Federal Rule of Criminal Procedure 16, Mr. Cuti had no meaningful opportunity to prepare a defense against the accountants' testimony. Moreover, the court did not subject the accounting testimony to the rigors of *Daubert* and Rule 702. Indeed, the government never argued that the witnesses' opinions could have withstood such scrutiny.

Permitting the government to prove its case using surprise expert testimony is the very outcome that Rule 701(c) was designed to prevent. Though important in all cases, Rule 701(c)'s constraints are particularly important in criminal cases. Here, for instance, Mr. Cuti was sentenced to three years in prison plus a potentially bankrupting fine and restitution order, despite the absence of economic harm to anyone or illicit gain by Mr. Cuti, following a trial where the government was allowed to deviate from the Rule's plain requirements. This Court should grant the petition, vacate the judgment, and remand for a new trial.

STATEMENT

A. Rule 701(c)

In 2000, in response to this Court's landmark decisions regarding expert testimony, *see supra* p. 4, Federal Rule of Evidence 702 was revised to "affirm[] the trial court's role as gatekeeper" in "exclud[ing] unreliable expert testimony" and to codify the standards for reliability of proffered expert testimony required by *Daubert* and its progeny. *See* Fed. R. Evid. 702, 2000 advisory committee's note. At the same time, Rule 701 was revised "to eliminate the risk that the reliability requirements set forth in Rule 702 will be evaded through the simple expedient of proffering an expert in lay witness clothing." Fed. R. Evid. 701, 2000 advisory committee's note. Under the amendment, opinion testimony by a lay witness is limited to that which is "*not based* on scientific, technical, or other specialized knowledge within the scope of Rule 702." Fed. R. Evid. 701(c) (emphasis added). "The amendment does not distinguish between expert and lay *witnesses*, but rather between expert and lay *testimony*. … [It] makes clear that *any part of a witness' testimony that is based upon*

… *specialized knowledge* within the scope of Rule 702 is governed by the standards of Rule 702 and the corresponding disclosure requirements." Fed. R. Evid. 701, 2000 advisory committee's note (final emphasis added).

B. Anthony Cuti And Duane Reade

Petitioner Anthony Cuti is the former Chief Executive Officer of Duane Reade, Inc., which owns drugstores in the New York City metropolitan area. When Mr. Cuti became CEO in 1996, Duane Reade had just 59 stores and was on the brink of bankruptcy. He launched an aggressive expansion program that turned the company around. By 2004, Mr. Cuti had grown Duane Reade to over 250 stores with more than $1.7 billion in revenue, making it the largest retailer in Manhattan and the signature drugstore of New York City.

Since Duane Reade lacked an in-house real estate department, Mr. Cuti outsourced that function to a real estate brokerage and consulting firm, Winick Realty Group ("WRG"). Acting on WRG's advice, Duane Reade repositioned some existing stores into new locations. Although moving to new locations was expected to yield long-term profits, it was expensive in the short term. After a few years of rapid expansion, Mr. Cuti noted that the relocations were not yielding the returns WRG had projected and asked WRG to share some of the short-term relocation costs. In 2000, he negotiated "concession" payments from WRG to recoup such costs. From late 2000 through mid-2004, WRG paid approximately $12 million in concessions to Duane Reade. As former WRG partner Cory Zelnik explained at trial, WRG often received nothing in *direct* exchange for a given concession payment; rather, WRG made the payments to preserve its exclusive relationship with Duane Reade. CAJA 1106-1107. That exclusive rela-

tionship was lucrative: WRG earned millions in excess of its concession payments through brokerage commissions related to opening new Duane Reade stores and relocating old ones. CAJA 333, 357-368.

Duane Reade's outside auditors, PricewaterhouseCoopers ("PwC"), audited all of the real estate concession transactions, closely evaluating each one to determine whether the payments from WRG should be immediately recognized as income or amortized over time. CAJA 1572-1573, 2713. Because no specific accounting guidance existed for such transactions at the time, PwC and Duane Reade extrapolated from Generally Accepted Accounting Principles ("GAAP") certain criteria for determining the appropriate timing of revenue recognition. CAJA 1509-1513. The accounting issues were so difficult and subjective that, on multiple occasions, PwC asked its national office for rulings. *E.g.*, CAJA 1721-1723, 1757-1758. In the wake of Enron and other accounting scandals, the criteria necessary to recognize concession income up-front changed significantly and became increasingly restrictive. CAJA 1728-1729, 2248-2249. Duane Reade and PwC frequently disagreed over the appropriate accounting, but the amounts were sufficiently small that PwC deemed the differences immaterial. CAJA 1641, 1997.

Beginning in 2001, Duane Reade's financial statements specifically disclosed the amount of real estate concession income it recognized each quarter. CAJA 1508. Although several Wall Street analysts followed Duane Reade, none ever referenced concession income in reports. Analysts generally viewed Duane Reade as a "Growth Story" and continued to recommend its stock even after the attacks of September 11, 2001, which destroyed Duane Reade's most profitable store and generally depressed New York's economy. CAJA

E37-43. After a year of missing analysts' earnings expectations (CAJA 2258-2281), however, the company's stock had dropped from $40 per share to under $20 in 2002 and never recovered.

C. Duane Reade's Acquisition By Oak Hill And The Ensuing Dispute With Mr. Cuti

In December 2003, taking advantage of Duane Reade's greatly depreciated stock price, a multi-billion dollar private equity firm, Oak Hill Capital Partners, announced its intent to acquire Duane Reade's stock and take it private. The deal closed in July 2004 at a price of $16.50 per share. Oak Hill retained Mr. Cuti as CEO, and he voluntarily relinquished tens of millions in guaranteed compensation in exchange for a "profits interest" in the company, aligning his interest with Oak Hill's. CAJA 3428.

Almost immediately, disagreements arose between Mr. Cuti and Oak Hill, chiefly concerning Mr. Cuti's desire to continue Duane Reade's growth. CAJA 2324-2326. Despite having promised to provide capital for new stores, Oak Hill instead began closing stores. In November 2005, Oak Hill terminated Mr. Cuti without cause. CAJA 3425.1.

In September 2006, Mr. Cuti initiated employment arbitration proceedings against Duane Reade and Oak Hill, alleging wrongful termination and other claims, and seeking return of the relinquished compensation, among other damages. CAJA 3426-3467. Oak Hill responded with a series of investigations that claimed to discover two accounting fraud schemes that Oak Hill claimed were supposedly directed by Mr. Cuti. CAJA 3497, 3509-3511. Oak Hill raised these allegations as defenses and counterclaims in the arbitration, claimed

that Mr. Cuti's employment agreements were invalid due to fraudulent inducement, and sought over $100 million in damages.

At Oak Hill's urging, the government began a criminal investigation of Mr. Cuti in May 2007. At the government's and Oak Hill's request, proceedings in the arbitration, including discovery, were immediately stayed. On the eve of Mr. Cuti's trial in 2010, Oak Hill sold Duane Reade to Walgreen's, realizing a profit of $200 million.

D. District Court Proceedings

In October 2008, Mr. Cuti was indicted on charges of securities fraud, conspiracy, and making false statements to the SEC. The government alleged that, from November 2000 through June 2005, Mr. Cuti created fake transactions with third parties (primarily WRG) in order to inflate Duane Reade's reported income. The government further alleged that Duane Reade earned no actual income from those transactions because any money paid to Duane Reade was returned to the third parties in subsequent transactions. Unlike the money that came in, which was generally recorded entirely in the quarter in which the transaction occurred, the payments going out were amortized, typically over as long as fifteen years, so that they did not significantly offset the income recognized from the incoming money.[2]

Before trial, the prosecution announced that it did not intend to call any expert witnesses. CAJA 330-331. Although Mr. Cuti disclosed his intent to call an execu-

[2] These alleged "round-trip" transactions were relatively small. Combined, they affected earnings by a few cents per share in any given quarter, typically far too little to enable Duane Reade to meet or exceed analysts' expectations.

tive compensation expert regarding the absence of any illicit gain, he did not retain an expert to testify on accounting issues. Indeed, there was no need, as all parties apparently agreed on the proper accounting: Fake transactions should not be accounted for as income, but if the challenged transactions had real economic substance, then no accounting fraud occurred. Thus, the essential issue for trial was whether those transactions had real economic substance, as Mr. Cuti maintained, or if they were shams, as the indictment charged. CAJA 48-55.

At trial, the government was unable to prove beyond a reasonable doubt that the concessions were part of fraudulent round-trip transactions. While its star witness, WRG's Zelnik, testified that Mr. Cuti offered vague assurances that WRG would earn its money back, Zelnik never attributed any incriminating statements to Mr. Cuti. Zelnik also denied that Mr. Cuti ever promised to make WRG whole dollar-for-dollar and testified that he did not think that he or Mr. Cuti did anything wrong. CAJA 996-999. Although the government attempted to show that certain concession payments by WRG were offset by return payments lacking any legitimate business purpose, three of its own witnesses, including Zelnik, established that the payments to WRG were commissions to which WRG was contractually entitled as Duane Reade's exclusive broker, even when it did not perform the brokerage work. CAJA 790-795 (Zelnik); CAJA 2697, 2901-2905 (Duane Reade's Chief Financial Officer); Trial Tr. 1853-1857 (Duane Reade's former General Counsel). Because the government did not prove any offsetting sham payments, the concession income was real.

Given the failure of the government's theory that WRG's concessions lacked economic substance, the

government advanced a backup theory, arguing that the associated income from the WRG concessions was recognized *too early*. According to the prosecution, the income should have been amortized instead of recognized immediately. CAJA 1601-1603. To support that theory, the government called PwC auditor Kevin Hallinan, who was the partner in charge of auditing Duane Reade's financial statements from 2001 through 2004, and John Henry, Duane Reade's CFO, who was responsible for deciding how to account for the concession income. CAJA 1488, 1515-1516, 2396.

Much of the accountants' testimony consisted of recounting their original review of the concession transactions at issue, and that testimony is not challenged here, as it was testimony by fact witnesses as to what they observed. The problem arose after Hallinan and Henry testified that they did not recognize certain documents, even though those documents were in the company's files. The court then allowed them to explain, "[f]rom an accountant's perspective," the significance of those documents they did not remember seeing. *See, e.g.*, App. 46a-47a. The prosecutors also asked the witnesses to assume that they had seen certain documents and then testify how, hypothetically, GAAP would have required different accounting treatment for the concessions if those documents had been taken into account. *See, e.g.*, *id.* 46a. ("Q: Had you been shown all those documents, how would it affect the accounting?"); *see also id.* 50a-51a.

In addition to hypothetical questions based on documents that the witnesses testified they had never seen, the prosecutors also asked dozens of vague hypothetical questions based roughly on Zelnik's testimony. For example:

> Q: If a payment is made from [a WRG affiliate] to Duane Reade and you learn that Duane Reade will return that money through another transaction, how do you account for the two transactions?
>
> [objections overruled]
>
> [Hallinan]: In the facts that you described, the moneys received would be associated with those go-forward transactions, and *the accounting could take on any number of forms*. It could either be accounted for as a loan if the moneys were just due back to [WRG], so that would not be an income item.
>
> If it was meant to be a payment for purposes of engaging or insuring that there would be future transactions with [WRG], then those payments would be related to those future transactions. So the income would not be recognized until those future transactions and obligations of Duane Reade to enter into such were recognized.
>
> So those are two of the potential scenarios, but those are more facts and questions that those were reasonable, and *my predisposition would be just upon hearing the facts at that high level that immediate income would not be proper*.

App. 48a-49a (emphasis added); *see also id.* 52a-53a, 56a-57a, 60a-70a, 72a; CAJA 2453, 2622.

Mr. Cuti objected repeatedly, pointing out that answers to hypothetical questions about the proper accounting treatment of the concessions, based on the effect of particular documents or government-presented scenarios, called for expert testimony inadmissible

through witnesses not disclosed as experts. *See, e.g.*, App. 44a-45a. The district court overruled the objections, noting that the witnesses were accountants and ruling that it was appropriate for them to explain how certain materials would have affected the accounting treatment. *Id.*; *see also id.* 57a-60a.

A particularly telling violation of Rule 701(c) occurred during Henry's testimony, when the trial court—in an apparent attempt to address this concern—actually exacerbated the problem by *directing* the prosecution to elicit specialized accounting testimony in a way that divorced it from personal reaction or observation and gave it the air of objective expertise:

> THE COURT: … I don't care what his personal opinions are. You can ask him questions about the documents from the accounting point of view. … Keep his opinion out of it.
>
> [Prosecutor]: OK. I will ask him how it would have affected his accounting treatment.
>
> THE COURT: No, not *his* accounting.
>
> [Prosecutor]: *The* accounting treatment.
>
> THE COURT: *How would it affect accounting treatment for a transaction* if this document—you know, just keep it like that.
>
> …
>
> [Mr. Cuti's counsel]: It's the same thing.
>
> THE COURT: Well, it's acceptable.

App. 62a-63a (emphasis added); *see also id.* 57a-60a. When Henry later prefaced an answer with, "My opinion is…," the court instructed him to answer "[n]ot in terms of your opinion, but in terms of *your knowledge*

of the applicability of the accounting rules." *Id.* 64a-65a (emphasis added). Henry then repeated his previous answer, prefacing it with "[b]ased on my knowledge of the accounting rules." *Id.* The judge allowed the testimony.

The jury convicted Mr. Cuti on all counts. After a seven-month *Fatico* hearing to determine loss, *see United States* v. *Fatico*, 441 F. Supp. 1285 (E.D.N.Y. 1977), the government could not prove that the alleged fraud caused loss to Oak Hill or anyone else and did not even try to prove any illicit gain by Mr. Cuti. The court nonetheless imposed restitution of over $7.6 million—for legal expenses Duane Reade incurred investigating Mr. Cuti—on top of a sentence of 36 months' imprisonment and a $5 million fine.

E. Court Of Appeals Proceedings

The Second Circuit affirmed. App. 1a-20a. As relevant here, it rejected Cuti's argument that the hypothetical accounting questions posed to Hallinan and Henry "improperly elicited expert opinion testimony from non-expert witnesses." *Id.* 6a-14a.

The court of appeals acknowledged that the witnesses were "unique" because they were "certified and experienced accountant[s]." App. 8a. But it believed that their testimony was exempt from the requirements of Rule 702 because the testimony was supposedly not opinion testimony, but factual in nature. According to the Second Circuit, because the hypothetical accounting questions were "limited by the factual foundation laid in earlier admitted testimony and exhibits" and "utilized facts that had been independently established in the record," and because the "witnesses' reasoning … was based on undisputed accounting rules,"

the "testimony fell near the fact end of the fact-opinion spectrum." *Id.* Discounting Federal Rule of Evidence 602's requirement that a fact witness's testimony be based on "personal knowledge of the matter" (*id.* 6a n.6) as "not an absolute" (*id.* 9a), the Second Circuit ruled "that the challenged testimony was properly admitted as factual testimony" (*id.* 10a).

The Second Circuit alternatively ruled that the challenged testimony was "admissible as lay opinion under Federal Rule of Evidence 701." App. 10a. The court conceded that the "witnesses' reasoning … was based on undisputed accounting rules" for revenue recognition, and that those accounting rules are "technical and unfamiliar to everyday life." *Id.* 8a, 11a. Nevertheless, it held that Rule 701(c) did not bar admission of the testimony because it was not "'rooted exclusively [in the witness's] expertise,'" and because it merely applied the accounting rules to the facts established in the case rather than "address[ing] the soundness of the accounting rules." *Id.* 12a (first alteration in original).

The Second Circuit denied panel rehearing (App. 29a-30a) and stayed the issuance of its mandate pending the filing and disposition of this petition (*id.* 31a-32a). Both lower courts had denied Mr. Cuti's motion for bail pending appeal. Mr. Cuti reported to prison on January 31, 2012. On December 10, 2013, he was released from custody and is presently on supervised release. Payment of the fine and restitution, which together exceed $12 million, has not yet become due because Mr. Cuti's appeal is still pending.

REASONS FOR GRANTING THE PETITION

The post-*Daubert* amendments to the Rules of Evidence leave no doubt that testimony based on scientific, technical, or other specialized knowledge is admissible when and only when the trial court exercises its gatekeeping function to ensure that the testimony meets the reliability requirements of Rule 702. Rule 701(c) closed the loophole that would have allowed parties to evade the reliability requirements of Rule 702 through the use of lay opinion testimony. Nevertheless, the circuits are deeply divided over the reach of that provision, with some circuits—including the Second Circuit in this case—improperly allowing admission of specialized testimony without compliance with Rule 702.

Multiple circuits closely observe Rule 701(c) and require opinion testimony based on specialized knowledge to meet the requirements of Rule 702 regardless of whether the witness's opinions are partially based on first-hand observations or professional experience. In contrast, other courts cling to their pre-amendment precedents and allow lay witness testimony that is based on specialized knowledge as long as it is not based *exclusively* on such knowledge. That construction opens a gaping loophole through which litigants—and in criminal cases, the government—can evade the disclosure and reliability requirements imposed by the Federal Rules of Evidence and Federal Rules of Civil and Criminal Procedure, as well as this Court's precedents. This Court should grant the petition to resolve the division of authority on this important issue and prevent the injustice that results when surprise "expert" testimony is admitted without any assurances of reliability.

I. THE SECOND CIRCUIT'S HOLDING THAT LAY OPINION TESTIMONY BASED IN PART ON SPECIALIZED KNOWLEDGE IS ADMISSIBLE UNDER RULE 701 DEEPENS AN EXISTING CIRCUIT SPLIT

A. The Decision Below Exacerbates The Division Among The Circuits

Despite Federal Rule of Evidence 701(c)'s clear prohibition against admission of lay opinion testimony that is "based on scientific, technical, or other specialized knowledge," the circuits are divided over the treatment of opinion testimony that is based in part on specialized knowledge and in part on personal experience. *See United States* v. *Hilario-Hilario*, 529 F.3d 65, 72 (1st Cir. 2011) (acknowledging that "circuits, and indeed decisions within a circuit, are often in some tension" with respect to the line between expert and lay opinion testimony). The Sixth, Seventh, Ninth, Tenth, and D.C. Circuits draw a clear, administrable line consistent with the Rules' plain language: when opinion testimony is based even in part on specialized knowledge, it is subject to pre-trial disclosure requirements and the reliability standards of Rule 702. In contrast, the Second Circuit below joined the Third, Fifth, and Eleventh Circuits in a more lax interpretation of Rule 701(c). Under their reading, lay opinion testimony that is based in part on personal experience and in part on specialized or technical knowledge may be admitted without satisfying the disclosure and reliability requirements that Rule 702 imposes on expert testimony.

The Tenth Circuit, both before and after the 2000 amendments to the Rules of Evidence, underscored that lay opinion is permissible under Rule 701 "'only if [the witness's] opinions or inferences do not require *any* specialized knowledge and could be reached by any

ordinary person.'" *LifeWise Master Funding* v. *Telebank*, 374 F.3d 917, 929 (10th Cir. 2004) (emphasis added) (opinion testimony of company CEO about damages model inadmissible because it involved technical, specialized concepts including "moving averages, compounded growth rates, and S-curves"); *Randolph* v. *Collectramatic, Inc.*, 590 F.2d 844, 846 (10th Cir. 1979) (Rule 701 "does not permit a lay witness to express an opinion as to matters which are beyond the realm of common experience and which require the special skill and knowledge of an expert witness"). Recently, the Tenth Circuit refused to admit as lay opinion a broker's testimony about the value of a building, distinguishing the "technical judgment" "required in choosing among different types of depreciation" and in "[a]ccurately accounting for the interaction between depreciation and damage" from the types of "elementary mathematical operations," like simple averages, that it had previously admitted as lay opinion testimony under Rule 701(c). *James River Ins. Co.* v. *Rapid Funding, LLC*, 658 F.3d 1207, 1214-1215 (10th Cir. 2011) (distinguishing *Bryant* v. *Farmers Ins. Exch.*, 432 F.3d 1114 (10th Cir. 2005)).

The Seventh Circuit draws the same clear line. In *United States* v. *Conn*, it held that lay opinion testimony is inadmissible "'to provide specialized explanations or interpretations that an untrained layman could not make if perceiving the same acts or events.'" 297 F.3d 548, 554 (7th Cir. 2002) (quoting *United States* v. *Peoples*, 250 F.3d 630, 641 (8th Cir. 2001)). Accordingly, *Conn* held that a federal agent's testimony opining whether the defendant's guns were collector's items was expert testimony, not lay opinion, because it "was not based only on his observations; rather, the testimony was based on his accumulated expertise obtained through experience and training" and so was subject to

the requirements of expert testimony under Rule 702. *Id.* And in *United States* v. *Oriedo*, the Seventh Circuit held that law enforcement testimony about drug packaging techniques was inadmissible lay testimony, because it was "not limited to what [the agent] observed in the search or to other facts derived exclusively from *this particular* investigation," but instead drew on specialized knowledge: his "wealth of … experience as a narcotics officer." 498 F.3d 593, 603 (7th Cir. 2007) (emphasis added).

The D.C. Circuit has similarly ruled that opinions derived in part from past professional experience are not admissible lay testimony. Thus, a law enforcement officer testifying as a lay witness "may not testify about drug topics that are beyond the understanding of an average juror." *United States* v. *Wilson*, 605 F.3d 985, 1026 (D.C. Cir. 2010); *see also United States* v. *Smith*, 640 F.3d 358, 365 (D.C. Cir. 2011) (admission under Rule 701 of officer testimony interpreting drug slang was error because "knowledge derived from previous professional experience falls squarely 'within the scope of Rule 702' and thus *by definition* outside of Rule 701" (quoting Fed. R. Evid. 701(c)) (emphasis added)).

Likewise, the Ninth Circuit excludes lay opinion testimony based on specialized knowledge, even when such knowledge is applied to facts the witness perceived. Indeed, the Advisory Committee's commentary on the revised Rule 701 favorably cited the Ninth Circuit's decision in *United States* v. *Figueroa-Lopez*, which ruled that a witness's perception of "the facts on which he wishes to tender an opinion does not trump Rule 702." 125 F.3d 1241, 1246 (9th Cir. 1997) (officer's testimony that defendant was behaving like an experienced drug trafficker was inadmissible under Rule 701 because it was based on the "'specialized knowledge' of

law enforcement"). Consistent with its pre-amendment precedent, the Ninth Circuit recently found error in the admission of an investigator's "specialized and highly technical testimony about the cause of [an] explosion," explaining that "'*any part* of a witness'[s] testimony that is based upon scientific, technical, or other specialized knowledge … is governed by the standards of Rule 702,'" "even when the expertise involved is specialized knowledge gained as part of a witness's job." *Rodriguez* v. *General Dynamics Armament & Technical Prods.*, 510 F. App'x 675, 676 (9th Cir. 2013) (quoting Fed. R. Evid. 701, 2000 advisory committee's note).

The Sixth Circuit has reached similar conclusions, citing the addition of subsection (c) to Rule 701 as a basis for disregarding pre-amendment cases that "allowed witnesses to apply specialized knowledge while giving lay testimony." *United States* v. *Ganier*, 468 F.3d 920, 926 (6th Cir. 2006) (excluding testimony interpreting forensic software reports under Rule 701 because it required "knowledge and familiarity with computers … well beyond that of the average layperson"). And in a case much like this one, the Sixth Circuit held that auditors' testimony on the propriety of related-party transactions was inadmissible under Rule 701 notwithstanding the auditors' personal involvement with audits of the defendants' records, because their opinions were based on "a working knowledge of Medicare reimbursement procedures" that "relied to a significant degree on specialized knowledge acquired over years of experience as Medicare auditors." *United States* v. *White*, 492 F.3d 380, 403-404 (6th Cir. 2007).

In stark contrast to these five circuits, which have recognized and followed the plain text of Rule 701(c), the Eleventh, Fifth, Third, and now the Second Circuits permit lay witnesses to offer testimony based on spe-

cialized knowledge without complying with Rule 702. The Eleventh Circuit has explicitly held that its pre-amendment precedents allowing lay witnesses to testify regarding their "particularized knowledge garnered from years of experience within [a] field" remain undisturbed by the addition of Rule 701(c). *See Tampa Bay Shipbuilding & Repair Co.* v. *Cedar Shipping Co.*, 320 F.3d 1213, 1223 & n.17 (11th Cir. 2003). This judicial "particularized knowledge" exception, which figures nowhere in the Rules, permits admission of testimony that would be inadmissible under Rule 701(c) in the circuits discussed above. For example, in *United States* v. *Graham*, the Eleventh Circuit permitted testimony about how fraudulent loan transactions are generally structured and executed that was "based on [the witness's] own personal knowledge of mortgage fraud, which he had acquired through his experience as a former real estate closing attorney who had engaged in fraudulent transactions of that nature." 643 F.3d 885, 898 (11th Cir. 2011). Under the majority approach described above, that testimony would be inadmissible as lay opinion because it drew on "specialized knowledge acquired over years of experience," *White*, 492 F.3d at 403-404, that "an untrained layman" would not possess, *Conn*, 297 F.3d at 554. Yet the Eleventh Circuit allowed it notwithstanding Rule 701(c).

The Fifth Circuit has followed the Eleventh Circuit's approach. Citing *Tampa Bay Shipbuilding*, the Fifth Circuit reversed a district court's exclusion of a portion of witness's damages testimony that was "based on particularized knowledge based on his position as vice-president of the research foundation." *Texas A&M Research Found.* v. *Magna Transp., Inc.*, 338 F.3d 394, 403 (5th Cir. 2003). And just this year, the Fifth Circuit held that agent testimony about drug jar-

gon was admissible as long as it was "based, in part, on his investigation" of the conspiracy at issue, even if it was also "drawn in part from his law enforcement experience." *United States* v. *Akins*, 746 F.3d 590, 600 (5th Cir. 2014).

The Third Circuit also admits opinion testimony of non-expert witnesses that is jointly derived from overlapping personal experience and specialized knowledge. Apparently of the view that the addition of subsection (c) to Rule 701 did not alter the law in this area, that court continues to rely on pre-amendment precedent allowing "professionals to give lay opinions when the opinions are based on personal knowledge of the issues, along with specialized experience." *United States* v. *DeMuro*, 677 F.3d 550, 562 (3d Cir. 2012) (citing *Eisenberg* v. *Gagnon*, 766 F.2d 770, 781 (3d Cir. 1985)) (plain error review).

The opinion below places the Second Circuit on the side of the Eleventh, Fifth, and Third Circuits and in conflict with the Sixth, Seventh, Ninth, Tenth, and D.C. Circuits. Rather than apply the plain text of Rule 701(c), which draws a clear line between testimony based on specialized knowledge and testimony based solely on personal experience and common knowledge, the Second Circuit held that the accountants' testimony was admissible lay opinion as long as it "was not rooted exclusively in [their] expertise." App. 11a (quoting *Bank of China, N.Y. Branch* v. *NBM LLC*, 359 F.3d 171, 181 (2d Cir. 2004)).[3]

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[3] In *United States* v. *Garcia*, 413 F.3d 201 (2d Cir. 2005), which involved a police officer's testimony regarding the functioning of drug conspiracies, a panel of the Second Circuit appeared receptive to the majority understanding of Rule 701(c)—although the discussion may have been dicta, because "the government vir-

It is plain that, had Mr. Cuti's case arisen in a different circuit, his appeal would have succeeded and a new trial would have been ordered. This Court should grant the petition and resolve this significant disagreement among the courts of appeals.

B. The Decision Below Is Wrong

The mere existence of the circuit split described above would warrant certiorari. But it is particularly warranted here, because the Second Circuit chose the wrong side of the debate and did so in a situation in which a criminal defendant's liberty and financial solvency are at stake. This case is an optimal vehicle for resolving this issue.

The court of appeals held that the application of complex accounting principles to independently established facts does not constitute expert testimony when such testimony is not "rooted exclusively" in specialized accounting knowledge. That approach cannot be reconciled with the language of Rule 701, and indeed the Second Circuit did not even attempt such a reconcilia-

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tually conceded the inadmissibility of the challenged testimony, devoting most of its time to arguing harmlessness." *Id.* at 201 n.6. However, the panel in this case confirmed the Second Circuit's position that opinion testimony is admissible through a lay witness as long as it is not "rooted exclusively" in specialized knowledge (App. 11a-12a) and distinguished the discussion in *Garcia* as limited to cases where the witness's "specialized experience" was "accumulated from other cases" (App. 12a). Even with that minor exception, the Second Circuit is still on the wrong side of the split. Nothing in the text of Rule 701 suggests that the admissibility inquiry should turn on the origin of the witness's specialized knowledge, such that opinion testimony is inadmissible if the testimony is based on experience accumulated "from other cases" (as in *Garcia*) but admissible if based on years of education, training, and experience regarding a complex subject like GAAP (as here).

tion. The text of Rule 701(c) unequivocally states that non-expert testimony "in the form of an opinion is limited to one that is … *not based* on scientific, technical, or other specialized knowledge." Fed. R. Evid. 701(c) (emphasis added). There is no exception for testimony partially based on specialized knowledge. Indeed, the advisory committee note underscores that "*any part* of a witness' testimony that is based upon scientific, technical, or other specialized knowledge … is governed by the standards of Rule 702." Fed. R. Evid. 701, 2000 advisory committee's note (emphasis added).

Thus, the Second Circuit's recognition that "the witnesses' reasoning … was *based on* … accounting rules," (App. 8a (emphasis added)) cannot be reconciled with Rule 701(c)'s prohibition of testimony "*based on* scientific, technical, or other specialized knowledge within the scope of Rule 702." There is no doubt that revenue recognition accounting under GAAP is specialized knowledge, and the Second Circuit did not rule otherwise. App. 11a (characterizing the accounting principles as "technical and unfamiliar"); *see also Shalala* v. *Guernsey Mem'l Hosp.*, 514 U.S. 87, 100-101 (1995) (noting GAAP "is often indeterminate," "addresses many questions as to which the answers are uncertain," and requires "'continuous judgments and estimates'"); *Free Enterprise Fund* v. *Public Co. Accounting Oversight Bd.*, 130 S. Ct. 3138, 3175 (2010) (discussing the "technical nature of [the Accounting Board's] job" and "the need to attract experts to that job"). The advisory committee notes to Rule 702 contemplate that accounting standards will be a subject of expert testimony. Fed. R. Evid. 702, 2000 advisory committee's note (citing *American College of Trial Lawyers Standards and Procedures for Determining the Admissibility of Expert Testimony After* Daubert,

157 F.R.D. 571, 579 (1994) (testimony concerning "accounting standards" must be evaluated by reference to the "knowledge and experience" of that field)). Indeed, parties frequently hire accountants to offer expert testimony about proper accounting methods under GAAP. *See, e.g.*, *Dodge* v. *Comptroller of Currency*, 744 F.3d 148, 156 (D.C. Cir. 2014) ("Experts within and independent of the [Office of Thrift Spending] testified that Dodge's accounting practices did not conform to GAAP."); *SEC* v. *Todd*, 642 F.3d 1207, 1216 (9th Cir. 2011) ("[P]arties presented competing expert testimony concerning the propriety of Gateway's accounting treatment of the Lockheed transaction."); *Art Midwest Inc.* v. *Atlantic Ltd. P'ship XII*, 742 F.3d 206, 218 (5th Cir. 2014) (relying on expert accountant testimony to find that proceeds from a sale were applied to reduce the underlying debt).

It is no answer to say that the testimony was not "rooted *exclusively* [in the witness's] expertise." App. 12a (emphasis added; alteration in original). The fact that the witnesses *also* possessed personal knowledge of certain events in question does not immunize their entire testimony from the requirements of Rule 702 and the disclosure requirements of the Rules of Civil and Criminal Procedure. That a witness may testify based on personal knowledge under Rule 701 does not change the fact that "any part of a witness' testimony that is based upon scientific, technical, or other specialized knowledge" must comply with Rule 702. Fed. R. Evid. 701, 2000 advisory committee's note; *see also id.* (Rule 701 does not distinguish between "expert and lay *witnesses*, but rather between expert and lay *testimony*").

Nor does it matter that the dispute in this case involved not the accounting rules in the abstract, but their application to the facts of the case. App. 11a. Ap-

plying complex, specialized rules such as GAAP to the facts of a given case is the quintessential role of an expert witness and is certainly no less "specialized" testimony. The plain text of Rule 702(d) makes clear that testimony "appl[ying] the principles and methods to the facts of the case" is within the scope of expert testimony covered by Rule 702, and therefore excluded from lay opinion by Rule 701(c). *See* Fed. R. Evid. 702, 1972 advisory committee's note ("The use of opinions is not abolished by the rule …. It will continue to be permissible for the experts to take the further step of suggesting the inference which should be drawn from applying the specialized knowledge to the facts."); *see also United States* v. *Morgan*, 554 F.2d 31, 33 (2d Cir. 1977) ("Opinion testimony of expert witnesses has traditionally been given in response to hypothetical questions based upon the evidence in the case.").

Additionally, the requirements for admission of expert opinion testimony cannot be evaded by declaring such testimony to be "factual testimony," as the Second Circuit did here. App. 10a. The Second Circuit's reasoning on this score was fundamentally incorrect. As a preliminary matter, the Court acknowledged that the witnesses made "inference[s]." App. 8a. At the time of trial, Rule 701 expressly encompassed "opinions or inferences." Fed. R. Evid. 701 (emphasis added). So even if the witnesses had not expressed "opinions"—which they did—Rule 701(c) would still apply, barring "inferences" based on specialized knowledge.

In any event, the accountants' testimony was not factual. Answers to hypothetical questions, and assertions of what the accounting treatment "would have been" under different circumstances (*e.g.*, App. 72a-74a), are necessarily *counter*factual. The Second Circuit's ruling to the contrary departs from other circuits

that not only characterize answers to hypothetical questions as opinion testimony, but limit such testimony to expert witnesses. *See United States* v. *Henderson*, 409 F.3d 1293, 1300 (11th Cir. 2005) ("[T]he ability to answer hypothetical questions is 'the essential difference' between expert and lay witnesses."); *Certain Underwriters at Lloyd's, London* v. *Sinkovich*, 232 F.3d 200, 203 (4th Cir. 2000) ("Unlike a lay witness under Rule 701, an expert can answer hypothetical questions and offer opinions not based on first-hand knowledge."); *United States* v. *Parker*, 991 F.2d 1493, 1500 (9th Cir. 1993) (district court properly excluded answer to hypothetical question because "defense counsel made no effort to qualify [the witness] as an expert"); *Teen-Ed, Inc.* v. *Kimball Int'l, Inc.*, 620 F.2d 399, 404 (3d Cir. 1980) ("[t]he essential difference" between a lay witness and an expert witness is that "a qualified expert may answer hypothetical questions"); *see also Tribble* v. *Evangelides*, 670 F.3d 753, 758-759 (7th Cir. 2012) (reversing district court's finding that witness "offered no opinion at all" when witness testified about what "would" happen); Weinstein & Berger, *Weinstein's Federal Evidence*, § 701.03[4][a] (2d ed. 1997) ("[A]lthough qualified experts may properly testify in response to hypothetical questions, lay witnesses generally are not entitled to express opinions based on hypothetical questions.").[4]

[4] The handful of cases that the Second Circuit cited as support for its conclusion that lay witnesses may answer hypothetical questions to establish materiality are not to the contrary. App. 9a. None held such testimony to be "factual," and admission of the opinion testimony at issue in each could reasonably be justified under Rule 701. Indeed, none involved application of specialized knowledge or reasoning like the accounting expertise required to assess the timing of revenue recognition under GAAP.

There is no question that in this case the erroneous admission of accounting testimony "had [a] substantial and injurious effect or influence in determining the jury's verdict." *Kotteakos* v. *United States*, 328 U.S. 750, 776 (1946). Indeed, despite the government's strenuous argument to the contrary, the Second Circuit never suggested that any error under Rule 701 was harmless. The prosecution relied heavily on the accounting testimony of Henry and Hallinan to prove its theory that even if the concessions had economic substance, revenue from them should have been amortized instead of recognized immediately. That testimony was also the linchpin of the government's argument about criminal intent; the prosecution argued that, because Mr. Cuti had prior accounting training himself, he must have known of all the supposed accounting problems to which Henry and Hallinan were allowed to testify on the stand. CAJA 3250. Accordingly, reversal of the improper admission of the accounting testimony would entitle Mr. Cuti to a new trial.

II. THE QUESTION PRESENTED IS HIGHLY IMPORTANT AND RECURRING

Since Rule 701(c)'s adoption in 2000, this Court has never provided interpretive guidance as to its meaning and scope. Such guidance is needed to prevent the circumvention of the disclosure and reliability rules that govern admission of expert testimony and to preserve the gatekeeping role of trial judges.

Questions about the Rule's proper application regularly arise in a variety of factual contexts. They confront trial courts with some frequency in cases involving accounting rules, particularly in cases involving allegations of accounting or securities fraud. *E.g.*, *United States* v. *Goyal*, 2008 WL 755010, at *3, *7 (N.D. Cal.

Mar. 21, 2008) (allowing lay witnesses with accounting expertise to establish GAAP violation using hypothetical questions), *rev'd on other grounds*, 629 F.3d 912, 918 (9th Cir. 2010); Mot. in Limine to Exclude Lay Testimony Relating to Accounting Requirements Properly in the Purview of Experts, Dkt. No. 1027, *United States* v. *Howard*, No. 03-cr-93 (S.D. Tex. Apr. 6, 2006); Mot. in Limine to Exclude Lay Opinion Testimony About GAAP and Revenue Recognition, Dkt. No. 214, *United States* v. *Shanahan*, No. 04-cr-126 (D.N.H. Oct. 31, 2006).[5]

Without this Court's intervention, courts in some circuits will continue to admit the testimony of "expert [witnesses] in lay witness clothing." Fed. R. Evid. 701, 2000 advisory committee's note. Such rulings undermine the fairness of trials, particularly criminal trials, in at least two ways. First, testimony based on specialized knowledge can be "both powerful and quite misleading because of the difficulty in evaluating it." *Daubert* v. *Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 595 (1993). Trial judges thus play a critical role in determining whether the witness is qualified to give the testimony and whether the methods are valid and reliable. Notably, witnesses who *also* have personal knowledge of the relevant facts may have biases that affect the soundness of their application of their specialized knowledge—matters that the district judge should

[5] These questions also frequently arise in state courts, some of which follow federal law when interpreting parallel state evidentiary rules. *See, e.g.*, *People* v. *Stewart*, 55 P.3d 107, 123-124 (Colo. 2002) (interpreting state evidentiary rule regarding admission of lay opinion testimony in light of federal appellate cases discussing admissibility of officer testimony based on specialized knowledge); *Ragland* v. *State*, 870 A.2d 609, 620 (Md. 2005) (interpreting state evidentiary rule in light of 2000 amendments to Rule 701).

assess under Rule 702. Absent such scrutiny, the jury may be exposed to misleading or unreliable testimony that risks unfairly swaying their view of the case. *Cf. United States* v. *Lopez-Medina*, 461 F.3d 724, 742-745 (6th Cir. 2006) (finding plain error for failure to instruct jury on the dual role of a witness who testified as both a fact witness and an expert witness and noting the "risk of [jury] confusion inherent" in such circumstances). Second, skirting the reliability requirements for expert testimony through a dubious invocation of Rule 701 allows litigants to avoid disclosure requirements that enable opponents to prepare effective cross-examination, seek preclusion of improper or irrelevant testimony through motions in limine, or obtain another expert to challenge the proffered opinion. *See* Fed. R. Civ. P. 26(a)(2); Fed. R. Crim. P. 16(a)(1)(G). Thus, as the Advisory Committee noted, "there is no good reason to allow what is essentially surprise expert testimony." Fed. R. Evid. 701, 2000 advisory committee's note.

The government affirmatively represented to Mr. Cuti that it would not call any expert witnesses. CAJA 330-331. Accordingly, Mr. Cuti did not prepare to defend the company's accounting practices, nor did he proffer an accounting expert of his own. But when the government's star witness was unable to corroborate the government's primary theory, causing a prosecutor to concede during trial that the WRG concessions were "not illegal" (CAJA 1601-1603), the government quickly changed course. It relied heavily on the accounting testimony of Henry and Hallinan to argue that *even if* the concessions were legal and had economic substance, Duane Reade's income was nevertheless misstated as a matter of GAAP. By repeatedly testifying about "what the accounting treatment would be" under hypothetical facts, those witnesses made the government's case

without the reliability assurances the Rules require before admitting such specialized accounting testimony. In fact, the government did not argue that the accountants' opinion testimony could have passed muster under Rule 702.

To make matters worse, the accountants' specialized testimony was admitted without the fair warning required by Federal Rule of Criminal Procedure 16. As a result, Mr. Cuti had no meaningful opportunity to prepare a defense against the accountants' *post hoc* contentions about what the accounting treatment ought to have been or to proffer an accounting expert of his own to rebut their testimony.

The government's tactical use of "surprise expert testimony" in this case (Fed. R. Evid. 701, 2000 advisory committee's note) illustrates the very kind of mischief Rule 701(c) was added to prevent. The government should not have been allowed to sandbag Mr. Cuti in this way, and a new trial should have been ordered. The Court should grant the petition, reverse the judgment of the Second Circuit, and remand for a new trial.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

BRIAN C. BROOK
RYAN P. BATES
MATTHEW J. PEED
CLINTON BROOK & PEED
1455 Pennsylvania Ave. NW
Suite 400
Washington, DC 20004

SETH P. WAXMAN
Counsel of Record
WILMER CUTLER PICKERING
HALE AND DORR LLP
1875 Pennsylvania Ave. NW
Washington, DC 20006
(202) 663-6000
seth.waxman@wilmerhale.com

MARK C. FLEMING
BROOK HOPKINS
WILMER CUTLER PICKERING
HALE AND DORR LLP
60 State Street
Boston, MA 02109

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APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA,
Appellee,
v.

ANTHONY J. CUTI, WILLIAM J. TENNANT,
Defendants-Appellants.

August Term 2012
(Argued: October 25, 2012 Decided: June 26, 2013)
Docket Nos. 11-3756, 11-3831

Before: JACOBS, Chief Judge, WALKER, Circuit Judge, and O'CONNOR, Associate Justice (retired).*

Defendants-Appellants Anthony Cuti and William Tennant, former executives of the retail drugstore chain Duane Reade, appeal their convictions for securities fraud in the District Court for the Southern District of New York (Batts, J.). Cuti and Tennant arranged fraudulent transactions to inflate Duane Reade's reported earnings in SEC filings. Among the issues raised on appeal by Cuti is the admission of non-expert witness testimony as to what the accounting treatment of the transactions would have been absent the fraud. Tennant asserts primarily that the jury lacked sufficient evidence to convict him and that the district court had no basis to give a conscious avoidance instruction. We

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* The Honorable Sandra Day O'Connor, Associate Judge (retired) of the United States Supreme Court, sitting by designation.

conclude that the district court did not abuse its discretion in admitting the lay witness testimony and that Tennant's claims are without merit. Affirmed.

* * *

JOHN M. WALKER, JR., Circuit Judge:

Defendants-Appellants Anthony Cuti and William Tennant appeal from judgments of conviction following a jury trial in the District Court for the Southern District of New York (Deborah A. Batts, Judge).[1] This opinion addresses Cuti's claim that the district court erred in admitting testimony from two lay witnesses as to what the accounting treatment of certain fraudulent transactions would have been absent the fraud, and Tennant's claims that his conviction should be overturned for insufficient evidence to prove his knowledge of the fraud and that it was error for the district court to give a conscious avoidance jury instruction. We conclude that the district court did not abuse its discretion in admitting the testimony of the non-expert witnesses and that Tennant's claims are without merit.[2] AFFIRMED.

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[1] Cuti was convicted of conspiracy under 18 U.S.C. § 371 (Count One) and substantive offenses of securities fraud in violation of 15 U.S.C. §§ 78j(b) & 78ff, 17 C.F.R. § 240.10b-5 and 18 U.S.C. § 2 (Count 2), making false statements in two SEC filings in violation of 15 U.S.C. §§ 78m(a) & 78ff, 17 C.F.R. § 240.13a-1 and 18 U.S.C. § 2 (Counts 3 and 4), and making false statements in another SEC filing in violation of 15 U.S.C. §§ 78o(d) & 78ff, 17 C.F.R. §§ 240.15d-1 & d-13 (Count 5). Tennant was acquitted on Count 1 and convicted on Count 2. The district court sentenced Cuti and Tennant principally to imprisonment for three years and time served, respectively, and imposed fines of $5 million on Cuti and $10,000 on Tennant.

[2] The appellants' other arguments on appeal are addressed in a summary order issued simultaneously with this opinion.

BACKGROUND

Cuti was the former president, chief executive officer, and board chairman of Duane Reade, a retail drugstore chain in the New York City metropolitan area. Tennant was Duane Reade's former chief financial officer or CFO and senior vice-president, who continued to consult for the company on real estate matters after his formal retirement.

The trial evidence, which we take as credited by the jury, showed that from 2000 to 2004, Cuti and Tennant (collectively, "defendants") executed a number of schemes to inflate the company's earnings in quarterly and annual financial statements filed with the Securities and Exchange Commission ("SEC").

The principal scheme consisted of the fraudulent sale of real estate concessions and other rights that Duane Reade held in its storefront leases. When Duane Reade vacated a storefront with an unexpired lease, the right to the remainder of the lease term could have residual value and be sold back to the landlord or to a broker, especially when rental rates had risen. Cuti and Tennant, however, inflated earnings by fraudulently selling real estate concessions that were virtually worthless and surreptitiously repaying the purchasers through payments disguised as expenses.

Cuti and Tennant's primary counterparty to the transactions in this scheme was the Winick Realty Group ("Winick Realty"), a commercial real estate brokerage firm and its subsidiaries (collectively, the "WRG entities"). At trial, Cory Zelnik, a partner at Winick Realty, testified that in 2000, the WRG entities paid $806,000 for concessions in eight leases that Duane Reade had already sold, assigned away or planned to abandon and another $890,000 for options to buy out

Duane Reade from three leases that were of minimal value to Winick Realty. The defendants repaid the WRG entities for these outlays using a sham consulting agreement and padded brokerage fees. The revenue immediately recognized from these transactions helped Duane Reade bridge a gap between its true earnings and analysts' expectations for the fourth quarter of 2000. In subsequent quarters, the defendants continued to arrange other sham transactions to inflate company earnings and to repay the counterparties.

Because Duane Reade recognized such significant income from these activities, its external auditor, PricewaterhouseCoopers ("PwC"), required the company to include in its financial statements filed with the SEC, a note stating that the company had no side agreements with or other obligations to the transaction counterparties. At trial, the government produced evidence of side agreements and demonstrated, through witness testimony and voluminous documentation, how the defendants executed and concealed their fraudulent conduct from the company's internal accountants, PwC, the SEC, and the investing public.

As part of its case, the government called Kevin Hallinan, the PwC partner who was Duane Reade's lead outside auditor, and John Henry, Tennant's successor as CFO and the company's chief in-house accountant, to testify as to how they had accounted for the proceeds from the fraudulent transactions; how they would have accounted for the transactions had they been aware of the full facts; and how the material information that was withheld from them led to misstatements in the company's financial statements.

The rules governing the accounting of real estate concession transactions, as Hallinan and Henry ex-

plained, are set forth under generally accepted accounting principles ("GAAP") including Financial Accounting Standards Board Statement No. 13 and SEC Staff Accounting Bulletin No. 104. In order for revenue generated from such a transaction to be recognized immediately, (1) Duane Reade had to have negotiated with the counterparty at arms' length, (2) the transaction must have had value, (3) to the extent the transaction relieved Duane Reade of its obligations under a lease agreement, the company could not be committed to enter into another lease with the same landlord, and (4) the transaction could not create any further obligations for Duane Reade to perform. If any of the foregoing criteria were not satisfied, immediate revenue recognition would have been inappropriate. Both the company's internal accountants and outside auditors adhered to these rules in booking revenue from real estate concession transactions. At trial, the defendants did not dispute that these rules were appropriately and consistently applied.

To demonstrate the impact of the defendants' deception on the preparation and review of the company's financial statements, the government presented Hallinan and Henry with information that Cuti and Tennant had withheld, such as side letters to the transactions, and asked how the withheld information would have affected their accounting. In each instance, Hallinan and Henry replied that if they had been aware of the withheld information, they would not have recognized the full amount of the transaction proceeds as immediate revenue. Defense counsel objected to the use of "what if-you-had-known" questions as eliciting inadmissible expert opinion testimony from fact witnesses.

In his defense, Tennant asserted that, like Hallinan and Henry, he too was deceived by Cuti's fraudulent

scheme and signed transaction documents without knowing that fraud was afoot so there was insufficient evidence of his criminal intent to support a conviction. He also objected to the district court's inclusion of a conscious avoidance instruction in the jury charge, which he claimed was unwarranted and prejudicial.

These arguments are again raised on appeal and we consider them in turn.

DISCUSSION

I. Cuti's claim as to the non-expert testimony

Cuti argues on appeal, as he did below, that the "what-if-you-had-known" questions posed to Hallinan and Henry improperly elicited expert opinion testimony from non-expert witnesses. Because both Hallinan and Henry, while professional accountants, were not qualified as experts, Cuti insists that their testimony as lay witnesses was inadmissible.

We accord a district court's evidentiary rulings deference, and reverse only for abuse of discretion. *United States v. Robinson*, 702 F.3d 22, 36 (2d Cir. 2012). A district court has abused its discretion if its ruling is based on an erroneous view of the law or on a clearly erroneous assessment of the evidence, or if its decision cannot be located within the range of permissible decisions. *In re Sims*, 534 F.3d 117, 132 (2d Cir. 2008).

The Federal Rules of Evidence allow the admission of fact testimony so long as the witness has personal knowledge, *see* Fed. R. Evid. 602,[3] while opinion testi-

[3] Rule 602 provides in relevant part:

> A witness may testify to a matter only if evidence is introduced sufficient to support a finding that the witness has personal knowledge of the matter. Evidence to

mony can be presented by either a lay or expert witness, *see* Fed. R. Evid. 701[4] & 702.[5] The initial question is therefore whether the contested testimony should be characterized as fact or opinion. "[T]he distinction between statements of fact and opinion is, at best, one of degree." *Beech Aircraft Corp. v. Rainey*, 488 U.S. 153, 168 (1988). We need not adopt verbatim Judge Posner's observation that "[a]ll knowledge is inferential, and the combined effect of [Federal] Rules [of Evidence] 602 and 701 is to recognize this epistemological verity but at the same time to prevent the piling of inference upon inference to the point where testimony ceases to be reliable" to acknowledge its essential truth. *United States v. Giovannetti*, 919 F.2d 1223, 1226 (7th Cir. 1990).

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prove personal knowledge may consist of the witness's own testimony.

[4] Rule 701 states:

If a witness is not testifying as an expert, testimony in the form of an opinion is limited to one that is: (a) rationally based on the witness's perception;(b) helpful to clearly understanding the witness's testimony or to determining a fact in issue; and (c) not based on scientific, technical, or other specialized knowledge within the scope of Rule 702.

[5] Rule 702 states:

A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if: (a) the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue; (b) the testimony is based on sufficient facts or data; (c) the testimony is the product of reliable principles and methods; and (d) the expert has reliably applied the principles and methods to the facts of the case.

In this case, the inference that Hallinan and Henry were asked to make in answering the hypothetical questions was limited by the factual foundation laid in earlier admitted testimony and exhibits, the factual nature of the hypotheticals, and the witnesses' reasoning, which was based on undisputed accounting rules. These limitations left little room for the witnesses to engage in speculation and ensured that their testimony fell near the fact end of the fact-opinion spectrum.

Moreover, the witnesses, although not qualified as experts, were fact witnesses of a unique sort. Each was a certified and experienced accountant personally familiar with the accounting of the transactions at issue. The hypothetical questions utilized facts that had been independently established in the record. If the facts as the witnesses had understood them were A and the true facts were B, it was not inappropriate to ascertain, from the very witnesses responsible for their accounting, whether B would have affected that accounting under the same, undisputed accounting rules. And, since the applicable accounting rules were explained in detail, the reasoning process that the witnesses employed in answering the hypotheticals was straightforward and transparent to the jurors, who could readily discern whether the responses given were reliable.

Cuti also contests whether the witnesses had sufficient personal knowledge, as required by Rule 602, to provide factual testimony. *See* Fed. R. Evid. 602. This rule makes personal knowledge a foundational requirement for fact witness testimony and is premised on the common law belief that "a witness who testifies to a fact which can be perceived by the senses must have had an opportunity to observe, and must have actually observed the fact." Fed. R. Evid. 602 advisory committee's note.

However, personal knowledge of a fact "is not an absolute" to Rule 602's foundational requirement, which "may consist of what the witness thinks he knows from personal perception." *Id.* Similarly, a witness may testify to the fact of what he did not know and how, if he had known that independently established fact, it would have affected his conduct or behavior. As this case illustrates, "what-if-you-had-known" questions that present withheld facts to a witness are especially useful to elicit testimony about the impact of fraud. Although we have not addressed the issue squarely, other circuits have permitted the use of hypothetical questions to inquire into the effect of a fraud. *See, e.g.*, *United States v. Orr*, 692 F.3d 1079, 1096-97 (10th Cir. 2012); *United States v. Laurienti*, 611 F.3d 530, 549 (9th Cir. 2010); *United States v. Jennings*, 487 F.3d 564, 582 (8th Cir. 2007); *United States v. Ranney*, 719 F.2d 1183, 1187-88 (1st Cir. 1983); *United States v. Bush*, 522 F.2d 641, 649-50 (7th Cir. 1975).

It also bears noting that there was nothing in the prosecution's questions or in the answers they elicited that prevented the defense from challenging the factual accuracy of the disputed testimony. Indeed, Cuti pointed out at trial that at least one document Hallinan claimed not to have seen was actually recorded in a log of documents covered by PwC's audit, and thus Cuti was able to argue that the auditor could not have been deceived about the accounting for that transaction. Cuti also questioned the materiality of the accounting distortions to the company's overall financial statement by extracting an admission from Hallinan that the fair comparison for the proceeds generated from the real estate concession transactions was to the company's pre-tax income and not to the considerably smaller after-tax net income figure.

While we hold that the challenged testimony was properly admitted as factual testimony, we alternatively hold that it is admissible as lay opinion under Federal Rule of Evidence 701, which permits a lay witness to give an opinion if it is limited to "one that is: (a) rationally based on the witness' s perception; (b) helpful to clearly understanding the witness's testimony or to determining a fact in issue; and (c) not based on scientific, technical, or other specialized knowledge within the scope of Rule 702.

Cuti argues that the hypothetical questions posed to the witnesses violated each subsection of Rule 701 because Hallinan and Henry were asked to comment on facts that they had not personally perceived; because their interpretation of evidence already admitted was not "helpful" to the jury; and because the witnesses used specialized expertise and were not properly qualified as experts in accordance with Rule 702.

Cuti's Rule 701(a) objection is unpersuasive because, as discussed earlier, the witnesses were not testifying to the existence of facts, but simply acknowledging that knowledge of such facts, already admitted into evidence, would have caused them to alter their accounting treatment. Their testimony was plainly helpful to the jury within the meaning of Rule 701(b).

Cuti's Rule 701(c) contention also fails but requires a bit more elaboration. The Advisory Committee's Note on Rule 701 instructs that "a witness' testimony must be scrutinized under the rules regulating expert opinion to the extent that the witness is providing testimony based on scientific, technical, or other specialized knowledge within the scope of Rule 702." Fed. R. Evid. 701 advisory committee's note, 2000 amend. Lay opinion under Rule 701 must be limited to opinions that

"result[] from a process of reasoning familiar in everyday life." *Id.*

Cuti insists that if Hallinan and Henry's answers to the hypotheticals are characterized as opinion, they are necessarily expert opinion and must satisfy the qualification requirements of Rule 702 because the testimony involved the technical and specialized knowledge of the accounting profession. At first blush, the accounting rules involved in the recognition of revenue from real estate concession transactions appear technical and unfamiliar to everyday life, but those rules or their interpretation were not in question in this case. The only issue was whether the withheld facts would have altered the rules' application.

We held in *Bank of China, N.Y. Branch v. NBM LLC* that a witness's specialized knowledge, or the fact that he was chosen to carry out an investigation because of this knowledge, does not render his testimony "expert" as long as the testimony was based on his "investigation and reflected his investigatory findings and conclusions, and was not rooted exclusively in his expertise." 359 F.3d 171, 181 (2d Cir. 2004). However, if the testimony was "not a product of his investigation, but rather reflected [his] specialized knowledge [of the banking industry], " then it was impermissible expert testimony. *Id.*, at 182.

A similar question arose in *United States v. Rigas*, 490 F.3d 208 (2d Cir. 2007). There, an accountant with personal knowledge of a company's books testified to the accounting impact of debt reclassifications, which the government had already established as fraudulent. We held that the accountant's testimony was lay opinion because it did not address what the appropriate accounting technique should have been, but was instead

simply offered to show what the amount of the debt would have been had the fraud not occurred. *Id.* at 225.

The testimony in this case was not "rooted exclusively [in the witness's] expertise" and did not address the soundness of the accounting rules. When the issue for the fact-finder's determination is reduced to impact—whether a witness would have acted differently if he had been aware of additional information the witness so testifying is engaged in "a process of reasoning familiar in everyday life." *See* Fed. R. Evid. 701 advisory committee's note, 2000 amend. The testimony of Hallinan and Henry in response to the hypothetical questions was therefore also admissible as lay opinion.

United States v. Garcia, 413 F.3d 201, 216 (2d Cir. 2005), is not to the contrary. In that case, we held that an undercover law enforcement agent could not testify as lay opinion that, based on his knowledge gleaned from other drug interdiction cases, the defendant was a partner in the narcotics distribution conspiracy. Such testimony was inadmissible because the opinion was based on specialized experience that the agent had accumulated from other cases and involved a specialized reasoning process not readily understandable to the average juror. Nothing similar occurred here. These witnesses testified based only on their experiences with matters pertinent to this case, and their reasoning was evident to the jury.

Cuti also challenges the admission of the contested testimony as undermining the presumption of innocence by assuming his guilt. In support of this argument, Cuti highlights Second Circuit case law that forbids such questions in the cross-examination of defense character witnesses. *See, e.g.*, *United States v. Russo*,

110 F.3d 948, 952 (2d Cir. 1997); *United States v. Oshatz*, 912 F.2d 534, 539 (2d Cir. 1990).

This argument fails because the challenged questions here were not directed at character witnesses and made no assumption of guilt. Hallinan and Henry were asked, for the most part, narrow questions on direct examination designed to assess the impact of the fraudulent omissions on their accounting treatment. The district court took pains to limit the hypotheticals to the impact of the withheld information and barred the witnesses from speaking to the wrongfulness of the defendants' actions, leaving that analysis to the jury. And, as noted, Cuti had ample opportunity to challenge the factual accuracy of the disputed testimony.

Finally, Cuti argues that the manner in which the government presented the withheld information to the witnesses was flawed because some questions were open-ended, some were phrased in terms of opinion, and some were based on material not in the record. The district court reasonably required the government to reformulate its questions in some instances, but it did not always do so. We have examined the record and find any missteps in this regard to be minor relative to the witnesses' entire testimony and harmless to the outcome of the trial. When a court, upon review of the entire record, "is sure that the [evidentiary] error did not influence the jury, or had but very slight effect, the verdict and the judgment should stand." *Kotteakos v. United States*, 328 U.S. 750, 764 (1946).

In sum, we hold that under these circumstances the contested testimony was admissible fact testimony that was relevant, probative, and—for the most part—carefully controlled so as not to be unfairly prejudicial. *See* Fed. R. Evid. 401, 403 & 602. Alternatively, it was

admissible as lay opinion testimony. *See* Fed. R. Evid. 701. The district court did not abuse its discretion in admitting the challenged testimony.

II. Tennant's claims

A. Sufficiency of evidence

Tennant argues that, even though he signed the various documents used to effectuate the fraudulent real estate concession transactions and return-trip payments disguised as commissions and consulting fees and engaged in other related activities, there was insufficient evidence that he knew or should have known that fraud was afoot to allow the case to go to the jury.

We review a claim of insufficient evidence de novo, *United States v. Geibel*, 369 F.3d 682, 689 (2d Cir. 2004), but must uphold the jury verdict if "drawing all inferences in favor of the prosecution and viewing the evidence in the light most favorable to the prosecution, any rational trier of fact could have found the essential elements of the crime beyond a reasonable doubt." *United States v. Santos*, 449 F.3d 93, 102 (2d Cir. 2005) (quotation marks omitted). A defendant challenging a conviction on sufficiency grounds undertakes a "heavy burden." *United States v. Kozeny*, 667 F.3d 122, 139 (2d Cir. 2011). A judgment of acquittal can be entered "only if the evidence that the defendant committed the crime alleged is nonexistent or so meager that no reasonable jury could find guilt beyond a reasonable doubt." *United States v. Espaillet*, 380 F.3d 713, 718 (2d Cir. 2004). In a close case, where "either of the two results, a reasonable doubt or no reasonable doubt, is fairly possible, the court must let the jury decide the matter." *United States v. Temple*, 447 F.3d 130, 137 (2d Cir. 2006)(quotation marks and alteration omitted).

In considering the sufficiency of the evidence supporting a guilty verdict, the evidence must be viewed in the light most favorable to the Government. *Id.*, at 136-37. To "avoid usurping the role of the jury," *United States v. Guadagna*, 183 F.3d 122, 129 (2d. Cir. 1999), the Court must resolve all issues of credibility in favor of the jury's verdict, *Kozeny*, 667 F.3d at 139. The Court must also "credit[] every inference that the jury might have drawn in favor of the government," *Temple*, 447 F.3d at 136-37, because "the task of choosing among competing, permissible inferences is for the [jury], not for the reviewing court." *United States v. McDermott*, 245 F.3d 133, 137 (2d Cir. 2001).

Tennant argues that evidence of his knowledge of the fraud is insufficient because Zelnik could not definitively place him at a particular meeting where Cuti discussed this conspiracy with the principals of the WRG entities, who were in on the scheme. On that basis alone, Tennant reasons that his conviction was based on evidence that was "'at least as consistent with innocence as with guilt,'" and must be reversed. (Tennant Brief at 45 (quoting *United States v. Mulheren*, 938 F.2d 364, 372 (2d Cir. 1991)). This approach is flawed because not only must the evidence be viewed in the light most favorable to the government, *Santos*, 449 F.3d at 102, it must also be analyzed "in conjunction [with all of the evidence and] not in isolation," *United States v. Persico*, 645 F.3d 85, 104 (2d Cir. 2011). This is so because the sufficiency test "must be applied to the totality of the government's case and not to each element, as each fact may gain color from others." *Guadagna*, 183 F.3d at 130.

We have little difficulty rejecting Tennant's argument that the evidence was insufficient to support the jury's finding that he was aware of the fraudulent char-

acter of the transactions at issue. He either knew or had to know that the so-called real estate concession rights that Duane Reade was selling to the WRG entities in 2000 were valueless because he had personally signed or approved transactions that had rendered those very rights worthless in the first place or was otherwise privy to information that revealed their sham character. One conspicuous example of this is the lease remainder in the storefront at 19 Park Place, which Duane Reade sold, pursuant to a document that Tennant personally signed, for $12,500 back to the landlord of that property. The very next day, Tennant personally signed the $806,000 deal with the WRG entities into which the same concessionary right was bundled for $75,000. The jury was entitled to infer guilty knowledge on the part of Tennant, the company's former CFO and senior vice-president who was experienced in real estate matters, from his signing two contracts on back-to-back days to sell the same leasehold interest to two different buyers. Against this and similar evidence, his plea that other company personnel failed to tell him of the fraud could reasonably be rejected by the jury.

Moreover, Zelnik testified at trial that not only was Tennant aware that the concessions being sold were worthless, Tennant and Cuti also determined the arbitrary values that the WRG entities would pay for them, and that it was Tennant who devised the vehicles used to make return payments to the WRG entities. The totality of the government's evidence was more than sufficient for the jury to conclude that Tennant was aware of the fraud that he was helping to perpetrate.

B. Conscious avoidance charge

Tennant faults the district court for including a conscious avoidance charge in its instructions to the jury, which he says caused him prejudice and warrants reversal of his conviction. The district court instructed the jury that Tennant "knowingly" committed fraud if he was "actually aware he was making or causing a false statement to be made," or if he "(a) was aware of a high probability that, because of the [real estate concession] transactions at issue, Duane Reade's reported financial results were false or misleading but (b) that he deliberately and consciously avoided confirming these facts." (Tr. 5004-05). The Court cautioned, however, that the "knowingly" element would not be satisfied if "Tennant actually believed that the transactions were legitimate and not improper." (Tr. 5005).

Tennant takes no issue with the form of the conscious avoidance instruction, but rather argues that the charge should not have been given at all because there was an insufficient factual predicate to support it. This argument is without merit.

We review a claim of error in jury instructions de novo, reversing only where there was prejudicial error in the charge as a whole. *United States v. Ebbers*, 458 F.3d 110, 124 (2d Cir. 2006). "A conscious-avoidance charge is appropriate when (a) the element of knowledge is in dispute, and (b) the evidence would permit a rational juror to conclude beyond a reasonable doubt that the defendant was aware of a high probability of the fact in dispute and consciously avoided confirming that fact." *Id.* (quotation marks omitted); *see also United States v. Ferguson*, 676 F.3d 260, 277-78 (2d Cir. 2011). For example, in a securities fraud case, if a defendant attended meetings that were part of the

charged scheme, yet argues that he lacked the requisite scienter because, for example, he "didn't bother to read in full" the documents he signed, the charge is appropriate. *Ebbers*, 458 F.3d at 124-25.

The Government "need not choose between an 'actual knowledge' and a 'conscious avoidance' theory." *Ferguson*, 676 F.3d at 278.

To the contrary, in many cases, the evidence supporting each theory will be the same:

> [T]he same evidence that will raise an inference that the defendant had actual knowledge of the illegal conduct ordinarily will also raise the inference that the defendant was subjectively aware of a high probability of the existence of illegal conduct. Moreover, [conscious avoidance] may be established where a defendant's involvement in the criminal offense may have been so overwhelmingly suspicious that the defendant's failure to question the suspicious circumstances established the defendant's purposeful contrivance to avoid guilty knowledge.

Kozeny, 667 F.3d at 133-34 (quotation marks omitted) (first alteration added).

District courts should pay heed, however, to circumstances in which a conscious avoidance charge may be inappropriate. This is so when the only evidence that alerts the defendant to the high probability of the criminal activity is direct evidence of the illegality such that the question for the jury is whether "the defendant had either actual knowledge or no knowledge at all of the facts in question." *United States v. Nektalov*, 461 F.3d 309, 316 (2d Cir. 2006)(quotation marks omitted). Similarly, if the defendant denies ever having access to

the facts that the government claims should have alerted him to the fraud, the issue is not whether the facts he knew should have alerted him but whether he could even have known those facts. *See, e.g., United States v. Adeniji*, 31 F.3d 58, 63 (2d Cir. 1994).

In this case, the district court did not err in giving the conscious avoidance charge. The government's theory was that, because Tennant was immersed in sham concession agreements that he personally signed or approved, determined phony values for the contracts, figured out how to get money back to the WRG entities through overpayments and sham consulting services, and met with the principals of the WRG entities to these ends, Tennant had actual knowledge of the fraud.

In response, Tennant argued both that the evidence was lacking that he knew of the fraud and that the facts of which he was aware were insufficient to alert him to a high probability of fraud.[6] This purported lack of knowledge defense, despite Tennant's deep involvement in the transactions that effectuated the fraud, all but invited the conscious avoidance charge. The same evidentiary facts that supported the government's theory of actual knowledge also raised the inference that he was subjectively aware of a high probability of the existence of illegal conduct and thus properly served as the factual predicate for the conscious avoidance charge, *Kozeny*, 667 F.3d at 133-34. Finally, the

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[6] For example, Tennant's able counsel argued in summation,

> There is no evidence that [Tennant] knew anything about improper sales of leases or lease rights [to the WRG entities]. Then and now he believed them to be entirely proper, arm's-length transactions.

(Tr. 4850).

government did not have to choose between an "actual knowledge" theory or a "conscious avoidance" theory, *Ferguson*, 676 F.3d at 278, and the district court did not err in giving both to the jury. Of course, it is plausible that the semi-retired Tennant, attending part-time to complex transactions, might have been sufficiently disengaged or trusting that in fact he lacked knowledge on any culpable level; but the jury was empowered to find otherwise, and did.

CONCLUSION

For the above reasons, and for those set forth in the accompanying summary order, the judgments of conviction and sentence are AFFIRMED.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA,
Appellee,
v.

ANTHONY J. CUTI, WILLIAM J. TENNANT,
Defendants-Appellants.

Docket Nos. 11-3756-cr(LEAD); 11-3831-cr(CON)

At a stated term of the United States Court of Appeals for the Second Circuit, held at the Thurgood Marshall United States Courthouse, 40 Foley Square, in the City of New York, on the 26th day of June, two thousand thirteen.

SUMMARY ORDER

PRESENT: DENNIS JACOBS,
Chief Judge,

JOHN M. WALKER, JR.,
Circuit Judge,

SANDRA DAY O'CONNOR,
Associate Justice (retired).*

* * *

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* The Honorable Sandra Day O'Connor, Associate Justice (retired), of the United States Supreme Court, sitting by designation.

Appeal from judgments of the United States District Court for the Southern District of New York (Batts, J.).

UPON DUE CONSIDERATION, IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the judgments of the district court are **AFFIRMED**.

Anthony Cuti and William Tennant, two former senior executives of the New York drugstore chain, Duane Reade, appeal from the judgments of conviction of the United States District Court for the Southern District of New York (Batts, J.). Cuti, the former CEO of Duane Reade, was convicted of conspiracy to commit securities fraud, securities fraud, and making false statements to the SEC, among other things, and sentenced to three years' imprisonment, three years' supervised release, a $500 special assessment, and a $5 million fine. Tennant, the former CFO, was convicted of securities fraud and sentenced to time served, followed by three years' supervised release, as well as a $100 special assessment and a $10,000 fine.

Cuti and Tennant raise numerous issues on appeal. We assume the parties' familiarity with the underlying facts, the procedural history, and the issues presented for review. Cuti's challenge to the admission of lay opinion testimony and Tennant's claims as to the sufficiency of evidence and the conscious avoidance charge are addressed in a separate opinion issued concurrently with this order.

[1] Cuti argues that the district court erred by denying Cuti's request for a Rule 17(c) subpoena to Duane Reade and Jeff Winick. We review the denial of a pretrial Rule 17(c) subpoena for abuse of discretion. *United States v. Nixon*, 418 U.S. 683, 702 (1974); *see also*

United States v. Green, No. 07-3517, 2008 WL 4104220, at *1 (2d Cir. Aug. 27, 2008) (citing *Nixon*). Under *Nixon*, a party moving for a pretrial Rule 17(c) subpoena, "must clear three hurdles: (1) relevancy; (2) admissibility; (3) specificity." 418 U.S. at 700; *see also United States v. Stein*, 488 F. Supp. 2d 350, 364-65 (S.D.N.Y. 2007). The district court did not abuse its discretion in concluding that Cuti's request for a Rule 17(c) subpoena did not meet this standard.

[2] Cuti also claims that the district erred by limiting the cross-examination of John Henry and Jerry Ray. We review a district court's decision to limit the scope of cross-examination for abuse of discretion. *United States v. Cedeno*, 644 F.3d 79, 81 (2d Cir. 2011).

The Confrontation Clause protects "an opportunity for effective cross-examination, not cross-examination that is effective in whatever way, and to whatever extent, the defense might wish." *United States v. Owens*, 484 U.S. 554, 559 (1988) (internal quotation marks omitted; emphasis in original). "[T]rial judges retain wide latitude insofar as the Confrontation Clause is concerned to impose reasonable limits on such cross-examination based on concerns about, among other things, harassment, prejudice, confusion of the issues, the witness' safety, or interrogation that is repetitive or only marginally relevant." *Delaware v. Van Arsdall*, 475 U.S. 673, 679 (1986). In determining whether the district court abused its discretion in limiting cross-examination, we must ask whether "the jury [was] in possession of facts sufficient to make a discriminating appraisal of the particular witness's credibility." *United States v. Laljie*, 184 F.3d 180, 192 (2d Cir. 1999) (internal quotation marks omitted).

To the extent that the district court actually limited Cuti's cross-examination of Henry and Ray, the court did so based on recognized grounds (*e.g.*, jury confusion, marginal relevance, etc.). *See Van Arsdall*, 475 U.S. at 679. We cannot conclude that the district court abused its discretion by imposing these limitations.

[3] Cuti argues that the district court erred by admitting the hearsay testimony of Cory Zelnik (allegedly recounting statements made by Winick) pursuant to Rule 801(d)(2)(E)'s coconspirator exclusion to the hearsay prohibition. We review a district court's admission of purported hearsay evidence under Rule 801(d)(2)(E) for clear error. *United States v. Coppola*, 671 F.3d 220, 246 (2d Cir. 2012).

To admit hearsay evidence of the statement of a coconspirator, a district court must find by a preponderance of the evidence that a conspiracy existed, that the members included the declarant and the party against whom the evidence is offered, and that the statement was made during and in furtherance of the conspiracy. *Id.* As an initial matter, it is not clear that Zelnik actually introduced any out-of-court statements made by Winick. A review of the record reflects that Zelnik was typically referring to his own views, or was speaking on behalf of the business entities Winick Realty Group, Danielle Equity, or Store Ops. None of Zelnik's testimony involved him introducing out-of-court statements made by Winick. In any event, even if Zelnik's testimony introduced hearsay, Cuti has not established that the district court clearly erred in finding that Cuti, Zelnik, and Winick were co-conspirators and that Winick's "statements" were made during and in furtherance of the conspiracy.

[4] Cuti contends that the government improperly introduced a new theory of the case during rebuttal summation. When, as here, a defendant has objected at trial, we review a claim of improper argument to the jury for prejudicial error, considering the severity of the misconduct, the curative measures adopted, and the certainty of conviction absent the misconduct. *United States v. Helmsley*, 941 F.2d 71, 96 (2d Cir. 1991).

Here, the statements made by the government during rebuttal summation were by way of response to statements made in closing by Cuti's counsel, and were based entirely on evidence introduced by the government at trial. Such rebuttal summation is proper. *United States v. Rubinson*, 543 F.2d 951, 966 (2d Cir. 1976). Even if rebuttal summation was improper in the limited respect raised by Cuti, he has not shown that it deprived him of a fair trial, warranting reversal. *See United States v. Pena*, 793 F.2d 486, 490 (2d Cir. 1986).

[5] Finally, Cuti argues that the district court erred in imposing a $5 million fine before fixing the amount of restitution. When, as here, no objection is made below, we review the district court's imposition of a criminal fine for plain error. *United States v. Pfaff*, 619 F.3d 172, 174 (2d Cir. 2010). Because the district court did consider restitution before imposing the fine, as required by 18 U.S.C. § 3572(a), the district court did not err, plainly or otherwise.

[6] Tennant claims that he suffered prejudice when the government argued during opening and closing statements that Tennant profited from his participation in the fraud and that Oak Hill suffered some loss. We review a claim of improper argument before the jury—where no objection was made at trial—for plain error, meaning that the error affected substantial rights and

affected the outcome of the proceedings. *United States v. Williams*, 690 F.3d 70, 77 (2d Cir. 2012). We must reject Tennant's challenge unless the error "seriously affect[ed] the fairness, integrity, or public reputation of [the] judicial proceedings." *United States v. Carr*, 424 F.3d 213, 227 (2d Cir. 2005) (internal quotation marks omitted).

Tennant has failed to make such a showing. As to profit, Tennant points to statements by the government that Tennant sold his stock options for $2.9 million after participating in several of the real estate concession transactions. These statements are supported in the record and appear accurate, despite Tennant's characterization otherwise. And even if the statements were erroneous, Tennant does not remotely approach the steep showing of prejudice necessary under plain error review.

As to loss, Tennant points to the government's suggestion that Oak Hill relied on Duane Reade's manipulated financials in deciding whether to buy the company. These statements bear upon the issue of materiality and are adequately supported in the record. In any event, even if the government argued loss without factual support, Tennant has not established plain error.

[7] Finally, Tennant claims that the district court erred in denying his motion to sever his trial. A district court's decision to grant or deny severance "is virtually unreviewable on appeal," and the defendant bears a very "heavy burden" to establish a "miscarriage of justice." *United States v. Locascio*, 6 F.3d 924, 947 (2d Cir. 1993). "[T]he burden on a defendant to establish that severance was improperly denied is not an easy one to carry," because the defendant must show "prejudice so

great as to deny him a fair trial." *United States v. Cardascia*, 951 F.2d 474, 482 (2d Cir. 1991). Tennant has not shown that the district court's refusal to sever the trial brought about a miscarriage of justice.

Finding no merit in Cuti and Tennant's remaining arguments, we hereby **AFFIRM** the judgments of the District Court.

FOR THE COURT:
CATHERINE O'HAGAN WOLFE, CLERK

/s/ Catherine O'Hagan Wolfe
[Seal]

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA,
Appellee,
v.

ANTHONY J. CUTI, WILLIAM J. TENNANT,
Defendants-Appellants.

Docket Nos. 11-3756(L); 11-3831(CON)

At a Stated Term of the United States Court of Appeals for the Second Circuit, held at the Thurgood Marshall United States Courthouse, 40 Foley Square, in the City of New York, on the 15th day of January, two thousand fourteen,

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ORDER

Before: DENNIS JACOBS,
JOHN M. Walker,
Circuit Judges,
SANDRA DAY O'CONNOR,
Associate Justice (retired).*

Appellant Anthony Cuti having filed a petition for panel rehearing and the panel that determined the appeal having considered the request,

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* The Honorable Sandra Day O'Connor, Associate Justice (retired) of the United States Supreme Court, sitting by designation.

IT IS HEREBY ORDERED that the petition is DENIED.

For The Court:

Catherine O'Hagan Wolfe,
Clerk of Court

s/ Catherine O'Hagan Wolfe
[Seal]

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA,
Appellee,
v.

ANTHONY J. CUTI, WILLIAM J. TENNANT,
Defendants-Appellants.

Docket Nos. 11-3756 (L); 11-3831 (con.)

At a Stated Term of the United States Court of Appeals for the Second Circuit, held at the Thurgood Marshall United States Courthouse, 40 Foley Square, in the City of New York, on the 3rd day of February, two thousand and fourteen.

ORDER

Before: Dennis Jacobs,
John M. Walker, Jr.,
Circuit Judges,
Sandra Day O'Connor,
Associate Justice (retired).*

Appellant Anthony Cuti, through counsel, moves to stay issuance of the mandate pending the filing and disposition of a petition for a writ of certiorari in the Supreme Court of the United States.

* The Honorable Sandra Day O'Connor, Associate Justice (retired) of the United States Supreme Court, sitting by designation.

IT IS HEREBY ORDERED that the motion is GRANTED.

For the court:
Catherine O'Hagan Wolfe
Clerk of Court

/s/ Catherine O'Hagan Wolfe
[Seal]

APPENDIX E

PERTINENT RULE EXCERPTS

Fed. R. Crim. P. 16

Rule 16. Discovery and Inspection

(a) Government's Disclosure.

(1) ***Information Subject to Disclosure.***

* * *

(G) *Expert Witnesses.* At the defendant's request, the government must give to the defendant a written summary of any testimony that the government intends to use under Rules 702, 703, or 705 of the Federal Rules of Evidence during its case-in-chief at trial. If the government requests discovery under subdivision (b)(1)(C)(ii) and the defendant complies, the government must, at the defendant's request, give to the defendant a written summary of testimony that the government intends to use under Rules 702, 703, or 705 of the Federal Rules of Evidence as evidence at trial on the issue of the defendant's mental condition. The summary provided under this subparagraph must describe the witness's opinions, the bases and reasons for those opinions, and the witness's qualifications.

(2) ***Information Not Subject to Disclosure.*** Except as Rule 16(a)(1) provides otherwise, this rule does not authorize the discovery or inspection of reports, memoranda, or other internal government documents made by an attorney for the government or other government agent in connection

with investigating or prosecuting the case. Nor does this rule authorize the discovery or inspection of statements made by prospective government witnesses except as provided in 18 U.S.C. § 3500.

* * *

(b) Defendant's Disclosure.

(1) ***Information Subject to Disclosure.***

* * *

(C) *Expert Witnesses*. The defendant must, at the government's request, give to the government a written summary of any testimony that the defendant intends to use under Rules 702, 703, or 705 of the Federal Rules of Evidence as evidence at trial, if—

(i) the defendant requests disclosure under subdivision (a)(1)(G) and the government complies; or

(ii) the defendant has given notice under Rule 12.2(b) of an intent to present expert testimony on the defendant's mental condition.

This summary must describe the witness's opinions, the bases and reasons for those opinions, and the witness's qualifications[.]

(2) ***Information Not Subject to Disclosure.*** Except for scientific or medical reports, Rule 16(b)(1) does not authorize discovery or inspection of:

(A) reports, memoranda, or other documents made by the defendant, or the defendant's attorney or agent, during the case's investigation or defense; or

(B) a statement made to the defendant, or the defendant's attorney or agent, by:

(i) the defendant;

(ii) a government or defense witness; or

(iii) a prospective government or defense witness.

(c) Continuing Duty to Disclose. A party who discovers additional evidence or material before or during trial must promptly disclose its existence to the other party or the court if:

(1) the evidence or material is subject to discovery or inspection under this rule; and

(2) the other party previously requested, or the court ordered, its production.

(d) Regulating Discovery.

(1) ***Protective and Modifying Orders.*** At any time the court may, for good cause, deny, restrict, or defer discovery or inspection, or grant other appropriate relief. The court may permit a party to show good cause by a written statement that the court will inspect ex parte. If relief is granted, the court must preserve the entire text of the party's statement under seal.

(2) ***Failure to Comply.*** If a party fails to comply with this rule, the court may:

(A) order that party to permit the discovery or inspection; specify its time, place, and manner; and prescribe other just terms and conditions;

(B) grant a continuance;

(C) prohibit that party from introducing the undisclosed evidence; or

(D) enter any other order that is just under the circumstances.

Fed. R. Civ. P. 26

Rule 26. Duty to Disclose; General Provisions Governing Discovery

(a) REQUIRED DISCLOSURES.

* * *

(2) *Disclosure of Expert Testimony.*

(A) *In General.* In addition to the disclosures required by Rule 26(a)(1), a party must disclose to the other parties the identity of any witness it may use at trial to present evidence under Federal Rule of Evidence 702, 703, or 705.

(B) *Witnesses Who Must Provide a Written Report.* Unless otherwise stipulated or ordered by the court, this disclosure must be accompanied by a written report—prepared and signed by the witness—if the witness is one retained or specially employed to provide expert testimony in the case or one whose duties as the party's employee regularly involve giving expert testimony. The report must contain:

(i) a complete statement of all opinions the witness will express and the basis and reasons for them;

(ii) the facts or data considered by the witness in forming them;

(iii) any exhibits that will be used to summarize or support them;

(iv) the witness's qualifications, including a list of all publications authored in the previous 10 years;

(v) a list of all other cases in which, during the previous 4 years, the witness testified as an expert at trial or by deposition; and

(vi) a statement of the compensation to be paid for the study and testimony in the case.

(C) *Witnesses Who Do Not Provide a Written Report.* Unless otherwise stipulated or ordered by the court, if the witness is not required to provide a written report, this disclosure must state:

(i) the subject matter on which the witness is expected to present evidence under Federal Rule of Evidence 702, 703, or 705; and

(ii) a summary of the facts and opinions to which the witness is expected to testify.

(D) *Time to Disclose Expert Testimony.* A party must make these disclosures at the times and in the sequence that the court orders. Absent a stipulation or a court order, the disclosures must be made:

(i) at least 90 days before the date set for trial or for the case to be ready for trial; or

(ii) if the evidence is intended solely to contradict or rebut evidence on the same subject matter identified by another party under Rule 26(a)(2)(B) or (C), within 30 days after the other party's disclosure.

(E) *Supplementing the Disclosure.* The parties must supplement these disclosures when required under Rule 26(e).

* * *

(4) *Form of Disclosures.* Unless the court orders otherwise, all disclosures under Rule 26(a) must be in writing, signed, and served.

(b) DISCOVERY SCOPE AND LIMITS.

* * *

(4) *Trial Preparation: Experts.*

(A) *Deposition of an Expert Who May Testify.* A party may depose any person who has been identified as an expert whose opinions may be presented at trial. If Rule 26(a)(2)(B) requires a report from the expert, the deposition may be conducted only after the report is provided.

(B) *Trial-Preparation Protection for Draft Reports or Disclosures.* Rules 26(b)(3)(A) and (B) protect drafts of any report or disclosure required under Rule 26(a)(2), regardless of the form in which the draft is recorded.

(C) *Trial-Preparation Protection for Communications Between a Party's Attorney and Expert Witnesses.* Rules 26(b)(3)(A) and (B) protect communications between the party's attorney and any witness required to provide a report under Rule 26(a)(2)(B), regardless of the form of the communications, except to the extent that the communications:

(i) relate to compensation for the expert's study or testimony;

(ii) identify facts or data that the party's attorney provided and that the expert considered in forming the opinions to be expressed; or

(iii) identify assumptions that the party's attorney provided and that the expert relied on in forming the opinions to be expressed.

(D) *Expert Employed Only for Trial Preparation.* Ordinarily, a party may not, by interrogatories or deposition, discover facts known or opinions held by an expert who has been retained or specially employed by another party in anticipation of litigation or to prepare for trial and who is not expected to be called as a witness at trial. But a party may do so only:

(i) as provided in Rule 35(b); or

(ii) on showing exceptional circumstances under which it is impracticable for the party to obtain facts or opinions on the same subject by other means.

(E) *Payment.* Unless manifest injustice would result, the court must require that the party seeking discovery:

(i) pay the expert a reasonable fee for time spent in responding to discovery under Rule 26(b)(4)(A) or (D); and

(ii) for discovery under (D), also pay the other party a fair portion of the fees and expenses it reasonably incurred in obtaining the expert's facts and opinions.

* * *

(e) SUPPLEMENTING DISCLOSURES AND RESPONSES.

(1) *In General.* A party who has made a disclosure under Rule 26(a)—or who has responded to an interrogatory, request for production, or request for admission—must supplement or correct its disclosure or response:

> (A) in a timely manner if the party learns that in some material respect the disclosure or response is incomplete or incorrect, and if the additional or corrective information has not otherwise been made known to the other parties during the discovery process or in writing; or
>
> (B) as ordered by the court.

(2) *Expert Witness.* For an expert whose report must be disclosed under Rule 26(a)(2)(B), the party's duty to supplement extends both to information included in the report and to information given during the expert's deposition. Any additions or changes to this information must be disclosed by the time the party's pretrial disclosures under Rule 26(a)(3) are due.

* * *

APPENDIX F

EXCERPTS OF TRIAL TRANSCRIPTS

A-1538-1539

Hallinan – direct

* * *

Q. Had you been provided with copies of the possession letter and the lease, what would you have done?

MR. WEINGARTEN: Objection, your Honor.

THE COURT: I will allow it. You may answer.

A. Had we seen these additional documents in addition to the late delivery agreement itself that we were provided, there are clearly inconsistencies in the documents. The late delivery agreement indicates that the landlord is paying because of the late delivery. It states that delivery was after December 15 '01 is my recollection, and that is in contradiction to the terms of the delivery stated in the lease agreement.

And then further the possession letter, as we stated, indicates that the company received access within the prescribed window stated in the lease agreement. So there are inconsistencies that were critical to the accounting assessment.

* * *

A-1542-1543

Hallinan – direct

* * *

Q. In connection with the $500,000 late delivery payment, can you explain the significance of Cuti's representation to you?

A. The significance of this representation is, based on the documents I have now seen, the representation being inaccurate, leads me to question whether or not—

MR. WEINGARTEN: Objection, your Honor. May we approach?

THE COURT: You may.

(At side bar)

MR. WEINGARTEN: Judge, here is the issue. This witness is an auditor. Obviously he can testify as to what he did in realtime while working at Duane Reade; what information he received, what information he didn't receive.

We are well beyond that. He's testifying now as to his opinion about different things and what he's concluded now that he's looked at documents later on.

He's asked hypothetical questions. He is not an expert witness. He was not proffered as an expert witness. I would respectfully request that his information be limited to what he did with his five senses in realtime.

THE COURT: He is an accountant.

MR. WEINGARTEN: True.

THE COURT: He is telling us what he needs to make his decisions. If he is not given those materials, it affects what he does as an accountant, and I think it is appropriate for him to state that.

* * *

A-1547

Hallinan – direct [at sidebar]

* * *

MR. WEINGARTEN: Since we are up here, I think this is coming. I think there is a world of difference between what the prosecutor is asking, did you have access to X a piece of information. He may say no. Then, had you known that, had you known this piece of information, the hypothetical question that calls for his opinion. I think they should be limited to A and not be allowed to do B.

THE COURT: No. I disagree with you. I overrule your objection. An accountant has to have certain information. If he has certain information, he does his job and comes to a conclusion.

If he isn't given all the information, the conclusion that he comes to is not the same he would have come to had he been given all the information.

So I think it is permissible, and I will allow him to explain or state what the significance was. Would your opinion have been different, would your approval have been different, whatever. Yes.

* * *

A-1563

Hallinan – direct

* * *

Q. Which documents were you not shown in connection with the audit of the $2.1 million payment?

A. We were not provided a copy of the modification agreement where we just discussed the proposed pur-

chase and sale involving Blue Trophy of that site, and we were not provided a copy of the lease agreement.

Q. Had you been shown all those documents, how would it affect the accounting?

A. The information included in the documents that we were not provided, include significant facts critically important to determine what the appropriate accounting is. Considering a review of these facts in all these documents, it would have in my mind resulted in immediate income recognition not being proper, because it evidences that Duane Reade was going to be moving into a building that was controlled, owned by or anticipated to be controlled and owned by Blue Trophy.

* * *

A-1590

Hallinan – direct

* * *

Q. Can you explain between the 2001 agreement and the 2002 agreement, can you explain how those coexist?

MR. WEINGARTEN: Respectfully object, your Honor.

MR. KENNEY: Objection, your Honor.

THE COURT: As an accountant confronted with the two documents, what would you understand them to mean?

THE WITNESS: From an accountant's perspective, I see conflicting data, and I would have to understand how I reconcile the two documents in order to draw a conclusion on the appropriate accounting.

Q. If you could explain what steps you would take to rectify the two agreements.

MR. WEINGARTEN: I respectfully object.

THE COURT: Reconcile the two.

Q. Reconcile.

MR. FITZGERALD: Thank you.

A. To reconcile the information in the documents, I would have discussions with members of Duane Reade's finance function and any others that had insight as to these transactions.

* * *

A-1605-1606

Hallinan – direct

* * *

(In open court)

Q. Mr. Hallinan, if the payment made in 2001 of $690,000 was made in connection with Duane Reade's relationship with Winick Realty, how would that change the accounting?

MR. WEINGARTEN: Same objection, your Honor.

MR. KENNEY: Objection, your Honor.

THE COURT: Overruled. You may answer.

A. Those are different facts than those which are in this agreement, and I would need to understand all the facts, but my strong predisposition would be that a payment of the nature you described would not be expected to result in immediate income recognition.

Q. Can you explain why?

A. Such a payment as was described is associated with the relationship with Winick, which implies there is ongoing activity, and there is no specific occurrence to which that payment relates, and so there's no ability to record that amount as income immediately in the income statement because accounting rules don't dictate that when you receive cash it results in immediate income by default.

One needs to understand the purpose and the basis of the payments, and the fact that someone pays money to a company doesn't mean that the company has earned income.

Q. If a payment is made from Danielle to Duane Reade and you learn that Duane Reade will return that money through another transaction, how do you account for the two transactions?

MR. KENNEY: Objection, your Honor.

MR. WEINGARTEN: Objection.

THE COURT: You may answer.

A. In the facts that you described, the moneys received would be associated with those go-forward transactions, and the accounting could take on any number of forms. It could either be accounted for as a loan if the moneys were just due back to Winick, so that would not be an income item.

If it was meant to be a payment for purposes of engaging or insuring that there would be future transactions with Winick, then those payments would be related to those future transactions. So the income would not be recognized until those future transactions and

obligations of Duane Reade to enter into such were recognized.

So those are two of the potential scenarios, but those are more facts and questions that those were reasonable, and my predisposition would be just upon hearing the facts at that high level that immediate income would not be proper.

* * *

A-1615

Hallinan – direct

* * *

Q. Thank you. Can you explain, what would the accounting be for this payment if Duane Reade moved down the block to another building owned by the same landlord?

A. It goes back to the criteria and discussions, points I raised earlier, which is, if a lease concession transaction is obligating Duane Reade or is in anticipation of Duane Reade entering into another site with the same party or an affiliate of that party of this agreement, then the payments received under this agreement get related to for accounting purposes the subsequent relocation, and so they would not be entitled to immediate income recognition.

They would be accounted for in connection with the accounting for the lease of the new site entered into, which would mean that the income would be recognized over the term of that new lease, which would be many years out.

* * *

A-1617-1619

Hallinan – direct

* * *

Q. When read together, what is the effect of these two agreements?

A. When read together, from an accounting perspective, they are important, critical factors to considering the appropriate accounting, because the one document references a go-forward lease arrangement with Mr. Goldman and his affiliated entities, whereas the first agreement we reviewed speaks to a payment that Mr. Goldman's entities were going to be making to Duane Reade to exit a site.

So it falls into that discussion point I raised prior, which is these are linked transactions from an accounting perspective, because the money received then should be applied against the go-forward lease for the new site.

Q. Which of these two agreements were you shown in connection with the $1.126 million that Duane Reade took into income?

A. If I could just to make certain I'm referencing the correct agreements, if I could see the first agreement, I don't remember the exhibit number.

What I referenced as the lease concession agreement, which is noted as Government Exhibit 3150, we, Price Waterhouse, reviewed, read that document in connection with our reviews done during that period or audit work. But we did not see the lease surrender agreement, which is, I will call it the second agreement.

Q. Had you seen both agreements, how would it affect the accounting?

A. As I described a moment ago, the accounting required would link the two agreements together, and so immediate income recognition would not be permitted or accepted. We would disagree with that treatment. I would expect that, subject to all of the facts coming to light through discussion and further inquiry, I would expect that this amount of money received under the first agreement would be recorded to income over the lease, the new lease term for the new site Duane Reade was entering into.

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A-1620

Hallinan – direct

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Q. If PwC had seen the payment from Goldman to exit 464 Fulton Street, the lease amendment between Goldman and Duane Reade related to 464 and 522 Fulton and this lease between Duane Reade and 522 Fulton Realty LLC, how would that have affected the accounting for the $1.126 million payment?

A. Based on these documents and the facts reflected in them, it would have resulted in no immediate income recognition. The amount of money received would have been attributed to and recorded as income over the lease period going forward.

* * *

* * *

Q. What would the accounting treatment be if the $800,000 payment by Danielle was related to another transaction with Duane Reade?

MR. WEINGARTEN: Respectfully object.

THE COURT: I'll allow it. You may answer.

A. Based on that additional fact, we would need to make additional inquiries of the company and we would need to ensure that there were no other facts that were relevant, important, to the accounting decision. Then we would do a new assessment because it would be clear that the original assessment was not complete because of information that's contrary to the facts that you have just presented me or the different scenario you presented me.

Q. What would the accounting treatment be if the $800,000 payment by Danielle was for the right to continue serving as Duane Reade's real estate broker?

MR. WEINGARTEN: Respectfully object.

THE COURT: I'll allow it.

A. If the payment were for purposes of continuing and ensuring future transactions and activity with Winick, as I understood your question, the accounting result would be that immediate income recognition would not have been allowed, because it would be a payment received in connection with future obligations of Duane Reade to engage in future activities, and so the earnings process, a[s] we refer to it, would not have been complete. So immediate income recognition would not

be appropriate, because the company hadn't fulfilled all of its obligations associated with having received those moneys.

* * *

A-1669-1670

Hallinan – direct

* * *

Q. Returning briefly to Exhibit 740. Mr. Hallinan, if you were told that all this agreement does is assign an income stream to Store Op but not the right to control the lease, that Duane Reade continues to control the lease, how would that affect the accounting?

A. That's a substantial fact, a significant fact, that needs to be considered in the accounting. Again, subject to my complete review of all the documents; I would have to do that in order to draw a definitive conclusion.

My initial assessment is that if the company were just assigning the income revenue stream, that in my mind indicates that Duane Reade has a go-forward ongoing service obligation as the primary tenant for that site. Meaning if Duane Reade is serving as effectively the primary tenant and subleasing the space to Equinox and the revenue stream Duane Reade is receiving from Equinox is sold to Store Op or another third party, in order for those revenue streams to be assured, Duane Reade would have to continue to fulfill its obligations as a primary tenant at that cite. Put differently, if Duane Reade didn't fulfill its obligations under its primary lease, then Equinox wouldn't be able to basically have a cite presence, and thus presumably it wouldn't pay.

In very simple terms, I see it as being indicative of Duane Reade has an ongoing obligation relative to that income stream that it sells, in the sense that it's Store Op in the background, and it would beg the question of shouldn't the accounting for all monies received from Store Op be accounted for over the longer period, over the future performance period, than I just described. Put more simply, I wouldn't expect income recognition because of the continued performance obligation that I expect Duane Reade has.

* * *

A-2015-2016

Hallinan – Redirect

* * *

Q. What would the accounting for these real estate concession transactions be if you learned that Winick was not an arm's length party in the negotiations?

A. If I understood the question to be what would the accounting be if these were not arm's length transactions?

Q. Yes.

A. From an audit perspective, we would have additional questions just, again, to understand, try to understand and gain insights into what the purpose of the transactions were. But from a pure accounting perspective, transactions between related parties, which is effectively the contra to arm's length transactions, meaning they are not independent, stand-alone, would be requiring significant additional disclosures as to the fact that there were transactions in the financials entered into among parties that weren't dealing on an

arm's length basis, because that's a critical piece of information to the user of financials.

Q. And when you began to answer that question, you talked about the other things you would have to go through. What other questions would you have?

A. That would be from the, I will call it the auditing perspective, which would be I would charge my team and myself with making inquiries of management as to what was the purpose of the transaction. When there are transactions that are not at arm's length, the auditor needs to ascertain or conclude they can't ascertain as to whether those transactions represent true fair value, and the auditor also needs to understand other relationships, activities amongst the related parties that should be—that are understood to ensure that a proper accounting is given. So there are a number of questions and additional paths to go down in terms of the decision tree, I will call it.

Q. And you reference one of the inquiries you would make is whether or not they represented fair value. What if they did not represent fair value?

A. If the company knows, but put that aside, if the auditor gains an understanding that the transactions are not at fair value, at a minimum, there needs to be disclosures in the financial statements that these transactions are not representative of fair value in order that the reader understands that the financials could have a significant change one way or another if those transactions were a fair value. So without being able to define what the fair value on a transaction is, the auditor has to either conclude they can't conclude their audit or they need to ensure there is appropriate disclosure, so the reader can understand there is this non-arm's

length transaction reflected in the financials, if it is significant.

* * *

A-2017-2019

Hallinan – Redirect

* * *

Q. Would it also change the accounting treatment if the Winick payments were related to other transactions?

A. When you say the Winick payments, I will assume that you are speaking to the lease concession transactions.

Q. The amounts paid to Duane Reade by Danielle or Store Op. If you understood these payments were linked to other deals, would that change the accounting?

A. It would be—it would change the accounting if the accounting had been immediate recognition for a specific transaction and if the conclusion originally was that immediate recognition was appropriate because there was no linkage to other transactions, but then we subsequently found out or during that time we found out that the payment was related to other transactions in the future, the immediate income recognition would not be agreed to by PWC and the company should have concluded that it related to future transaction and be amortized taking its income in future periods.

Q. How would it change the accounting if you learned that Duane Reade had promised to reimburse Winick for the cost of the deals?

A. If Duane Reade had promised to reimburse Winick, then that would equate to an amount Duane Reade owed back to Winick. So one potential accounting would be that it would—Duane Reade would have recorded liabilities, meaning amounts payable back to Winick to the extent they owed those monies back.

Q. And how would it change the accounting if the payments by Winick were part of an arrangement to share his real estate brokerage commissions with Duane Reade?

A. That would lead to a conclusion that the monies received by Duane Reade needed to be linked to in a counterpart connection with the future brokerage payments made by Duane Reade to Winick. So, in effect, immediate income recognition would not be proper, and you would take those monies received by Duane Reade up front and record them as a reduction credit against those future commissions paid to Winick in future periods.

So from a financial reporting perspective, to put it simply, income recognition immediate up front would not happen, and the benefit of those monies Duane Reade received would be recorded over any future number of years when those anticipated transaction, those future brokerage commission payments were made to Winick.

* * *

A-2368-2372

Henry – direct

* * *

Q. At the time you were considering these transactions, what did you believe about whether or not the

transactions with Winick, let's start there, and his entities were arm's length transactions?

A. I believed that they were. I believed we were getting value for value we were giving up.

Q. A[nd] what was the basis of that belief?

A. The fact that we had very knowledgeable people who were involved in the process. I think Tony Cuti had built the chain from relatively few stores to a very large chain, was intimately familiar with the stores, [k]new the locations very well, [k]new the values of the real estate that he had helped build over the years. I think Bill Tennant was also very familiar with our real estate, had been working on the real estate for some time. I think where general counsel was involved, they were knowledgeable about the transactions that were being entered into.

Q. What did you believe at the time that you were reviewing these deals about whether they stood on their own?

A. I believed they did.

Q. What, if anything, did you know or believe about whether or not the counterparty to the transaction was being reimbursed by Duane Reade for the cost?

A. I didn't know that.

Q. What if you had learned that the counterparty was being reimbursed for some or all of the costs?

MR. WEINGARTEN: Your Honor, may we approach?

THE COURT: Certainly.

(At the side bar)

MR. WEINGARTEN: We are about to enter into the [la]nd of the hypotheticals. You may recall I objected when the government did this with Hallinan and the Court overruled the objection. I think this witness is materially different than Hallinan. Hallinan was an outside auditor, not connected to Duane Reade. This guy is right in the soup. He was there every day.

It's entirely appropriate to ask the questions we have had thus far: What did you know, what did you do, who does what to you in real-time. But for him to offer his opinion about what he may have heard later or a hypothetical question I think is inappropriate. I think it is extremely prejudicial, it's in the form of argument. And to the extent it has a residue of relevancy, it's outweighed. A 403 analysis should prevent the government from asking this witness, who was there every day, a fact witness, hypothetical questions.

MR. KENNEY: We have the same objection, your Honor. I would add to that an objection which I made before, which is the government has a pattern of using a friendly witness to, in effect, sum up. It's really argument. It's hypothetical questions and positive answers for their theory of the case, and I object to it.

MR. STREETER: Your Honor, I think what I asked him was what did he believe about whether or not they were or were not being reimbursed. Then I think I asked him what the accounting treatment was or how he would have treated it if they were being reimbursed. The first question is not a hypothetical question.

MR. WEINGARTEN: I believe the question I objected to, and I was waiting for this, was "had you known."

MR. STREETER: I can rephrase the question. I can ask him what would the accounting treatment be if you knew that a counterparty to one or these deals was being reimbursed?

THE COURT: How about take out the "you knew"? How about: What would the accounting treatment be if a party—OK?

MR. STREETER: Thank you.

THE COURT: That you can do.

(In open court)

THE COURT: Mr. Streeter.

MR. STREETER: Thank you, your Honor.

BY MR. STREETER:

Q. Mr. Henry, what would the accounting treatment be for a real estate concession transaction if the counterparty to Duane Reade was being reimbursed by Duane Reade for the costs of doing the deal?

A. From the standpoint of income recognition, it would prevent that income recognition.

Q. Why is that?

A. Because if they are being reimbursed for that income, there really isn't any income. If you're paying out something to get the same thing back, it's not income.

* * *

A-2390-2391

Henry – direct

* * *

Q. What effect would it have on your assessment of the economic substance if Duane Reade had already done the thing it was obligated to do in the agreement?

A. If it had already done the think it was obligated to do in the agreement, without the understanding that that was being done in return for the payment that was being made, it would indicate that the agreement was not a valid agreement, at least as I think of it at this point.

Q. Putting that, aside for a moment, what income recognition treatment would you give this transaction if Danielle was reimbursed by Duane Reade for the cost of it?

MR. WEINGARTEN: Objection, your Honor.

THE COURT: I'll allow it.

A. That would cause me to have to reverse the accounting treatment.

Q. What do you mean by "reverse the accounting treatment"?

A. Meaning that we couldn't recognize the income up front. So if they're being reimbursed for this income that Danielle is paying Duane Reade, it says there is another agreement and there's another condition here, and it would prevent us from recognizing the income.

* * *

* * *

Q. You said that this document would have caused you concern at the time. Can you explain why?

A Well, I say that based on my review of the documents, you know, at the current time, and, you know, in the preparation I had seen the other JB 62 agreement. To the extent that this consulting arrangement created 831,000—

MR. WEINGARTEN: Your Honor, may I approach, please?

THE COURT: You may.

(At the sidebar)

MR. WEINGARTEN: I don't think it's right for the government's key witness, after he's been prepped endlessly, to offer his view of what the transaction means to him, after his work with the government. I just don't think that's right. Obviously—

THE COURT: I agree with you. And I have told you before, Mr. Streeter, that I don't care what his personal opinions are. You can ask him questions about the documents from the accounting point of view. What would this mean, what would that mean? Keep his opinion out of it.

MR. STREETER: OK. I will ask him how it would have affected his accounting treatment.

THE COURT: No, not his accounting.

MR. STREETER: The accounting treatment.

THE COURT: How would it affect accounting treatment for a transaction if this document—you know, just keep it like that.

MR. WEINGARTEN: He's done it. And he's done it endlessly. It's going to be the same question over and over again. He's done that. We're past that. I mean, the witness—the accounting treatment has been established.

THE COURT: Mr. Weingarten, they have the burden of proof. They get the right to bring them—there are millions of documents in this case. And actually to have somebody bring them together in some form is very helpful. You have your right to cross-examine. But I will not prevent the government from making clear what their claim is in this case. But it has to be done not based on how would it change what you would do, what did you think of doing.

MR. [WEINGARTEN]: OK. Two things, Judge. One of the issues, though, is, on cross-examination, that I'm trying to establish this guy saw everything, did everything.

THE COURT: Fine. And guess what happens after cross-examination.

MR. [WEINGARTEN]: OK, understood.

THE COURT: You know it, happens. And guess what. In this case there's no recross. So come on.

MR. STREETER: OK. Can I just, for clarification I should ask him, what accounting treatment would apply if—and then say whatever the evidence. Is that what you're saying?

MR. WEINGARTEN: It's the same thing.

THE COURT: Well, it's acceptable.

(In open court; jury present)

BY MR. STREETER:

Q. Mr. Henry, what accounting treatment would apply if the proceeds from Duane Reade's stock was used to reimburse Danielle for the cost of paying for the $806,000 deal?

A. If one was used for the other, it would cause us to have to reverse that income recognition, in my opinion.

Q. Why is that?

A. Because the income for the sale to Danielle has to stand on its own, and it can't be affected by other side agreements or other obligations. So if Duane Reade had an obligation to reimburse another party for—to generate the funds to pay that, that was an obligation that was understood as part of that deal, clearly. It just would not be the right accounting treatment to record this as income, in my opinion.

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A-2418

Henry – direct

Q. If that 500,000 had been paid, how would it have been accounted for?

MR. KENNEY: Objection.

THE COURT: You may answer.

A. My opinion is it would have been taken over the term of the lease.

THE COURT: Let me interrupt you, Mr. Henry. Not in terms of your opinion but in terms of your knowledge of the applicability of the accounting rules, would you answer the question.

A. Based on my knowledge of the accounting rules, it would be taken over the term of the lease.

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A-2424-2425

Henry – direct

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MR. STREETER: * * *

Q. The $500,000 in Government Exhibit 317, how was that taken into income at the time in question?

A. That was recorded in the first quarter of 2001 as $500,000.

Q. Was it taken immediately or over time?

A. Immediately.

Q. How would the accounting rules have applied if Duane Reade had reimbursed the payer with an extra $500,000 worth of stock through a drugstore agreement for that payment?

A. We would not have been able to have recorded the 500,000 as up-front income.

Q. Would you have been able to record it at all as income?

A. I don't believe—in my opinion, no.

Q. Why not?

A. Because the company is creating the payment that is creating the ability to pay that back to us. So it's another obligation that is being created by the company to pay to someone else something to get back to itself as income. It just wouldn't work from an accounting point of view.

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A-2459-2460

Henry – direct

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Q. Did you ever have any suspicion at the time that Winick was being reimbursed by Duane Reade for some of the costs of doing these deals?

A. No.

Q. What would you have done if you had had that—what would be the accounting treatment? What accounting treatment would apply if Winick was being reimbursed for some or all of the costs of doing a deal?

A. If Winick was being reimbursed by Duane Reade for the cost of doing these real estate concession deals, that would create a side agreement or a separate obligation, which would cause these deals not to stand on their own, and therefore you would have to consider that commitment that was being made. And in my opinion on the accounting treatment side, that would take away the ability to recognize this as upfront income, because there's an obligation to Duane Reade that it should pay to get this income.

Q. Did you have conversations with—let's start with Mr. Cuti—about whether a particular deal could or could not be taken in particular quarter?

A. I would think that I did. I can't recall conversations that I had with Mr. Cuti specifically. But I would think that in any of the follow-up activity, I would have had conversations.

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A-2465

Henry – direct

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THE COURT: Why are you asking, what if you had known?

MR. STREETER: I made a mistake, your Honor.

THE COURT: Well, when it was objected to and sustained, what should you have asked? What accounting treatment would apply if they didn't have—OK?

MR. STREETER: OK. Will do. I apologize, your Honor.

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A-2471-2473

Henry – direct

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Q. What would the accounting treatment be if Danielle had no interest in purchasing these particular termination options?

MR. KENNEY: Objection.

THE COURT: I'll allow it.

A. If they had no interest, then there wouldn't be any income for it.

Q. Why is that?

A. Because there is no way they would be real. They wouldn't be able to make any money. There would be no basis for them to pay.

Q. Why would there be no basis for them to pay make it so that there would be no income under the accounting rules?

A. Can you repeat the question again?

Q. Just be careful, I might actually ask the reporter to read it back.

THE COURT: You might want to rephrase it.

MR. STREETER: OK. Can I ask the reporter to read back the answer so I can be sure to ask the right kind of question?

THE COURT: The prior answer?

MR. STREETER: His answer before my question that you asked me to rephrase.

THE COURT: All right. The answer is, "Because there is no way they would be real. They wouldn't be able to make any money. There would be no basis for them to pay."

Your question: "Why would there be no basis for them to pay make it so that there would be no income under the accounting rules?"

A. Again it goes back to the whole concept of a real deal, economic substance. If there was no basis for them to be paying for it because they had no interest in it, then there would be no basis for us to have a transaction and recognize income from it. It wouldn't make sense, so there wouldn't be an accounting, it wouldn't pass an accounting income recognition.

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A-2477

Henry – direct

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Q. What accounting treatment would apply if Danielle had no interest in buying this particular set of rights?

A. Again, it would go to the same process we discussed before. If there was no interest in these rights, there was no economic basis for them to get a benefit for it, it wouldn't have been a deal with substance. So recognizing $400,000 as income wouldn't have been appropriate.

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A-2540

Henry – direct

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Q. What accounting treatment would have applied if there had been some separate arrangement for Winick to be reimbursed for some or all of the costs of doing the March 13th deal?

A. You would have to consider that in terms of the transaction. If there was going to be a reimbursement for all of the costs based on the transaction, then there wouldn't have been any income recognition.

Q. What would the accounting treatment be if there were no economic substance to the March 13th transaction?

A. If it's clear there is no economic substance, it questions whether or not the transaction would make sense, and there wouldn't really be much of a basis for recognizing income.

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A-2547-2548

Henry – direct

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Q. Mr. Henry, at the time of the events in question in 2003, did you know of any relationship between the deals described on the first page of 462G and the deals described on the second page of 462G?

A. No.

Q. What effect would it have on the accounting treatment if there was a connection between those deals?

MR. KENNEY: Objection.

THE COURT: Overruled. You may answer.

A. If there was an obligation on the part of any of the deals on one side versus the income on the other side that was an obligation of Duane Reade, it would have needed to consider that in recognition of net income.

Q. What effect would it have on the accounting if the deals on the first page of 462G were being used in part to reimburse for the cost of the deals on the second page of 462G?

MR. KENNEY: Objection.

THE COURT: Overruled. You may answer.

A. If it was being reimbursed and it was an obligation that the company had in relationship to those income deals or concession deals, it would have had to have been considered and would have caused us not to be able to recognize the income.

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A-2573-2574

Henry – direct

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Q. Mr. Henry, if the agreements for Petrina Diner, Government Exhibit 1808, and for 100 West 57th Street, Government Exhibit 830, were payments by Duane Reade to reimburse the Winick entities for doing real estate concession deals, what effect would that have on the accounting?

MR. WEINGARTEN: Respectfully object.

MR. KENNEY: Objection, your Honor: Argument.

THE COURT: Overruled. You may answer.

A. Again, if the payments were made as consideration for the concession deals that were being paid to Duane Reade, then you would have to consider these payments in relation to that.

Q. What if the payments were to reimburse the Winick entities for the cost of doing deals?

A. If that was an obligation to reimburse them, it was that was part of those deals, it would have interfered with the recognition of income.

Q. At the time of the events in question, what connection, if any, did you know of between the 100 West 57th Street deal, the Petrina Diner deal, and lease concession deals that the Winick entities had signed?

A. I did not know of any.

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A-2593

Henry – direct

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Q. W[hat] effect on the accounting treatment would it have if Winick bought this lease from Duane Reade for $1.1 million and then sold it for $300,000 to the landlord?

A. If that was the sum and substance of the whole transaction, it would have meant it would have been a significant loss, and, you know, one would wonder why one would enter into a transaction like that.

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A-2623-2624

Henry – direct

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Q. Under the accounting rules, would it be possible to take income on this if there wasn't an assignment of the rights under the lease?

A. I don't think so. I can't say for sure.

Q. Why was assignment of the lease important?

A. Assignment of the lease got us off our obligation as the primary obligor again, and therefore we were not primarily responsible to perform under the lease going into the future.

Q. And why was that important for income recognition?

A. Because otherwise the income would have had to have been deferred over the term of the lease.

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A-2633

Henry – direct

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Q. What effect on the accounting treatment for the $3.45 million would it have been if Duane Reade had not actually transferred the rights and responsibilities of the lease to Store Op on July 28, 2004?

A. We would not be able to recognize that income.

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A-2637-2638

Henry – direct

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Q. Do you know why Duane Reade is paying Winick to sell a lease that Duane Reade had supposedly sold to Store Op?

A. I do not.

Q. How would the accounting treatment for the $3.45 million have been different if Duane Reade hadn't actually sold the lease to Store Op?

MR. WEINGARTEN: Asked and answered, your Honor.

THE COURT: I'll allow it. You may answer it.

A. Again, as I said, if the lease had not been sold and we were still obligated under the lease, there would have been no income recognition.

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